UHY Hacker Young
Chartered Accountants

Automotive outlook 2022

Predictions for the year ahead from our specialist automotive team

driving your profit

Helping you prosper

With the evolution of EV and moves towards the agency model, what's in store for 2022?

Contents

State of the market

The last two years have clearly been one of the strangest periods of trading for all businesses and this has certainly been the case in the motor retail sector.

Dealers have been forced to contend with not only a global pandemic and various lockdowns, but also a global shortage of semi-conductors and other raw materials, both of which have had a profound impact on the market. Yet despite this backdrop, 2021 was a year like no other! From record profits to a surge in transactional activity, when we issued our 2021 Outlook at the end of the Q1 lockdown, none of our experts had predicted quite what would follow.

Throughout 2021 we saw unprecedented levels of consumer demand. However, with supply shortages resulting in new car registrations falling 28.7% below pre-Covid levels according to SMMT data, it was very much the year of the used car overall. Record sales of used cars, offset against a background of limited stock levels, saw demand continually outstrip supply. This resulted in the UK reporting the biggest used car price rise increase in Europe with INDICATA reporting a 28% increase in the first 11 months of 2021.

So have supply shortages been a good thing for motor retail? For the majority of our clients, the answer is yes. For years, the UK automotive retail sector was widely characterised as suffering from chronic oversupply. From pictures of vehicles stockpiled at the docks and airfields, to wading through pages and pages of consigned vehicles on a dealer's floor plan statement, to seeing row upon row of pre-registered vehicles, all the tell-tale signs were there.

Covid-19 arrived and factories shut down, supply was constrained and registrations hit a 10 year low. It could have been a disaster for the industry. Paradoxically the shortage of vehicles, alongside government Covid-19 support measures, meant dealer profits were considerably better than normal for the vast majority, with improved margin retention outweighing the volume shortages. And, in addition to much improved margins, cash generation was strong due to the reduction in working capital from lower turnover and stock levels. For many, this resulted in 2021 being the most exceptional year of trading in recent memory.

As we move through the first half of 2022, we expect supply to remain constrained with dealers continuing to enjoy strong margins. Electrification and semi-conductor shortages are likely to continue to impact the new car market in the UK in the short to medium-term and we do not see new vehicle production starting to normalise until the latter half of 2022 at the earliest. But will we go back to the bad times of having too many cars and not enough customers? This is a question we ask our panel of experts in our interview on page 19, and we received an interesting mix of replies.

With the traditional dealership model looking set to embark on a period of transition over the next ten years, its future continues to be questioned. The pandemic has generally accelerated the pace of change towards online sales and there are a number of disruptors (most notably Cazoo and Cinch) who are looking to establish themselves in that space, with significant investment backing. For a number of years, manufacturers have been typically looking to rationalise their network size, including moving to a 'hub and spoke' concept. The termination of the entire franchise network by Stellantis, announced in May 2021, is a good example of the changes that are taking place.

The move towards electric vehicles by 2030 creates further uncertainty around the back end of the dealership model. The significant investment required by all manufacturers is leading them to investigate the distribution model with a view to streamlining and eliminating excess cost. This looks set to result in a significant change to the way in which new vehicles are sold, with the introduction of the agency model looking increasingly likely. And as the electric vehicle parc grows, the opportunity for aftersales inevitably diminish. At the same time, the changing technology will require significant investment in facilities and training. Smaller and more marginal locations will be unlikely to make this investment, certainly in the short to medium term.

From the evolution of EV to the potential move to agency, it seems we are entering a defining period for the sector over the medium term. Whilst this backdrop creates uncertainty and makes it difficult for businesses to plan, following an exceptionally strong year of cash generation during 2021, we are confident there is a solid platform to build 2022 into another good trading year and we remain positive in our outlook for the industry.

> **"We are entering a defining period for the sector over the medium term"**

Roadmap to our Outlook

With surplus cash and strong trading encouraging dealers to look at growth prospects, 2021 led to a general increase in buying appetite for motor retail businesses, with some headline grabbing deals being concluded. We shine a spotlight on the 2021 transactions market and share our predictions for 2022 and beyond on page 3.

Several vehicle manufacturers have announced a shift to an agency model for the sale of new cars in the UK, but what is agency? Our experts consider the complex dynamic of the model, discuss what it could mean for your dealership and consider the potential financial implications on page 5. We also hear from Iain Larkins, founder of Radius Law, who considers the legal aspects and reasons for shifting to agency.

The experts at Auto Trader have also contributed to this year's Outlook, sharing their thoughts about the key trends impacting the new and used car market and what may be next. The platform saw an average of 64 million cross platform visits in 2021, marking a 15% increase on the prior year. With the volume of leads delivered to retailers in 2021 also seeing significant growth, increasing 20% on 2020, and 62% on pre-pandemic 2019, the article on page 11 is a must read for all dealers.

And of course, we can't plan for 2022 without considering the tax planning opportunities. Our UHY tax experts outline the available tax mitigation options on page 13 and shine a spotlight on how dealers can benefit from R&D tax relief on page 15. We also hear from tax specialist, Alastair Kendrick, who considers what you can do from an employment tax perspective to embrace the electric revolution on page 17.

Finally, we once again have asked a panel of automotive experts for their views on how the landscape is likely to look for the sector through the rest of 2022 and beyond. Commenting on the market were UHY automotive experts, David Kendrick, Paul Daly and Ian McMahon, Mon Motors Group Finance & Commercial Director, Roger Moore, Williams Group Managing Director, Guy Adams and Head of Research at Zeus Capital, Mike Allen. Read our Experts Panel debate on page 19.

We hope you find real food for thought in this, our 6th Automotive Outlook. If any of the topics covered prompt any questions, you will find our contact details on page 28 – our specialists will be pleased to assist and we look forward to hearing from you.

Electrification and semiconductor shortages are likely to continue to impact the new car market in the short to medium-term

The current and prospective transactions market

With lockdown upon us during the first quarter of 2021, it was a very uncertain and strange period for the sector; who could have predicted the following nine months of trading to follow? Record profits, cash balances higher than ever and dramatically reduced stock levels on balance sheets led to a surge in transactional activity.

Despite the uncertainty as we moved into 2021, transactions continued to progress. Although no deals completed during the Q1 lockdown, the remaining months of 2021 saw activity intensify with some headline-grabbing deals concluding by the end of the year.

The headlines

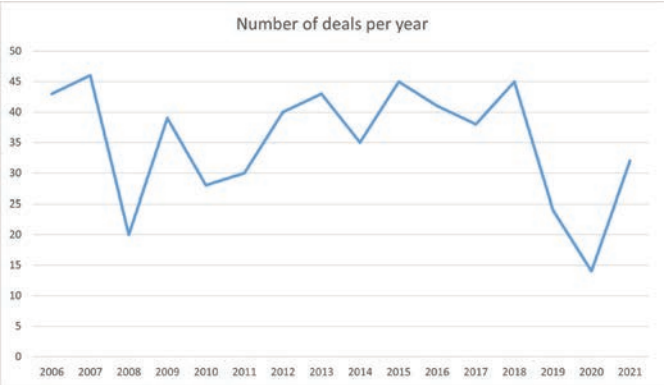
2021 at a glance

- Transactional activity started slowly however, in the nine months from March 2021, 32 deals were completed. This is at a level close to that of 2018, demonstrating a real demand for expansion from many businesses.
- Two headline-grabbing deals completed; with Cambria being taken private off the AIM market and the significant acquisition of Motorline Holdings by Marshalls.
- The disruptor eyes up retail entry with Constellation (Cinch and BCA) agreeing the acquisition of 64.4% of Marshall Motor Holdings PLC, likely to complete in April 2022, also taking them private. A deal no one could have predicted.
- Strong international interest remains with several new international investors appraising UK acquisition opportunities.
- Goodwill is very much back on the agenda, and significant sums paid in a number of the deals completed.

Outlook for 2022

- Potential for big deals in 2022, with businesses delivering record performances in 2021 and a significant pent up demand for acquisitions.
- Regional consolidation looks set to accelerate with acquirers sat on large cash balances and smaller operators considering an exit off the back of 18 months strong financials and a healthy order bank moving forward.
- Continued activity within the auto tech market is likely, with a significant number of deals completed during 2021 and a number of pipeline deals currently.

Deal volumes and trends



Post Q1, deal activity was back to historic levels and we anticipate levels will exceed this in 2022. With 2020 being a strange trading year, but profitable in the main for most dealers, 2021 was nothing short of record-breaking! This two-year performance and promising outlook for 2022 has seen a surge in the average deal value as well as substantial goodwill payments being made for businesses.

