

# HORWATH PROFIT FOCUS INDUSTRY OVERVIEW

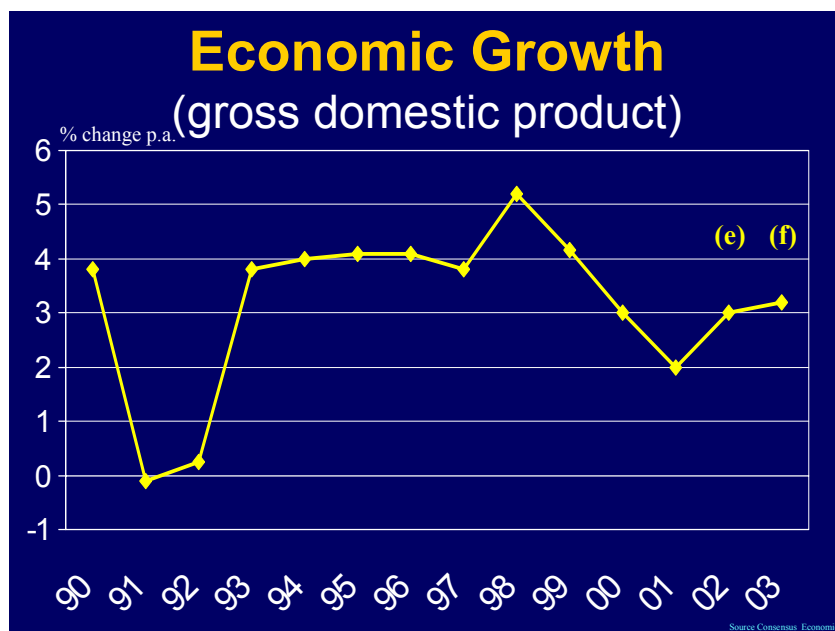
## 2002 FULL YEAR SUMMARY

The Australian Economy continues to perform remarkably well considering all the external global threats. With a forecast growth rate of over 3% for 2003, although down from the mid 1990's, it remains one of the strongest in the western world.

Strong domestic demand has enabled it to weather the negative impact of the global economic turbulence. The fallout of the global equities market and its flow-on effect on business and consumer confidence has been far less severe for Australia compared to other major world economies.

Sure the world economic recovery is still shaky (particularly in Japan) which will have some impact on us, but the facts show the Australian Economy has proved to be far more resilient than what many people give it credit for.

The threat of a major war in the Middle East doesn't help business and consumer confidence, and the drought continues to cast a shadow over the farm economy and rural communities. These events in themselves can have dire consequences, but history has shown fortunately their impact is generally short term. Indeed, most analysts predict the present drought to break within the first half of 2003, which should add another ½ to 1% to overall economic growth.



## 2003 Economic Growth (GDP) Forecast (%)

Australia	3.2
NZ	3.0
USA	2.5
Europe	1.5
Japan	0.5

Source: consensus economics

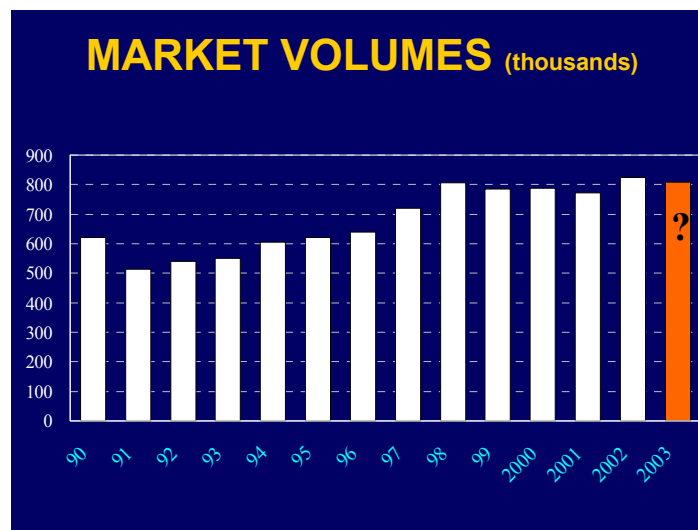
In spite of all the threats there are many positives and the economic fundamentals remain sound. The economy continues to grow relatively strong with good employment growth, a healthy business outlook, continued low interest rates and resilient domestic demand.

