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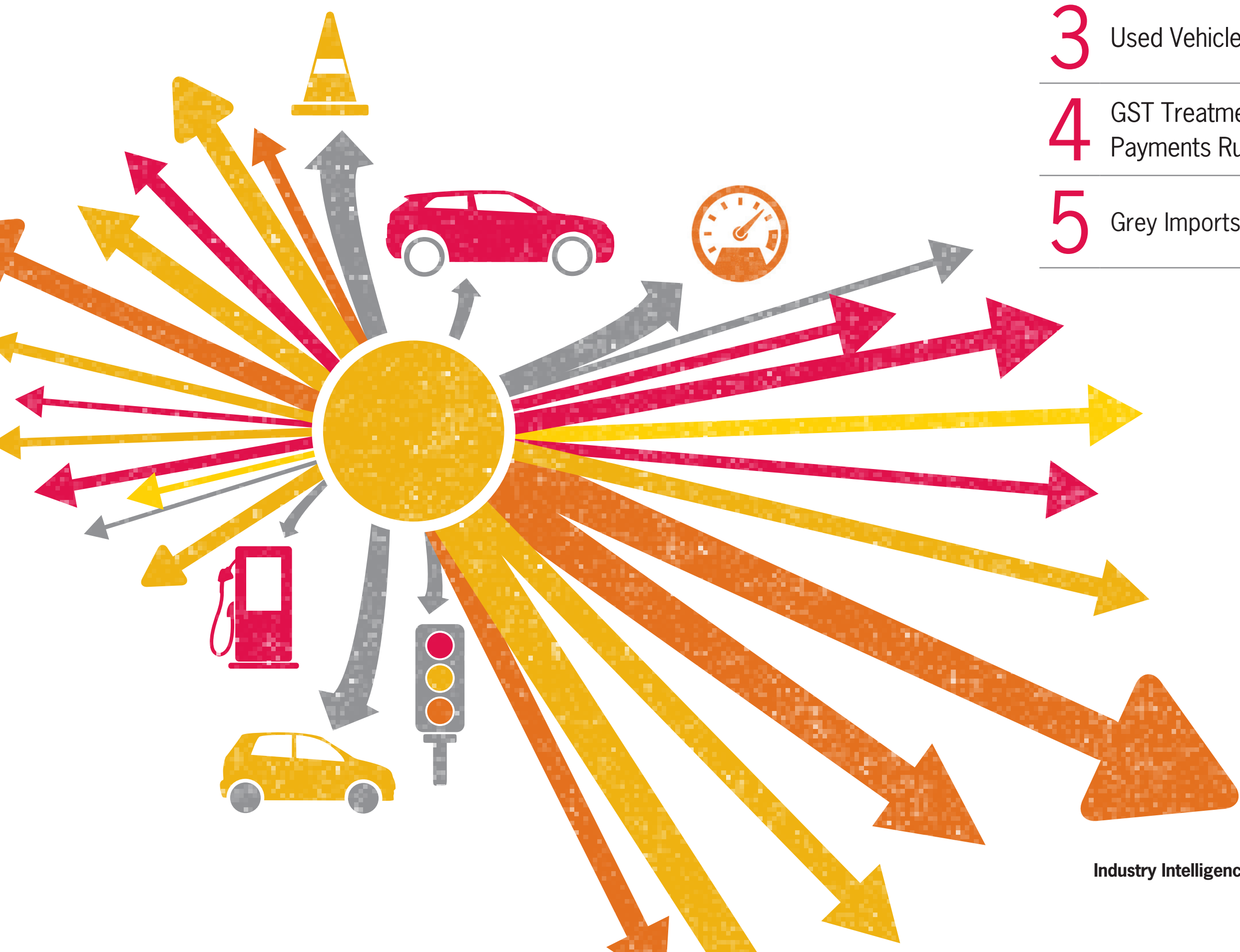
SEPTEMBER / OCTOBER 2014

Industry Intelligence Unit
Automotive Dealership

Welcome to the third edition of the Automotive Industry Intelligence Unit (IIU) for 2014. Internationally, Grant Thornton member firms are leaders in automotive supply chain and dealership advice, with specialist teams across the globe dedicated to this industry.

