

WHO WILL DRIVE YOUR DEALERSHIP?

Succession planning essentials



Can you afford to invest in a succession plan?



Derek Comestro, Market Executive,
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You can't afford not to.

Those of us at Bank of America Merrill Lynch, alongside our wealth management colleagues, work all the time with dealerships like yours. Too often, we see that auto dealers put off succession planning—and the result is serious consequences to the business.

Lack of a management succession plan can lead to a situation where no one is sure who's in charge of your dealership. Inadequate planning can jeopardize your business and your family's financial future.

Upfront planning can help provide a seamless transition for your dealership whenever you are no longer at the helm. When you retire, the plan you've created will help you protect the business you've built, and allow your family and staff to benefit from your hard work.

We know that succession planning isn't easy. We can help you get started, help you organize a plan and help make sure nothing is forgotten.

Creating a plan will require time, money and tough decisions. But we know from experience that short-term pain can set up a long-term gain for your dealership as well as your family.

Having a succession plan in place also is increasingly important to manufacturers, who—like you—want to make sure your dealership continues as a thriving business.

You have worked too hard and too long on your business to not address this critical aspect to the successful continuation of the company. And we are your financial solutions provider in making sure your dealership continues to thrive.

Helping dealers understand and manage the planning process is our commitment to our clients.

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The time is now to **PLAN FOR SUCCESSION**

Whether through disability, retirement or death, inevitably the time will come when you are not running your dealership any more. And that is why every dealer needs to create a succession plan to protect the future of his or her business.

“Honestly, the appropriate time to start thinking about succession planning is the day after you buy the business,” says Holly Swan, managing director and wealth strategist at U.S. Trust, Bank of America Private Wealth Management. “No one does that, but that’s the right time.” Or maybe even before purchase; it could be structured in the acquisition.

“Every dealer needs to ask: What is going to happen to this company if something happens to me? And then the dealer needs to plan accordingly,” Swan says.

“ Whether now or later, every dealer needs to ask: What is going to happen to this company if something happens to me? And then the dealer needs to plan accordingly. ”

SUCCESSION PLANNING ENCOMPASSES A NUMBER OF IMPORTANT CONSIDERATIONS:

- Designating a person who will operate the business if you are suddenly disabled.
- Creating a detailed plan to leave the business to your family, a partner or a colleague.
- Investigating the best ways to help those who inherit the business pay the estate tax and other costs associated with transferring the dealership to a new owner.
- Preparing your business to be sold if there are no obvious successors.
- Naming a person who will run the dealership until the business is either sold or officially passed on to new internal owners.

You’ve worked hard, whether building your business from the ground up or leading an established institution. Maybe you have added another dealership or two. You’ve invested in the real estate. Life is good. You love your job, and things are going well.

So why would you want to think about succession planning?

Whether through disability, retirement or death, inevitably the time will come when you are not running your dealership any more. And that is why every dealer needs to create a succession plan to protect the future of his or her business.



Two-thirds of business owners who responded to the 2016 U.S. Trust Insights on Wealth and Worth® Survey do not have a formal succession plan, including seven in 10 business owners over age 50.

ASK YOURSELF:

- What will happen to my dealership(s) when I retire?
- What will happen to my dealership(s) if I am disabled?
- What will happen to my dealership(s) when I die?

If you don't have an answer and a plan in writing for each of these scenarios, it's time to start succession planning.



Holly Swan, Managing Director and Wealth Strategist, U.S. Trust



TOP CONCERNS FOR AN AUTO DEALER

- Transferring my business to family members at my death
- Transferring my business to non-family members at my retirement
- Reducing my estate taxes
- Creating a lasting legacy for future generations
- Avoiding planning-related pitfalls
- Enhancing liquidity to preserve my business
- Reducing my income taxes
- Planning for my real estate
- Building a planning road map to keep me on track

“This is a very personal business for them. So they don’t want to think about leaving their dealership—it’s so much a part of who they are.”

The goal of all of these steps is to provide for your family and your staff and to protect the business you have built.

Swan says that in her experience, auto dealers are less interested in succession planning than most business owners. “The type of person who is attracted to the dealership business tends to be a self-made person, often who’s worked his way up in life, and one who often has a stronger relationship with his dealership than with his family even,” she says. “This is a very personal business for them. So they don’t want to think about leaving their dealership—it’s so much a part of who they are. Retirement doesn’t necessarily excite them, so they don’t think about it.”

Although succession planning primarily deals with the future of the business from a managerial and ownership perspective, business owners who begin working on a succession plan find it often overlaps with estate planning, which is all about preparation to transfer assets either during life or after death. Sometimes one set of legal and financial documents can meet both needs, Swan says.