## New Vehicle Sales

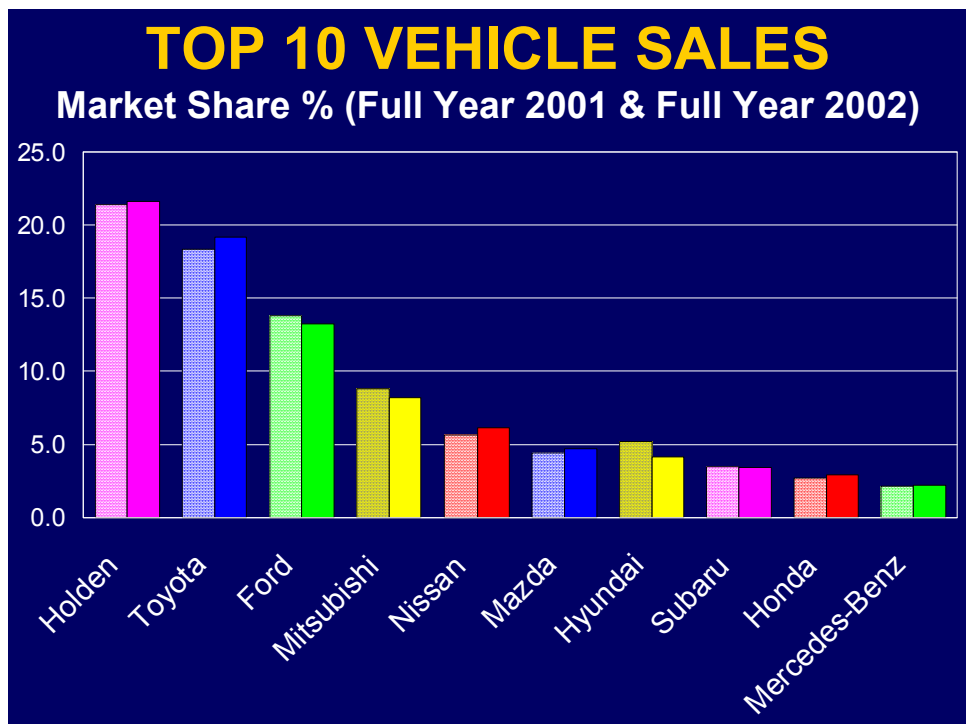
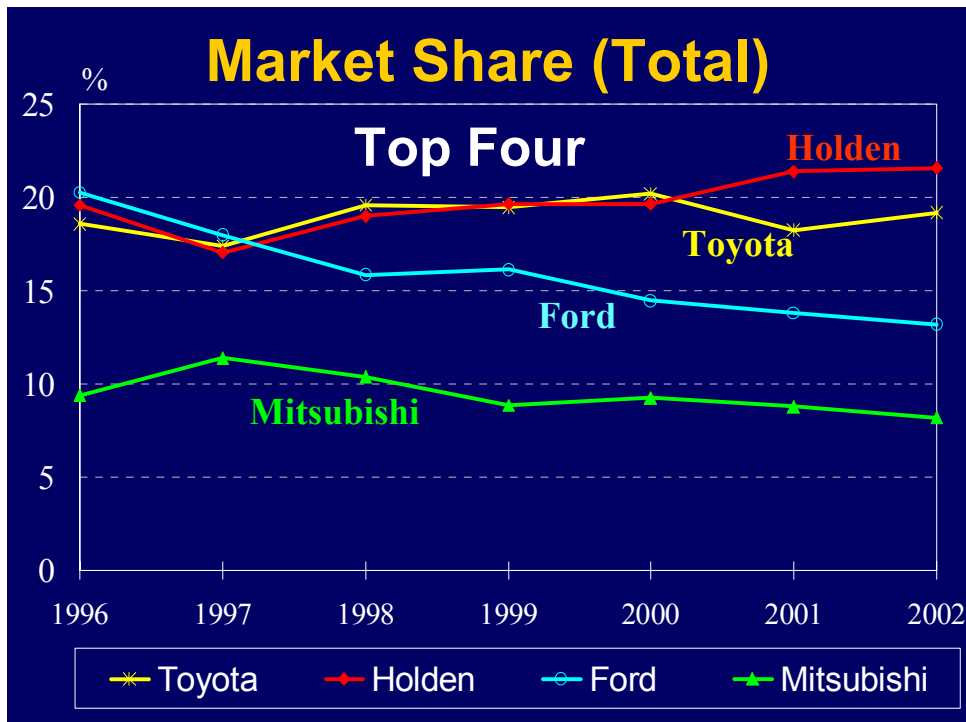
Motor Vehicle Sales for 2002 finished with an all time record of 824,309 vehicles, up 6.7% on 2001, and well ahead of the previous record of 807,669 set in 1998.

Continued low interest rates together with strong economic fundamentals and an ever-increasing proliferation of models should see another year of strong new vehicle sales for 2003.

Most major manufacturers anticipate another strong year, but down a little, with forecasts ranging from between 800-815,000 units. The FCAI is more optimistic with their forecast of 825,000 just ahead of last year's record.



Holden achieved an all time sales record of over 178,000 vehicles to claim overall sales leadership for the 3<sup>rd</sup> time in the past four years, ahead of Toyota, Ford and Mitsubishi. Interestingly Holden's previous record was way back in 1973, almost 30 years ago.



The following franchises all enjoyed record sales for 2002.

<b>RECORD SALES FOR 2002</b>			
<b>Holden</b>	<b>178,392</b>	<b>Audi</b>	<b>4,160</b>
<b>Subaru</b>	<b>28,112</b>	<b>Hino</b>	<b>2,828</b>
<b>Mercedes Benz</b>	<b>18,077</b>	<b>Alfa Romeo</b>	<b>2,513</b>
<b>BMW</b>	<b>12,663</b>	<b>Jaguar</b>	<b>1,751</b>
<b>Kia</b>	<b>12,237</b>	<b>Citroen</b>	<b>1,705</b>
<b>Peugeot</b>	<b>6,630</b>	<b>Kenworth</b>	<b>1,319</b>

The Holden Commodore was Australia's best selling car for the 7<sup>th</sup> consecutive year, ahead of its traditional rival the Ford Falcon. At 88,478 vehicles it was it's second best ever sales result behind 1998.

With the successful release of the all new BA Falcon late in the year and its shower of accolades from motoring journalists, 2003 no doubt should see a closer contest for the number one spot.

Looking at imported vehicles it was the new Toyota Corolla, released early in 2002, which took the honours as number one imported vehicle.

<b>TOP 10 VEHICLES 2002</b>			
<b>Rank 2002</b>	<b>Rank 2001</b>	<b>Model</b>	<b>2002 Volume</b>
1	1	Holden Commodore	88,478
2	2	Ford Falcon	54,629
3	3	Toyota Corolla	34,948
4	5	Toyota Camry	30,952
5	4	Holden Astra	29,536
6	6	Mitsubishi Magna/ Verada	23,405
7	9	Mitsubishi Lancer	18,646
8	10	Ford Falcon Ute	17,883
9	8	Nissan Pulsar	16,258
10	15	Mazda 323	15,941

As seen in the chart below, of the Top 30 franchises by volume, many of the biggest growth rates have gone to the Europeans. Renault, Peugeot and Citroen, all French marques took the top 3 places. Although some may have come from a low prior year base, it is indicative of the increasing number of franchises and models available on the Australian market today. This proliferation of models is all great for consumer choice and helps drive sales volume, however it puts a downward pressure on gross margins and dealer profitability.

Looking at the chart below although the market was up 6.7% on the prior year, for individual franchises it's worth noting how sales can vary significantly from one year to the next.

For a large volume selling franchise, Nissan enjoyed the largest growth of 16%, largely due to the success of the X-Trail All Terrain Wagon, and took the honours as the number one overall importer.

