UHY Hacker Young
Chartered Accountants

2018 Automotive Sector Outlook

Predictions for the year ahead from our specialist automotive team.

Helping you prosper

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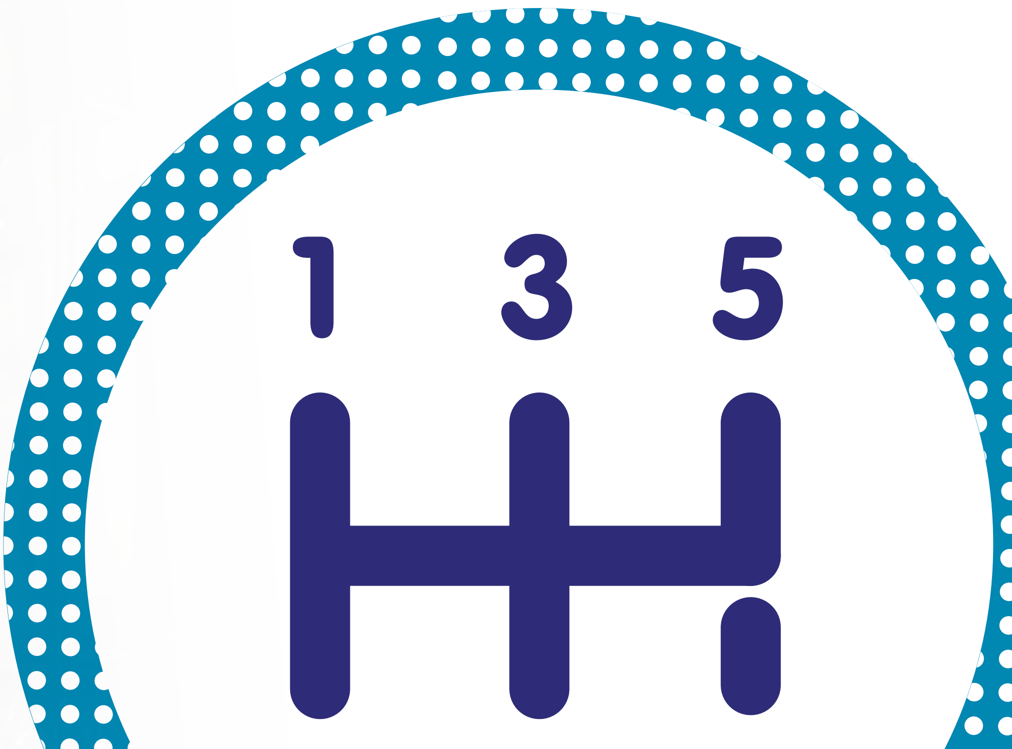


State of the market

> The statistics surrounding the leasing market continue to show a rapid pace of increase in the value of funds advanced, signalling no indication of slowing consumer interest.

The automotive sector entered 2017 in rude health, defying Brexit and demonstrating resilient consumer demand. Maintaining that kind of momentum was always going to be challenging given the weakness of sterling and the uncertainties surrounding Britain's exit from the EU – so how has it fared since and what are its prospects looking ahead?

As we moved further into 2017 we saw headwinds building, with any future deal with the EU on the free movement of goods still subject to tough negotiation. The impact that border controls and trade tariffs are likely to have on the future of the sector are being hotly debated by experts across the sector's leading forums and events. Added to which, Government policy changes relating to emissions and electric cars may alter the outlook for future purchases – of diesels in particular.

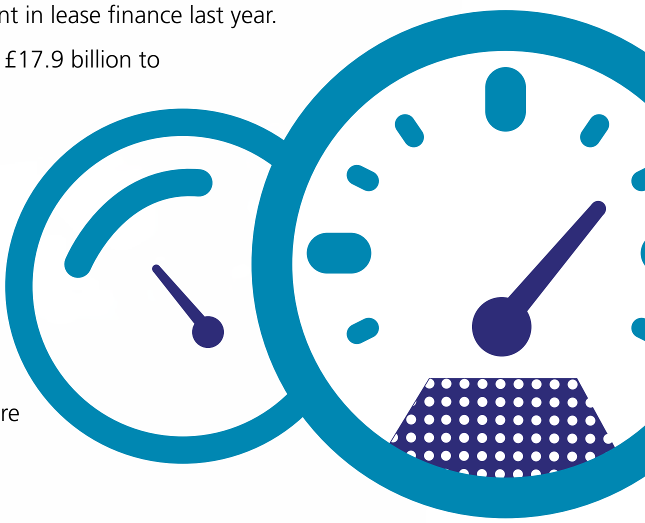
It may yet be too soon to call "peak car" – there were still more than 2.5 million new car registrations in 2017 according to SMMT figures, weakening slightly from just under 2.7 million the year before. And the statistics surrounding the leasing market continue to show a rapid pace of increase in the value of funds advanced, signalling no indication of slowing consumer interest.

However, the signs are that these pressures are starting to have an impact. The sector needs to remain agile and innovative if it is to withstand them and even find ways to capitalise on any opportunities afforded.

But the sector is renowned for responding ably to such pressures, as history has proved. In this year's report we focus on the state of the market as we enter 2018, analysing how well-placed it is to weather any storms on the horizon – and how resourceful and responsive it may need to be to manage and exploit changing market conditions.

The headlines

- New car registrations remained in excess of 2.5 million in 2017[1], just over 150,000 down on 2016, a 5.7% fall and the first year-on-year decline in six years.
- The amount of money advanced to finance car purchases has more than doubled in the last five years as consumer demand has grown: £33.2 billion[2] was lent in lease finance last year.
- The value of new leases for new cars has increased 3% from £17.9 billion to £18.4 billion in the last year alone.
- The value of new leases for used cars is up by 10%, from £13.4 billion to £14.8 billion, in just the last year.
- Transaction activity in the retail market remains buoyant, largely as a result of interest from international investors.
- Leasing costs are stable: the average monthly cost of leasing a basket of some of the more popular car models has hovered at around £230 per month over the last six months. However, some noticeable differentiation between brands is evident.
- Retailers' inventory has reached a record high, with 16% more unsold stock than a year ago. This is now worth £27.3 billion, up from £23.6 billion last year.



Maintaining momentum as headwinds hit

Concerns over the strength of automotive retail heightened towards the end of 2017, as SMMT figures showed the first September decline in new registrations in six years, dropping 9% compared to the same time the year before.

Six years of continued growth in registrations is actually unusual for the UK, with most periods showing annual ups and downs, so this was always going to come to an end. Since the turn of the century, average registration numbers are around 2.35 million, so 2.54m registrations in 2017 and predictions for 2018 and 2019 at 2.43m and 2.4m respectively are still well ahead of that long term average.

