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ProfitFocus

Motor Industry Services

Australian Industry Overview 2011

Welcome to the 2011 Deloitte Motor Industry Services Industry Overview

Foreword

2010 was a game of two halves.

The first six months benefited from the flow through effect of the investment allowance, the slowdown in production and reducing inventory plus low interest rates. All factors resulted in one of the best six month periods to 30 June 2010 seen during my 30 years in the industry.

The 2nd half was a different game. The incentives were gone, stock started to flow (too) freely in some cases and interest rates increased 40%. Despite all these factors, the industry still had one of its best six months ever, capping off the best 12 month result we've ever seen.

That aside, the game changed. We were now in the new normal with the external calls to action totally gone. The market needed to survive on its own merits and in all free markets, there were winners and losers.

Average dealers suffered the most, with a net profit decline of 30% over the last six months, from a high of 2.5% to around 1.8% for the most recent six months.

Benchmark dealers (the average of the Top 30%) also declined by 15% from 4.5% net profit of sales to 3.8% over the same period.

The Top 5% (the best 50 in the country) actually went forward by 12% from an amazing 6.5% net profit on sales to 7.3% for the six months.

So as custodians of the numbers, we did our job and spent the time to understand what drives Top Performance and why the Top 5% continues to improve, whilst 95% of the market chases down the new norm.

What we found was interesting, but not unexpected:

1. The Top performers *plan* to make 5% net profit on sales. It's not a wish or a budget. It's a plan committed to in writing, agreed to by the management team, with a series of very tangible actions by department to achieve the result and then implemented.
2. This plan becomes the focus of their monthly management meetings, less about the numbers and more about the non financial KPI's (internet and showroom statistics, service retention and CRM measures) and their level of achievement. The financial KPI's are still critical. These are the score board in the end, but looking at bad numbers doesn't make them better. The only way to improve these is to drive better actions (process) and measure the outcome.
3. The focus is on the customer, not the franchise. Core KPI's like 25% total dealership gross from used cars; 50% of service vehicles booked-in as 'all makes'; 95% first service and 70% 3-year service retention; 60% of cars sold to repeat / referral customers. All are focus areas.
4. Parts and Service Absorption at 80% is the first number on Page 1 of the management report. Not buried in line 33 of page 11.

5. They never hear or talk about competition. These dealerships don't have any when 60% of next month's deals are in their service driveway. A fair price is all that matters. What also matters is that customers are happy, interacted with at major 'decision points' and followed up so they never leave the CRM funnel.

6. Front end gross is king. A focus and reward structure built around creating value per customer interaction and maximising front end gross means the need to chase back end (re-earnable) margin isn't as critical. This takes the pressure off inventory levels and the distressed selling which destroys good process.

7. People generate 100% of the gross and represent 70% of the costs. So they are attractively rewarded, Top 5% Dealers are using schemes that generate customer successful actions, not just outcomes. Outcomes are always important and for this there are Minimum Acceptable Standards (MAS) of performance, many of which are Deloitte benchmarks or better.

8. Coaching and training are central to the manager's role. To get the best results requires constant education (learning) and development (training). Constant coaching by the manager gets the team process centric and accountable for the result.

All this sounds fairly basic but the basics are not simple. The most difficult thing is making this all happen 100% of the time to 100% of customers and not get distracted.

2011 will be a fantastic year for the industry. We will have our challenges, but for a well run dealership living the mantra above, the results will multiply.

I wish you every success in 2011 and enjoy the industry overview.

Regards

Wayne Pearson
Managing Director
Deloitte Motor Industry Services Pty Limited

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The economic outlook

The economic outlook

Not without its challenges, the outlook for the world economy is far more favourable than that of a year ago when world economic markets were battling the fall out of the Global Financial Crisis (GFC). If not for the intervention of governments globally, the consequences would have been significantly worse.

The legacy of government rescue packages and stimulus schemes has seen the burden of debt being transferred from private to public hands. Many of the worlds' western governments have significant debt burdens and are under pressure to rein in expenditure and budget deficits.

Although the worst of the GFC appears behind us, the residual impact will linger on well into the future, particularly in the Eurozone. As seen in the chart below, the consensus forecast for 2011 shows a significant turnaround from 2009, a period when all major western economies experienced economic slowdowns.

Global key economic indicators (%)

	Economic growth					Interest rates*		Inflation			Unemployment	
	2007	2008	2009	2010 Latest	2011	Jan 09	Dec 10	2008	2009	2010	Sep 09	2010 Latest
Australia	4.3	2	0.9	2.7	3.3	3.61	4.95	4.4	1.9	2.8	5.8	5
USA	2.8	0.9	-2.5	3.2	3	0.29	0.24	3.7	-0.3	1.6	9.7	9.4
Britain	2.9	0.6	-4.7	2.7	1.9	2.13	0.8	3.5	2.1	3.2	7.9	7.9
Japan	1.5	0	-5.3	5.3	1.4	0.78	0.16	1.5	-1.3	-0.8	5.7	5.1
Euro Zone	2.8	0.7	-3.9	1.9	1.5	2.31	1.01	3.2	0.3	1.6	9.5	10.1
Germany	2.5	1	-4.7	3.9	2.4	2.31	1.01	2.6	0.3	1.1	8.2	7.5
China	11.2	9.1	8.2	9.8	8.9	1.41	4.36	5.9	-0.8	3.2	9.2	9.6
India	8.9	6.2	5.5	8.9	8.6	4.57	7.19	8.1	9.8	11.9	9.1	10.8
South Korea	5.2	4.2	-1	4.4	3.9	2.97	2.97	4.9	2.8	3	3.8	3.6
South Africa	5.1	3.5	-2.2	2.6	3.7	11.33	5.53	11.4	7.2	3.5	23.6	25.3
Thailand	4.9	4	-4.3	6.7	4.3	3.85	2.4	5.8	-0.9	4.3	1.2	0.9

Source: Consensus Forecast, The Economist – 28 January 2011
* 3 month money market

The so called 'sovereign debt issue' in Europe is inhibiting any sustained improvement over 2010 into 2011. Consequently, growth is expected to be sluggish and patchy. The challenge for economic policy makers in Europe and the USA is the lack of available options to stimulate sustained GDP growth.

The two traditional tools of monetary and fiscal policy initiatives are no longer feasible options. Interest rates are already near zero and further major government expenditure is not possible, with pressure to rein back budget deficits and relieve public debt.

The Australian economy is far better placed than most western economies. Government stimulus incentives in 2009, together with dramatically falling interest rates have helped to avoid a technical recession. **Australia now has enjoyed 19 consecutive years of economic growth**, the best performance of any major western economy.

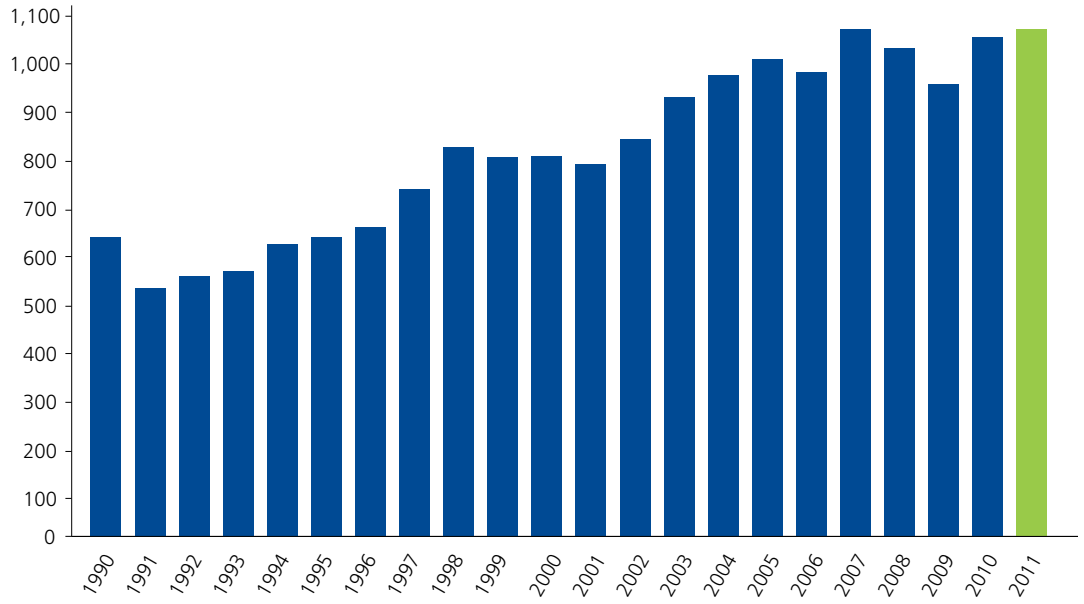
The outlook for the Australian economy over 2011 remains positive despite the recent string of natural disasters and unfavourable exchange rates for exporters. China continues to grow and the flow on effect of the resource boom is permeating into the broader Australian economy.

The strong Australian dollar has helped put a downward pressure on inflation with prices for imported products remaining relatively low. However a tight labour market and continued price increases for energy and agricultural products has created inflationary pressures. Consequently most analysts are forecasting an upward trend on official interest rates. The consensus forecast for year end is for an increase of less than half a percentage point above the current rate of 4.75%.

Trading conditions and new vehicle sales review

Trading conditions and new vehicle sales review

Market volumes ('000)



* FCAI Forecast for 2011

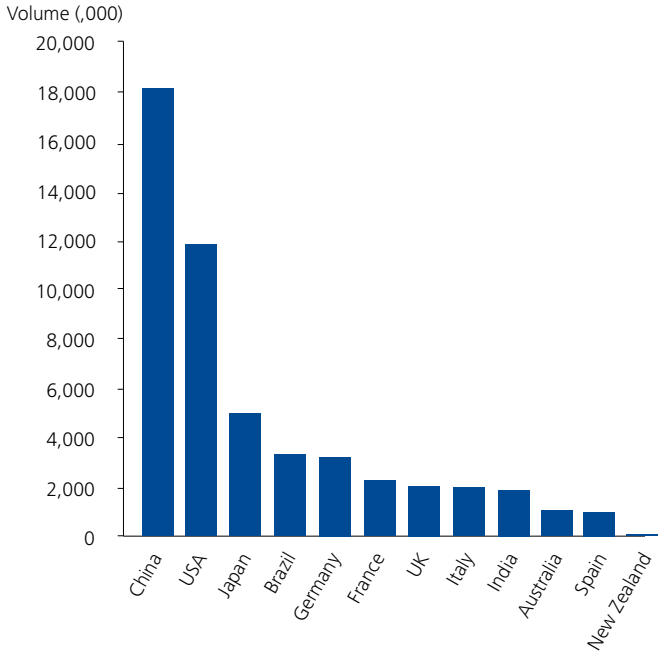
Australian motor vehicle sales for 2010 eclipsed the million unit mark for the third time in history. At 1,035,374 units it was up 10.5% on 2009 and ahead of initial forecasts from most vehicle manufacturers and industry analysts.

Sure, economic conditions generally improved from the previous year as government initiatives helped lift demand. However, as we'll highlight shortly, it was Australia's perceived relatively healthier economic state and capacity to absorb excess inventories built up overseas which created a market characterised by supply push and in some cases significant numbers of pre-registered vehicle sales.

The official vehicle sales forecast for 2011 from the Federal Chamber of Automotive Industries (FCAI) is 1,050,000 which would eclipse the previous all time record by a mere 18 units set in 2007.

The Automotive Industry is indeed a truly global market with Australia inextricably linked to events overseas. The chart on the following page shows sales performance across some of the worlds' major automotive markets.

Global sales by market
Full year 2010 and % change



The USA was eclipsed by China for the first time during 2009 to relinquish their title as the world's largest automotive retail market. Sales in the USA fell from 16.1 million in 2007 to just 10.4 million in 2009. This was in spite of significant government incentives including a $4,000 'cash for clunkers' incentive scheme.

Major government intervention, model rationalisation, funding restructuring and generally improved trading conditions saw Detroit's 'Big Three' recover over 2010. The overall market for the USA finished 2010 up 11%, with 11.5 million motor vehicles sold. General Motors retained the title as number one selling car company. Chrysler Group recovered 17%, but it was Ford which made the biggest improvement, up 19%. Ford enjoyed sales growth across most of their product range with the renewed F-series pick-up truck claiming the title of America's top selling vehicle for the 34th consecutive year. Ford generated goodwill in the eyes of American consumers having not taken up direct government rescue funds during the GFC and in fact are back in the black having generated profits during the second half of 2010.

The European market was up a mere 1% in 2010 with 19.3 million units sold. The Europeans were on their knees at the beginning of 2009. However sales started to soar after very generous scrappage schemes were implemented in many European markets. As seen in the chart above. Germany, the largest automotive market, experienced the highest growth rate since reunification of East Germany in the early 1990's, despite the generally poor economic environment during 2009. Not unexpectedly, vehicle sales in Germany plunged 21% to 3.2 million units for 2010 as the pull forward effect and the general impact of the government scrappage program ending took effect.

France, as the second biggest market in Europe, was up just 1% and the same as the overall European market.

In Asia, as mentioned above, China overtook the USA to claim the title of the world's largest automotive market in 2009 with 13.7 million vehicles sold. China extended their lead in 2010, up a whopping 32.8% for the year with 18.1 million vehicle sales, ahead of the best market the USA has ever achieved.

A booming Chinese economy and emerging wealth will see natural demand for automobiles continue to grow. Interestingly China is yet to be a major exporter of automobiles as fulfilling domestic demand has been up to this point in time the prime market focus. This may however start to change.

There is speculation that the Chinese government is concerned about the impact of rapid growth of domestic vehicle sales and Chinese car manufacturers may need to look to western markets to meet sales targets.

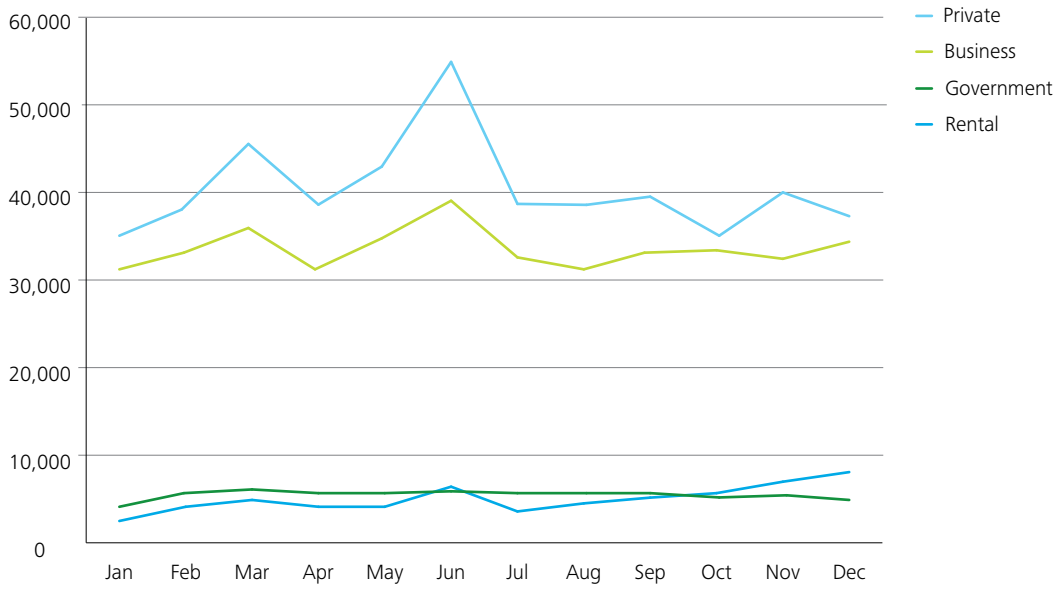
If the current trend continues, it is anticipated the Chinese domestic market will exceed more than that of the USA and European markets combined with over 35 million units by 2020.

The Chinese environment protection ministry estimates the already 170 million motor vehicles (25 times more than in 1980) is generating over 50 million tonnes of exhaust emissions a year. 30% of China's 113 biggest cities failed to meet national clean air standards. Chronic traffic congestion, insufficient parking space, pollution and other undesirable consequences of rapid vehicle growth have increased the speculation that Chinese authorities will start to curb growth of domestic sales. Exporting to the west is the most obvious immediate strategy in order to keep Chinese plants operating at high capacity. The implications for western markets, including Australia, could be quite significant. As previously highlighted, there is already significant oversupply of inventory globally and a shift by the Chinese from a domestic to global focus will only exacerbate the current oversupply.

The private market is still the biggest buyer type in Australia as seen by the following chart. However the Australian government investment allowance program initiated during 2009 changed buying cycles and impacted sales by buyer type in to 2010.

