Is now a good time to sell your Retail Car business?

Timing the market has always been the "Holy Grail" for investors, but judging the point where a market either bottoms out or peaks has been the challenge.

However, the likes of Warren Buffett seem to have done this consistently better than most. The last time I checked, his exposure to UK Auto retail was zero, perhaps indicating the Berkshire Hathaway portfolio movements as unreliable?

For those of you not inclined to read all my musings on this matter, the short answer to the question posed above is – **probably**.

However, that is contingent on the answers to the posed questions below.

Do you want to be in this business in 10 years' time?

The reason for this question is based on my contention that the industry is having to reshape itself more significantly than at any time in the last 40 years. The changes in products, consumer behaviour, digitalisation and distribution will be so fundamental that it could potentially take a decade to find an equilibrium where investors can feel confident that the business model is "set" and can therefore be optimised and deliver consistent profits.

Are your manufacturer partners starting to talk about different modes of distribution?

The OEMs are under severe operational cost pressures, with post pandemic balance sheets looking depleted and the imperative to migrate powertrain technology to a greener future, now means that areas of traditional expertise and scale economy are becoming redundant. Electrification and driving a path toward "Net Zero" emissions is the biggest challenge to face this industry in corporate memory. With UK legislation now demanding all new vehicles sold after 2030 are not ICE, it means that the clock is ticking. As ever some OEMs want to be ahead of the game, but this means accelerating production of a higher cost and lower margin product. This leads to them needing to save in other areas of the business and as you may have guessed this is with the distribution costs.

Sales allowances, dealer margins, inventory costs and logistics are all encapsulated within distribution costs and depending on the sales channel these can range from 20 – 40% of the RRP. Therefore, is it little wonder that this is considered a fair target for the accountants to expect some savings to occur.

It is seen as convenient that the automotive industry is at last starting to digitalise its sales process to allow customers to transact online if preferable. The pandemic created an accelerated demand and capability of retailers, all of which re-enforces the opinion in some manufacturers that reducing the costs associated with distribution is now not only desirable but feasible.

So, what is the impact? At best, it means lower product margins but as we have seen with some OEMs, it can also mean the introduction of a different contractual relationship where retailers become sales agents.

To grow or not to grow?

Scale has traditionally been a route to resolve several of the economic challenges within the automotive industry, whether it be the ability to manufacture at lower unit costs, buy competitively or have a stronger negotiating position with a partner.

A big concern for me in this industry is that scale has driven down cost but often at the detriment of the customer experience, and unfortunately, significant parts of the industry have been generally slower to place the customer at the centre of everything it does. Within the car brands that I have been a part of over the years, it was always the smaller dealers who topped the CSI rankings and yet often found their viability threatened by a larger neighbour and the value driven broker system.

However, at present that is the way of the world and is not solely defined to the automotive industry. Further consolidation is inevitable and may have to accelerate, here is the reason why:

As mentioned above, the transition to EV places huge cost pressures on the OEMs, forcing them to look for cost savings in distribution. Whether it is agency or lower margins, dealers will feel the pinch and unless they can offset, profits and viability will decrease.

Offsets

- Greater new car volume production – in a stagnant market this can only be achieved by less dealer points of representation.
- Multi-branding is permitted to help boost production.
- Growth in aftersales – parc size reduction and growth in EVs makes this a challenge.
- Reduce overheads – tough in current inflation climate including energy costs set to grow and property costs also increasing.
- Grow remarketing channels – three years of reduced markets mean that supply will be constrained.

So, not easy to do!

This industry is heading towards one of fulfilment by moving significant aspects online and ultimately towards less car ownership and more mobility services. In my opinion, lowering the cost of operation, in particular logistics, will be key to giving customers what they want when they expect it. If there is less money in selling a new car, then having the lowest unit costs of operation is going to be key to profitability, inevitably players with scale will drive the lowest unit costs.

A number of the 'disruptors' have an advantage in this space as they have lower operating overheads, logistics and reconditioning scale operations, often through links with traditional disposal routes, and a fully digitalised sales process vs dozens of £40k per annum car sales executives. Of course, where they are building pan European brand, marketing expense/establishment costs are high in this phase, but the model is gaining acceptance and the investors have deep pockets.

What will happen next?

The direction of travel in automotive retail is set. Volkswagen Group, Stellantis, BMW, Volvo, Mercedes and Ford have all indicated a preference for future distribution to be on a sales agency basis representing over 50% of the 2022 YTD market. Implementation timescales will vary as the OEMs look to adopt at least some of what the retailer networks have done, but it appears that the course is now fixed, and it will be difficult for other OEMs to be competitive in cost in the long term if they do not follow a similar strategy.

Undoubtedly, all of this will lead to the necessary consolidation phase. Dealer networks sizes are specified from a time where the supply of new cars into the industry was in excess of 2.5 million units and a global pandemic had not driven the necessity to find a socially distanced way of transacting. Many retailers now face the reality of full order books and showrooms devoid of products to show, yet the industry will still register and sell everything it can produce in 2022.

This points to significant redundancy in the model and the perfect opportunity to reduce the costs of distribution.

What should investors do?

Investors need to have a long-term plan that plots a course through this period of significant change and re-invention. Some may decide that it is time to explore an exit while the market is characterised by strong profits. For others, there may be an opportunity to grow and re-engineer their operations. Now is the best time to evaluate all options for your situation.

MHA MacIntyre Hudson have extensive experience within automotive retail and can support investors in developing a future strategy as well as implementing any plan that is proposed. Our Corporate Finance team are well placed to help deliver growth through acquisition or the release of value through divestment. We can provide sector specific expertise in capital and tax planning to ensure that strategies are optimised for value.

The upcoming months and years will undoubtedly be filled with equal amounts of challenge and excitement and at MHA we'd love to help investors find a path to future prosperity.

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