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Case Study Automotive Dealership and General Issues to be considered in a crisis

Matthias Beck, Ernst & Young Restructuring Frankfurt, October 2005

Case Study Automotive Dealership – Situation

- Automotive Dealership with 30 POS in several legal entities, ~ 800 employees
- Revenue ~ 300 m€ / ongoing loss situation
- Financing facilities nearly completely utilized / no cash pooling
- Financing banks were not willing to extend existing facilities
- Inhomogeneous processes in the respective POS
- No standardized controlling, i. e. reliable data in a reasonable time was not available
- Sales tracking system for the sale of new and used cars was not available
- No planning and controlling tool for the dealer's garage

Case Study Automotive Dealership – EY approach (I)

- Implementation of a **daily cash management** comprising all entities to ensure liquidity and to optimize cash usage (~ 30 different bank accounts)
- Setting up a **restructuring concept** including
 - *a fix-sell-close concept*
 - Evaluation of the business that can be shifted from POS to be sold / closed to the remaining POS based on OEM data
 - Identification of key staff to be transferred to the remaining POS
 - *operative restructuring measures*
 - POS measures, e. g.
 - re-alignment of the remaining POS (partially focusing only on sales)
 - establishment of used car centres and so improving the attractiveness for customers

Case Study Automotive Dealership – EY approach (II)

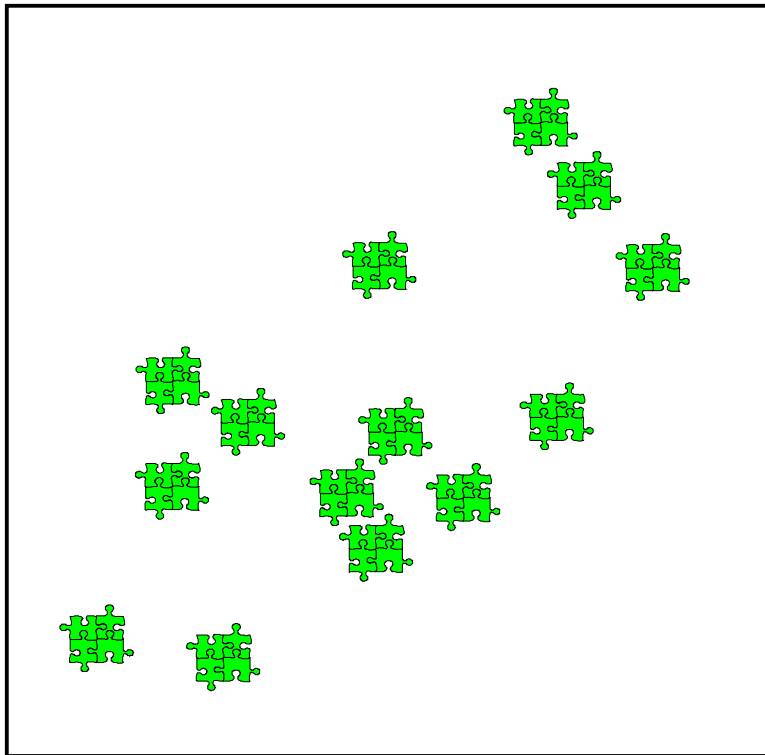
- HQ department measures, e. g.
 - re-alignment of group-wide work flow ensuring more efficiency as well as the compliance with the OEM's requirements
 - implementing a sales tracking tool as well as a planning and controlling tool for the dealer's garage
 - implementing an inventory management for used cars
- *cost cutting measures*
 - reduction of employees due to centralisation of tasks
 - wage and salary cuts for the remaining employees
- *financial restructuring measures*
 - evaluating bank positions and optimisation of capital structure
 - developing an alternative financing structure as a basis for talks with potential investors