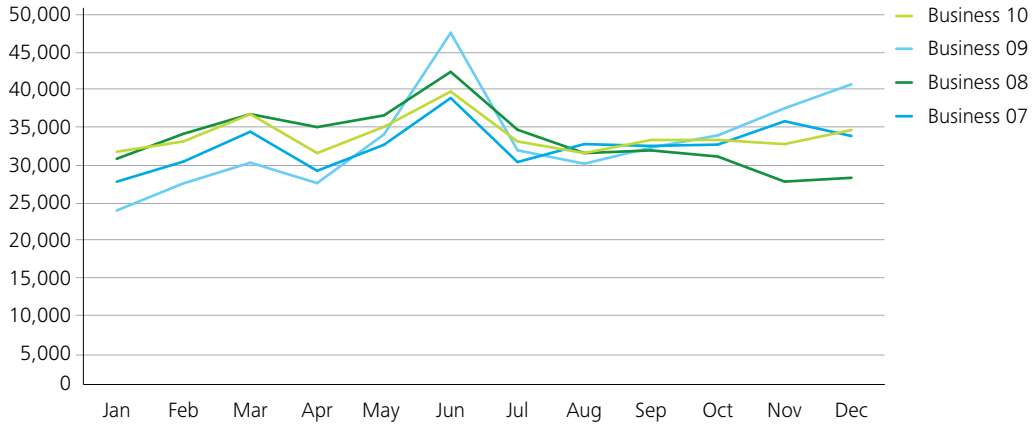
Vehicle sales by buyer type

Excluding heavy commercial full year 2010



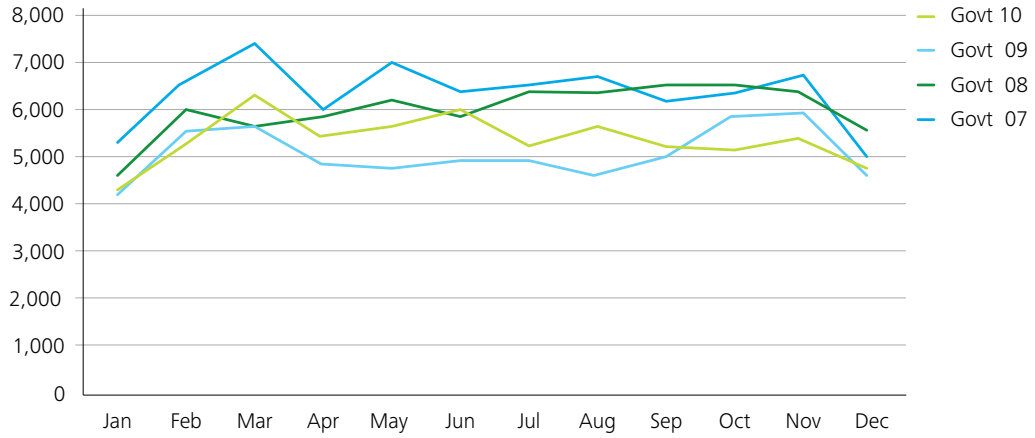
As seen in the charts which follow, the first two months of the year are historically slow for business sales, due largely to purchasing cycles with business and fleet companies winding back over the traditional Australian summer holiday period. After that, private and business broadly move in alignment with each other. The government investment schemes offered either 10%, 30% or 50% taxable allowances to small or large businesses throughout 2009 for purchasing new vehicles. The chart over the page reflects the impact with abnormal peaks for June and December 2009 as the relevant programs ended. The impact on 2010 can clearly be seen with a very significant carryover of sales in the March Qtr of the new-year. Many car companies, including market leader Toyota, stated their carry over order bank into 2010 was at an all time high for commercial vehicles.

Business market



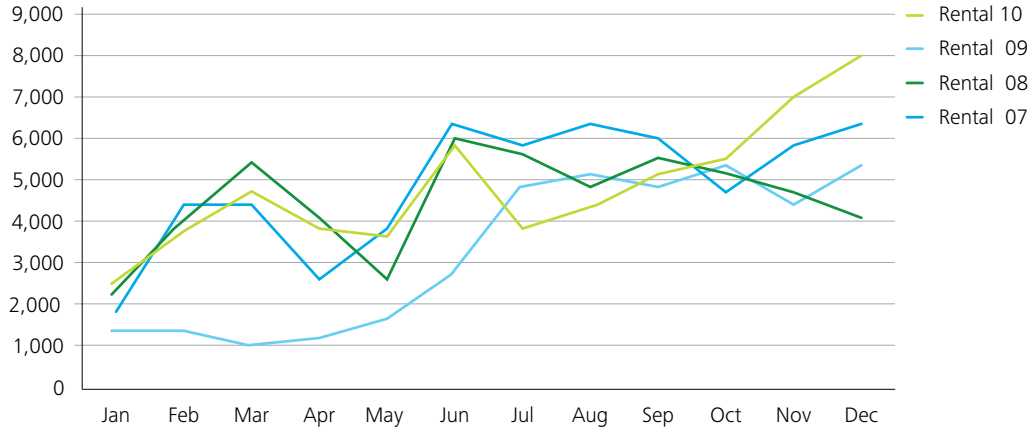
As the worst of the GFC appeared behind them, private buyers re-entered the market in 2010 with extremely competitive deals on offer, the result of excessive vehicle inventory levels across the industry bringing intense competitive pressure.

Government market



The most volatile buying segment over recent times has been the rental market. As seen in the following chart, rental companies took a very conservative approach during the worst of the economic slowdown and didn't increase vehicle purchasing until mid 2009 when vehicle replacement pressures were relieved. The December Quarter of 2010 saw a very significant lift in rental vehicle sales.

Rental market



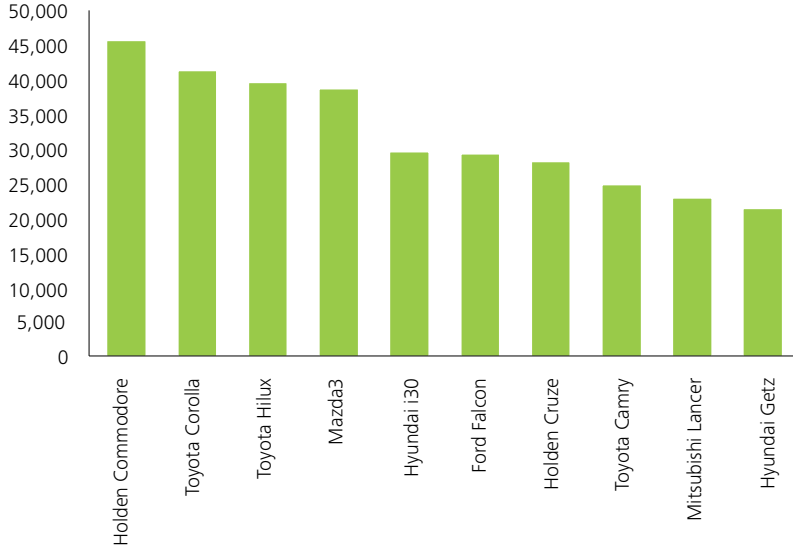
1,035,574 vehicles were sold across Australia over 2010, the second best on record and up 10.5% on prior year.

Toyota once again comfortably achieved market leadership for the eighth consecutive year selling 214,718 vehicles, up 6.8% on the previous year but below its all time record of 238,983 vehicles set in 2008.

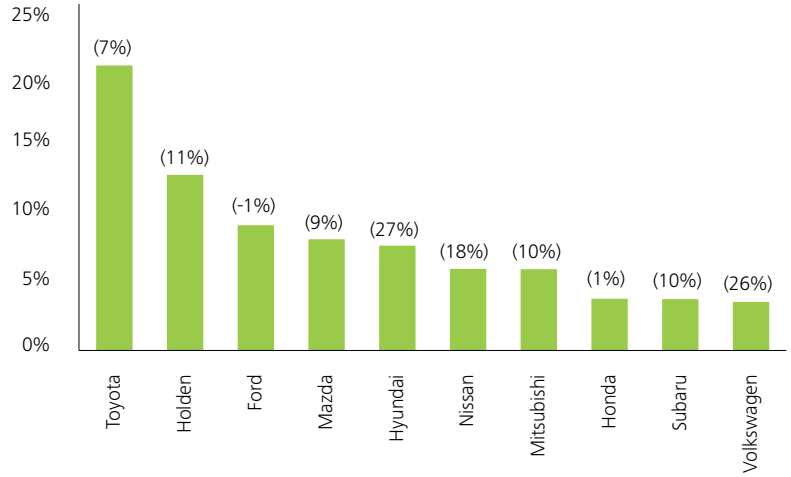
Toyota's market share dropped from 21.4% in 2009 to 20.7% in 2010. Toyota cites a lack of new models for the decline in market share and predict its market share will climb closer to their long term objective of 25% as a number of major new models are to be released from the September Quarter 2011 including Camry, Yaris and an all new Corolla in 2012.

Toyota had three of their vehicles in the top ten selling models in 2010 and retained segment sales leadership with Corolla (small), Camry (medium), Prado (medium SUV), LandCruiser (large SUV), HiLux (PU/CC 4x2 and 4X4) and HiAce (van).

Top 10 model sales
Full year 2010 and % change



Top 10 vehicle sales
Full year 2010 % market share (and % change)



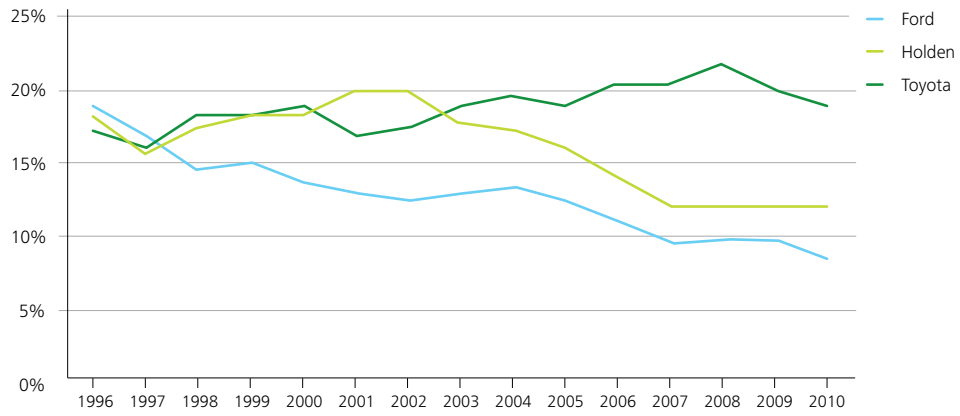
Source: VFacts

Holden lifted sales 11% over 2010 though remain some distance in second behind Toyota. The locally manufactured Holden Commodore (up 3.5%) achieved the title of Australia's top selling model for the 15th consecutive year, a commendable performance considering the large car segment in which it competes has steadily reduced over the last decade. The Ford Falcon as its traditional rival slid to sixth position on the top sales ladder, down 5% on the previous year.

Holden have attempted to reduce their dependence on Commodore and become more competitive across their model range by sourcing vehicles form their GM Daewoo stable (Barina, Captiva and Epica) and will be producing the Holden Cruze small car locally in Australia from early 2011.

General Motors is the owner of Daewoo Korea and have announced they plan to abandon the name Daewoo. From the end of March 2010, their Korean subsidiary will be renamed GM Korea Co, with their mainstream cars branded Chevrolet for the local South Korean market. For Australia they will remain branded as Holden products.

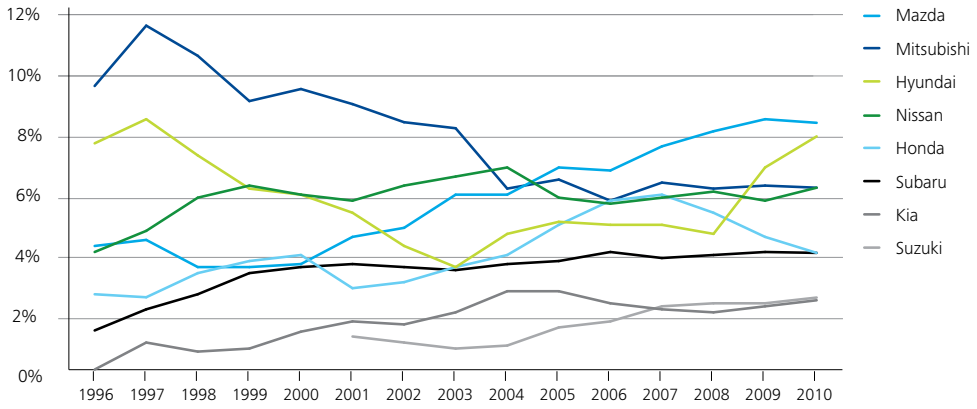
Market share (total)
Local three manufacturers



Source: VFacts

The other local manufacturer, Ford, remains in third place for 2010 recording a market share of less than 10% (9.2%) for the first time. Ford, despite having a broad range of competent vehicles, were the only top ten brand to sustain both a decline in sales and market share over 2010. An Australian icon, the Ford Falcon, once Australia's best selling car is competing in the steadily declining large car segment. The Falcon station wagon was discontinued by Ford Australia as Australian buyers flocked to the Sports Utility Vehicle (SUV) segment for their family car of choice. The Ford Territory, once the number one selling SUV in Australia is ageing and both Focus and Fiesta, although receiving plenty of accolades from the motoring community, have fallen below their sales expectations. In some cases, stock availability has been a challenge with some model specifications.

Market share (total)



Source: VFacts

Mazda, the former subsidiary of Ford is in fourth position, but now much closer at just 1% behind Ford in market share. Mazda achieved an all time sales record of 84,777 units in 2010 with both the 3 and 2 models leading the charge.

Hyundai enjoyed the biggest growth in sales across all major brands in Australia to come in at fifth position with a record 80,038 sales, up 27% on 2009. Hyundai has branded itself as the fastest growing car company in the world and their spectacular growth has not been confined to Australia. In the USA they achieved strong growth during the GFC and this growth continued into 2010, up more than 20%.

Quite paradoxically the GFC saw sales soar globally for Hyundai. The brand has now shaken off the cheap and cheerful perception evident during the 1980s and 1990s. More customers looked closer at the brand during the tougher economic times. Many consumers were pleasantly surprised to find Hyundai vehicles had sound quality, good specification, were aesthetically pleasing yet remained affordable.

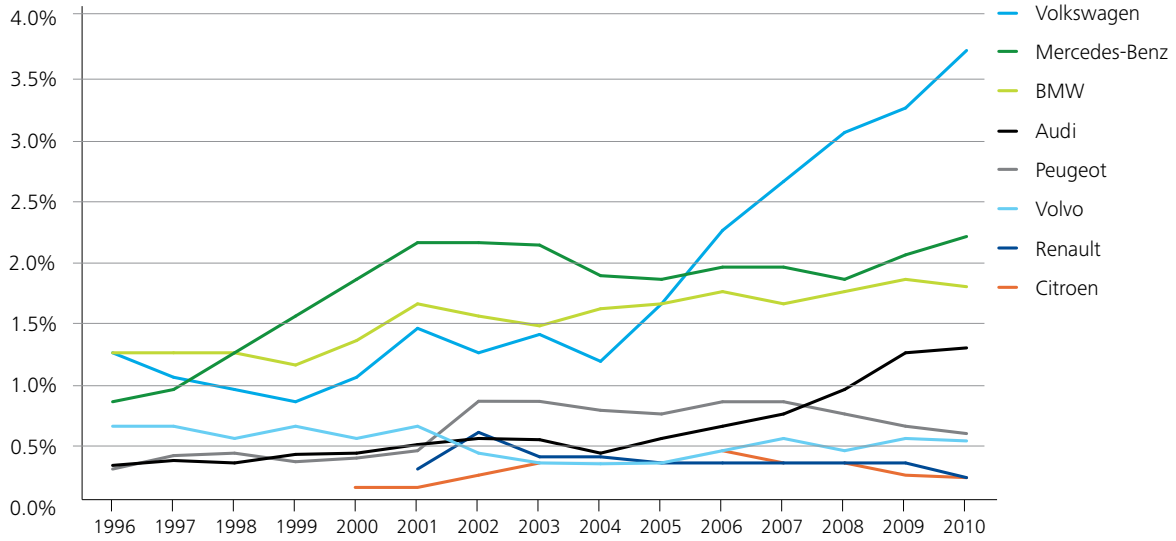
Hyundai now have a very broad range of vehicles with the i30 small car leading the sales charge, up a substantial 39% to finish as Australia's 5th best selling model. The ageing and soon to be discontinued Getz had a successful year finishing ahead of the Toyota Yaris to be number one in the light car segment. The Getz ran in parallel with Hyundai's new model in the light car segment, the i20.

Nissan overtook Mitsubishi to claim sixth position with the new Micra contributing to overall growth in sales volume of 18%.

Mitsubishi lifted their sales by 10% over 2010. Lancer their biggest selling vehicle was helped by significant lifts across their SUV range including Pajero, Outlander, and the new Challenger.

Honda was heavily exposed to the global sales crash during the 2009 GFC, particularly in the USA where they have previously enjoyed great sales success with the Honda Accord. Their sales slipped 21% over 2009 and failed to recover during 2010 with a nominal 1% lift in sales.

Market share (total)
Eurpoeans



Source: VFacts

Volkswagen remains the number one European brand (by sales) in Australia having enjoyed dramatic growth over the past six years. As seen in the chart above, market share has soared as sales lifted 26% over 2010 to finish at 38,016 units. The Volkswagen Golf, Tiguan, and the new Polo enjoyed significant lifts in sales. Volkswagen, the worlds' thrid largest car company, now has around 15 separate models competing in Australia. Their broad range of vehicles will also include the all-new Amarok utility built in Argentina from early 2011.

The Volkswagen Group sold a record seven million vehicles in 2010 globally with a growth rate of 13.5%, placing them in number three position and closer to their aspiration of being number one globally. Those honours in 2010 went to Toyota for the third consecutive year, pipping a resurgent General Motors by a mere 28,000 units. Both sold around 8,400,000 vehicles for the year. For both GM and Volkswagen, the Chinese market has become a very significant contributor with China representing 28% and 25% respectively of their global automotive sales.

Like Volkswagen, their sister brand Audi has enjoyed significant sales growth both globally and in Australia over recent years. Audi is now challenging Mercedes Benz and BMW for sales leadership in the Australian luxury market.

