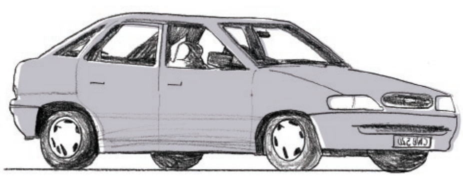
Grant Thornton

Regular research papers and articles providing sector specific insights and issues analysis – Automotive sector.

May edition 2008 – Automotive

Industry Intelligence Unit

Welcome to the second edition of the automotive IIU. Internationally Grant Thornton member firms are leaders in the automotive supply chain and dealership advice, with specialist teams across the globe dedicated to this industry.

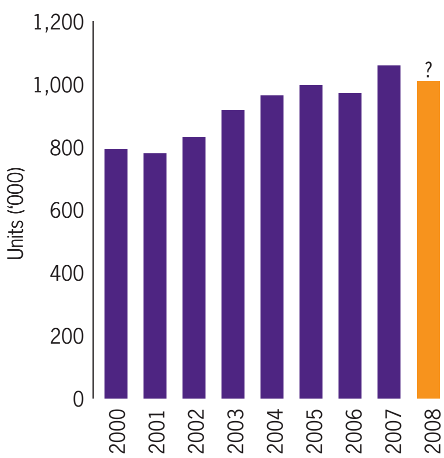


In this automotive edition we concentrate on the dealership space focusing on the following key areas of the automotive industry:

- Brief overview of Australian automotive market
- Key drivers supporting vehicle sales
- General update on vehicle sales for the first three months of 2008
- Outlook for 2008
- Vehicle sales around the globe.

Annual vehicle sales 2000 to 2008

Source: Vfacts



Australian automotive market

Vehicles sales in the Australian marketplace broke through the one million unit barrier for the first time in 2007 with total sales of 1,049,982 – a 9.1% increase for the year. The automotive dealership market has been strong since 2001 with the exception of a small decline in 2006. Since 2001, automotive sales have increased by approximately 33%. The graph on the left summarises the last seven years.

The big question - what will happen in 2008? Our view is vehicle sales will top one million units again this year as we believe the manufacturers will push stock into the market.

Vehicle sales in Australia are dominated by New South Wales (31%), Victoria (25.8%) and Queensland (21.3%) as shown in the table below.

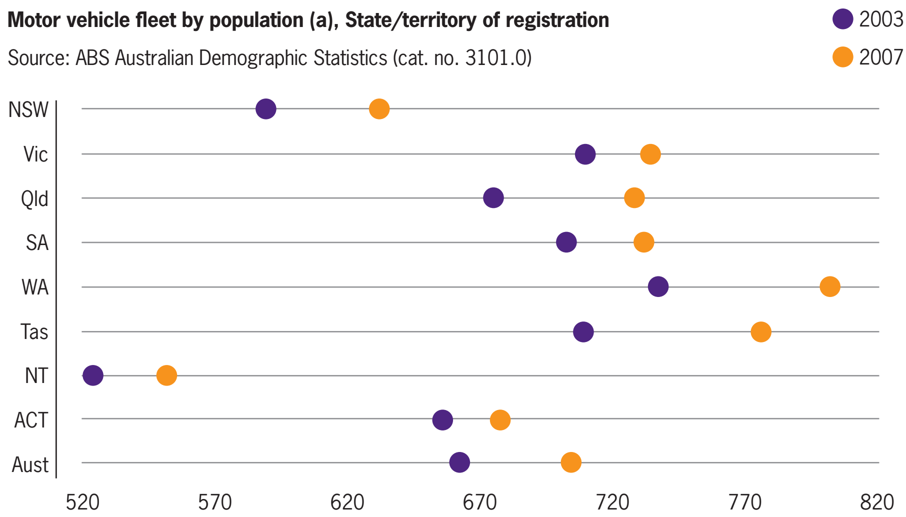
State	Share
New South Wales	31.0%
Victoria	25.8%
Queensland	21.3%
Western Australia	11.4%
South Australia	6.1%
Tasmania	1.7%
Australian Capital Territory	1.6%
Northern Territory	1.0%

According to the 2007 Motor Census, there were 14.8 million motor vehicles (including motor cycles) registered in Australia at 31 March 2007. In 2007 there were 705 motor vehicles per 1,000 resident population in Australia which is an increase of 42 vehicles from the 2003 figure of 663. Western Australia had the highest rate with 800 vehicles per 1,000 residents while the Northern Territory had the lowest rate with 553 vehicles per 1,000 residents. The graph opposite shows the movement by states between 2003 and 2007.

