UHY Hacker Young
Chartered Accountants

2019 Automotive Sector Outlook

Predictions for the year ahead from our specialist automotive team.

Helping you prosper

Contents

State of the market

It would not be an accurate summary of 2018 without acknowledgement that Brexit has dominated the automotive headlines for the last 12 months. At the time of writing, the way forward for the UK was probably more uncertain than at any time during the last 24 months. Without Parliament able to reach an agreement on the best terms of exit from the EU, we have started 2019 with a rational level of concern.

SMMT analysis suggests that the imposition of EU tariffs on cars alone could add at least £2.7 billion annually to import costs and £1.8 billion to export costs. If the car brands and retail networks are unable to absorb these extra billions, import tariffs alone could increase the list price of cars imported from mainland Europe to the UK by an average of £1,500*.

The general economic uncertainty has been playing its part in declining new car registrations since the referendum. Last year saw total registrations drop by just under 7% on 2017 levels, and further from the all-time peak in 2016. But it was diesels which took the biggest knock, with a 30% drop in new registrations following an increase in the levels of road tax for new diesel vehicles and general environmental pressures on consumers.

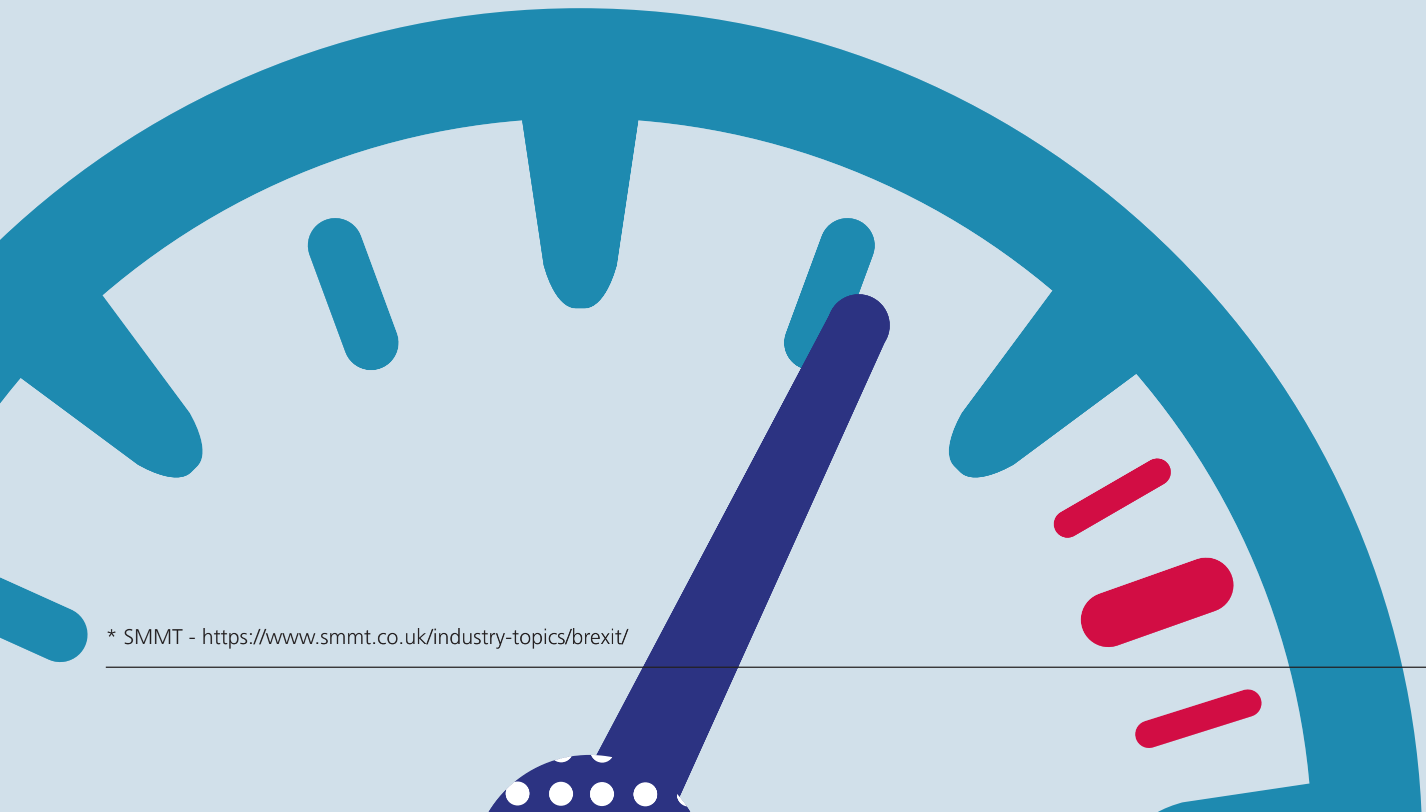
But it has not all been doom and gloom. In terms of business performance, while the share prices of some of the sector's leading PLCs have taken a huge knock, our experts report that this is not a reflection of the financial success of those operating in the sector. From our conversations with clients and other business leaders, 2018 largely saw solid levels of profitability.

Deal activity within the motor trade has also been rife, with 2018 seeing the highest number of total annual transactions completed since pre-recession. While deal numbers were high, however, deal values have dropped away somewhat and our experts have certainly noticed an increase in the length of time taken to complete a transaction; most likely another impact of the Brexit effect. Read more about the deal trends during 2018 and our predictions for this year on page 9.

2018 was also the year that the ICDP told us that the key automotive 'megatrends' being discussed and debated as likely to have a real impact on the sector were all "exaggerated", with those being alternative fuels, autonomy, connected cars, purchase and usage restrictions and transport as a service.