Vehicle sales (Top 30)

% change full year 2010 vs full year 2009

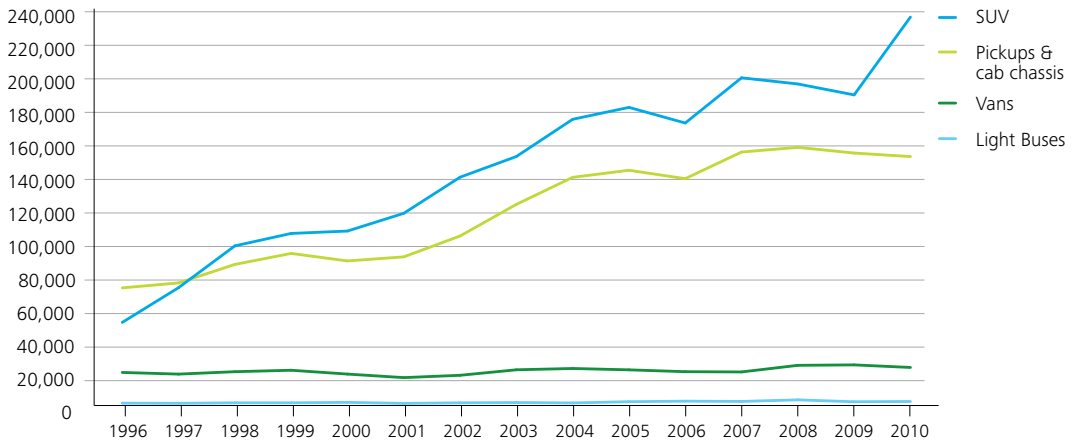
Full year 2010		Full year 2009	Full year 2010		Full year 2009	Full year 2010		Full year 2009
Isuzu Ute	43.40%	>999%	Proton	16.10%	-11.90%	BMW	5.20%	-1.00%
Jeep	42.50%	-19.90%	Audi	14.10%	20.20%	Citroen	0.10%	-40.70%
Skoda	31.90%	53.10%	Lexus	11.80%	-12.50%	Ford	-1.30%	-7.80%
Hyundai	26.60%	39.20%	MINI	11.70%	-2.50%	Peugeot	-1.70%	-20.80%
Volkswagen	26.40%	0.70%	Holden	11.20%	-8.30%	Honda	-2.60%	-21.20%
Land Rover	25.60%	-11.70%	Mitsubishi	9.60%	-6.10%	Chrysler	-19.50%	-26.40%
Kia	22.90%	-1.30%	Subaru	9.60%	-5.20%	Renault	-20.50%	-24.80%
Suzuki	22.10%	-9.90%	Mazda	9.10%	-2.60%	Dodge	-21.20%	4.70%
Nissan	18.50%	-10.70%	Toyota	6.80%	-15.90%	Fiat	-29.00%	-11.00%
Mercedes-Benz	17.50%	2.50%	Volvo Car	5.90%	4.50%	Great Wall	250.80%	-

Source: VFacts

As seen in the chart above detailing vehicle sales of the top 30 brands by volume, sales are volatile between periods. Although the market was up 10.5% overall, individual movements by brand differ significantly. The automotive industry is notoriously cyclical with many brands having peaks and troughs through product cycles. Although many brands now have a huge range of models, this adds a further complexity making it difficult to achieve advertising cut through for slow selling models and escalating holding costs.

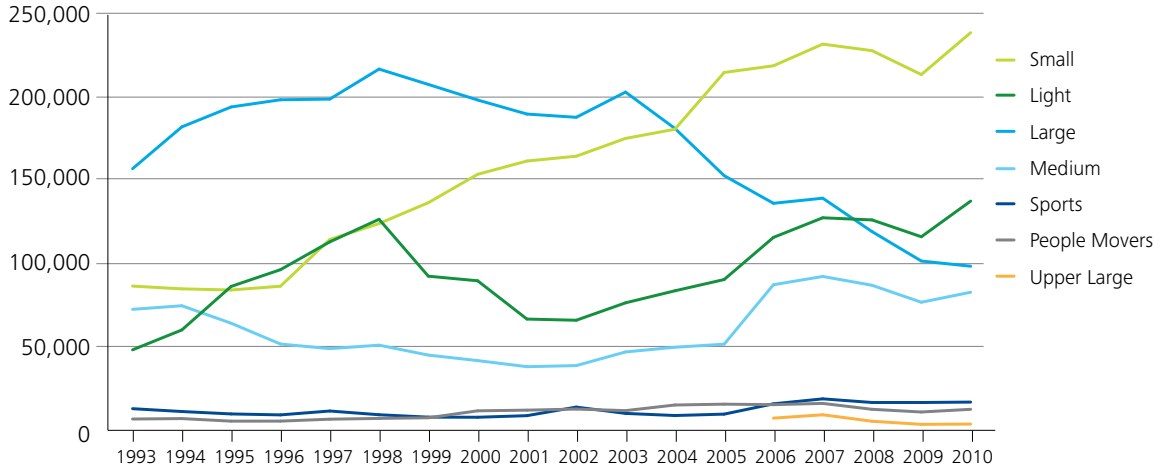
The People Mover segment is a prime example where the cost of stocking a slow moving line is proportionately very high. Once hailed as the new family car segment in the 1990s, it has failed to live up to expectations and now represents just over 1% of the total industry sales. Today few car companies compete in the segment. As seen in the chart below, the SUV segment is now the vehicle of choice for families. SUV sales now represent one in five vehicles sold across the industry.

Segmentation trend
SUV & light trucks



Source: VFacts

Segmentation trend
Passenger



Source: VFacts

As economy and fuel considerations become more important in consumer's minds, the small and light car segments have grown commensurately. The small car segment alone now represents close to a quarter of total sales. The reduction to the large car segment is evident. As seen in the chart on the previous page, the once dominant large car segment continues to decline despite vastly improved value for money offerings. Historically supported by subsidised fleet sales and dominated by the locally produced Holden Commodore and Ford Falcon, the decline of locally built cars mirrors the decline in locally produced vehicles. As seen in the chart which follows, locally produced vehicles now account for just over 14% of total industry sales.

The strong Australian Dollar has helped importers. So has the general nature of the Australian automotive market. With tariffs reduced to 10% from 1 January 2010 and with Free Trade Agreements already operational with Thailand and the USA, the Australian market is one of the most open and competitive in the world. No less than 46 passenger brands and 14 heavy truck brands complete in Australia. The winner is surely the consumer who now enjoys a vast choice.

Locally manufactured vs imported new vehicles

	Full year 2010		Full year 2009		% Change
	Volume	% of total market	Volume	% of total market	
Holden	59,362	5.7%	58,535	6.2%	1.4%
Ford	50,173	4.8%	54,100	5.8%	-7.3%
Toyota	36,778	3.6%	34,756	3.7%	5.8%
Mitsubishi	1	0.0%	10	0.0%	-90.0%
Total Locally Manufactured	**146,314**	**14.1%**	**147,401**	**15.7%**	**-0.7%**
Total Imported	**889,260**	**85.90%**	**789,927**	**84.3%**	**12.6%**
Total Market	**1,035,574**	**100.00%**	**937,328**	**100.0%**	**10.5%**

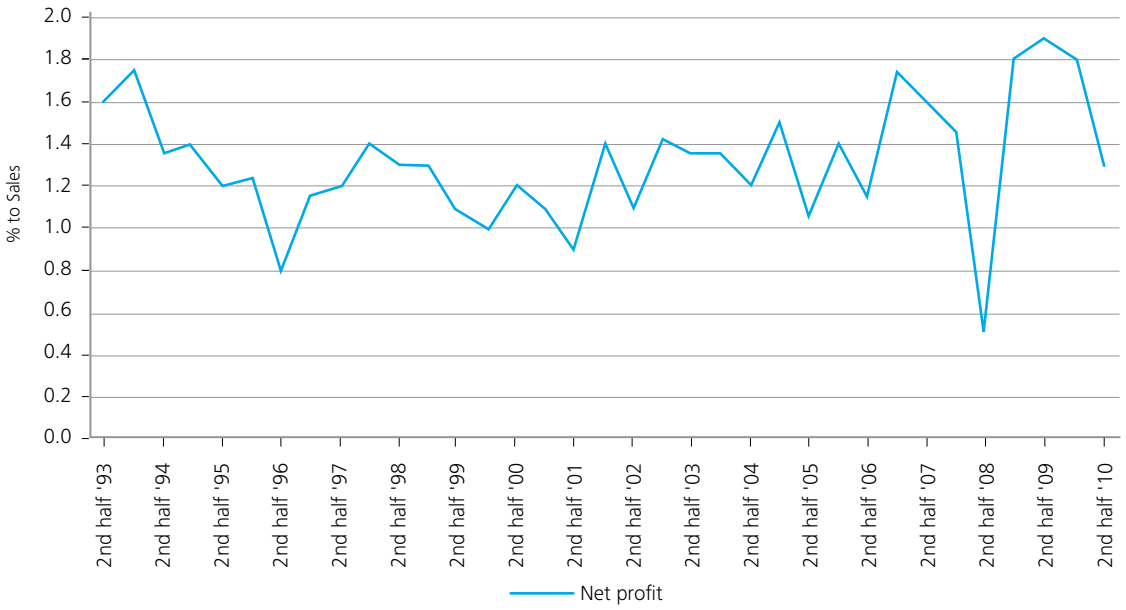
Source: VFacts

Dealership profitability

Dealership profitability

The past two years has been the most extraordinary period for the automotive industry. Paradoxically, it was the global financial crisis which acted as a catalyst to produce unexpectedly strong trading results for automotive dealers.

Net profit % of sales
Industry trend



As seen in the chart above, net profit to sales for the average Australian dealer in the Deloitte Profit Focus database soared to just under 2% during the height of the GFC in 2009. This was the best result for decades.

The GFC hit the global automotive industry hard. An industry which historically had been characterised by excessive new vehicle inventories, dramatically pulled back production as key global markets (e.g. USA) crashed. The result was a lower, though some would say more realistic level of inventory across the industry. As demand lifted with the Federal Government stimulus package, near record low interest rates and restored consumer confidence, dealer revenues lifted.

On the expense side of the equation, the GFC provided the environment to change work cultures, cull out inefficiencies, improve staff retention, tighten expenses and negotiate more competitive deals from distressed suppliers.

The net result was significantly above average profits for dealers. It was indeed a golden era, albeit short lived. 2010 saw net profits fall to around 1.2–1.5% as the government stimulus package ended, interest rates began to rise and critically a renewed supply push of inventory meant holding costs rose and gross margins fell.

As seen in the charts below, most brands enjoyed a peak in profits over 2009 followed by a decline in 2010. Nonetheless, 2010 was at least better than 2008 which included the devastating second half when the industry collapsed before the government intervention lifeline was introduced in 2009.

An interesting observation during these volatile times was the gap between the average and Top 5% best performing dealers widening. This implies that the best operators always strive to maintain a culture of operational excellence at all times. Such dealers do not become complacent during good times. Many of the Top 5% best dealers were achieving profits of at least 4-5% of sales, over double that of average operators in the better trading times.

The clear points of difference for the Top 5% elite Dealers as identified in a recent McKinsey survey in the USA are their internal Dealership practices. They include:

- Talent management
- Customer loyalty
- Performance planning

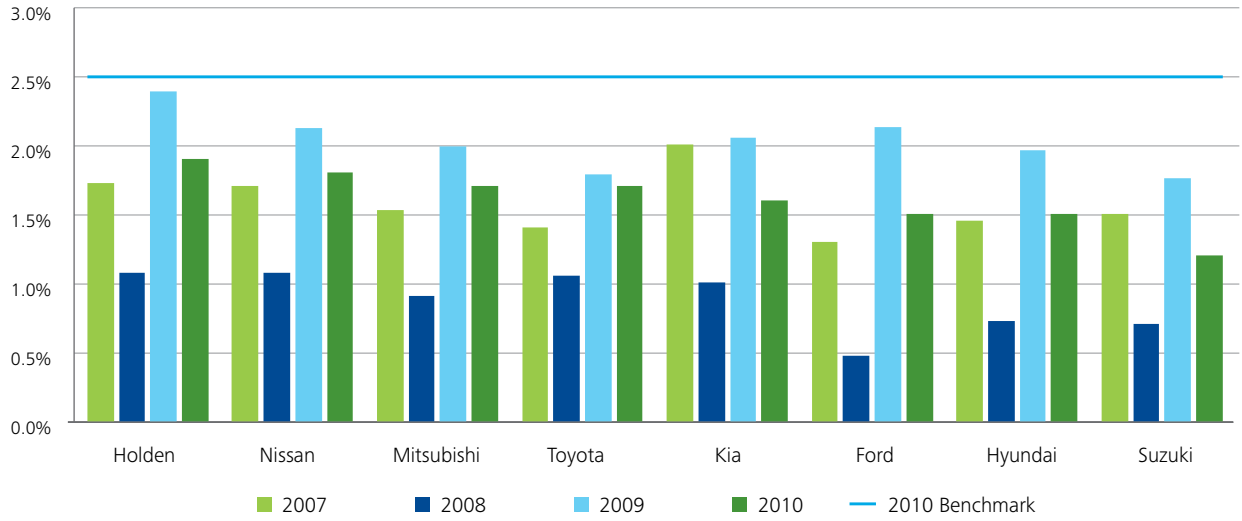
Talent Management begins with effective recruitment practices and nurturing staff to develop their ability through structured and ongoing training to ultimately create tomorrow's leaders.

Customer Loyalty centres on organised retention practices that reduce reliance on conquest business by offering a sufficiently positive experience each time the customer calls to ensure they return again.

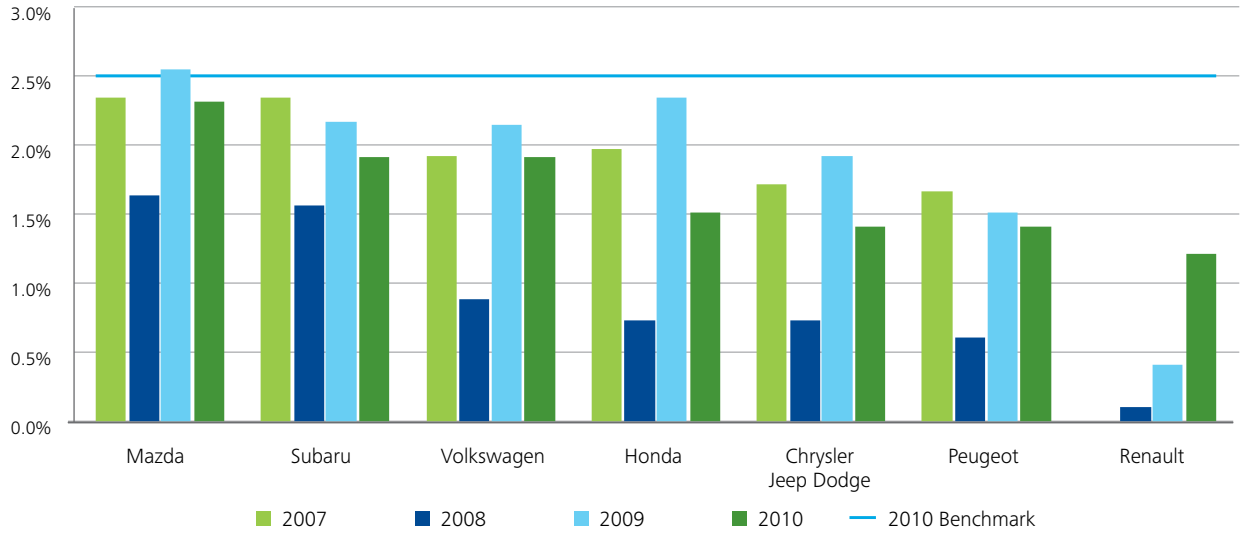
Performance planning ultimately ties all operational activities together.

Net profit % of sales

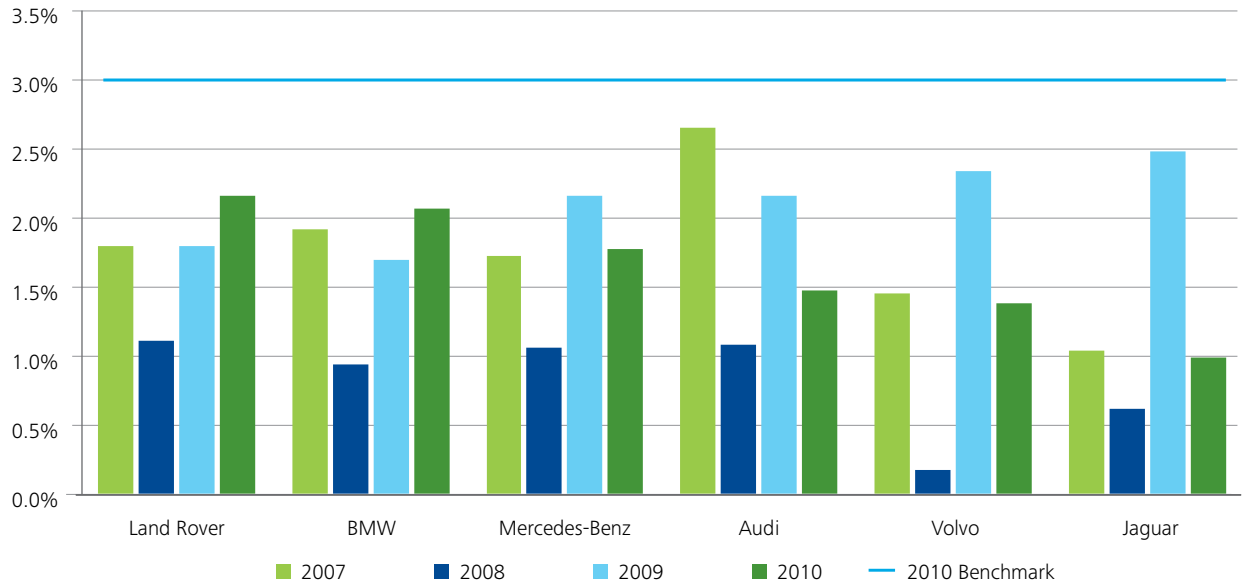
Non luxury



Net profit % of sales
Prestige



Net profit % of sales
Luxury



New vehicle profitability

New vehicle profitability

The Australian automotive industry is one of the most open and competitive markets in the world. For a country of 22 million people there are actually more brands than the USA, a country fifteen times larger with a population of some 300 million people.(for example, Alfa, Fiat, Renault and Citroen were not represented in the USA in 2010, though Fiat is set to return in 2011 off the back of the Chrysler network).