Multiples do not appear to have changed dramatically; however, the values that are used to calculate the average profitability, coupled with the forecasts for 2022, are leading to substantial valuations in the main.

With businesses enjoying lower stock levels than normal, significant margin increases and a general upturn in profitability, cash availability has never been so strong, increasing interest in opportunities and driving values upwards as a result.

"we envisage deal numbers will reach the highest levels seen during the past decade"

The outlook for 2022

Big deals in the offing

With record profits likely to be reported by many for YE 2021, international interest stronger than ever and PLCs in buying mode, now could be the time for some of the privately owned larger groups to make their move. Motorline was one of the first in Q4 of 2021, but it would not be surprising if others follow suit. As ever, timing is everything.

Cazoo to follow Constellation?

With the Constellation acquisition of Marshalls looking very likely to complete and manufacturers uncertain how to react, would it be unthinkable for Cazoo to follow? Rumours have been circulating for some time, and with the war chest behind them, almost every group could be a potential target.

Regional consolidation

Towards the end of 2021, we saw a number of smaller dealerships swallowed up by the PLCs and regional groups looking to expand. After a couple of years of good profitability, privately owned one to three site businesses may be well suited to a larger player that can benefit from economies of scale and fit in with the longer-term network plans of their manufacturer partners. We predict an upsurge in 2022 and are having numerous conversations with dealers considering an exit; providing substantial opportunities for those looking to grow.

Distressed opportunities

With profitability having been so strong for 18 months, cash balances in the main higher than ever and a lack of supply meaning strong margins and little pressure on dealers, it is unlikely that we will see any distressed opportunities in 2022. Should supply return significantly in the latter part of the year, dealers will need to keep a close eye on working capital which will undoubtedly tighten, potentially bringing the odd distressed opportunity; however, we do not envisage many, if any.

As 2022 unfolds…what's ahead?

With an increasing number of transactions in 2021 and a very strong pipeline and active marketplace as we have entered 2022, we envisage deal numbers will reach the highest levels seen during the past decade, with some strong valuations also likely.

Some dealers have concerns regarding the future of the sector and agency agreements. Others are very bullish and moving with the times, taking advantage of strong market conditions. Both suggest there could be plenty of activity over the next 12-24 months.

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 privately owned businesses look to liquidate their investments after a couple of solid years trading, as well as some much larger groups taking advantage of the consolidators and international entrants looking for a substantial acquisition.

The agency model: is it the future of automotive retail?

The prospect of significant changes to the way in which new vehicles are sold has been worrying car dealers for a number of years now, and experiments in other countries such as Australia and South Africa are bringing that threat to life.

With Mercedes Benz informing their network that both Mercedes and Smart retail sales will take place on an agency basis from 1 January 2023, the time has come to see how the UK market stands up to the changes and inevitable disruption that will result. In this article, UHY automotive partners, Paul Daly and Ian McMahon, along with Radius Law founder, Iain Larkins, delve into the detail and provide their thoughts about where the agency model may take us.

What is agency? The legal side

There are different legal definitions for different laws but generally an agent is defined as:

'a person [or company] .. with the power to negotiate and/or conclude contracts on behalf of another person [or company] for the sale of goods or services.'

Perhaps the most important part of that definition is that the agent is negotiating **on behalf of** another person or company. Today, most automotive franchised retailers buy new vehicles from the manufacturer and then **re-sell** the vehicles to end-customers. Under agency the retailers would not buy the new vehicles, they would sell them on behalf of the manufacturer.

It's also worth distinguishing agency from manufacturer **direct** sales. Large fleet sales are usually direct sales by the manufacturer, although confusingly are often referred to as agency sales. In large fleet sales, the retailers are not usually involved in negotiating or concluding the sales and their duties are normally limited to PDI and handover services.

The table below summarises the different distribution models.

Why the change?

There are lots of reasons for the drive towards an agency model. One of the most cited reasons is price control.

Our UHY team believe the change is quite simply because of manufacturer concerns that the significant costs of developing new EV architecture (and battery unit cost) will not be recovered from a consumer who does not want to pay any more money. Driving cost out of the distribution channel, especially when considering the additional potential benefits of digitisation of the process, is the major influencing factor to help maintain future manufacturer profitability.

From a legal perspective, Iain Larkins explains that under the traditional franchise model, it is generally unlawful for the manufacturers to dictate sale prices – the pricing decisions must be left to the retailer. This is to ensure there is a healthy intra-brand price competition.

Any attempt by a manufacturer to control the price is likely to breach the law and expose it to huge fines and even prison sentences for those directly involved.

We have all seen the impact of intra-brand competition – with new car prices tumbling particularly with the rise of price comparison services. In a **genuine agency** model, manufacturers may control the selling prices and therefore eliminate intra-brand price competition overnight.

It's worth noting here that this does not necessarily mean that the consumer will be subjected to higher prices. With the increasing trend to lease or PCPs and higher residual prices driven by the manufacturer price control, it's likely that total life cost will not increase. Of course, there will also be healthy inter-brand competition.

	Agency	Direct sales	Franchise
Who sells to the customer?	Brand	Brand	Network partner
Who negotiates the sale?	Network partner	Brand	Network partner
Who sets the retail price?	Brand	Brand	Network partner
Who bears the risks?	Brand	Brand	Network partner
Who bears brand specific costs?	Brand	Brand	Network partner

In this table we have referred to the manufacturer as the Brand and the retailer as the Network Partner.

Iain notes that other reasons for shifting to agency include:

- **To make the business model fit for the future**. Undoubtedly buying habits are changing because of the growth of digital sales, the transition to electric and consumer interest in multiple mobility solutions. Whether agency is the answer to these changes, remains to be seen.
- **Data**. To give the manufacturer more access to the customer data.

What does genuine agency mean?

You may have noticed the words genuine agency model above. Iain points out that this is important as the manufacturers will only be allowed the benefit of price control if it is a genuine agency model. For the agreement to be qualified as a genuine agency agreement, the agent must not bear any, or bear only insignificant, risks. The risks can be categorised into three categories:

- **contract-specific risks** – risks directly related to the contracts concluded/negotiated eg. financing of stock
- **risks related to market-specific investments** - investments specifically required for the type of activity for which the agent has been appointed
- **risks related to other activities undertaken in the same product market** (if the manufacturer requires the agent to undertake those activities eg. aftersales services).

However, risks that are related to the activity of providing agency services in general (eg. risk of the agent's income being dependent upon its success as an agent or general investments in premises or personnel) are not relevant to the assessment of whether an agreement constitutes a genuine agency agreement.

Whether the agent is taking on a risk will be assessed on a case-by-case basis, taking account of the economic reality of the situation.

Will the planned changes to the block exemption impact the trend to move to agency?

There are two block exemptions that are relevant to the automotive sector, the vertical block exemption, and the motor vehicle block exemption. The former expires in May this year and the latter in May next year although expect a one-year transition period for each.

In short, the block exemptions make some allowances for practices that are considered to be in the best interests of consumers but that otherwise may be contrary to competition law. This includes allowing automotive manufacturers to limit the number of new car franchise partners.

Generally, the regulators consider that the block exemptions have done their job of providing a competitive marketplace for the consumer, so do not expect any significant changes and in any event the block exemptions are mostly irrelevant to an agency model. Nevertheless, there has been a promise of more detailed guidance about agency as part of the review of the block exemptions.

> **"Any attempt by a manufacturer to control the price is likely to breach the law."**

How will it affect your dealership?

With the odd exception of some of the smaller brands, it seems that almost all manufacturers plan to move to some form of an agency model in the coming years, affecting the vast majority of motor retailers.

What will the impact be?

There is still a lot of uncertainty about the impact, with the devil very much being in the detail of how each arrangement is going to be structured. However, from Ian and Paul's discussions to date, they believe the options being explored are as follows:

1. Genuine agency, as described above, where a relevant share of overheads are covered by the manufacturer, and a fixed handling fee or commission payable for acting as agent on each transaction. The key challenge with this option being how to calculate a relevant share of costs given there are other activities taking place in the dealership.
2. As above, but with the genuine agency only applicable to certain sales channels eg. BEV or corporate sales.
3. Alternative arrangements where the full legal criteria for an agency agreement has not been met. UHY envisage this being a popular option in the UK. A typical structure would be:
    - A handling fee will be payable on each sale which may be a fixed amount or based on a fixed percentage of the retail price of the vehicle. The retailer will potentially be able to discount some of this percentage into the customer deal/manage the part exchange valuation as well as retain the opportunity to sell finance and other additional products.
    - New vehicle stock will be retained by the manufacturer meaning that risks associated with slower moving stocks as well as stocking charges will be avoided by the retailer.
    - Demonstrator fleets will be provided by the manufacturer (or managed on their behalf by a third party).
    - There are differing approaches to used cars, with some planning to allow retailers to retain control whilst others (eg. as BMW have already implemented in South Africa) control availability and pricing of cars up to say 1 year old.
    - New vehicle advertising and costs will become centralised, as campaigns are carried out by the manufacturer on behalf of their network of sales outlets.

