NADA 2021 REVIEW

FEBRUARY 2021

IDEAS | PEOPLE | TRUST

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WELCOME TO THE 2021 NADA REVIEW

In light of the ongoing pandemic the NADA conference still went ahead but in a virtual format. Rather than being in New Orleans attending the conference in person, Malcolm and I attended the conference virtually from the safety of our homes!

To their credit NADA were still able to put on a significant amount of seminars covering the usual areas such as vehicle sales, after sales, digital and human resources and our review includes summaries of the seminars that we attended.

What was clear from these was that, like the UK motor retail industry, the US rebounded very strongly since Spring 2020 and like the UK dealers have adapted well to the new way of working and interacting with the customers.

As in the UK the turnover of staff in the industry remains too high and the dealers that are the most successful are the ones that have cracked the employment proposition by offering a career path, investing in the right training for the staff and provide timely and constructive feedback to allow continued development.

In the US they are forecasting increased M&A activity in 2021 and this is in line with what we reported in our recently released **Motor 150 report**. It was encouraging to hear that multiples have not changed significantly in the US and as always the franchise is the key driver for the multiple valuation. It was also interesting to hear that only 12% of businesses transition to the third generation in family ownership and in the US this could increase M&A activity.

Our report finishes with Glenn Mercer's updated review on the dealership of tomorrow. He concluded that the dealership model is in good health, remains profitable and there is no change to previous assertions that there will continue to be evolution rather than revolution in the sector, albeit with some challenges on the way.

This was further supported by Jim Farley, the CEO of Ford, who acknowledged how the industry has had to change over the past 12 months and will continue to change. It is interesting to note (that certainly in the US) he sees that the biggest impact for Ford in the future will be the connectivity, rather than the electrification, of vehicles. Although in the UK (and EU) we believe electrification will have the bigger impact.

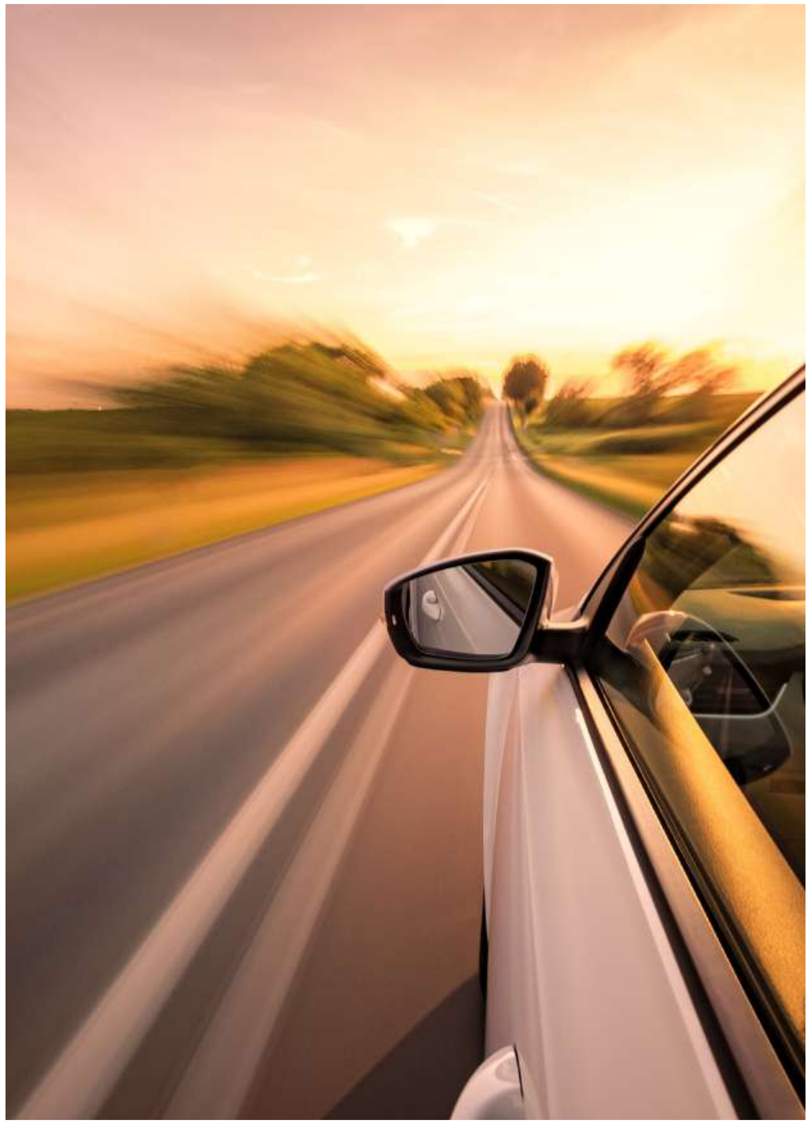
If you would like to discuss any of the content in our NADA Review 2021, please do not hesitate to contact either myself of Malcolm.