“Owners have passionate feelings about what they want to have happen with their business,” Swan says. “Some feel strongly that they want it to go to their kids—but haven’t asked if the kids feel the same way, and haven’t really assessed if they are equipped to run a dealership. Also, oftentimes key managers—those designated as successors—might want a piece of the business in order to stay on.”

She says effective succession planning considers all this.

WHAT WILL HAPPEN TO YOUR DEALERSHIP?

As your career winds down and you think about retirement—and what will happen to your dealership after you leave it—you have several options to consider. You can:

- Liquidate the business—a real but usually unappealing option.
- Take the business public—an option only for a small number of carefully groomed companies that have achieved a critical size with clear growth prospects.
- Transfer ownership to employees, management or partners.
- Transfer ownership to family members.
- Sell to a financial or strategic buyer.

Why is succession PLANNING SO IMPORTANT?

Succession planning is really about taking a complete look at where you are in your family life and understanding what is the best thing for you as a business owner—and also asking, “is that the right thing for my business and family?” says Holly Swan of U.S. Trust.

Customizable solutions are available for almost any situation. If the dealer would like to pass the business on to a manager or partner, a buy/sell agreement can be created. If the dealer expects the business to be sold to a third-party outside buyer, steps can be taken to maximize the perceived value. Alternatively, the dealer can sell only a partial interest in the dealership to an outside buyer to raise funds and provide liquidity.

Or a dealer might have three children, only one of whom is involved in—and interested in—the dealership. “We’re seeing more and more private equity deals set up as part of the planning process, to reward the kid who is involved in the business yet be fair to the others,” Swan says. Those sorts of deals allow the owner to pass control to the involved offspring, while monetizing part of the business and passing that on as inheritance to the others.

At bare minimum, Swan says, every dealer’s succession plan should include an agreement with the family to keep a key operational staff member—a general manager, for instance—in place during any transition to new ownership, even if the business will be sold. Increasingly, auto manufacturers are asking for such a succession plan to be in place for their dealers.

Even if you think you have the legal documents such as a will and a trust in place to pass your wealth on to someone else, U.S. Trust senior wealth strategist Bob Goodman says, “Many times we see individuals who have entities in place that serve goals for the business but don’t address the needs of succession planning. There is no overarching plan to deal with all the issues of succession.”

And finally, consider this: The federal estate tax will take 40 percent of your assets over \$5.43 million. Estate taxes are due nine months after the owner’s death, meaning that beneficiaries have only a limited amount of time to come up with the money.

“Many times we see individuals who have entities in place that serve goals for the business but don’t address the needs of succession planning.”

Swan and Goodman say mitigating the effect of the estate tax on your family and beneficiaries—by gifting some of your wealth to beneficiaries during your lifetime, buying insurance or moving assets to liquid accounts—requires planning.

“You never want to have to sell business assets in a fire sale in order to cover the taxes,” Swan says.

WHAT MAKES YOUR BUSINESS ATTRACTIVE TO A POTENTIAL BUYER?

- Stable, healthy revenue stream and cash flow
- Good visibility into future financial performance
- Strong history of profitability with the potential to expand over time
- Strong industry fundamentals
- Leading market share or unique market position
- Diversified and loyal customer base
- Proven, strong, competent and remaining management team (or belief that value can be created through management changes and/or additions)
- Tangible assets: equipment, inventory, property, computers in good shape
- Intangible assets: brand, trade secrets
- Desirable location
- Growth potential (organic and/or through acquisition)



Bob Goodman, Senior Wealth Strategist, U.S. Trust



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Steps to a **SUCCESSFUL TRANSITION**

You're ready to create a succession plan. Where do you start and what do you need to keep in mind? Here are the key steps to take and pitfalls to avoid:

ASSEMBLE THE RIGHT TEAM OF PROFESSIONALS TO HELP.

“A lot of business owners, especially self-made businesspeople, don't involve their advisors as often as they should,” says Holly Swan of U.S. Trust. “They think, ‘I grew this business myself.’ Often they don't have a lot of liquidity; their free dollars go back into the business. So calling an attorney and watching the clock tick and the legal fees accumulate is unappealing.”

But an effective, successful plan will require the correct set of professional advisors. That probably means more than one attorney: your corporate counsel as well as an estate lawyer—their expertise is different and you will need both. “We recommend looking beyond the M&A attorney who helped you acquire the dealership—he probably is not an expert on estate planning,” Swan says.

While you may not want to involve more than one attorney and the rates may be higher for specialized attorneys who handle succession planning, they may ultimately save you money because they are faster and provide up-to-date, expert knowledge, she says.