<b>VEHICLE SALES (Top 30)</b>					
<b>Full Year 2002 % Change</b>					
<b>Renault</b>	<b>134.5</b>	<b>Hino</b>	<b>15.6</b>	<b>Kia</b>	<b>0.5</b>
<b>Peugeot</b>	<b>92.1</b>	<b>Mazda</b>	<b>14.7</b>	<b>Mitsubishi</b>	<b>-0.5</b>
<b>Citroen</b>	<b>69.7</b>	<b>Honda</b>	<b>13.5</b>	<b>Suzuki</b>	<b>-2.4</b>
<b>Jaguar</b>	<b>65.7</b>	<b>Toyota</b>	<b>11.7</b>	<b>Saab</b>	<b>-5.3</b>
<b>Lexus</b>	<b>34.2</b>	<b>M-Benz</b>	<b>10.8</b>	<b>Volkswagen</b>	<b>-10.2</b>
<b>Jeep</b>	<b>27.5</b>	<b>Holden</b>	<b>7.7</b>	<b>Volvo Car</b>	<b>-10.5</b>
<b>Alfa Romeo</b>	<b>24.2</b>	<b>Daihatsu</b>	<b>4.5</b>	<b>Hyundai</b>	<b>-14.7</b>
<b>Audi</b>	<b>18.6</b>	<b>Subaru</b>	<b>3.9</b>	<b>Daewoo</b>	<b>-17.1</b>
<b>Nissan</b>	<b>16.0</b>	<b>BMW</b>	<b>3.7</b>	<b>Land Rover</b>	<b>-17.6</b>
<b>Isuzu</b>	<b>15.7</b>	<b>Ford</b>	<b>2.3</b>	<b>Chrysler</b>	<b>-22.7</b>

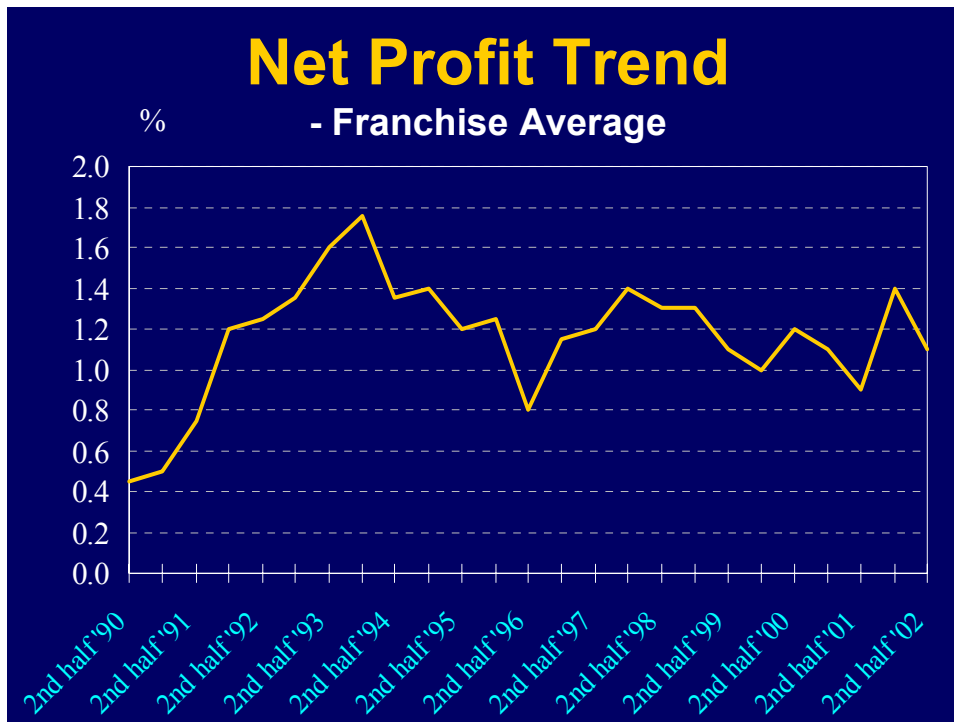
## Dealership Profitability

2002 saw an all time record number of new vehicle sold. 2002 also saw a record number of models competing in an increasingly crowded market place. The consequence of such rampant model proliferation is fierce competition and pressure on gross margins and dealership profitability.

The Horwath Profit Focus Database reveals that across all reporting franchises combined, the average dealer made between 1.1 and 1.4% net profit to total dealership sales turnover over 2002.

The first half of 2002 saw the market exceed 400,000 units for the first time ever, with stronger vehicle profitability (both new and used) and an average bottom line of 1.4%, the strongest since 1998.

Unfortunately the 2<sup>nd</sup> half saw profitability for the average dealer fall to 1.1% largely due to weaker vehicle profitability.



The department profitability chart below shows the average dealer continuing to generate a net loss in new vehicle overall, this was in spite of the record overall industry new vehicle sales.

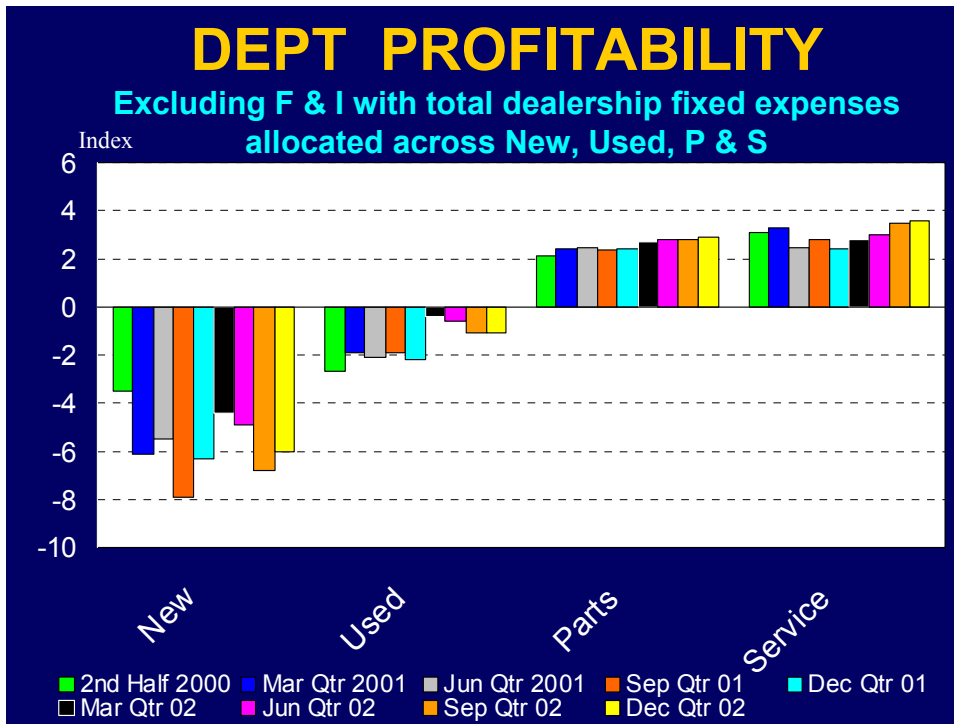
The smallest loss over recent years was achieved in the second half of 2000. At this time the GST affected sales resulting in a record second half year volume.