In this Automotive IIU we concentrate on the following key areas of the automotive industry:

1. General update on vehicle sales for first nine months of 2014
2. Imported vehicles
3. Used Vehicles
4. GST Treatment on Incentive Payments Ruling
5. Grey Imports

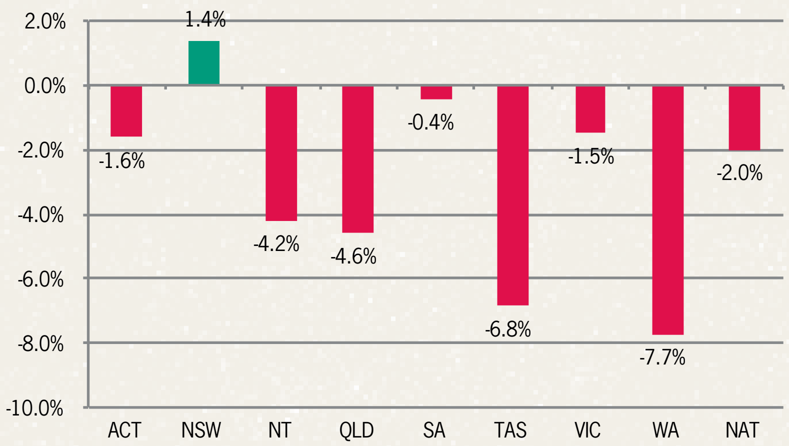


Vehicle sales update: September 2014

The first nine months of 2014 have continued the downward trend in vehicle sales which commenced in August 2013. Sales have fallen this year by 2.0% (16,991 units).

As outlined in Figure 1- State growth, all states experienced negative growth in the first nine months of 2014 with the exception of New South Wales which is on the back of strong growth in 2013.

Figure 1 – State growth



Source: Vfacts

Table 1 – Sales figures October 2013 – September 2014 outlines the last twelve months' movements. Sales have experienced negative growth in ten of the last twelve months. September 2014 was the first month of positive sales since December 2013 on a National basis.

Table 1 - Sales figures October 2013 – September 2014

	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT
New South Wales	-0.9	1.6	4.7	3.4	0.8	2.5	-1.4	0.3	1.0	2.9	-2.8	5.9
Victoria	-0.4	7.0	4.3	-5.7	-4.1	3.8	-8.3	-0.7	2.2	0.7	-4.1	0.9
Queensland	-7.9	-9.8	-2.0	-1.7	-5.7	-5.7	-3.5	-4.8	-6.1	-4.6	-10.1	2.1
South Australia	-2.0	3.2	-3.6	-14.1	-2.4	8.8	-9.0	0.1	7.6	0.5	-2.0	4.3
Western Australia	-8.2	-15.9	-6.6	-14.6	-12.0	-9.3	-9.4	-6.5	-2.7	-3.0	-10.2	-2.7
National	-3.1	-1.4	1.4	-3.7	-3.8	-0.1	-5.2	-2.3	-0.4	-0.4	-5.5	2.5

Source: Vfacts

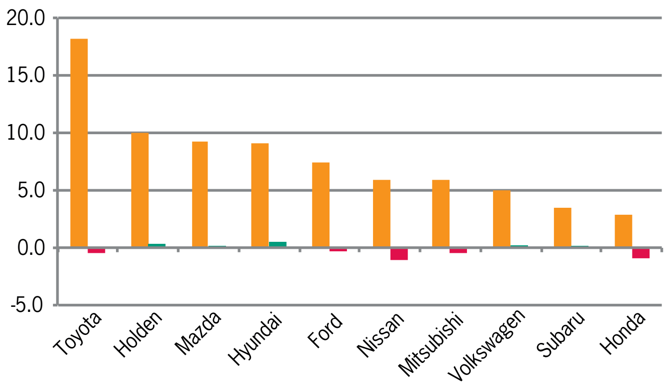
While the market has fallen 2.0% for the first nine months of 2014, it is important to look at the market by State (outlined in Table 1 – Sales figures October 2013 – September 2014), brand, and buyer profile.

The fall in the market has been concentrated in the passenger segment (down 5.3% or 22,378 vehicles) and the light commercial segment (down 3.8% or 5,918 vehicles). The SUV market continues to grow (up 4.8% or 11,993 vehicles) with the main driver being the SUV small segment with growth of 17.4% (9,563 vehicles). This increase has been driven by the Holden Trax (up 4, 148),Nissan Juke (up 1,846) and Nissan Qashqai (up 1,841).