The process also will involve your accountant, as well as your financial advisors.

Avoid problems by designating one member of the team of advisors as the lead person, U.S. Trust's Bob Goodman says. “Too many chiefs and everyone thinks they're running the show,” he says. If you have an investment or wealth advisor, that person may be willing and able to coordinate the efforts of the team at no extra cost to you.

SIT DOWN WITH YOUR ADVISORS, YOUR FAMILY AND KEY STAFF AND FIGURE OUT THE BEST THING FOR YOU AND YOUR BUSINESS.

It's time for honest talks with your family members about their interest in staying involved in the business. “Some dealers have an idea about their kids' future involvement, but have to ask if the kids really feel the same way,” Swan says.

The same thing is true about key managers, who may be interested in becoming owners, or part owners. On the flip side, their loyalty may rest with you; they may not want to stay on permanently without you there, but may be willing to do so during a transition to new ownership.

“These conversations can be a lengthy process, and the owner can end up in a tug-of-war looking at all the possibilities. It's hard not to come at it from an emotional perspective,” Swan says. “But once the dealer looks at all the numbers, and where everyone stands, they can step back and figure out what really is best for the business and the family.”

Remember to plan for three scenarios: Who should take over the business if you are disabled? What should happen to the business if and when you retire? What will happen to the business upon your death? The answers might not be the same for all three questions.

Once you have an idea who should take over the operations if you are disabled and where the business will end up after you're gone, there's a variety of ways to turn that plan into reality: buy/sell agreements, trusts, private equity deals, changes in corporate structure or gifts. That's where your professional planning team's expertise will come into play.

Swan suggests planning early, with the right advisors, and then putting your assets into the entity you create. It's important to honor the formality of that legal entity. She says dealers can get in tax trouble when assets are in an entity, but the dealer continues to act as if they are still personal assets.



IF YOU'RE THINKING ABOUT LEAVING YOUR DEALERSHIP TO YOUR CHILDREN

- Communicate your goals regarding the company with family members regularly.
- Expose your children to the business at an early age.
- Encourage your children, if they're interested in the business, to educate themselves in the appropriate skills, with formal education and job experience outside the firm.
- Determine the appropriate person in the family with the right temperament, skills and experience for leadership.
- Consider working with an outside expert, possibly a professional psychologist or a third-party expert in family business dynamics, who can help with decisions about family succession and facilitate regular family meetings.
- Create a board with a majority of nonfamily members, which can be helpful in professionalizing the plan.

AVOID PITFALLS

SITUATION

- Various entities have been created to allow for succession and estate planning, and valuation discounts have been taken as appropriate.

CHALLENGES

- Planning can be voided if formalities such as meetings, note keeping, and other records are erroneous or not kept, or if the financial structure created by the various entities is not respected.

POTENTIAL SOLUTIONS

- Planning for your own financial needs should be done prior to implementing a gifting plan. Do not give away more than you can afford to part with.
- For auto dealers with many stores, plan in phases and keep the entity naming mechanisms simplified to allow for easier record keeping and documentation.
- Consider using Delaware Dynasty Trusts, and separate operating businesses from real estate.

Swan warns that automaker approval of a succession plan is not automatic, and in her experience not always predictable.



MAKE SURE THE PLAN INCLUDES A WAY TO PAY ESTATE TAXES.

Your money—and your dealership’s assets—may be almost completely tied up in capital assets, real estate or long-term investments. The succession plan should include a way to create some liquidity—available funds that your spouse, children or partners can access quickly to pay any estate tax and other expenses of transferring the business to your chosen successor.

“One of our objectives in estate planning is to realize that even with the timing the government allows for estate taxes, the kids or other successors may not have the ability to pay the estate tax when something happens,” Goodman says.

“The inheritors may have to sell off assets to pay the estate tax. But one way around that is to buy life insurance or create a bucket of money outside the business that’s easy to access to pay those taxes,” he says. A portfolio of assets specifically designed “for liquidity down the road,” he says, makes your beneficiaries’ lives a lot easier.

ACCEPT THAT IT’S GOING TO COST YOU SOME MONEY TO SET UP A SUCCESSION PLAN.

Just creating a set of estate-planning documents including wills, trusts and power of attorney papers can cost \$5,000 to \$10,000, Goodman says. The succession planning process goes beyond that and will cost more depending on what path you choose. For instance, you might want to change the way your business is structured—split your business into voting and nonvoting shares, and then gift some of those nonvoting shares to your children through a trust. That will require putting in place several new legal documents.

