Key Advisor

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Dealer news and tips

KeyBank
Dealer Finance

Executive Outlook

It's clear that market conditions are evolving rapidly, presenting challenges and opportunities for those ready to act. In this edition of our newsletter, we've curated insights to help you navigate and thrive in this dynamic landscape.

First, we explore dealership acquisition strategies that align with current market trends. Whether you're looking to expand or make a strategic exit, understanding the key factors associated with buy/sell transactions can help you capitalize on opportunities.

Additionally, don't miss our deeper examination of the Key Merchant Services (KMS) Credit Card Surcharge Program that we introduced in 2021. This feature highlights how you can achieve significant operational savings while maintaining strong customer relationships. Several years of results from participating clients make a good business case to take a closer look for your dealership.

We hope these articles provide valuable guidance and spark new ideas for your business. As always, our goal is to support you with information and tools to help you succeed.

Scott C. Young
National Director
KeyBank Dealer Finance
scott_c_young@keybank.com

Brian Bateman
National Sales Manager
KeyBank Dealer Finance
brian_p_bateman@keybank.com

Dealership franchise sales were up 38% over the same period last year,[1] according to the First Quarter 2024 Blue Sky Report® by Kerrigan Advisors.

Dealerships can save thousands each month on card processing fees, directly increasing their profit margins by not having to absorb interchange costs.

[1] https://www.kerriganadvisors.com/in-the-news/auto-dealership-buy-sell-market-begins-2024-with-record-transactions-on-track-to-nearly-double-pre-covid-average

Capitalizing on growth opportunities: A strategic approach to dealership acquisitions

If you are considering expanding your dealership holdings through acquisition, now is the time to sharpen your pencil. Dealership franchise sales were up 38% over the same period last year,[1] according to the First Quarter 2024 Blue Sky Report® by Kerrigan Advisors. Driven by an increase in the number of sellers coming to the market (without a related rise in buyers), Kerrigan expects 2024 to be a franchise buyer's market for the first time since the COVID-19 pandemic.

Exciting as this opportunity might be for growth-minded owner-operators, the "What next?" question can inhibit your ability to seize the moment. But it doesn't have to. In this article, we demonstrate how a smart capital strategy can put you in the driver's seat to achieve your goals.

What are you buying and why does it matter?

Because the "basic" uses of funds can vary depending on several factors, using terminology common among buyers and sellers is helpful.

- **Current assets** include short-term assets intended to be used or sold within a year, e.g., vehicle inventory, receivables, parts, and accessories.
- **Fixed assets** are long-term assets such as machinery, furniture, fixtures, and equipment.
- **Working capital and current ratio** both help assess a company's ability to support business operations. While closely related, they differ in definition and how they impact the borrowing power of a given company.

  Working capital is a measure of the liquidity available to operate the company effectively. The minimum amount, or working capital guideline, is generally set by the manufacturer. Derived by subtracting current liabilities from current assets, this figure is represented as an absolute dollar amount. Working capital measures typically defined in a lender's financial covenants are generally referred to as net working capital and exclude certain short-term assets such as prepaid expenses and "friendly" receivables.

  Current ratio, on the other hand, is derived by dividing total current assets by current liabilities. Also a key measure of liquidity, current ratio measures a company's ability to cover its short-term obligations with its short-term assets. As a ratio, it fluctuates with the expansion and contraction of the balance sheet. A higher current ratio reflects a stronger liquidity position, whereas a lower ratio may indicate potential liquidity challenges.
- **Blue sky (or goodwill)** is the intangible market value of the franchise, or the premium paid that exceeds the net of assets and liabilities. The value of the company's historical earnings performance is also a key consideration of blue-sky valuation.
- **Real estate** transactions for dealership property acquisitions typically require minimum buyer's equity of 20% of the appraised value. However, a buyer may reduce the equity needed at closing by negotiating a lease with the seller that includes a future option to purchase.

  As part of the approval process for a change-in-ownership transaction, manufacturers often require a buyer's commitment to make substantial facilities improvements. Some lenders, including KeyBank, provide construction finance options to help your organization facilitate improvements to fulfill this requirement.