Overall, our UHY experts foresee a material reduction in the level of margin being offered by the manufacturers, albeit balancing this will be a reduction in costs and discounting.

Inevitably there will be winners and losers as retailers move over to the new model.

Ironically, the impact of the Covid-19 pandemic may well have right sized the headcount in many dealerships and the advances made in digital transactions and interactions should assist the network towards the agency transition.

Location and premises

A retailer operating in a wealthy affluent area that has previously suffered from other competing dealerships pumping vehicles into territory may now find they can enjoy the full benefits of their location. On the flip side, businesses that are in secondary locations and rely on pumping vehicles out may suffer, or even no longer be viable under the new agreements.

The control the manufacturer can exert on the dealership corporate identity (or visual identity) should become more limited, with corporate/visual identity guidance only being applicable to the new car display areas.

Although the process of bringing new vehicles to market may well differ, many networks will have an existing blend of facilities:

- Those which have been invested, designed and constructed pre-agency.
- Those for which the corporate identity spend may be reduced, as dealers seek to balance the investment with the available return of a fixed margin sales arrangement.

We have seen examples of some premium brands reducing the size of the facility requirement in recent years, partly driven by the availability of digital media allowing the configuration of vehicles in a high-resolution format, but also in willingness to allow some market areas to operate with a 'hub and spoke' structure.

Employees and colleagues

Another big potential change is with regard to staff. Will the days of the highly rewarded and commissioned new car salesperson be numbered? Instead will we see a focus on a generation of 'product geniuses' in the style of an Apple or Tesla store?

Certainly, the training and development of these individuals may well be provided by the manufacturer, or even 'implanted' into the dealership environment to fulfil the order taker role for the new car sales.

Changes to the dealership planning and financial model

Historically, dealerships would be seen as four or five business units under one roof.

- New Car Sales
- Used Car Sales
- Service Sales
- Parts Sales
- Bodyshop/SMART repair/Vehicle Rental etc.

Naturally the assessment of performance of these business units would happen between Sales and Aftersales.

One established health check for dealers has been Overhead Absorption which compares the direct profit contribution from Parts and Service (plus Bodyshop etc) with the fixed cost base. We often see strong performing dealers achieving in excess of 80%, and in some cases over 100% (so 80p of every £1.00 of their fixed cost is covered via aftersales income).

As retailers look towards the agency type new car sales arrangement, we expect more will identify that they have 'their business' being aftersales and used vehicle sales, and the new vehicle sales outlet, for which they have less control over.

As such, bringing used vehicle direct profit into this KPI would see an expectation that the fixed cost base should be covered pound for pound by the income generated by operations under the control of the dealer, leaving the new car agency income to be the icing on the cake.

Network structures

A shift to agency will still require the manufacturers to have a widespread, convenient aftersales network. We have already seen a shift to a more moderate 'hub and spoke' structure within some networks, acknowledging the importance of a footprint for aftersales above all else.

Whether the placement of sales outlets will be as vitally important in the future is to be seen, however the risk to a network of dictating to their customers on how they will buy a car needs to be cautiously assessed.

Typically, a customer will be more comfortable progressing more of the purchase journey for a new car online, than say a used vehicle; however, the risk of dictating the changes in this decision will be key to a brand maintaining relative market share. If the convenience of a customer is compromised by having to travel further to a new car sales outlet then, for many segments within the new car market, our UHY experts believe this will potentially see a shift away from brand loyalty.

What are the challenges going forward?

Radius Law's view

It will be fascinating to see how the agency model develops. Nothing is insurmountable but we do see some challenges, including:

- **Existing facilities** – Retailers have made investments in the existing facilities and some of those investments would, under an agency model, need to be funded by the manufacturer. If these retailers transition to agency, will the manufacturer pay for the existing investments?
- **Dual role** – Often the agency proposals seem to be piecemeal with a plan to move to agency for some but not all products, often for EV only. The regulators have expressed concern whether these so-called 'dual role' models (where a party is appointed as an agent for some products and franchise for other products) can be genuine agencies.
- **It's not just new cars** – We all know that used part-exchange cars are integral to the sale of new cars, but if the used car business is not included in the agency model then there will be challenges delivering a seamless buying experience to the consumer.
- **Terminating agents** - Under the franchise model, termination is relatively simple (at least in the UK) - a termination notice is issued and at the end of the termination period, the franchisee is terminated. Under agency there is a complex calculation for compensation payments.

We have already seen a shift to a 'hub and spoke' structure

UHY's view

Overall, we foresee that the consequences of agency (both intended and unintended) could be huge, with gaps in representation or unsatisfactory premises (eg. multi franchise v desire for solus) resulting for the manufacturer. Inevitably a strategy of sitting back to see how the implementation goes for competitors will be followed by some of the brands.

Whilst we are currently operating in a supply constrained new car market, we believe this situation will not last forever and over-supply will return to the UK market, particularly when account is taken of the rapid growth of brands like Tesla as well as potential new Chinese entrants into the EV segment.

Franchise retailers' marketing and sales skills have been a key facet in the armoury of managing this oversupply historically. Their expertise in lead generation and customer conversion should not be underestimated. Removing these skills is a risky strategy and we are yet to be persuaded of the expected cost savings, especially given the narrow margins that retailers operate within (and much of that margin is generated by used vehicles and aftersales).

Material cost savings in distribution can only really be generated by reducing the size of the network, but that brings (potentially unacceptable) levels of risk to the volumes that can be distributed for the manufacturer. It will be a bumpy road ahead as manufacturers seem determined to give agency a try, but we can't help but feel we might just end up back where we started once these experiments have played out through a full economic cycle.

Five areas of focus

1. **Review your existing sales and aftersales dealer agreements,** and closely scrutinise any new versions issued. Seek professional specialist advice if necessary.
2. **Look critically at the costs attributable to sales operations.** Do we know what the new car sales contribute?
3. **Be cautious of corporate identity spend** which encompasses both the sales and aftersales department, or be clear with your brand partner on the extent of the spend.
4. **Be clear on your new car opportunity in your area of influence.** Is the net of your 'pump out' volume and others 'pump in' positive or negative?
5. **Consider the practical changes of a shift to agency.** Will this change your staff profile for example? Will you need fewer sales executives and more product geniuses? How will new car agency influence how you operate your used car or aftersales business?

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Iain founded Radius Law in 2013 and leads its automotive practice – one of the largest dedicated automotive law teams in the UK representing automotive manufacturers, retailers, parts suppliers and trade associations. Prior to establishing Radius, Iain was the Chief Legal and Compliance Officer for the Mercedes-Benz UK Group. If you would like to know more about the legal structure of agency, please contact Iain on the contact details above.

Ian McMahon

Paul Daly

UHY experts Paul Daly and Ian McMahon contributed to this article. Ian joined our UHY automotive team in autumn 2021, bolstering the strength of our experienced leadership team. With over 20 years' experience in the sector, he specialises in due diligence, SME advisory, statutory audit, OEM and network studies, further enhancing our advisory and assurance offering to dealers and OEMs alike. Ian's contact details, along with Paul Daly's, can be found page 28 of this publication.

Be clear on your new car opportunity in your area of influence.

Auto Trader guest opinion: industry trends impacting the new and used car market

As consumer demand remains robust at the start of 2022 and used car prices continue to rise, we asked the experts at Auto Trader to share their thoughts about the key trends impacting the new and used car market and for their opinion about what may be next.

In addition to broader economic factors, Auto Trader are constantly monitoring the new trends, changing market dynamics and evolving consumer behaviors they believe will have the biggest short and long-term impact on the automotive sector. In this article, Richard Walker, Data & Insights Director at Auto Trader, considers the two trends he believes will be sat firmly at the top of the agenda for most retailers this year.

The transition to digital

Arguably the biggest change we've seen over the last 20 months or so is the shift in consumer sentiment towards online retailing. Outside of the automotive sector, 28% of all UK retail sales were being made online by the end of last year, which based on the pre-COVID trajectory wasn't predicted until the end of 2026 – it represents seven years of growth condensed into just two. It's quite remarkable and a strong sign of where automotive is heading. Indeed, we're already seeing plenty of our own evidence of this growing trend and the opportunity it represents for those automotive retailers embracing it. Not only did we see the volume of enquiries sent to retailers last year through our platform increase 20% on 2020 and a massive 62% on pre-pandemic 2019 (highlighting the growing digital mentality of car buyers), but in our consumer study of over 5,000 car buyers, 72% are now open to buying a car online.