Brand comparison

Toyota continues to lead the market with 18.1% market share followed by Holden on 10.0% and Mazda at 9.2% as detailed in Figure 2.

Figure 2 - Brand comparison by market share

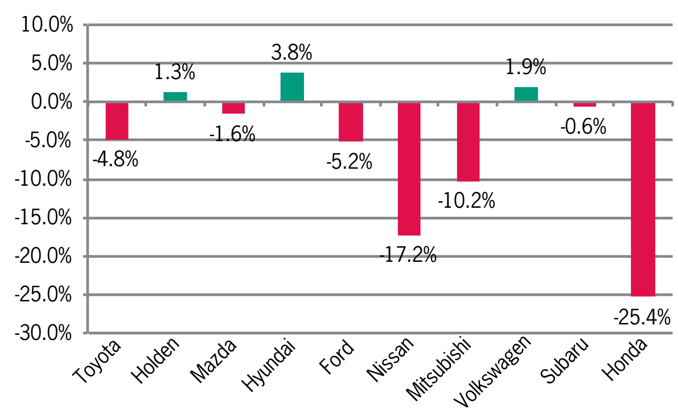


Source: Vfacts

The combined vehicles sales for the Top 10 brands has fallen by 4.7% whilst the combined vehicles sales for Top 11 to 20 brands has grown by 12.8%

Figure 3 – Sales growth by brand – Top 10 demonstrates that despite the market being down 2.0%, a number of manufacturers have experienced an increase in sales. Holden, Hyundai and Volkswagen have all gained market share, while Nissan, Mitsubishi and Honda sales have fallen significantly down 17.2%, 10.2% and 25.4% respectively.

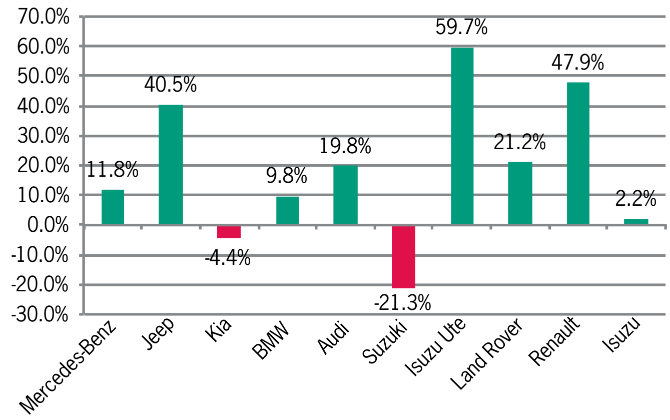
Figure 3 - Sales growth by brand



Source: Vfacts

As noted earlier in the report, the Top 11 to 20 brands continue to experience growth with the exception of Suzuki and Kia as shown in Figure 4 – Sales growth by brand – Top 11-20.

Figure 4 – Sales growth by brand – Top 11-20

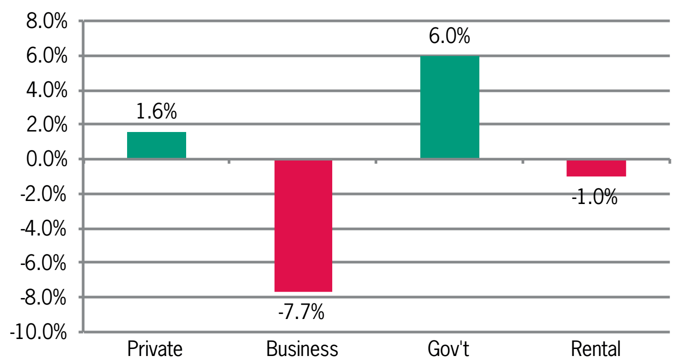


Source: Vfacts

Buyer profile

The key buyer profiles are private, business, government and rental. The private buyer is the most profitable buyer whilst government and rental buyers leave dealers with minimal gross profit as detailed in Figure 5 – Buyer profile areas. In the first nine months of 2014, there has been a fall in business buyers (down 7.7% or 24,593 vehicles) and rental buyers (down 1.0% or 404 vehicles) which account for the fall in the market.