[1] https://www.kerriganadvisors.com/in-the-news/auto-dealership-buy-sell-market-begins-2024-with-record-transactions-on-track-to-nearly-double-pre-covid-average

Components of the capital landscape

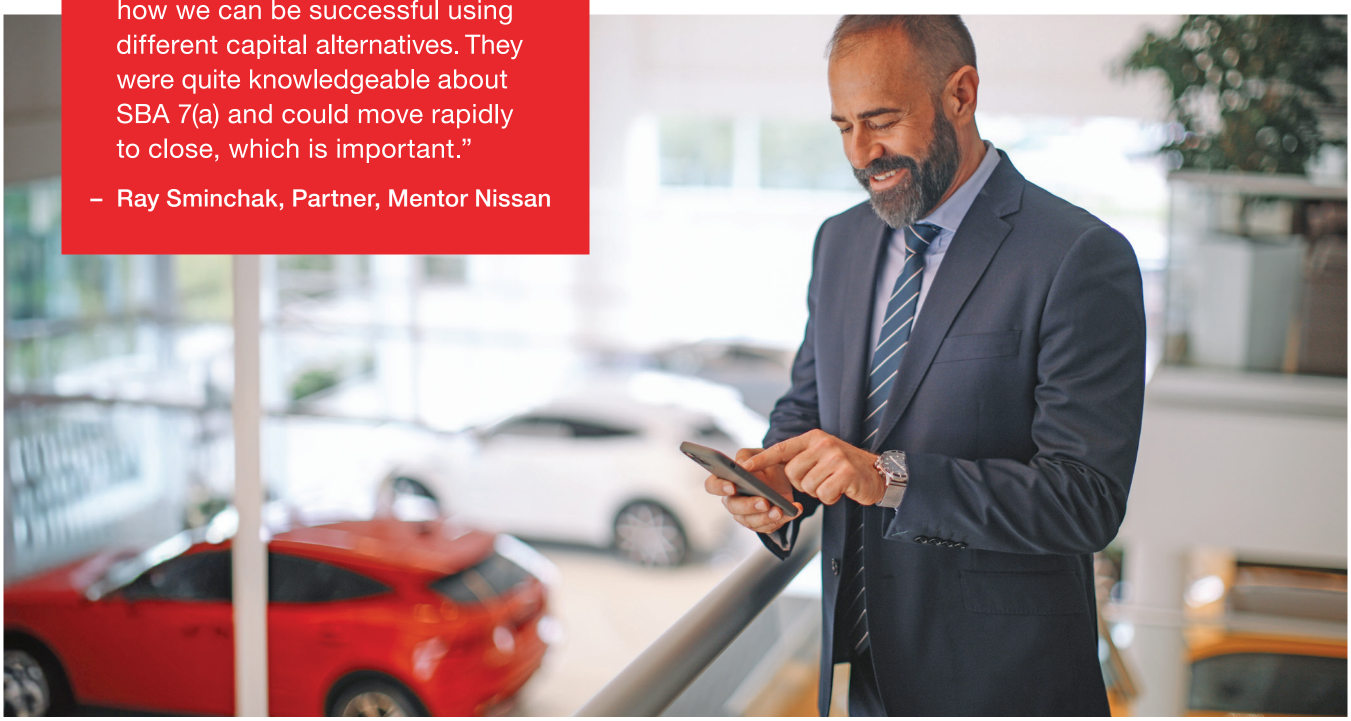
Equal to the importance of defining your assets ("uses") is understanding what options are available to pay for them ("sources"). Because dealership acquisitions require a substantial upfront investment, it's often necessary to use more than one source of capital. It's important to know the breadth of resources available and how they can be leveraged to support your overall strategy.

- **Buyer's equity** is simply capital (or cash) the buyer puts toward a purchase. Business owners often prefer not using 100% personal equity; however, a certain amount is generally required by the manufacturer and the lender for any acquisition.
- **Lender financing** is a blanket term for credit facilities provided by a financial institution. In the context of car dealerships, lender financing types and terms include new- and used-vehicle floorplans, commercial real estate mortgages, working capital term loans, and lines of credit.
- **Service contract advances** can be an instrumental source of alternative funding for new business ventures. In this relationship, a service contract provider advances funds to the buyer based on the anticipated future sale of service contracts (e.g., an extended warranty). The advanced funds are then repaid over time as the buyer sells the service contracts over the term of the contract.
- **Seller financing** is just that: financing arrangements made directly between the seller and the buyer. This can be a favorable way for the seller to generate a stream of future income and possibly defer taxes.
- **SBA 7(a)** is the U.S. Small Business Administration's primary loan program. It provides financial assistance to small businesses, which can be used for a broad range of purposes, including:
  - Acquiring, refinancing, or improving real estate and buildings
  - Short- and long-term working capital
  - Refinancing current business debt
  - Purchasing and installing machinery and equipment
  - Purchasing furniture, fixtures, and supplies
  - Changes of ownership (complete or partial)
  - Revolving funds
  - Construction
  - Business establishment

Often government-guaranteed and arranged through an SBA-approved financial institution (KeyBank is among the top 10), the SBA 7(a) loan has generous borrowing limits ($500,000 – $5 million) and can include longer-than-average amortization terms at a fixed rate.