Fix - Sell - Close Concept

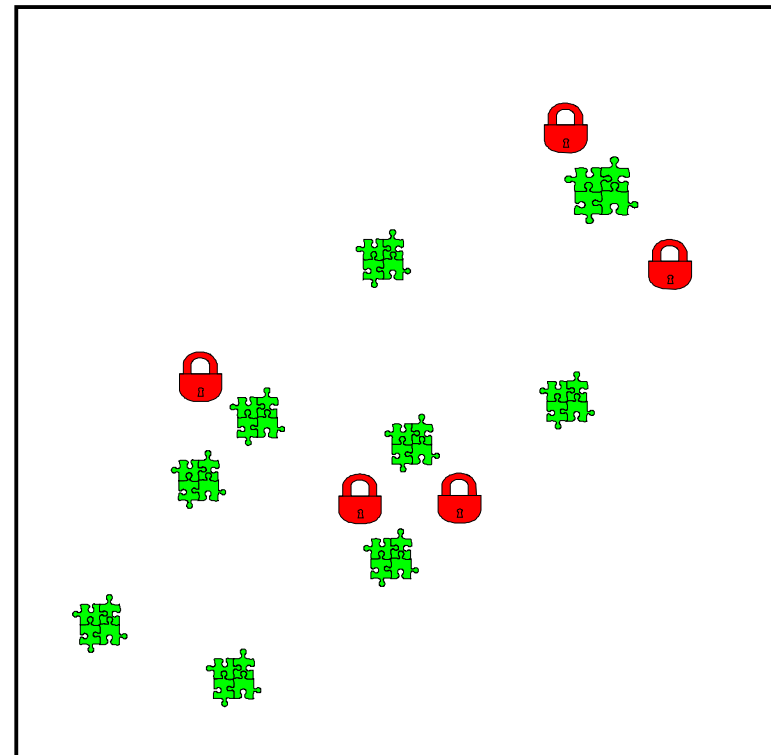
Criteria (Rules) to close: Real Estate / Performance / Market Potential / Competitors