In contrast, September Quarter 2001, when average new vehicle inventory levels were extremely high and grosses low, very significant losses in the new vehicle department were sustained.

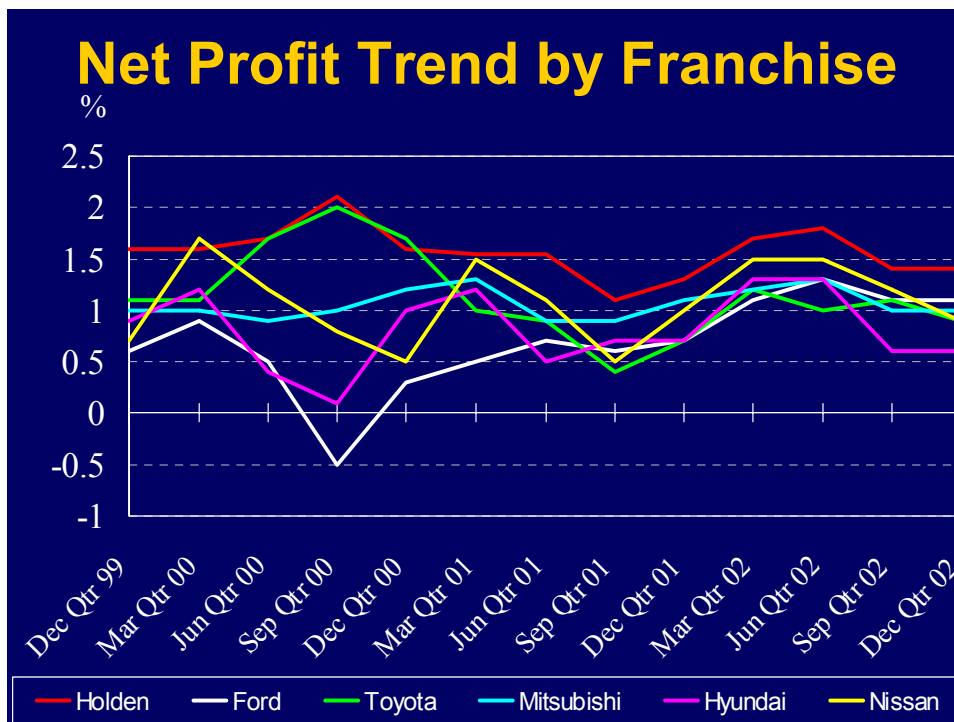
March and June Quarters 2002, although significantly under breakeven were nonetheless better than past averages. Stronger than expected sales and tighter stock availability may have contributed to the better grosses and improved profitability over the period.

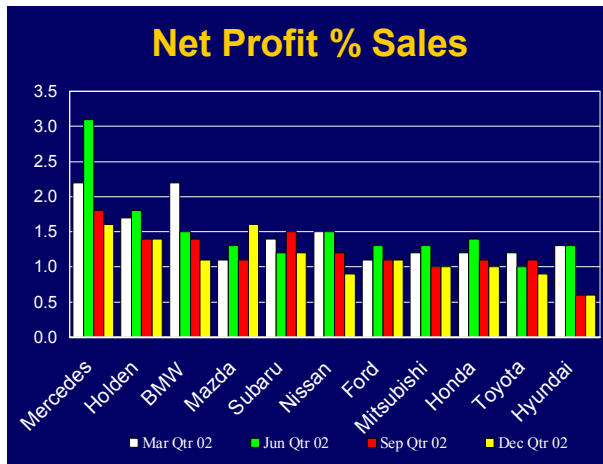
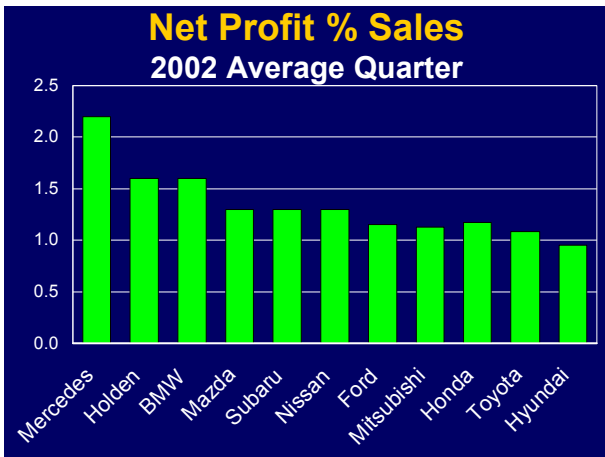
The used vehicle department is in a similar loss position to new, however the size of the loss is far smaller with a significant improvement over 2002, particularly over the March and June Quarters.

Along with Finance and Insurance, it's the Parts and Service departments, which continue to provide the vital income to offset the profitability drain from the vehicle departments.



As seen in the chart below, a broad general industry improvement in profitability occurred in the first half of 2002 where almost all franchises showed a lift in profits for March and June Quarters compared to preceding year Quarters. This improvement failed to continue into the second half in spite of the record new sales volumes.





