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LGT CONTROLLER'S ROUNDTABLE EVENT
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Succession

Introduction

Ladies and Gentlemen,

I appreciate you all inviting me back to speak today. As some of you may know, I am a recovering attorney that has been consulting with car dealers for five decades.

Today, however, I am not here to speak to you about the law, or gifts, or revocable trusts, or other estate planning techniques.

The factories can talk to you about forms to fill-out; and the lawyers and succession planners can talk to you about their methods.

Today I am here to pass-on to you some real world observations and suggestions, based upon 42-years of watching successors come and go.

At the end of the day, I hope I will have imparted to you some thoughts and approaches that you will integrate into your thinking in order to accomplish your goals.

23% Survive

According to the Small Business Administration, 90 percent of U.S. businesses are family owned, but only 30 percent of such companies succeed in the second generation. Just fifteen percent (15%) make it to the third generation. http://sbinformation.about.com/od/buyingorselling/a/succession.htm

See too: Bloomberg Businessweek, February 13, 2006, stating only one-third survive.

Recently, a Toyota executive spoke to me about a 23% survival rate.

Think about that.

Everyone walks out of a succession seminar thinking that succession planning is a common thing, and no big deal.

In truth and in fact, the statistics show there is a 70% failure rate on the first try and an 85% failure rate on the second try.

If I told you that if you tried crossing the street in front of the hotel today, you would have a 15% chance of making it to the other side alive, would you try it anyway?

Whether the survival rate is 23% or 30%, does not make much difference. Either way, it does not say much for the dealers that implemented the plans.

So what does it all mean? It means a lot of people in these seminars need to know more about succession plans what kind of trust to establish, or how to save taxes.

The forms and techniques could be perfect, but it would not matter if you do everything correctly and the patient dies. The goal is for the second and third generation dealers to survive.

How you apply what you learn about the real-world side of the equation, is going help determine whether or not a dealership, or dealership group will survive or fail.

Nobody and no dealer group, is too old, or too big to fail.

Woolworth, Gimbles, and Lehman Brothers all folded or filed bankruptcy.

Every single year some dealer, or some dealer group, in Ward's 500 files for bankruptcy protection, or goes under.

I have sold second generation dealerships that were #1 in the region, stores that were #1 in the state and stores that were #1 in the nation. They were all upside-down when I sold them – some as much as $20 or $30 million in the red.

In order to put together a successful plan, you have to keep your feet on the ground and stick to reality. You have to keep your eye on the donut and not the hole. The donut is the success of the plan.

> On October 22, 2008, Michael Kahn was touted on the front page of ***Automotive News*** as the new boy wonder in the car business whose ". . . approach seems to typify an aggressive new brand of dealer."
>
> Sheldon Sandler, CEO of Bel Air Partners, said: "I don't think there are many dealers who have gone to the level of . . . entrepreneurship that [Kahn] has. He has a broader vision about

> the relationship between real estate and car dealers than you would ordinarily find."
>
> On February 24, 2009 Kahn was again on the front page of ***Automotive News***. The article began: "Mike Kahn ***ran*** (past tense) the fastest-growing U.S. dealership group . . . ." Emphasis added.

You are the controllers. You are the ones that have to stick to reality. You are the ones that have to keep your dealer from smoking that funny stuff, or breathing that rare air and thinking he or she is bullet proof.

When I was a kid lawyer (and knew then a lot more than I do now), I used to keep a rack of empty spice jars on my wall, labeled with the names of the big dealers that got into financial trouble.

Then, when a dealer came into my office with a problem, I would say: "Hey, that's not all bad." And I would walk to my rack of jars and pick out a name familiar to them, say "Michael Kahn." Then I would walk back to the dealer, pop the cork and tell him: "Take a whiff of the air Michael was breathing. Mike had a $40 million dollar problem and while he was breathing this air, everything was fine."

Learn from History

As an historian, I have to say that succession sagas have always been quite interesting and quite entertaining.

If you remember your history, the succession candidates in the English Monarchy went up and down like a yo-yo.

- We have Henry V, whose military genius came close to conquering France.
- Then we have Henry VI, who was a blithering idiot and whose wife eventually had to take control of the kingdom.

- Then we went back up again with Henry VII, who restored the political stability in England and achieved a number of commendable economic and diplomatic initiatives.
- Then down again with Henry VIII, who went off the deep end with six marriages and a reign of self-indulgence.

All of this brings us to our **first step** regarding succession. Ask yourself:

Is the potential successor more akin to Henry VII or Henry VIII?

If you have Henry VII, you can move on to step two in your planning.