The average age of all vehicles registered in Australia as at 31 March 2007 was 10.0 years compared to 10.4 years in 2003. The graph below shows the average age for the period 1971 to 2007.

Motor vehicle fleet by population (a), State/territory of registration

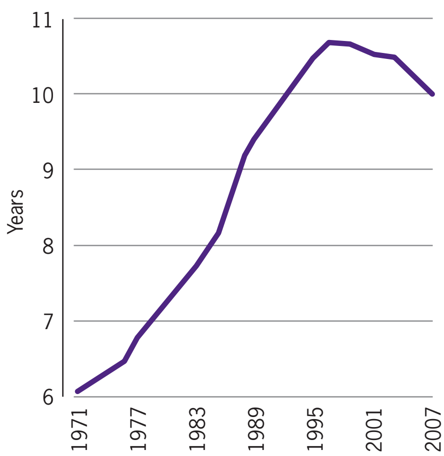
Source: ABS Australian Demographic Statistics (cat. no. 3101.0)



(a) Both Estimated Resident Population data and Motor Vehicle Census data are at 31 March.

Estimated average vehicle age of vehicle fleet

Source: ABS



Key drivers supporting vehicle sales

There are a number of drivers which have led to the increase in the number of motor vehicles purchased. Some of the key drivers are:

- State of the economy
- Low interest rate environment
- Consumer confidence and business confidence
- Rising asset values
- Increased model choice
- Shorter ownership cycles
- Increase in leasing
- Vehicle affordability.

Three months to 31 March 2008 update

In January 2008, the Federal Chamber of Automotive Industries forecast 1,000,000 sales for 2008. The first quarter sales have been extremely strong with sales YTD up by 3.3% (8,385 units). While January (+6.9%) and February (+7.4%) were positive, March was down by 3.3%. However, the March figures may have been affected with the timing of Easter with three less selling days in the month.

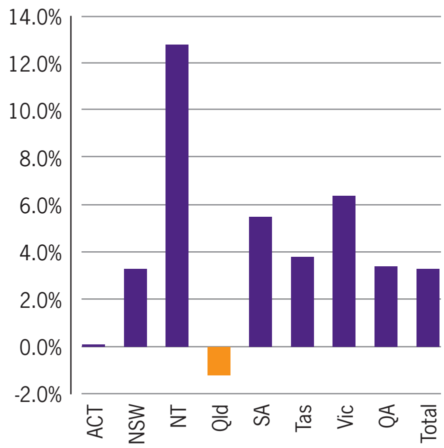
While the market was up 3.3% for the first quarter it is important to look at the market by state, brand and segmentation. In subsequent IIUs, we will provide a detailed look at one of the major states in each publication.

State

As outlined in the graph below, all states with the exception of Queensland had a positive first quarter. It is important to note that while Queensland is down 1.2%, this follows an increase of 10.4% in 2007.

State based movement March 2008 YTD

Source: Vfacts



Despite the market being up 3.3%, a number of manufacturers are increasing sales while a number continue to lose market share, as shown in figure 3.1. Holden, Ford, Honda and Nissan have all lost market share in the first quarter of 2008. Toyota has extended it sales by 7.1% in the first quarter to now be selling more vehicles than Holden and Ford combined.

The top 15 manufacturers represent 91.8% market share with Toyota holding 22.9%, followed by Holden at 12.8% and Ford at 10%. Mazda has clearly cemented fourth position as their market share continues to grow. In this and following IIU's we will continue to track the top 10 selling brands in the Australian marketplace, as shown in figure 3.2.

Market segmentation

The Australian automotive market is broken up into four major segments with Passenger 59% and SUV 20.6% representing the major segment as outlined in figure 3.3.

Each of the segments are broken into further categories. In this issue and subsequent issues we will focus on the passenger and SUV segments only.

The passenger segment is broken down into a further seven segments (figure 3.4) with light (22%), small (40%), medium (14%) and large (18%) being the key segments. The movement within these segments is extremely important as the dealership receives a greater gross profit per vehicle for the larger vehicles than for the smaller vehicles. The first quarter of 2008 continued the trend of a movement away from the large segment to the small and light vehicles as shown in figure 3.5.

Movement within the passenger segment over the last six years is also shown in figure 3.6 as Australian consumers move away from the large car market to the light and small vehicles. Large cars have fallen from 34.9% in 2002 to just 18% YTD 2008.