Figure 5 - Buyer profile areas



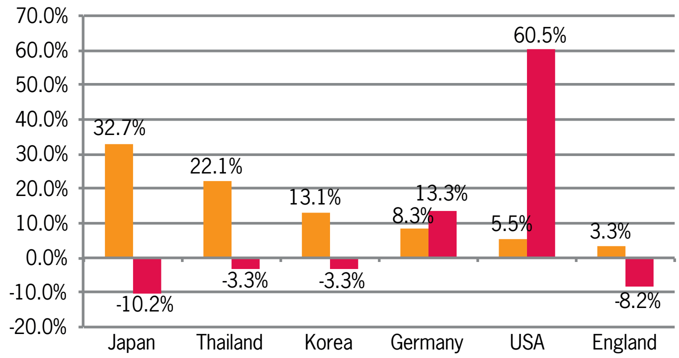
Source: Vfacts

Imported vehicles

With the recent decisions of Toyota, Ford and Holden to cease manufacturing cars in Australia, 100% of vehicles sold in Australia will be imported in future years. Australian made cars now account for less than 10% of vehicle sales in Australia.

Figure 6 – Australian sold vehicles sources, outlines the key countries from which Australia sources cars and movement on prior year. As shown below, vehicles sourced from USA and Germany have increased by 60.5% and 13.3% respectively.

Figure 6 - Australian sold vehicle sources



Source: Vfacts

Market Share of Imported Vehicles

YTD Varience 2014 vs 2013

One of the key factors facing the market in late 2014 is the likely fall in the Australian Dollar which will start to impact on vehicle pricing. Whilst, we do not expect to see a significant increase in pricing, we will see changes through reduction in manufacturer bonuses, more targeted low finance deals and potential changes in the level of vehicle specification.

The Australian dollar has fallen nearly 8 cents since the start of September against the US dollar and hit a four year low on Friday 3 October 2014 at 86.46c with further falls expected.

Used vehicles

Used vehicle profits have continued to decline across the automotive industry. Whilst the used vehicle market has grown, it has come through the private to private market and dealers have struggled to maintain market share with most now averaging less than 1 used vehicle sale for every 2 new vehicles.

Are dealers changing the way they do business to compete with the private market?

Technology (in particular the internet) is making it harder to operate in the traditional way. It is now a transparent market with customers not only more knowledgeable but willing to travel for the right vehicle.

If dealers don't change the way they operate, the time may come when we don't see new vehicle franchise dealers selling used cars. With potential deregulation of the industry, this would represent a significant lost opportunity.

Our Recommendations

Appraisal Process

In most cases the success or failure of a used vehicle occurs at acquisition. However, we still see dealers buying cars with reference to a fixed desired margin and load structure.

Whilst a more transparent market has long been considered negatively in dealing with used vehicles, you should be utilising the available information for your benefit, at the most crucial time, when appraising a vehicle. Rather than considering all vehicles as being equal and trying to achieve $2,500 gross profit, consider the potential Return on Investment (ROI) of each vehicle based on the average sell price for the vehicle in the market and the average days previously taken to sell similar vehicles (both of which are available online).

Utilising ROI will open the dealership up to trading and stocking vehicles previously wholesaled or even better reduce new vehicle deals lost due to offering below market for customer's vehicle.

Use of Stock Management Tools such as Stock Matrix

A key discipline we see within the best used car operators is the use of a stock matrix. Most managers know what to stock and what makes money, what they very rarely ever do is formalise their thoughts.

A stock matrix does this. The most effective way to put together a stock matrix would be to base target stock on vehicles where the best ROI was made. It is also important to consider not only what has sold within your dealership but also within your market by utilising market data available on the internet.

Implement disciplined policies on aged stock

Unfortunately, the used vehicle market is not static. Therefore you shouldn't wait for a vehicle to become a problem before you review pricing and advertising. Review all vehicles on a daily and weekly basis and consider implementing a formalised policy such as the following:

Timeframe	Recommended
72 hours	Recondition turnaround
0-30 days	Full gross margin
30-60 days	Review market data and advertising of the vehicle and re-price to sell (how may leads has the car had versus views?, are the pictures displaying the vehicle at its best?)
60-90 days	Review market data and advertising and consider re-pricing as low as cost
90 days	Wholesale

Again, the concept of ROI can be useful in determining when to wholesale vehicles. When a vehicle has been in stock beyond the time when a 100% ROI can be achieved, it should be re-priced and moved on. This assessment can be made every at 45 days.