Make no mistake, this shift online marks a massive transformation for the automotive industry and as 'digital first' retailers continue to grow their market share, online retailing will - or should - be viewed as a top priority for all automotive retailers, regardless of their size.

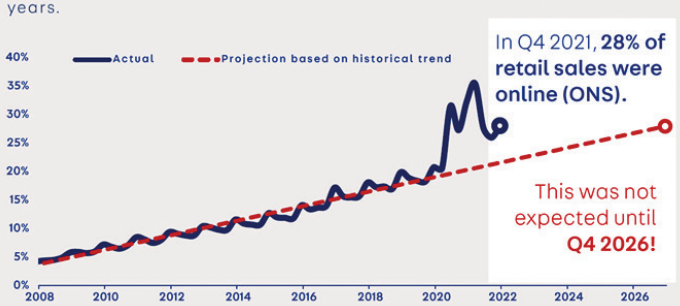
Based on what we're seeing, we have no doubt that the most successful automotive retailers in the coming years will be those that are able to cater for all buying needs and preferences, whether online, offline, or a blend of the two.

Rocketing used car prices

The other big trend that anyone would be hard pressed to have missed, is the recent rocketing of used car prices. Based on our Retail Price Index, which monitors over 900,000 pricing movements every day from the hundreds of thousands of used cars on our marketplace, as well as retailer websites, manufacturer websites and auctions houses, the average price of a secondhand car in January had reached £18,067. Quite remarkably, it marks a 31.3% year-on-year (YoY) increase, and the 22nd consecutive month of price growth. To put this figure into context, in January 2021 the rate of growth was at 8% YoY, which was a record, and by some margin.

This massive price growth continues to be fuelled by simple economics – high demand, and low supply. During 2020 and early 2021, used car prices were affected by very strong levels of consumer demand (driven in part by the aversion to public transport and strong household savings), coupled with the ongoing constraints in used car supply. However, in May 2021, just as the market returned to some semblance of normality following three months of physical showroom closures, the world-wide supply shortage of semi-conductors hit new car supply very hard and with quick and deep knock on effects on the used car market. With record levels of used car demand surging even further, as reflected in the 27% increase in monthly visits to our marketplace (circa 65 million per month) versus 2019, the gap between demand and supply widened even further. The effect was a rapid acceleration in price growth; so much so, that we saw five years-worth of price growth condensed into just seven months.

COVID had an immediate and lasting impact on consumer behaviour, with years of digital acceleration occurring in just months. At the end of 2021, 28% of all UK retail sales were online, representing 7 years of growth in just 2 years.



Highlighting just how strong this recent price growth is, more than one in five (21%) of the nearly new cars currently available (those aged up to 12 months) are more expensive than their brand-new equivalents. Nearly half (46%) are priced within 5% of the RRP. The reason for this previously unheard-of phenomenon is down to the same dynamics affecting the wider used car market ie. very high demand – in this case from car buyers unable or unwilling to wait for a brand-new car to become available – coupled with very low supply.

What's next?

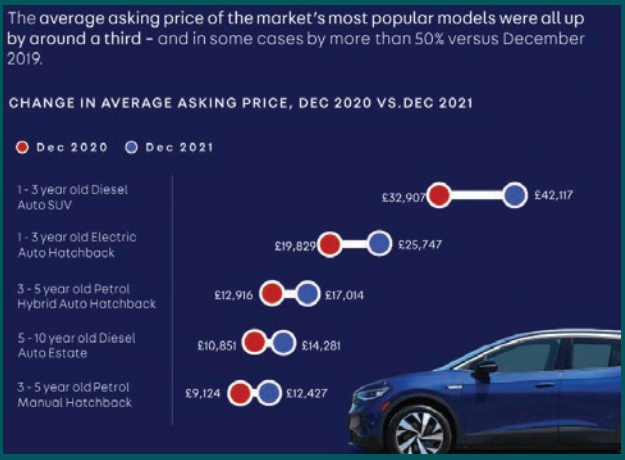
The question is whether these unique market dynamics can continue? Well, from what we're tracking, the answer is a resounding yes. Demand will be driven by a growing economy and a robust jobs market, as well as an increasingly positive sentiment towards car ownership, a growing number of younger drivers coming into the market and a backlog of circa 1.5 million missed sales. Coupled with the fact new car supply challenges will continue until at least mid-2022, any speculation that these dynamics, and therefore used car prices, will change significantly anytime soon, is simply incorrect.

It's careful consideration of these dynamics, as well as potential headwinds, such as growing inflation (our analysis shows inflation has had limited impact on used car transactions historically), which have shaped our predictions.

Based on the latest economic projections, our modelling calculates that with unconstrained supply, we'd see circa 2.4 million new car sales in 2022. However, supply will ultimately dictate the new car market, so given the current outlook for microchips, we estimate sales will be just under 2 million sales. It's an increase on 2020 and 2021, but frustratingly not as strong as it could be.

Fuelled by continued levels of demand and boosted by would-be new car buyers, we expect a far stronger recovery for the used market, with transactions close to 2019 levels, between 7.71 and 7.95 million.

As the last two years have shown, market conditions can change very quickly, but as long as there are no significant disruptions to trading, we're confident in these predications and, moreover, have plenty of cause for a positive 2022 outlook.



Richard Walker
Data & Insights Director
Auto Trader

Richard looks after Data and Insight at Auto Trader, overseeing the company's Enterprise Data Warehouse and Real Time Data Capability, both of which are used to present performance data to customers. He is also responsible for the analytics function that analyses data in order to share insights and recommendations across the business and to customers. Having been with Auto Trader for 20 years, Richard has a range of experience, which includes roles in the UK overseeing the organisation's research activity, and heading up the Market Intelligence function.

To read other insights from Auto Trader, visit https://www.autotraderinsight-blog.co.uk/

Planning for tax hikes - what are the options?

The taxation world in the UK is currently one of impending rises through the publicised hikes in National Insurance from April 2022 and corporation taxes from April 2023. But there remain planning opportunities in place surrounding Capital Allowances, Research and Development tax credit claims (see the article overleaf for more detail) and also with the timing of expenditure.

The planned tax rises

National Insurance rates will increase from 6 April 2022 by 1.25% across the board of all classes of National insurance. Employees will pay more under Class 1, and employers will pay more under Classes 1, 1A and 1B. The employee rises will mean less money in monthly pay packets. The employers' rises, while a cost to the employer, will also be available for Corporation Tax relief and represent a 1.01% increase in real terms.

Class 1 National Insurance will be payable on the employee's salary, whilst Class 1A and 1B is payable on the employee's expenses or benefits. This may be a good time, therefore, to review the benefits you provide to employees to see if any alternatives that do not trigger a Class 1A or 1B liability are available.

The Corporation Tax main rate will increase from 1 April 2023 to 25%, applying to profits over £250,000. A small profits rate of 19% will apply to companies with profits of £50,000 or less, and then we have a return to a marginal relief calculation for those companies with earnings between the £50,000 and £250,000 levels. This sort of calculation was last seen in the Financial Year 2014.

Businesses that are not run through a corporate structure are still taxed at the 20% / 40% / 45% Income Tax rates and, as far as we are aware at present, there are no indications of this changing in the future.

Available tax mitigation options

Any successful business must make profits, but with profits come tax, so you need to consider the best options to get the balance between profits and tax correct.

Reinvesting within the business gives the entrepreneur one option at tax mitigation. Capital Allowances are available to all businesses on assets acquired in any accounting period on equipment, machinery, business vehicles and, to a certain extent, commercial property acquisitions.

There are a myriad of rates, timescales and conditions applying to each category of allowance and acquisition, so professional advice should be sought before capital expenditure is incurred to ensure that you correctly understand what rate of allowance will be available.

The relatively significant change in Corporation Tax also opens up the possibility of planning when expenditure of a revenue nature should fall. Currently, any revenue expenditure incurred by companies will attract a 19% Corporation Tax rate of relief, whereas, after 1 April 2023, this will attract a 25% rate of relief. If you can defer discretionary, non-essential expenditure until after April 2023, you will attract a higher rate of relief on that expenditure. For example, can non-essential repairs or staff bonuses, if normally paid in March (and following discussion with staff), be deferred until April?