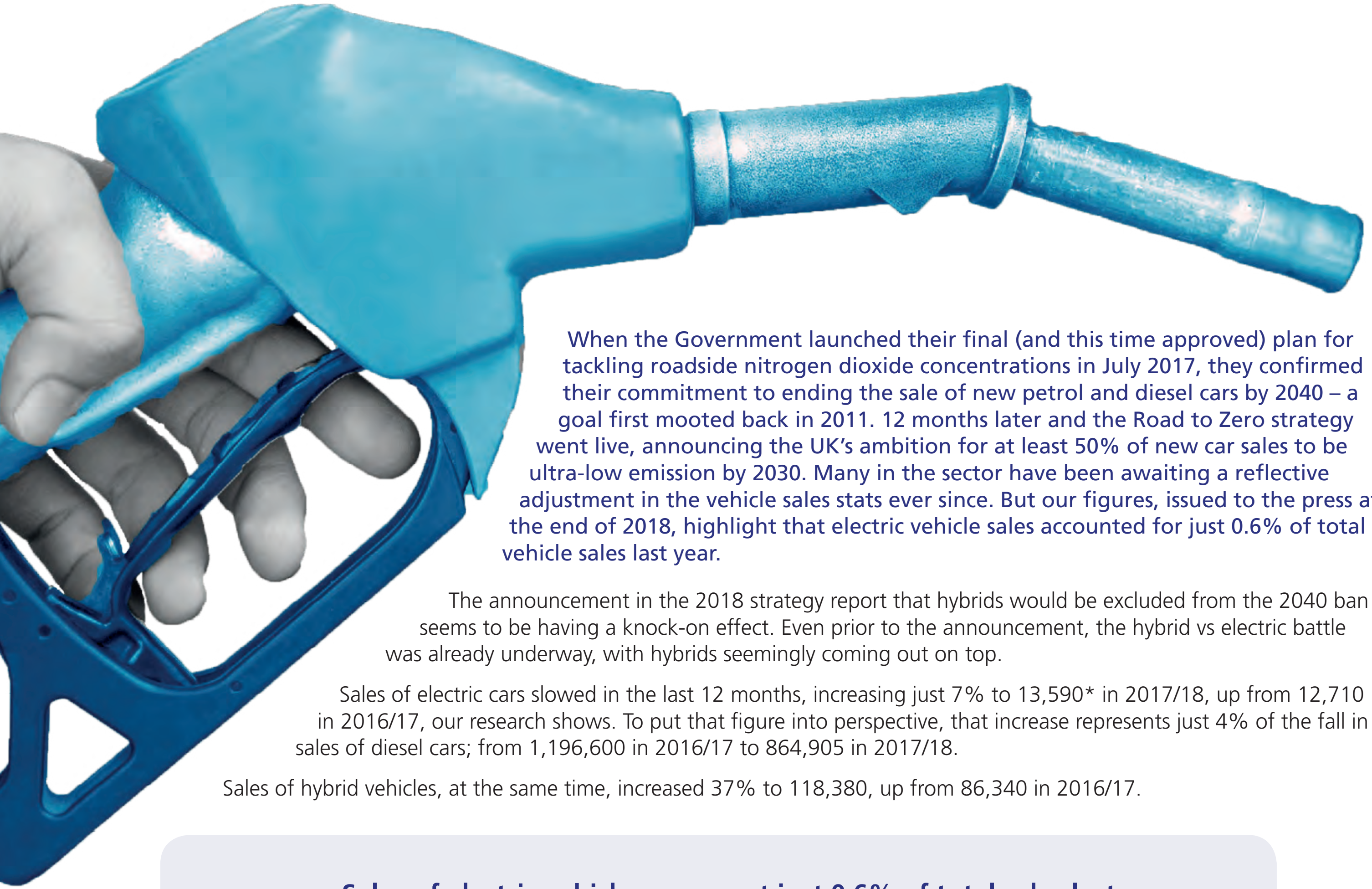
In this year's Outlook from UHY's specialist automotive team, we take a look at some of the key issues being discussed in our meetings with business leaders. We debate whether the increasing trend for online dealerships marks the start of a new retail strategy on page 8. We have also looked at the changing landscape amongst alternative fuel vehicles, page 3, and our experts have outlined our view of the five key areas in which the best performing motor trade businesses excel on page 11.

In addition to the views of our own team, we have also 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 2019 and beyond. Read our Experts' Perspectives debate on page 13.



* SMMT - https://www.smmt.co.uk/industry-topics/brexit/

Hybrid vs Electric: let battle commence

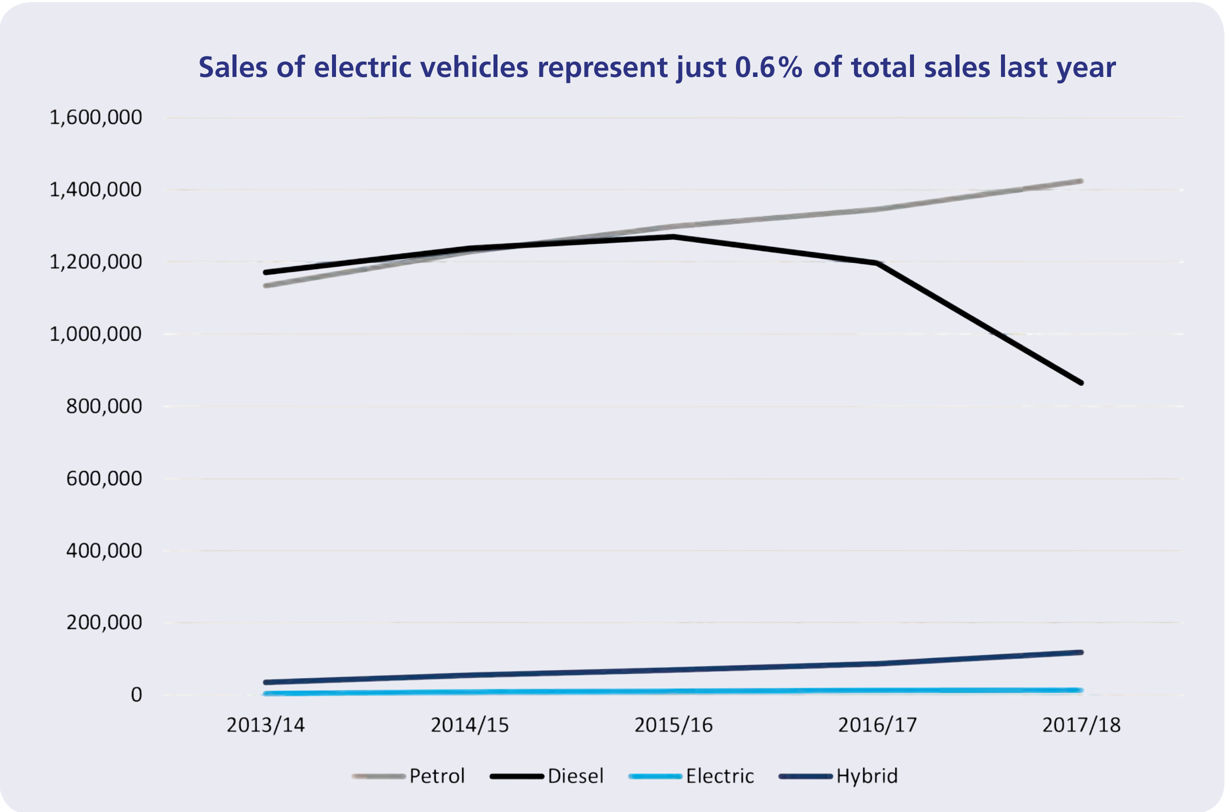


When the Government launched their final (and this time approved) plan for tackling roadside nitrogen dioxide concentrations in July 2017, they confirmed their commitment to ending the sale of new petrol and diesel cars by 2040 – a goal first mooted back in 2011. 12 months later and the Road to Zero strategy went live, announcing the UK's ambition for at least 50% of new car sales to be ultra-low emission by 2030. Many in the sector have been awaiting a reflective adjustment in the vehicle sales stats ever since. But our figures, issued to the press at the end of 2018, highlight that electric vehicle sales accounted for just 0.6% of total vehicle sales last year.