STEVE LE BAS
PARTNER – HEAD OF MOTOR RETAIL

MALCOLM THIXTON
PARTNER – MOTOR RETAIL

A DATE FOR THE DIARY:

The 2022 NADA conference is to be held in **Las Vegas from the 10h March to the 13th March (pandemic permitting)**



CRACKING THE CODE TO REMOTE SELLING

JOE ST JOHN | AUTOFI

92% Start car-buying journey online

17 HOURS Researching online for vehicle purchase

187 MINUTES Transacting an automobile purchase at a dealership

1.2 VISITS Dealership visits are down in the last decade

Source: Auto CB 2018, AutoTrader Key Car Buyer Stats, Accenture & McKinsey Car Retail Studies

Joe started the seminar by noting that the consumer behaviour has definitely changed and COVID-19 has only served to accelerate this change.

EXTRAORDINARY IS THE NEW ORDINARY

- To 'crack the code' to remote selling, dealers must rethink their traditional methodology and adjust to new customer expectations and buyer journeys
- Dealers must influence customer decisions by adopting a "buy anywhere" approach and embracing transparency.

THE DIGITAL EXPERIENCE MUST ELIMINATE FRICTION

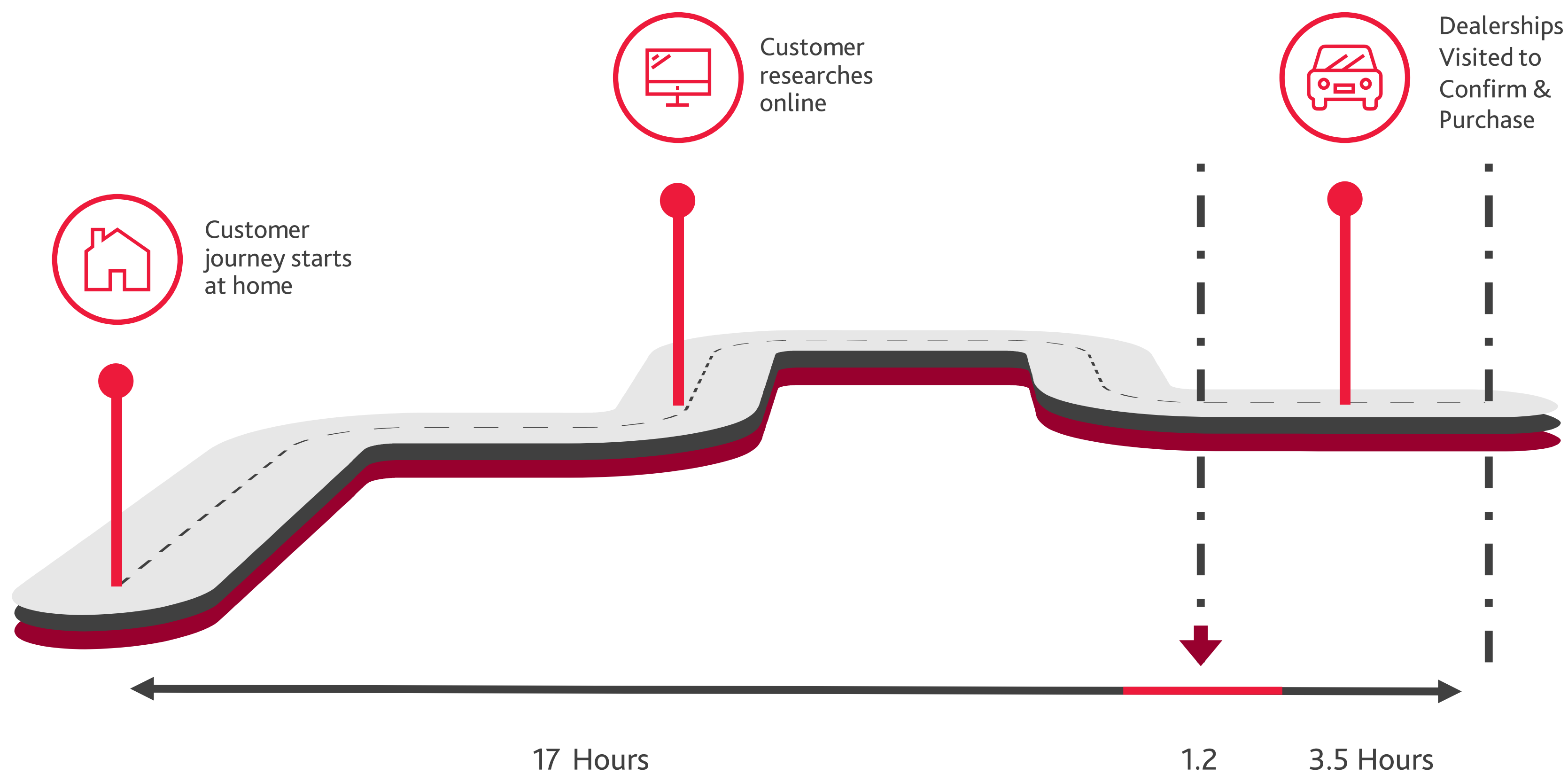
- Convenience is the key to this and Joe posed the question as to why Domino's and Peloton have done so well, not just over the past 12 months – again it comes down to convenience
- Dealers have and will continue to have to change as the traditional brand promise does not equal the modern customer expectations. Customers come to a dealer's website to learn more or buy a vehicle. So dealers must eliminate clutter and misleading call to action buttons. A web-site should only have two or three call to action buttons and dealers should look to continually streamline the user experience and create a purchase-focussed buying journey
- The site should make it easy to obtain pricing and other information transparently. By doing this you will deliver on the dealership's brand promise and create a delighted customer.