46 car and 14 heavy truck brands are represented in Australia, including Chinese and Indian brands which are also yet to compete in the USA.

Vehicle import quotas and tariffs have progressively been withdrawn over the last two decades. The current import tariff of just 10% is in stark contrast of the 57.5% rate of barely more than 20 years ago. Australia now has Free Trade Agreements (zero tariff) with the USA and Thailand with negotiations in place with a number of other countries.

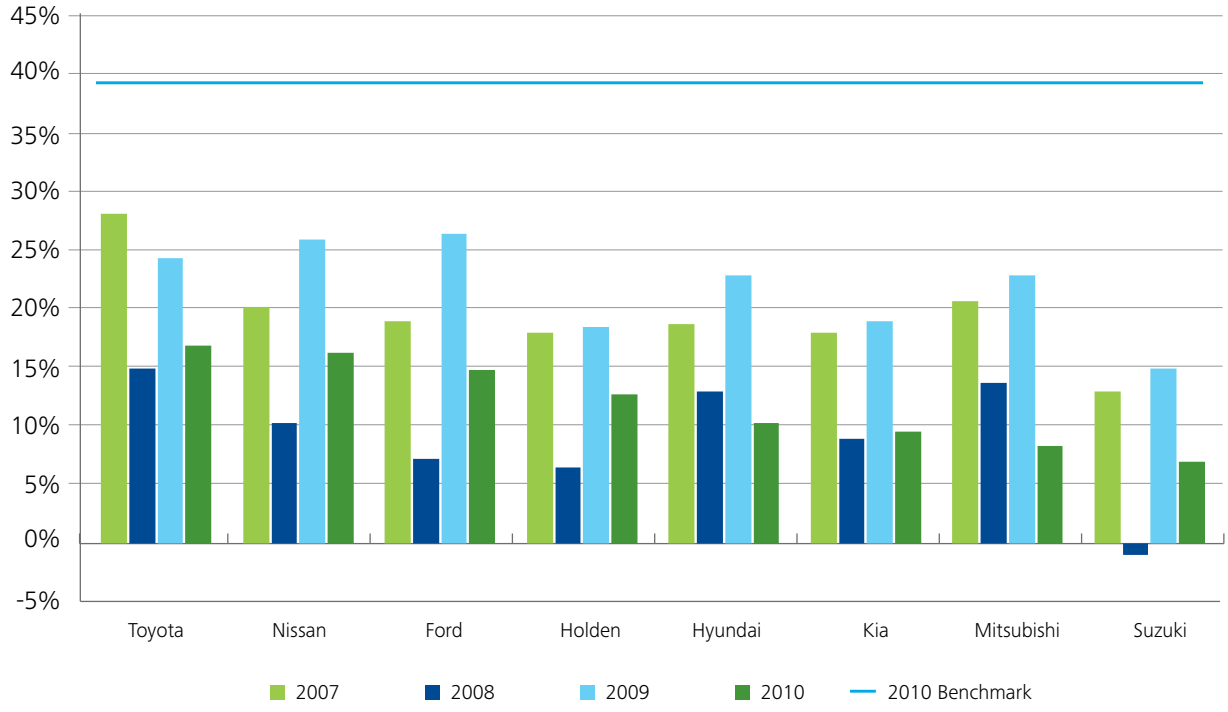
The strong Australian dollar has made it tough for local manufacturers to compete. Imported vehicle prices have fallen due to these favourable exchange rates along with competitive pressures.

Indeed it is a very competitive market which has long been characterised by lean margins and weak new vehicle profitability. After allocating a share of dealership overhead expenses such as rent and administration costs, the average Australian dealer loses money selling new vehicles.

Even at a department selling gross level (department gross profit less department variable and semi-fixed expenses) results remain diminished. As observed in the charts below for non-luxury and prestige brands, even though results did improve over 2009, a general decline in overall department profitability occurred in 2010.

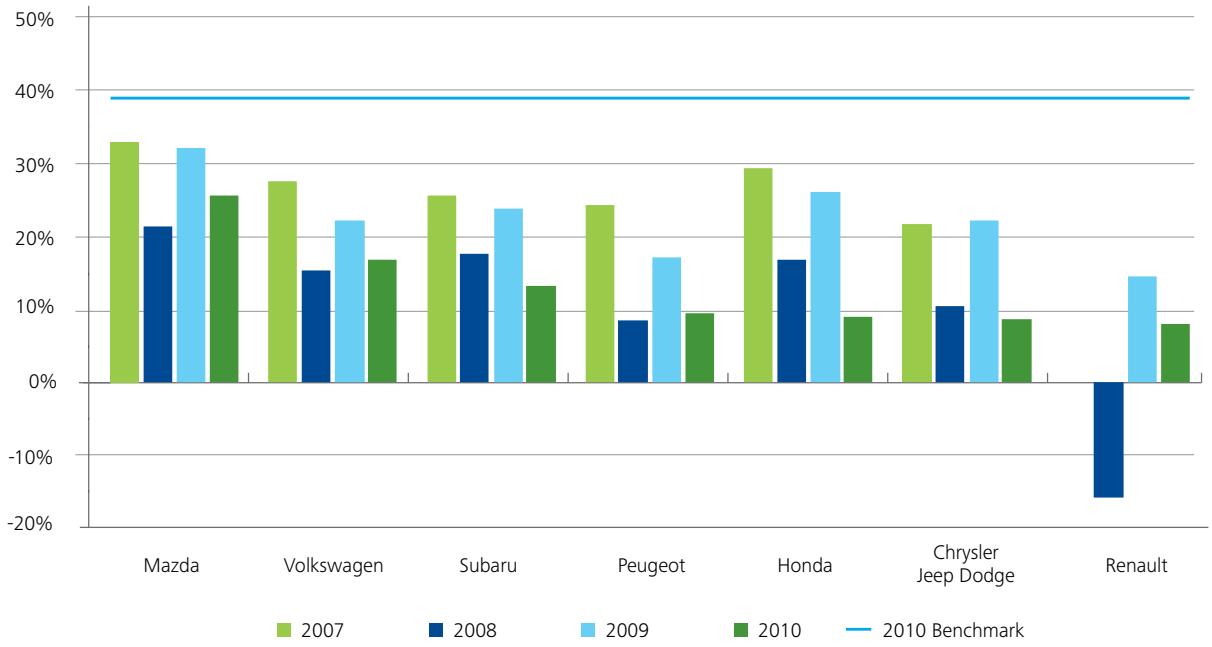
Rising inventory levels producing lower margins from increased holding costs were contributing factors to the decline in profitability.

New selling gross %
Non luxury



New selling gross %

Prestige



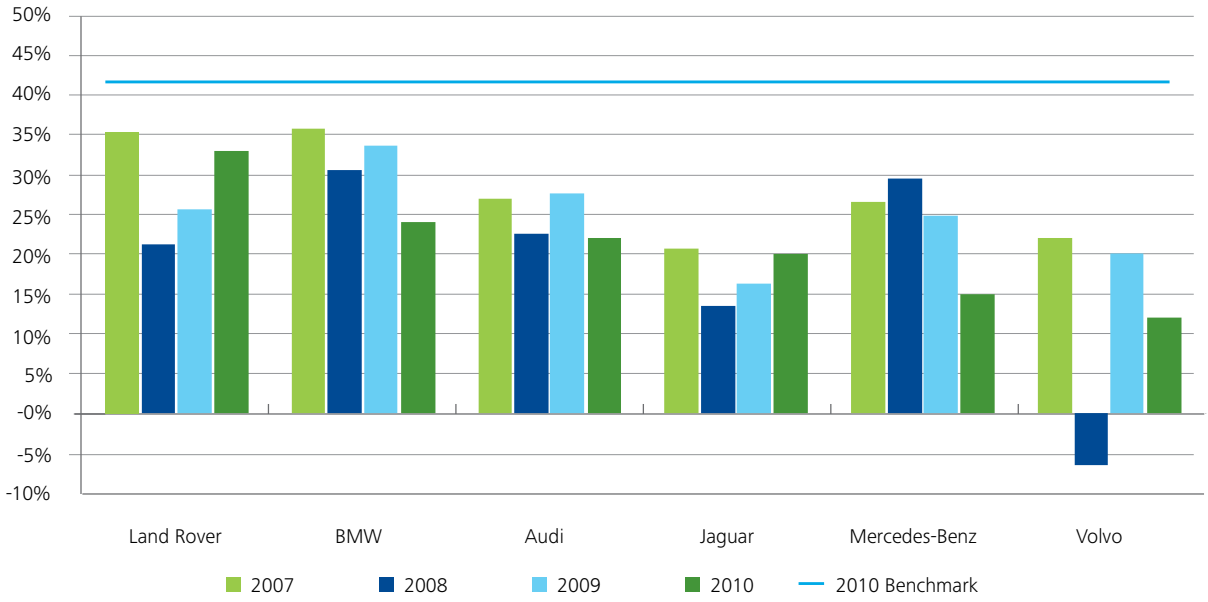
The luxury market has been extremely challenging. As expected, the GFC had its greatest impact on higher end product sales across the broader economy.

The recovery did restore some confidence, however the Australian luxury vehicle market has seen a significant increase in inventory supply push originating from overseas markets.

Local distributors and dealers have been under significant pressure to shift predetermined volumes of inventory. This has seen a shift from new vehicle income remaining at the front of the deal to being re-earned post-sale based on meeting volume targets.

As seen in the charts below, the two biggest luxury sellers in Mercedes-Benz and BMW both sustained significant drops in selling gross and generally weaker gross margins over the recent periods. In some cases significant factory incentives based on broad criteria are allocated to the total dealership bottom line as other income rather than departmentalised in new vehicles.

New selling gross %
Luxury

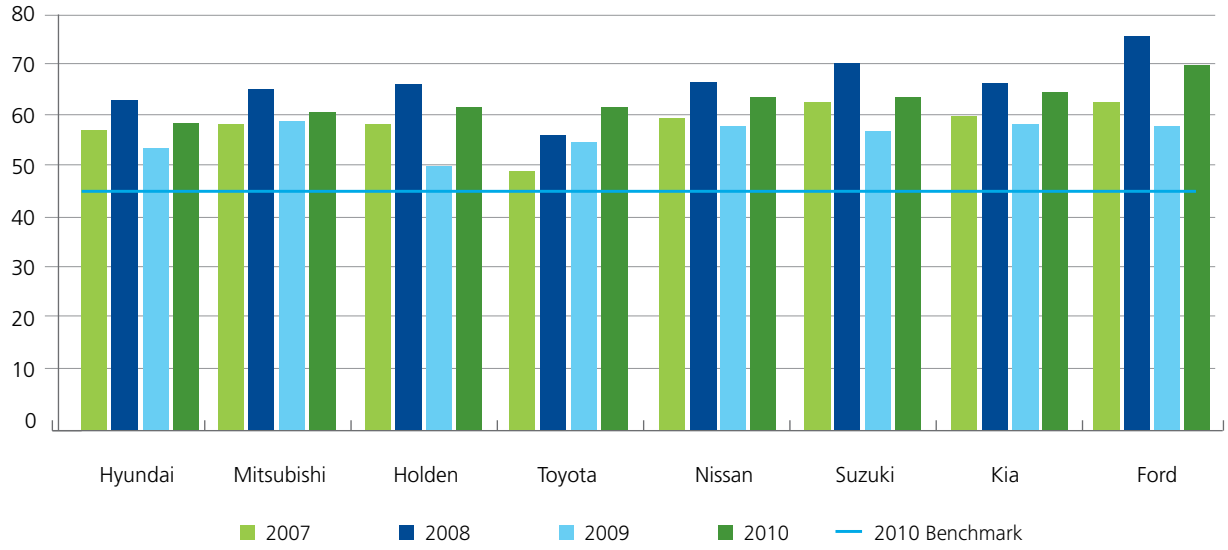


The correlation between inventory levels and gross margins is direct. As seen in the charts below, 2009 was a period where inventory levels fell as a result of vehicle manufacturers slashing production in response to the GFC which consequently lifted gross profit margins for almost all non-luxury brands.

As the market reverted back to a more pre-GFC supply 'push' environment, inventory levels rose in 2010 and consequently gross margins began to fall. Excessive inventory levels inevitably lead to distressed marketing and downward pressure on gross margins.

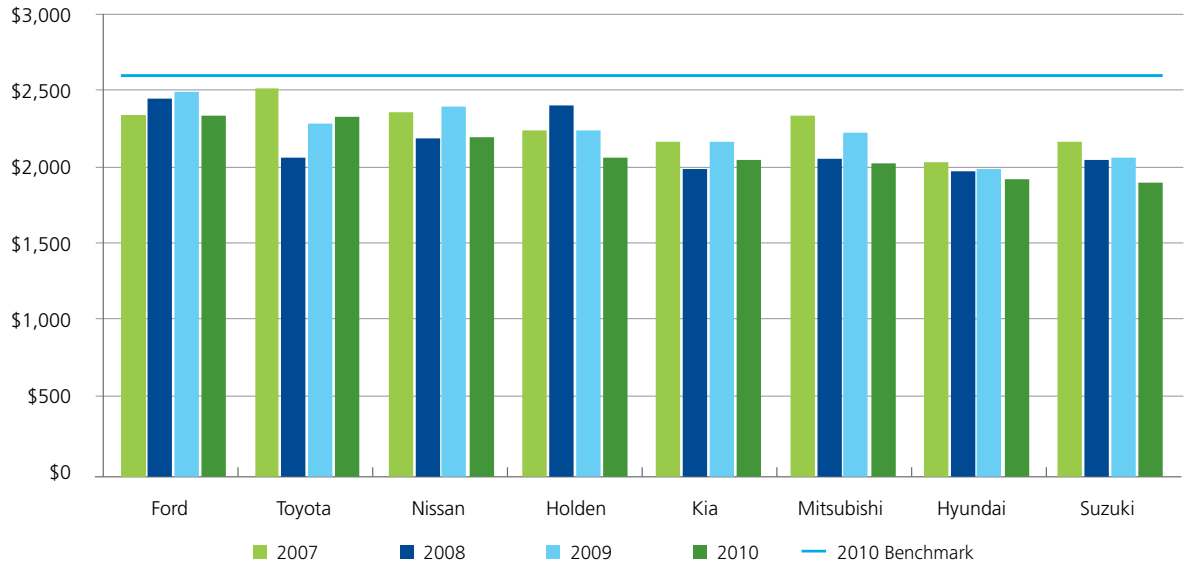
New days supply

Non luxury



Gross profit $ per new vehicle retailed

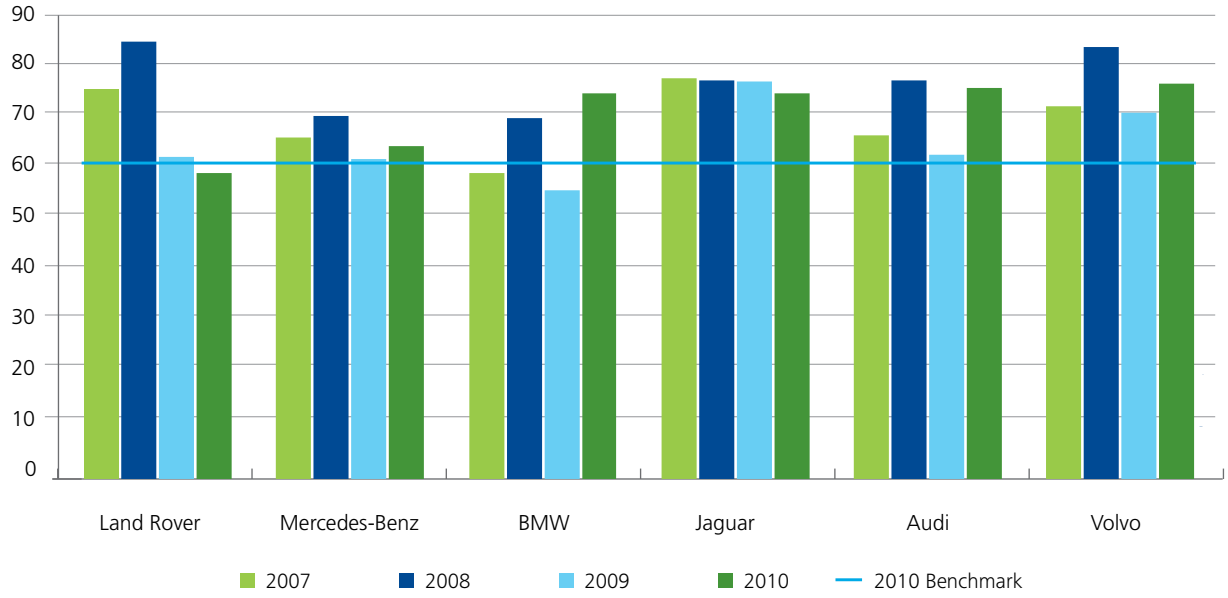
Non luxury



As raised earlier, it was Australia's perceived relatively healthier economic state and capacity to absorb excess inventories built up overseas which created a market characterised by supply push, resulting in some cases of significant preregistered vehicle sales volume. Preregistered vehicle sales create an illusion that days' supply is lower than reality. However the pull forward effect and impact on vehicle residual values poses a threat of longer term damage to the brand.