The announcement in the 2018 strategy report that hybrids would be excluded from the 2040 ban seems to be having a knock-on effect. Even prior to the announcement, the hybrid vs electric battle was already underway, with hybrids seemingly coming out on top.

Sales of electric cars slowed in the last 12 months, increasing just 7% to 13,590* in 2017/18, up from 12,710 in 2016/17, our research shows. To put that figure into perspective, that increase represents just 4% of the fall in sales of diesel cars; from 1,196,600 in 2016/17 to 864,905 in 2017/18.

Sales of hybrid vehicles, at the same time, increased 37% to 118,380, up from 86,340 in 2016/17.



*Year-end 30 June

Date	Sales of Petrol	Sales of Diesel	Sales of Electric	Sales of Hybrid	Total all fuel types
2013/14	1,134,054	1,171,470	4,051	35,165	2,344,740
2014/15	1,228,106	1,237,765	8,725	55,021	2,529,617
2015/16	1,298,639	1,269,956	10,470	69,289	2,648,354
2016/17	1,345,519	1,196,599	12,708	86,335	2,641,161
2017/18	1,424,313	864,905	13,586	118,377	2,421,181

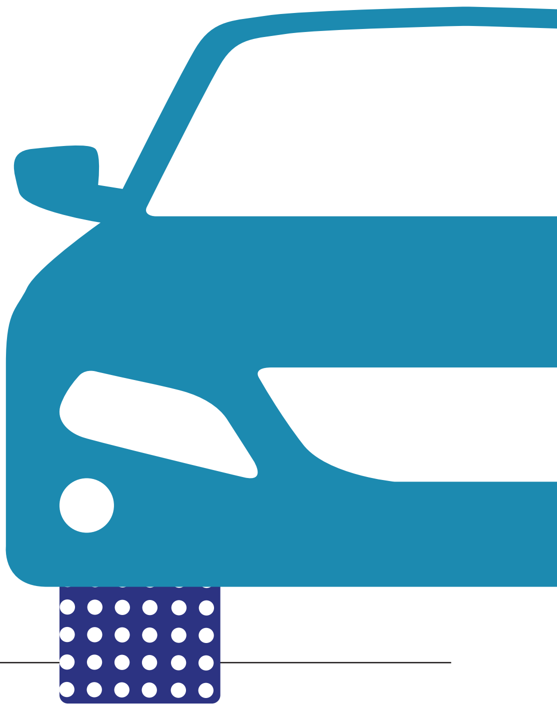
Is it true love for the hybrids?

It seems the issues with poor electric sales are more supplier and infrastructure based than related to overwhelming hybrid demand. The slow progress that the automotive industry has made in introducing affordable electric vehicles has frustrated many UK car dealerships as the limited range of products available cannot meet potential demand.

Despite car manufacturers' ambitions to dramatically increase production volumes and ranges of electric vehicles, there are currently very few affordable or competitively priced options on the market. This means that the potential market for electric vehicles is still very limited, restricting sales growth.

And whilst there is demand for electric, consumers have raised concerns over the lack of infrastructure and the battery life of vehicles. Consumers demand convenience and, whilst energy storage proposals continue to develop, until 'fast charge' options are conveniently available, there may be a continued challenge to gain significant traction.

A slump in diesel sales has been accelerated by tax increases and stricter emissions tests which have limited new model launches, but that has put a real dent in overall car sales. To help fill that gap, manufacturers and dealers need to see a return to better grants and tax incentives for purchasers of electric and hybrid cars – particularly in view of the Government's ambition for this to be "the biggest technological advancement to hit UK roads since the invention of the combustion engine."



Are we prepared to weather a storm?

This year's Outlook talks widely about the challenges facing the sector. In our meetings with stakeholders, we are regularly asked our views on the ability of the sector to withstand these challenging economic conditions. And there is every possibility of more challenging trading conditions ahead. How resilient can the sector be in those circumstances? This is the question the many current and prospective investors in the sector want to know, as well as the supporting stakeholders; suppliers, captives, banks and the manufacturers/their national sales companies.

In this article, we respond by giving our views on a number of factors:

1. Levels of potential downturn in demand
2. The potential impact for other income streams
3. The current financial strength of the sector

1. Levels of potential downturn in demand

Clearly, the greatest influence on any downturn in performance will be driven by the new car market. Whilst the future is impossible to predict, examining historical levels of car registrations, including through recession, can be a useful guide. The graph below looks at data from the start of the century, covering the recessions in the early 2000's and the most recent 2008 Great Recession.

The level of registration peaks have remained reasonably consistent through the period, at around 2.6m. The trough around 2008 saw a fall of around 24% peak to trough. Whilst significant, the fluctuation is modest compared to many other countries within the EU. Spain, for example, moved from a peak of 1.6m vehicles in 2006 to 0.7m in 2012 causing huge distress within the sector.

And the reasons for this benign environment in the UK? It's complex. Generally, however, our vehicle consumers are more robust.

Source: SMMT website - https://www.smmt.co.uk/vehicle-data/car-registrations/

Positives for the sector

We have:

- a cultural variance; with the UK consumer more 'addicted' to the vehicle change cycle and the latest products and technology
- a dependence on a monthly payment model; with a natural change cycle occurring as the vehicle comes to the end of its contractual or finance period
- historically, a very significant fleet market (although this is less prevalent today)
- the ability of the manufacturers' national sales companies to find alternative channels to market (such as short term hire, and pre-registration exercises).

In our view, the explosion in levels of vehicle financing and increasing popularity of Personal Contract Hire (PCH) will help in moderating any downturn in registration activity.

The 24% fall in volume was also largely absorbed by the sector without widescale business failures. Many of the disposals that took place during the recession were actually businesses in distress that were effectively forced into a change of ownership by one of the major stakeholders.