However, such a dip in the critical 'new number plate' bellwether month was bound to cause consternation in the industry, not least because it was the sixth straight monthly fall. Overall the year ended 6% down, with diesel sales down 17.1% in the year, but as the SMMT pointed out, the new car market still remains the third biggest in a decade at over 2.54 million vehicles sold.

Uncertainty over the UK's medium-term economic prospects may have played a part in knocking consumer confidence as Brexit negotiations drag on, weighing down the pound, but other factors have also had a significant impact. Among these is likely to be the government's recent announcement of a policy shift towards electric cars and away from diesel over the next few years. Diesel owners in particular may have been left wondering how this could affect future resale values, and potential diesel buyers may now think twice before purchasing.

This, together with significant press coverage of the emissions scandal, is likely to be a key factor behind the 17% year-on-year drop in diesel sales seen at the end of 2017. Although these figures focus on new car registrations, used diesel sales may well suffer in a similar way. Automotive expert, Professor David Bailey of Aston University, has warned that diesel cars will account for only 15% of the UK car market by 2025, down from a peak of 50%, in the light of what he refers to as "diesel's slow death"[3].

Coming after a bumper year in 2016, the signs as we exited 2017 were that conditions are becoming more challenging, and major macro-economic and political factors are beginning to be felt. Despite heavy discounting to help meet manufacturers' increasingly onerous volume targets, and appealing finance offers to tempt buyers, demand appears to have peaked and dealers are nervous about the prospects for 2018 and beyond.

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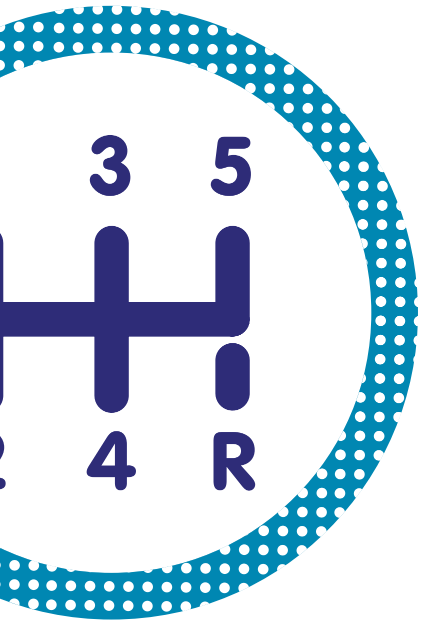
[1] SMMT
[2] Data from the Finance & Leasing Association, 31 October 2017
[3] BBC News online – Diesel car sales set to plunge again this year – 9 January 2018

Industry reassured by FCA's stance on car finance

> While current sentiment veers towards an 'all clear' it is an issue that is likely to be closely monitored by the FCA as we look ahead to 2018 and beyond.



The industry breathed a sigh of relief when the Financial Conduct Authority (FCA) publicly downplayed criticism in some quarters that the growth in car finance could trigger economic turmoil if rising interest rates or unemployment levels undermined consumers' ability to repay their loans.

Fears of an imminent lending clampdown by the UK's financial services regulator appeared to have been unfounded; although the FCA's head said that the watchdog would not be complacent about the issues.

The FCA announced in their 2017/18 business plan that a key area of their focus would be sighted on motor finance products. According to the FCA, these account for some 29% (£58 billion) of the UK's total £200 billion of consumer credit.

With a particular emphasis on Personal Contract Purchase (PCP) agreements and the potential risks for both the lender and the consumer, the FCA seem to be assuring themselves that direct consumer risk exposure is limited.

It is clear that car finance plays a critical role in helping people to afford the cars they want, and to upgrade them regularly, but the FCA threw the motor trade a word of caution and referred to dealerships' duty to ensure customers understand what they are signing up to. The message is upbeat, but still salutary: car finance products serve a useful purpose and are not, in themselves, a bad thing. However, dealerships need to ensure they have covered all the bases when checking suitability and affordability of finance products.

The FCA's comments to date may have eased the pressure, but with the Bank of England (BofE) among those voicing concerns over car finance, their work is still ongoing. They continue to work in conjunction with both the BofE and the Prudential Regulation Authority on areas of regulation that fall under their remit, and state on their website that they will continue to explore answers to the following questions:

- Are firms taking the right steps to ensure that they lend responsibly, in particular by appropriately assessing whether potential customers can afford the product in question?
- Are there conflicts of interest arising from commission arrangements between lenders and dealers, and if so are these appropriately managed to avoid harm to consumers?
- Is the information provided to potential customers sufficiently clear and transparent, so that they can understand the risks involved and make informed decisions?
- Are firms managing the risk that asset valuations could fall and ensuring that they are adequately pricing risk?

In order to assure themselves of the answers to these questions, their ongoing plans include supervisory reviews of FCA-authorised lenders, detailed analysis of millions of anonymised credit reference agency records, and careful scrutiny of firms' sales practices and processes.

While current sentiment veers towards an 'all clear' it is an issue that is likely to be closely monitored by the FCA as we look ahead to 2018 and beyond. We will update you further in our UHY automotive blog on release of the promised FCA 'update' on this topic, due sometime in Q1 of 2018.

If you want to understand more about your own business' situation in relation to compliance with the FCA regulations, our national automotive team includes an FCA specialist team who have considerable experience working with regulated businesses and guiding them through the strict and wide-ranging regulations they must adhere to.

For more information, or to arrange an FCA healthcheck with our team, please contact Daniel Hutson in our London office at d.hutson@uhy-uk.com or on 020 7216 4889.

Value of car dealers' unsold stock continues its upward trajectory

The value of dealers' inventory has now reached a record high, with 16% more unsold stock on forecourts than a year ago. Its value has now hit £27.3 billion, up from £23.6 billion last year – and now equates to some 18% of the turnover of the sector.