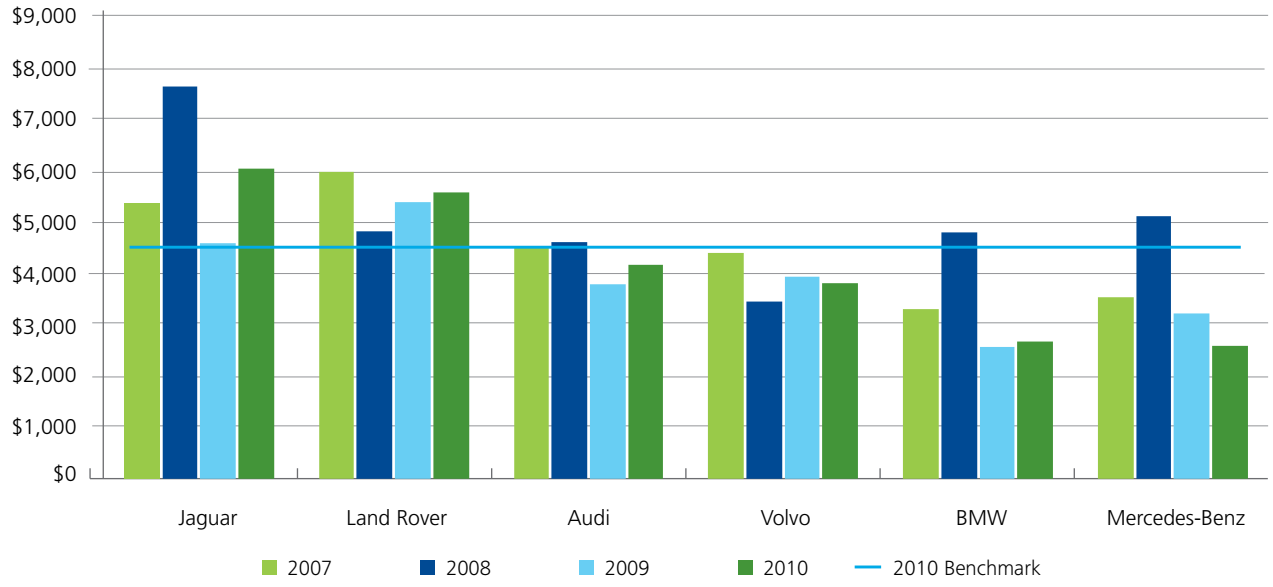
New days supply

Luxury



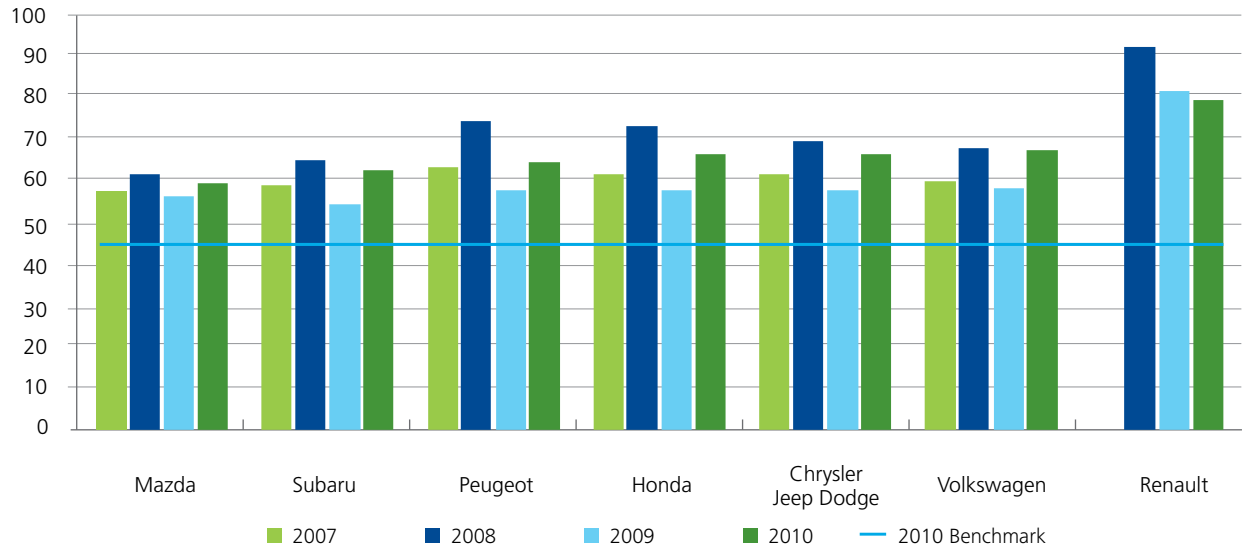
Gross profit $ per new vehicle retailed

Luxury



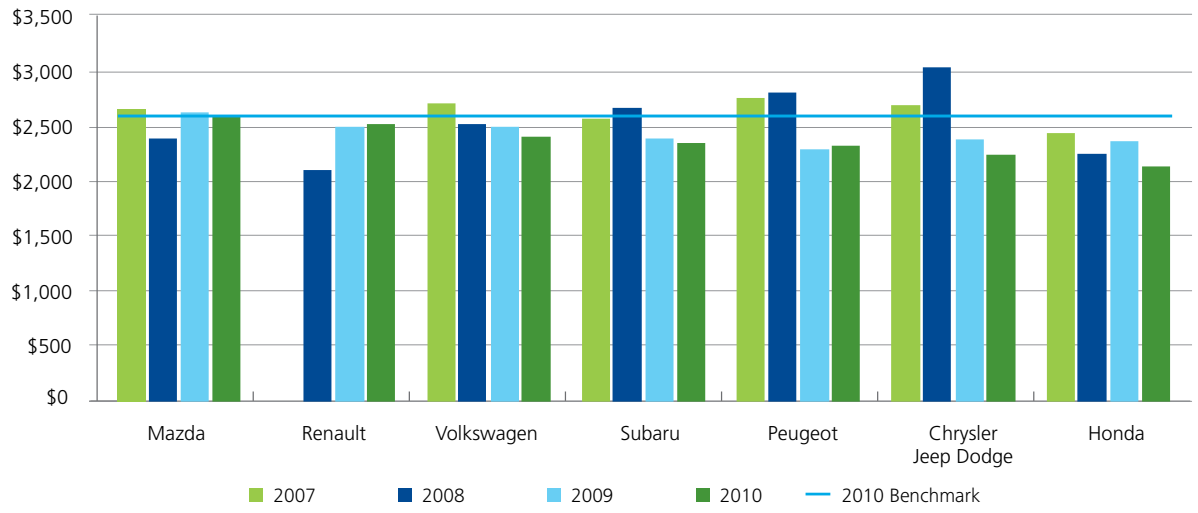
New days supply

Prestige



Gross profit $ per new vehicle retailed

Prestige



Used vehicle performance

Used vehicle performance

The used vehicle department has long been one of the most challenging aspects of operating a franchised dealership. The market is influenced by many factors, particularly the new vehicle market and general economic conditions.

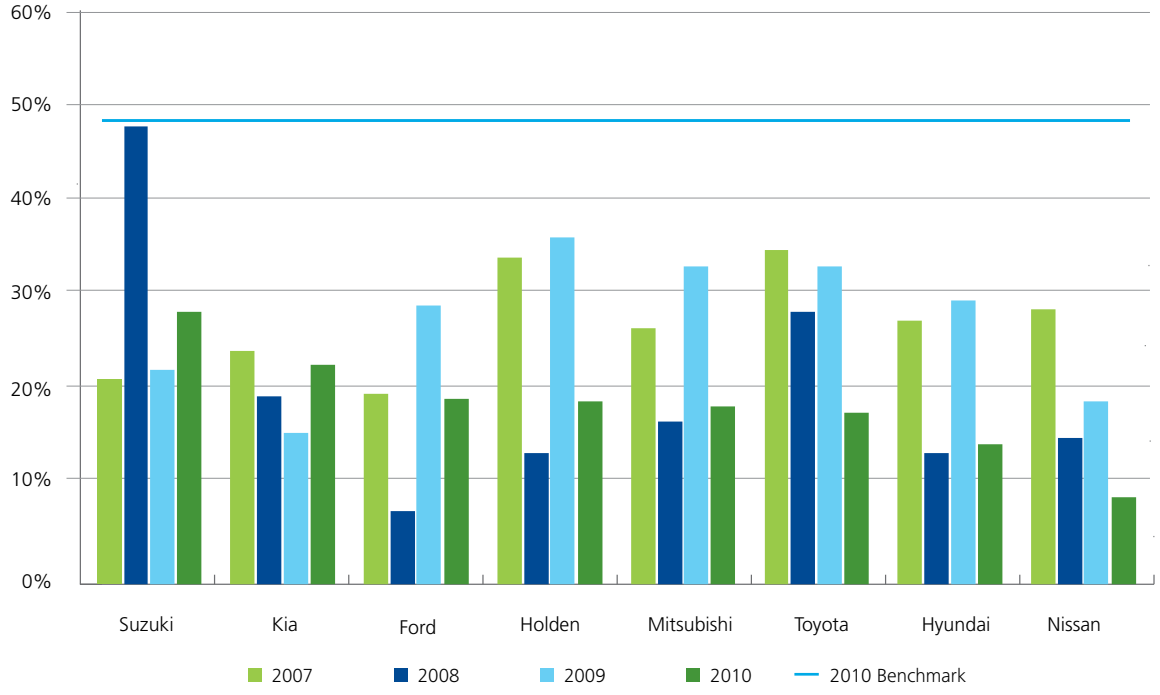
The extraordinary volatility experienced over the last two years in the automotive industry and across the broader economy has created both threats and opportunities. The good used car operators are true 'traders' and understand the implications of all the influencing factors and manage their operations accordingly.

The textbook theory applies of market behaviour played out in practice over such volatile times. As seen in the charts below, the relationship between inventory levels (both new and used), new car price movements and changes of key economic indicators are well correlated.

From the first half of 2008 when the impact of the GFC was being felt, interest rates were still generally rising, along with new vehicle inventory levels while at the same time new car prices were falling. The flow on effect for used cars was severe. Almost all brands sustained declining gross profit margins and used vehicle department performance, as measured by selling gross, fell significantly.

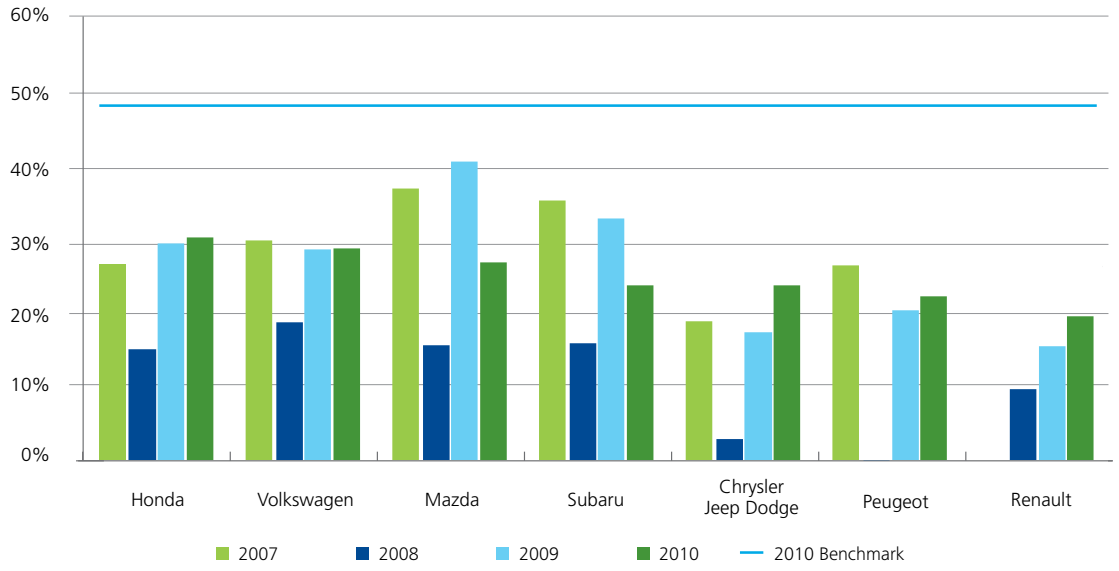
Used selling gross %

Non luxury



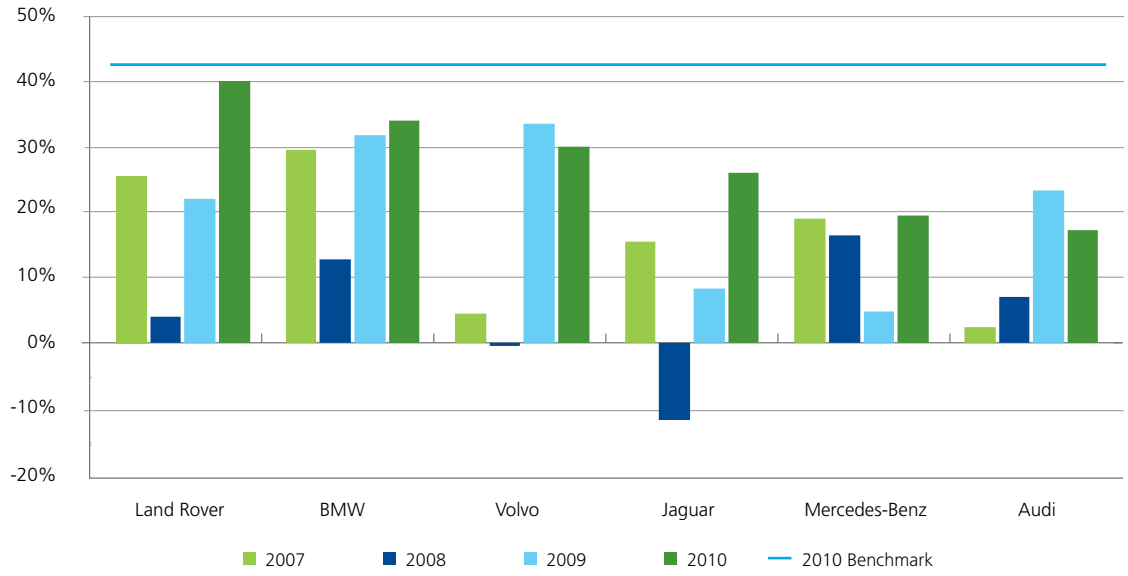
Used selling gross %

Prestige



Used selling gross %

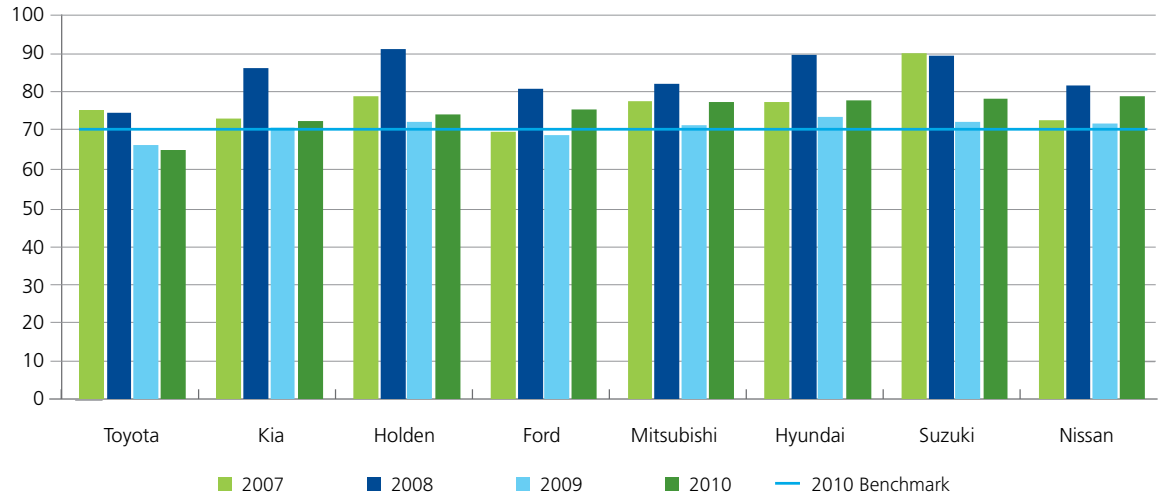
Luxury



Trading conditions completely reversed in 2009. As the GFC started to affect the broader economy, interest rates fell from over 7% to around 3–4%. Both new and used inventory levels dropped as vehicle manufacturers slashed production. At the same time, new car prices started to rise with a weakening Australian dollar. It was at that point theoretically the best possible used vehicle trading environment. Not surprisingly, gross profit margins and used vehicle selling gross consequently rebounded. Dealers were enjoying good times, however the good times came to an end as 2010 began.