2. Impact for other income streams

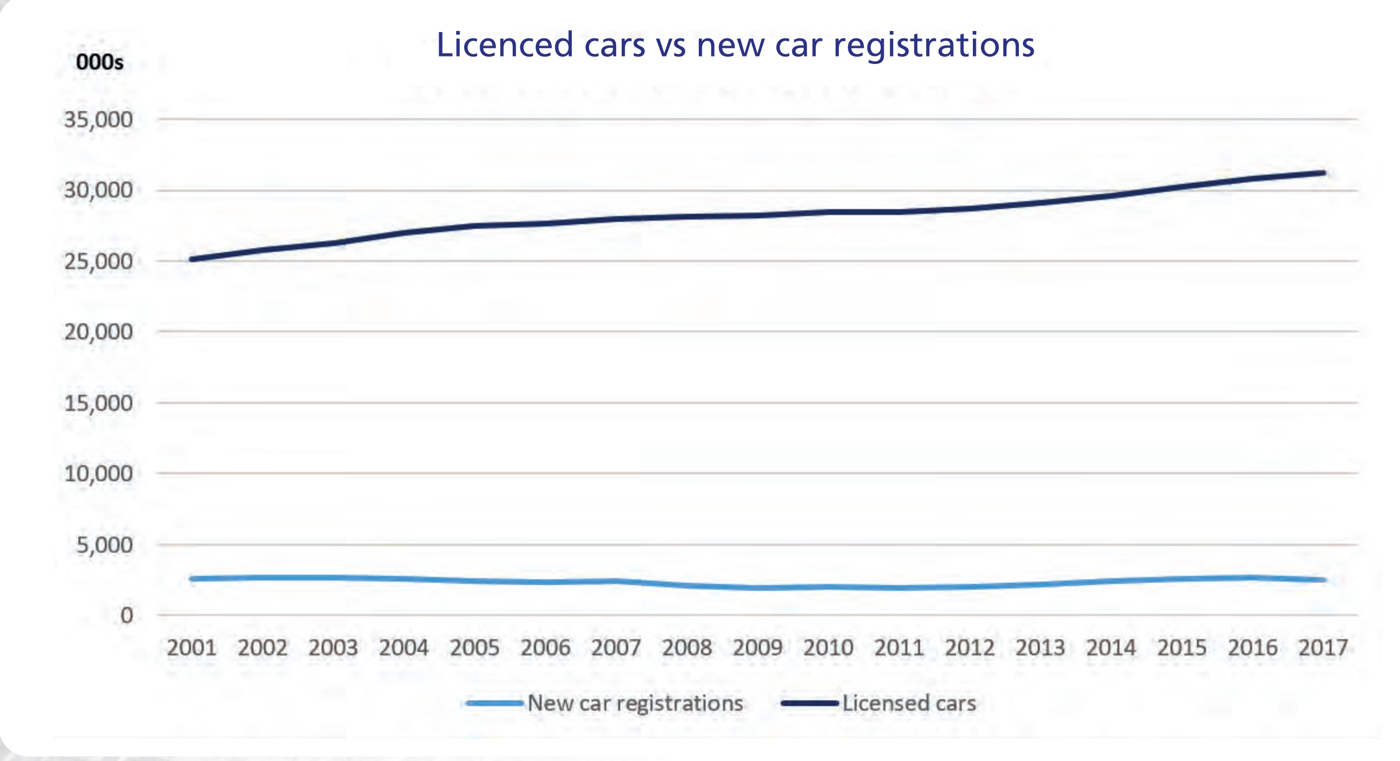
Used cars

In 2008, one of the biggest threats to both profitability and liquidity was used car stock. As the market slowed, dealers were left with significant volumes of unsold stock which then began depreciating heavily. Dealers were forced to either liquidate this stock, suffering heavy losses, or retain it; with the resulting increasing demands for working capital. In 2009, as consumer and dealer confidence slowly returned, there was a clear opportunity to drive profits out of the used vehicle departments due to the very low prices that the vehicles were commanding. Prices slowly appreciated back to a more normal level. The net result was that used cars were one of the biggest contributors to the overall average loss position of a dealer made in 2008 followed by the much higher than average profits (as a % of turnover) enjoyed in 2009.

If an economic downturn were to occur, it is this area which would again be of greatest risk to a motor business.

Aftersales

The key driver for aftersales is the volume of vehicles licensed for use on the roads. Statistics demonstrating the trends are set out below:



In contrast to new registrations, there has been an ongoing and sustained increase in the number of vehicles licensed for UK roads, demonstrating the scale of the aftersales (service, parts, body repair) opportunity.

A major strength of the sector is this growing parc of vehicles which will require ongoing repair and maintenance. The average repair order size during the last recession increased due to the ageing UK vehicle fleet. The franchised motor retail sector, however, is not necessarily positioned to capitalise on this opportunity, being heavily reliant on vehicles that remain within their manufacturer warranty period between three to seven years.

Positives for the sector

- The 2008 recession was unusual in its severity, with the 1920s being the last comparable recession.
- Some of the issues in 2008 were the result of extremely high stock levels of new, self-registered and used stock held on dealer forecourts. Whilst stock levels have increased significantly since the low point in 2010, a subsequent weakened sterling, recovery of the European markets and WLTP have all helped to keep stock levels under a greater degree of control.
- The increased use of PCH type products offer an additional release valve for excess supply, rather than it sitting on dealer forecourts or compounds.

3. The current financial strength of the sector

Unfortunately, there is little data available to analyse the current financial health of the sector. Whilst there is a plethora of data on profit performance, there is very little publicly available to support balance sheet and liquidity strength. This is partly due to the incompatibility of profit performance reporting by brand/location against balance sheet; often at an overall group level.

Monitoring of the balance sheet is largely the domain of the stakeholders with a financial interest and, given that we often receive instructions from these stakeholders to review 'dealers of concern', they are a useful barometer of levels of distress in the sector. In the last five years, we have seen a gradual reduction in these instructions, with stakeholder discussions indicating record lows of 'dealers of concern'. The last six months has seen a reversal of this trend, although we are still at very low historical levels. Of course the data used is often significantly out of date (reliance on filed statutory accounts) so any endemic problems can take some time to fully manifest themselves.

From a banking perspective, there appears to be an increasing degree of nervousness in the lending decisions from the mainstream banks, which does not reflect the overall sense of comfort around the current financial position. Our own view is that the sector is tainted by the negative sentiment surrounding the wider retail sector.

Positives for the sector

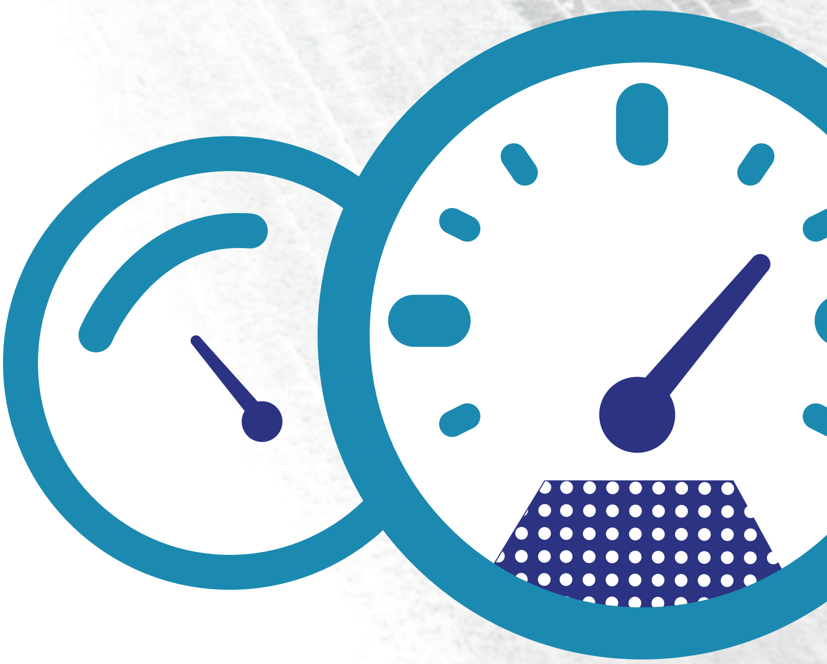
- Following a sustained run of profitability, significant operating cash has been generated.
- The investment demands, particularly from Jaguar Land Rover, Mercedes, BMW, Ford, Nissan and Audi have absorbed much of this cash and increased long term borrowings. Much of this investment is now complete.
- Long term and sustained increases in stocks have been offset by matching increases to short term liabilities. We will need to wait for 2018 accounts to start to be filed, but our current view is that there has been a significant easing in stock pressures during 2018, primarily due to the stock cleansing following WLTP.