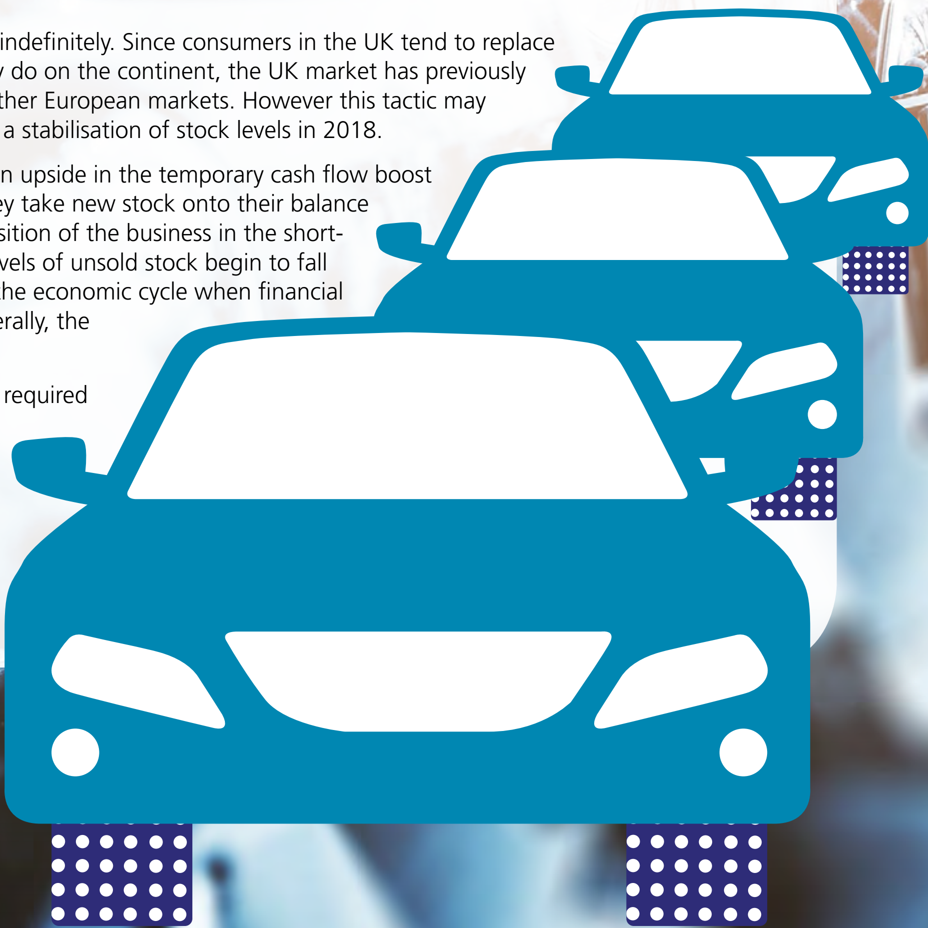
As manufacturers continue to find more ways to transfer higher stock levels to dealerships, and retailers struggle to meet challenging sales targets, this trend could be storing up potential problems for the future. It could make it harder for retailers to invest in their businesses for one thing, as this stock sits on their balance sheets.

It also runs the risk that if new car sales dip – as they are already showing signs of doing – and retailers cannot shed excess inventory, they may have to explore costly alternatives to keep the stock moving. A move towards offering additional discounts or self-registration exercises would not be in their interests, or those of manufacturers.

It is a trend which cannot continue indefinitely. Since consumers in the UK tend to replace their cars more frequently than they do on the continent, the UK market has previously absorbed excess production from other European markets. However this tactic may soon run its course, and we predict a stabilisation of stock levels in 2018.

For some retailers, there has been an upside in the temporary cash flow boost they receive from the VAT when they take new stock onto their balance sheets. This may flatter the cash position of the business in the short-term, but clearly poses risks once levels of unsold stock begin to fall again. If this happens at a point in the economic cycle when financial performance is under pressure generally, the consequences could be serious.

For the brands impacted, caution is required when assessing cash forecasts and we would recommend that sufficient headroom in facilities should be maintained to allow for a moderate reduction in new stock levels moving forwards.



Demand for lending to finance purchases grows

Scrutiny from the FCA may well increase if the amounts lent via car finance continue to grow at recent rates. However, low cost finance will likely be needed if sales are to remain robust through the period of Brexit uncertainty.

The most recent data shows that there has been a doubling in the amount of money advanced in the UK to finance car purchases in the last five years. Some £33.2 billion in lease finance was provided during 2015/16, up from £13.4 billion in 2010/11.

This is good news for new car sales, as the monthly payment model means customers can agree to frequent upgrades. The value of new leases provided to customers for new cars has risen 3% in the last year, from £17.9 billion to £18.4 billion[4].

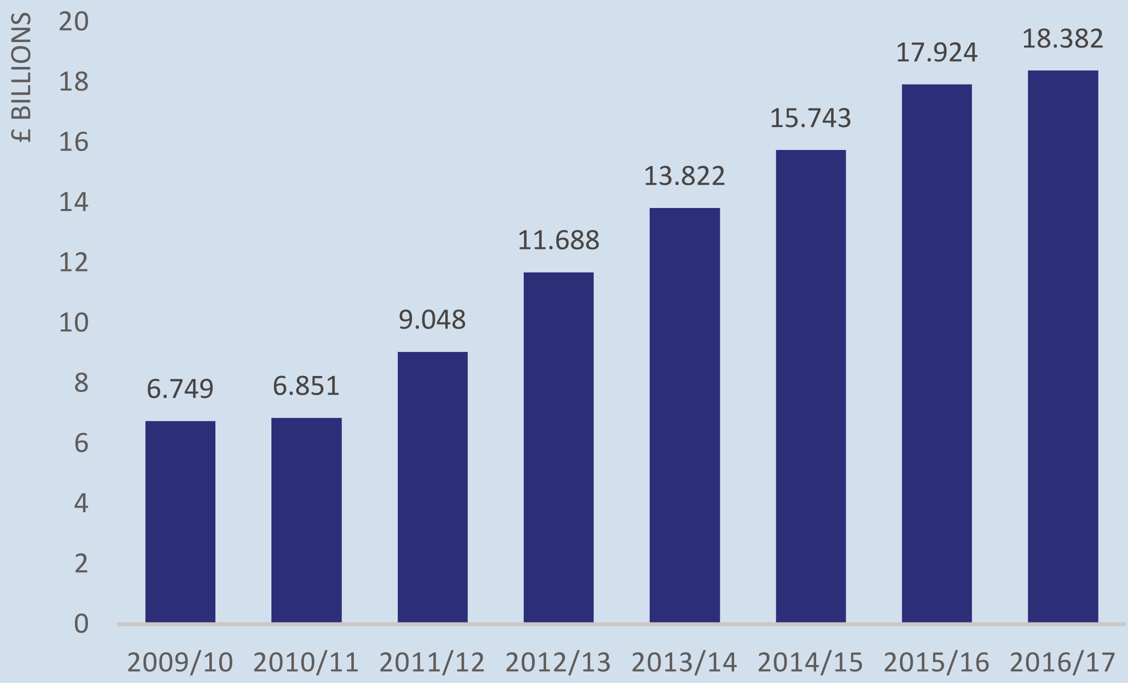
The popularity of this model has also helped fuel the recovery in car sales post-recession, with the provision of point of sale finance being used as a vital tool to unlock sales. It is an approach that is working: the value of new leases for used cars has increased by 10% since last year from £13.4 billion to £14.8 billion.

