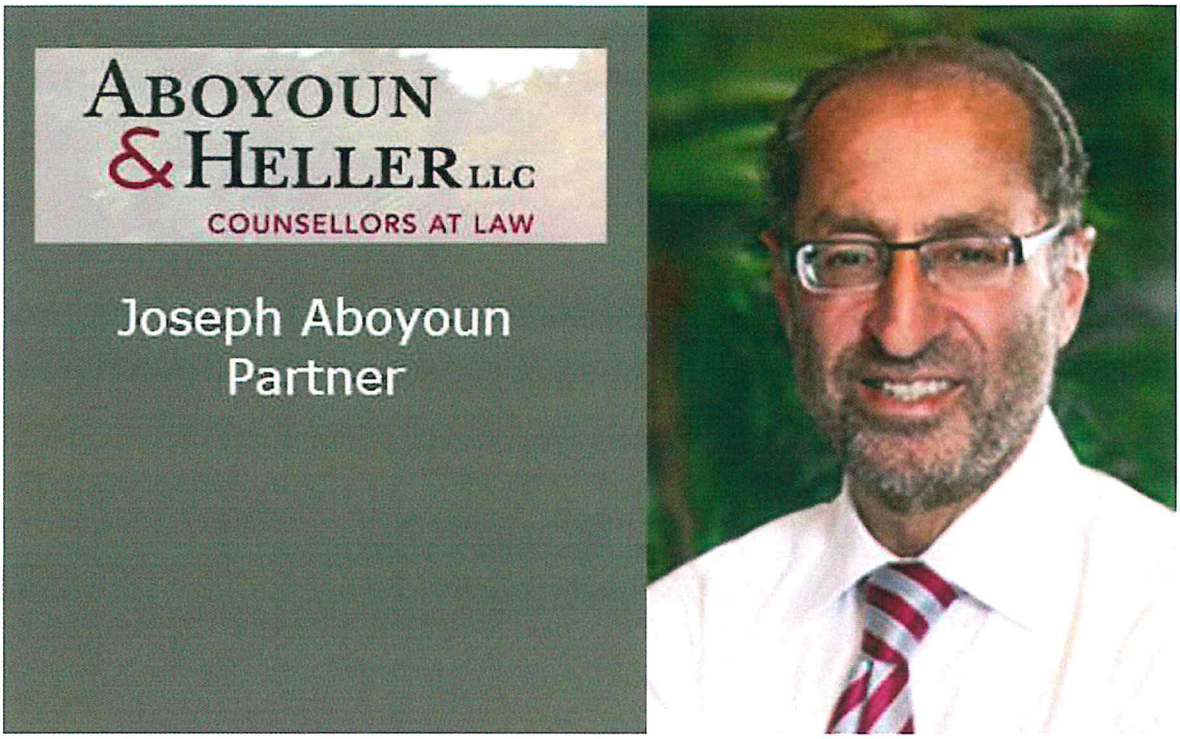

The buy sell deals you may want to avoid

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Contrary to the classic Yogism, when you come to a fork in the road, rather than taking the road less travelled sometimes it is better to turn around and head back home. This advice applies to dealership acquisitions that you might consider along the way. There are some deals that are just not worth pursuing. Let's explore the challenges of identifying that avoidable deal.

Difficult Seller

A good starting point in this evaluation is to assess the seller. Is the owner one that will negotiate in good faith and honor the deal once it is inked? There are sellers in every market who have an established "rep" as notoriously difficult or even worse. If you are dealing with such a seller, you are advised to take precautions and conduct as much due diligence on the character and reputation of the seller as the deal itself.

If not, you can be exposed to several issues down the road, including, a lack of cooperation from the seller as deal problems develop (e.g. environmental problems) or efforts by the seller at every turn to renege on the

deal. Some buyers assume that all of this can be rectified with a properly-crafted buy-sell agreement. However, as the old saying goes, a handshake from an honorable person is much more valuable than a contract. There is no contract under the sun that can adequately protect you against a dishonorable party.

Deal Issues

One must evaluate the issues affecting the target store as early as possible in the negotiation process. These issues must be identified long before the formal due diligence process belongs. Some of the most significant of these may include the following:

- **Facility Issues.** This is a huge factor to consider when pursuing a deal. If the dealership is not compliant with the current facility guidelines established by the franchisor, both in terms of site and image requirements, the deficiencies must be assessed immediately and must be a significant factor in the price negotiations. Even if these are acceptable, the franchisor deadline for completing the upgrade and the likely impact (i.e., disruption on operations) must be considered.

- **Performance Issues.** What if the dealership is suffering from performance inadequacies in terms of franchisor requirements? Most buyers will readily assume that their superior management will overcome their problems after closing. However, this aspect requires further scrutiny. First, how will the factory address these deficiencies in the ultimate franchise approach? Will the approval require the execution of a term agreement instead of a standard agreement? Will the anticipated deadlines for compliance be reasonable or attainable? How does one turn a store historically deficient in sales or CSI around in a year or two? Are the problems just a function of the seller's mismanagement, or is it a deeper question about the market surrounding the store? For example, we know that some markets are more suitable to high-end products than regular vehicles, and vice versa._

- **Site Control.** Another significant area to explore are site restrictions/limitations established by the franchisor. This is commonly referred to as site control. The seller may have agreed to long-term restrictions and was even paid to do so. Some of these arrangements can extend to *25 years*. GM is notorious for this. If your plans are to move the franchise and replace it with a competitive brand, the site control can be the death knell of the deal. At the very minimum, it must be a major factor in the price negotiations.

- **Other Concerns.** Here are some additional aspects to consider:

- Known environmental problems should always be a concern. We have seen all too often a buyer underestimate the cost and consequences of an environmental clean-up, and the cost and disruption associated with a post-closing remediation program.
- An insolvent seller also presents huge challenges for the buyer. How does the buyer guarantee that the seller's creditors will cooperate with the deal and not disrupt it down the line? This could lead to a bankruptcy filing by either the seller or an involuntary filing by its creditors. If this occurs, the deal can turn into a bidding war. In the end, you could simply serve as the seller's stalking horse, only to lose the deal to one of your competitors, with only significant deal costs to show for your efforts.
- A target dealership which has a collective bargaining agreement (CBA) in place also requires additional scrutiny. If the deal involves an assumption of the CBA, the buyer is cautioned against any potential funding deficiencies under the CBA that it may inherit, as well as any withdrawal liability exposure.

ROFR Concerns

Lastly, the well-prepared buyer must evaluate the right-of-first-refusal (ROFR) aspect of the deal at the very outset. If it is reasonably probable that the manufacturer will exercise its ROFR and flip the deal to its preferred operator, the buyer may be better off walking away from the deal as early in the game as possible. While there are ways to preclude or avoid a ROFR exercise (so-called poison pills included in the buy-sell agreement), the sophisticated buyer must ask the most important question: Should the deal be pursued nonetheless? Is it really advisable to force a relationship with a manufacturer who prefers someone else and, worse one who has a low estimation of you?

There are a host of problems that can arise in an acquisition that involve factors beyond your control, such as those addressed in the article. When you decide to pursue a deal, it is imperative that these factors be considered and evaluated as early in the process as possible.

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