2020 Automotive Sector Outlook

Predictions for the year ahead from our specialist automotive team.

Helping you prosper

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State of the market

Whilst there is little doubt that the UK automotive sector remains one of the UK's most resilient and important economic pillars, 2019 was a tough year for the sector with the continuing burden of political and economic uncertainty finally having an impact.

The challenge surrounding the ongoing Brexit saga loomed over us as a key concern for most businesses across the country. For the UK automotive industry, the stakes were particularly high, with the SMMT announcing that "Every minute of delay could cost approximately £50,000 in gross value added to the industry, over £70 million per day (based on a five day working week)." [1]

With consumer confidence heavily knocked by political uncertainty in the lead up to the general election, the pressures were particularly evident in Q3 and Q4 of 2019. With 158,639 new car sales in November 2019, SMMT figures revealed that sales were down 2,018 (1.3 per cent) on the same month in 2018. That fall was significantly less pronounced than in October, when the market was down 6.7 per cent. It was not all doom and gloom for new car sales, however, with hybrids, plug-ins and electric cars continuing to grow in popularity and plenty of new, exciting and more affordable models due to launch in 2020.

As the year came to an end, we saw the Conservative party gain a huge majority in the general election which resulted in the UK leaving the EU on January 31 this year. Whatever your opinion of the election outcome, a firm result is better for consumer confidence and the economy than the stand-off we have had for the past two years. That sentiment was shared by the National Franchised Dealers Association (NFDA) who stated that it hoped the election result "will stimulate the motor retail industry", provide "clarity for business going forward" and act as a stimulant for the sector. [2]

Although much now depends on the resulting trade talks with the EU, which are set to take place throughout 2020, dealers are at least in a position to better plan their strategies and budgets for 2020 and beyond. Following an increase in new car registrations in December things were looking positive, but January saw the market fall once again as we exited the EU and the government announced its ambition to end the sale of all vehicles with an internal combustion engine by 2035.

So, as we start to make our way through 2020, the outlook remains uncertain with a number of changes evident across the industry, ongoing profitability pressures and predictions about disruptive trends and the future of the dealership model. However, there are many excellent dealer groups out there that have a history of demonstrating strong resilience, and we are confident they will continue to do so.

Roadmap to our Outlook

During 2019, we saw a major change in the leadership of the PLCs, following depressed share prices and new management at two of the largest groups in the country. 2019 also saw a number of PLCs dispose of sites, a trend we expect to see continue during 2020. We discuss transaction trends and deal values, including the impact of the PLC de-consolidation and the continued appetite for the value brands, on page 4.

With expectations of a challenging year for revenue growth in 2020, we focus on the key areas to assist with controlling costs and improving profitability on page 8, we also take a deeper look at the rise of the electric vehicle and whether this really could spark radical change for the industry on page 10, and our tax experts outline the key VAT and PAYE issues impacting on the sector on page 16. On page 6 we hear from FCA expert, Robert Dedman, who discusses the impact of the FCA's continued scrutiny on the sector and looks at how this could affect the dealer business model going forward – it is an essential read for any dealer.

In addition, we have asked a panel of automotive experts, from both within the businesses and also advising them, for their views on how the landscape is likely to look for the sector through the rest of 2020 and beyond. In the words of one of our expert panellists "There is no doubt 2020 will have its challenges, but we believe those dealers who remain focused will more than hold their own." We couldn't agree more. Read our Experts Panel debate on page 18.

We hope you find real food for thought in this, our 4th Automotive Outlook. If any of the topics covered prompt any questions, you will find our contact details on page 21 – our specialists will be pleased to assist and we look forward to hearing from you.

[1] SMMT 2019 UK Automotive Trade Report, June 2019

[2] https://www.am-online.com/news/market-insight/2019/12/13/nfda-hopes-conservative-election-win-will-stimulate-motor-retail

Brexit puts the brakes on transaction activity

Despite Brexit uncertainty having little impact on the level of transaction activity during 2018, it's fair to say 2019 painted a very different picture.

By the end of the year we had seen a significant decline in the number of deals completed, as well as a considerable fall in deal values. Whilst we had been predicting a downturn for some time, the results were in sharp contrast to 2018 which saw dealer profitability maintained and the continued expansion of groups. This was not the case for 2019. With a lack of acquisition appetite, particularly amongst the majority of the PLCs who were not in buying mode at previous multiples, there was a notable reduction in activity.

2019 at a glance - the headlines

- **Deal activity almost 50% down**, with 24 deals completed in 2019, compared to 44 in 2018 and 38 in 2017
- **No 'mega' deals reported with huge goodwill sums**, and a general drop in the average deal value
- **De-consolidation from the larger groups** – a number of the deals completed in 2019 have involved the larger groups and PLCs disposing of non-core sites or businesses at the brand's request
- **Significant uncertainty within the PLCs** – CEO departures for both Pendragon and Lookers and profit warnings from both throughout the period
- **International owners involved in 22.5% of transactions (18% in 2018)**, possibly due to the exchange rate benefit and also a new entrant in AW Rostamani making bolt-on acquisitions.

Deal volumes and values trends

In summary

There has been a significant decline in the number of deals completed in 2019 with deal volumes almost 50% down year on year, back to the levels of the recessionary times 10 years ago.

Whilst deal values were within a similar range to 2018, goodwill multiples are softening and we would anticipate this to stabilise in 2020.

The big picture

PLCs slimming down

2019 saw a number of PLCs dispose of sites, whether that be manufacturer encouraged or a strategic decision by the board to focus on a smaller number of brand partners. Pendragon continued to sell off a number of their Land Rover Jaguar sites, including the Stoke business to Rybrook and the Swansea business to Sinclair Group. Inchcape also disposed of a number of Volkswagen group businesses, including two Audi businesses to Motorline and four Volkswagen businesses to Group 1. Jardine sold eight Volkswagen and Skoda sites, plus two Honda businesses to Marshalls as they rationalise their portfolio. Finally, we saw Lookers close a number of 'non-core' dealerships, including some of the Ford sites recently acquired as part of the Jennings acquisition in 2018.

Continued interest from overseas

Whilst the interest of international investors in the UK automotive market has continued, it is fair to say those who are not already in the market have paused in recent times to understand the full impact of the governmental challenges and Brexit outcome. Whilst the exchange rate still looks attractive, and softening multiples are making acquisitions extremely good value in comparison to overseas opportunities, we finally saw the climate of uncertainty cause concern with international buyers. However, the likes of Group 1, AW Rostamani and Motus, who are already well represented in the UK, continued to purchase businesses and grow their market share; perhaps suggesting those with established management and a better understanding of the market feel more confident to grow their business in the UK, looking at the longer term picture and potential returns.