=> More than 1/3 to close

POS Before Restructuring



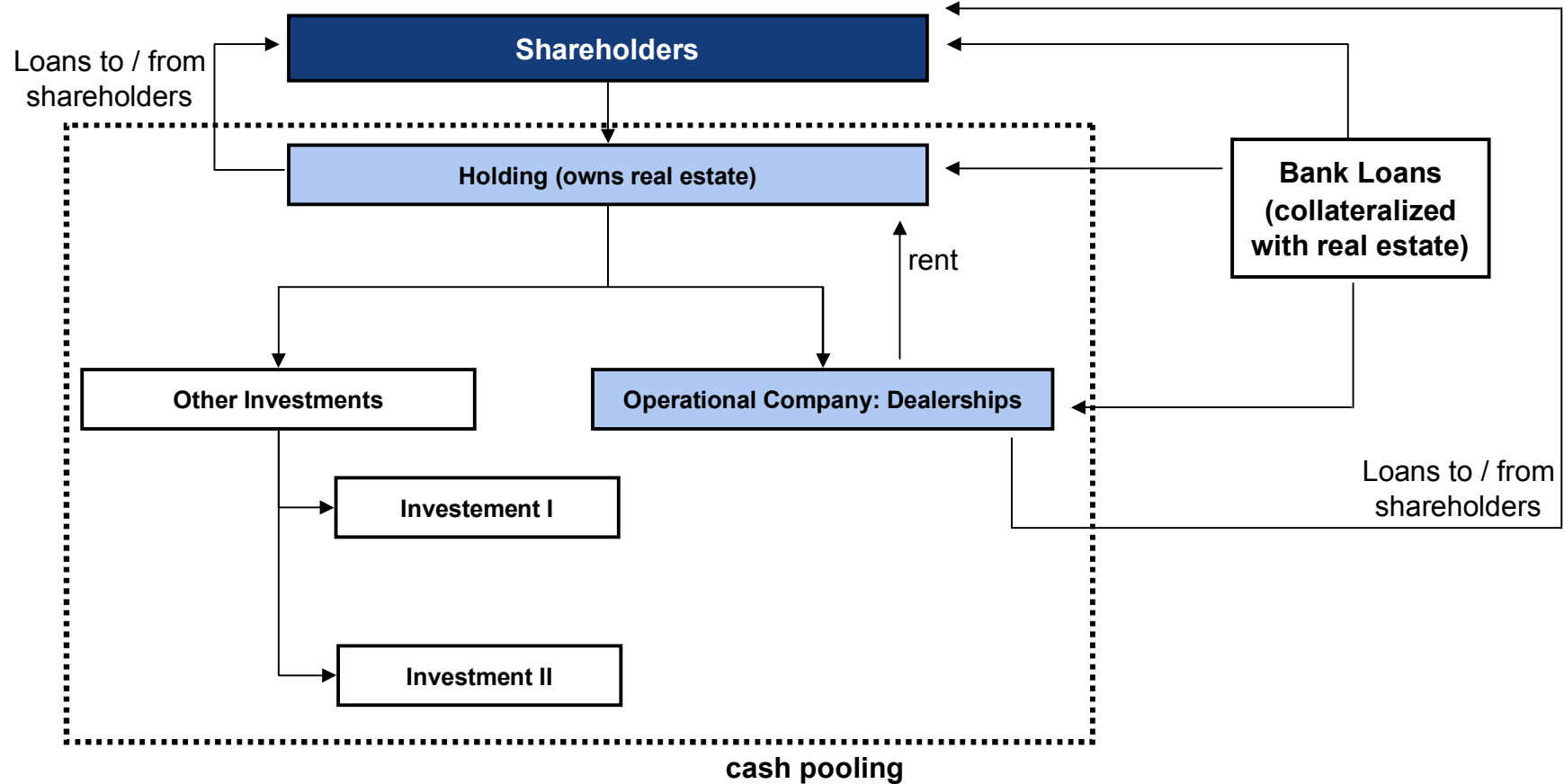
POS After Restructuring



Case Study Automotive Dealership – Results

- Liquidity could be ensured – efficient cash management was introduced
- POS were sold and so bank debt could be reduced
- Efficiency and service utilization of the remaining POS increased
- Sales tracking system helped to stabilize sales of new cars
- Costs were reduced – employees were set free
- A new investor was found
- Investor bought all loans collateralized by real estate and injected fresh money
- Investor also became majority shareholder
- Probable strategy: Realise real estate potentials and team up with a big (multinational) dealership

Group Structure



General Issues to be considered in a crisis

- **Profit and Loss Transfer Agreement (PLTA)**
- **Cash Pooling / Shareholder loans**
- **Insolvency Causes: Illiquidity and Overindebtedness**

Profit and Loss Transfer Agreement (PLTA)

- **Duration:** Usually at least 5 years due to tax reasons, earlier termination without negative tax implications possible for good cause (e. g. sale of shares, merger)
- **Liquidation / Insolvency:** PLTA ends automatically upon dissolution and the commencement of voluntary (solvent) liquidation proceedings (disputed) and upon the commencement of insolvency proceedings for the subsidiary
- **Loss compensation claim:** Claim against dominating company arises after the end of each financial year of the subsidiary. If the claim gets due the subsequent cash payment could lead to a **cash crisis of the dominating company**
- **Consequences of termination:** Creditors of the subsidiary whose claims arose prior to the registration of the termination of the PLTA are entitled to request security for their claims from the former dominating company within a preclusion period of six months after the registration of the termination of the PLTA.
This rule also applies for employees having received a working-place guarantee from the subsidiary before the PLTA came to an end.

