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Selling the Dealership, Part 2: How Much Is the Business Worth?

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The market for dealerships remains strong, and owners who have felt inclined to sell could find this an opportune time to exit their businesses. Making the decision to sell is only the first hurdle, though.

Dealers also must come up with a value for their dealerships and decide whether to bring in professionals to help with the process.

Determining dealership value

Ultimately, the value of any business comes down to the amount that a willing buyer will pay and a willing seller will accept, also known as fair market value. Several different types of factors affect that amount.

Real estate costs

Dealers need to think beyond the current appraised value of their real estate. For example, outstanding image compliance costs can drive the value down. To reduce this effect, a seller can develop a plan for achieving compliance and obtain manufacturer consent to that plan. This might help to limit the risk that the buyer will have to face unreasonable image upgrade demands of the manufacturer in exchange for deal approval.

If any of the buildings and facilities are in need of improvements, that will play a role. Sellers should secure any necessary repairs or upgrades or expect a reduction in the purchase price. Generally, dealers find it more advantageous to implement repairs themselves than to accept a price reduction based on the buyer's estimate of the related costs.

Environmental compliance is another concern. Prospective buyers and their lenders will require a Phase I environmental site assessment (ESA) and, if it reveals potential contamination, a more thorough Phase II ESA. If remedial cleanup actions are necessary, that will affect the dealership's value.

Blue sky

The blue sky value accounts for a significant amount of a dealership's worth. That value typically is calculated based on a multiple of the previous three years' "normalized" earnings before interest, taxes, depreciation, and amortization. Normalization adjustments are made to remove the distorting effect of, for example, nonrecurring gains or losses, discretionary expenses, related-party agreements, unreasonable compensation, or related-party rent.

Once that amount is determined, a multiplier is applied based on industry benchmarks and the following additional factors:

- Franchise
- Geographic market and opportunities
- Operational improvement opportunities
- The quality of the staff and management that will continue with the business
- Inherent liabilities (for example, a dealership that has for years offered a program that provides every vehicle sold with free oil changes for life)

Other assets and liabilities

A dealership's value will be hurt if it has "water" in the balance sheet, meaning it carries assets on its balance sheet that are valued at more than market value. An example would be if used vehicles are recorded on the books at costs higher than market price. Alternatively, its value could be boosted if it has "undervalued" assets. For example, a dealership might have fixed assets that have been aggressively depreciated and therefore are carried on the books at less value than they actually are worth. A dealer also must consider the effect of any longer-term contracts that a buyer might not assume, such as a contract for credit card machines or a dealer management system.

Potential professional assistance

A formal appraisal provides a reliable value, but it also requires an investment that can reach into the thousands of dollars. Many dealers forgo formal appraisals, confident in their knowledge of the market. The decision about whether to engage a professional appraiser might turn on whether a dealer chooses to retain a broker. Experienced brokers generally possess sufficient knowledge of the market and potential buyers to provide a useful estimate of a dealership's value without an appraisal.

It is not unusual for dealers to believe they can attract competitive bids using their own resources, particularly in a market rich with prospective buyers. Selling a business without a broker allows dealers to avoid broker commissions. Brokers' fee schedules vary, but they typically run about 10 percent for the sale of blue sky and business assets and 6 percent on the real estate. Dealers with a strong sense of potential buyers might find it prudent to approach those buyers first, without engaging a broker. They still will need some assistance assembling the necessary offering materials, but they will save on commissions.

Nonetheless, dealers increasingly are hiring brokers, at least for larger transactions. Dealers operating on their own might have trouble finding the right buyers to maximize their proceeds. They also can learn the hard way that buyers who seem qualified actually are not, but brokers can screen out such candidates before dealers invest substantial time and energy on them. Dealers that do opt to use a broker must select one who knows the industry and the relevant market well.

Next steps

Regardless of whether a dealer decides to lean on professionals' expertise, several other essential steps lie ahead. The final article in this series will discuss the nuts and bolts of the sales process itself, including creating marketing materials, identifying qualified buyers, preparing letters of intent, performing due diligence, and completing purchase agreements.

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