Sales staff commission structure

The most important benchmark within the used vehicle department is gross profit per salesperson per month ($35,000) as it represents achieving the correct balance between sales volume, gross margin and the number of sales staff.

It is therefore imperative that your commission structure is focussed on achieving this benchmark and therefore is providing an incentive for both volume and gross profit.

GST Treatment on Incentive Payments Ruling

On 1 October 2014, the Commissioner released the Goods and Services Tax Ruling GSTR 2014/1 – Goods and services tax: motor vehicle incentive payments that provides guidance on the GST treatment of incentive payments made by motor vehicle manufacturers, importers and distributors (manufacturers) to motor vehicle dealers (dealers) under floor plan (bailment) arrangements.

This Ruling is the finalised version of draft GSTR 2014/D1 which was issued in April this year following the Full Federal Court decision in AP Group Limited v Federal Commissioner of Taxation in September 2013.

We believe this is a positive step forward and provides much needed clarity to the motor vehicle industry around the GST treatment of common types of incentive payments paid and received by manufacturers and dealers, respectively.

Where a motor vehicle incentive payment is made by a manufacturer to a dealer, the dealer's conduct may give rise to the dealer having made:

- a supply to the manufacturer for consideration
- a supply to the customer for consideration
- no supply for consideration

A supply to the manufacturer for consideration

A dealer's conduct will give rise to a supply, by the dealer to the manufacturer for consideration in the form of a motor vehicle incentive payment, where the dealer does something specific for the manufacturer for that payment. For example, where a manufacturer pays a dealer to fit a towbar to each of its vehicles, the dealer will be making a supply of fitting services to the manufacturer for that payment.

The entry by a dealer into a specific obligation will also give rise to a supply for consideration where the relevant incentive payment is made for entering into that obligation. For example, where a manufacturer offers a dealer an incentive payment if they promise to abide by certain standards regarding the presentation of their showroom.

A supply to the customer for consideration (third party consideration)

Where the supply of a particular motor vehicle(s) to a customer is the reason for the incentive payment and there is nothing specific the dealer does for the manufacturer for the payment, the supply for consideration is that of the motor vehicle by the dealer to the customer. Where the manufacturer's payment is third party consideration for a supply made by a dealer to its customer, the dealer is liable for GST on the total consideration it receives for that supply, including the incentive payment from the manufacturer. Common payments in this category include:

- fleet rebates
- run-out model support payments
- payment for the dealer selling a vehicle to a customer with 'free accessories' included

For example, where a manufacturer makes an incentive payment to a dealer for a vehicle when it is sold at a discounted price to a customer, the incentive payment is a third party consideration for the supply and the dealer will need to account for the GST on the total consideration it receives for the supply.

This will also impact the dealer's luxury car tax calculations for luxury motor vehicles sold. Specifically, the GST inclusive market value of the motor vehicle will need to include the value of such payments for the purposes of determining whether luxury car tax applies.

No supply for consideration

Where the dealer does not make any supply for consideration, the dealer is not liable for GST and the manufacturer is not entitled to an input tax credit. In these circumstances, an incentive payment may give rise to other GST consequences, for example, the parties may have adjustments under Division 19 or Division 134 of the GST Act. For example, where the manufacturer runs a competition awarding the sales assistant (employed by one of its dealers) who makes the most sales the dealer has not made a supply to the manufacturer for consideration as there is no conduct which can be identified as a supply – the dealer does not do anything, or agree to do anything, for that payment.

The Ruling also discusses at length the application of Division 134 to incentive payments and outlines a number of worked examples that illustrate when there is an increasing adjustment (GST liability) for dealers or a decreasing adjustment (GST credit) for the manufacturers.

The Ruling applies to tax periods starting on or after 1 May 2014.