Cash Pooling / Shareholder loans

- Cash Pooling and PLTA are combined in most cases
- In **case of a crisis** of the subsidiary the combination of both can easily lead to a heavy financial burden for the dominating company
- On the one hand the dominating company has to **pay for the loss compensation** each year, on the other hand the subsidiary consumes **cash out of the cash pooling => risk of double payments** if drawings under the cash pooling become equity replacing
- **Shareholder loans**, provided by the dominating company **in a crisis**, are likely to be viewed as **equity replacing** and therefore **must not be repaid** as long as the financial crisis of the subsidiary continues and to the extent the repayment would impair the statutory nominal capital (§ 30 / 32a GmbHG). The similar patterns apply for any kind of rental contracts with the shareholders
- Similar rules would apply, if e. g. the dominating company intends to **terminate the cash pooling** to limit its cash risks

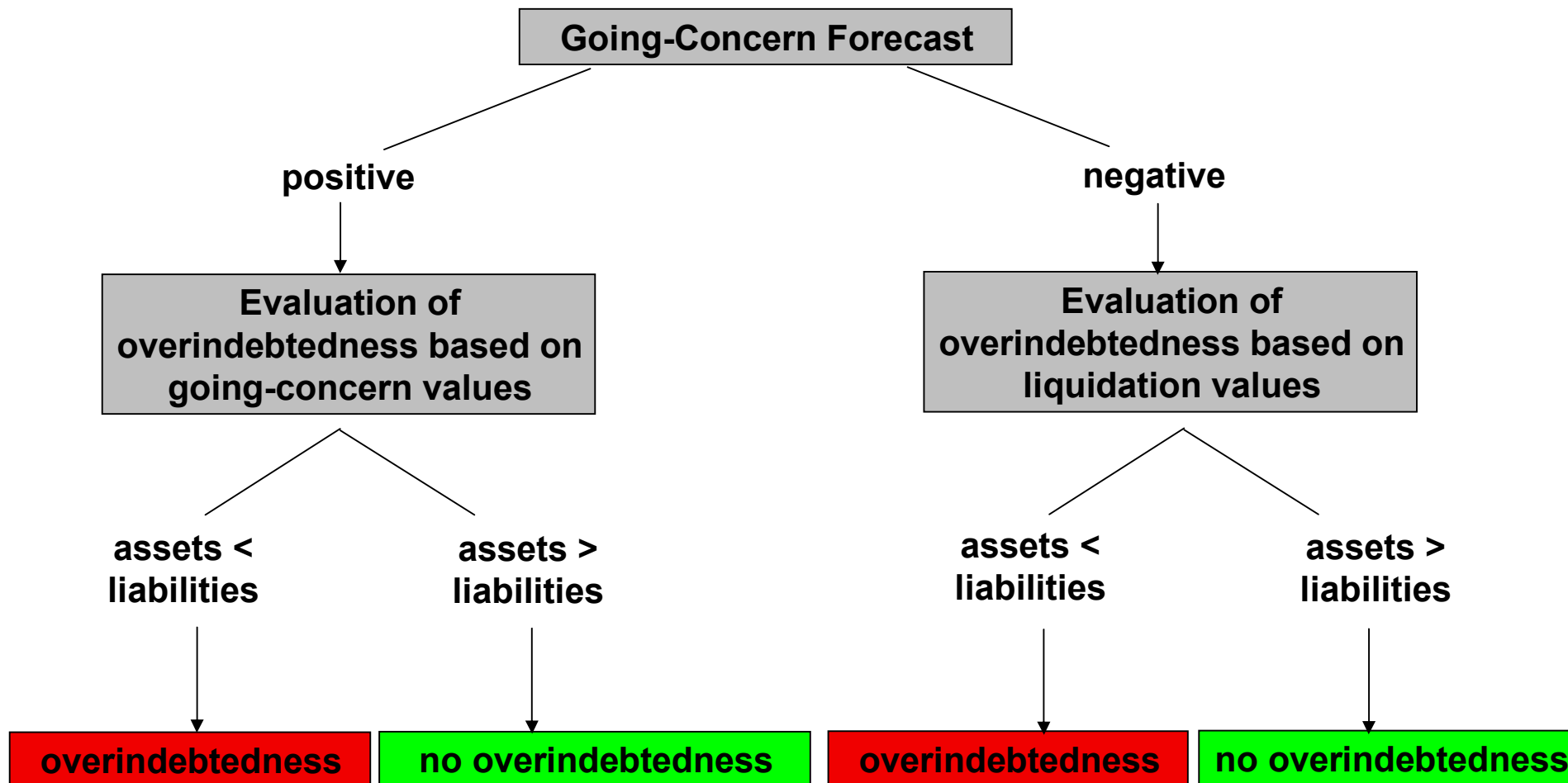
Insolvency Causes: Illiquidity and Overindebtedness (I)