Swan and Goodman suggest a ballpark figure of \$10,000 to \$50,000 for the cost of thorough succession planning—again depending on the complexity of the succession plan, how many stores you operate and what documents you already have in place.

But they quickly point out that even if it sounds expensive now, it will be more difficult and more costly to wait. “Anything you do will cost less if you do it upfront,” Swan says.

REMEMBER YOUR AUTOMAKER WILL WANT TO KNOW WHAT YOU HAVE PLANNED.

Swan reminds dealers that the automaker also will need to sign off on the succession plan. “Manufacturers are concerned about what happens to a dealership. They are making an investment in the store owner, so of course from a brand perspective they want to make sure they are protected,” she says. Automakers recognize that most successful dealerships have a key person, in addition to the owner, who keeps things running smoothly. They encourage putting a plan in place that retains that key person for a transitional time. That one element of planning can dramatically impact the long-term success of the operation.

Swan warns that automaker approval of a succession plan is not automatic, and in her experience not always predictable. “It’s not consistent, even looking at one automaker. It’s really on a case-by-case basis. I have seen one manufacturer accept one plan from a dealer who is larger and extremely successful that they would not accept from a smaller or less successful dealer,” she says.

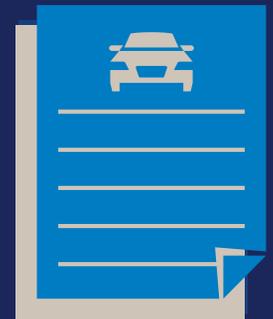
Review your plan ON A REGULAR BASIS

Once you have a plan in place, the work is not done. You'll need to pull everything out and look at it periodically, in case the plan no longer fits the situation.

"Your family situation might change," U.S. Trust's Holly Swan says. "For instance, the success of the plan might be counting on one of your kids getting experience and training. That might not happen. You'll also need to keep asking if the store manager is still in place, and still comfortable with the plan, based on the current situation."

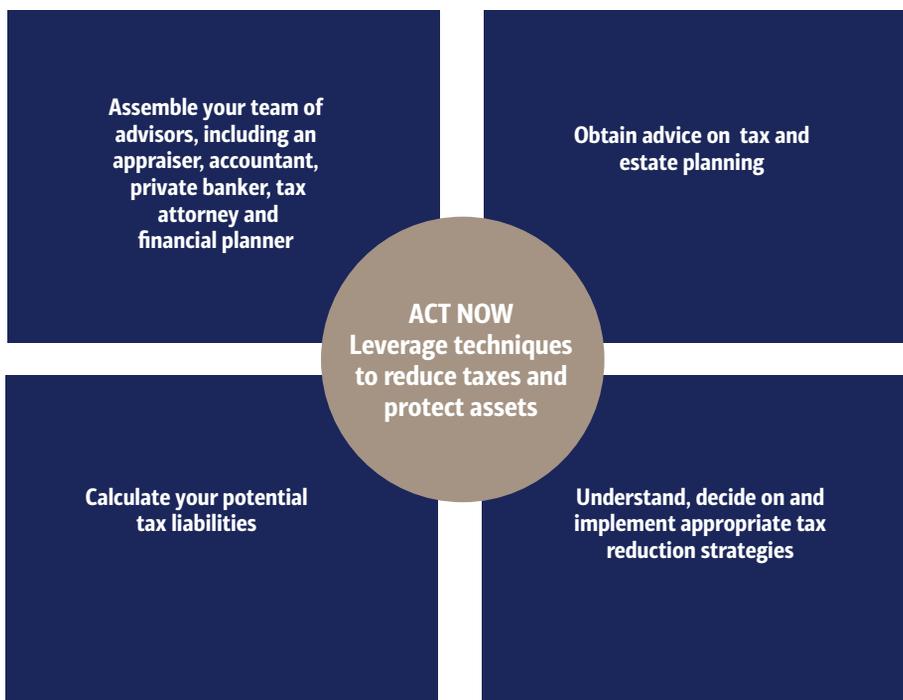
U.S. Trust's Bob Goodman suggests looking at the plan annually. "People's lives change," he says. "If you've named a successor, maybe a child or a key person at your dealership designated to operate the business during a transition, check in and make sure that plan is still appropriate."

In addition, any time there is a major change in tax law or in your family or organization, the plan should be revisited. "A good advisor will help you create a flowchart with all the documents," Goodman says. "When there's a big change in your life or business, pull out that sheet; you can assess which parts of the plan still work, or might not work any more."



Revisit your plan annually and whenever there is a major change in tax law or your family or organization.

ESTATE-PLANNING STRATEGIES





40%

The federal estate tax will take 40 percent of your assets over \$5.43 million.