Not necessarily easy to accomplish, but can sales be accelerated so that they are achieved prior to 31 March 2023 by means of advertising campaigns, discount offerings etc.

The next two to three years will be challenging for business owners as they look to recover from the pandemic whilst the government look to fund the national debt arising from it. However, each change in taxation announced does provide an opportunity for business owners to plan, so make sure you are doing so!

Smart advice on corporate tax planning can help you achieve very substantial benefits. If you would like to speak to one of our tax specialists, please get in touch using the contact details on page 28.

The table below provides information on the current rates across a broad spectrum of allowance categories

	Plant & Machinery						Structure & Buildings
	Bought new	Bought second hand	Assets held for leasing	Main rate assets	Special rate assets	New disposal rules	
Super-deduction (130% FYA)	Yes	No	No	Yes	No	Yes	N/A
Special rate FYA (50% FYA)	Yes	No	No	No	Yes	Yes	N/A
Annual Investment Allowance (100% up to £200,000)	Yes	Yes	Yes	Yes	Yes	No	N/A
Writing Down Allowances (18%)	Yes	Yes	Yes	Yes	No	No	N/A
Writing Down Allowances (6%)	Yes	Yes	Yes	No	Yes	No	N/A
Freeports (100% ECA Uncapped)	Yes	No	No	Yes	Yes	No	N/A
Structures & Buildings Allowance (3% pa)	N/A						Yes
Freeports (SBA 10% pa)	N/A						Yes

The relatively significant change in Corporation Tax opens up the possibility of planning

Are you missing out on R&D tax relief?

Many dealerships are unaware that they can benefit from research and development (R&D) tax relief. Are you missing out?

If your dealership is creating new products, services or processes, you may be able to make a claim.

It is a common misconception that R&D relief is only available to scientists wearing white coats and goggles. In reality, the relief is available across a complete range of industries, including automotive dealerships.

With Covid-19 triggering an acceleration in digital developments, there is a greater need for showrooms to be well represented online. This has led to advances in the quality of photography, together with the production of high quality videos, so that the buyer's experience is enhanced. Dealerships can have large numbers of vehicles to list online, so any system has to be capable of uploading vehicle details in a timely and efficient manner.

Systems also have to be linked together, such as integrating stock management with online sales, emails, servicing and accounts, so that the whole customer experience runs smoothly.

For example, any information which a customer obtains online should also be consistent with the information obtained within the dealership, such as vehicle pricing and vehicle specifications.

Car dealerships are also always looking for new and innovative ways to advertise and inspire customer purchases. Many dealerships, therefore, took the opportunity during lockdown to carry out refurbishments to their showrooms. This may have included creating elaborate displays, so that showrooms stand out against competitors. These displays may use materials in a way that has never been implemented before. The development may have involved the creation of sketches using 3D models using computer-aided design (CAD) programs. Prototypes may then have been created, to see whether the development is feasible. The development may also include multimedia features, such as illuminated alcoves and shelving. Other areas of development may have been carried out within workshops with protoypes developed using different materials.

Creating new software systems, innovative showroom displays and new tools as discussed above, are all examples of things which can be eligible of R&D tax relief.

If you have not yet explored the relief, it is highly advisable to do so.

What is R&D tax relief?

R&D tax relief is available to companies and either reduces a company's corporation tax liability or, if they are loss making, can provide a cash sum.

There are two R&D tax reliefs available; the Small and Medium Enterprise (SME) scheme and the Research and Development Expenditure Credit (RDEC) Scheme. Under the SME scheme, companies can claim up to 25% of the costs incurred on R&D, or up to 33% if the company is loss making. The RDEC scheme is mainly for large companies and is less beneficial providing 10.53% of tax relief.

What expenditure can qualify for the relief?

The qualifying expenditure for the claim must be revenue expenditure and not be of a capital nature. Qualifying costs include:

- Staff costs, excluding benefits in kind
- Travel and subsistence, but only if incurred by employees and reimbursed by the company
- Consumable expenditure – materials and equipment used in the activity but not incorporated into the product
- Utilities – heat, light and power consumed in the R&D process
- Subcontracted R&D – there are restrictions under the RDEC scheme
- Software licences used specifically for R&D purposes.

It is worth noting that the classification of revenue expenditure is not always the same when it comes to recording the treatment of the spend for accounting purposes. This means an eligible R&D cost may be suitable to be capitalised as an intangible asset where there is a future economic benefit to the business.

How can you claim the relief?

The claim is included within your corporation tax return and supporting computations. It is highly recommended to prepare an R&D report, which demonstrates to HMRC the company is eligible for the relief.

The deadline for submitting a claim is two years from the end of your company's accounting period. For example, if your accounting period is 31 December 2020, the deadline for submitting the R&D claim is 31 December 2022.

For more information or to discuss your potential R&D claim, please contact one of our automotive advisers named on page 28 or get in touch with author and R&D specialist, Sasha Talbot, at s.talbot@uhy-uk.com or on +44 161 236 6936.

What qualifies as R&D?

To qualify for the relief, your company must be undertaking a project which seeks to achieve an advance in science or technology. This is generally a project which:

- seeks new scientific or technological knowledge which is not in the public domain or readily deducible
- creates or makes an appreciable improvement to an existing product, process or service through technological changes
- increases overall knowledge or capability in the field of technology.

The advance must not simply be an advance within your company's own state of knowledge or ability, but an advance within the overall knowledge or capability.

There must be uncertainty at the commencement of the project as to how the advance is going to be achieved. This means that it is not known whether it is scientifically possible or technologically feasible.

"If your dealership is creating new products, services or processes, you may be eligible to claim"

Gearing up for the electrical revolution

No one reading this Outlook will need reminding that the sale of new cars fuelled by diesel or petrol will be banned by 2030, according to the UK government's 'Ten Point Plan for a Green Industrial Revolution'.

In 2021 we saw that, of the 1,647,181 new cars sold in the UK, around 11% were pure electric vehicles. Whilst the move to electric will have been impacted by the semi-conductor shortage, it is suggested by some that 2022 will be the year for the company car to go all-electric. Only time will tell if this prediction is right but, in preparation, employment tax specialist Alastair Kendrick provides some useful pointers about the current tax rules and shares his thoughts about what is happening in the market place.

Reduced government subsidy

Over recent months, we have seen the government reduce the levels of subsidy they are providing those who acquire a pure electric vehicle. At present, the subsidy is only available on cars which have a list price of £32,000 or below, with the grant limited to £1,500. The limit had previously been set at a list price of £35,000 or below, and the grant was then £2,500 (the grant had been originally set at £3,000, before being reduced to £2,500).

There are also different rates of reduced subsidy for those acquiring electric vans.

It appears that the government, who have invested significant sums in the electric revolution, are wanting to reduce their support. Whilst the sale of electric vehicles continues to increase, it is expected that they will take the opportunity to further reduce or stop completely any subsidy. It may be that that the long-term plan of HM Treasury is to stop all support by 2030, when all new cars sold will have to be electric.

What are the current tax rules in relation to electric vehicles?

There is still confusion over the tax rules in relation to electric vehicles. The key areas are summarised below:

1. Corporation Tax

If a car is being bought by a business, they are eligible to claim a first-year capital allowance on the purchase price of the vehicle. This means in the year of purchase the business can claim 100% tax relief on the cost. However, if the vehicle is later sold, the sale proceeds are then caught to tax by way of a balancing charge. It should be borne in mind that the government are proposing to increase the rate of Corporation Tax in April 2023, from 19% to 23%. On this basis, if a vehicle is acquired in the current tax year, the first-year allowance would give 19% of the purchase price. If, however, the car was sold say in April 2024, the sale proceeds would be taxed at 23%.

We have no certainty over how long the 100% first year allowance will continue to be available.

2. Benefit in kind

There are similar concessions in respect of the benefit in kind rules in regard to pure electric cars. At present, the benefit in kind is limited to 1% of the list price of the car. The government has set the rates at 2% for 2022/23 and 2023/24 tax years. At the time of going to press, we have not been given any indication of the tax rates from April 2024.

There is also a concession in regard to pure electric cars via a salary sacrifice arrangement. It is currently possible for an employer to provide a car to an employee with the contribution met out of gross pay. At present, for a pure electric car the salary sacrifice arrangement falls outside of the OpRA rules.

It is very likely that at some point the government are going to seek to increase the level of benefit in kind rates on these cars. With more employees moving into electrical vehicles, unless the rate of the benefit in kind is increased there will be a significant hole in government figures. The big question is when is that likely to occur? We expect a gradual increase year on year from April 2024 until April 2030 and predict we will hear more on this during the next Budget announcement.

What is happening in the market place?