Profitability pressures

A number of the premium brands such as BMW, Audi and Mercedes came under profitability pressures in 2019. It has become clear that buyers are moving their focus more towards return on investment as opposed to the brand logo above the dealership door. There has of course been the continued impact on many franchises from vehicle supply issues, whether this has been linked to emissions, factory shortages or inventory being diverted to other markets. How long this may continue for we do not know, although signs of improvement are starting to show.

Uncertainty around property valuations and wavering lending appetite

A significant proportion of motor businesses are heavily invested in freehold properties which have appreciated nicely over the past decade. Over the past 12 months we have seen larger variances in valuations, in certain circumstances up to a 30% differential between professional opinions. We would always expect a level of difference in opinion, but this gap appears greater than we have ever seen before and most likely driven by lenders being extremely cautious and valuers not wanting to fall foul of 'over valuing an asset' should something go wrong.

Shifting gears

Although transaction numbers have reduced, this is no surprise given the environment of political and economic uncertainty that engulfed 2019. As we enter into a transition phase following the UK's exit from Europe, there are still some areas of uncertainty. However greater political stability means businesses that are keen to expand will be able to make more confident decisions and those looking at an exit can be confident that they can still take advantage of the £10m Entrepreneurs' Relief capital gains rate.

We expect to continue seeing strong demand for the right business, however it is critical to identify the strategic buyer early in a process to deliver maximum shareholder return. Opportunities will continue to become available as larger groups trim their portfolios and smaller dealer groups come under greater financial pressure and scrutiny, therefore looking to exit. The de-consolidation of the PLCs will bring opportunities for those well placed privately owned businesses with funds in place to make strategic acquisitions.

The majority of buyers are likely to be international investors, with a small number of the PLCs and privately owned groups also in the market. This is in contrast to the last five years where a significant proportion of the purchases were made by the larger groups, perhaps signalling it is time for a change.

As we move through 2020, we hope we will see manufacturers address the dealer profitability challenges and, with a more stable general economic environment, we expect to see a gradual improvement in both deal volumes and deal values as the year progresses.

Our predictions for 2020

Based on our current discussions with clients and our wider contact base in the sector, we expect the following trends and themes to emerge during 2020:

- Greater international interest
- Potential for distressed business opportunities to become available, with many lenders taking a pessimistic view on the retail market
- Transaction activity from medium sized groups to continue as larger groups dispose of parts of their business and smaller operators look to exit
- Businesses that have grown significantly in recent times may feel pressure from brands and funding partners to de-leverage through part disposal of non-core assets
- Continuing appetite for the value brands; in particular Kia, which is seen to offer a strong product range, reasonable investment levels and a very stable UK management team
- An increasing interest from the likes of Toyota, Lexus and Volkswagen due to upcoming EV product lines
- Further expansion in the area of used car stores/sites amongst the PLCs and mid-sized groups
- Some diversification away from the typical retail model with franchised retailers showing a growing interest in IT businesses, brokerage businesses, finance brokerages and low-cost used car operations.

Protecting your business from FCA action – the expert's opinion

In early 2019, the Financial Conduct Authority (FCA) published its highly anticipated findings on the motor finance market. It quickly became clear that the sector is a priority for the FCA, which expressed concerns that the industry's approach to car finance and associated products is a driver for large levels of consumer detriment.

With the regulator's scrutiny showing no signs of diminishing, it is vital all lenders and brokers fully understand the consumer credit requirements and disclose all the facts to potential buyers. We spoke to Robert Dedman, Special Matters and Government Investigations partner at international law firm, King & Spalding, who shared his views about the FCA's ongoing sector focus, highlighted some of the key issues dealers should be aware of and provided his top tips to help ensure compliance. **The insights shared are invaluable and an essential read for any dealer.**

GAP insurance – what is likely to happen to the ability to sell this and similar products?

I don't expect the FCA will look to ban point-of-sale GAP insurance altogether unless it feels that the industry is mis-selling those products on a very large scale.

However, if the FCA finds significant problems in GAP insurance sales – for example as a result of an enforcement investigation, or thematic or supervisory work – it might well look to intervene in the sector again in a more targeted way. If it did, you might expect further constraints around point-of-sale GAP insurance, although I would be surprised if the FCA reached straight for an outright ban on the insurance as economically the product serves a useful purpose when sold appropriately.

Interest Rate corridors – are these likely to be reduced further or eliminated altogether?

The FCA issued a consultation paper late last year in which it proposes to ban any arrangements between a lender and a broker in the automotive sector where the lender pays commission set by reference to the total charge for credit provided to the consumer.

Interestingly, variable commission models (where the amount of work done by the broker dictates the commission paid) are not going to be banned, but the FCA has said it will monitor these arrangements carefully to make sure they are not just discretionary arrangements in disguise.

Although this is just a consultation, it is likely that the rules will be made later this year in similar form as the FCA has consulted on.

Does Appointed Representative status effectively mitigate the risks?

It can do, but not all that much. Appointed Representatives (ARs) are bound by the same rules as everyone else. It's just that the Principal firm is responsible for their compliance with the rules.

So, you might think this means that being an AR is a kind of 'regulation lite'. I think you do that at your peril.

Given the Principal is responsible to the regulator for their ARs' compliance, they are required to have risk management and control frameworks for overseeing them. Where the Principal is particularly risk averse, this can lead to some fairly intrusive compliance processes and checks. It also means that the AR's ability to form its own judgement about the risk appetite it wants to have can be severely curtailed.

And the FCA have some pretty broad powers to intervene in individual firms if needed. So, all in all, I'm not sure I'd say that AR status is the solution to intrusive regulation.

Are you aware of any particular areas the FCA will be turning their attention to this year?

Given the findings of the FCA's Motor Industry Review, and the high profile nature of the actions they have taken over the last year, I expect the FCA to continue to take a keen interest in the automotive industry, particularly if matters come to light suggesting significant compliance problems across the sector.

The FCA is very focused on the embedding of the Senior Managers and Certification Regime (SMCR). The FCA has placed a lot of emphasis on the ability the SMCR gives it to hold people at all levels of the regulated sector to account. So expect to see more enforcement cases against individuals to arise when there have been significant failings.

I also expect the FCA to do more to protect vulnerable customers. They put out a consultation on identifying and protecting vulnerable consumers in July 2019, and will feedback on those proposals later in the year.

Finally, another area of focus for the FCA across the financial services industry is the question of 'culture' and the impact of a negative culture in business as a driver for consumer detriment. This is likely to continue in 2020.

What areas of non compliance have you found or are you aware of in the sector?

Obviously I can't talk about specific clients, but turning the question on its head slightly, I think the best businesses are those which look proactively at compliance issues, take them seriously when they arise, and make sure that any affected consumers are made good.

