Deciding the Who, How and When of Exiting Your Dealership

It's never too early to plan your exit strategy – the rewards are many, the perils plentiful, and the mistakes unforgiving.

By Kim Phelan

Deciding how to exit the business of owning and operating a construction equipment dealership – of any size or number of lines – to put it bluntly, ain't for sissies.

That's because the "how" of exiting is completely wrapped up in the deeply complex choice of "who" will take over.

And the stakes are incredibly high – higher than any deal you've ever done in your career. What's at stake: Family relationships, the wellbeing of your employees and their families, and fulfilling your goals your way.

The "when" of exiting greatly influences the how and who questions. Starting a plan isn't just for owners in their 60s – although plenty of good options are available to the owner who's eyeing retirement in two to five years. But a business exit done well, some say, can and should actually be a 15- to 20-year process.

The longer the exit planning – revisited regularly as part of annual strategic planning – the more likely you'll be able to leave on your ideal terms.

Better planning can mean greater agility and readiness to seize opportunity. For example, if someone walked in tomorrow and made an offer to buy you out, would you be able to make the right call? Or would it take you three months to figure out if they made a good offer? (Assuming the buyer is still interested at that point.)

External timing factors are important, too, especially in such a cyclical industry.

"You've got to pick the right time – and right now could well be the right time," says equipment dealership advisor Garry Bartecki, who is also CFO at Illini Hi-Reach near Chicago. "[Dealerships] are all worth a lot today, and two years from now they may be worth 40 percent less if we go into a recession. Interest rates right now are good. The banks still have money and they want to lend. So right now, on my 'Time-to-Sell Scale of 1 to 10,' this is a 9 ½."

Recessions are lasting longer, he added, and presently, he says, there's more debt than there was in 2008. "The next one's going to be similar," warns Bartecki.

Hundreds of stories – what's yours?

What you don't want is to let your exit and its consequences merely happen to you and your family. Experts recommend defining exactly what your exit means to you – is it walking out the door with a lump-sum payout? Is it gifting the business or taking a note so the kids can buy it?

Regardless of who else has an ownership interest in the company, you and your spouse must know your priorities and goals, and be prepared to articulate them clearly to your family, your leadership team, your employees and your manufacturer(s).

Dealer business models share many common traits, frequently including family own-

ership, but every scenario is unique. Consider, for example, some slightly disguised, real circumstances:

(1) John, 64, runs his single-line company with his younger brother, but they've got three other siblings with ownership interest. And while John's 20-something daughter is pursuing a career in finance now, she could become a viable candidate for ownership in a few years. How can they ensure future success of the dealership while caring for the needs of a 90-year-old mom and sisters in their 70s?

(2) Ken is 66, and his son Jack, 31, is currently sales manager at their multistate, single-line dealership – but Ken has two other kids who aren't in the business. He's got to be fair to all as he transitions ownership to Jack.

(3) Brad, 58, has a strong multiline, multi-branch company that's growing – in fact, he recently bought another competitor. But Brad's millennial kids aren't in the business and don't want to be. What should he be looking at?

(4.) Steve is a high-energy, uber-competitive 50-year-old owner of five single-line branches – he's got two girls in college and a third in high school; he thinks only the latter is a remotely possible candidate for joining the business. Is it too soon for him to formulate a plan?

If you choose to proceed with a family succession plan, don't lose sight of the fact that "dad," and/or "mom," or any other owners have to be paid out as part of the process, unless there's an abundance of additional assets to fall back on, notes Bartecki.

Manufacturers: The wild card that complicates your decision

As if deciding what's best for business and family weren't enough, dealer exit plans are enormously impacted by manufacturers. Know what your state dealer laws stipulate concerning manufacturer approval well before you take steps toward any course of ownership transfer. What's more, know what your manufacturer is going to say before they say it.

"You have to be familiar with the [manufacturer's] history – what's happened in terms of ownership transition in the past?" said Bartecki. "Talk to other dealers. Find out if the OEM has turned down any other potential buyers. What's going to appease them is finding the right person to replace you – that's what's going to make the deal or break the deal."

"When I talk to single-OEM guys," Bartecki continues, "the first thing I tell them is, don't waste your time or money unless you know what the hell they're going to say. Now the person with three or four lines obviously has more flexibility – I've never seen anybody like that get turned down by one of the lines."

Attorney Lance Formwalt, Seigfried Bingham PC, Kansas City, Missouri, echoes that no matter the exit path you choose, you'll definitely have to work with your manufacturers, so make sure you open communications with them early in the process.

"You may not always agree with what they're telling you, but at least you'll understand what they're telling you," Fromwalt says. "And understanding can be a powerful thing."

And you may conclude the time is not right or that different options may open up if you're patient, Formwalt adds. "Part of that consideration is where the manufacturer's 'head' is at right now – manufacturers do change strategies, and people in those roles change over time," he says.

Sometimes waiting is the answer.