Holden, who have blitzed the opposition for new vehicle sales leadership over recent years, remain the most profitable large volume franchise relative to sales turnover averaging 1.6%.

Mazda, riding on the success of the new Mazda6, experienced the largest lift in profitability for the December Quarter. In contrast Hyundai with their significant drop in new vehicle sales volume sustained the largest fall in profitability over the final two quarters of 2002.

Ford, enjoyed a large lift in new vehicle profitability over the December Quarter, with the success of the new BA Falcon, however unfortunately they sustained a significant offsetting loss in used vehicles resulting in a poorer than expected overall bottom line for the December Quarter.

But once again, it was Mercedes-Benz who claimed the title of the most profitable Top 12 franchise averaging between 1.6 and 3.1% over the four Quarters of 2002.

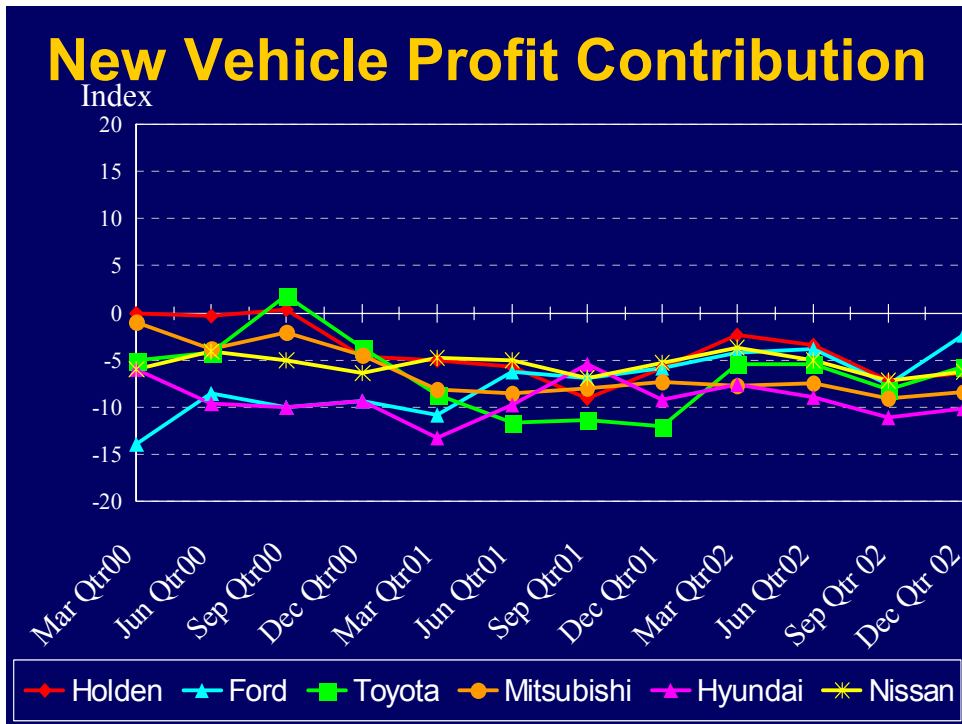
## New Vehicle Profitability

The general new vehicle profitability was analysed in detail in the dealership profitability section above.

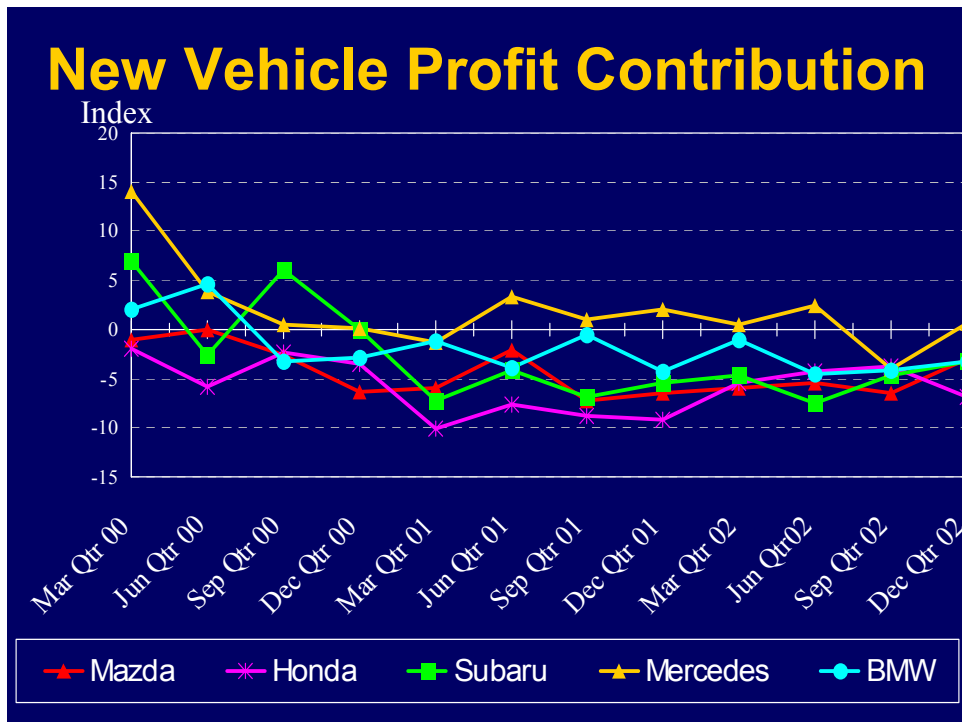
Looking at specific franchises some broad industry wide trends are clearly evident. March Quarter 2002 saw almost all major franchises show an improvement. Stronger vehicle sales, tighter stocking levels and stronger grosses being the main contributing factors.

June Quarter was also a better than average result. However, September Quarter saw a drop off with overall weaker vehicle grosses, while the December Quarter recovered with many franchises enjoying stronger sale volumes and grosses.

But the reality is, in spite of the extremely strong new vehicle sales volumes, unfortunately the average large volume selling franchise dealership continues to make a net loss in the new vehicle department. Holden, the dominant sales leader has performed best over most of the year, but it was Ford with the success of the new BA Falcon, who charged ahead for the final Quarter of the year.