In answer to the question...

We believe so. Historically, the sector has withstood economic shocks. From our perspective and understanding of the current market, we believe the sector will remain resilient to any impending economic downturn because of its strengths:

- The robust UK consumer who retains a stronger than average appetite for motor vehicles compared to the rest of the EU.
- The availability of other revenue streams, notably aftersales, which are reliant on the UK motor vehicle parc that has demonstrated sustained growth for the last 25 years, even through recessionary periods.
- The interface with, and influence of, the manufacturer partners who operate sophisticated early warning systems for their dealer networks and create changes of ownership to stronger operators where necessary before failure can take place.
- The significant average balance sheet strength arising from a sustained run of healthy profit generation and reinvestment of a high proportion of those profits into valuable property assets from which the businesses operate.

And, last but not least, our sector owners and managers have the ability to respond quickly to changing market conditions and adapt their business models to ensure survival, even through the difficult times that many commentators think may be heading our way.



Online dealerships: signs of a changing retail model?

Many automotive commentators have spent the last five to ten years speculating about how far e-commerce will alter the existing retail model for dealerships. Could some of the transactions from high profile tech companies in the automotive space last year be further indication of the move to a fully online purchasing process, or will the 'bricks and clicks' retail strategy continue into the foreseeable future?

Big brand tech companies hit the sector

Some would say the model has been adjusting for years, and that the online element is a key part of the purchasing process for most of today's buyers. Certainly, the introduction of Dealer Auction, through a Joint Venture arrangement between Cox Automotive and Auto Trader UK, reflects the belief amongst some that online automotive retail platforms are the way forward. As does eBay's acquisition of Motors.co.uk, which now takes its online car sales offering across three separate sites with more than 620,000 combined car listings. And with lower property, people and infrastructure costs removing the barriers to entry into the automotive market, these new operators can leverage on their existing brand strength to make huge inroads quickly and easily.

Others have a more conservative view of how far the online model will extend, however. ICDP, renowned for their research programmes into automotive distribution, stated in their special report[1] at the end of last year, 'The European Dealer of Tomorrow', that "e-commerce players will play a greater role than they do today" but also stated that they "do not foresee a 'Blockbuster' moment for car retailing, where the sector is revolutionised in a few years." The full report provides a detailed view of the likely dealer model by 2025-2030, based on more than 25 years of research and analysis. The report highlights that, despite the increase in the range of information available to buyers online, the online research is not replacing the need to visit a dealership, with the number of visits to dealer sites as part of the purchase process actually increasing steadily over the last six years. The report does highlight the need for dealerships to adjust their customer experience in response, however, ensuring that they have a high calibre of individual ready to support the customer when they do visit.

…but customers still demand a dealership experience

An article in Forbes Magazine[2] last year pointed to physical retail as being the strategic focus of the future. The article suggests "today's generation of customers is much more interested in experiences than objects", and the likes of Tesla would seemingly agree. They are already geared to this focus on experience rather than product within their physical sites. Their showrooms feature only one or two core luxury products and one or two very knowledgeable salespeople, with a premium experience for everyone visiting the high traffic stores. But the digital experience is highly personalised and consistently accessed both online and in-store, in an experience comparable with that of Apple. Both Tesla and Apple have a real focus on demonstrating the brand and vision through their retail sites, not just purely through the product.

The Forbes article suggests "the power of experience is unstoppable…allowing you to differentiate your brand from your competitors. A physical space is much easier to individualize than a webpage — it's not a list of items on a screen." Whilst the negative sentiment across the broader retail sector prevails, as a result of the weekly reports of numerous high-profile brand store closures, we are also witnessing extreme online competition. The ability to attract attention and stand-out online is becoming increasingly challenging.

The ICDP report summarises that retailers should be focusing on an omnichannel approach. And our experts in the Experts' Perspectives article on page 13 of this Outlook agree. Buying a car is one of the most significant purchases made within the majority of households and, with a need for ongoing after-sales support, servicing and maintenance, buyers have the need for an ongoing dealership relationship. The digital space is there for information and convenience, whereas the physical space exists to build, support and extend the ongoing experience.

[1] 'The European Dealer of Tomorrow' – ICDP, August 2018
[2] 'Online Retailers: Why Physical Retail Should Be Your Next Move' – Sergio Mannino, Forbes Council, 11 April 2018

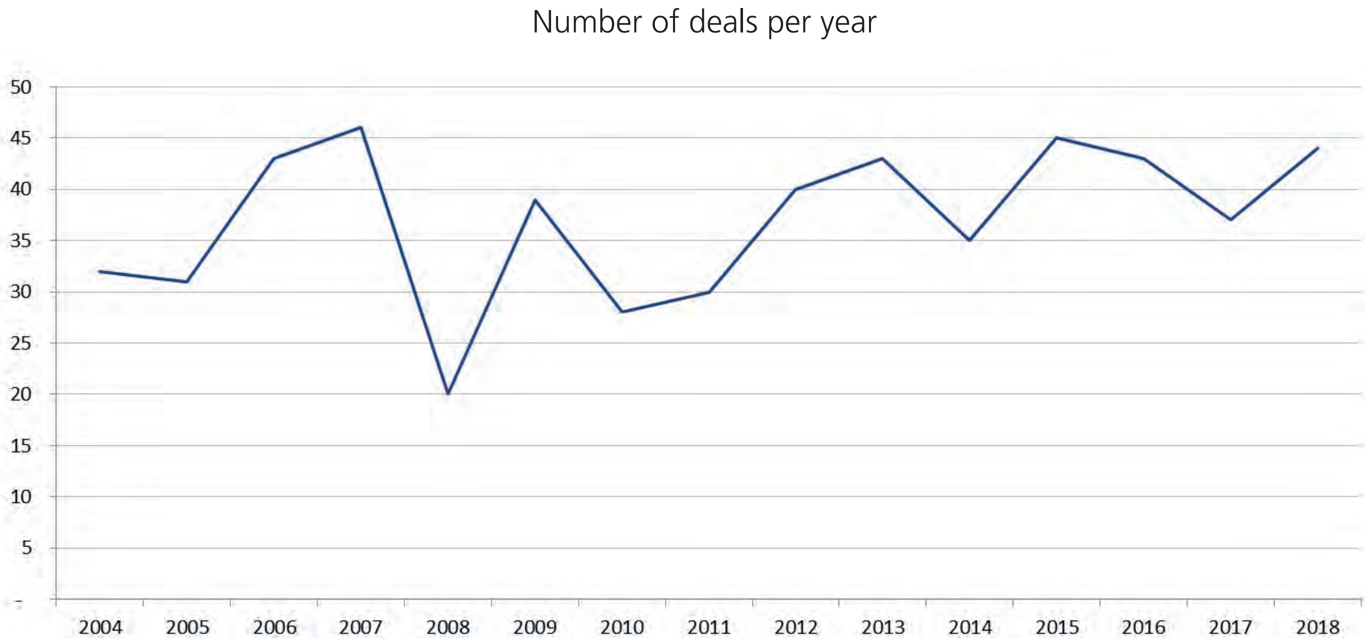
Multiple deals, despite a potential 'no-deal'

