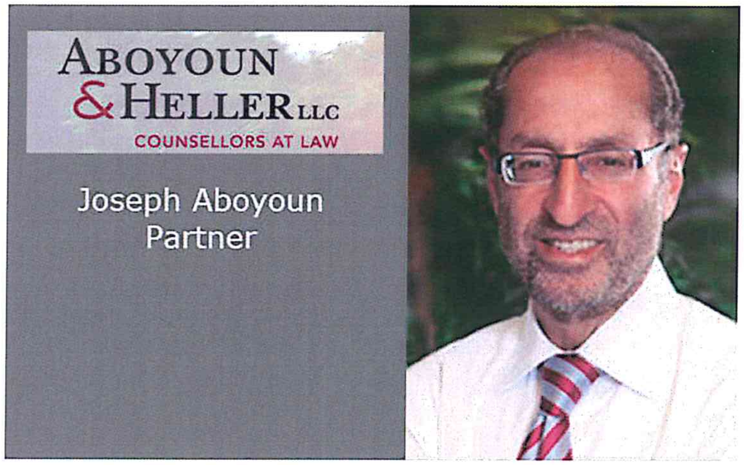

Motor vehicle inventory issues in buy-sells: how real value can be gained or lost

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The price negotiations in a buy-sell do not end with the establishment of the blue sky amount. To achieve an optimum deal, many additional terms must be addressed. One of the more significant price points is the motor vehicles inventory. There is no such thing as a standard inventory provision. There are several components and nuances, both with respect to what inventory is included in the deal and the prices to be paid for each category. If overlooked or handled incorrectly, significant financial consequences can result.

INCLUDED UNITS

The obvious starting point is to determine which vehicles are included in the deal. The following are the most important categories:

1. New Vehicles. This is, of course, the most significant category. These are customarily limited to the "current" model year or the actual model years specified in the agreement. What if a model is current at the time of buy-sell execution, but not at closing? Should the prior model year (i.e., leftover) be included? What about the requirement that the unit be "unused". Does this mean less than 50 miles? 100? 500? Should swaps be treated differently? As always, the devil is in the details and the details must be fully vetted in the negotiations and properly addressed in the buy-sell.

2. "Punched" Units. These are units that are reported to the factory as sold at retail, but remain in inventory. These have become commonplace as a result of a push by many manufacturers to achieve a target level of "retail" sales to satisfy their shareholders and/or Wall Street. This area presents a formidable concern for both seller and buyer. One of the obvious pitfalls is that the warranty period is already running on these units.

3. Damaged Vehicles. These present a separate concern. Minor damage can, of course, be adjusted with dollars. However, if the damage exceeds the thresholds established under a state's consumer laws and, as such, requires disclosure to the consumer, the buyer's willingness to purchase such units rightfully disappears.

4. Demos. Needless to say, units with mileage, even though considered new, require special attention. Typically, these are limited in both the number of units the buyer will accept (e.g., 6) and a specified ceiling on the mileage (e.g., 5,000 miles).

5. Loaners. As in the case of demos, loaners are usually subject to limitations. The main restriction is that the unit must be properly enrolled in the franchisor's loaner program and be entitled to all credits and benefits thereunder.

6. Company Vehicles. The threshold question here is whether these units are included in the price established for fixed assets or will carry a separate price. This category typically includes the parts van, courtesy vehicles and maintenance vehicles.

7. Pre-Owned Vehicles. This category also includes so-called program units. Whether pre-owned vehicles are included or excluded from a deal is purely a matter of negotiation. There are strong arguments on both sides of the table. One thing is, however, clear: the aspect should never rise to the level of a deal-killer. A selling dealer has multiple options regarding the disposition of its pre-owned units in the event a mutually-satisfactory deal cannot be struck.

A properly-negotiated buy-sell should consider each inventory category. Whether each one ultimately makes its way into the agreement, and how each is addressed, will depend on the negotiation skills of the parties and their representatives, as well as the drafting skills of their respective counsel.

PRICE

Once the scope of the motor vehicles inventory is determined the focus naturally shifts to price. Again, there is nothing standard or automatic here. The price for each category of vehicles must be carefully negotiated. The following are the most significant pricing concepts:

1. New Vehicles.

   a. Unused Units. The price for such units usually starts with the "factory invoice price", which is then subject to several potential adjustments, including the following:

      i. Holdback;

      ii. Floor plan allowance;

      iii. Advertising;

      iv. Model change allowance;

      v. Other factory incentives, allowances or credits paid on invoice (as opposed to payment upon retail sale);

      vi. Missing equipment; and

      vii. Damage

Needless to say, all of these are subject to negotiation and, even, exclusion. From a buyer's perspective, all adjustments should be included to the full extent since it wants to be "into" the unit at the same price as its competing dealers; otherwise, it starts operations at a competitive disadvantage. As for the seller, a substantial portion of the benefits derived from the adjustments has already been spent or absorbed and it is not inclined to give the benefits to the buyer.

The floor plan allowance is a price example. The buyer wants this benefit in order to subsidize the carrying costs of the units after the closing and to remain competitive. The seller, on the other hand, has already used this money in operations and is not thrilled with giving it back. Needless to say, the adjustment is often times compromised (e.g., a 50/50 split or an allocation based upon the duration of the unit in inventory). The advertising credit entails similar dynamics. When the deal involves hundreds of vehicles, the gain or loss of their adjustments can, of course, translate into significant dollars.

   b. Demos. Typically, the price for demos tracks the price for unused units, but involves an additional adjustment for mileage. This can range from $ 0.15 to $ 0.50 per mile depending on the nature of the inventory (i.e., regular units verses high-line vehicles).

2. Loaners. The establishment of the price for loaners can be a tricky negotiation. Customarily, sellers will request a price equal to its book value for the units. This includes the cost of the vehicles less any loaner incentives provided by the factory and, perhaps, less any write-down employed by the seller as part of its customary accounting (e.g., 1% per month). The Buyer on the other hand, wants the price to equate to the real value of the units based upon model year, mileage and condition. Somewhere in the negotiations these potentially-conflicting approaches must be reconciled or one or both of the parties must show some flexibility.

3. Company Vehicles. If the price for these is not already included in the price for fixed assets, the price is customarily based upon fair market value.

4. Pre-Owned Units. Many times, the parties will endeavor to employ one of the wholesale price guidelines to value pre-owned inventory (e.g., Kelley Blue Book). However, these discussions can become bogged down, especially where the condition of a unit is in question. The better approach may be to establish a mutual price for a unit and exclude those where mutuality cannot be achieved. In the latter event, the seller can simply sell the unit at wholesale prior to, or immediately after, closing.

The point here is straight-forward. There are many details to be negotiated in a buy-sell when it comes to motor vehicles inventory. If competently addressed, significant value can be gained in a deal. If not, as the buyer, you may be absorbing hidden acquisitions costs that were not anticipated or budgeted. As a seller, you may effectively give back some of your blue sky money that you so skillfully obtained in your negotiations.

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