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Dealer Digest

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ACCOUNTANTS & ADVISORS

Is it time to hire a CFO or controller?

When dealerships grow to a certain size, their owners often face an important decision about oversight of the financial side of the business: Should they hire a high-level financial executive to oversee the dealership's finances?

There is no one-size-fits-all answer to this question, as many factors beyond size go into the decision. Yet expanding dealerships should regularly and carefully consider the possibility of hiring either a CFO or a controller.

Strategic financial direction

As mentioned, dealerships usually need to reach a minimum size before it's financially feasible for them to hire a financial exec. Generally, there are two thresholds in play:

1. Having revenues of around $75 million or operating multiple smaller stores means you may be ready to hire a controller.
2. Having revenues of around $300 million while running multiple locations could indicate it's time to hire a CFO.

If your dealership has already met one of these thresholds, or soon will, consider the potential benefits of hiring a financial executive. Perhaps the biggest is the ability of this kind of professional to bring a higher level of strategic and analytical skills to the financial management of your dealership that go beyond just basic number-crunching.

A CFO or controller can provide strategic financial direction for your dealership. Doing so includes looking beyond day-to-day financial management to more holistic, big-picture financial and operational planning. He or she will take a seat at the executive table and serve as the owner's go-to person for all matters related to dealership finances and operations.

Roles and responsibilities

A CFO or controller will be able to go beyond merely compiling financial data to providing an *interpretation* of the data that demonstrates how financial decisions will impact all areas of the dealership. He or she also will be able to demonstrate how improved data interpretation can help lead to better management and operational decisions. And this person can plan capital acquisition strategies so your dealership has access to financing as needed to meet working capital and operating expenses.

In addition, a CFO or controller will serve as the primary liaison between your dealership and its bank to ensure your financial statements meet the bank's requirements and help negotiate any loans needed. Analyzing possible merger and acquisition and other expansion opportunities also falls within a CFO's or controller's purview.

And if you're stuck in between …

Your dealership might find itself stuck in the middle: not quite big enough to afford a full-time CFO or controller, but too big for your office manager or bookkeeper to continue managing the finances.

In this instance, your CPA may be able to work with your existing financial staff to provide oversight of the financial and accounting functions and strategic expertise on an outsourced basis. This way, you'll receive the high-level financial and operational know-how you need without having to pay the high salary and other overhead required for an executive position — an efficient and cost-effective solution.

The specific roles and responsibilities of a dealership CFO or controller usually include the following:

- Making sure adequate internal controls are in place to help safeguard the dealership from internal fraud and embezzlement,
- Performing ratio analysis and comparing the dealership's financial performance to benchmarks established by similar-size dealerships in the same geographic area,
- Determining whether it would be beneficial for the dealership to perform a cost segregation study and, if so, spearheading this effort,
- Bringing the financial operations of multiple franchise locations together and looking for ways the dealership can benefit from economies of scale, and
- Implementing improved cash management practices that will boost the dealership's cash flow and improve budgeting and cash forecasting.

A CFO or controller also can analyze the tax and cash flow implications of different capital acquisition strategies — for example, leasing vs. buying equipment and real estate.

A major commitment

Hiring a full-time CFO or controller represents a major commitment in both money and time. This executive will likely command a six-figure salary and an attractive benefits package, so first make sure your dealership has the financial resources to support this level of compensation. If you hire a CFO or controller before your dealership can afford it, your profitability will likely suffer.

Bringing in a financial exec also will require a time commitment on the part of ownership and the existing management team. They'll have to bring the CFO or controller up to speed on all aspects of the dealership's finances and operations. If this training doesn't go well, or the new exec isn't granted enough decision-making authority afterward, he or she could become bored and leave your employ — wasting your efforts and disrupting the business.

Care and caution

Take great care and caution in making this decision. Hiring a CFO or controller at the right time can pay big dividends for your dealership — but doing so at the wrong time can be costly. ■

Cash flow — the lifeblood of a dealership

Most dealerships gauge financial success by their profitability. After all, profits are what fuel owners' and other shareholders' income, enable dealerships to compensate employees generously, and allow the stores to grow and expand.