ACTIVELY ENGAGE WITH REMOTE CUSTOMERS

- Apply the same skills and techniques as you apply to customers at the dealership
- Actively listen to remote customers – acknowledge their actions, ask clarifying questions and provide them answers transparently
- Drive commitments by laying out next steps of choice
- Strive to become an active resource not a roadblock to the customer's buying decision.

CREATE A SEAMLESS ONLINE-TO-SHOWROOM EXPERIENCE

- Preparation is the difference between average and exceptional remote sales – customers who have spent time completing a vehicle purchase online expect the dealer to have done the same
- Prepare the vehicle, paperwork and people before the customer arrives – the customer is becoming more and more time poor
- Bridge the experience from online to showroom with a customer connection and make sure you set the agenda.



SIX STRATEGIES TO IMPROVE GROSS AND VOLUME IN YOUR USED CAR DEPARTMENT

TOMMY GIBBS | TOMMY GIBBS AND ASSOCIATES

Tommy set out simple disciplines to help solve the most pressing issues in the used-car department. Dealers' today struggle to find a balance between volume and gross profit so must establish core disciplines if they are going to be competitive in today's ever-changing automotive market nd manage their stock as investments not inventories.

01 RETURN ON INVESTMENT (ROI) AND THE RECON ISSUE

Maximising and measuring ROI on every used car is critical to maximise your profits. The focus must be on turning stock as quick as you can from the day it is purchased through the time to get it ready for sale on your forecourt and website. It is a false premise to keep stock on the basis that you can't replace it.

02 30 IS THE NEW 60

Tommy urged dealers to report profit per unit split between vehicles held for under and over 30 days to demonstrate to their teams the difference in profit which is always significantly higher for faster moving stock.

03 THE BASIC OF ALL BASICS

This is simply about managing and pressing your costs down.

04 THOSE EXPENSIVE UNITS ARE EATING YOUR LUNCH

Tommy recommended daily reporting of the most expensive units of your used car inventory to your service director and sales management team to raise awareness and focus on getting them sold as early as possible, pricing keenly and allocating bonus money on the sale.

05 LIFE CYCLE MANAGEMENT

All vehicles must be assessed on day one by the used car management team who decide whether to wholesale or retail and assign a specific expiry date, rather than an average 30 or 45 day for example. An experienced team will know the vehicles that will be difficult to sell (due to age, colour, mileage or even gut feeling) and so should not wait until day 61 before trading out.

06 RETAIL OUT OF YOUR HOT MESS

Rather than dump your aged stock into the wholesale market it is more often than not better to write it down and retail it, at least then you have a chance of earning additional F&I money and maybe picking up a part exchange where you could earn further profit.

MANAGING THE PARTS INVENTORY VS THE NEW AND USED VEHICLE INVENTORY

DAVE PIEUCH | AUTOMOTIVE CONSULTANTS GROUP INC

Dave stated there are seven habits to drive parts profitability.

1 BELIEF SYSTEM

Which is to provide the right part at the right time. Dave believes that parts managers have three primary concerns (none being profitability!):

- Parts obsolescence
- Parts fill rate – ie do you have the part in stock when required?
- Stock value.

Parts managers number one fear is buying stock that may never sell.

2 DEFINITIONS AND TERMINOLOGY

Should parts stock be given the same priority as vehicle stock ie couldn't a new or used vehicle stock be considered another part number?

Dave also questioned what was the true definition of a lost sale? Is it in fact a potential missed opportunity?

3 NADA GUIDELINES

The following guidelines were noted:

90-95%	80%-85%	10% or less	30 days or less
Stock order performance	First time off shelf fill rate	Emergency purchase	Special order parts ageing

SALES ACTIVITY

75% 0-3 months' sales activity

23% 4-6 months' sales activity

2% 7-12 months' sales activity

0% Over 12 months' sales activity

4 RETURN ON INVESTMENT

The NADA guidelines are as follows:

- 8 annual gross turns – sales at cost for last 12 mths months /average stock for last 12 mths
- 5 annual true turns – last 12 mths stock order receipts/last 12 mths sales at cost/last 12 mths stock investment.

5 OBSOLESCENCE CONTROL

This was stated as the number one issue and prevents higher first time off shelf fill rates. One commentator noted that if no sales in six months there was a 49% chance of no future sales and no sales in nine months a 67% chance of no future sales. If a part does not sell for 12 months of more there is a 98% chance that it will not be sold.