That said, no business operates in a zero-failure environment, so the key is to understand where the greatest risks are, and then to make sure these are prioritised for review by Compliance. It's important for a business to consider how it can monitor for potential problems and prioritise Compliance resource appropriately. Management Information (MI) is key to this. Examples of trends in MI that could indicate problems might include:

- a spike in non-compliant GAP insurance sales
- a significant, and unexplainable, rise in the proportion or number of low mileage PCP/PCH contracts at a location
- a spike in complaints at a location, which might indicate problems with the sales process, or
- significantly increased staff turnover in a location, leading to larger proportions of new staff.

Are you aware of any particular sub-sectors the FCA are focusing on? For example, Independents, larger dealers?

The FCA tends to focus on areas that have the most consumer detriment. So they will always tend towards more intensive action against the bigger players in the market.

That said, when you look at the FCA's regulatory action in the automotive industry last year, leaving aside the high profile enforcement investigation, you will see action taken by the FCA to close down a number of smaller firms as well. The regulatory toolkit, as we call it, isn't just all about fining and enforcement. The FCA also have a range of supervisory powers which they can deploy if needed that can have a real impact on a firm's business, from appointing a skilled person to review the firm's compliance and requiring the firm to pay for it, right up to taking away the firm's permission to undertake regulated activities for good.

Top tips for managing the risk

Robert's number one tip is to make sure you take the time to understand the risks in your business and then design and implement an appropriate Compliance framework that takes account of those risks.

Below that, his top seven Dos and Don'ts are:

1. **DO** make sure that your Compliance function is adequately staffed and independent enough that it is able to exercise effective oversight.
2. **DO** ensure that the tone from the top of the organisation makes clear that Compliance is central to everything the business does.
3. **DO** ensure that your Compliance function has access to a range of MI to help them identify compliance hot-spots.
4. **DO** ensure you have appropriate governance of Compliance matters, including regular reports to the Board about compliance issues.
5. **DON'T** forget your regulatory obligation to be open and co-operative with the FCA under Principle 11.
6. **DON'T** forget to review your Compliance arrangements regularly (and with external support as needed) to ensure they are fit for purpose.
7. **DON'T** forget to keep your Compliance documentation up to date, and to review it regularly.

About Robert Dedman

Robert is a Partner in the Special Matters and Government Investigations practice at international law firm, King & Spalding. His practice is predominantly in financial services and consists of advising clients on regulatory issues, conducting compliance reviews, and supporting clients where there is the potential for, or an actual, enquiry or investigation by the regulator.

As the former Head of Enforcement at the Bank of England/Prudential Regulation Authority (PRA), Robert has nearly a decade of experience as a senior regulator and has a deep understanding of how the regulator approaches the various issues it has to deal with.

In addition to his role at the Bank of England, Robert has worked in a number of legal roles at the FSA (as it then was), including leading the legal team that set up the FCA and the PRA.

If you would like to speak to Robert about FCA compliance matters, you can contact him at rdedman@kslaw.com or call 020 7551 7552.

Cost control – our Top 10

Driving the bottom line through profitable revenue growth is most likely the objective of virtually every business. Dealers are faced with a daily pressure to improve profitability and increase margins and an essential aspect of achieving this is a sustained focus on controlling costs.

Cash requirements can fluctuate significantly throughout the year and without constant vigilance, you could find yourself in an uncompetitive situation with bloated overheads. We have outlined ten practical solutions to help manage costs, improve operational efficiency and optimise profit.

1 Does the role sell a car, part or hour?

Any motor retail cost base is heavily influenced by head count. In better economic times, we often see additional roles being created, particularly in the larger businesses where layers of management and support teams can become part of the norm. Headcount budgets should be created from a clean sheet annually to ensure that the 'last year plus a bit of inflation' doesn't creep into the business. For larger businesses, central headcounts get absorbed into dealer profit and loss via a management charge. It is important that there is an appropriate degree of challenge over these management charges as these can be a real point of differentiation.

2 Take full advantage of offers and collect bonuses

From a cost reduction perspective, there is often too little focus placed on seeking to reduce the net cost of the new vehicle. This is due to the perception that there is little influence that can be placed in this area. Whilst this may be true for the initial invoicing of the vehicle, the same cannot be said of bonuses, especially tactical. From an accounting and process point of view, we still see a real difference in approach to this critical area. On the one extreme, we see dealers place their trust in the sales manager and manufacturer to ensure the bonuses due are correct. On the other hand, there are businesses that are totally dedicated to understanding the nuances of the complex manufacturer offer with extremely strong controls over the collection of the amounts due.

3 Appraise the used car purchase and part-ex processes

Another critical area is to ensure that used vehicle purchase prices are as low as possible. How much effort is placed by senior management on the purchase of used vehicles? Certainly our clients that are dedicated to used cars (and make significant profits) obsess over this area. In contrast, franchise dealers will often delegate this task to sales managers who are often, understandably, more focussed on achieving the new car target. The result can be poor buying decisions from convenient sources, resulting in over paying for poorly specified and undesirable vehicles. Equally the quality of the part exchange process is often questionable – how often do management sample check the physical stock to the appraisal document to ensure the appraisal has been carried out diligently?

4 Minimise used and demonstrator writedowns

Used cars are a depreciating asset and yet daily focus on the drivers of stock turn is not always present. Focusing on the basics in this area can have a positive impact on stock turn. Are there reports in place to review cars awaiting preparation and sold awaiting delivery? Are physical checks carried out to ensure these reports are accurate? On conclusion of the sale, how robust are the discussions with the customer to ensure the vehicle is turned into cash quickly? Within the larger used car supermarkets we see very strong processes, such as the vehicle returning back on sale if not collected by the customer within three working days. Whilst this may seem extreme, there may be similar policies that could be implemented that work with the particular dealer's business ethos and customer base.

5 Review employee vehicle car costs

One of the areas we would typically look at when carrying out an operational review is the comparison between self registered vehicles and the required demonstrator and courtesy mix. The incremental vehicle count can be significant and often symptomatic of difficulties in hitting the new car target. Regardless, the resulting writedown costs or reduced margins have a significant drag on profitability. Many of these vehicles are driven by employees on costly company car or alternative arrangements in addition to inefficient 'static' demonstrators. We would recommend a clean sheet approach to defining the demonstrator and courtesy plan and frequently measuring the level of deviation from these plans. For vehicles that are required, it is worth considering whether an Employee Car Ownership Scheme (ECOS) could work for the business.

6 Alternatives to self registrations

Self registered vehicles can be very costly in terms of their upkeep. In the present market, meeting manufacturer volume targets can be extremely challenging, necessitating the requirement to find alternative sales channels rather than relying on self registrations. The natural starting point would be to closely examine the existing enquiry management process to ensure the retail and corporate opportunity is being maximised. In addition, exercises to clear excess units via low (or even negative) margin channels such as brokerage can be explored and a cost benefit analysis carried out and compared to excess self registrations.