We are seeing a significant emphasis on persuading employers to offer cars to employees via a salary sacrifice scheme. The information available suggests there is a considerable amount of interest in setting up these types of schemes and we have seen these offered in many cases instead of a traditional company car. It will, however, be interesting to see whether such arrangements remain viable if and when the benefit in kind rates increase.

What can dealers do to embrace the electric revolution?

Dealers may wish to consider whether there is an opportunity to provide electric cars to employees, either simply in respect of the demo fleet or to a wider population via an affinity scheme. If there is an intention to proceed down this route, it could make sense to set up such arrangements using a salary sacrifice scheme. However, there are a number of issues that need to be addressed to ensure compliance with the specific tax rules, so it is important that professional advice is taken.

“There is still confusion over the tax rules in relation to electric vehicles.”

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Alastair Kendrick is an employment tax consultant with considerable experience in employment status and IR35. As a specialist in the automotive sector, he supports a number of our sector clients, especially in the area of company cars. He is a former HM inspector of taxes with 16 years’ experience working in the Big Four before working for a number of smaller firms.

What lies ahead for the sector: the experts' perspective

We asked a panel of industry experts for their insight on the outlook for the automotive sector through 2022 and beyond.

David Kendrick
Head of Automotive
UHY Hacker Young

Paul Daly
Automotive partner
UHY Hacker Young

Ian McMahon
Automotive partner
UHY Hacker Young

Guy Adams
Managing Director
Williams Group

Roger Moore
Group Finance & Commercial Director, Mon Motors

Mike Allen
Head of Research
Zeus Capital

2021 was the most exceptional year in recent memory. Do you expect to see more of the same in 2022? What are your predictions for 2022 trading as vehicle supply returns?

David Kendrick, UHY's head of automotive, kicked off the panel discussion on a positive note, declaring that in his 20 years' advising the sector he has never seen margins at the levels dealers enjoyed throughout 2021. Despite last year predicting a strong six months trading post Q1 lockdown, David admits he is "not sure anyone envisaged what actually happened. 2021 was a phenomenal year."

But will 2022 be another exceptional year? The good news is that our panellists expect trading conditions to remain strong for at least the first six months of 2022. David elaborates "there are huge forward order banks with full margins across the deals, coupled with a lack of supply for part, if not all, of the year." He is confident that until a proper supply returns from the majority of brands, as well as the used car market volumes stabilising, profitability and performance will remain in the medium term.

Guy Adams, Managing Director of premium automotive retailer Williams Group, is also optimistic about 2022, although he is not expecting to see quite the same results as 2021. Guy acknowledges that new car order banks are at an all-time high, but cautions that the used car market could prove challenging, explaining "supply will be constrained after two years of reduced new car sales and OEMs are not pushing the secondary market."

Guy outlines that used cars are no longer as attractive as new on a monthly payment. Whilst availability may force some people down the used channel, he believes the majority of customers will recognise that a new car makes more sense than anything under 12 months. He adds "I'm not sure consumers will be that impatient to sacrifice time for cost". However, given the supply constraints, Guy does expect margins will hold up and remains confident for H1.

Roger Moore, Group Finance & Commercial Director at Mon Motors Group, one of the largest dealer groups in South Wales and the West of England, injects that he will be glad when vehicle supply returns. He states that whilst "manufacturers will tell you dealers are never happy with the supply levels – too much or too little supply - if 2022 transpires to bring a modest increase in supply, I would be very happy." However, Roger clarifies he "wouldn't be too excited if we saw a return to excess supply in the market".

UHY automotive partner, Ian McMahon, thinks the most pivotal aspect of 2022 will be around the pricing and market proposition of used cars. As new car supply comes back, he anticipates a number of used car transactions through the part exchange process. He warns that dealers should be prepared to quickly adjust the used car residuals as nearly new vehicles return to the forecourts. Ian adds that, should new car supply improve more than expected, manufacturers "won't need to massage supply to achieve the WLTP EU CO2 targets" and we could quickly be back into a position where "the focus will be on managing the oversupply of new cars coming to market".

> **"Given OEMs are making more money not pushing volume, it's now in their interests that they maintain more of a pull model then push."**

It seems the general consensus amongst our experts is that 2022 looks set to be a game of two halves. UHY automotive expert, Paul Daly, expects the second half of the year to be very manufacturer dependent, and foresees some of the manufacturers "springing out of the box with supply earlier than others and looking to take advantage of that situation." Head of research at Zeus Capital, Mike Allen, thinks supply will take a little longer to return, predicting it will be the "back end of the year at the earliest before we see full supply, and more likely 2023." However, both agree that it is hard to have much visibility beyond the first six months, outlining that performance will largely depend on whether Covid-19 disruption starts to abate, as well as how inflation plays out. Paul cautions that "cost pressures, especially around staff cost inflation and the return of rates charges above the £100k cap, will be significant."

Summarising, Paul shares that overall his clients and contacts have written more cautious budgets of around 50 to 60% of the exceptional profit achieved in 2021. David's outlook is a little more optimistic, anticipating "a 20% decrease in year on year profitability by the end of 2022", however, he caveats that this will very much depend upon supply. Both Paul and David agree that if good conditions remain, there is the potential for these budgets to be exceeded and David concludes that "all in all, 2022 should remain a strong year for the sector."

Ukraine conflict update

Since our interview took place, Russia has launched a devastating attack on Ukraine. These are terrifying times for Ukrainians and we are witnessing a mass exodus of refugees. With western sanctions imposed on Russia and a vow from the UK to further ratchet up the economic pressure and support for Ukraine with finance, weapons and humanitarian assistance, the impact of this conflict will be far reaching for some time to come.

From an industry perspective, the conflict is already having an impact with Oxford's BMW Mini plant announcing a five day halt to production at the start of March, due to a shortage of parts coming from Ukraine. Western sanctions on Russia could also hit the availability of materials used by manufacturers as the country is a major producer of metals such as titanium, nickel, cobalt and lithium. Following a short catch-up with our panellists, they confirmed that their initial positive outlook for 2022 had been severely undermined by recent events.

Our thoughts are with the Ukrainian people at this devastating time.

2021 was characterised by supply shortages. Reports suggest we will never go back to the bad times of having too many cars and not enough customers. What are your thoughts?

There was some debate amongst the panel in response to this question. Mike suspects there is some truth to it, reminding the panel that we are still living through the supply shortages. He expects the impact to reverberate beyond 2022 in the used car market, given the sustained shortages of one to three year old cars. Reflecting on 2008/09, which saw a shorter period of production closure, Mike points out that the period resulted in "high used car margins for three to four years after the event." He adds "I see the same scenario playing out on used car margins on the back of the current semi-conductor shortage."

As Roger alluded to during the opening discussion, he is confident that an alignment of supply with natural market demand can only be a good thing. To illustrate the point he quotes BMW's Chief Financial Officer Nicolas Peter who, in September 2021, told the FT that BMW had "seen a significant improvement in pricing power in the last 24 months." This increased pricing power saw BMW's margin in its last reported quarter (at that time) reach almost 16 per cent, up from 8.6 per cent in the same period in 2018. So, Roger explains, "whilst reduced supply is clearly beneficial in terms of gross margin for the dealer networks, it more importantly appears to be beneficial to the manufacturers, so they may well be on board with the strategy of producing volume to meet natural market demand."

The other dealer on the panel, Guy, thinks it is less likely that the balance will be kept in check. He can't believe that, at some point, supply won't exceed demand. However, in support of Roger's comments, Guy recognises that "given OEMs are making more money not pushing volume, it's now in their interests, as much as ours, that they maintain more of a pull model than push."

Paul also thinks it is wishful thinking to suggest we won't go back to the times of too many cars and too few customers, highlighting that the nature of manufacturing is that the incremental cost of the extra unit is not high since the initial outlay has already been spent. He explains that supply is ultimately a factor of productive capacity and "there has been little in the way of capacity removed from the system. Quite the reverse, in fact".

To illustrate his point, Paul cites Tesla's new mega factory in Germany, as well as a plethora of Chinese products likely to enter the UK in coming years. Ian also expects oversupply to creep back in, and believes as more 'white label' Chinese developed EV models enter the European mainstream markets, "the ability to 'reign back' supply will be nigh on impossible, with the local NSC needing to commit to the factory well in advance of any oversupply red flags being raised."

Sharing their final thoughts, David summarises that whilst it would be lovely to think that the oversupply won't occur again, the UK is a strong market for vehicle sales within Europe and, as supply returns and manufacturers have targets to hit, he has "no doubt we will return to the volumes we have seen in the past." Paul admits that he also can't foresee an NSC sales director ordering the same or fewer cars next year. He comments "it is human nature to want to grow a business. Covid-19 has enabled a welcome respite in the supply push, but it will certainly return in future unless there is a material reduction in productive capacity." David concludes that he hopes they are wrong, "as one thing we have learnt, is that a market without over supply allows dealers to make money."

