Insight Report 2021

Cox Automotive Grant Thornton

DRIVING OPPORTUNITY: DEPLOYING GROWTH MINDSET ON THE JOURNEY TO 2030

Rounding off a challenging period for automotive: what's next?

> In conversation: the outlook

Join Philip and Owen as they pull together the key highlights from this year's Insight Report, shining a spotlight on key trends which are impacting on the sector.

IN CONVERSATION: THE OUTLOOK

Cox Automotive outlook

Philip Nothard - Insight & Strategy Director

When we shared our last Outlook in late 2020, we talked about the challenge of blaming 2020 performance on ‘unprecedented’ events and the futility of hoping for a return to ‘normal’. Of course, we all know, there is no such thing as ‘normal’ anymore and, indeed, there may not be again. But, in reality, this is nothing new. The global automotive sector is constantly evolving. While the pace of change may be accelerating, the sector has always looked forward rather than back.

Let’s look first at COVID-19. The pandemic has clearly caused significant problems for an industry that was already in a state of flux. Between temporary plant shutdowns, ‘pingdemics’ with workers isolating, consumers unable to leave their homes, dealerships closing their doors, and a change in the way people travel, there is now a lag in the supply of vehicles and artificial inflation in the used car market due to shortages in the new. Unheard of previously, vehicles are now an appreciating rather than depreciating asset. While there may be a softening of used values, they are unlikely to return to pre-pandemic levels, as supply constraints, cost of new, and manufacturing expenses are all going up. This is a worldwide concern and, with manufacturers increasingly taking a global view, one which is set to continue.

Focusing in on the UK and European markets, another big challenge has been the implications of Brexit. While mixed up with the pandemic, the UK’s exit from the European Union has had significant ramifications for cross-border operations. As we write this outlook, there have already been delays in getting supplies across the Channel, issues around driver shortages, increased container shipping costs, and more besides. It perhaps won’t be fully clear what the knock-on effect of Brexit will be for several years to come; however, there is an increased complexity at the moment.

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A further issue, which can be linked to COVID-19 and Brexit, but which has been around for a lot longer, is the endemic skills and knowledge shortage in traditional sectors – of which automotive is one. An ageing workforce, an unwillingness in some quarters to embrace new technologies, difficulties moving people around the world to work, and perceptions that it is an industry that is dying: no wonder it is difficult to recruit across some parts of the automotive sector today. Yet, we see that there are plenty of opportunities.

Being bold, we might argue that the automotive sector needs a facelift. No longer are we a manufacturing-led business. To attract talent and, putting it frankly, investment, we need to reposition the automotive sector as a technology-led operation. This is already the case for many of the challenger brands and new entrants to the sector, listing themselves in the technology rather than motor category on various global stock exchanges and seeking investment from venture capital firms and finance houses which traditionally fund technology-led enterprises.

With the two most significant trends in our sector converging – digital transformation and electrification – this shift in perception becomes more important than ever. Looking at those trends in turn, we need to be clear that digital transformation and digital retail have been on the horizon for a very long time. Indeed, the automotive sector has been lagging behind counterparts in other sections of the retail industry, where personalisation, same day delivery, and build-on-demand have been the norm for many decades. The pandemic has indeed accelerated digital deployment, but it was only a matter of time before other market forces drove this change anyway.

The challenge we have in the short-term is ensuring that, in the excitement of getting every part of the sales process online, we don't leave behind a digitally excluded part of the population who may not want or know how to access technology. This could be due to issues with skills and knowledge, concerns over privacy, or infrastructure issues denying internet access. Indeed, globally, there is a massive difference in how and when people can benefit from digital retail.

Looking at the electrification roadmap, we could easily suggest that the 2025 and 2030 deadlines around the world are coming both too quickly and too slowly all at once. That the automotive sector is moving to electrification is not in question, but how it does so and with what other powertrains and fuel types in the mix is still uncertain. In many economies, there is a

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growing realisation that a pure electric vehicle approach is unlikely to meet all demand. Likewise, decarbonising heat, homes, and commercial premises is going to take a significant proportion of renewables investment.

There are calls from some quarters of the industry to accelerate the pace of change, with more investment required in infrastructure to support new energy vehicles and increasing mobility solutions. Conversely, other commentators argue the regulatory drivers for change are too soon to enable all businesses and individuals to keep up. There is a danger we create a two-tiered society – those with the money to go digital and electric, and those who get left behind. As in many of the key historical eras which have seen significant change, with progress for many comes pain for a few.