If you are dealing with Henry VIII, a wise succession plan would be to sell the store(s) and set-up a spendthrift trust.

Assuming for the moment that we have a Henry VII caliber potential successor, the **second step** would be to determine whether he or she is interested in being a dealer.

I have a good friend that is a very successful dealer, who related the following story to me.

He told me that he approached his daughter about working in one of his stores and going through the chairs to be a dealer.

Then he related how very disappointed he was when she told him she did not want anything to do with the car business.

My friend then told her, "Well listen, I am just trying to get you prepared for life after I am gone. You will have to do something to earn a living." Whereupon his daughter, shaking her head from shoulder to shoulder, responded: "I don't think so."

If you face that situation, go back to the Henry VIII scenario and plan on selling the store(s) and establishing a trust.

Assuming we have a Henry VII caliber successor candidate, and assuming further Henry, or Henrietta, wants to be a dealer, **step three** would be to establish a plan to assure his or her success.

Step three takes hard work and discipline on the part of the dealer. NADA schools and 20-groups are necessary, but they are not the total answer. Being in a 20-group does not guarantee a successful dealer. Neither does NADA Dealer School.

Contrary to some opinions, one does not, upon graduation from Dealer School, have the Holy Ghost descend upon them, giving them the ability to speak several languages and to go on and conquer the world.

The most common plan I have seen

The one common quip I heard from second generation dealers that went under was: "I worked my way through the chairs and graduated dealer school."

The most common observation I made of the failures was they worked a few weeks in each department, while living at home, or in some expensive condo, they drove high-line vehicles and lived on an allowance of a few thousand dollars a week, to cover the expenses that the company credit card did not cover and, when they graduated from dealer school, they thought they were dealers.

Back to History: Norman Schwarzkopf / Douglas MacArthur

Both Norman Schwarzkopf and Douglas MacArthur were second generation soldiers who had fathers who were generals in the United States Army.

When they decided to follow in their fathers' footsteps, their fathers did not send them off to general schools to learn the trade and give them cars to ride, money to spend and a warm meal at home in the evenings.

They each went out and worked their way through the ranks, living with their fellow soldiers and facing the same trials and tribulations of the troops.

The best plan I have ever seen had a similar genesis

When I was a young lawyer, one of my clients was approached by his brother to let him work his way through the chairs so that he could be a dealer someday.

So here is what the dealer (call him "Joe") did.

1. With each position, Parts, Service, F&I, Used Cars, New Cars, etc., he paid his brother Jim the same salary as the position Jim was filling.

   When Jim complained, Joe explained that when he (Joe) came-up through the chairs he was paid the appropriate rate for each position and that unless Jim learned to live on the pay he received for the job he was doing, he would never really appreciate the position of people that had to do the job and what they were experiencing.

2. Aside from sending Jim to 20-group meetings and dealer school, after Jim had attained a manager's position Joe sent him from California to Denver to work for a dealer in Colorado.

   The last test was that if Jim could work for Dean Buick for two years, without getting fired, then he would be ready for his own store.

When Jim asked why he could not just work at a local dealership, Joe explained that if he did, then he really could not be sure of his own ability because everyone would know he was the dealer's brother.

Joe gave the example of Jim going to the local auction. He said that if Jim went to the local auction to buy a used car, the people would hesitate about trying to take advantage of him because they would all know he was Joe's brother and they would not want to antagonize Joe.

On the other hand, the people in Denver would not give a damn what Jim's last name was. They would deal with him like the stranger he would be. They would grind him harder and Jim would have to make the deal using only his own skills, without the assist from his brother's name.

The story ended successfully because Jim retired as a California Toyota and Honda dealer and enjoys his retirement.

A Current Case – Roundtable Food for Discussion

Six months ago, I was confronted with a situation where the dealer established a succession trust. Upon his death, or incapacity the spouse was to takes-over as trustee. The dealer is in the early stages of Alzheimer's, but is not totally incapacitated.

The spouse has de facto taken over the dealer's functions, but has not done so officially. While in the de facto position, the spouse has been undermining the dealer's intentions.

It is my belief that this scenario will be playing out more and more as the life span of our population increases.

Dementia and Alzheimer Disease are not new to the world; there are just more people living long enough to experience it and medicine has developed a better identification system for it.

The CFO / Controller's Function

The controller and CFO have the same duty they always have with their dealer – to tell the unvarnished truth.

"Hey boss, do you know your kid reminds me a lot of Henry VI?"

If he or she does not know who Henry VI is, you might leave a book about him on his/her desk, and another in the bath room, and then have Amazon send one to his/her home.