The next tier of franchises are generally more profitable, nonetheless most franchises still sit below the breakeven mark on average. Only Mercedes and BMW have been close to, or above breakeven over recent times.

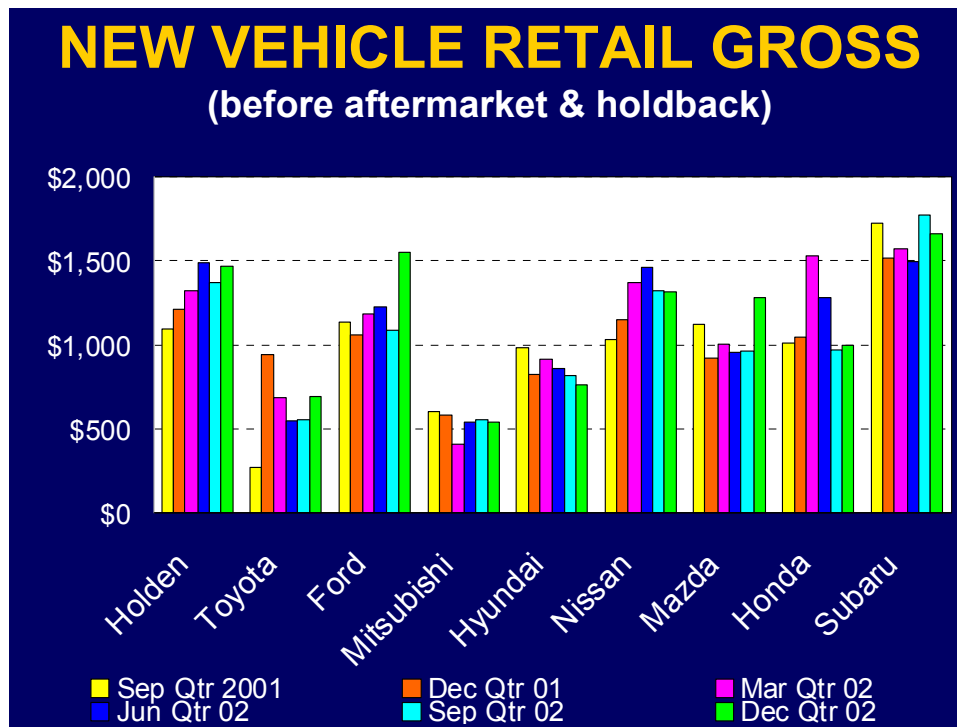


# New Vehicle Retail Grosses

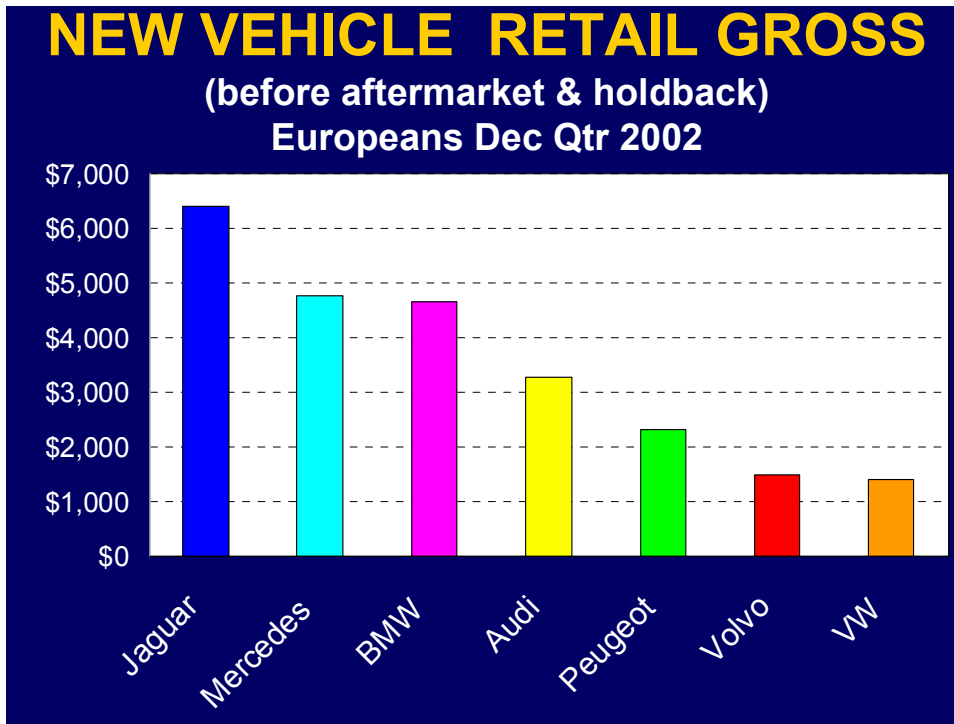
The proliferation of models is all great for consumer choice and helps drive sales volume, however it puts a downward pressure on gross margins. Of course model mix can influence average grosses across a franchise, and there is no doubt grosses will move in line with a franchise's model cycle.

This is clearly evident on the chart below where both Ford and Mazda experienced significant lifts in their average grosses over the December Quarter 2002 primarily due to the successful launch of the Ford Falcon BA and Mazda6. It's interesting to note that Ford now clearly leads their arch rival, Holden, a first for some time.

Hyundai grosses have steadily declined, however the key issue for them is the significant drop in sales volume. Mitsubishi grosses although steady remain relatively low, while Toyota have been typically volatile.