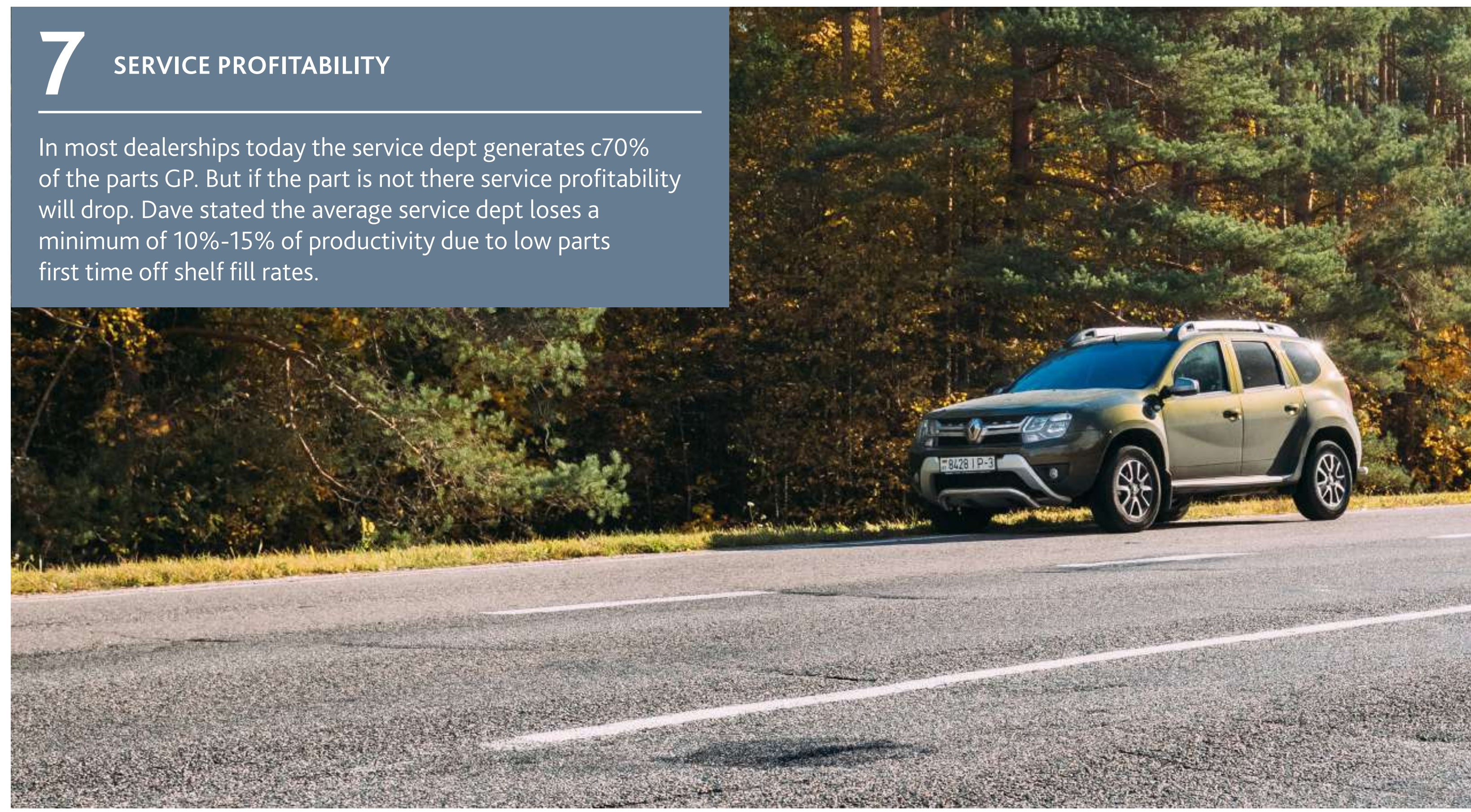
The simple fact is that all parts will eventually become obsolete, current parts obsolescence exceeds industry guidelines and obsolescence needs to be managed before it happens. So the question is – Why don't we treat our parts obsolescence like our aged and used stock?

6 PARTS PROFITABILITY

Ensure you have the right part at the right time and ensure parts stock is reconciled on a monthly basis so there are no year-end surprises – either up or down.

7 SERVICE PROFITABILITY

In most dealerships today the service dept generates c70% of the parts GP. But if the part is not there service profitability will drop. Dave stated the average service dept loses a minimum of 10%-15% of productivity due to low parts first time off shelf fill rates.



COVID-19'S EFFECT ON FRANCHISE VALUE AND THE BUY/SELL MARKET

ERIN AND RYAN KERRIGAN | KERRIGAN ADVISORS

In the US (much like the UK) deal making in the sector was at full throttle pre COVID-19 which then largely put a stop to acquisition activity.

Erin noted that again like the UK, dealerships profits have rebounded since the lows of March to record levels during the summer. Showing that the industry is both resilient and nimble. This record level has been achieved through increased margins ie volume was not key to the growth and there has been a reduction in expenses as dealer groups reacted to a new way of working and engaging with customers. The increase is also partly shift to higher margin used cars.

Average used to new ratio increased to 1.15:1 compared to a five year average of 0.8:1.

However, Erin stated the P&L is still in a state of flux and questioned whether these increases in profits were sustainable and could then increase future value. She concluded that they probably were not and were being led by lower headcount. In the US in Sept 2020, only 56% of dealers were fully staffed and the average units sold per month per sales person had increased by 60% from 2019 to 16 per month. This together with online sales activity up by 50% has led to online sales being 20% of total sales in US dealerships.