Trust me. I understand the implications of what I am saying. In the real world, there is a saying: "It doesn't pay to be right when the boss is wrong."

Here is how I handle that.

All of my clients know that I will always tell them the truth, but with the following caveat.

They know I will not grind them about the topics. I know that if I keep grinding them, they will eventually tire of me and I will be gone.

So I let them know that I will tell them once that their buddy "Harry, or Joe, or Larry" is a crook, or that they are doing this or that wrong and, and I will not tell them again.

I let all my clients know that unless I tell them I have changed my mind, I will continue to believe what I told them, but I understand we cannot have a good relationship if I continue to grind them about it.

In the end, you and I have to always remember that **it is the dealer's money and he or she has the right to risk it or lose it however they want**.

Now let's talk about the current buy/sell market.

The Current Buy/Sell Market

Market Update

Framework Agreements

First let's get a little background.

Framework Agreements need to be understood when discussing public companies, or when selling a dealership, or when discussing transactions such as the Berkshire/Van Tuyl deal.

Framework Agreements are a natural defense mechanism of manufacturers in that they help protect the factories against any group or groups gaining so much power that it or they can dictate terms to them.

I remember back in the 1990s, a Chrysler vice president telling me that if a group could adversely affect six percent of Chrysler's sales, Chrysler would go under.

If and when a group gets so powerful that it can dictate to a manufacturer, then not only will small dealers face trouble, but some of the larger, private dealership groups would be placed at a disadvantage.

If and when one group can dictate to a factory, that group would have the power to set the rules for contests, distribution of vehicles, production, and so forth.

Framework Agreements were originally created by the factories to limit public ownership of their dealerships. Each factory has its own rules and if a dealer is going to approach a public company, or a large dealer group, it would be wise to learn what agreements limit that group or company.

We do not have the time to go into much detail today about such agreements, but I have attached an article I wrote about them back in 2005.

When I was negotiating the sale of a particular Toyota dealership, one of the publics indicated it wanted to purchase the dealership, but it already owned one Toyota store in the same market (the maximum allowed at the time).

The public told the factory it would sell the other store if it entered into a buy-sell with my dealer; however, the factory told the public that it had to sell the store before it submitted a buy/sell. Exit one potential purchaser.

The subject matter of Framework Agreements is a course unto itself and there are some very interesting stories. We represented the first Indian Tribe to get approved as an owner and the factory people had no idea as to how to deal with them.

Ford knew how to deal with large dealership groups, both public and private, but how does one transact business with a Sovereign Nation that has immunity from lawsuits and does not have to pay taxes?

The Van Tuyl / Berkshire Automotive Transaction

Let's use the framework discussion to segue into our review of the Berkshire - Van Tuyl transaction. There are so many aspects of this transaction that no single news article or discussion can do it justice.

Below are just a few of the aspects of the deal.

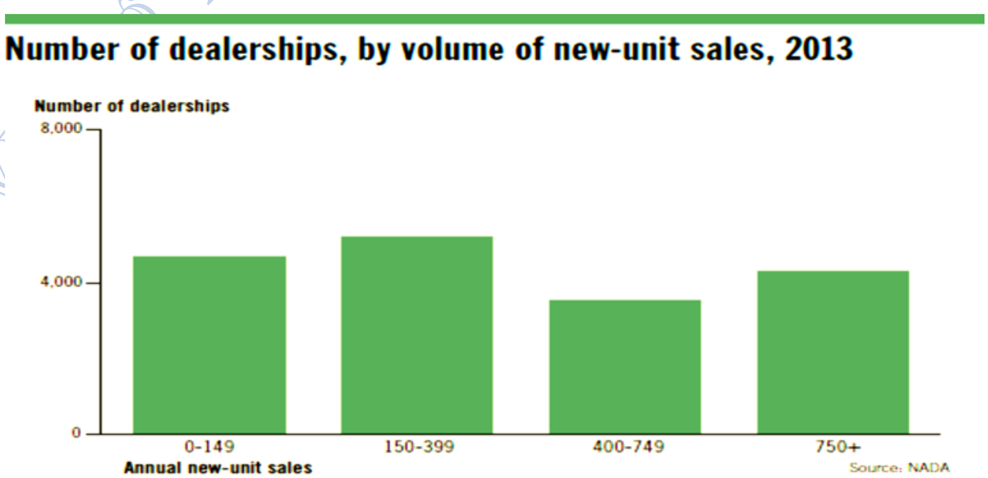
- **The effect on the stock market prices of public companies**. The market was hyped and the stock value of the publics spurted up after the announcement of the sale.