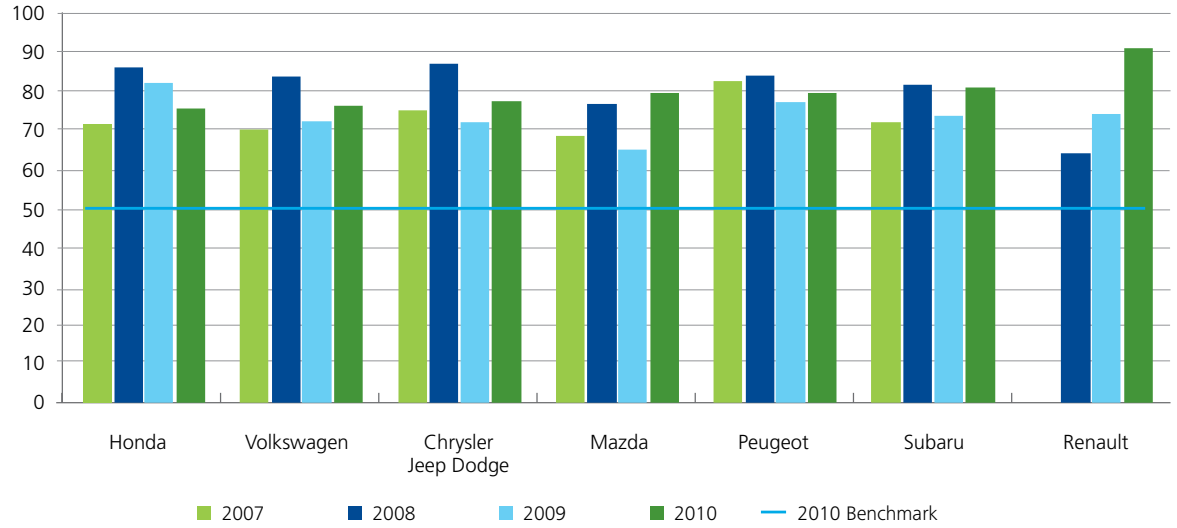
Used days supply

Non luxury

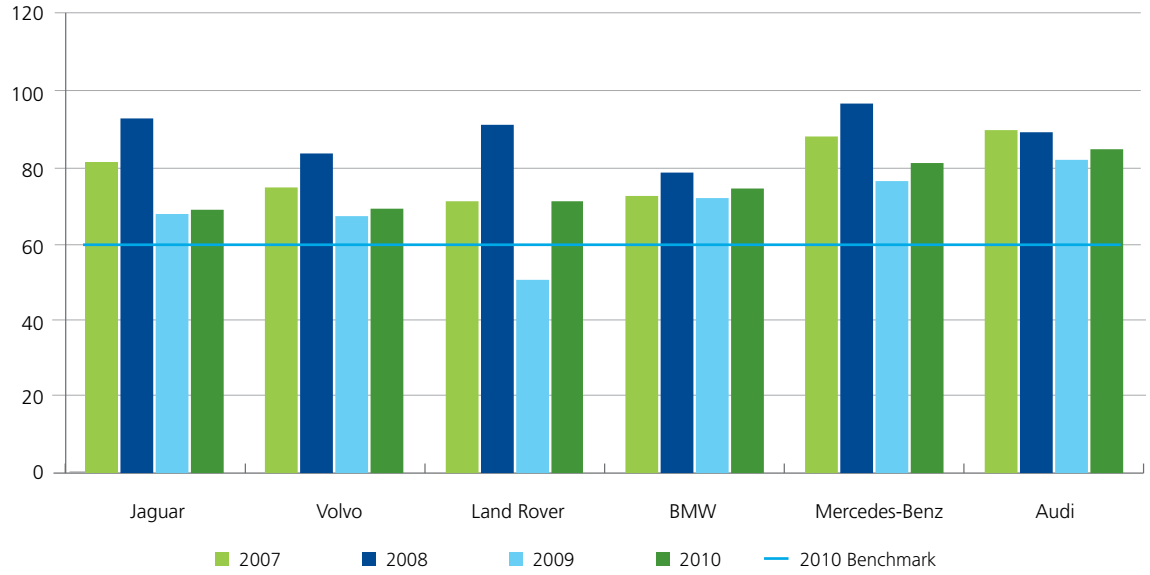


Used days supply

Prestige

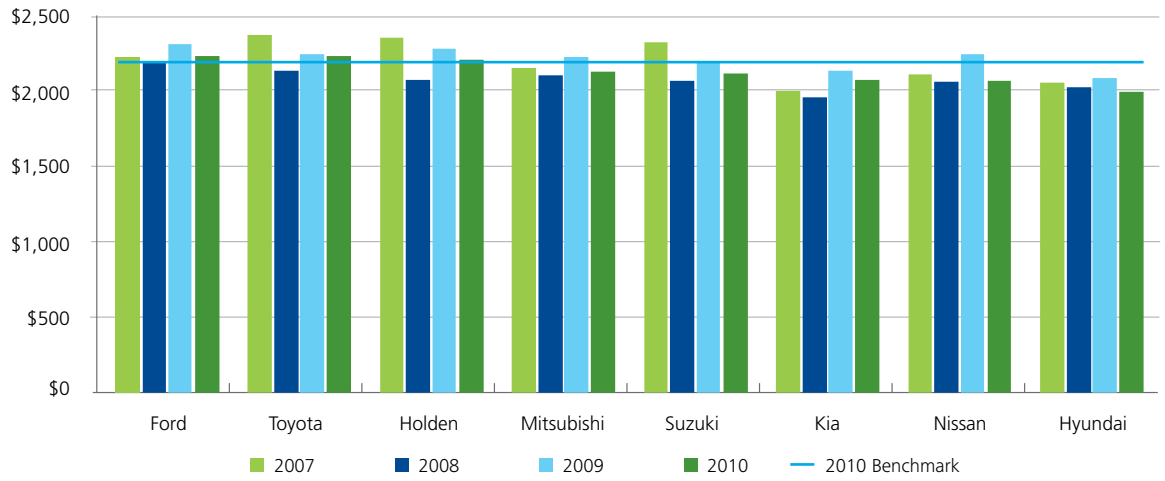


Used days supply
Luxury

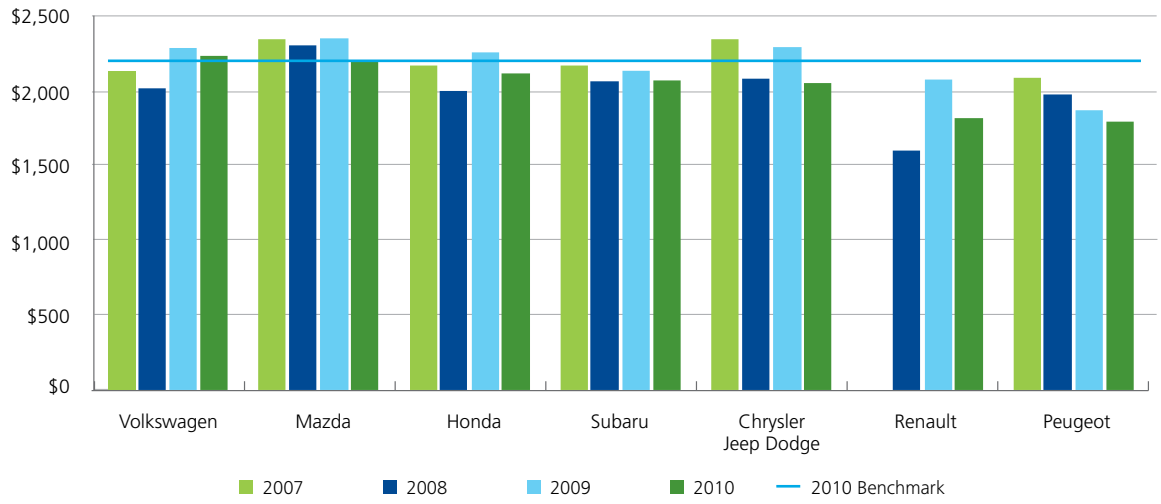


Although residual effects of the GFC lingered on, the worst appeared to be over at the start of 2010. Interest rates started to rise along with resource prices, which were being fuelled by the booming Chinese economy. Consequently, the Australian dollar also rose, enabling importers to drop prices of their model ranges. While the USA and European economies stumbled along, vehicle distributors looked upon the Australian market to absorb capacity overseas. The resulting supply push and flood of new inventory created challenging trading conditions for used car operators in Australia. Again, not surprising, trading results reflected the textbook theory with weaker used car performances experienced across most brands, particularly in the latter part of 2010.

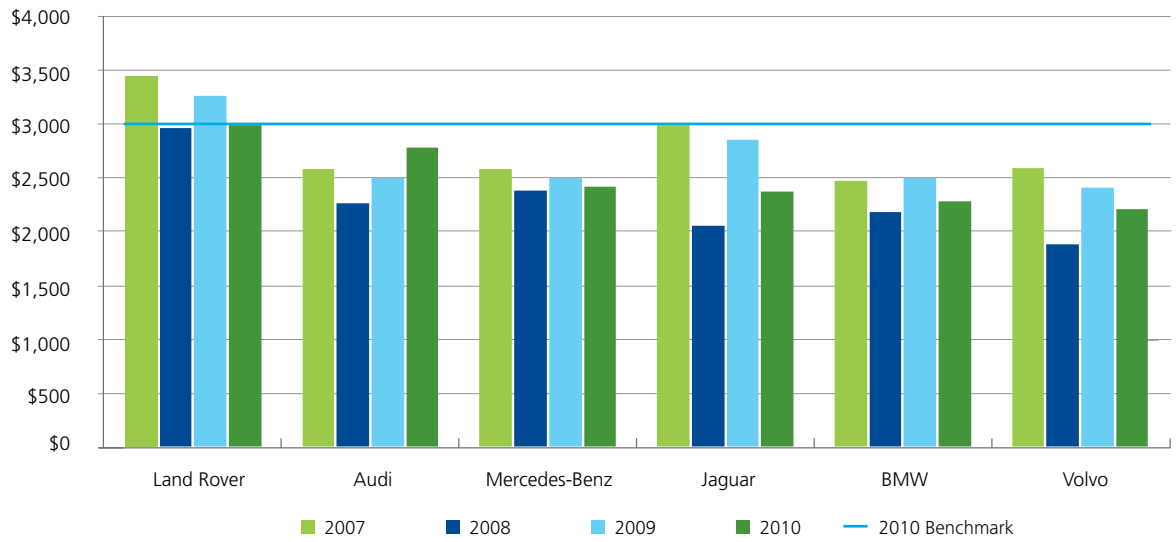
Gross profit per used vehicle retail
Non luxury



Gross profit per used vehicle retail
Prestige



Gross profit per used vehicle retail
Luxury



So what lessons need to be learnt (or re-learnt) over this volatile past two years? Firstly, from a broader perspective, it is critical to recognise the consequences of an aggressive supply push of new vehicle inventory. Understandably during the events of the GFC there was a financial imperative to shift excess new inventory overseas and inject much needed liquidity (funding) into the working capital of manufacturers. The GFC was an extraordinary event and manufacturers during more normal trading conditions should attempt to recognise the pursuit of sales to satisfy volume targets using a supply push strategy is questionable. The public admission by Toyota global head Mr Toyoda at a press conference in the USA of this very fact is a sobering reminder.

At a dealership level it is recognised time and again, the key to a well run used vehicle operation is inventory management. This fact has not altered in decades!

The best used vehicle operators know that gross profit is generally made at the point of acquisition. They proactively manage their inventory with reference to prevailing trading conditions. They adjust inventory prices dynamically (weekly), aiming for a desired maximum return on investment (ROI). The internet, rather than being an enemy can be used as a 'real time' point of reference in order to assess the market value of stock and as a means of clearing inventory before it becomes a problem.

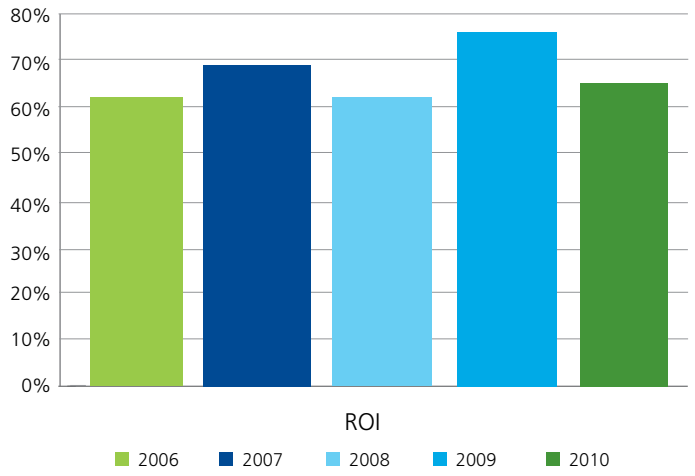
The very best used car operators proactively managed their businesses during the GFC and did not sustain the volatile swings of the broader market. Indeed, during the most challenging times the gap between the best operators and average increased significantly.

The best used car dealers are now formally incorporating gross return on investment (ROI) as part of their performance criteria. Rather than focusing purely on the transaction value achieved (i.e. gross profit), ROI provides a more inclusive measure of performance by factoring the cost of sale and most importantly the number of days the vehicle was in stock. (ROI = gross profit divided by cost of sales times annualised turnover rate).

For all these factors detailed above, the best used vehicle ROI achieved over recent times across the industry was in 2009.

Used vehicle ROI

Return on investment



The impact of the internet has become pervasive across the commercial world. Its impact on the automotive industry has grown considerably over recent years. All dealerships with only a miniscule number of exceptions have an internet website. Many now have dedicated departments devoted to managing internet lead enquiries and overall online activity.

When customers arrive at the dealership, 88% of them have already used the internet to determine the type of used vehicle they wish to purchase, the specification and have some idea of competitive pricing. The best dealer operators are managing their internet departments using the same core principles as a traditional sales department. They measure performance against operational benchmarks such as follow up response time, appointments to inquiries, test drive and the conversion ratios of each. **The core principles of communicating with customers have not changed, just the means of communication delivery.**

Another impact of the internet has been on vehicle trades. Dealers will usually achieve better results by sourcing vehicles through customer trade-ins rather than buying through external sources such as an auction. The internet has provided customers a means of disposing their original vehicle privately, rather than trading it in to the dealer. This important source of inventory has been steadily declining for dealers. The better dealers are attempting to curtail this decline by promoting their dealership on it's inherent strengths including convenience, wide choice, buying in confidence, security of title and warranty support. Plus the same better dealers are sourcing trading stock from vehicles listed for private sale on the web.

The biggest issue impacting used vehicles now and into the future is the share-of-real-estate to display. Over time as new vehicle volumes have grown, more dealership real estate has been absorbed by new vehicle showrooms and display. To counter this, Dealers need to secure more of their front apron for used vehicle display.

Finance and insurance

Finance and insurance

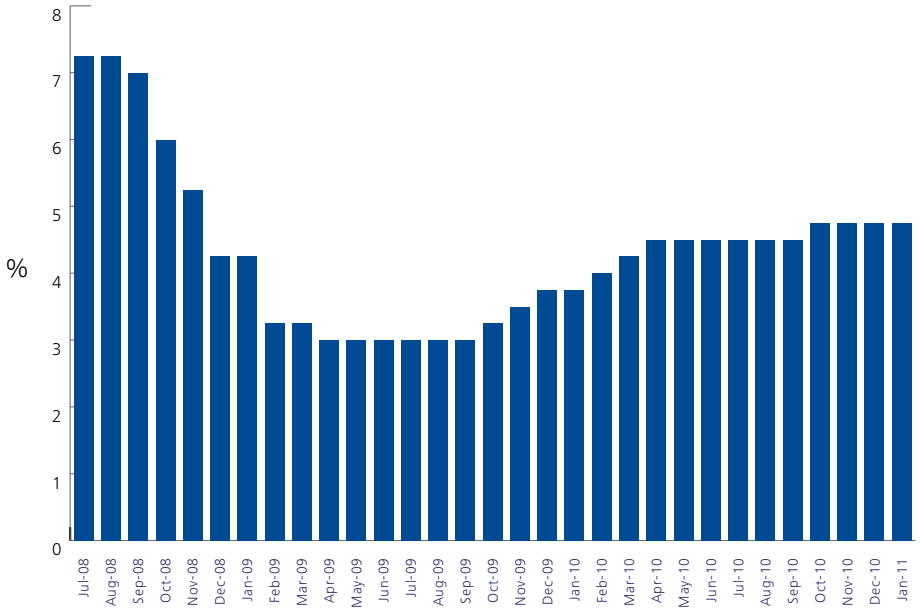
For many retail and service industries operating in ultra competitive markets throughout the commercial world, an anomaly has been created whereby profits flowing from the sale of core products are at best marginal while secondary products contribute to the bulk of the overall bottom line. This is precisely the case for automotive dealers who typically lose money selling their core product (motor vehicles). They have become increasingly adept, though at the same time dependent upon related activities such as finance and insurance, aftermarket products, parts, accessories, servicing and repairs.

The contribution to total dealership profit of finance and insurance (F&I) is very significant. If measured in terms of pure gross profit contribution (i.e. before taking into account any direct expenses) for a well balanced dealership, F&I should contribute at least 12% of the total dealership gross profit generated by new, used parts and service departments. On a net basis however, F&I often contributes to at least half the total dealership bottom line on average. For some dealers it represents the entire bottom line. Some would say such dealerships are too dependent on F&I, particularly in the light of the uncertainty and vulnerability associated with the recent global financial crisis.