The UK automotive sector remains a significant player in the global marketplace, but the short-term impacts of the pandemic, Brexit, semiconductor chip and rubber shortages, and more, could see that position being threatened in the medium to long-term. Manufacturers are thinking global rather than local, and the UK automotive sector must do the same. Even the Society of Motor Traders and Manufacturers (SMMT), which represents the UK motor industry interests, has taken on an office in Brussels in recognition of the need for the sector to think beyond UK borders. The UK and Europe need to recognise they are part of a massive global picture. Manufacturers are not treating regions in isolation any longer.

Looking to the future, our forecasts are heavily dominated by the impacts of a global focus on sustainability, decarbonisation, and technology. The organisations which succeed in this new automotive era are those who build or buy the capability to keep up with the global pace of change; those who partner strategically around the world to create networks which offer holistic international solutions; those who find ways to remove borders and barriers; and those whose vision is focused on enabling people to remain mobile, whatever shape that will take.

Our role at Cox Automotive is to enable our partners and customers to embrace and build on change; to access the insight and intelligence which will support their business endeavours today and long into the future; and to navigate and respond to the consumer-driven trends which are reshaping the sector. We work closely with customers to complement their business activities, to consult on their next steps, and to create opportunities for mutual benefit in years to come.

We all know that the global automotive sector will be unrecognisable in ten years' time; the question is, will you be ready?

IN CONVERSATION: THE OUTLOOK

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Owen Edwards, Head of Downstream Automotive,
Grant Thornton UK LLP

The automotive industry has once again met its challenges head on, adapting to the demands generated by COVID-19. The industry has successfully navigated the move to online sales while also increasing profits for many automotive retailers. However, the task going into 2022 is to try to maintain this profitability against a head wind of disruption in the automotive supply chain and distribution and retail automotive industry.

The shortage of semi-conductors will continue to impact the automotive industry upstream (manufacturing) and downstream (factory gate to the end consumer). This situation has meant new vehicle supply has been disrupted, which in turn has generated a shortage in used vehicles. Manufacturers and governments have already reacted, indicating there will be a large level of investment to prevent such an issue occurring again. There are now several longer-term strategies to build more local semi-conductor plants which should alleviate the issues around supply.

The rise in raw material costs will impact the automotive industry as well as the UK and global economies. It will take time for raw material price increases to fully filter down to the end consumer, but this is likely to end with higher vehicle prices as well as rising general living costs, pushing up inflation in the UK and globally. What is not clear in the UK is how far the Bank of England will allow inflation to rise before increasing interest rates. This is something that has not been seen for a very long time.

In the longer term, there are further changes expected for both the upstream and downstream automotive industries. For the upstream (manufacturers), the increase in emissions regulation is posing further changes; specifically, the move from ICE to EV and the push to a circular economy and zero emissions is taking in the total life of the vehicle, from birth to death. The move for the manufacturers to review their total vehicle life impact on the environment will also add additional costs to the manufacturers of vehicles.