Despite a year of economic uncertainty in the run-up to Brexit, the vote to leave had little impact on the level of transaction activity within the motor trade in 2018. Deal levels were back up around pre-recession levels, following a small dip in 2017, with a growing trend for activity within the digital space and also surrounding the Volvo brand. And we predict that motor retailers' appetite for growth (or exit) during 2019 will remain unabated.

2018 at a glance – the headline stats:

- **Deal activity showing no signs of slowing:** 44 deals completed in 2018, compared to the 38 in 2017 and 41 in 2016
- **Increase in activity within the digital motor space:** three transactions involved high profile web-based retailers
- **No 'mega' deals reported, and a general drop in the average deal value**
- **Drop in activity amongst the premium brands:** only 12.5% of total transaction volume happened within the premium brand space, down from 22% in 2017 and 60% in 2016; a reflection of the weakening financial performance across the brands
- **Volvo represented in 5 of the 40 deals**

Deal volumes and values trends



Whilst there was a moderate yet healthy rise in the number of deals completed in 2018, the area of real interest was the drop in average deal value from 2017. This was most likely a result of the move away from PLC and international activity in purchasing premium brands and the prevalence of activity amongst the smaller to mid-sized groups.

The interest of international investors in the UK automotive market per se continued during last year, although not quite at the boom levels of 2017. We saw another new entrant in the guise of AW Rostamani with the Brayley Group acquisition, which was a great deal for the industry. But while the investors are still circling, they are more cautious in their outlook. There is a clear incentive for the overseas investors to ensure the first UK acquisition is the right one. Although we have been talking to many interested international parties, there is currently a hesitance to take the plunge amongst many – most likely the Brexit effect.

Continuing from 2017 was the theme of low volumes in activity amongst the premium brands. Very few premium sites actually changed hands during 2018 - something that became increasingly apparent as the year progressed. Jaguar Land Rover and BMW each came to the end of five-year contracts in 2016 and 2018 prompting peaks in activity in the run up to those years. That has now subsided and, in conjunction with the weakening financial performance of some of the premium brands, there has been less appetite to sell.

As the brutal impact of the WLTP emissions scandal eases around Audi, and with BMW likely to see improved performance next year with the introduction of new models, expectations are that activity in the premium market will start to improve.

But it was Volvo who caught our eye in 2018, represented in five of the six mid-brand deals to have completed through the year. It seems the VRE investment requirements are creating a desire to sell, particularly if the owner is approaching retirement. At the same time, the brand's strengthened product offering, as well as a strategy to compete in the premium market, are creating a healthy appetite amongst buyers.

We may also be witnessing the start of a new acquisitive trend into 2019, as the 2018 list of automotive transactions saw the inclusion of three high profile tech businesses. In the second half of 2018, Cox Automotive and Auto Trader UK entered a joint venture arrangement which resulted in the development of Dealer Auction, the new digital marketplace for wholesale vehicles. This was followed by Aston Barclay's acquisition of The Car Buying Group, one of the UK's largest consumer car buying companies. And finally, with a name we weren't expecting to see in the list, eBay bought Motors.co.uk to strengthen its online car sales offering through Gumtree. Read more about our view of online dealerships as the potential new retail model on page 8.

Our predictions for 2019

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 2019:

- Transaction activity from medium sized groups to continue at the higher levels seen in 2018
- A more balanced supply and demand position amongst smaller businesses in the sector during 2019, following the acquisition of some slow sellers during last year
- A continuing appetite for the value brands, in particular Kia - as seen through 2018 - and Suzuki, due to its heavy concentration on petrol models and low franchise investment requirement
- A resurgence of franchise growth from the PLCs, with the exception of Pendragon who currently appear more focused on used car sites
- More mid-sized groups looking to launch used car sites for the resale of their part-ex vehicles

The road ahead

The most significant volume of activity this year is likely to come from the mid-sized groups. A run of strong performance over the last seven years has provided them with a 'war chest' of funds to go to market and fulfil their aspirations for further business growth.

Single site brands continue to find it increasingly difficult to operate without a change in modus operandi. Not only has the level of competition become fierce, but the increased compliance impacting the sector, from the constraints of GDPR to the convoluted requirements of the FCA, means compliance has become a costly exercise. For these businesses, the only route available is often the outsourcing of the work without the internal resource to manage the processes themselves. And with more mid-sized groups looking to grow, these one or two site businesses will become a welcome hunting ground.

The motor trade's top performing businesses: five key things they do well

Our automotive experts are regularly crossing the thresholds of the UK's leading dealerships and believe that there are a number of key areas in which the top performers all excel. In this article, we outline the five areas which we believe deserve real focus from automotive business owners and their senior leadership teams.

1

Think about presentation from the customer's perspective

Disappointingly, we frequently see levels of presentation within dealerships falling short of the 'expected standard'; and by 'expected' we mean in relation to customers' expectations, rather than that of the brand or local management team.

The motor trade requires a commitment to presentation in-line with, or possibly ahead of, the rest of the retail sector. When looking at some of the High Street's leading retailers, taking John Lewis as an example, stores are well-stocked, well-presented and well-staffed, and that becomes the standard through the customer's eyes.

The best performing automotive sites have a different level of attention to detail regarding presentation, with those who do it well instilling a discipline of walking the site weekly with their management team and viewing the site and the experience through the customer's eyes. Those who do this, and implement the necessary changes, manage to present even the oldest of buildings and a tired corporate identity well.

2

Develop a used car stock strategy

Businesses with a robust but not onerous stock ageing policy always fare well. Good sales managers understand that the quicker a used car is prepared for display and offered for sale the quicker the car will be sold and the greater the return is likely to be.

Ensuring time is planned into the workshop, valet bay and smart repairer seven days ahead of arrival date will ensure the car is advertised and up for sale within a week of arriving, and hopefully sold quickly after that. Where we have witnessed poor used car returns it is frequently the case that they are either not prepared correctly, ie. still showing signs of damage, often resulting in questions from prospective buyers around the potential for discounts, or we tend to find they have been sitting in stock for two to four weeks before even being displayed.