The legacy from the GFC has been a tighter credit market. There has been a shift in negotiating power from dealer to finance companies. Wholesale bailment margins have increased while official interest rates remain significantly below the pre-GFC period rates, although rates are creeping up with improving economic conditions as seen in the chart below.

Australian official interest rate announcements

Reserve Bank of Australia cash rate



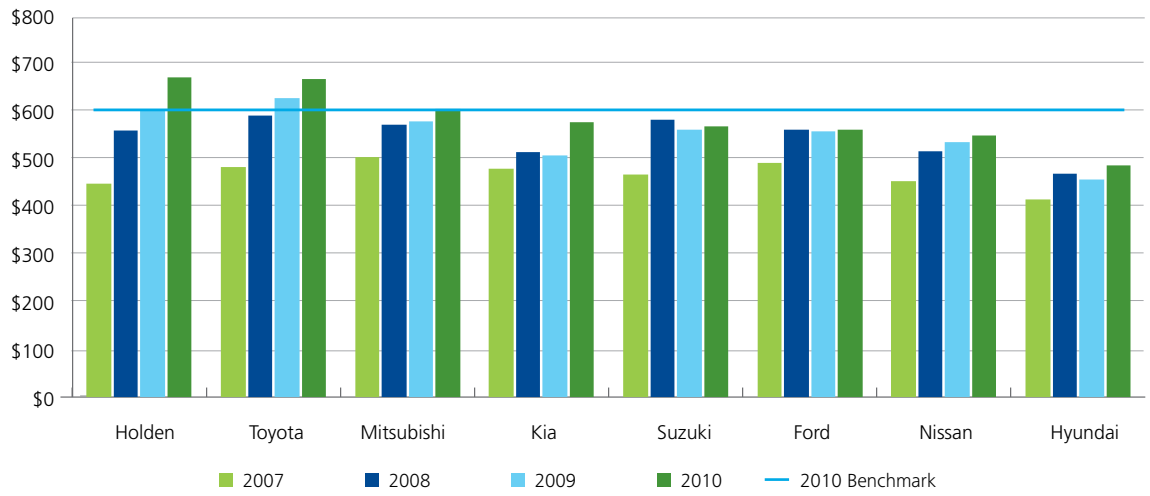
Source: RBA

Relatively low interest rates have stimulated consumer demand. However finance providers, spooked from the previous loose control of the credit binge leading up to the GFC, have become more conservative with their lending practices. Although financial providers are becoming somewhat less risk-averse than in 2009, anecdotal feedback from dealers indicates acceptance levels remain on the low side.

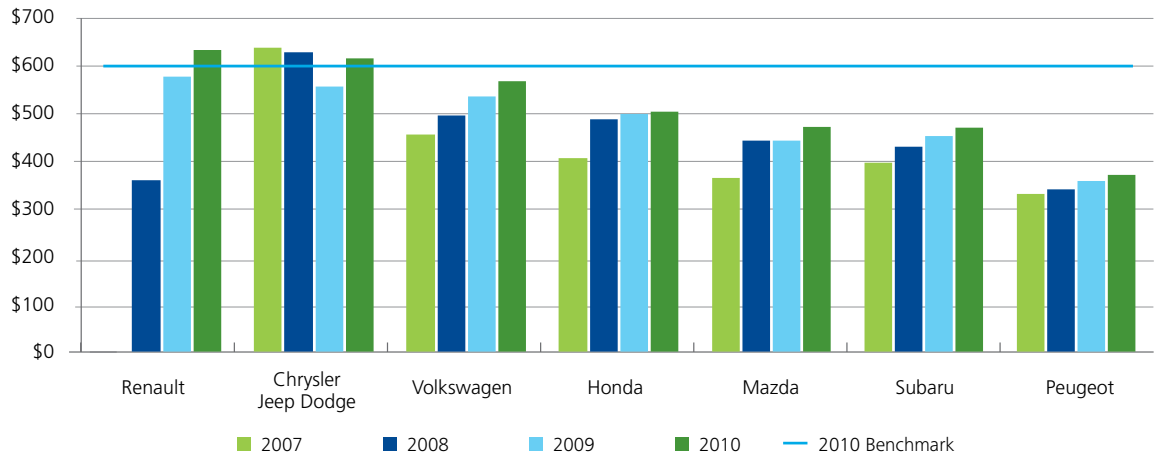
Consequently, finance penetration rates sit around 25–30% on average – well below the 40% plus level frequently experienced previously.

Nonetheless, opportunities for the good operators remain lucrative for studies continue to show that over 80% of vehicle purchases are not paid for in cash and financed in some form.

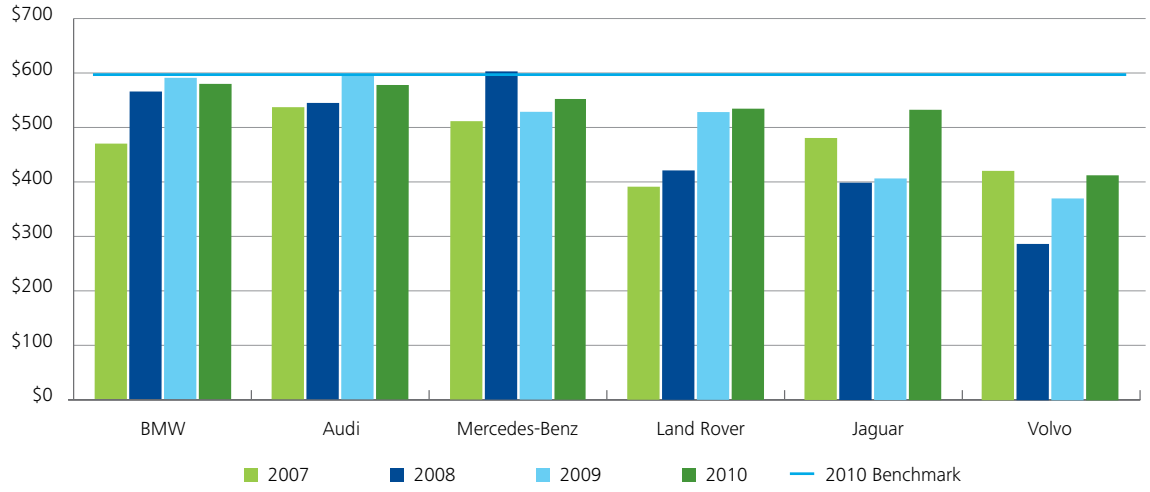
F&I Income PNVR
Non luxury



F&I Income PNVR
Prestige



F&I Income PNVR
Luxury



Perhaps the best measure of F&I performance is income per vehicle retailed. As seen on the charts above it is pleasing to see this has generally lifted over the last several years despite the inherent challenges of the GFC. A greater focus and accountability on F&I performance, the result of poor front end profitability, together with trained and informed staff are reasons cited. The extra income acquired through loan establishment fees is another.

Fixed operations (parts & service)

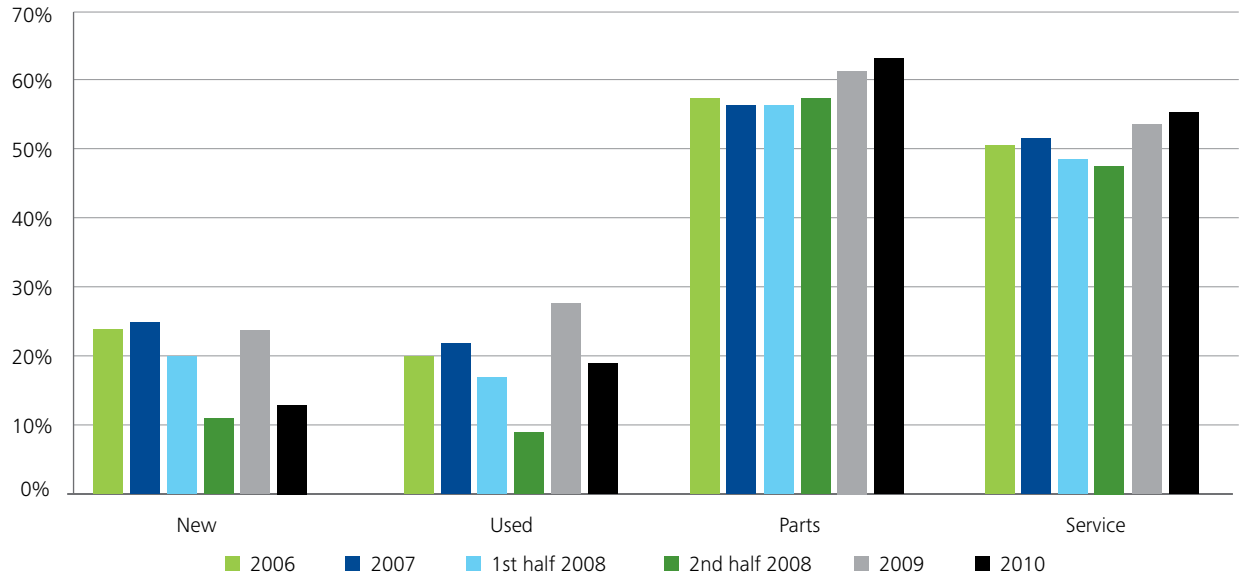
Fixed operations (parts & service)

Parts and service are now referred to collectively as 'fixed operations', implying they operate at a fixed, less volatile level but critically, operate together. This inherent feature was graphically illustrated during trading conditions of the GFC. As seen in the chart below, selling gross contribution from vehicle departments plummeted while the parts and service departments held firm.

This regular, more certain contribution clearly demonstrates the importance of building up strong parts and service operations in order to provide a buffer in volatile times. Astute dealers have long recognised this and have devoted more time to the so called 'back end' of the business, rather than the attention the 'front end' of the business tends to demand.

Fixed operations importantly plays a vital role in helping to offset the profitability drain commonly experienced in the vehicle departments. Vehicle operations are historically volatile, going up and down through product and economic cycles while parts and service provide relatively stable income.

Selling gross by department

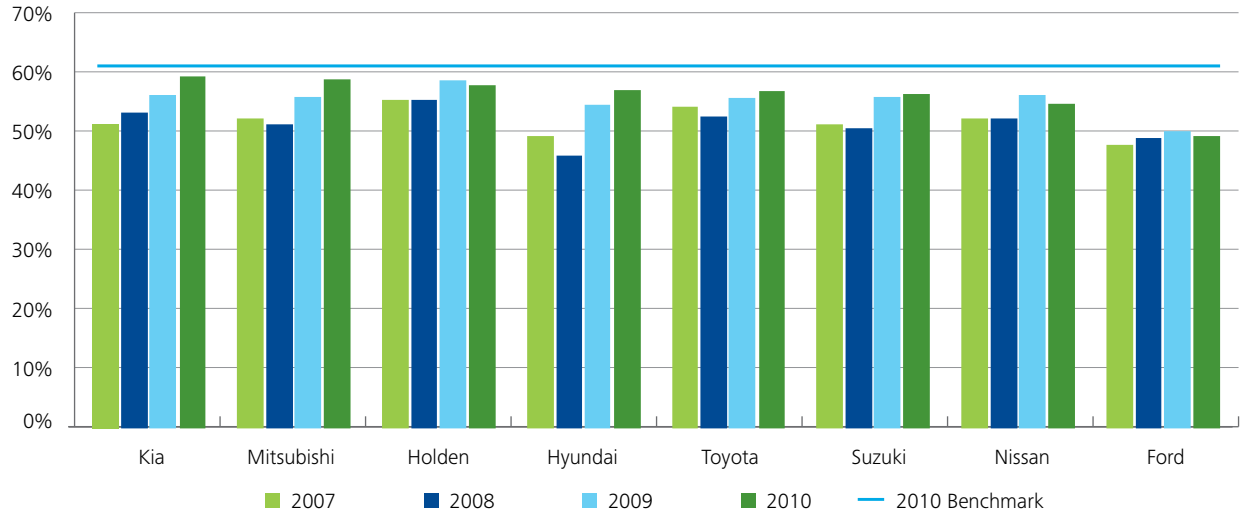


A dealership's ability to buffer any economic storm is often measured by 'parts and service absorption' or the ability of the parts and service income to cover total dealership fixed expenses. The higher the percentage, the easier it is for the dealership to trade profitability in times of weak vehicle demand. The current Profit Focus benchmark is 55-60%.

Ironically across the industry, fixed operations generally improved over the recent more challenging economics times. Often by necessity dealers were forced to have a greater focus on the 'back end' of the business, as 'front end' contribution from new and used vehicles declined.

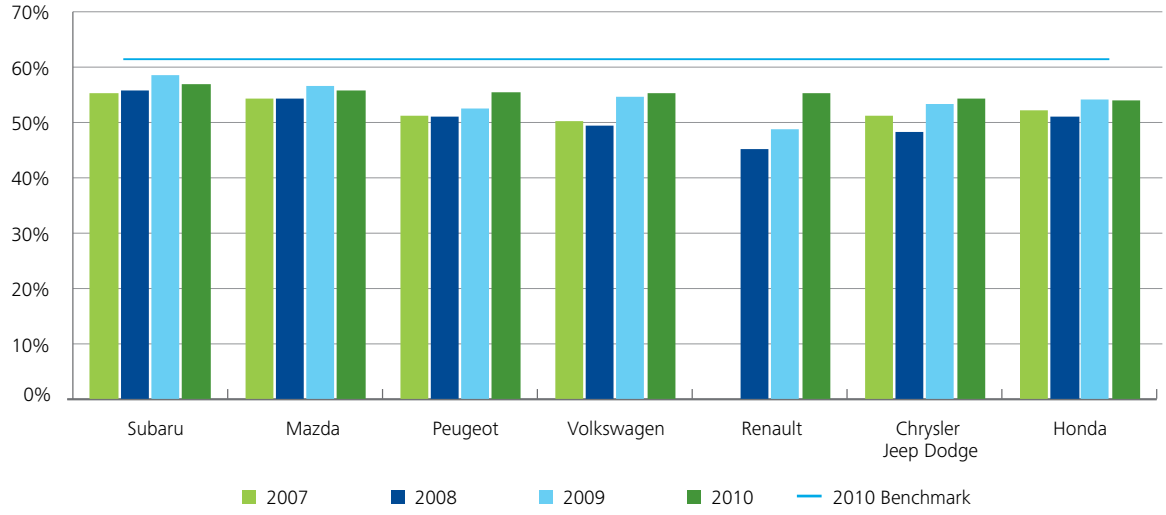
Service selling gross %

Non luxury

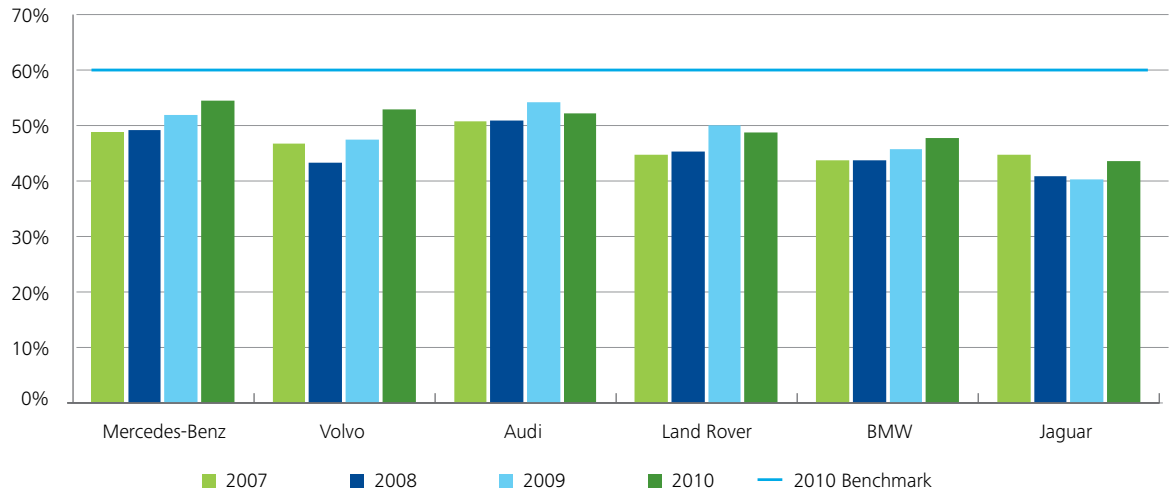


Service selling gross %

Prestige



Service selling gross %
Luxury



A multitude of factors have contributed to a steady decline of service income streams. These include vehicle service intervals being extended, shorter standard repair times, parts replacement rather than repair, a tendency for shorter new vehicle ownership cycles and aggressive competition from non-new vehicle franchise operations including chains and independents.

Decades ago most automotive dealers were a one stop shop for all vehicle service needs. Many provided fuel, tyres, body shop and full mechanical servicing. Over time other service providers steadily entered the market and took away sizeable slices of the income cake. It has only really been the last few years that a larger more coordinated formal attempt to reclaim this traditional share of the industry has been made.

Toyota's Service Advantage and Mitsubishi's Capped Price Servicing Programs are strategic initiatives to keep customers in the franchise dealership loop by providing competitive vehicle servicing offers.