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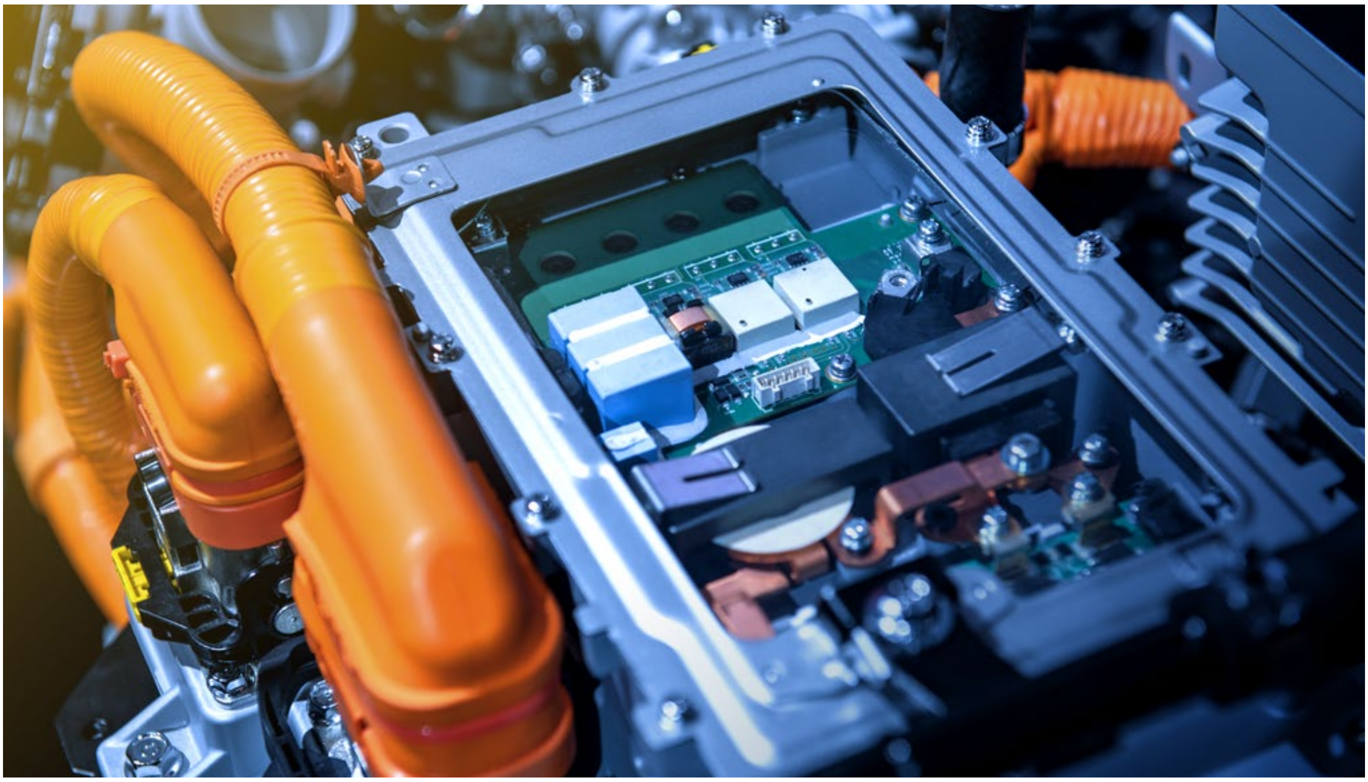
We know this will challenge manufacturing processes e.g., EV battery production is likely to be more locally focused due to the expense of moving such components around the world. We are starting to see such movement with the increase in battery product in both Europe and UK, estimated to be around 600 GWh by 2030, rather than sourcing those batteries from China and Asia.

Hydrogen will have part to play in the development of EVs. The commercial vehicle market is suited to using hydrogen vehicles, where total cost of ownership is lower than that for battery heavy good vehicles. There will be further investment in hydrogen, both the vehicles and the infrastructure required to make this alternative fuel viable.

Connected and Autonomous Vehicles (CAVs) have already started to enter the market at SAE Levels 1-3. Manufacturers are pushing the boundaries to move CAV to Levels 4 and 5, vehicles which do not have human interaction. The increased investment in this technological change will mean investment costs will rise in the vehicle manufacturers. With higher costs in this space, further cost reduction will be required in other areas to grow earnings. This cost reduction is expected to come in many guises: reducing production costs, increased efficiency, or further consolidation. There has already been consolidation with PSA, Citroen, Vauxhall, Opel and FCA, now called Stellantis. However, the manufacturing of vehicles is only one part of the lifecycle of vehicle. Vehicle manufacturers will also be looking to reduce their costs in the distribution and retailing of vehicles.

Over the past 12 months, there has been significant change in the distribution and sales of vehicles. COVID-19 has led to many automotive retailers making the move to selling vehicles online, both new and used. This shift to a digital sales approach has meant there has been investment in online processes. Many of the manufacturers are either at the start of moving to the agency model or are reviewing how it might work for them. There are considerations about the impact this would have on their retail network, as well the potential to reduce costs in the longer term. The transition from the current franchise model to the genuine agency model will be complex and take time as this requires a



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shift in the areas of operations, commercial activities, finance, and culture. However, the genuine agency model is not a standard model which fits everyone, hence we believe that the non-genuine agency model will be preferred by most manufacturers – a hybrid between the current franchise model and genuine agency model. Each manufacturer will have to review what parts of the agency model benefit them and the dealer and retail networks.

We believe the next five years will see the automotive industry, upstream and downstream, go through significant change. With this in mind, it is critical companies develop strategies that position their themselves in a strong position to survive and thrive. In the automotive upstream industry, the move from ICE to EV is one key area of change. Those in castings, stamping, cooling systems, coatings, etc can adapt and move from ICE to EV production. In the automotive downstream industry, companies need to build a strategy for online and a digital retail strategy. They also need to react to the potential change of the agency model as well as further consolidation in this market; whether retailers, de-fleeting services, brokers, fleet, or rental.

Our role is to partner with our clients and customers to ease the journey of change, developing business models and strategic plans which focus on cost reduction, generating efficiency gains, and transitioning business long-term while still maintaining profitable growth.

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