Fig 3.1: Movement in sales YTD March 2008 to YTD March 2007

Source: Vfacts

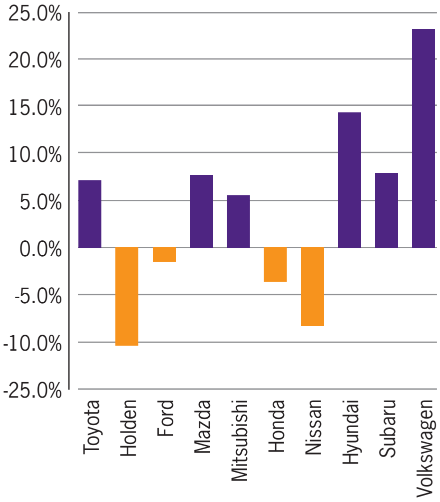


Fig 3.2: Market share YTD March 2008

Source: Vfacts

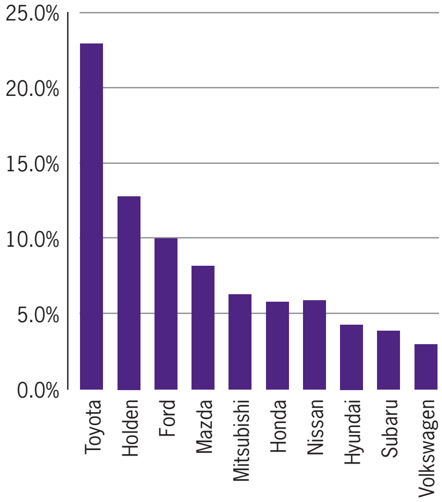


Fig 3.3: Market segmentation March YTD 2008

Source: VFacts

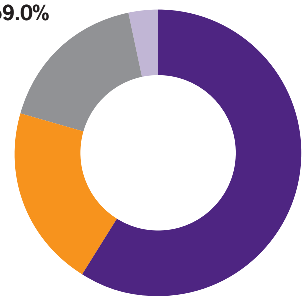


Fig 3.4: Breakdown of passenger segment

Source: VFacts

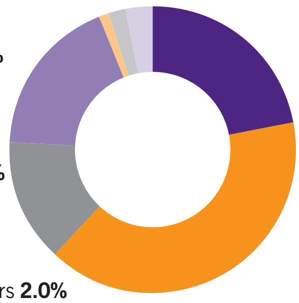


Fig 3.5: Movement in sales YTD March 2008 to YTD March 2007

Source: Vfacts

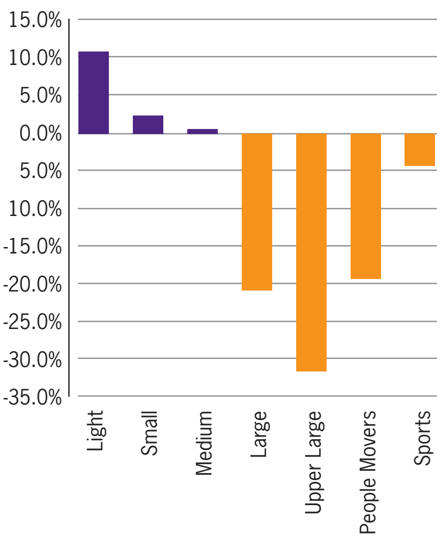
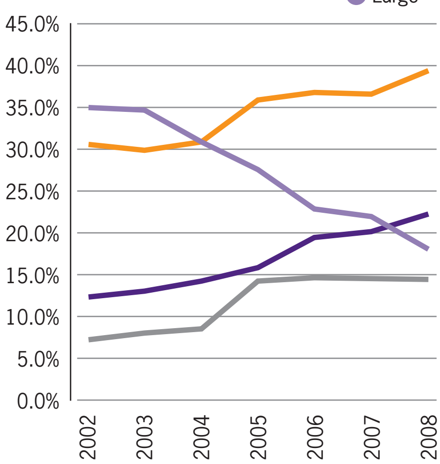


Fig 3.6: Passenger segment 2002 to 2008

Source: Vfacts



Outlook for 2008

The big question for 2008 is what will happen to vehicle sales? While vehicle sales are up 3.3% for the first quarter, it is unlikely that a new record will be set in 2008 for a number of reasons. Lets consider three of the key drivers outlined earlier behind vehicle sales numbers being:

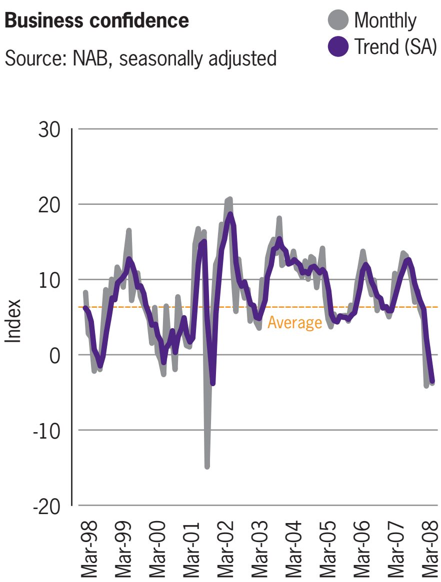
- Low interest rate environment
- Consumer confidence and business confidence
- Rising asset values.

Low interest rate environment

- The RBA has lifted rates by 1% since July last year. In addition to the RBA rises, the banks have passed on further rate rises as a result of increased funding costs.
- These interest rate rises reduce disposable income together with dissuading consumers taking on more debt.

Business confidence

Source: NAB, seasonally adjusted



Consumer confidence and business confidence

- A number of surveys point to a decline in consumer and business confidence. Recent surveys include:
  - The Westpac-Melbourne Institute of Consumer Sentiment fell 9.1% to 88.6 in February to its lowest level since September 1993. In March 2008, the index fell a further 1.3% to 87.4. The three months to March showed the sharpest decline in the index (21.2%) since its introduction in January 1975.
  - The NAB business confidence survey fell to its lowest level in March 2008 in the monthly's history (-4 points) excluding September 11 2001, as outlined in the graph on the left.

Rising asset values

- Two areas where households have increased their wealth over the last 5 to 10 years has been through the sharemarket and property. Individuals have used equity in their homes / gains from the sharemarket to purchase their new vehicles. The well publicised sharemarket decline has led to margin calls and losses on the sharemarket.

As a result of higher interest rates, declining consumer and business confidence, a flat property market, margin calls and sharemarket losses, the number of sales to private buyers is likely to fall in 2008. In addition, the government has indicated that it is cutting expenditure which may lead to lower government purchasing.

Offsetting the potential fall in new vehicle sales due to the change in the above drivers will be the requirement to sell the stock which has been produced for the Australian marketplace by manufacturers. This will add pressure to new vehicle margins as dealers try to meet manufacturer targets. Some dealers will also register cars as demo's to meet the targets and then try and deal with the problem later.

While we have considered the effect on the top line with the likelihood that sales will decline together with margin pressure, dealers' costs are also increasing. Dealers will need to ensure they are proactive in ensuring that their dealership is operating at optimum levels and also ensuring they monitor their expense base.

One of the major expenses of a dealership is interest, as the majority of dealers fund their new, used and demonstrator vehicles by way of bailment or floor plan financing. The credit crunch has affected interest rates and also the margin which some financiers are prepared to lend. In addition to stock financing, dealers who have purchased facilities and have their funding maturing this year will be paying significantly higher rates.

The changes in circumstances could result in some losses by financiers. However, it is important to note that good operators will continue to make good money as they will adjust to changing times.

Global review of major markets

Europe

Total Passenger Sales for Europe (EU + EFTA) has fallen by 1.7% to 31 March 2008 after a 9.5% fall in March figures. The whole of the European market sells approximately the same number of vehicles as the US does on a monthly basis.

Outlined in the table below is the movement in vehicle sales for the larger countries and a graph outlining manufacturer market share.

	YTD March	% Chg 08/07
Germany	735,914	+2.6
United Kingdom	683,349	-0.7
Italy	663,532	-10.0
France	526,121	+1.3
Spain	347,734	-15.3
Belgium	169,864	+3.7
Netherlands	164,037	+1.7
Ireland	93,045	-7.2
Poland	86,926	+19.5
Greece	79,271	-0.1
Romania	74,028	+23.6
Austria	73,778	-2.0

United States

In March J.D. Power and Associates predicted that new-vehicle sales in 2008 are expected to reach their lowest levels since 1995, dropping to 14.95 million cars and light trucks. New-vehicle sales for 2008 were originally forecasted at 15.7 million units.

"While the automotive industry's slow performance in January and February certainly contributes to the anticipated drop in new-vehicle sales, declining consumer confidence and spending as well as turbulent financial and economic market conditions are primarily driving the decline," said Jeff Schuster, executive director of automotive forecasting for J.D. Power and Associates.