But there's another component of your dealership's finances that's at least as important as profits, if not more so: cash flow. Emphasizing profits over cash flow is like putting the cart before the horse. Dealerships without adequate cash to cover operations and overhead can run into financial trouble and, in a worst-case scenario, never even be able to realize those healthy profits that appeared like a mirage on the balance sheet.

Be realistic

There's good news and bad news for dealerships when it comes to cash flow. The good news is that the cash flow cycle of a dealership is unlike that of most other businesses. For example, you aren't buying raw materials to manufacture a product and then sell it to customers on 30- or 60-day payment terms, thus creating accounts receivable.

Instead, your dealership receives cash for vehicles sold from the financing bank usually within three to five days after the sale is completed. At that time, you have to pay down your floor plan line of credit for the amount you've borrowed to keep the vehicle on your lot. So, unlike a manufacturer, you don't have to worry about collecting accounts receivable from your customers in a timely manner.

But the bad news is that many dealerships get lulled into a false sense of security because of

the relative certainty of the dealership cash flow cycle. As a result, they often fail to take simple steps that could improve their cash flows and their financial operations.

This can be most common in the parts and service department. Obviously, this side of the dealership doesn't operate on the same cash flow cycle as vehicle sales. Therefore, parts and service managers should follow cash flow management practices similar to those of any business that generates accounts receivable. These include:

- ❏ Issuing invoices in a timely manner,
- ❏ Producing aging schedules to see which customers are late in making payments,
- ❏ Enforcing credit policies, and
- ❏ Aggressively pursuing collection of past-due payments.

Also pay close attention to warranty receivables. Be sure to follow manufacturers' instructions and procedures to the letter when completing warranty paperwork, to avoid payment delays and thus accelerate these collections. These payments are typically made in 30 to 60 days; so if yours are stretching out longer than this, talk to

the manufacturer to find out what's causing the delay.

Accelerate sales cash

In addition, there are things that can be done to accelerate your dealership's cash flow on vehicle sales. For starters, process paperwork (including the title and license) quickly. Every day that paperwork is held up is a day that cash flow is delayed. Your floor plan line-of-credit payment will be due to the bank a certain number of days after the vehicle's sale — regardless of whether paperwork snags have postponed receipt of your cash.

Also keep a close eye on inventory. Proper inventory management is always a balancing act — keeping enough of the right vehicles on your lot to meet customer demand without overstocking vehicles and paying excess interest. Minimizing your floor plan interest expense will go a long way toward boosting cash flow.

Like warranty receivables, Sales Performance Incentive Fund (SPIF) bonuses call for careful completion of manufacturers' paperwork. Delays in receiving this money will inhibit your cash flow.

Focus on flow

It's often said that cash flow is the lifeblood of a business — and this is just as true for dealerships as it is for any other type of enterprise. By focusing on these tips, you can help keep your dealership's cash flowing. ■

Put the puzzle together

Dealership valuation is both an art and a science

You may have spent decades building your dealership. When it comes to selling it, or passing the business on to your heirs, a basic question arises: How much is your dealership worth?

The answer depends on many factors, and this is where the experience of a professional valuator comes into play. He or she can help you determine what your dealership is worth — on the market or on paper.

Starting with book value

As a starting point for your dealership's value, the valuator may use book value of shareholders' equity. This is the difference between the carrying values of assets and liabilities on your balance sheet.

The valuator also may adjust for items that are omitted, exaggerated or understated on your balance sheet. Examples include contingent environmental or legal liabilities, write-offs for uncollectible receivables, and fully depreciated equipment.

If you own your facility, the valuator will obtain a real estate appraisal and add the value separately to the preliminary appraisal of your operations. He or she also will adjust your earnings (or cash flow) for reasonable rent expense. If this isn't done, your real estate will be double-valued.

Factoring in "blue sky"

Another piece of the valuation puzzle is intangible value — also known as "blue sky" or goodwill. The value of goodwill may be applied to your franchise's value. Goodwill often is determined using a price-to-cash-flow or price-to-earnings multiple, based on comparable transactions.