7 Avoid VAT/PAYE assessment costs via compliant processes

VAT and PAYE compliance appears to be a continual focus area for HMRC on the sector. Current focus areas, such as the assessments into inadvertent provision of private fuel and discrepancies between DMS and finance company self-billing invoices, have seen many dealers become embroiled in uncomfortable and damaging VAT disputes. Due to the high turnover of the businesses and the ability to go back many years, the results of some assessments can be eye watering, often running into six figures even for relatively small businesses. Focusing on compliance, including regular health checks over common problem areas, can assist in reducing this risk.

8 Technician efficiency – are they providing true value for money?

The major cost in the service department is the technicians. Most dealers have systems in place to monitor the efficiency of their technicians, but the accuracy and quality of data collated is often poor, making it difficult to carry out a true assessment of their performance. Time spent focusing on the controls over the collation of this data, and then working with it, can assist in driving additional hours, or reducing costs, in this critical area.

9 Work with brands to optimise network strategy from a cost point of view

A significant amount of change has started to take place over the manufacturer's network strategy. A number now acknowledge that a reduction in the number of dealers represented (or a 'hub and spoke' model) is required. Challenging the status quo and looking to take advantage of this change of view (eg. by negotiating the change in status of a business from full dealer to satellite) can have a material impact on the cost base in the medium term.

10 Make the most of buying clubs and other purchasing organisations

Last but not least, there remain numerous traditional areas of cost control that should be reviewed as a matter of course to ensure value for money is obtained. Many dealer groups rely on buying clubs to increase their purchasing power and often these clubs will carry out cost reviews on a 'no win no fee' basis, ensuring that any investment in this area is self funding. Typical areas of focus include oil, F&I commission and utilities as well as smaller ticket items such as stationery and telephony costs.

The spark for radical change

The 'electric buzz' is building momentum with an increasing interest from customers. The question is no longer 'should I purchase an electric vehicle', but 'when'?

The Automotive Future Forum is a small group of industry experts focused on providing the digital and physical infrastructures for new electric vehicle (EV) Original Equipment Manufacturers (OEMs). They believe more change will take place in automotive distribution, ownership and mobility between 2020 and 2030 than in the last 100 years. In this article, we hear from founding partners, Craig Fraser and Malcolm Earp, who consider where the future of automotive mobility is heading.

Where are we currently?

New car registrations in the UK for 2019 versus same period in 2018

Full year	YTD 2019	YTD 2018	% change	Mkt share 2019	Mkt share 2018
Diesel	583,488	746,332	-21.8%	25.2%	31.5%
Petrol	1,498,640	1,466,024	+ 2.2%	64.8%	61.9%
BEV	37,850	15,510	+144.0%	1.6%	0.7%
PHEV	34,734	42,232	-17.8%	1.5%	1.8%
HEV	97,850	83,528	+17.1%	4.2%	3.5%
MHEV diesel	32,217	3,833	+740.5%	1.4%	0.2%
MHEV petrol	26,361	9,688	+172.1%	1.1%	0.4%
Total	2,311,140	2,367,147	-2.4%	Source SMMT	

BEV-Battery Electric Vehicle; PHEV-Plug-in Hybrid Electric Vehicle; HEV-Hybrid Electric Vehicle; MHEV-Mild Hybrid Electric Vehicle

The latest figures reveal how the switch to electric is translating into numbers and demonstrate the impact of:

- Greater control and substantive penalties; with fines set to increase in 2020, investment is being pushed towards pure electric vehicles and hybrids.
- The introduction of 'City Charges', with ULEZ in London and others following; creating a panic button for city drivers who own pre-Euro 6 powered vehicles.

These factors, particularly alongside the demonisation of diesel, are reflected in the above table with new diesel falling a further 21.8% in 2019. We expect diesel to continue to decline and the electric and hybrid mix to build momentum, albeit from a low base and still taking a small slice of the cake.

Obstacles challenging future growth of electric vehicles

The Government's 'Road to Zero' strategy declares that the sale of new conventional petrol and diesel cars will end by 2035. However, there are several interacting and conflicting concerns making it difficult for economic and automotive experts to predict mix and volume of new cars over the next five years. Over the following points, we look at the key areas to consider.

1. Brexit, Trade Deals and Tariffs

A number of countries, including China, have held off investment in the UK pending Brexit uncertainty. With a clearer political position in place, we can expect to see several new entrants from China and Asia competing for share in the UK car market as the desire for electric and hybrid models increase.

In China alone there are over 470 companies producing electric vehicles. It is the largest global car market and, in 2018, more electric cars were sold in China than in the rest of the world combined. With such a large home market, and as the global centre of EV battery manufacturing, China is likely to dominate the EV market.

2. Government legislation

The UK government is a signatory to the Paris Agreement 2015 on Climate Change and has already passed into law the Climate Change Act 2008 which legislates to enforce maximum CO2 emissions from vehicles.

However, the recent demonisation of diesel has dented this objective and across the UK and EU we have seen vehicle CO2 levels increase since 2015, as customers change to petrol vehicles which produce 20% more CO2 than the corresponding diesel vehicle. This has been further exacerbated by an increasing trend towards heavier SUV vehicles.

Penalties have been levied upon OEMs to encourage CO2 reductions and, from 2019, these ratcheted up to €95 per gram of CO2/km for each non-compliant vehicle sold. It is estimated that OEMs in Europe will potentially incur €billions in penalties.

The results of this is a rush to launch hybrid vehicles. However, as they are more expensive to make, this is not a long-term solution, hitting OEM profits at a time when they need to invest heavily in EVs. The winners in this are likely to be Toyota and the Alliance (Renault Nissan Mitsubishi) who already have well-established ranges of hybrid vehicles and a long track record with consumers.

3. OEM collaboration and consolidation

The viability of OEMs making electric cars and autonomous vehicles will come under the spotlight and future profitability will be dependent on collaboration on research and development. For some car manufacturers, mergers and further consolidation will become omnipotent to achieve the scale and power necessary to lower the production cost base to make buying electric cars more attractive.

4. EV Battery Supply

Purchase price consideration, charge downtime and driving range are still major obstacles to wider up take of pure electric vehicles and there is a link in terms of the economics and supply of these vehicles to battery technology, production and availability.

While it is anticipated that the cost of producing batteries will reduce through the next ten years, the availability of the raw materials to make Lithium ion batteries is a challenge for the European brands. Until recently, the EU based OEMs have been slow to invest in battery making and to secure the supply of battery material Lithium, Cobalt and Nickel, enabling the Asian battery manufacturers to ring-fence materials.

However recent battery manufacturing announcements show Europe producing 17% of global EV batteries by 2029 whilst China continues to dominate with a forecast 69% of EV battery manufacturing in 2029 and North America at 8%.[1]

Many in the battery industry are working on alternatives to the ubiquitous Lithium-ion battery and are experimenting with alternative chemistries like Sodium and Aluminium which have the advantage of more readily available raw materials, reducing the environmental damage associated with the raw materials for Lithium batteries.