FACTORS AFFECTING FRANCHISE MULTIPLE VARIABILITY

Average Blue Sky Multiple

Factor	HIGHER MULTIPLE	LOWER MULTIPLE
Earnings Growth Expectations	High Growth	Low/No Growth
Buyer Demand	High Demand	Low Demand
Real Estate	Low Rent/ Image Compliant	High Rent/ Building Project
Market Vehicle Preference	Franchise Highly Suitable	Franchise Unsuitable
Market Representation	Single-Point Market	Over-Franchised
Customer Relations	High CSI & SSI	Low CSI & SSI
Revenue Mix	High Level of Fixed Ops	Low level of Fixed Ops

Average Blue Sky Multiple

Blue sky multiples should be applied to proforma adjusted earnings pre COVID 19 and expected future performance as the economy reopens.

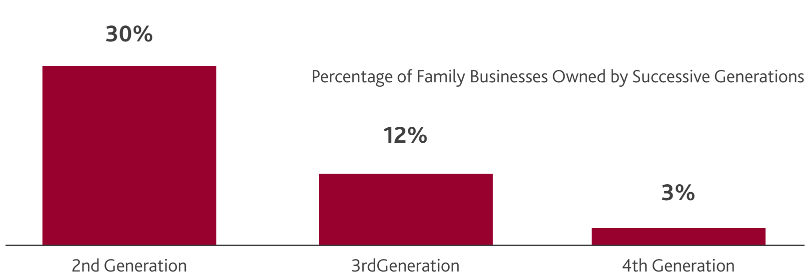
Therefore, when looking at profits on a sale or purchase transaction it should be considered whether the profits are sustainable and multiples should be applied to adjusted earnings pre COVID-19 and expected future performance as the economy reopens.

There are a number of factors affecting the multiple applied to transactions. Erin noted that there has been no significant changes to the goodwill multiples being applied which in the US average at 3-4 times with some premium brands attracting north of seven times.

As in the UK, Ryan is expecting transactions to pick up in 2021 and this will mean further consolidation and expectations as the large groups will become more powerful in the sector. This is further substantiated by the following graphic which notes there continues to be a changing of the guard in ownership.

Encouragingly, Ryan stated that the value of real estate remains high and COVID -19 has not impacted property values as it has in other areas of retail. This further demonstrates the underlying strength and resilience of the industry.

ONLY 3% OF FAMILY ENTERPRISES TRANSITION TO 4TH GENERATION



Source: Harvard Business Review

IMPROVE EMPLOYEE EXPERIENCE TO IMPROVE CUSTOMER EXPERIENCE

CHASE ABBOTT | COX AUTOMOTIVE

Chase began by stating that dealership staff turnover is at an all-time high and that the traditional method of employing staff is not a sustainable employment proposition for the industry.

DEALERSHIP TURNOVER IS AT AN ALL-TIME HIGH

80% of dealership sales people turnover annually[1]

20% of dealership staff are likely to look for another job in the next six months[1]

1/3 of non-management employees do not feel engaged or excited about their jobs[1]

54% of employees say it is harder to do their job effectively now than before the coronavirus outbreak[2]

This in itself creates an issue as two thirds of customers say that experience is more important than the price when making a purchase decision and they would pay more or even switch brands for a great experience. In addition, there are fewer customers in the market and they are doing more online.

61% of shoppers want to do more of the purchase steps online compared to the last time they purchased a vehicle. So it's time to invest in your employee experience.

Sources: 1. 2019 Cox Automotive Dealership Staffing Study, 2.2020 CNBC/SurveyMonkey Workforce Survey

- Sales staff are the top driver of customer satisfaction according to surveyed consumers
- Top performing dealers have turnover rates that are 17% lower than dealers in the bottom quartile and are three times more profitable than the average.

SO HOW DO YOU RETAIN STAFF?

- **Recruiting and hiring**
  It is not currently working due to long hours, work-life balance, confusing/changing pay plans, lack of development opportunities, out of date software. So to recruit and hire effectively, dealers needs to consider their sourcing processes, pre-employment assessments, cross dept interviews and have a clear on boarding process.
- **Reduce repetitive and morale draining tasks**
  Chase stated that in a recent survey 65 of salesman time on average is spent on non-revenue generating activities. You can reduce these tasks by website optimisation, AI and digital retailing.
- **Equip your staff with tools to be productive**
  Have cutting edge technology, improve use of AI and ensure all processes are up to date. Chase questioned the use of AI, however in light of the success of businesses like Spotify, Netflix and Amazon have through the use of AI he noted that dealers should embrace this developing technology.
- **Enable flexibility for digital sales**
  This is of key importance as there is a 30% higher close rate for digital retailing leads and a 26% higher gross profit. So groups need to have flexibility to cater for every type of customer ie have different processes for online, walk-in and hybrid experiences. The staff need to understand which type of customer they are dealing with in transaction.

- **Identify coaching and opportunities from data**
  62% of dealership employees say career growth is an important consideration and 39% of current dealership employees are considering leaving because they don't feel like there is an opportunity for advancement. The key is to have regular coaching, mentor and development sessions and create a clear pathway of development and advancement.
- **Improve customer experience**
  Customers notice this and 42% of customers return because they have had a good previous experience. Whilst 64% of dealers have seen a positive impact in vehicle sales as a result of implementing a digital retailing solution.