Low interest rates over recent years have also encouraged the use of car finance to rise, as people were no longer put off by the cost that their borrowing may incur. Products such as PCPs are also helping to improve repayment affordability.

It seems that consumers also increasingly see car ownership as similar to the mobile phone purchasing model, with customers opting for monthly payment plans, and focusing on monthly cost rather than headline price when determining affordability.

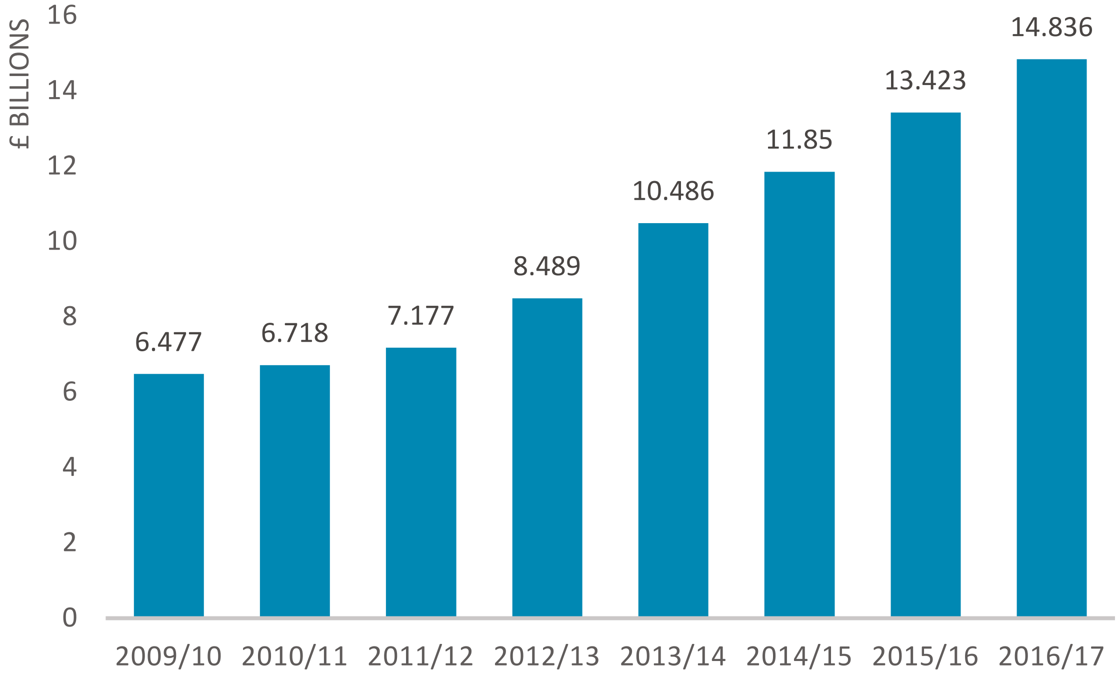
With the increase in interest rates and potential for further rate rises on the horizon, however, there are also risks to be considered. These rate rises will naturally increase the monthly payment. We have a strange situation where expensive models (mainly German brands) are cheaper per month than the equivalent mainstream product. This is because interest rates are low and residuals on those German brands are strong. Residuals depend on demand being in balance with supply, however. As the German brands share of the market continues to increase, there is a risk that this supply vs demand balance is broken.

Money lent to customers for new car purchases rising



[4] Data from the Finance & Leasing Association, year ended 31 August 2017

Money lent to customers for used car purchases rising



Leasing prices are stable

For most of the last year the cost of leasing has remained by and large stable, with the average monthly cost of leasing a basket of some of the more popular car models hovering at around £230 per month. The final two months of 2017 saw a slight decline, though whether this is a blip or the start of a longer trend is too early to say.

Manufacturers and dealers will be watching this closely. For consumers though, the steadiness in average costs is good news as concerns over rising inflationary pressures thanks to sterling's weakness have started to intensify.

Looking at the second half of 2017, of the models analysed by UHY, there were significant variations between manufacturers. Out of the ten vehicles monitored, five had increased in price since July while five had reduced in price.

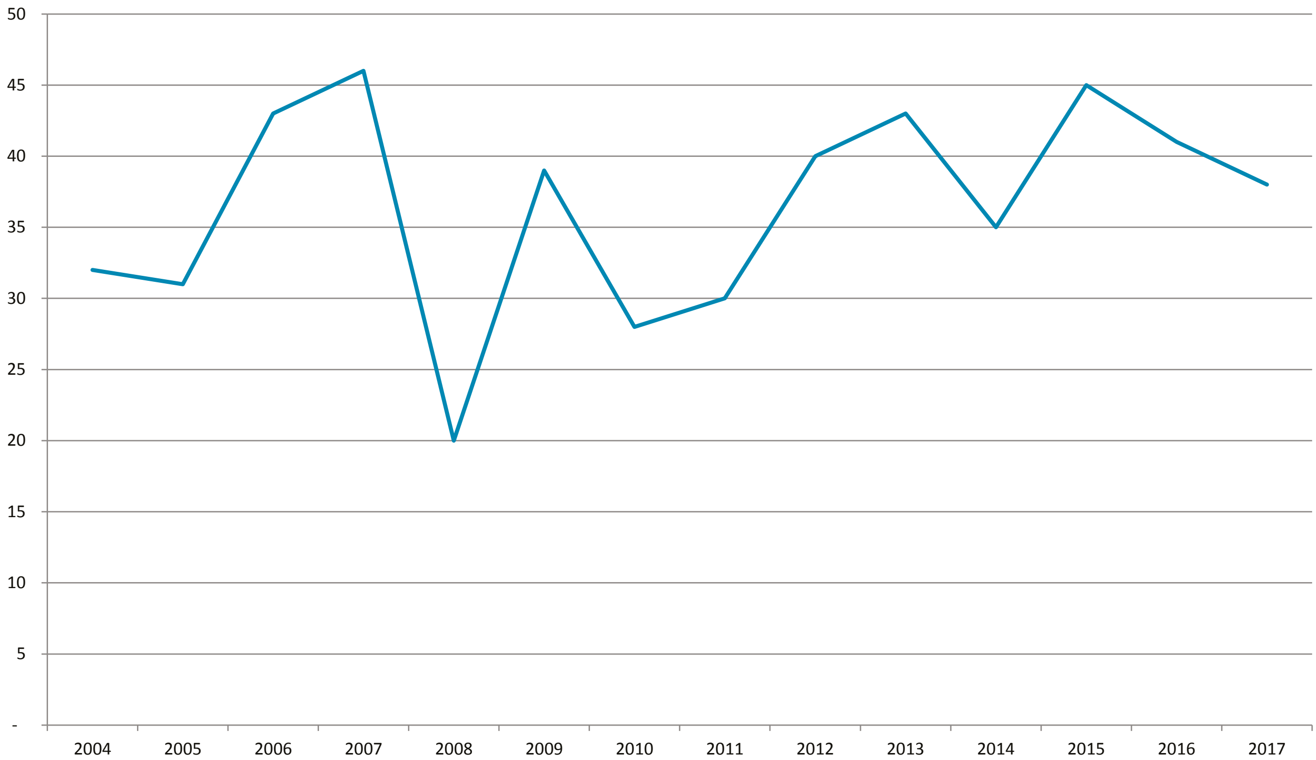
The analysis has been performed by comparing a basket of vehicles for a monthly PCH (Personal Contract Hire) deal. Since it is estimated that over 90% of retail sales are now made on some form of a monthly PCP or PCH deal, this is a useful measure.