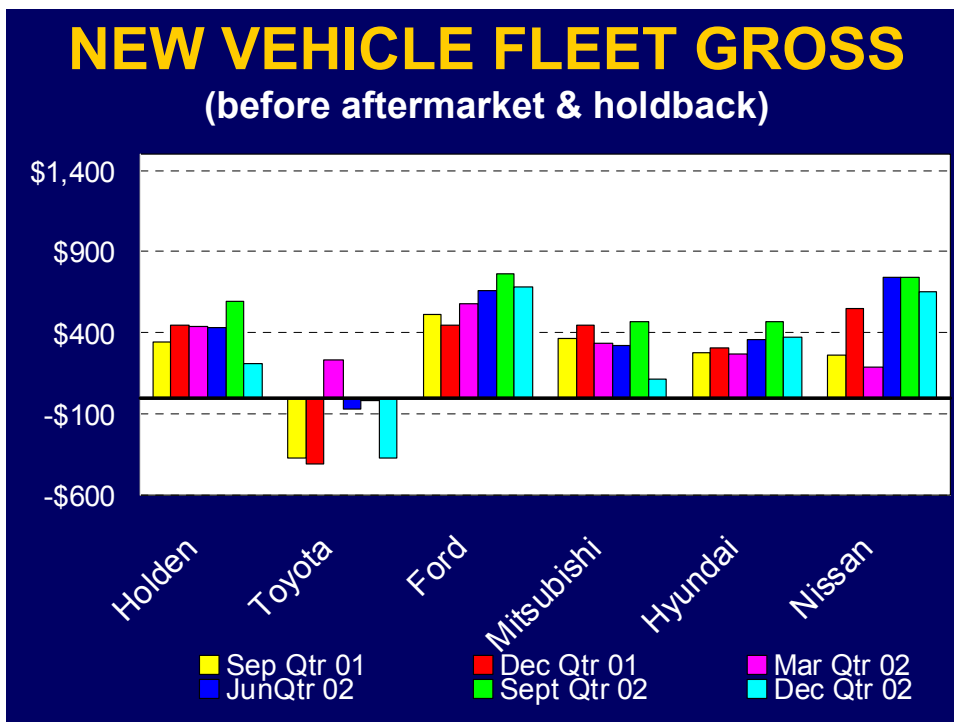


As expected, retail grosses of the European marques who compete predominantly in the luxury and prestige segments are higher than the volume selling franchises.



### New Vehicle Fleet Grosses

September Quarter 2002 saw a general lift in fleet grosses. However grosses softened as competition hotted up at the latter part of the year with model run-outs and an almost unprecedented release of significant volume selling new models, including the VY Commodore, BA Falcon, Camry, Mazda6, Hyundai Getz, etc. This was in contrast to the stronger retail buyer grosses.



## New Vehicle Days Supply

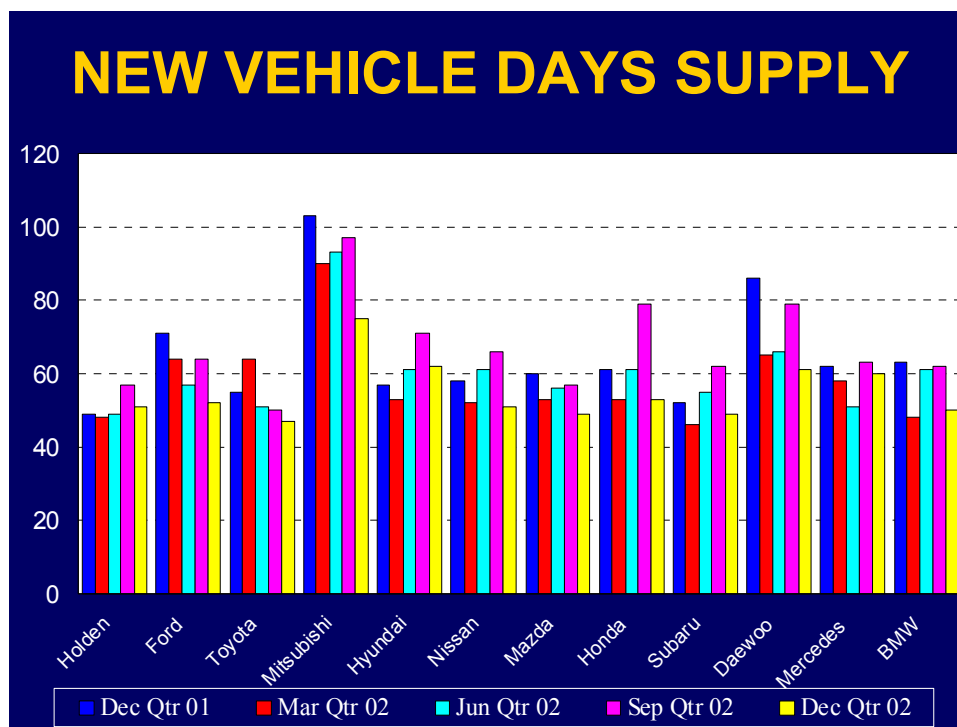
The stronger than expected strength of the new vehicle market may be a contributing factor for why the average new vehicle days supply is generally lower for the first half of 2002 compared to prior years.

Indeed, many car companies revised up their sales forecasts as the year progressed. This would have been one of the reasons for why grosses tended to be somewhat stronger over the earlier Quarters of 2002.

As supply kicked in, the September Quarter 2002 which generally saw higher days supply, new vehicle retail grosses tended to soften.

Many of the major franchises had model run-outs for their larger selling models and in some cases stock was tighter than similar run outs of the past. Ford in particular had a tighter runout for the Falcon.

The chart below shows Mitsubishi is still heavily stocked relative to sales as they come to terms with lower than expected sales and the added complexity of a new vehicle ordering system in the short term.