Inflation has been on a sharp upward trajectory and hit its highest level in over 10 years in the latter part of 2021. What risks do you see for the motor trade?

All of our panellists were in agreement that higher inflation creates risks from both a consumer demand perspective as we learn to live with rising costs, as well as from a company perspective in terms of managing the cost base.

First delving into the issue of business costs, Mike highlights that motor retailers notoriously have high fixed costs "typically consisting of staff at c60% of costs with energy costs on top at 4-5%". Roger adds that one of the key challenges for the motor trade will be its ability to increase gross margin in the face of higher costs driven by inflation. With increases in salaries and energy costs being significant factors over the past few years, Roger points out "our ability to increase gross margin at a similar rate is difficult." Mike agrees, adding that "in a low margin industry, managing these costs will be critical to all dealers' profitability this year."

Ian believes wage pressure will be one of the largest contributing factors to the decisions made within the motor retail business model over the next few years.

> **"the relationship between salary and service pricing has held a strong correlation for many years"**

Guy shares similar concerns and is worried wage pressure will put further burden on employee retention, explaining that "as costs rise at home, incomes will come under pressure and people may be forced to start looking for higher paying jobs either inside or, increasingly, outside of the sector."

Adding to the wages discussion, Ian points out that in aftersales, the relationship between salary and service pricing has held a strong correlation for many years. As a result, Ian believes the cost of an average service has to increase. He advises, "manufacturers and dealers both need to be actively factoring in inflationary increases when setting the prices of service plans and any 'fixed price' offerings to customers."

The panel also agreed that one of the obvious impacts of rising inflation was the effect it will eventually have on consumer confidence, which we all know is key to a strong motor retail market. On the topic of vehicle affordability, Guy highlights that "when you combine increasing interest rates alongside cars not being as heavily discounted, after years of low rate PCP deals, consumers are going to get a bit of a shock." This will also be compounded by the general cost of living increase driven by other factors in the economy. He continued that "whilst people have built up their cash reserves over Covid, the test will be if they are willing to spend this or keep it to weather the storm. If they decide its best to sit on things then we could see a drop in demand towards H2."

Despite panel wide concern about the risk of rising inflation, Guy concludes "at the end of the day, people still like to change their car regularly and there are lots of exciting new vehicles, especially EVs, to tempt them."

People like to change their car regularly and there are lots of exciting new vehicles, especially EVs, to tempt them

How do you think the agency model may affect the sector?

The proposed agency model is a complex dynamic, and one we cover in detail on page 5 of this Outlook. The big question discussed during our panel discussion was whether or not the model is good news for dealers. It caused quite a bit of debate amongst our panel.

Roger believes the agency model could be a good thing, but caveats this will only be the case if it is executed properly. He voiced concerns about the hybrid and lite models "where the manufacturers put the most profitable models through agency channel, providing the dealer with a handling fee, and the more challenging models through traditional margin model." However, Roger is a believer in the full agency model, explaining that as long as the handling fee is appropriate, he trusts the model will result in consistent margins and reduced cost. He explains "the margin should be consistent if the manufacturer outlaws customer cash backs and other workarounds, and the cost base will reduce because no longer will dealers be incentivised to 'pump out' cars all over the country on transporters."

Guy is less convinced by the proposition. He understands why OEMs would want a more consistent consumer offering, especially for their digital platforms, but cautions that if the aim is to try and maintain a consistent price point, he is not sure it will work, commenting that "customers will still negotiate and dealers will still deal." He reasons "if dealers see a significant reduction in new car margin through an agency agreement, they will put an even greater focus into used cars to drive profitability. I can't see that being great for manufacturers."

Mike is also sceptical. He doesn't think every OEM will go down the agency route, but expects some premium marques with brand power to do so. He believes that the "devil will be in the detail" and success will be to do with "how effectively costs are shared to make this viable for both parties." However, like Roger, Mike doesn't think the model is necessarily a bad thing. He said "in theory if this is executed well, it would make the sector more asset light, which should in turn increase Return on Capital. Typically when this happens, higher multiples are applied." He concludes "the only concern I would have is whether it rewards mediocracy and whether retailing standards start to diminish. A dynamic retail environment is required, especially in times when negative equity might return, which is a possibility given the strength in residual values we have seen over the past year."

Ian also foresees potential issues, reminding the panel that "manufacturers have not historically been the best at dealing with the customer directly and, as such, many retail groups have differentiated themselves by offering a customer experience which builds trust, and often can overcome the price point pressures in a normal market." He worries that, if the agency model removes the ability for the dealer to build rapport and differentiate themselves, "both the brand and the network will lose out." David adds that he doesn't see any need to change the current model and is not convinced that any manufacturer has yet worked out how it will work in practice, stating he "can see agency coming in and then quickly being reversed back to the old model."

Following a dramatic swing towards online car sales during the pandemic, dealers have developed their expertise in this area. Where do you believe this will go next?

Since we launched our Outlook six years ago, we have been asking our panel of experts for their thoughts about online retail. Whilst the consensus has always been that digital is important, it was only necessity driven by the pandemic that triggered any marked change. Do our experts now think the online model will become the preferred way of transacting? The unanimous response remains to be that digital, whilst now an essential part of the offering, will not entirely replace the need for dealership visits and personal interaction.

UHY experts, David and Paul, actually think that the swing towards digital may have now plateaued and predict the mix shifting back towards physical in 2022. David comments "It has been proven by research that consumers still like to visit a dealership to consider their purchase." Whilst he agrees that there are a percentage of consumers who prefer the online process and "there is clearly a space in the market for this", he does not believe it will materially remove the future of the dealership model. He adds "some none core locations are already being removed from the map and perhaps we will see more of this, but fundamentally I believe it will remain a mixed model in the future."

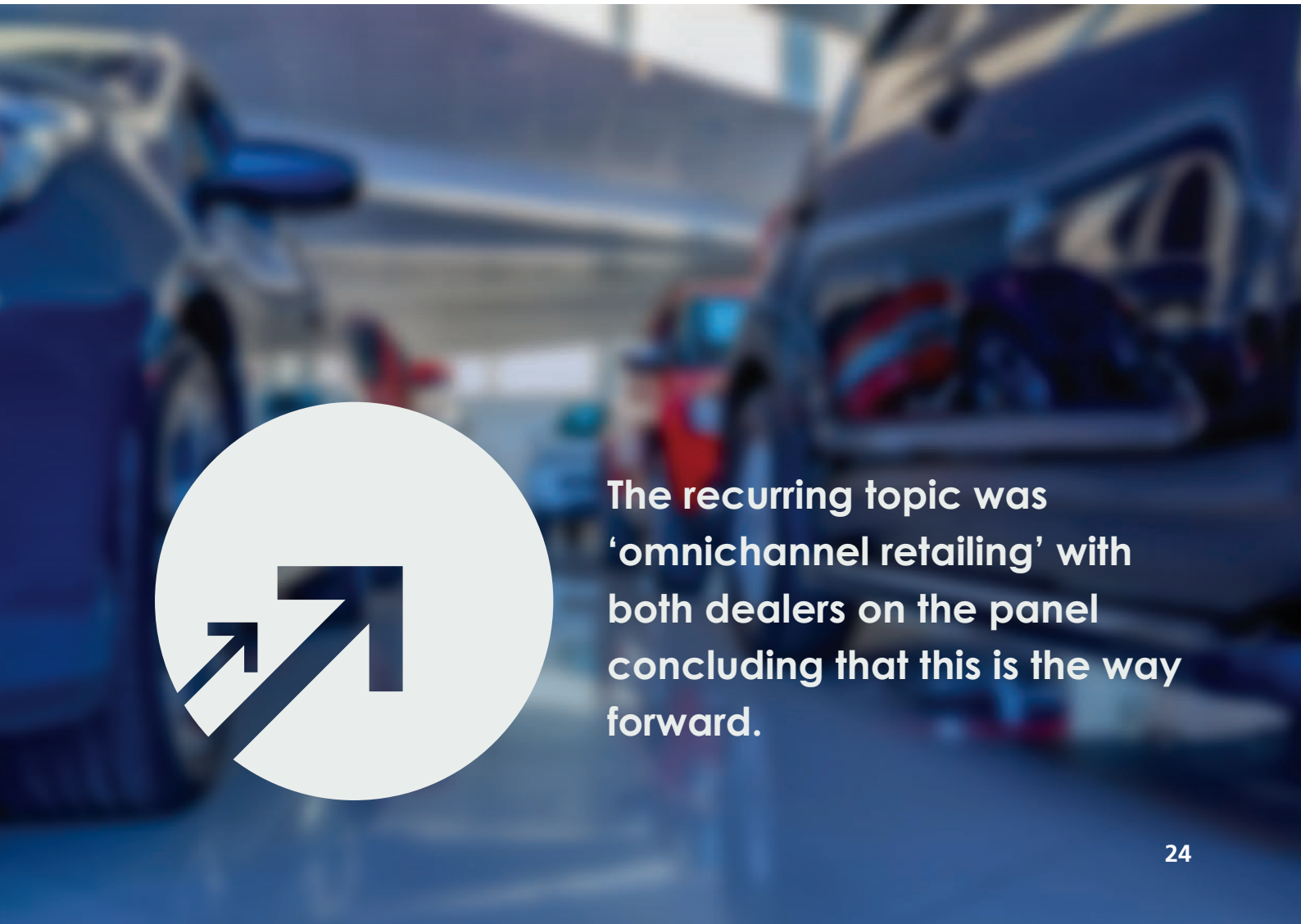
Paul agrees in the short-term, however, longer term he thinks there will be a steady move towards increasing levels of online sales as the younger generation form a greater proportion of the buying consumer. Having observed the way his own children behave, he notes "the younger generation will typically be more confident in an online purchase than they are in a physical situation."