	Brand	Model	Jul £	Aug £	Sep £	Oct £	Nov £	Dec £
1	Ford	Fiesta	174.92	174.92	164.92	169.28	177.28	177.28
2	Vauxhall	Corsa	165.95	178.95	178.95	186.95	186.95	186.95
3	Ford	Focus	182.95	175.28	210.28	175.28	194.28	194.28
4	VW	Golf	254.28	204.95	204.62	255.28	204.62	212.62
5	Nissan	Qashqai	212.95	232.95	223.5	225.95	220.95	220.95
6	Vauxhall	Astra	225.95	225.95	246.95	217.95	242.95	217.95
7	VW	Polo	204.53	204.41	174.65	190.84	190.84	190.79
8	Mini	Hatchback	239.95	239.95	239.95	257.95	194.95	189.95
9	Mercedes-Benz	C Class	348.95	356.27	356.27	356.27	372.95	367.95
10	Audi	A3	303.28	307.28	307.28	284.95	284.95	294.95
Average monthly cost of leasing			**£231.37**	**£230.09**	**£230.78**	**£232.07**	**£227.07**	**£225.37**

Outlook on consolidation of the automotive industry

The automotive retail sector remains extremely strong and vibrant – thanks largely to its rich mix of larger operators along with smaller, growing businesses. However, maintaining this robust foundation is going to require a lot of work. 2017 started to show signs of moderation, following a number of years of intense deal flow activity; a change in trend that will not have come as a huge surprise to anyone in the sector.

Number of deals per year



2017 at a glance – the headline stats:

- A slowing of deal activity last year, but still above 2014 levels - 38 transactions completed to the end of 2017, compared to 41 in 2016 and 45 in 2015.
- Significant reduction in levels of UK motor retail plc activity, with international buyers driving the market in 2017 against ongoing sterling weakness.
- Increase in levels of BMW related consolidation with five smaller retailers acquired by larger players.
- Substantial fall in the level of premium franchise activity at 22% of total transaction volume, compared to 60% in 2016.

While historically this vibrancy was catered for via a combination of manufacturer-sponsored schemes and leveraged management buy-outs – both of which provided significant wealth creation for a number of operators, in recent years the situation has become more challenging. Sponsored dealers and MBOs are now all but non-existent, creating a void of new entrants. The upshot could be an even greater concentration of power in the hands of just a few big players in the future – which could undermine competition and innovation going forward.

This is a shame because despite numerous downbeat commentaries, the sector has remained remarkably resilient and continues to offer strong returns on investment. This should make it extremely attractive territory for investors. What's more, there is certainly no shortage of talent waiting in the wings to exploit opportunities - they just need to be presented to them.

And while there might be concern around the UK sector's immediate ability to maintain the last few years' levels of transaction activity, overseas investors are the far-away stars that continue to shine a light on the sector.

It was international investment that stimulated most of the deal activity last year amidst the continued weakness of sterling, with all of the sector's largest deals reported having been acquired by an international owner. And this interest appears to be continuing at a pace, with the first deal of 2018 announced just inside the New Year with the US's Penske Automotive Group Inc. completing their acquisition of The Car People. The deal makes the UK Penske's second largest market, with them planning to sell 55,000 used cars in the UK this year.

UHY's predictions for transaction activity in 2018

Predicting appetite for a particular business is an inexact science at best. However, the market remains active and our current pipeline of deals in progress is strong. We would expect the following trends and themes to emerge as 2018 progresses:

- **A potential return to a greater volume of distressed businesses entering the market.** These businesses, with or without the assistance of an official receiver, are likely to be traded around asset value making them attractive to turnaround specialists.
- **Further consolidation in the premium space as demand for these businesses remains undiminished,** despite trading performances that are showing signs of peaking.
- **Dealer groups with significant exposure to single brands will look to diversify their risk** through selective acquisitions within their geographical market area.
- **At the smaller end of the market, Kia will continue to be one of the highlights that businesses are looking to add to their portfolios.** It is seen to offer a strong product range, reasonable investment levels and a very stable UK management team.

The road ahead

Calling the time at which the market will change is always difficult to predict and for now activity and pricing levels remain strong. 2017 has seen a return to more significant volumes of selective one and two site acquisitions which typically command lower levels of goodwill and we can see this trend continuing to grow.

Many of these smaller businesses reached maturity many years ago and their ability to adapt to the changing market dynamics and ongoing need for scale is recognised by owners who themselves may now be looking at retirement options.

To mirror the overseas interest and activity, it seems as though the time may have come for the UK's well-managed sponsored operators to come back into the market and provide the next generation of entrepreneurs the industry needs to succeed.

Overall, we foresee an active market in 2018, but with fewer high value deals and a degree of moderation in pricing and goodwill expectations.

Technical focus: preparing for GDPR

From 25 May this year, the Data Protection Act will be superseded by the General Data Protection Regulation (GDPR), an EU wide regulation that the UK government has confirmed will not be affected by Brexit. The regulation brings with it potential of fines for data breaches of up to 4% of global revenue or EUR 20 million, whichever is higher, on top of any individual lawsuits brought against companies, and application of the legislation is expected to be stringent.

We spoke to Iain Nickalls, director of integrated applications provider, eDynamix, for his views on what the introduction of GDPR really means for the sector and how best to evaluate your position and ensure your compliance.

Iain's view, which is widely held by IT and data experts within the sector, is that the potential impact is significant, to say the least. Iain said that "without a shadow of a doubt this is a huge threat but, in general, the sector isn't yet taking it sufficiently seriously. Some of this inertia is due to a lack of understanding around what's required to be compliant."