No Matter What, Do This

For the purposes of limiting the scope of this discussion, we'll focus on just three primary methodologies for exiting the business, offering some pros and cons, advice and caution for: (1) Selling the company to an outside buyer; (2) Creating an ESOP and thus creating your own buyer; and (3) Transferring the business to a family member, most commonly offspring of the owner.

But before that, here's a quick checklist of considerations, regardless of the exit path you ultimately choose:

- **Valuation of your dealership.** Select a professional with extensive experience in this specific, capital-intensive industry. They'll use templates and formulas that take into consideration your assets, the cash flow and performance of the company, the leadership team, the real estate, and more. Adjustments will have to be made if you've got personal assets on the books like boats, cars and country club memberships. Bartecki says the value of the dealership will usually wind up at five to six times the adjusted EBITDA number. In the case of forming an ESOP, the valuation process will be extremely formalized and highly objective.

- **Employees = value.** Remember when we said the stakes of this decision are high? Be careful, experts say, in how you communicate with employees and take note of how they feel about your exit plan. Do they respect your designated replacement and feel confident about who will be at the helm after you? Are they worried what an outsider will do? If your key people leave, the value of your business is diminished. Also, a time of transition creates vulnerability – beware of competitors pirating your best salesmen.

- **Next owner(s) must understand this business.** Whether it's your kid or other family member, a current leader in the business, a private equity group, or a buyer from the next county, it's essential that the next owner has the wherewithal to operate at a professional level, has a track record of success, as well as deep comprehension of the sales process and profit centers.

- **Get a board.** Besides key family members and members of your leadership team, your board should have at least a few non-family representatives, such as an attorney, a tax/accounting professional, a banker, a business consultant, etc. When the hard conversations between family must be had, other people sitting there raising questions, says Bartecki, can help "stop the yelling and screaming."

- **Know your tax position.** Again, bring in only the pros who know your industry and sit with them every couple of years. Understand your business structure – S Corps vs. C Corps and what it means to the exit plan you're favoring. "Be really careful ... a lot of guys are jumping to become C Corps when they shouldn't; and it'll cost them when they sell the company," says Bartecki. "And you've got to really, really understand your federal tax position – because that will absolutely kill you if you make a mistake."

Considerations for selling to an outside buyer

A clear advantage to the non-family sale of your business is that you're more likely to get cash, the whole enchilada, up front.

Which leaves you with the following key considerations:

1) Remember your manufacturer still has to approve the deal. If you proceed without their consent, they could drop you, and if that happens, your buyer could back out, too.

2) As a seller, you want to get the best possible price for your business. Here are some out-of-the-box ideas to help you locate qualified buyers who are also more likely to get the OEM stamp of approval.

(A) Merger. "I think mergers could be a good way of thinking about an exit strategy," says Formwalt. "You can combine with someone without impacting your balance sheet so to speak. It's a tax-free transaction, generally, and a way to maybe increase the scope of your business."

A merger may help you increase margins and become a stronger player in the business, Formwalt adds. And that could make your company attractive to more private equity buyers, who tend to favor larger dealers versus small.

"Then the other benefit is, in some of these merged companies, you can have five, 10, or more owners," Formwalt said, who adds that many times, your likely buyer may be another owner. "That's a much simpler transaction that can have better tax consequences than if you're going to sell your business to somebody else."

(B) Expansion As An Exit Strategy? Hear us out. You want to create some competition for your business to get the best price. Depending on your age and how much time you've got before you want to exit, and depending on your OEM's perspective and territory boundaries, perhaps engineering more qualified "neighbors" is an option. Could you be expanding your geographic footprint over the next five to 10 years, gaining more adjacent dealers who could become future prospective buyers? Formwalt thinks so.

(C) Offering Memorandum. This is Bartecki's approach: "You've got to generate some competition. You can sell it to one guy that you know, but you're never going to know if you got the best price. You get three or four guys looking at it, you'll get the best price. So, I put the offering memorandum together, clean up the numbers, give some rough projection numbers – then I go out and say, okay, within 100 miles, let's see who's out there that might be a potential buyer. I send them out a letter, with a nondisclosure agreement attached. If they want some information, they sign the nondisclosure agreement, but I don't give them anything unless I'm sure they're qualified to do it and have the money to do it.

"Then, if you've got two or three guys bidding on it, chances are you're going to wind up with a higher number than you would have gotten otherwise. And you'll have more flexible terms. You'll be able to do more things. You might be able to stave off some of the tax issues."

Considerations for creating an ESOP

At the risk of being redundant, check with your manufacturer before you spend time or money pursuing an Employee Stock Option Plan – some OEMs embrace them, some don't. Know where yours stand.

Both Bartecki and Formwalt are advocates of ESOPs, provided the dealer meets the qualifications. It's a heavily regulated program by the Department of Labor and the IRS, because, essentially, the ESOP turns your company into an employee benefit, like a 401(k). The process is formalized and can be more expensive than a transaction because it requires the formation of a benefit plan and often the negotiation of a bank loan. However, the owner gets to essentially create his own buyer and receive positive tax advantages, while retaining a bigger share of the sale price. It'll take several months to put together, and family members who work in the business can continue to do so.