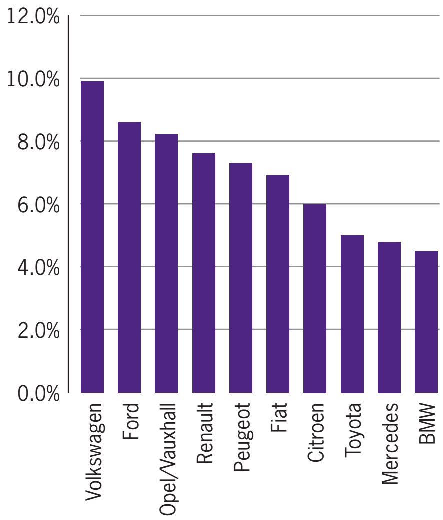
In early April 2008, March vehicle sales were released with double digit falls with GM and Chrysler down 19%, Ford 14% and Toyota 10%. Jim Farley, Ford Motor Co.'s sales and marketing chief said Ford is concerned the shrinking availability of consumer credit will continue to hurt sales and that the second quarter could be more difficult than the first.

Outlined below is snapshot of the first quarter in US Auto sales. The top 10 brands represent approximately 74% of total vehicle sales with Chevrolet, Toyota and Ford all experiencing market shares greater than 13%.

The US automotive sales are down 7.9% YTD. As can be shown by the diagram below, Honda is the only manufacturer in the top 10 to experience growth in the first quarter . Dodge, Chrysler, Chevrolet and Jeep have all experienced double digit falls.

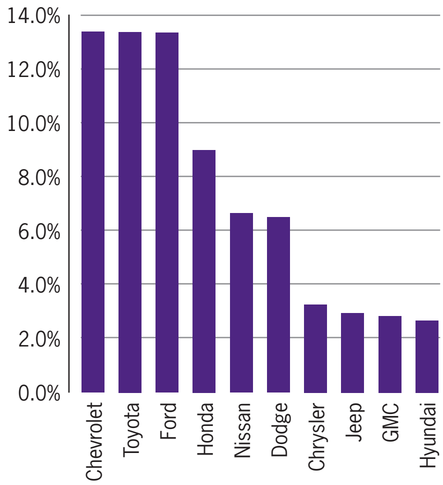
Market share (EU + EFTA) YTD March 2008

Source: Vfacts



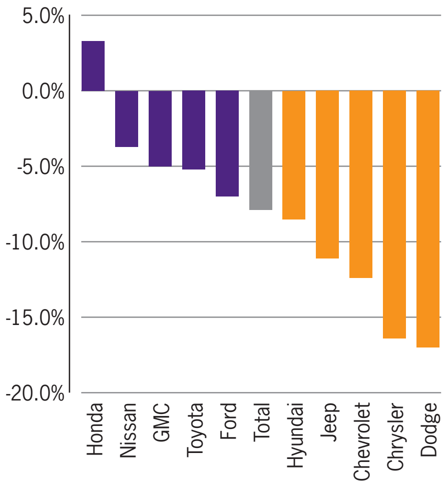
United States Market Share By Brand YTD March 2008

Source: J D Power and Associates



United States movement in sales YTD March 2008 compared to YTD March 2007

Source: J D Power and Associates



Industry Intelligence Unit

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They share a commitment to provide high quality services to all our clients and provide services which include assurance, taxation, reorganisation / reconstruction, corporate advisory, wealth investment management, risk management, and specialist business advice.

What is the Industry Intelligence Unit?

The IIU is unique in its objective of providing stakeholders in the SME and business owner markets with information, understanding and analysis of the issues faced within specific industries and sub-industries. The IIU also seeks to provide pragmatic, commercial, practical measures and initiatives to improve stakeholder value.

Industry focus

The IIU utilises the industry experience and expertise of Grant Thornton partners and staff across Australia. The IIU is predominantly focused on the following industries and their related sub industries:

- Property
- Retail
- Aged Care
- Automotive
- Hospitality
- Financial Services.

SMEs and business owners

SMEs and owner managed businesses form the backbone of the Australian economy. They have unique characteristics and face challenges which larger public companies and multinationals rarely encounter.

Grant Thornton's experienced partners have developed an intimate understanding of the needs of SMEs and business owners in the above industries and others. This IIU seeks to apply examples of this experience in the sectors on which it reports.

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