And while retailers are being warned regularly in the press about the likely repercussions from failure to comply, it seems the manufacturing side of the sector should be equally afraid. Iain pointed out that "with manufacturers taking substantial customer data and information from dealers, they too will need to address their data handling, systems and processes. From the very beginning of a transaction, the customer must consent to the transfer of their data down the line to the OEM. Without this consent the OEM is in breach of the GDPR if they use the data for marketing purposes and the dealer is in breach for sharing it."

Compliance with the new regulation will require a stringent audit of what data you are holding, where and why, with significant changes to how this is all managed going forward.

The six key principles of compliance

As a headline summary of what GDPR means for businesses, there will be a legal requirement from May to demonstrate your compliance with six key principles around the management of personal data:

1. **Lawfulness, fairness and transparency** – all data must be processed fairly and lawfully.
2. **Purpose limitation** – data must be used for the specific purpose it was obtained and nothing else.
3. **Data minimisation** – the data held should be appropriate and limited to what is needed for the agreed purpose.
4. **Accuracy** – be able to demonstrate that the data is accurate and up to date.
5. **Storage limitation** – data is to be kept for no longer than is necessary for the purpose it is held.
6. **Integrity and confidentiality** – data must be held and processed in a way that ensures it is protected from loss, damage, destruction and unauthorised processing by appropriate security.

The principle of consent

The new regulations also demand more accountability for the use of personal data and enhance the rights of individuals. They apply to all businesses processing personal data, even if the data is not computerised. Personal data is anything that may identify people; such as name, email address, IP address or even CCTV footage. You cannot use personal data without the consent of the individual, and there is a presumption that the consent expires if not regularly renewed.

The guidelines state that:

- If consent has not been given in the last two years, use of the data is unsafe.
- Consent must be given by a positive action by an individual (ie. not just the failure to untick a box).
- The wording of a consent request must be clear and must name any third parties that may have access to the data. It must also give clear instructions on how consent may subsequently be withdrawn.
- Individuals will have the right to submit a Subject Access Request to a business that holds their data, allowing them to confirm that their data is being processed and to access that data along with other supplementary information. These requests will need to be dealt with within one month.
- Businesses must have a Privacy Notice and it is recommended that they carry out Privacy Impact Assessments to identify and reduce the privacy risks to the business.

We asked Iain Nickalls to clarify what all of this means from his perspective as a systems provider to the automotive sector.

How easy is it to ensure compliance with GDPR and is compliance likely to require significant investment, or is this something that can be managed with the introduction of simple processes?

I don't think significant changes to process are required, but the biggest investment will come in the form of substantial time and effort. Automotive businesses are not only required to audit themselves and their own internal management of data, but to also audit third party suppliers with whom they exchange data, which I believe will be the most time consuming element of compliance. Businesses will need to ensure they have addressed all areas of customer data and contact, from sending a marketing email to storing customers' bank details and other personal data. And all of this information, including how it is held and managed, will need to be made available to customers.

Under current legislation, a retailer could have multiple privacy policies across multiple systems covering, for example, the website, service plans and vehicle healthcheck systems to name a few. Under GDPR, all of these policies will need to be centralised to avoid discrepancies.

The regulation hits in only a few months. Is there still time to ensure compliance before 25 May?

Yes there is, with the necessary focus and with the identification of a team, or key personnel, who are dedicated to making it happen. As a priority you should document all of your data stores and silos of information, ensuring you know exactly where this data came from, what happens to that data and that you are able to make all of this available to a customer on their request.

Businesses will potentially need to appoint a Data Protection Officer (DPO) to address GDPR compliance, and this can't be anyone in the senior IT team. Is this something that the sector is geared up for?

Within their own business, it's unlikely. Probably 9/10 companies will have third party data controllers who manage the sending of their reminders, welcome emails etc. It is very likely that companies will choose to outsource their DPO responsibilities to an external supplier.

What are the risks of doing nothing? We are hearing of the potential for EUR 20 million fines, or 4% of global turnover, whichever is greater.

There are likely to be a few big fines early on. JD Wetherspoon have just scrapped their existing contact database completely and are starting again, rather than facing the potential fines. For many businesses, customer information may have been sat on systems relating to a purchase ten years ago which is no longer needed, but have dealerships got the mechanisms to destroy this data? Under GDPR, there is a requirement to report data breaches to the Regulator within 72 hours of discovery. It is obvious that this would apply to a hacking incident but it also includes everyday mishaps such as the loss of a memory stick containing client data or putting a letter addressed to one individual into an envelope addressed to another.

What are the three key things that everyone should look to ensure they have addressed in order to deal with this threat?

1. Ensure you are gaining correct consent and that it's granular to the customer's requirements.
2. Ensure you have a centralised privacy policy.
3. Have mechanisms in place to allow all customers access to the data held on them anywhere across the business.

How are you working with automotive businesses to address GDPR and what support/service can you provide?

eDynamix can provide advice to businesses from a consultancy perspective, helping them with the auditing and making recommendations on what they should be changing. We also have a consent authorisation server, however, which is a whitelist of contact preferences which will not allow any communication to leave a business without the correct data and authorisations.

If you would like support from **eDynamix** to help work towards GDPR compliance, you can **contact their client services team at clientservices@edynamix.com** or **call 0845 413 0000**.

What lies ahead for the sector: the experts' perspectives

We asked a panel of industry experts for their insight on the outlook ahead for 2018 and beyond. Here are their views on some of the most pressing issues facing the automotive sector.

Commentating on the market were:

David Kendrick
Head of Automotive
UHY Hacker Young

Paul Daly
Automotive Partner
UHY Hacker Young

Mike Allen
Head of Research
Zeus Capital

Robert Forrester
CEO
Vertu Motors plc

Mike Hawes
Chief Executive
SMMT

"As consumer confidence faces the barrage of Project Fear media coverage in the run-up to Brexit, there will be more and more pressure on players within the automotive retail space."

Robert Forrester, Vertu Motors plc

Do you expect M&A activity in the space to increase or decrease, and why?

Our panel agree that M&A activity looks set to remain strong. The general consensus is that privately-owned groups will continue to look to exit and take advantage of appetite from larger groups with robust balance sheets searching for growth or international entrants seeking a foothold in the market. However, there is also a sense that tougher trading conditions may well lower valuations next year. As UHY Hacker Young Partner Paul Daly puts it, "Expect plenty of supply and a moderating of price expectations."

It was felt by the panellists that uncertainty over the outlook and weak sentiment could also play a part. Robert Forrester of Vertu Motors said "as consumer confidence faces the barrage of Project Fear media coverage in the run-up to Brexit, there will be more and more pressure on players within the automotive retail space". There was mutual consensus that not all businesses will be able to be sold, and that smaller, subscale operations may not make it. UHY's Head of Automotive, David Kendrick, said that "with increasing volume pressures on the dealer network and the risk of under-performance within certain manufacturer networks, there is likely to be increased activity around distressed business sales."