"You can keep your company, and you can get out from all of your personal guarantees," says Bartecki. "You can avoid paying future income taxes and you can still get another bite at the apple if the ESOP is sold; you will have warrants; you will have stock appreciation rights; you'll have your regular salary and bonus compensation program. Plus, you'll have probably 50 or 60 percent of the company in your bank account – as cash. With no obligations on it. So that's not bad.

"But, you've got to qualify," he adds. "You've got to have the cash flow. And you've got to do your homework."

It's not a simple process, but doable, says Bartecki, if you have a sound, profitable company with an EBITDA in the industry's upper quartile. The bank or other liabilities have to be paid off, although typically bank debt is transferred to the new ESOP bank. You can pay capital gains tax on the proceeds received, or you may have the option to defer the tax – as an ESOP, the company no longer pays any income tax. "Run your numbers to compare what is at stake between ESOP and an asset sale," he says.

Considerations for transferring ownership to family

Statistics do not bode well for family business succession. Numerous studies have demonstrated that two-thirds of businesses aiming to transfer ownership from first to second generation will fail. The same percentage also fail in the attempt from second generation to third, according to Dana Telford, principal consultant at The Family Business Consulting Group. Failure, he says, may not mean the business dissolves, but the goal of keeping it in the family fails. It's not until the third and fourth generations and beyond that the odds improve – double, in fact.

From a human/relational perspective, you, the owner, walk a paradoxical line that doesn't occur so much in the other exit strategies: On the one hand, you desire a family business legacy; on the other, you desire peace and harmony in the family. It's tricky to do both.

"You can't go far in this business without hearing a tragic story of sibling love and partnership that turned into war, litigation and bankruptcy," says Telford.

Which is why getting it right is so crucial.

Families are the closest, most permanent relationships that we have. "If something goes wrong in a transition, it's not easy to shake off," Telford explains. "It's so important that it's handled carefully."

From an owner's perspective, two simple practices will go a long way toward keeping relationships intact – transparency and inclusion. Both will act as a salve to your kids, their spouses, and your siblings whenever the sore subject of fairness flares up.

As a dealer principal, the idea of transparency may scare you more than anything – if so, consider bringing in a consultant and let them say the truths that have to be said.

Telford says there are two parts of a strong foundation for conducting even the most basic transition conversations.

1) They must set a code of conduct. This has to do with how they will treat each other. The words they will and won't use. It has to do with respect, listening without interrupting, not taking things personally but taking personal responsibility, and acting like grown-ups with the people you grew up with. When conversations about skills, weaknesses, money and control have to happen, there's a language they'll be prepared to use.

"It gives them the chance," says Telford, "to handle it professionally and not like little kids

in the back of the station wagon fighting over who gets the front seat."

2) They must all agree and adhere to a set of guiding principles and core values. This might be integrity, honesty, kindness, service. By agreeing, family members commit to living by the values – and also subject themselves to accountability and confrontation if their behavior doesn't conform.

Even when the family learns the ground rules for communicating with one another, the 800-pound gorilla in the room remains for you, the owner: Who is going to control this business when I'm out of it?

Telford prefers to think of the decision not so much in terms of a primate, but a very special waterfowl, instead.

"Along the way of doing business, you've created a golden goose," he says. "And the golden goose is valuable because it lays golden eggs.

"So, who should take care of the golden goose in the next generation? Should it be the oldest male? Should it be the one who got the highest degree of education? Should it be the one who yells the loudest or is a bully to the other ones? No, it should be the one who knows how to take care of the goose, because the golden eggs are what everybody's really interested in."

"Sometimes," Telford continues, "there's no one in the sibling group or the cousin group who can care for the goose as well as an outsider. So, who should run the business? Well, it should be the person who can run the business better than anybody else."

If your final answer to that merit-based mystery turns out to be one of your kids, Telford has a few parting recommendations:

- Make them go out and conquer something. Make them leave the nest – and we're not talking about college. Leave, work, and return with war stories of victory and valor, Telford says. Maybe that's two years on a fishing boat in the North Sea, or maybe it's working at another dealership in your OEM network. But get them out into the real world of authentic employment and let them discover what they are capable of.

- Make sure they want it. Their transition into the business must be voluntary. "That's going to take away so many of your problems," says Telford. Make it okay for them to say, "I don't want to be an owner; I still love you and I want you in my life, but I don't want to own stuff with you, and I don't want to work with you."

- Consider establishing a family council. Start it with the help of a third party initially with the goal of being independent with family members after a few years. This is like a board for the family – meeting two or three times per year, it creates a regular platform for discussing priorities, concerns, plans, money, the next generation and more. Again, be inclusive – that means in-laws/spouses, too.

Starting May Be the Hardest Part

Not sure where to begin with planning your business exit strategy? Or do you need a second opinion? Contacting one or all of the professionals cited in this article would be a wise step.

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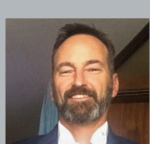

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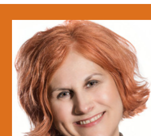

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