Battery architecture is also under development as current EV batteries consist of 100s of pouch cells or 1,000s of cylindrical batteries with the power gathered from each cell. Scientists are working on a more compact battery which has the potential to double the energy by volume and could provide the extra EV energy storage we need for the future.

[1] Benchmark Mineral Intelligence

5. Infrastructure/Energy

The Energy Savings Trust forecasts that by 2030 there could be 8-11 million hybrid or electric cars on UK roads, and over 25 million by 2040. This would equate to about 80% of overall cars on the road at that time.

At present approximately one third of households in the UK do not have a driveway or garage and cannot install a home charge–point. Currently there are more than 25,000 charging points across the UK, and this will have to increase substantially as the demand increases. The requirement for short charge down-time will also increase, leading to high power charging. Chargers are being developed to charge at 1mw (1,000kw), with the prospect of charging the EV battery for 75 miles of range in five minutes.

The Government must lead from the front and accelerate the number of charging points available. Importantly they must also ensure the electric grid has the capacity to power the increasing demand in electric vehicles. It has been estimated that charging 10 million EVs on the road in 2030 will need between 11GW and 20GW of extra capacity. However, smart charging and vehicle-to-grid technology means EVs will be able to help smooth electricity usage through the hours of the day, National Grid says. They will be able to charge mainly when demand is low and even feed back into the grid when demand is high.

6. Cars and future mobility

Almost all car manufacturers are making a push towards electric and autonomous vehicles, partly fuelled by intense competition from new entrants like Tesla, BYD and NIO, but mainly driven by government pressure to reduce carbon dioxide emissions and the drive towards cleaner air quality.

We are already seeing large fleet and leasing companies taking a more active interest in the electric and hybrid vehicles available. 2020 will see a near doubling of the current product range with the arrival of the following EVs:

- Porsche Taycan
- Honda e
- Vauxhall Corsa e
- Mini Electric
- BMW ix3
- Peugeot e-208
- VW ID 3
- Polestar 2

The future is bright

The future of electric vehicles looks very positive. Look out for a ‘quantum leap’ in the next five years as we see some very exciting products hitting the showrooms, from new to existing brands, with pricing becoming more affordable as we reach 2025.

The challenge will be for dealers to become mobility retailers, which will require a new approach to the business model. The industry will undoubtedly need fewer dealer points and the representation will evolve with customer experience centres, and a highly developed digital channel supported by high street and shopping mall representation.

On page 14, we look at the challenges dealers are facing as they work to adapt to EVs and discuss how you can ensure your dealership is fit for the future.

Want to know more?

Visit www.uhy-uk.com/EVs-spark-change for more about the history of electric vehicles and a detailed analysis about the key areas impacting the future development of EVs.

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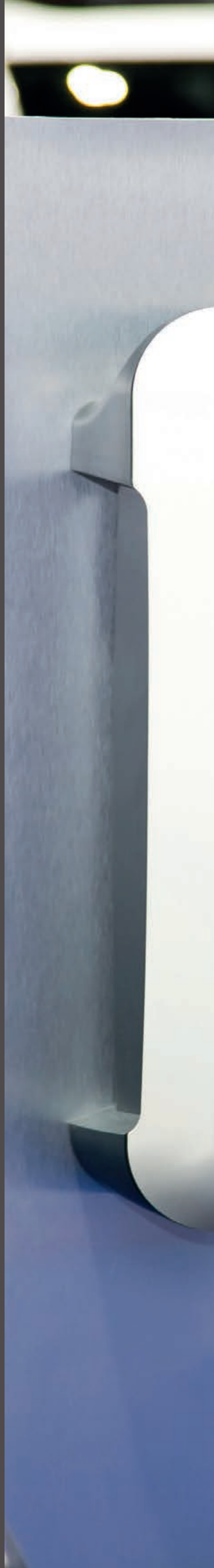

Clearing the EV hurdles

During a period of change it's about the survival of the fittest. What is uncertain about electric vehicles (EV) is the rate at which this change is going to take place, but what is certain is the need to get fit for the future. Automotive Future Forum founders, Craig Fraser and Malcolm Earp, consider how dealers can get in shape.

Profitability challenges

According to Auto Trader, footfall at dealerships has plummeted from 30 million visits in 2010 to 7 million in 2018. A combination of digitisation, improved technology and reliability presents motor dealers with a major challenge regarding future profitability.

EVs need considerably less servicing and have many fewer moving parts which will adversely affect dealer after-market profitability. Already we are seeing in some Scandinavian markets, where there has been a big switch to EVs, that dealer profitability has declined by circa 40% and is expected to fall further.

However, a move to subscription-based services should off-set the drop in dealer profitability as dealers become like the Apple Store; able to maintain a profitable ongoing relationship with customers as their local mobility supplier. But this won't happen without significant realignment of the dealer business model.

Omni-channel retailing

As we enter a world of new players, new technology, new subscription mobility services and new connected services, digital will play an increasingly important part in retailing. More powerful computers and applications will enable advanced virtual reality to demonstrate vehicles and their applications.

To support this, brands and their dealers will need to be where the customers are; in the shopping mall and the new interactive high streets of the future. These highly interactive mobility shops will function in attracting the customer to the brand and integrating with an advanced digital channel. Their purpose will be to show the potential customer the product and mobility services and ensure they are set up to interact from their advanced personal digital devices from home, the office and elsewhere. Primarily they will be about customer experience and engagement rather than overt selling.

New skills

New skills will be required in the networks replacing Sales Executives and Service Advisors with two key customer facing functions:

1. Sales Acquisition Managers responsible, with their marketing and digital teams, for attracting new customers to the brand and the dealership.
2. Customer Account Managers, responsible for managing the ongoing relationships with customers and for ongoing sales of subscription based and connected services, the maintenance of the vehicles, and as product and services gurus.

In addition, dealers will also need to provide much of the logistics for the brand locally. One thing is certain; customer care, communication, transparency and ease of engagement will be paramount features of future mobility retailing.

Making sure your dealership is Fit for the Future

The following isn't intended to be comprehensive, but it outlines some first level actions to consider in assessing whether your dealership is fit for the future:

1. Borrowings

Any change will need investment and dealers should be building plans to significantly reduce borrowing. However, this can't be done without addressing some of the key efficiencies.

2. Daily Operating Controls (DOCs)

Central to addressing the efficiencies of the business is a clear focus on DOC systems, managing daily the performance of the business.