BUSINESS OUTCOMES OF HIGHLY ENGAGED TEAMS

% ↑ 18 Sales Productivity	% ↑ 23 Profitability	% ↓ 18 Turnover for High-turnover Organizations

Source: 2020 Gallup Employee Engagement and Performance: Latest Insight from the World's Largest Study

BUILD MILLENIALS AND GEN ZS INTO YOUR HIGHEST PERFORMERS

JARED HAMILTON | DRIVING SALES

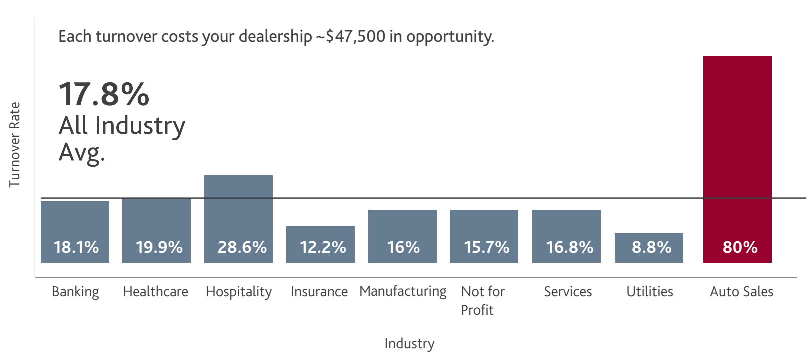
Without the right skilled people dealers will never be able to access the full value of their business. You need to optimise your greatest asset – your people and in particular the millennials.

UNDERSTAND THE MILLENNIAL CHALLENGE

57% Millennial turnover rate (all positions)

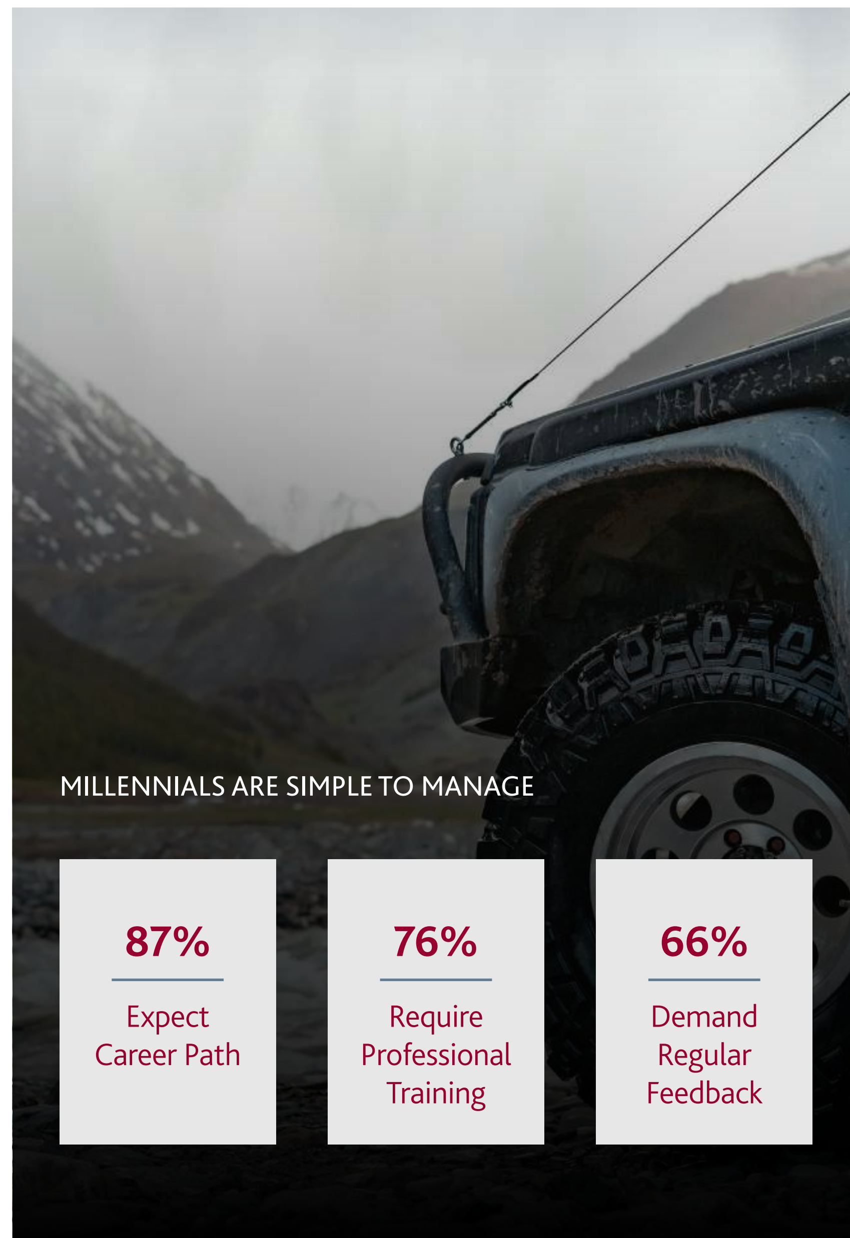
219% Millennials turnover more than Boomers

61% of all dealership new hires are Millennials



Outside of the industry, the average staff attrition rate is 18% while the automotive industry has one of the highest rates at 80%. Attrition costs dealers bottom-line opportunity, one study estimated the hard and opportunity costs for dealers at $47,500 for each attrition.