- **The effect on Van Tuyl's ability to purchase brand dealerships** – remember what we discussed about framework agreements.

  Large, private companies have framework agreements similar to the publics and if there is not a formal agreement, the factories have the same concerns and considerations when reviewing buy/sells submitted by them.

  Consequently, regardless of Berkshire's money, Van Tuyl will be limited in the number and location of brands it can acquire.

- **The effect on the buy-sell market**. All the publics and all of the large privates are still in the market and will continue to buy dealerships just as they did before Berkshire bought Van Tuyl.



To help put the Berkshire deal in perspective, the National Automobile Dealers Association (NADA) reported that there were 17,665 dealerships in the U.S. last year [www.NADA.org/nadadata].

Berkshire bought Van Tuyl, which has 78 dealerships.

When you get back to your office, try putting 17,665 marbles in the left drawer of your desk and then taking out 78 marbles and putting them in the drawer on the right side of the desk. Then let me know the effect the 78 marbles in the right drawer have on the 17,587 marbles remaining in the left drawer.

The Berkshire transaction is causing talk: (a) because it involves Warren Buffett, a hot topic of the day; and (b) because the press is enamored with saying "Babababa billion" – with a "B".

Bill Gates put his money on AutoNation. Big names like Michael Dell (Dell Computers) tried to get in the game.

The fact is investment by outsiders into the car business is being driven by the same force that drives them to invest in the stock market. "Return on Investment."

A ten-year T-Bill is going for about 2%. Prime rate on Fed Funds is about 3%. A five-year CD is going for about 2%. The last time interest was so low, Elvis Presley was singing "Heartbreak Hotel."

Blue Sky - "Multiples" is shorthand for "Greater Fool"

Regardless of what you hear, purchases of dealerships are based upon the buyer's perspective of the type of return on investment he or she will receive, not upon some hard and fast multiple of earnings.

My friend Mike Beaver bought Lighthouse Toyota out of bankruptcy for $10 million blue sky, plus around another $9 million in assets. The store had no profit. (Jacksonville Business Journal, ***Automotive News***, March 22, 2013)

The store made money from the first day he opened it and the last time I talked to him it was earning a strong six figures per month.

How was that acquisition accounted for in the multiples game?

Every time I open Automotive News and read that a particular brand is worth “x” times earnings, I ask myself: “How does anyone even know that?”

On June 23, 2014, ***Automotive News*** ran a story that there were 48 dealership sales reported the first quarter, of which two were Audi dealerships. The article goes on to state that the multiples reported in its April 23 issue were still good.

In April, the chart showed Audi dealerships bringing multiples of 6 to 7 times earnings.

Of the two Audi stores sold in the first quarter, we sold one of them at multiples of over twice those shown in ***Automotive News***. I continue to wonder what the other store sold for to arrive at an average of 6 to 7 times earnings.

How can anyone even know the blue sky paid for each of the 48 stores sold in the first quarter in order to get an average?

If I gave you the sales prices and the financial statements you still would not be able to tell me.

You would still also need to know all of the adjustments made to the statement.

- Was the dealer’s family employed at the store?
- Did the store own an airplane or yacht?

- Did the dealer have an interest in the advertising company used?

A store is a business opportunity and a business opportunity is worth what an investor believes would be a reasonable return on the value of the investment – and that could be almost anything – ten percent, twenty percent, thirty percent. It is a subjective decision of the investor.

There are many considerations in addition to Return-On-Investment that go into determining the value of a dealership: Location, Upside, Personnel, Brand, Condition of Facility, and so forth.

I have attached several methods of determining a dealerships “goodwill” value:

- Multiples;
- Public Company comparisons; and
- Concluded Earnings Values.

I like the Concluded Earnings method and I personally think that it is that method that is driving the current market and the blue sky values

Right now, if you invested in T-Bills, you could expect about a 2% return on your money. Wealthy investors are looking for a better return. That fact is one of the main reasons the stock market keeps rising.

It was also probably one of the driving forces behind Buffett getting into the car business.

The Concluded Earnings Value is a “best guess,” Return on Investment calculation considering the return on T-Bills, the risk of the investment, and the natural long-term growth rate of the economy.

As can be seen by the attached chart, in applying those considerations, one must still calculate both the actual earnings of the dealership and its potential earnings.

That concludes my presentation and, if anyone has any questions or comments, you may make them now, or at any time during the course of this event, or you can send me an email.

Thank you for the opportunity to visit with you all and for your time and attention.

A copy of the full text of the speech and its exhibits may be found at:

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