Reflecting on his own experience, Guy comments "like all businesses, we have developed a comprehensive digital proposition. Whilst this is still growing, its clear people still prefer to come to a site, see the cars and deal with people." He believes this will especially be the case as we move towards EV, with customers having a myriad of questions, either on the product or charging. Guy adds "with so much to consider, they want someone they can talk face to face with to help navigate which car to go for."

The recurring topic during this discussion was 'omnichannel retailing' with both dealers on the panel, Roger and Guy, concluding that this is the way forward. Roger illustrated why he felt an omnichannel approach was so important, stating that "for a while, the industry has been told that an enhanced experience for a customer is one without friction. If the customer wishes to commence their journey online, then touch the vehicle in person, then revert back to online to conclude the sale, we have to facilitate that. Some may wish to purchase entirely online, some will continue to want to buy entirely in the dealership and some will want to do a bit of both." Guy agrees, adding "I believe people who know exactly what they want, and how much they want to pay, will be happy to search for the best deal and do it all online. Others might do this to ensure they don't miss out on a car as stock moves quickly. But most still want some form of physical interaction with the dealer. We will continue to move towards an omnichannel approach with customers coming into the process at different stages depending on their own preferences."

Guy highlights the need for the sales processes and team set up to adapt to reflect the omnichannel approach, foreseeing that digital teams will only expand. Mike agrees and outlines that whilst the omnichannel model has been well executed by most, there is always room for improvement. He predicts "with slick customer journeys and more marketing investment going into the sector, it would not surprise me to see dealers starting to embrace AI over the coming years to further improve their interaction with customers."

Continuing the omnichannel discussion, Ian sees an opportunity to move the new and used car remote viewing process further towards a completely digital process. He envisages an augmented reality opportunity where sales people join the digital world to answer any queries the customer might have.



The recurring topic was 'omnichannel retailing' with both dealers on the panel concluding that this is the way forward.

There were some big ticket deals towards the end of 2021; including Marshalls acquisition of Motorline followed by the Constellation Automotive takeover of Marshalls, as well as Cambria's move to private ownership. What are your thoughts on these deals and what are your expectations for 2022? Do you think we will see further new entrants?

Paul opened the conversation by highlighting that we should not underestimate the Constellation Automotive acquisition, highlighting that it is "the first significant new entrant into UK franchised motor retail for many years." And, of course, since we held our panel interview, Cinch, BCA and Webuyanycar owner Constellation has followed up its move to acquire Marshalls with the purchase of a 19.9% stake in fellow car retail PLC Lookers, proving just how significant this entrant is in the market.

There is suspicion amongst the panel that some of the listed motor retailers have become frustrated at the lack of understanding by the financial markets of just how hard they have worked, and yet the 'value' in the business is not reflected in the share price. Given valuations have not kept up with the rising earnings performance, Mike thinks there may be more consolidators in the PLC arena. Using Cambria as a case in point, he highlights that they "spent more than a decade on public markets without the share price really advancing from its initial level. Sometimes being on the public market just does not work out."

Roger can also understand the desire to go private if the board doesn't feel the market is applying a fair valuation to its shares, especially given the increased costs and management distraction of operating a PLC. However, he cautions that a manufacturer is likely to be quite concerned about private equity (PE) ownership within their network.

He explains "PE houses have one driver – to make money through an exit at some future point. Some funds hold their investments longer than others, but there can be a conflict between the way a PE backed company is run versus a privately owned company, or even a PLC."

Given the current severe shortages of used vehicles, Paul would not be surprised if another entrant was to consider investment, particularly given the modest valuations that UK franchise motor retail sees relative to overseas and similar distribution models. Ian thinks the attraction has to exist for further integration to support any changes in the networks as the bite of agency starts to happen. David points out that the rumours regarding Cazoo entering the franchise dealer network continue to circulate and he is confident that the deal market will be very active in 2022, remarking "based on our current pipeline, it could be a record year for the number of transactions…only time will tell."

Where do you see the industry 10 years from now?

Everyone on our panel expects to see changes in the industry over the next ten years, but some think these changes will be more marked than others.

Paul shares that he has always taken the view that change will come much more slowly than people expect, but he admits it "now genuinely feels that we are already into the process of major change." Roger wouldn't be surprised if the entire market was operating on an agency model in 10 years' time. He explains "we have full agency trade parts businesses, in which the entire cost base is funded by the manufacturer partner and we earn commission based on our sales performance. We have no working capital requirement and pricing is determined entirely by the manufacturer. It works incredibly well. It may be a step too far for the franchised networks, but within 10 years I would certainly expect to see movement towards that model."

All of our panellists feel this will be a defining period for the sector and that the evolution of EV and alternative fuel vehicles looks set to be the biggest driver behind change. Paul explains "in 10 years' time, we will inevitably be feeling the effects of a much reduced aftersales opportunity as the UK 5 year vehicle parc will be well on the way to having a significant BEV content." He continues "that BEV influence will also mean a number of new brands will have established themselves, with their own distribution model if current trends followed by the likes of Tesla and Genesis are replicated. Brands like Chinese Nio are planning to come to Europe in the next five years offering a premium electric SUV experience at the inevitable highly competitive prices."

As a result of EV, all expect the number of physical franchise locations will inevitably have reduced to enable costs to be managed, with much more multi franchising taking place and a more consolidated number of franchise partners. David predicts a "smaller number of privately owned businesses, but still a significant number of companies in the sector". Guy also thinks there will still be physical stores where people come in to see and buy mobility or get it serviced; however, he adds "how many of these there are, if they are multi branded and who owns them will be interesting." Roger adds that "with electric vehicles 'coming like a train' and their associated impact on aftersales revenue, in 10 years the business model will need to look very different." He believes continued consolidation in the sector has to be a must, outlining that "fewer investors and fewer points of sale driving more economies of scale is what the future feels like to me."

As we came to the end of the interview, it was evident that it is a time of change for the industry. Roger remarks that the industry will continue to adapt as it "embarks on a complete transition in respect of electric vehicles, mobility solutions, autonomous vehicles and changes to its traditional long standing business model."

Following a phenomenal year in 2021 with many talking of record profits, it will be interesting to see how those in the industry embrace change and look forward to the challenges over the coming years.

Mike wraps up the conversation by concluding that "there will be changes for sure, with increasing EV ownership having an impact, some adoption of agency and different entrants trying to disrupt a large and dynamic market". That said, he believes a lot of the successful dealers will still be around in 10 years' time, having pivoted their business models accordingly. He closes "one thing for sure is that the next 10 years will not be dull in this space!"

> **"All our panellists feel the next 10 years will be a defining period for the sector"**

Our national automotive team is led by partners who are totally dedicated to the sector.

Our automotive experience

UHY's automotive offering was established in 2013 and today we are employed as trusted advisers to more than 70 dealer groups across the UK automotive sector.

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

The team provide a wealth of services to dealers, suppliers, 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. 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.

With our fingers on the pulse of the current market and extensive experience across the breadth of the industry, we are able to draw on lessons learned and continually develop innovative solutions to the benefit of our clients; helping you make the most of opportunities and proactively identify and respond to emerging issues.

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