3. Used cars

Used cars is one of the major areas of efficiency opportunity:

- The retail or trade decision must be made on trade-ins at the time of agreeing the deal and trade sale planned for payment within three days of the vehicle landing

- Retail trade-ins should be prepared, cleaned and on display within three working days.
- Demonstrators should be written down to true market value as they are transferred to used car stock, and this includes ECOS cars.
- Used cars should be written down to true market values each month-end.
- Stock days should be determined by model and strictly adhered to. A first loss is always the best loss.
- Used vehicle stock should be planned based on demand analysis of your local market with the trading out of surplus stock and buying planned stock to help maintain good stock turn.
- For most brands, aim for an overall stock turn of between 30 days for volume brands and 45 days for prestige brands.
- Overage stock should be liquidated before it reaches 60 days.
- Use of equity: parity weekly analysis should be used to identify customers on PCP or finance contracts with potential good used car and potential to change early to a new contract.

4. Digital

Digital engagement is one of the major areas of efficiency improvement in UK dealerships. A recent Google car buying study revealed that 60% of car searches were conducted using a mobile device, but many dealers' websites were not configured to mobile device format.

Checking how 'mobile friendly' your web site is could prove to be one of the most important improvements in efficiency. Monitoring website traffic is a fundamental measurement and attracting internet 'hot-leads' (those with a phone number) is literally gold dust.

Results from a study of over 2,000 dealers by customer engagement system, Calldrip, highlighted that responding to a hot internet lead within 1 minute has a 31% closing rate, however responding after 20 minutes achieves the same closing rate as if responded to after 24 hours (6% to 8%), so the first minute response is critical.

5. CRM prospecting

Prospecting from the dealer data base is vital. However, it is important to handle replies promptly and with intelligence. CRM systems need to evolve so that a personalised ongoing relationship can be created with the customer, with a predictive database fully integrated and central to the future operation of all customer facing staff. Here are several criteria for personalised prospecting emails:

- Smart payment: customers who could lower their monthly payment on a new deal.
- Equity: customers with vehicle equity based on the payoff.
- Lower APR: customers who have a high APR contract.
- Cash payment: customers who bought with cash or with non-dealer financing.
- End of term: customers approaching the end of a lease, PCP or financing term.
- Service not sold: customers bringing in their vehicles for service who didn't purchase the car at the dealership.
- Lease over mileage: customers forecast to be over the mileage limit of their contract.
- Service defectors: customers who have not serviced their vehicle in the past 'X' months.
- Declined service: customers who declined service at their last visit.
- Sold not serviced: customers who have never been in for service.
- E.S.P.: customers whose manufacturer warranty is expiring.

A switch to car user-ship

A switch towards 'car user-ship' and subscription services and a move away from 'car ownership' will be a key factor in future car buying decision-making. This change will herald a new world of subscription-based services which will fully integrate mobility and lifestyle.

The mass adoption of EVs and eventual partial autonomy will see significantly reduced service and repair with much done online. However, a plethora of connected services should more than replace lost traditional profit centres and potentially could enhance profit, with ongoing relationships with the customer base.

If you would like to know more or would like to share your thoughts with the Automotive Futures Forum, you can find Craig and Malcolm's contact details on page 12 of this Outlook.

VAT and PAYE – are you compliant?

HMRC continue to focus on VAT and PAYE compliance within the motor retail sector as major opportunities to generate assessments.

With VAT in particular, we have seen an increase in the number of compliance checks taking place within our client and contact base. It is often the case that issues identified from a VAT perspective result in an employment tax check in the following months, further increasing the risks. The total size of the potential assessments can be very significant (often six figure sums) causing major distress for owners and management. We have outlined the key issues you should be aware of.

Key VAT issues

The typical VAT review by HMRC can be split into three parts; the general compliance issues that have been checked for years, other assessment points and the newer issues that are giving rise to material assessments.

General compliance issues

- Private use charges being paid to HMRC to account for the private use of demonstrator vehicles.
- Fuel scale charges being paid to HMRC to account for the private use of fuel paid for by the business.
- Accounting for deposits and credit notes correctly.
- Making sure that the VAT on debtors and creditors over six months old is correctly accounted for.
- Partial exemption calculation to ensure that all input tax is reclaimable.

A checklist would be sufficient to ensure these general compliance issues are not missed from your VAT return calculations.

Other assessment points

- Reclaiming input tax on commercial part exchanges.
- Zero-rated sales to disabled people.
- Value manipulation; AKA bumped transactions.
- Other zero-rated sales such as exports and removals.
- Correct treatment of plug-in grants.

With the exception of 'bumped' transactions and plug-in grants, the basis of these checks is around evidence and the retention of the correct documents to endorse the VAT treatment of the transaction. Where there is a lack of such documentation, HMRC will assess for the VAT that has been under declared or over claimed.

The E-sig issue

HMRC's most recent 'cash-cow' is the issue around e-Signature (E-sig) documents. 2019 saw many assessments raised with dealerships across the country that have not been getting this quite right. With the average Mid-Tier assessments being in excess of £100k, if HMRC have not been to review your records during 2019, you can be certain that they will be in touch in 2020.

The basis of the assessment is that HMRC unsurprisingly deem the sales invoice for the transaction to be that generated by the finance company's software and not the invoice generated by the DMS. Therefore when the e-invoice does not match the DMS invoice exactly, particularly on the sale of additional products which are sometimes entered as one figure, HMRC are relishing raising assessments to recover any under declared output VAT.

This problem can only be resolved by educating the staff who input data into the finance house applications. However as dealerships often work with several finance providers, each using different systems, this is a somewhat difficult task. Hopefully 2020 will see the finance houses work together with dealerships to improve software and help prevent this from happening, but this does not help with the assessments that are being raised in the meantime.

We are aware that HMRC have agreed resolutions with some dealerships on this matter. So if HMRC have not yet been in touch, now is a good time to test your systems to see if you are affected.

Key PAYE issues

HMRC continue to focus on the motor sector with PAYE inspections. Fuel is without doubt the biggest risk area, but it is not the only one, and the cost of dealing with a full scale HMRC inspection can be significant. Now is the time to get ahead of things.

Are you fuel compliant?

Fuel benefit has been an issue for a long time now. HMRC will always look closely at the arrangements dealerships have in place because, for them, it can be a very easy 'win' due to the way the rules work.

Where fuel cards are in operation in a business, there must be robust systems in place to account for their usage in order to demonstrate that no company funded fuel has been provided to employees for private journeys. If your employees are driving demonstrator vehicles and use a fuel card to take a customer on a test drive, are you able to account for exactly how much fuel was used with the customer, and is the balance then recharged to the employee after they drive that vehicle home?

Without extensive mileage logs it can be nothing short of impossible to 'prove the negative' and demonstrate to HMRC that not even a single drop of fuel was available to your staff, and that really is all it takes.

Situations like this can quickly lead to six figure settlements – regardless of how little fuel may be unaccounted for – so it is easy to see why HMRC are so fond of this issue.

Is a van really a van?

Looking beyond fuel, another significant area of focus is the question of whether a van really is a van. That may seem like a silly question, but when it comes to the definition of a 'van' for the purposes of PAYE and employee benefits, you would be surprised by what actually constitutes a 'car'.