Initiating that all-important **FAMILY DISCUSSION**

If you are the son or daughter of a successful auto dealer, you may realize the importance of succession planning but find it difficult to start the conversation with your parent.

Holly Swan of U.S. Trust suggests a good entry point is asking your parent to sit down and talk about the business in the context of your own personal life. “You might tell your parent that you’re doing your own financial planning now, and need to understand how the family business fits into your finances and your future,” Swan says.

Or, she says, ask to compare notes as you draw up your own estate-planning documents, including wills, trusts and power of attorney papers. “Tell your parent that you want to make sure that your planning documents are being drafted properly and accordingly, based on what’s in your parent and the dealership’s documents,” Swan says. “That is a good way to start talking about what exists and what needs to be done.”

Be confident and know that although it may be tough to get the conversation going, it’s critical for your parent, your family and the business.



SITUATION

TRANSFER BUSINESS TO FAMILY MEMBERS

- Auto dealer has no succession plan in place but would like family members to receive the business.
- Auto dealer often hopes to achieve a nonmonetary goal as part of a business succession plan.



CHALLENGES

- Transfer can occur during life or at death, but planning must occur during lifetime.
- Not all family members may be capable of and/or interested in running the business.
- Assets must be available to pay estate tax on value of business interests if applicable.



POTENTIAL SOLUTIONS

- Weigh options available for successful business succession planning:
 - Early engagement and planning is key.
 - Plans should be made during lifetime: The more time available to plan, the more likely the selected strategies will be detailed and effective.
 - Provide for transfer of controlling and economic interests in the business.
 - Directly address issues of fairness (value, control, future interest in appreciation).
- Auto dealer’s will or revocable trust should provide clear direction for continuation and/or sale of the business.
- A management committee can oversee business operations if family members will not be able/willing to do so.
- Fund estate tax obligation with insurance and an irrevocable life insurance trust (ILIT).

NAMAD keeps eye ON NEXT GENERATION

Minority-owned dealerships face special considerations in succession planning. Perhaps the top consideration is urgency: 90 percent of minority dealers are first-generation dealers, many of whom joined the industry as pioneers at about the same time. That means the average age of those dealers currently is more than 60 years old, making succession planning imperative, says Damon Lester, president of the National Association of Minority Automobile Dealers (NAMAD).

“Given the age of our dealers, it’s important for us to focus on legacy, as well as generational wealth, and to make sure that our dealer body—although not having parity with the rest of the industry—continues to provide a fair representation of ethnic minorities among auto dealers, particularly as the American population is becoming more diverse,” Lester says. He points out that 30 percent of all new cars and trucks are being purchased by ethnic minority consumers; if current minority-owned dealerships are sold to non-minorities, there will be fewer minority dealers even as the number of minority buyers continues to grow at a rapid pace.

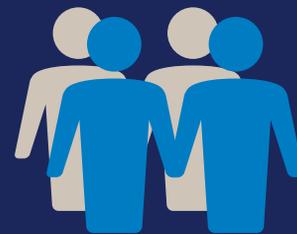
Lester says that as minority dealers leave the business through retirement or death, a majority of those dealerships are being sold to nonminority owners. “The seller should not be frowned upon for exercising their right to sell to the highest bidder; it’s just the numbers. There are 1,100 minority dealers in this country, but 18,000 nonminority dealers,” he says. “The chances are much greater that you’re going to sell to a nonminority dealer, unless there is access to capital to fund the high multiples franchises are going for nowadays.”

He says he has been emphasizing the importance of succession planning within the NAMAD membership. “There are things we have to focus on, particularly with the next generation,” he says. “The younger generation often is not in the business with their parents. We want to reach out to those sons and daughters, and educate them on the importance of legacy.”

Lester says many of the children of NAMAD dealers “shy away from the industry because they have seen the struggles mom and dad have gone through. We’re trying to help them understand it’s cool to be a dealership owner.” Legacy and creating generational wealth mean a lot to the family as well as to the communities they serve, he adds.

NAMAD has focused on its NextGen initiative, which encourages current dealers’ children and younger dealership managers to stay in the business. NextGen provides its own educational and networking opportunities, but also suggests the sons and daughters learn more about their parents’ business at dealer school—if they are not an approved dealership operator, there will be challenges in successfully keeping the business in the family.

“As we talk to our current dealers, we are urging them to look at ways to pass that torch on,” Lester says.



“ We want to reach out to those sons and daughters, and educate them on the importance of legacy. ”



Damon Lester, President, National Association of Minority Automobile Dealers (NAMAD)



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