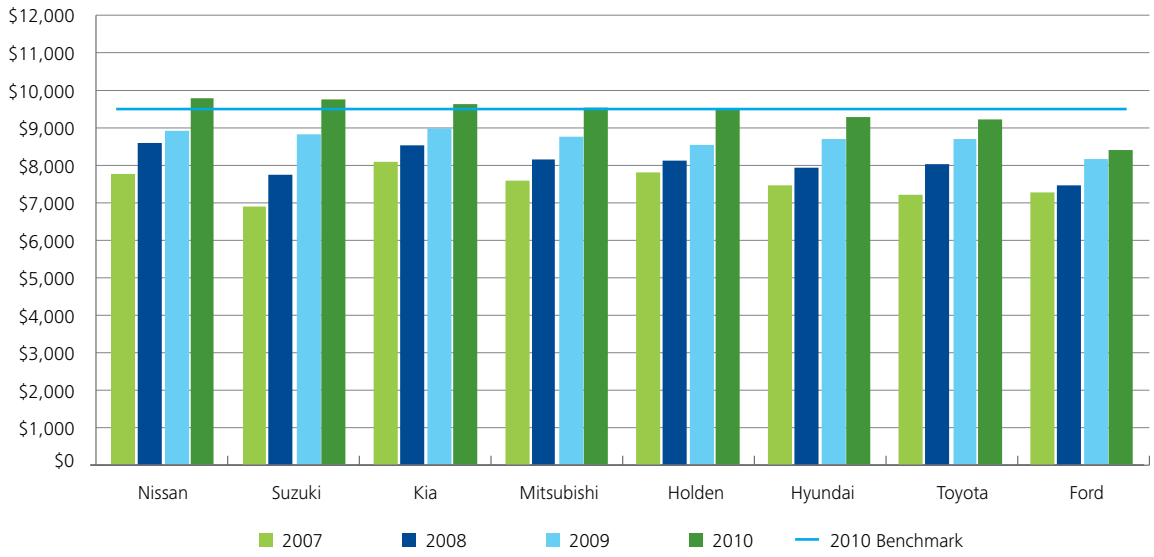
Initial reports indicate such programs have helped improve customer service retention levels which had plummeted to around 40% after three years of vehicle ownership. Some dealers report retention levels are up over 80% which is welcoming for the dealer network which has been burdened by steadily increasing operating costs. Real estate prices in prime locations have skyrocketed. There are increasing pressures to invest more on dealership facilities. Technician salaries have been under major pressure in the tight labour market as skilled workers continue to be offered lucrative salaries for careers in other industries such as the resource sector.

In addition, there has been pressure to offer CSI influencing activities such as customer loan vehicles and car-washing. Dealers have attempted to minimise leakage throughout the customer lifecycle by implementing customer retention management (CRM) programs. The better dealers closely manage CRM operations measuring key performance indicators and developing a dealership culture based around customer-centric practices.

As seen in the charts below labour gross per technician has generally lifted significantly across most brands. Improved technician work flow and productivity, more realistic labour rates to cover rising technician salaries and generally better systems of resource management have been contributing factors.

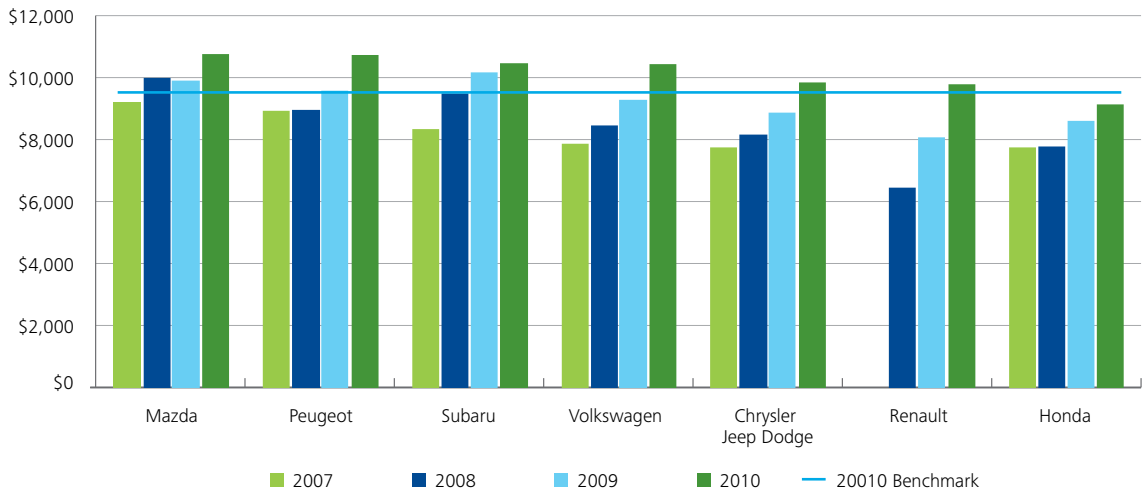
Gross profit per technician $

Non luxury



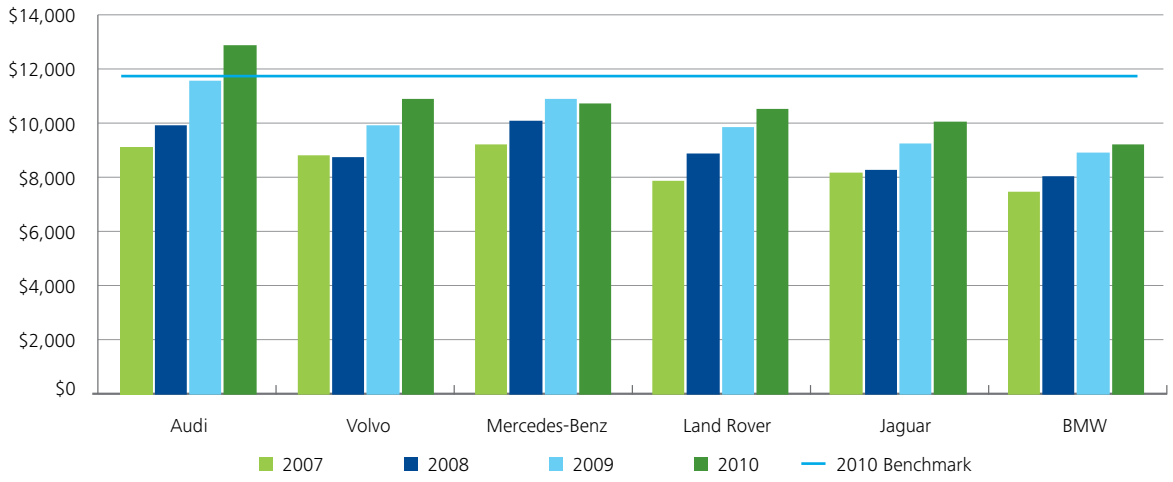
Gross profit per technician $

Prestige



Gross profit per technician $

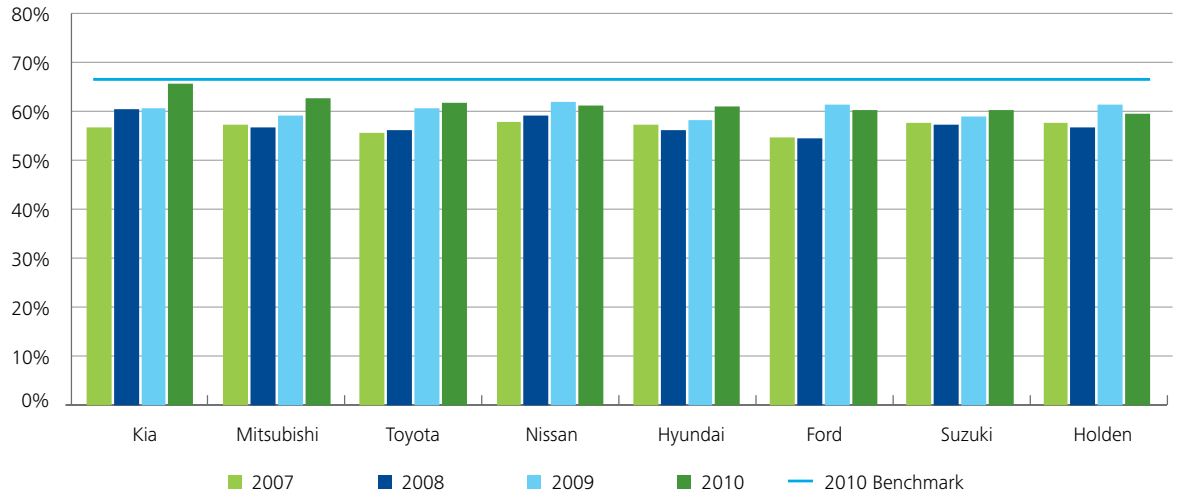
Luxury



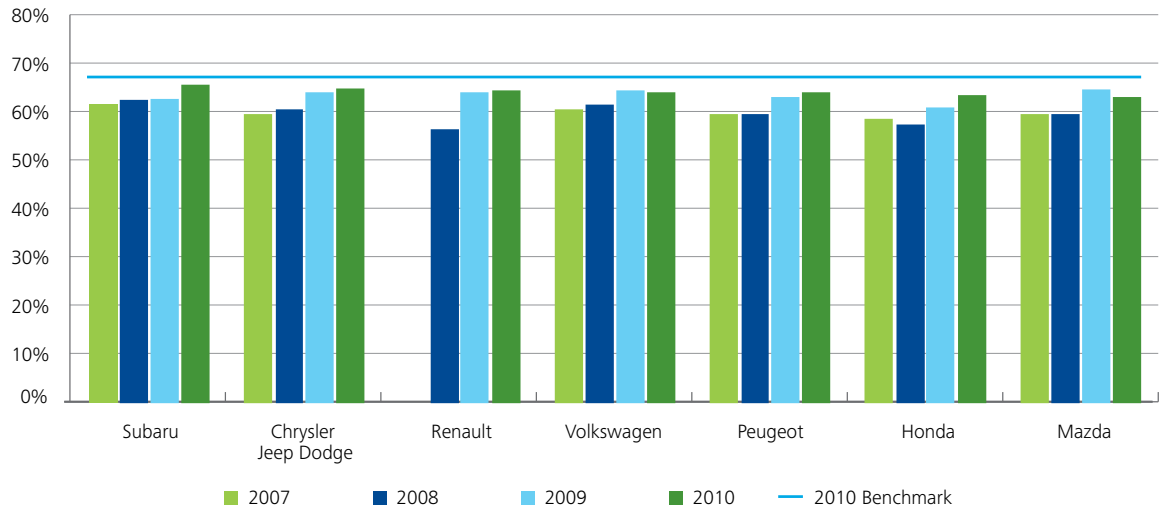
The parts department tends to be the most stable part of dealership operations. Unlike the sales department there is comparatively less staff turnover. In many cases dealers tend to devote less time to it as it appears relatively stable. This can create a false sense of reality as it can lead to complacent business practices.

The GFC was a wake-up call for many dealers unaware of entrenched complacent practices and poor asset management developing in their parts operations. Staff resource levels were subsequently adjusted to best practice levels and there was a greater focus on cash flow and inventory management. Many dealers assessed the true net contribution of individual customers taking into account all the resources devoted to servicing external trade customers and the trailing implications on cash flow. Ironically many dealers reduced the size of their parts departments yet significantly lifted their net profit in aggregate dollar terms.

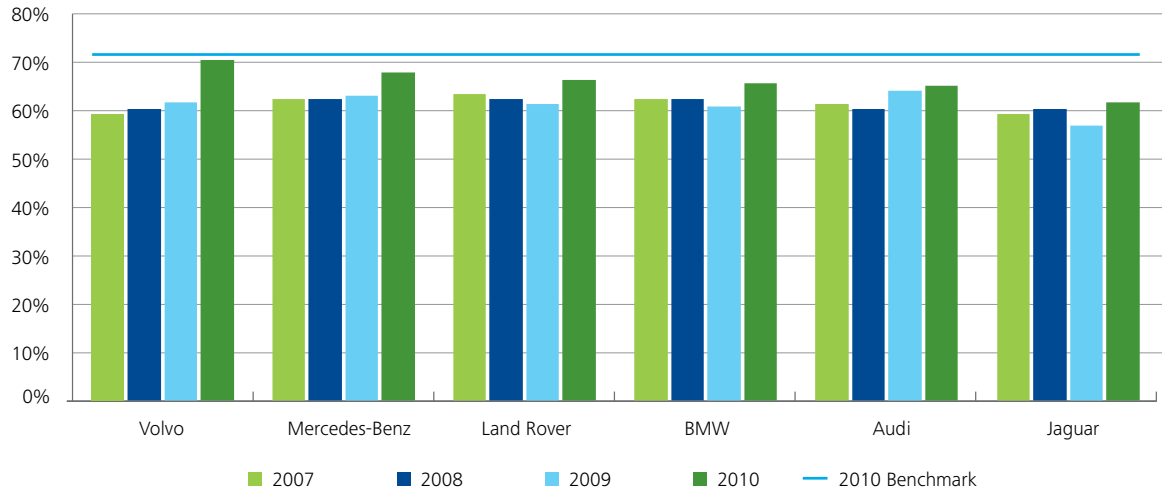
Parts selling gross % gross
Non luxury



Parts selling gross % gross
Prestige



Parts selling gross % gross
Luxury



As seen in the charts above, most brands have enjoyed an improvement in performance despite all the challenges that have emerged over recent years for parts operators. Insurance companies and large buying groups continue to exert pressure on margins, while the threat of a flood of grey imported parts from China and parallel imported parts from Asia remains present. Dealers have also lost opportunities to up-sell many parts and accessories as manufacturers improve features and specification levels for even basic entry level models.

Operating an automotive dealership will always be challenging. Despite the variability of the industry the best dealers will always prosper in the tougher times. They are adaptable and have developed cultures of entrenched operational excellence. This was illustrated by the growing gap between the average and the best operators during the challenging times over the last two years.

Focus areas for 2011

Focus areas for 2011

1. Service operating hours

There are 168 available hours in a standard working week. The average dealership service department generally trades for less than 40 hours per week. With utilisation of less than 25%, multi-manning and multi-shifting will be a means of extracting a better yield from a 'lazy' facility. Plus offering flexible hours for technicians will improve staff retention and create a point of difference to attract the highest quality candidates.

2. Non-financial data

Inquiry management is not new though 2011 will bring renewed focus upon this key area to capitalise on the media spend made and precisely measure both advertising effectiveness, source of lead and conversion ratios to order. And to combine with hard financial data, assessing the correlation between inquiry conversion and retained gross.

Appointments made	100%
Appointments kept	90%
Test drives	60%
Orders taken	40%

3. CRM funnel and the buying continuum

The journey must continue in 2011 towards greater CRM engagement. Reduced advertising spend, increased gross margin, greater salesperson productivity and higher servicer revenue are all realistic expectations of a functioning CRM process. The challenge is to ensure the development program is sufficiently resourced for implementation. Feed and plug the funnel!

The outlook ahead in 2011

The outlook ahead in 2011

The last two years have resulted in extraordinary trading conditions for Australian automotive dealers.

Ironically it was the GFC which provided the catalyst for vastly improved operating results. Dealer profits increased to unprecedented levels through a combination of government stimulus, lower interest rates, inventory reductions, improved margins, tighter expense management and most significantly of all, focussed work practices.

The perfect storm as it came to be known abated in 2010 and the industry gradually began returning to a more typical environment characterised by higher inventory, lower margins and intensive competitive activity.

The automotive industry is truly global. The residual impact of the GFC will leave scars that are likely to remain into the future and although the economic outlook is improving, growth will remain subdued and patchy across western economies. The relatively robust state of the Australian market has, and will continue to create a supply push environment. New vehicle inventory levels are expected to remain high, competition intense and margins lean. Cost control will be as vital as ever with expense pressures emerging with the labour market becoming even tighter, interest rates gradually rising and other items such as energy and real estate costs squeezing profitability.

Australia will continue to benefit from the booming Chinese economy and the overall resources boom. Imported Chinese automotive product will steadily continue to increase their presence on Australian roads. The negative impact of rapid sales growth in the domestic Chinese market and the anticipated increased government intervention to regulate the industry will lead Chinese auto manufacturers to increasingly look to the west for sales growth. This will put even further pressure on an already fiercely competitive Australian automotive market.

There will be continued downward pressure on new vehicle prices. Competition will intensify with high inventory levels requiring reduction and a favourable exchange rate for importers. Dealers must be vigilant with both new and used inventory management. The implications for used vehicle trading are direct and inevitably costly.

The internet will become even more pervasive in our lives. Hand held devices such as smart phones have increased the accessibility of information via the web. Knowledge is power and consumer empowerment will only increase. This will place downward pressure on margins, though it can also present an opportunity for dealers to extend their reach to customers in an efficient and cost effective way. Dealers need to assess the cost and associated benefit of every internet activity they engage in.

Strong and effective management will still remain the key to success. The best operators have learnt valuable lessons from the past and will ensure there is no complacency as trading conditions improve. Benchmark dealers recognise what aspects of their business they can control and adapt accordingly. People costs are by far and away the biggest expense of the business. Developing a culture of success, attracting and retaining high achievers with the foundation of effective leadership should always be the prime goal of every dealership. The tighter labour market anticipated over 2011 will make this aspect of operations even more vital.

And CRM development must be on the agenda of manufacturers and dealers alike. Resistance is futile! 2011 has to be the year of at least making a start with some form of systematic contact process with customers. And for those whose journey has already begun, the challenge is to gain an even better understanding of your customers and their preferences for higher levels of retention.

Above all else, 2011 promises to be a year of opportunity best capitalised upon by those who are organised and well prepared to take advantage of the rewards available.

Disclaimer
Source: Dealership data contained in this report has been obtained from over 800 dealers across Australia, together with the following manufacturers:

Audi
Chrysler – Jeep – Dodge
Hyundai
Jaguar
Kia
Land Rover
Mercedes-Benz
Mitsubishi
Nissan
Peugeot
Renault
Subaru
Suzuki
Volkswagen
Volvo

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