The inverse of a pricing multiple is a capitalization rate. Cap rates are a function of the business's perceived risk. These come into play if an appraiser applies a discounted cash flow analysis to value the dealership. Sounds tricky, but remember: The *higher* the cash flow and the *lower* the cap (or discount) rate, the higher the business's value.

Weighing other factors

There's a wide range of valuation multiples and cap rates for auto dealerships. Take product mix. Some brands sell better — and have higher growth prospects — than others. In general, new car dealers are more desirable than used car dealers. Likewise, mid- or high-end import dealers are more desirable than domestic or economy dealers. A strong finance or service department also might command a premium price.

Valuators consider location, too. Metropolitan dealers often fare better than rural dealers. And successful dealers have updated, accessible showrooms and ample inventory space.

Prospective buyers also evaluate financial statements before making an offer. They want a history of high profits and liquidity, efficient turnover, strong growth, and low debt.

In addition, valuators adjust earnings for discretionary expenses (such as excessive owner compensation), nonrecurring items (such as legal expenses) or deferred maintenance.

Getting ready

Even if a sale isn't in your immediate future, a valuator can provide you with the information necessary to draft a buy-sell agreement. This agreement provides a plan to follow in the event you or a business partner unexpectedly dies, becomes disabled or otherwise withdraws from the dealership. A valuator will help name and define your agreement's standard of value and suggest a formula for calculating it, so that ownership can be transferred at fair market value.

Your dealership's value also will affect the tax-related costs of gifting or bequeathing business interests, if you choose to pass the business to your loved ones. A valuation can prompt *supportable* discounts for lack of control and marketability, and prevent you from improperly estimating the value. Otherwise, your heirs could end up with a sizable estate tax bill that could force them to sell your business.

Choosing a pro

Transitioning the ownership of your business is a complicated matter. Make sure that the person assessing its worth is a valuation professional with experience in the automotive sector. ■

DEALER DIGEST

Longer-lasting cars lead to longer loan terms

Not so long ago, 60 months was about the longest that most dealerships and finance companies were willing to finance a vehicle. This reflected the old auto finance industry adage: When the car dies, the loan payments tend to stop.

But new cars today are built to last much longer than those built in the past — even the fairly recent past. One result is a gradual lengthening of vehicle loan terms.

Six out of every 10 vehicles financed today are financed for longer than 60 months, with 72 months having become the new standard vehicle financing term, according to the president of a major vehicle financing company. Vehicle loan terms up to 84 and even 96 months (or eight years!) aren't uncommon.

You may dislike longer loan terms because you fear they'll keep customers from buying vehicles as often. But some lenders say this isn't necessarily the case. In the same way that very few homeowners stay in a home for 30 years, a seven- or even eight-year vehicle loan doesn't necessarily preclude customers from buying a new vehicle before the term is up. ■

High MPG still draws buyers

The plummeting price of gasoline has been one of the top stories of the past year. So it's somewhat surprising that, for the fourth year in a row, fuel economy remains the most influential factor among new-vehicle buyers, according to the 12th annual Avoider Study conducted by J.D. Power and Associates.

The study's research director says this is because most people realize that gasoline prices are extremely volatile and could rise again as quickly as they've fallen. Buyers will own these vehicles for many years, he noted, and they want their fuel costs to remain low over the long term.

Fuel economy also was the second-most influential reason why new-vehicle owners rejected certain car models. ■

Millennial hiring is rising

About one out of every four dealership employees is now a millennial, according to the most recent Dealership Workforce Study conducted by the National Auto Dealers Association. This is good news because millennials — those born in the '80s or '90s — are expected to make up 40% of all new-car buyers by 2020, and millennial customers are likely to relate better to millennial salespeople.

However, turnover among these employees is 55%. Experts attribute this largely to the fact that many prioritize work-life balance, but many dealerships continue to demand long work hours — especially for sales staff. Consider adopting shorter workweeks and revising compensation plans to attract and retain more millennial employees. ■

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