In order to be considered a van, the vehicle must be of a construction primarily suited for the conveyance of goods or burden. This means that where a vehicle can be said to have multiple purposes it would no longer meet this rather narrow definition.

The perfect illustration of this is the VW Transporter Kombi, which as is hinted at with the name has a combined purpose and is not a van as far as HMRC are concerned. With a near £40,000 list price and CO2 emissions of up to 176g/km this is a very expensive prospect in comparison to the flat rate van benefit charge.

IR35 changes

There is a change coming in April 2020 relating to the use of 'personal service companies' which many will have heard referred to as IR35 legislation.

These rules look at the relationship between those supplying their services via a company and the end client engaging those companies, as to whether an employer/employee relationship exists in truth, and will require checks to be made by the end client to determine if they need to be deducting PAYE from any payments made to them.

The main area where this will be relevant within the motor sector is the provision of valeters who are often engaged via service companies. HMRC have been particularly concerned about the dealerships that are provided with valeters by third parties such as personal service companies or intermediaries acting almost as recruitment agents.

You will need to ensure these engagements are reviewed and that you have determined the correct treatment of the payments made.

How can we help?

Of course, whilst prevention is better than cure, we can also assist with mitigating the impact of any current or historical (last four years) assessments that HMRC have raised. In recent months we have assisted clients with a number of issues and have found that, in certain circumstances, negative equity based assessments can be challenged.

We would therefore recommend anybody who has received an ongoing or historical assessment to get in touch to see if we can assist.

What lies ahead for the sector: the experts' perspectives

We asked a panel of industry experts for their insight on the outlook for the automotive sector through 2020 and beyond. Here are their views on some of the issues being discussed at our meetings with the sector's business leaders and advisers.

Commenting on the market were:

David Kendrick
Head of Automotive,
UHY Hacker Young

Paul Daly
Automotive Partner,
UHY Hacker Young

Sir Peter Vardy
Chairman,
Peter Vardy Group

Steven Eagell
Chief Executive Officer,
Steven Eagell Group

Mike Allen
Head of Reseach,
Zeus Capital

2019 was a challenging year for the industry, what key issues do you put this down to?

All of our panellists were in agreement that the overriding challenge affecting the industry was a result of the political and economic uncertainty that engulfed the UK. There was a real consensus that this caused a decline in consumer confidence and resulted in increasing nervousness about making large purchases. Mike Allen, head of research at Zeus Capital, believes the uncertainty driven by Brexit and the UK general election had an effect on new car demand throughout the year, adding that "buyer confidence was also adversely impacted in the used car market through various phases of 2019 as well."

Vehicle supply issues were also seen to be a key concern for manufacturers, either due to emissions issues and shortages of compliant product or where vehicles have been diverted to alternative countries due to the exchange rate benefit. David Kendrick, UHY's head of automotive, explained "we have seen significant challenges with supply throughout the year with a number of brands - the biggest affected being Volkswagen Group." UHY's automotive expert, Paul Daly, agrees, adding that "the ongoing weakness of the pound means there are lower profits from UK sales for manufacturers. At the same time you have a European market that is still growing quickly and the net result is that we no longer get first call on the most popular vehicles here in the UK." Steven Eagell, Chief Executive Officer at Steven Eagell Group, flagged that the challenge is not only due to the lack of supply, but that many retailers have also struggled to adapt their processes in order to manage customer expectations due to longer lead times.

Mounting cost pressures were also cited as a key concern, particularly regarding people, property and system costs in light of greater FCA scrutiny. Paul explained that "wherever I go I am seeing sustained cost base increases. These are often not under the control of the business and result from bullish investment decisions, often imposed by manufacturers, made in better times. In addition, staffing costs seem to be continually expanding and eating into profits." David added that a number of dealerships now have a significant overhead base due to the size of the facilities they are trading from, meaning they are relying on all departments to contribute to the overall profitability. He went on to say "with a number of franchises we have seen limited to non-existent contributions from the new vehicle sales department, leaving a large hole in the P&L."

The dealers on the panel, Sir Peter Vardy, Chairman of Peter Vardy Group, and Steven Eagell, shared concerns that certain manufacturers chasing market share have forced dealers into regular preregistration activity and transacting low margin business through the renewal of PCP agreements too early into their lifecycle. Steven explained "this has a knock-on effect for used cars as they may be overpriced, and their monthly payments will be too near the equivalent new car."

With diesel demonisation still in full force, the lack of affordable electric vehicles was also seen as an issue and it was felt that consumers need more help and education on making their next car purchase decision. Sir Peter commented "the original proposal that it would all be sorted by 2040 was a good suggestion. Manufacturers could cope with the target and the infrastructure could be in place. But politicians issuing sound bites that 2025 was the in fact the date has scared everyone. It has panicked manufacturers and paralysed customers."

Cazoo launched in December 2019, vowing to "transform how eight million used cars are bought each year by putting the entire process online." What are your views about this?

Whilst all acknowledged that the new entrant appears to be a well funded and credible business with an impressive management board, our panellists did not see Cazoo making a substantial impact. Having seen the launched website, David said he is "struggling to see what is different to any other online click and buy platforms that dealers offer currently." He added "the vehicles are well presented and the process is user friendly, however the seven day cooling off period and part exchange appraisal may cause this model some difficulties. The dealers I have spoken to don't seem concerned about Cazoo being a significant disrupter."

Steven outlined that the big issue for dealers is how to differentiate and add value to the customer experience. He believes most customers will still feel the need to 'touch and feel' the product rather than completing the entire purchase online. He said "whilst Cazoo will also need to overcome the online difficulties of part exchange, finance, etc, I believe their biggest challenge, as with any used car business, will be procurement." Mike agrees, flagging that buying a car seamlessly online is not new, adding "there has been a lot of investment made in omni-channel retailing by all of the dealers to date, and we believe a 'clicks and bricks' hybrid model will work best." Sir Peter also pointed out that the internet allows for clear price comparisons "so it is not easy to sell at a premium, and unless that can be achieved, margins will be under pressure."

What is your outlook for 2020 and have you done anything differently in planning for the year ahead?

Views were mixed across the panel on this point but there was an agreement that consumer confidence is expected to improve following the majority outcome of the general election.

Paul flagged concerns, however, that with many trade discussions still to come the sector faces more of the same challenges and uncertainty. He said "I am speaking to clients mainly about options to manage costs and lean down the business without impacting on operating capacity for that reason."

Steven injected some positivity, predicting that 2020 could be a more successful year for retailers with hopes that the election result will "alleviate consumer uncertainty and stimulate the market." Adding, "let's also not forget that interest rates are still very low as is unemployment." David is also optimistic that 2020 will be a much better year for the sector. However, he recognised that new car targets need addressing, suggesting that "manufacturers will have to address the challenges around targeting and new car profitability if they want to maintain the focus of the dealer networks." Sir Peter agrees, stating that dealers must "try to negotiate more reasonable new car targets to avoid preregistration and look at areas of cost reduction."

