MARINE DEALER
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Due Diligence Essentials for Buyers and Sellers

By:
John Seymour
&
Thomas England

DHG
DIXON HUGHES GOODMAN LLP

DUE DILIGENCE ESSENTIALS FOR BUYERS & SELLERS

Quality of Earnings Analysis: What should we focus on?

Current Accounting Classifications

Other income and expense: To understand the margins properly we have to understand other income and expense. From a sellers perspective it is in our best interest to show these margins up front and peel back the onion to help for a smoother due diligence period and also telling your story and why your deal is attractive.
Mapping: Need to consider that the dealership financial statement is mapped correctly as compared to most other dealerships across the country. If you are in a 20 group, you probably understand this well.

People and Pay Plans

Relatives, inactive owners, over-paid employees: we need to understand who might be on the payroll that is not in line with the market or who might not really be "contributing" to the performance of the dealership.
Pay plans: As a buyer, you will need to consider the pay plans currently being utilized at the store. Coming in and changing things right off can potentially rock the boat and cause turnover. And do not just evaluate the pay plans but determine if employees are really being paid according to those pay plans.
Overall organization chart: this can be very useful, especially if this is a multi-store group. Many times, payroll won't always directly map with the responsibilities of the employees. i.e. Store managers running multiple stores, employees over the entire group.
Open positions, current or past: On the other side, there might be positions we need to fill or had a vacancy for a period of time. i.e. stores might have gotten away with a high performing sales manager that hasn't gotten that pay bump up to store manager.

Facilities and Rent

Remodel, renovations, or new facility: We may know we have to remodel or even build a new building. However, as a buyer, how does that impact the rent factor or depreciation?
Rent Factor: We need to understand if the rent factor has been market. We see times when the rent factor is too low or even too high depending on the circumstances. Being able to understand the proper rent factor and its impact on the quality of earnings is key. This may affect your negotiations on a potential real estate purchase, new lease or lease assumptions, or leaseholds.

Other

Rent and Real Estate: We discussed this but understanding if the real estate is included in the dealership's records or not.
Management companies and management fees: do we have management fees being recorded on another entity. As a seller, highlight this upfront.
Non-business-related expenses: This can be very beneficial for a seller to highlight any expenses that are really above and beyond the business. i.e. personal country clubs, "extra" advertising that might be more of philanthropy, personal vacations.

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Historical Balance Sheet Analysis: Why is it important?

True quality of earnings: We get focused on buying assets and the balance sheet doesn't matter. However, extra expense can be hung up on the balance sheet. A common example is having certain expenses being hidden in a prepaid expense account as the company is waiting to expense the item until a later period.
Reserves: Understanding chargeback reserves, potential "for life" programs with a reserve will help us understand future liabilities and expenses as they relate to F&I income or keeping customers happy with what they were promised.
Inventory: Inventory specifically can help you better understand future interest expense, especially as interest rates begin to rise.
Related Party: The related party balances and transactions would be on the balance sheet and can help you identify intercompany sales, non-business-related expenses running through the dealership.
Preparing for the closing: It's a good idea to get our hands around aged inventory, parts obsolescence prior to closing. This can help us as we prepare for negotiations at the closing table. It's always better to not have any surprises.

Non-financial factors: What to consider

People and Processes: Even if we are buying "assets" we don't want to turn around and have to rehire totally new people (in most deals). And we might implement our own policies and procedures, but we need to understand the current sophistication of current employees to consider additional training time built into the new deal.
Culture Shift: Be make sure there is a solid transfer of ownership culture early with a meeting, presentation, and meetings with key employees. Being able to present a solid front as a team, both the seller and buyer, will make all employees feel at ease.
IT Conversion: Verify the proper lead time is in place if planning to switch to a new DMS. Verify proper training time is set up.
Onboarding

- HR: Do we have the man power for the first 30, 60, 90 days ... the staffing needs initially can look much different than on going once things are settled.
- Accounting: Think about opening entries and closing entries.
- Recruiting: There most likely will be some turnover within the first 90 days, which can be healthy, can we refill these roles quickly?
- Seller's role: It can be helpful to have the seller stay on for a period of time to help with the transition. It can also help when closing down their own entity(ies) depending on the man power.

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Asset Purchase Agreement: What terms to look for?

New inventory: Typically straightforward pricing at invoice plus any add-ons or rigging.
Used inventory: It's best to agree on the approach to take for pricing used inventory early on whether it is seller's cost or using a valuation guide like NADA. And determine whether or not the seller may retain certain boats if a price is unable to be agreed upon. It's in the best interest of all parties to transfer these units at the closing table. i.e. seller doesn't want to wholesale or consign and the buyer needs used inventory to sell on the lot immediately.
Parts inventory: Ensure the purchase agreement spells out what to do with aged parts.
Fixed Assets:

- Be specific in the terminology for the cost of fixed assets as it can be very vague and subject to interpretation. You can use net book value or obtain a third party appraiser but ensure you agree to the methodology as these can be significant dollar amounts.
- New additions after the APA is signed. Don't forget about these!

Leases: Need to consider the assumption and transfer of leases during the negotiations of the real estate, rent, and fixed assets. These are can be intertwined from a real estate perspective. Also, be sure to account for any deposits or prepaid rent at the closing table.
Other

- **Prepaids and prorated expenses:** Examples include deposits on utilities, prepaid rent or prepaid real estate taxes.
- **Customer deposits:** Ensure credits are included at closing for any customer deposits
- **Settle Up Period:** Best practice is to build in a set timeline for when this will get accomplished.