"The KeyBank team understands how we can be successful using different capital alternatives. They were quite knowledgeable about SBA 7(a) and could move rapidly to close, which is important."

– Ray Sminchak, Partner, Mentor Nissan



Lender financing considerations

Being familiar with the terms and metrics commonly used in dealership purchase transactions is important, and being aware of your dealership's liquidity markers and how they are perceived or used by a lender can affect the outcome of a purchase. But remember, scrutiny can and should go both ways — not all lenders are equal, and the value of various lending products often depends on how the deal is structured.

Trusted relationships also play a crucial role in the success of a deal, as one seasoned capital broker points out. "The difference is in the relationship," acknowledges John Mecham, a 20-year client of KeyBank with 20-plus years of experience negotiating acquisitions for car dealers. "When you establish relationships with people you trust and like," he says, "it will get you through the deal, including the serious business decisions."

Flexibility is also valuable in any market and with nearly every deal type. Here are some considerations and questions to keep in mind when looking for a capital provider who can address current and future needs for a range of buy/sell opportunities:

- What loan amortization and term options are available? Are there interest-only alternatives?
- Are you confident that the lender will be able to deliver and meet closing date requirements?
- Do they have access to unique lending alternatives such as the SBA 7(a) loan?
- Are they committed to the automotive industry?
- Can they assist with personal needs in addition to commercial services and solutions?

Creating a skillful road map

Welcome to the foundation of a solid acquisition strategy: You've inventoried your assets and numerous means to account for them. To access the right capital in a strategic way, however, it requires a bit more homework and industry expertise. As a leader in dealer finance solutions, your KeyBank relationship manager is poised to help you:

- **Evaluate needs**: Once we identify the specific funding requirements for each asset category, we can help create strategies using as our compass the highest potential return and operational efficiencies.
- **Compare options**: Our breadth of lending relationships and experience enables us to optimize interest rates, repayment terms, and eligibility criteria.
- **Plan for the future**: Building trusted relationships over time is at the heart of our brand, which allows us to develop a long-term financial strategy and leverage a mix of funding sources within and beyond KeyBank products and services. This approach can help mitigate risks and ensure you have timely access to critical capital.

Realizing growth and/or acquisition opportunities is possible when you have access to reliable, creative resources. KeyBank has provided commercial lending to auto dealers for more than 80 years and continues to build long-standing industry relationships. Whether it's managing inventory, investing in equipment, ensuring sufficient working capital, or acquiring a franchise or other real estate, we're here to help you make strategic financial decisions that support the growth and sustainability of your dealership.

Learn more

For more information, visit key.com/dealer or contact:

Scott C. Young
National Director, KeyBank Dealer Finance
scott_c_young@keybank.com

Brian Bateman
National Sales Manager, KeyBank Dealer Finance
brian_p_bateman@keybank.com

"Our bankers are a good sounding board; not many finance institutions understand our business. With Key, they can grasp a concept we present and share ideas on how to pay for it."

– Jamie Pilla, Principal, Mentor Nissan

Increasing dealer profitability with a Key Merchant Services surcharge program

A creative savings strategy

In today's competitive automotive industry, dealerships are continuously exploring new avenues to enhance profitability while maintaining high levels of customer satisfaction. As costs continue to rise and margins shrink, finding innovative strategies to reduce expenses is crucial.

Passing the cost of processing fees on to customers who choose to pay with their credit cards is one approach dealerships can take to reduce expenses and increase profitability — without alienating their clientele. Here's how a surcharge program works and what you need to know to create a successful program for your dealership.

Background: Landmark litigation

Just over a decade ago, credit card surcharging was prohibited by law. As a result of a legal settlement to resolve claims brought by a group of U.S. merchants, however, merchants in the U.S. and U.S. territories were allowed to add a surcharge to certain credit card transactions beginning January 27, 2013. Merchants who chose to exercise the new law were required to publish consumer disclosure notices and adhere to other requirements agreed to as part of the settlement.

Note: Colorado, Minnesota, New Jersey, New York, and California have state-specific requirements for credit card surcharging; please consult your legal counsel for advice on surcharging in your state.