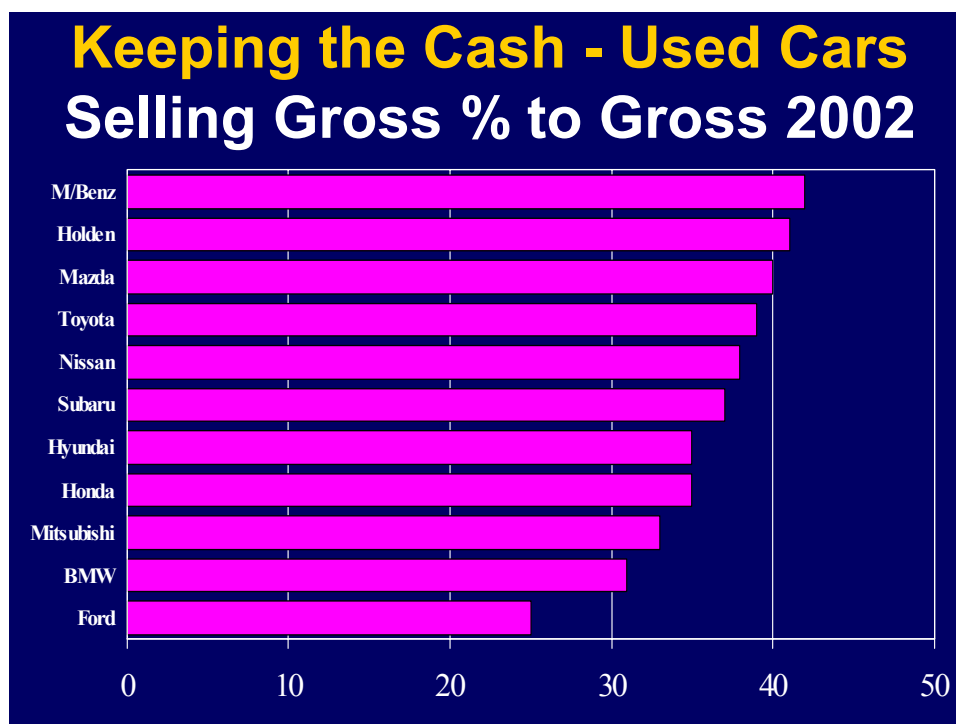


## Used Vehicle Performance

As seen in the department profitability chart earlier, the used vehicle department is in a similar net loss position as new vehicles, however the size of the loss is far smaller with a significant improvement over 2002, particularly over the March and June Quarters. Improved retail grosses were a major contributing factor.

There's no doubt managing a used vehicle operation can be one of the most challenging parts of a dealership's operation. In fact the volatility and the large variance between the good and not so good dealers reflects this. At least the very challenging time during the introduction of a GST on July 1, 2000, when significant losses were made in the subsequent quarter, are now well behind us.

The chart below compares franchise performance by selling gross.\* It shows, Mercedes Benz leading the pack ahead of Holden and Mazda. Next comes Toyota, who have long been stronger than average. At the other end, Ford would be disappointed in the relatively weak result for 2002 which unfortunately offset the gains enjoyed in new vehicle profitability over recent periods.



\* *Selling Gross is gross profit less departmental expenses ie. excludes the dealership's general overhead fixed expenses eg. rent, accountants salary etc which are inherently subjective to allocate across departments.*

## **Finance & Insurance**

In times of unspectacular vehicle profitability, the importance of maximising other profit sources such as F&I and an aftermarket income have become vital in helping to cover the profit drain from the vehicle operations.

The Horwath Profit Focus database shows, although some franchises are better than others on average, a big range in F&I performances within individual franchises exists. Indeed a good F&I operation can be found in all franchises indicating that it's more a function of having the right people in the seat, with the right systems and disciplines in place, rather than the right franchise sign out the front.

The contribution from the F&I department should be 10% or more of the total dealership gross profit in a well-balanced dealership. However, since most of the expenses generating F&I customers typically stay within the vehicle departments, the net profit contribution from F&I can be far more significant. In some cases, this can be at least half the total dealership's overall bottom line.

Finance penetration rates, one of the key performance indicators of the F&I department, for most franchises in the past have tended to average between 30 and 40% for both new and used vehicles. However, over recent quarters they have fallen somewhat resulting in a need to drop the Horwath benchmark from 45 to 40% for new vehicles.

## **Parts & Service**

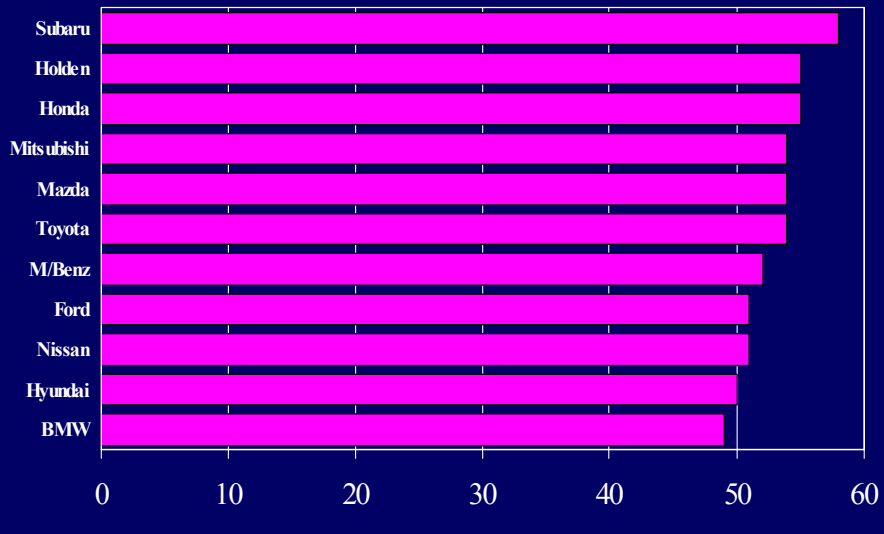
Fixed operations often plays a crucial role in helping to cover the profit drain out of the vehicle departments. As expected, all franchises generated a net profit in the parts and service departments, on average over 2002.

The charts below show parts and service selling gross as a % to gross for 2002 (selling gross is gross profit less direct department expenses ie excludes the dealerships general overhead/ fixed expenses which are inherently subjective to allocate across departments).

Of note, is that on average there was relatively small differences between franchises. This is in spite of the fact that individual dealers can show significant variances, and goes to show that a dealer can gear their business to achievable gross revenues no matter what franchise they have.

For some franchises they may appear reasonable on a selling gross basis, however their net profit may be less healthy after allocating general dealership overhead expenses. We often see this case in franchises which have sustained a significant drop in their vehicle 'car parc' due to a large drop in new vehicle sales over the long term. In such cases the dealer may have an efficient fixed operation at a selling gross level, but need to crank up the scale, which is a major challenge in itself with the continued low service retention levels we still see (typically after the 3 year warranty period expires).

## Keeping the Cash - Service Selling Gross % to Gross 2002



## Keeping the Cash - Parts Selling Gross % to Gross 2002