- **Always look at the legal entity!**
- According to latest court decision a company is **illiquid** if:
 - **the company was not able to fulfill min. 90 % of its due payables**
- The timeframe that was confirmed for fund raising is **3 weeks**
- In case of being able to **fulfill more than 90 % of its due payables** it is assumed that the **company is liquid with the exception** that it is foreseeable that the percentage will decrease below 90 % in the near future
- In case of being able to **fulfill less than 90 % of its due payables** it is assumed that the **company is illiquid**. An **exception is possible** if it can be assumed as nearly secure that the liquidity gap will be closed completely or nearly completely in the near future. In addition it has to be reasonable for creditors to wait until the closure of the gap seen under the light of the special situation of the company.
- The 90 % (or liquidity gap of 10 %) therefore means **no automatism for illiquidity** but was named by the court as **a disputable presumption**.

Insolvency Causes: Illiquidity and Overindebtedness (II)

- **Always look at the legal entity!**
- To evaluate whether a company is **overindebted** or not a **going-concern forecast** has to be performed to **define the valuation basis** of assets and liabilities
- Going-concern forecast means an **integrated planning model** to decide whether the company is **able to fulfill its future payment obligations based on the expected business performance** (future business concept)
- If the result of the going-concern forecast is **positive**, assets and liabilities are **valued based on going-concern values**
- In case of a **negative** going-concern forecast, **assets and liabilities are valued based on liquidation values**
- In an overindebtedness status the **usually binding accountancy rules do not apply**, i. e. deviating rules, that have to be substantiated, can be used

Overview: Evaluation of Overindebtedness



Ernst & Young at a Glance

Worldwide



Germany



Market Position

The second biggest audit and accounting firm

One of leading German audit and accounting firms

Employees

- More than 100,000 employees
- More than 5,000 TAS*) Specialists

- Approx. 6,600 employees
- Almost 600 TAS Specialists (60 CR)

Market Presence

- 140 countries
- TAS in more than 40 countries

- 22 offices in all German business centers

Revenue 2003

- E&Y total USD 13.1bill.
- E&Y TAS USD 1.2 bill.

- E&Y total: €900m
- E&Y TAS: more than €100m

Services

National and international customized audit, advisory, tax, transactions (including restructuring), real estate and legal solutions.

*) TAS=Transaction Advisory Services

Why Ernst & Young ?

Our Approach:

“Best team strategy”
and one contact person

Many years of experience
in restructuring,
liquidation and
turnaround management

Strong in the field of
small and medium-sized
businesses

Insolvency consulting
expertise

Competent in financial and
operating solutions

Implementation and
moderation competencies

National and international
network

A multidisciplinary practice



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Position:

Partner, Corporate Restructuring, Frankfurt/Main

Profile:

- 1991 - 1997 in Assurance & Business Advisory at KPMG in Frankfurt/Main
- 1998 - 2001 in Corporate Restructuring at KPMG in Frankfurt/Main
- Since 2001 Partner in Corporate Restructuring at Ernst & Young

Education:

- 1991 Diplom-Wirtschaftsingenieur (equivalent to MBA and M.Sc. in Electrical Engineering);
- 1995 Appointment as Tax Advisor
- 1996 Appointment as Chartered Accountant

Expertise:

- Matthias has a wide experience in Restructuring and Turnaround strategies.
- He also has implemented (solvent) liquidations and insolvency procedures.
- His particular areas of expertise include turnaround assistance, cash and working-capital management, cost accounting, project controlling, strategy development and various business analyses.