To reduce the impact you have to understand what to do to reduce your attrition levels and the good news is that it is relatively simple:



There is a 5-step process that has been proven to reduce turnover rates from 80% to approximately 27% in dealerships. These dealerships also found an increase in closing rates, gross, and CSI.

1. ASSESS: ACCOUNTABILITY THROUGH TESTING

Assess covers both sides of a competency framework. When hiring, managers should consider things such as their work ethic, aptitude, and company culture fit. Once hired, new trainees should be assessed to see where their strengths and weaknesses are in the 148-competency framework.

2. PLAN: GROWTH MAPS AND STRATEGIES

Dealers should also build a career map with room to grow and help employees stay engaged within their dealerships. Employees should be aware of which competencies they need to master to be eligible for promotion.

3. DEVELOP: CORE SKILLS AND COMPETENCIES

Employee training should be customized using store needs. If dealership performance is low in a specific area, additional training may be required or repeated.

4. MEASURE: BENCH MARKS AND PERFORMANCE REVIEWS

Dealers should measure their success. Performance reviews should be completed monthly.

5. REWARD: SHORT AND LONG TERM ALIGNMENT

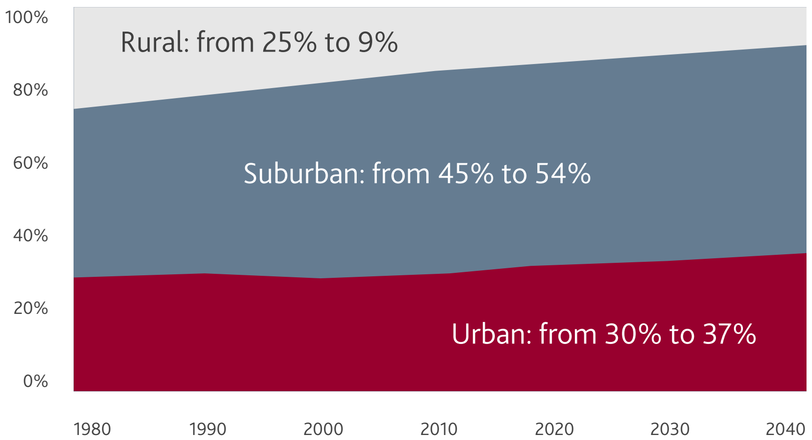
This is not a reward problem; however, it is recommended that as employees reach competency check marks, there should be compensation boosts as well.

By providing employees with competency supported career paths, turnover rates will decrease and productivity increase. This alignment is crucial to improving dealership profitability.

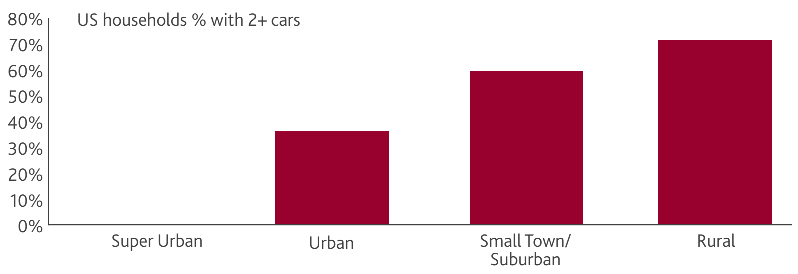
DEALERSHIP OF TOMORROW: 2021 UPDATE

GLENN MERCER | GM AUTOMOTIVE LLC

THE US IS EVER MORE SUBURBAN, AND THE SUBURBS BUY VEHICLES



Source: Department of Transportation, from Census Bureau projections



Source: National Household Travel Survey (NHTS), BMW, Bernstein analysis

Glenn presented an update on his report on the long term (10 year) outlook for dealerships, first published and presented at NADA in 2017 and split into two strands, mainly on the franchised new car dealership system but also looking at the changing world that could challenge the system.

In terms of volumes his view was unchanged in that the US market would still see a 17m 10 year average units sold supported by a growing population, increased GDP, population aging and suburbs growing.

Motor retail is rapidly rebounding from COVID-19, as cars are seen as a safe haven from disease and whilst working from home see less commute, there are more errands run and it accelerates suburban growth. Personal Contract Hire is still small in the US but growing. Pricing was expected to continue a “gentle upward drift” as older (more wealthy) drivers buy more cars and vehicles become relative cheaper in terms of share of household budget.

Dealer market share is expected to hold at around 95%, the dealership model is still the most common throughout the world despite (for example) relaxation of OEM ownership rules in Canada and a (faltered) direct sales experiment in China. Superior economics of direct sales have never been proven, only asserted and incumbent OEM’s lack the funds to buyout their networks’ massive investment and effectively already have very effective control of dealership behaviour. Glenn acknowledged however that there may be more interest (stimulated by experiments in Europe and elsewhere) in the agency model.