3

Operate a used car depreciation policy

It is imperative that used stock is revalued at the end of each month, and every business should have a clear policy on this. Reducing the Stand in Value (SIV) to CAP clean, for example, and taking the balance to a cost line in the profit and loss account keeps things 'tidy' from a financial position, but it also brings two positive operational benefits which should not be overlooked. The first, it focuses the mind of the management team on getting the car prepared, advertised and sold as quickly as possible (see point 2 above). This increases returns; as a car sold in its first ten days will be more profitable than one sold after that point. It also obviously increases stock turn and, by association, significantly improves the return from the used car operation.

The second benefit is the focus it encourages within the sales team. Reward schemes often relate to retained profit in used cars, eg. 10% of retained Gross Profit Per Unit (GPPU). This can often be counterproductive and is generally to be discouraged, however, many businesses still reward sales executives in this manner.

An example: A used car has been in stock for 14 days, is yet to be prepped, and is booked into the bodyshop for the repair of a dent and scratches the following week. After that point, the car will go into the workshop for its pre-sale check, a service and then a valet. It is then likely that the car will not be imaged for another few days, possibly taking us into week five of the car being in stock.

The original margin was £1,000

Minus VAT, taking it to £800

but the car has adjusted in value so it has been decided to reduce the retail price by £250

Resulting in a price of £750

Less VAT £600

In this example, if a salesman is being rewarded on the retained GPPU, which is more attractive - the newer car into stock with the higher GPPU or the vehicle that has aged and no longer has as high a margin? If, however, the car's SIV was adjusted in relation to book at the same time as the retail price then the GPPU, which remains largely constant, means that the sales team do not 'turn off' on particular used cars because they have no money in them. Get this and the prior point right and you're onto a winner!

4 Market intelligently

When finances are tight, it is tempting to reduce marketing spend in response. But reducing this spend and activity is effectively reducing the opportunity to proactively develop new business and instead leaving it to chance. The best response is in fact to ensure that your spend and activity is monitored, analysed and adjusted according to the resulting returns.

Marketing and business development activity is often broad-brush, rather than focused, making it expensive and hard to gauge the return. Ensure your activity is targeted, and track each and every penny spent in order to understand and justify the ROI. Use marketing intelligence tools to track conversions on emails, live chats and telephone calls and use Google Analytics to aggregate data. Those who do it well do it intelligently, and see huge success – regardless of the size of the business.

An example: A good sized business was spending £70K per month on paid search terms on Google. When asked what defined success, the owner responded that it was related to the number of leads generated by the spend. When asked if he was satisfied with his investment he replied 'yes'. When asked how happy he would still be if there was evidence that only £45K of the spend was responsible for driving 100% of the leads, it was clear that there was work to be done and the opportunity to cut costs yet receive the same return.

It is possible to invest in intelligence either through your own resource or through a third party. It is important to continue to invest in your marketing in order to drive opportunities to the business, but ensure that the spend is channelled in the places that generate the best ROI.

5 Review and control costs

Since the austere recessionary period from 2008, where the majority of businesses took a hard look at costs, we have seen investment slowly increase back to pre-recession levels, if not higher. But the investment is being directed in a somewhat adjusted direction. Whilst manufacturers have their standards and requirements, encouraging additional headcount to inflate the consumer experience does not always deliver additional profit. 'Meet and greet' executives are great for the consumer experience, but do their returns ultimately justify their investment?

The key change we are seeing in the best performing businesses is the removal of non-core operations from the main retail outlet. The primary costs of running a main retail location are very high, so it is important that you ensure this location is used for purpose. If you can move central services, vehicle storage, staff parking, vehicle preparation etc offsite to a more cost effective local facility, this unlocks additional retail opportunity at the site to drive profits.

Sharing our insights

The UHY team meet regularly with both client and non-client motor trade businesses across the UK. We use these meetings to explore a combination of strategic and operational opportunities – some unique to the individual business, others which have been seen across the sector - as well as responding to the specific challenges the business is currently facing to help optimise it for the future. We have access to a specialist database of relevant professional contacts, including dealer groups, manufacturers, captives and banks, and use our network to effect introductions and bring relevant opportunities. As well as sharing commercial opportunities, we share intelligence on industry developments and will give a full and forthright view of the strategic value in any decisions under consideration.

Whether you require a meeting to brainstorm our views on the market and competing brands, advice on how businesses are dealing with matters such as FCA compliance, the Criminal Finance Act 2017 and GDPR, specific targeting of potential opportunities or you require assistance to manage your historical tax exposures, our team can help. We can also provide expert insight in how to present your balance sheet in the best possible light to maximise stakeholder support, particularly for fund raising. To arrange a meeting, contact your local expert, detailed at the back of this 2019 Outlook.

Experts' Perspectives: what lies ahead for the sector?

We asked a panel of industry experts for their insight on the outlook for the automotive sector through 2019 and beyond. Here are their views on some of the issues being discussed at our meetings with the sector's business leaders and advisers.

Commentating on the market were:

David Kendrick
Head of Automotive
UHY Hacker Young

Paul Daly
Automotive Partner
UHY Hacker Young

Daksh Gupta
CEO
Marshall Motor Holdings plc

Mike Allen
Head of Research
Zeus Capital

"When you see the retail sector come under pressure, you see operators focusing on the management of stock far better than before."

Daksh Gupta, CEO
Marshall Motor Holdings

Our data has shown ongoing growth in stock levels in recent years up to 2017. Our view during 2018 was that, following the introduction of WLTP, there has been a significant reduction in both new and used stock levels sat on dealer balance sheets. What are your views and how do you expect stock levels to change through 2019?

All of our panellists were in agreement that the high stock levels seen on dealer balance sheets running up to 2017 certainly reduced during 2018. David Kendrick, UHY's head of automotive, went as far as to say that "the impact of WLTP hit stock levels hard last year." While all agreed that the impact of WLTP would have played a part, other reasons were also offered for the slump. Daksh Gupta of Marshalls believes many took proactive measures to manage their new and used car stock in response to the forecast drop in new car sales ahead of the start of the year. Daksh said "when you see the retail sector come under pressure, you see operators focusing on the management of stock far better than before".

The Brexit effect, with a weakened sterling, was also offered as a factor by most of the panel, including one of UHY's automotive partners, Paul Daly, who suggested there were lower levels of stock push from mainland Europe into the UK as a result and also following a recovery within other European markets. Mike Allen of Zeus agreed with Paul, and believes that the supply levels driven by OEMs will continue to be driven by foreign exchange rates, which remain uncertain and under pressure. Mike suggests that the trend for 2019 would be for "further investment into desirable used stock if it can be found at the right price". Daksh believes that certain brands will continue to be affected through 2019, particularly in light of the introduction of RDE2 this year, but foresees "a more normalised position for the sector, albeit it's still unclear on what the impact will be."