Do you believe in the phenomenon that businesses often underperform following a takeover? If so, do you have any views on the root causes and solutions?

For the most part, our panellists believe this is a significant problem - and unanimously they all say it comes down to business integration – or lack of it. Mike Allen of Zeus Capital sums up the issue saying, "It's all about the execution of the acquirer."

David Kendrick explains that "the importance of carrying out operational due diligence is crucial but often overlooked". He goes on to say that "business integration considerations should be front of mind for those paying significant goodwill for businesses to ensure the profit stream remains or improves post-deal, often this is not the case."

Robert Forrester and Paul Daly both make the point that cultural differences matter and need to be recognised by senior management. Daly explains "successful acquisitions are more often than not built upon foundations where there has been a meeting of minds and an agreement on shared objectives and shared values, where as a result the people involved in the newly created combined entity work harder together through mutual understanding and respect. The assessment and analysis of a company's culture should not be underestimated and an early alignment of approach and attitudes to conducting business can often lead to achieving the ultimate goal of growth, and long term success, much more quickly than would otherwise be the case." Forrester believes that "ultimately, it all comes down to management and the way they handle matters."

What are your predictions for resale values in the coming year and do you see any impact on related issues such as FCA related matters and potential risks for PCP type products?

The experts note the difficulty of crystal ball-gazing at this point in time, given the variety of different factors at play. Residual values have held up well and may well continue to do so – after all, as Mike Allen says, "the UK is a proven ecosystem when it comes to resale values". Allen's take is that "the auction houses, fleet and daily rental business all play a role. But there is potential for resale values to soften; largely due to slowing economic activity and a nervous consumer."

And other notable challenges remain. According to David Kendrick, "The problem I foresee is that current deals are so heavily subsidised by manufacturers, and with consumers enjoying low interest rate benefits, when they come to change their vehicle, the cost won't be like-for-like. This is when the PCP model could come under pressure."

One area Robert Forrester expresses concern about is premium residual values in the nearly new area. "The volume push by a number of premium manufacturers has the potential to create logjams of stock and more than normal hits on values," he says. "I suspect that the premium manufacturers have noted this and will be looking to balance things off to protect their own residual value exposures."

And Mike Hawes of the Society of Motor Manufacturers & Traders (SMMT) believes that whilst the new car market is down, this can lead to more consumers buying second hand, especially with added tax incentives.

In relation to the Bank of England (BofE) and the FCA's view of the sector's finance market, Mike added "I met with the BofE and discussed their interest in motor finance; they are more sanguine than alarmed by what they see – the risk with motor finance tends to sit with the loan provider, rather than the individual, so it's not like credit card debt which is of far more cause concern for the Bank. The FCA are continuing to gather further evidence on motor finance, but that doesn't mean they will draw negative conclusions. The level of defaults in the market is negligible."

The FCA's approach to PCP has been necessary and has resulted in no great detriment to the automotive sector, panellists believe. However, Mike Allen's view is that the FCA should be more overtly supportive of PCPs, in order to counteract any unhelpful negative press coverage which could harm consumer confidence.

Do you believe we will transition to electric vehicles and, if so, over what timescales? What impact is this likely to have for aftersales and servicing?

All our panellists agree that, though change is inevitable, it's likely to be very slow to arrive. Paul Daly believes "it's unlikely to happen in the next 20 years unless there is a quantum leap in battery technology". Most agree that the infrastructure needed for the widespread adoption of electric cars is a long way off and will cost a huge amount to implement, although Hawes believes "for urban London, electric vehicles make absolute sense".

Panellists also question whether electric will really take over, with a rapid push towards hybrid products seen as a more likely approach by manufacturers. Robert Forrester has a staunch view in this area, he says "The bottom line is that the UK does not have the electric generation capacity or indeed monies to build either the capacity or the infrastructure around charging points. My personal view is that we will see a rapid explosion of hybrid product between now and 2025 and, in the long run, I heavily suspect that hydrogen cars may be far more prevalent than electric", an opinion supported by Mike Hawes.

"The risk with motor finance tends to sit with the loan provider, rather than the individual, so it's not like credit card debt which is of far more cause concern for the Bank of England."

Mike Hawes, Society of Motor Manufacturers & Traders

"There could be further changes in the ownership profiles of brands and an increasing influence from outside Europe."

Paul Daly,
UHY Hacker Young

As far as aftersales and servicing are concerned, there will still be a need for regular maintenance, servicing and repairs. "Prices may need to rise to recover higher costs, but this should be achievable, as the main dealers will have a captive market by virtue of the increasingly specialist equipment and software required to keep the vehicles on the road", Paul Daly reasons. Mike Hawes supports this thinking saying "the importance of the transition is the impact on training and product experience for both franchised dealers and independents, but also for support organisations, such as the AA, RAC and Green Flag. The industry needs to be able to fix the vehicles, and to do it quickly."

Are there any other major changes you foresee in the shorter term (say five years)?

This question elicited a fascinating variety of responses. Robert Forrester thinks that one major area of change will be in the use of robotics and technology to increase productivity levels across the business – an area in which all sectors of the industry, dealerships included, are likely to take a keen interest.

For Mike Allen, digital will remain key, with Mike saying "how major PLCs combine digital retailing with physical retailing is likely to become an increasingly critical issue". David Kendrick is of a similar opinion, believing that the move towards "click and buy" will continue. David says "I believe the number of dealer representation points will reduce over the next five years, with manufacturers looking to concentrate on key locations for main dealerships in a 'hub and spoke' structure, though how successfully they do this remains open to question."

Paul Daly predicts "there could be further changes in the ownership profiles of brands and an increasing influence from outside Europe – similar to the Indian ownership of JLR or the Chinese ownership of Volvo."

And for Mike Hawes, he believes there are many changes impacting the industry, which he describes as "both exciting and challenging". He highlights connectivity and increasing levels of autonomous driving as real 'areas to watch' over the coming months and years. Mike believes, "levels of autonomy vary; the industry is largely at Level 2, with the Audi A8 at Level 3, but with the potential for some manufacturers to jump straight into the market at Level 4." Mike also believes that connectivity – the level of interaction between the vehicle and its surrounds "is developing at a pace, and I believe we will be there in 5-10 years in the UK, rather than 10-20."

Do you think retailers are taking full advantage of current aftersales opportunities?

Several of our commentators think not. Paul Daly questions "whether the level of growth dealers have accepted is in keeping with the true size of the vehicle PARC, given that the three-year PARC has grown by over 25% in the last ten years."