Mike predicts a difficult Q1 2020 trading period. However, his outlook has improved for the industry following the general election and he anticipates trading conditions will steadily improve during 2020. He explained "forecasts from Capital Economics anticipate UK GDP growth to be 1% during 2020 rising to 2021 with £/$ remaining above 1.25 and moving towards 1.30 during 2020. To our mind this should be good economic ingredients for a recovering new car market. It is also worth bearing in mind that following three years of declines in new car sales during 2016-19, the market has never fallen for four consecutive years, which should also give rise to some pent up demand unwinding from 2020 onwards in our view."

What's your view on the number of franchised representation points across the UK over the next five years?

Sir Peter believes there needs to be fewer dealerships operated in a market area approach, citing Mercedes Benz of being an example of a successful strategy. Steven agrees to an extent, although thinks that representation points may not reduce significantly, but that the number of manufacturers' partners will reduce. He added that "the type of representation may shift with manufacturers becoming more willing to change the 'rules' to suit the retailer and customer. Rather than the necessity of expensive full retail facilities at every representation point, we may find scaled down versions displaying the same corporate identity but with a more financially viable investment."

David is already seeing some manufacturers look to reduce their representation points, especially where a change of ownership is planned. He explained "this gives the brand the opportunity to assess their network plan and decide upon 'fit for purpose' locations moving forward. The hub and spoke model is very likely to become more common with smaller authorised repairer outlets supporting the main franchised dealership."

Mike also expects more capacity taken out of the market. He said "we would anticipate more volume throughput coming through fewer sites, which should therefore ensure those that survive are in a better position to thrive. We believe it will be the larger, well capitalised dealer groups that have already made the significant investments from 2014-18 that will benefit from this trend."

EV is becoming a very popular discussion topic and the reality of the arrival of EV products is now here. What is your view on how quickly the EV market will evolve and will it become the power source of choice?

We asked our 2018 panel a similar question and, at the time, all contributors agreed that the transition to electric vehicles (EV) was likely to be a very slow process. Two years later and our panellists agree that whilst EV has finally gained some traction, they expect to see a gradual transition to hybrid vehicles before pure electric vehicles start to take greater share later in the next decade.

Paul believes that even if growth does start to accelerate, it will take a number of years before there is a material impact on the vehicle parc. He said "In 2019 YTD Nov, pure electric vehicles represented just 1.5% of total new vehicle registrations and are a barely measurable percentage of the total UK vehicles registered on the road." Mike agrees, explaining that even using aggressive growth assumptions for EV growth, it will be below 20% of the total UK car parc by 2025 and is "therefore not a 2020 issue". He said "we believe EV will have a greater impact on the fleet market first given the current tax incentives on offer for company car schemes. If you look at the Norwegian market, it has been the tax incentives that have driven EV penetration here, and we anticipate no different in the UK over the medium term."

Steven also expects the growth of EVs to be slow. He said "EV will eventually become the power source of choice, but my view is that is long term rather than medium as the UK's infrastructure will need to change dramatically to cope with any future mass growth in this area. Availability of raw materials for batteries will slow down roll out and limited range from early battery technology is a barrier for many customers. The power to charge batteries will have to come from somewhere. Unless each EV is coupled with a fuel cell the building of more power stations will be an unpopular consequence for many potential customers. "

Sir Peter thinks technological developments and environmental concerns are nothing new and that EV will be a stepping stone to hydrogen technology with the early adopters of electric finding depreciation a problem as newer cars have greater range capacity.

What impact do you think the FCA's ongoing quest to ensure customers are treated fairly will have on the dealer business model going forward?

There was unanimous agreement amongst our panellists that FCA compliance is a key risk area for the industry and that management teams should monitor the final FCA findings, due in Q1 2020, very closely to ensure full implementation within their businesses. Sir Peter emphasised that "dealers need to be very aware of these issues and have policies in place that are fair and water tight".

Paul explained that from an audit perspective he has placed additional focus on FCA compliance in the current round of audit planning. He said "it is clear that our dealer clients take FCA compliance extremely seriously, recognising that it is a fundamental part of the business model. Some businesses take higher risks than others in this area and those are the ones that are more vulnerable to the ongoing efforts made by the FCA to ensure the customer is treated fairly."

David expects the process of buying a car to become increasingly transparent so "dealers that follow the rules and offer an exceptional customer experience will most likely succeed and those that do not may fall by the wayside". Steven shares the same feeling about the importance of compliance, highlighting that "whilst some organisations may view compliance with the FCA's requirements rather cumbersome and a distraction, there are clearly some large benefits as strict compliance keeps the unprofessional operators away from the industry."

What do you perceive to be the main challenges in running the largest groups and how do you see these challenges being overcome?

Sir Peter and David felt that the largest groups have grown to such an extent, the sheer number of sites and locations must be a challenge to manage effectively. David explained that he regularly has discussions with leaders about how large a group can become before control and influencing culture becomes too challenging. He said "many of the top leaders we speak to in the sector believe 50 sites is a challenge to manage, with others suggesting nearer 100." Sir Peter agrees, saying he "always believed that it is very difficult to manage a group with more than 100 dealerships."

Paul also highlighted that, contrary to expectation, the largest groups also often run with higher cost bases than the smaller groups with regional and head office head counts placing an additional overhead burden which are not necessarily outweighed by other economies of scale they are able to generate.

Steven felt the main challenges are not dissimilar to the ones all dealers come up against, with attracting and retaining the best people being the number one challenge. He said "we sometimes overcomplicate our industry and overlook the things that make all the difference. We need to only focus on the things that can affect our businesses, the single most important thing is to have the right people within the business. Having the right people with the right attitude and sticking to the organisation's processes will go a long way to ensuring a successful business."

Ending on a positive note, Mike gave his summary on the state of the market, saying "After looking at this industry for 20 years, one thing for sure is that there are many excellent dealer groups that can demonstrate strong resilience throughout the cycle. Of course there is no doubt motor retail is cyclical and profitability is invariably impacted during a downturn. However, if you look at the long term track record of many PLC dealer groups, their profitability always grows each cycle as they benefit from industry consolidation and economies of scale."

He concluded "There is no doubt 2020 will have its challenges, but we believe those dealers who remain focused will more than hold their own. Free cash flow yields look attractive to us with heavy capital expenditure cycles ending, and this could be something that entices investors back into the sector. Asset backed conservative balance sheets are also on offer across the sector, and we would expect further consolidation from some of the stable PLC operators especially if their valuations start to improve."

"There is no doubt 2020 will have its challenges, but we believe those dealers who remain focused will more than hold their own."

Mike Allen
Head of research,
Zeus Capital

Our automotive expertise

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 at **www.uhy-uk.com/automotive**.

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