Digital is accelerating but physical remains crucial despite the rapid shift online in the pandemic. Questions remain on whether it persists and what is the impact and of course definitions of “online” are numerous and varied! In terms of persistence, it is significant but data shows a preference for omnichannel equilibrium rather than online extrapolation – customers still chose dealers mostly on location and inventory (even Tesla has pulled back from closing all its stores). In terms of impact it is likely to be positive for dealer economics as there is early evidence that digital customers spend more on service and expenses should be lower as dealers leverage IT to improve efficiencies and productivity.

The consolidation of stores remains low in the US stabilising at around 18,000 for over a decade now as no OEM wants to give up an incremental sales point, some brands are growing, suburban sprawl is increasing and customers want a local touchpoint. The consolidation of ownership is still advancing but slowly (7,500 down from 10,000 a decade or so ago), although in the US there are less active publically owned groups.

In terms of profitability, new cars are stronger than hoped for but still fragile, expenses are coming down (in particular in terms of sales staff as online activity increases), but concern remains on the dependency of back end OEM payments that are still very significant. Used cars have surged but competition is increasing and F&I still remains a significant contribution to bottom line.

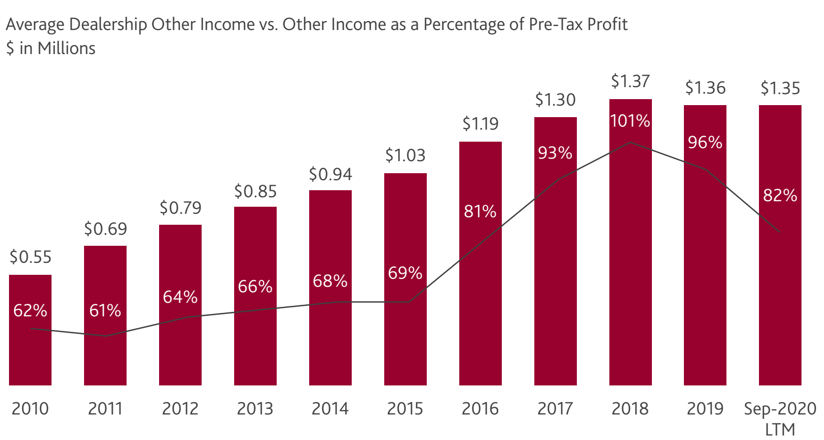
The service department still has lots of upside but still needs lots of work to gain it, it has increased in the US from 15% of total store gross in the 1980's to around 45% more recently. It is crucial to grow service otherwise it will shrink as quality improves and electric vehicles increase, the key to growth is customer convenience in terms of processes, location and time. F&I is still growing (mostly via products driven by better processes) but could be at risk in a more online world and increasing regulatory backlash.

Overall the outlook for profits remains strong (all past forecasts of profit decline have been wrong). This is a very robust industry, costs are highly variable (could be 70-80%), the business is highly diversified and although "fragile" due to OEM payments there are high costs to entry and it is in the best interests of the OEM's to have a long term sustainable network.

Turning to the changing world, electric vehicles growth is accelerating but largely supply driven and still only forecast to be c20% of the US market in 2030. (US oil supplies and petrol prices will be key differentiators from the UK market). Autonomous vehicles still on the way but delayed and the threat of Mobility Services (such as Uber) has receded for now, largely as it is becoming as a compliment to personal ownership rather than a substitute.

In concluding, Glenn remains positive about the dealership model, it is in continued good health, there will be evolution rather than revolution albeit challenges along the way.

CONCERN REMAINS RE DEPENDENCY ON BONUS



Source: NADA, Kerrigan Advisors

FUTURE OF THE AUTO INDUSTRY
JIM FARLEY | FORD AND RHETT RICART - NADA

This session was shown live from the main stage and focussed on Dealer/OEM relations which have never been more important, NADA Chairman Rhett Ricart and Ford CEO Jim Farley discussed how recent challenges have changed the face of auto retailing.

Jim acknowledged the continuing changes facing the industry from electric vehicles where 10% of all cars sold in Europe are now electric driven by the need to reduce CO2 levels. Customers are demanding increased range of these vehicles with 300 miles becoming the standard and there is a great push factor with the number of EV models now approaching 150 from only c40 a short time ago.

Ford are moving ahead of the curve with their Mustang Mach-E, which is now ahead of Tesla and they will be releasing the fully electric F150 and transit van very soon. Jim explained that electric commercial vehicles were only needing to allow c75 miles a day to hit current customer demands. However, supply is and will continue to be tight with global shortages of semi-conductors that will impact the entire automotive industry, although this will impact the used car market where demand and so prices will stay strong.

Jim said he originally thought that electric vehicles were going to have the biggest impact for Ford, however he now believes that connectivity is much more important. Ford have really invested heavily in this and the amount of data they are now getting every second of every day for an increasing number of their vehicles is key to driving quality and safety for their customers. To be able to use artificial intelligence to predict future failure in a car battery or an engine or braking component is a huge step forward, and will ensure that customers are able to rely on their vehicles so much more with time off the road for repairs reduced dramatically.

HOW WE CAN HELP YOU

If you would like further information about this publication or our specialist knowledge of the motor retail sector, please contact:

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