Grey Imports

Retail Motor Dealers continue to raise concerns about the potential impact on their dealerships of grey imports. The concerns raised by many Motor Dealer Principals regarding the negative impacts of grey imports on the Retail Motor Industry are largely supported by the AADA who have been campaigning vigorously to the Federal Government about the potential disadvantages posed by large scale imports of used vehicles into Australia. For many in the wider general community these concerns are seemingly insignificant, reflecting a lack of understanding and awareness of the critical issues and impacts that a relaxation of the current limitations would have on the industry.

We believe the debate which has been taking place over recent months is only now just starting to heat up.

The New Zealand Experience

If we want to see the stark impact of relaxation on grey imports we need only look across the ditch to New Zealand where in the early 1980's restrictions on used car imports were relaxed, resulting in a flood of used vehicles from Japan, many of which were of inferior quality. The aftermath of this action resulted in a number of negative impacts on that market, some of which are still being felt today. They included:

- A reduction in new car sales a result of which has only recently seen the New Zealand market bounce back to the same level of new cars sales as took place in the early 80's.
- The aging of the used car fleet in New Zealand being extended significantly.
- A flood of vehicles into the market with warranty / repair issues and many of which were arguably "junk" vehicles.
- Irregularities and concerns regarding odometer tampering.
- The introduction of vehicles into the market with inferior design rules and safety features compared to regulated used vehicles.
- An abundance of "backyard" operators entering the market.

The New Zealand experience should serve as a warning to the Australian Consumer Market but for many buyers the message is being ignored and not necessarily getting through.

Where are we now?

The Productivity Commission recently released its report - Australia's Automotive Manufacturing Industry. The report release on 31 March 2014 included under recommendation 5.4 that the Australian Government should progressively relax the restrictions on the importation of second hand passenger and light commercial vehicles. The relaxation of imports would apply to:

- Those vehicles initially manufactured no earlier than five years prior to the date of application for importation.
- Be limited to second hand vehicles imported from countries that have vehicle design standards which are consistent with those recognised by Australia.

It was further recommended that the Australian Government remove the $12,000 specific duty on imported second hand vehicles from the customs tariff as soon as practicable.

Whilst the Federal Government has indicated that it does not intend to allow Australia to become a "second hand dumping ground", retail automotive dealers remain wary.

The Retail Automotive Industry continues to be largely based around the SME market supported to a very large extent by family businesses. These businesses have made a substantial investment within dealership infrastructure and employ significant numbers of staff Australia wide. The potential for a widely based relaxation of import guidelines could see the introduction of many "non dealers" into the market place who could be importing inferior quality product from overseas.

We believe that in order to temper the concerns of the industry additional measures and safeguards need to be introduced, including:

- Introducing a structured warranty requirement for used imports.
- Regulations surrounding odometer readings and vehicle maintenance.
- Strict guidelines on vehicle safety standards.
- Stricter licencing requirements for small scale importers.

The Government will shortly commence a review into the Motor Vehicle Standards Act of 1989 and subsequent to this review it is likely to release its final recommendations in relation to grey imports.

The industry will watch developments closely as the perceived negative impacts of these recommendations may well shift the goal posts forever.

About Grant Thornton

Grant Thornton is one of the world's leading organisations of independent assurance, tax and advisory firms. These firms help dynamic organisations unlock their potential for growth by providing meaningful, forward looking advice. Proactive teams, led by approachable partners in these firms, use insights, experience and instinct to understand complex issues for privately owned, publicly listed and public sector clients and help them to find solutions.

Grant Thornton Australia has more than 1,040 people working in offices in Adelaide, Brisbane, Cairns, Melbourne, Perth and Sydney. We combine service breadth, depth of expertise and industry insight with an approachable "client first" mindset and a broad commercial perspective.

More than 38,500 Grant Thornton people, across over 120 countries, are focused on making a difference to clients, colleagues and the communities in which we live and work. Through this membership, we access global resources and methodologies that enable us to deliver consistently high quality outcomes for owners and key executives in our clients.

What is the Industry Intelligence Unit?

The IIU is unique in its objective of providing stakeholders with information, understanding and analysis of the issues faced within specific industries and subindustries. 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:

- Automotive Dealerships
- Energy & Resources
- Financial Services
- Food & Beverage
- Health & Aged Care
- Life Sciences
- Major Projects & Infrastructure
- Manufacturing
- Not for Profit
- Professional Services
- Public Sector
- Real Estate & Construction
- Retail
- Technology & Media

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