Paul Daly highlighted his frustration surrounding the lack of real-time information on balance sheet trends within the sector. With most dealerships having December year-ends, many accounts are not filed until June of the following year, leaving everyone "blind to current year trends". He cites that "most of the focus appears to be on profit and loss based metrics" and suggests that "it would be a really helpful barometer of financial health to also have a source of up-to-date balance sheet or liquidity data".

Is a shift in the dealership model to online retail a reality?

There was a real consensus amongst the panellists in response to this question. All acknowledged that the move toward a more online purchasing process is real, and has been developing for some time, but they were also in agreement that there is little likelihood of the majority of purchases moving entirely online; Daksh believes only a "very small single digit percentage" would prefer to buy that way.

All of the panellists believe the sector will continue down the omnichannel route to market, with three citing the consumer preference for a 'bricks and clicks' purchasing process; as Mike indicated, "consumers still require a test drive/brand experience as part of the wider purchasing journey" and David believes that with many purchases often involving a part-exchange, and with the newly purchased car still requiring servicing and ongoing maintenance "the long term future of the dealership will continue to be important."

But further digitisation of the customer experience, which all panellists believe is a reality, will also result in a "reduction in the number of physical retail outlets" believes David, with Mike suggesting that "the large, well-invested sites will survive."

Paul Daly flagged his concern around the "need for a fundamental change in the way dealer rewards operate." He feels there is much focus on the customer journey from online into the physical dealership, but little commentary around the reverse whereby a customer spends time in the dealership before ultimately placing their order online via the manufacturer's website. He wants more thought and development around the way dealers are rewarded in these scenarios.

With Brexit on the horizon, how are you preparing or seeing clients prepare? What are you doing differently, if anything?

We were keen to hear how Marshall Motor Group had been addressing the uncertainty thrown up by the referendum decision, as one of the UK's leading publicly listed car dealer groups. Daksh told us that the group have adjusted their position since Brexit became a reality, and have been cautious with investments. He said "From 2008 to 2016 we had bought and sold 140 businesses through multiple transactions, but since then we have only completed two deals, a small acquisition in Leeds and our recent acquisition of the Sandicliffe Motor Group's Skoda franchises, announced at the start of February. We have been very consciously protecting the business given the economic and political uncertainty. In addition we have been investing in the group's property portfolio for future growth in a number of brands. We are in a strong position now, and currently debt free – and it is important that this continues for everybody involved with the business. We will continue to maintain strong stewardship of the company."

Mike shares the same feeling that "PLC dealers have been working on cost efficiencies for at least 12 months, and have been getting their respective businesses in the best shape possible to help offset continued inflationary cost pressures, such as people, property and rates". Paul Daly confirms that this 'best practice' cost control is important, as well as ensuring "there is plenty of 'wool on the back' of the business in terms of liquidity and resources so that any downturn does not place undue pressure on the business."

David Kendrick also indicates that the focus for most businesses should be on delivering a strong 2019 Q1 performance. He has a level of frustration geared to the negative press that has been surrounding the market, saying "the press stir that has been created is far from helpful for any business." He also referenced the highly reduced share prices within the automotive PLC businesses which have restricted an element of activity.

All panellists agreed that the ongoing Brexit uncertainty had resulted in a level of caution amongst consumers, causing many to hold off their purchasing positions. Looking forward through 2019, however, Daksh believes there could be "latent interest and a surge of people who move to make purchases post-Brexit."

> "Consumers still require a test drive/brand experience as part of the wider purchasing journey"
>
> **Mike Allen,**
> **Head of Research**
> **Zeus Capital**

> "For many years, the sector has been expecting the used car bubble to burst yet, so far, reality has not met with expectation."
>
> **David Kendrick**
> **UHY Hacker Young**

What are your predictions for the shape of used car sale values over the next 12 months?

Again, this was another area on which our panellists were unanimous in their views. All saw 2018 as a robust year for used cars and are confident that this position is set to continue through 2019.

Mike highlighted that this will certainly be the case if the new car market remains "weak and clouded with consumer and economic uncertainty". David added that WLTP will have further assisted the buoyancy within the used car space. He said "for many years, the sector has been expecting the used car bubble to burst yet, so far, reality has not met with expectation". David points out that dealers will need to keep an eye on their used car stock and stock ageing, particularly if things take a turn for the worst, as they will need to be able to move quickly to avoid a significant loss position.

The sector has seen a drop in share prices amongst the leading businesses – what is your view on the reasons behind this slump? Do you foresee any change in investor appetite from City institutions for the sector moving forwards?

David highlighted his bewilderment at current automotive PLC share prices, saying "We have some very strong and well run PLCs in the UK automotive industry and the market cap of some of these businesses just doesn't make sense. Whilst the sector works on tight margins, many businesses have very strong balance sheets, backed by a healthy property portfolio – and generally in prominent retail locations." David thinks there is a nervousness in the City regarding retail generally, and in response to the negative press surrounding some of the automotive megatrends and that this is affecting the appetite of City investors.

Paul Daly believes that the pricing within the sector is effectively a reflection of an anticipated significant and sustained downturn in either trading, property values or both, with some of the PLCs having a market capitalisation below their heavily asset-backed balance sheet value. He believes "we are in a perverse situation where liquid shares trading on a recognised exchange are valued below what could currently be achieved in a private trade sale." As a result, he believes a recovery in share prices will eventually take place, although the ability to predict when is close to impossible.

Speaking as the CEO of an automotive PLC, Daksh shed some light on what he believes has caused the slump in share prices. He said "It's fair to say the sector has seen significant erosion in key multiples. Pre-Brexit, Marshall Motor Group was trading on double digit multiples – 10 or 11 times. Within months of Brexit, those multiples were down to 5 or 6 times. Our share price has not decreased in the same way, however, as we have been able to sustain profits through acquisitive growth."

"If you look at the sector generally, share prices have dropped around 40 or 50%, but that is not in line with earnings, it is more a result of sentiment surrounding the sector. If you look at the issues that have been impacting recently, and the resulting hype surrounding them, there have been numerous reasons not to invest – Brexit and the emissions scandal as examples. The same questions arise in every investor meeting that I go to."

Mike injected some positivity to the discussion by adding "investors recognise that current valuations are close to trough levels, with market values heavily asset backed. With capital expenditure levels also easing after a couple of years of heavy investment, we have flagged already to investors that cash flow yields are starting to look very interesting. That said, most require more earnings certainty before investing into a recovery cycle."

And ending on a positive note, Daksh gave his summary of the state of the market, saying "In my view, the crash and doomsday scenario that people have been predicting just hasn't happened. 2018 was my tenth full year as CEO of Marshalls and over that period we've had record results, including during 2017, and we expect the same for 2018.

We had our after-sales conference recently which confirmed that there is so much still for our businesses to go at. There is always lots of opportunity to improve, and that is what we have focused on in the last year and will continue to focus on through 2019. People are still making a profit and much of this success is attributable to a positive mindset."

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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**.

UHY Hacker Young
Chartered Accountants