In response, major credit card institutions have established rules and regulations for merchants to follow when implementing surcharges. While there are slight variations among card brands, the following general rules are universal[2]:

- The surcharge amount cannot exceed the cost of the transaction processing fee.
- Surcharge fees are strictly limited to credit card transactions, not debit or prepaid sales.
- Merchants must notify major credit card institutions in writing about their intent to surcharge (or delegate this task to their surcharge program provider).

[2] For a complete list of merchant surcharging FAQs published by Visa,® visit https://usa.visa.com/dam/VCOM/download/merchants/surcharging-faq-by-merchants.pdf.

Broad-based benefits

Dealerships can realize intangible and bottom-line advantages of implementing a credit card surcharge program, including:

- **Lower operating costs**: Dealerships can save thousands each month on card processing fees, directly increasing their profit margins by not having to absorb interchange costs.
- **Increased margins**: Savings from eliminating these fees can be redirected to offset other costs, such as service and maintenance expenses.
- **Payment-type flexibility**: Customers can choose to avoid surcharge costs by opting for alternative payment methods such as cash, checks, or debit cards, all of which incur much lower processing fees for the dealership.
- **Shift in buyer attitudes**: Not only is surcharging legal now but it is also becoming more common, with dining and retail establishments leading the way to shift consumer attitudes toward card-associated fees.

Transparent, active communication from the dealership is key to maintaining positive relationships with customers, however. Because many customers are now more business-savvy, they better understand and appreciate the cost of doing business. But they still want and deserve choices about how to pay for goods and services, which is easy to do with a little guidance. Your customers' experience is a factor to consider before deciding to implement a surcharge program.

Is surcharging right for your dealership?

Remember, the dealership benefits regardless of how the customer ultimately decides to pay. Surcharging serves as an expense mitigation and margin enhancement tool. How you communicate your surcharging program is very important, however.

The power of positioning

When a credit card is positioned as one of several payment options, the customer is more likely to perceive the dealer as offering flexibility and the surcharge itself as a standardized fee associated with choosing a credit card for payment. By choosing a different form of payment (cash, check, or debit card) the customer experiences more control and flexibility, while the dealership still benefits from reduced processing costs.

Other decision drivers

Other considerations and questions you should ask that will influence whether a surcharge program makes good sense for your dealership are:

- **Competitor practices**: Are other dealerships in your area implementing surcharges?
- **Customer communication**: What information must be disclosed to your customers about the surcharge?
- **Cost comparison**: What are the costs associated with credit cards and other forms of payment?
- **State regulations**: What surcharging laws and regulations exist in your state?
- **Equipment needs**: What equipment will be required to automate the surcharge process effectively?

KMS surcharge program best practices

Since offering the Key Merchant Services (KMS) surcharge program in 2021, we are excited to share three years of data that demonstrate significant cost savings for our participating dealership clients. Key benefits include:

- **Processing fee savings**: 75% – 85% reduction of client card fee expenses, on average.
- **Seamless integration**: Our surcharge program is easy to integrate into your business, offering state-of-the-art technology, email, and text receipts, and enhanced point of sale/checkout experiences for customers.
- **Exceptional customer service**: The KMS team provides assessment of savings, onsite training, shared equipment costs, and centralized sourcing for multiple financing services.
- **Compliance and simplification**: The program ensures compliance with card company and interstate regulations, offers streamlined processing and reconciliation through one portal, and provides fast funding with no large monthly service fees or long-term contract commitments.

Lead with service and trust

In an industry characterized by typically thin margins, eliminating manual or paper-based systems through a KMS surcharge program can help. First, you can realize significant savings on related operating expenses — every month. Moreover, cutting costs and improving efficiencies shouldn't compromise the good rapport you've earned with your customers.

The key is the program provider you choose.

With an 80-year history of serving car dealers, KeyBank understands your business. As a relationship bank, we also understand the expense and challenges that come with credit card acceptance. We bring industry experience, hands-on training, and dedicated service to ensure your dealership maximizes cost savings while maintaining the trust and satisfaction of your customers. We're here to help you drive long-term success.

Learn more

For more information about Key Merchant Services surcharge program, contact:

Chris Yelverton
Senior Vice President, KeyBank Payments
chris_w_yelverton@keybank.com
907-301-9638

Matt Lazowski
Vice President, Senior Payments Advisor, KeyBank Payments
matthew_d_lazowski@keybank.com
440-452-9132

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240927-2804798