David Kendrick feels that in general dealers appear to have this side of the business much more under control. "Dealers appear to have improved significantly in this area over the past decade. With overhead costs ever-increasing, the contribution of the aftersales business has never been more crucial. Service plans are now more common than ever, so ensuring that aftersales processes are efficient and effective is vital."

What are your views on the UK manufacturer base in a post Brexit world? Both the vehicle manufacturers and tier 1/2 supply chain?

For Robert Forrester, the outlook is positive. His view is that "the UK's many advantages as a manufacturing base have been proven over the last ten years, and a flexible, educated workforce is key to this success, with the weakening pound helping to boost profitability. Any sensible Brexit solution is likely to ensure we go from strength to strength", he says.

Other commentators are slightly less confident about prospects. "It's going to be difficult," states Mike Allen, "I hope that the strength of sterling will improve and that people will start to be able to make long term decisions as we get closer to a Brexit deal."

Paul Daly says, "There are a lot of threats longer term. The Government will have to respond to these and ensure they provide adequate support to the manufacturing sector. Friction-free trade through customs will be imperative." David Kendrick agrees, pointing out that "many industry manufacturers and suppliers work on a very tight time schedule for exports, and any delays could impact the supply chain process."

What future do you see for the bricks and mortar forecourts as the shift to online retail starts to emerge?

"The future will see fewer bricks and mortar forecourts, but they will still play a key role." So says Mike Allen, and the other panellists largely concur. The general view is that physical forecourts may well reduce in number, but key locations will remain because they remain fundamental to the ongoing requirements of manufacturers. Continued investment in such premises by dealerships as well as by investment funds also indicates that they see them as important long term; Mike Hawes highlights the giant dealership hub on the M4 corridor and the move to take dealerships into large retail outlets as examples of this.

The opinion was put forward that the new car model may move towards more of a direct supply mode as online starts to become more prevalent, but ultimately history shows that dealers are better placed to sell cars than manufacturers themselves. Kendrick says "Dealer groups are continuing to spend hundreds of millions on new premises which clearly highlights their view that these facilities are a good long term investment". Manufacturers will also continue to require a dealership network to manage oversupply in the market.

Robert Forrester believes that in order to get a new pattern of representation, "I suspect we are going to see a period of restructuring with a number of dealership closures. This restructuring is going to be a lot easier if retailers own their own freehold sites rather than being locked into long leases."

What trends do you predict for the future of franchised dealerships vs non-franchised?

The view at UHY Hacker Young is that there is unlikely to be any major change. David Kendrick thinks that dealer groups may consider used car operations as a good way to retail the significant number of trade vehicles the franchised operation generates. He points to Sytner's purchase of Car Shop as an example, and says he believed others would also be looking at similar opportunities.

However, Mike Allen foresees larger franchised dealerships getting bigger at the expense of the non-franchised. His argument is that manufacturers want to get closer to customers and will expect dealerships to work in partnership with them. "If they don't they'll fall away," he predicts.

Interest rate rises – what impact do you foresee going forward?

Paul Daly believes that when interest rates inevitably rise, the affordability of more expensive premium models could be compromised and we could see a shift back towards lower cost, lower spec models. David Kendrick agrees that this could put further pressure on the sector, but adds that "this would at the same time present an opportunity for dealers with greater potential for used car sales – for those that embrace it."

Mike Allen thinks a slow and steady approach to rate rises is likely, given the Bank of England's likely cautiousness over the fragility of the economy. Robert Forrester also believes the effect of interest rate rises will be muted and says that currency and residual values will have a bigger role to play in the cost to consumers of changing cars.

Moreover, Forrester says that "savers tend to be strong buyers of new cars, and therefore we may in fact see a positive benefit of rate rises in the marketplace!"

Mike Hawes also highlights the link between exchange rates and the price of input goods, indicating that "it's not all doom and gloom for the sector, but it does present some challenges".

It looks like the sector is in for an interesting few years! But what is clear from our experts is that they believe the sector has the ability to respond and adapt to whatever challenges it may face in the future.

"Dealer groups are continuing to spend hundreds of millions on new premises which clearly highlights their view that these facilities are a good long term investment."

David Kendrick, UHY Hacker Young

So where from here?

This is a critical time for the automotive sector, as it seeks to maintain the momentum of the last few years against a backdrop of major geo-political, macro-economic, and industry-specific changes.

From the ongoing Brexit debate to emissions concerns, the rise of electric cars changing established business models, and uncertainties over continued consumer confidence and spending power, there are several hurdles in sight going forward.

That said, the sector's well-deserved reputation for innovation and resilience should stand it in good stead to adapt as necessary, seizing opportunities where they arise.

According to our panel of experts:

- Transaction activity looks set to remain buoyant over the next 12 months, however the alignment of culture should not be underestimated to ensure smooth business integration following a takeover.
- Residual resale values are likely to continue to hold, however the PCP model could come under pressure as notable challenges remain.
- Whilst the transition to electric vehicles is inevitable, we are unlikely to see a step change within the medium term. A strong push towards hybrid products is seen as a more likely approach by manufacturers.
- A number of shorter term changes are also on the horizon, including the likely rise in the use of robotics and technology to increase productivity as well as potential changes in the ownership profile of brands.
- Whilst the future will see fewer bricks and mortar forecourts and a rise in digital retailing, physical dealerships will continue to play an important role. Developments in autonomy and connectivity are also continuing at pace, with the UK likely to see a real impact in 5-10 years rather than 10-20.
- Brexit will continue to be something of a double edged sword. Sterling weakness is helping drive the transaction market through the levels of international interest but the ongoing uncertainty and lack of progress in reaching a deal appears to be a contributing factor to weakening consumer demand.

The industry has long been adept at pioneering new technologies to increase demand and act as a competitive differentiator, streamlining operational efficiencies and process enhancements, or continuously improving financial products available to the market. As we look ahead, all these will remain key to future success.

Our automotive experience

Our national automotive team is led by partners who are totally dedicated to the sector and who, between them, have considerable experience in the motor industry.

The team provide a wealth of services to suppliers, dealers, manufacturers and OEMs, including audit and taxation, mergers and acquisitions, independent business reviews, operational support and many other aspects of compliance, best practice and controls.

With a client base that ranges from the supply chain to large franchise dealership groups, our experience includes dealing with automotive clients from a local and regional perspective, to working with a significant number of the Motor Trader Top 200 franchised dealer groups in the UK.

In addition, we have a particularly strong track record of helping dealers to achieve their longer term objectives and of helping sellers to select the right partner to ensure the successful completion of a deal.

We are committed to keeping our clients informed; regularly producing updates, briefings and blog posts on topical issues and recent developments within the sector. Visit our dedicated automotive page for further information: **www.uhy-uk.com/automotive**.

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