



AUTOMOTIVE OUTLOOK 2019

ACCELERATING BUSINESS

BDO



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INTRODUCTION



Canada's automotive retail market has experienced much change and uncertainty over the last few years. New trade agreements, fluctuating sales, and technological advancements have all made an impact on the industry. Some experts have gone so far as to predict the end of vehicle ownership and declare dealerships obsolete.

The reality is quite different. While autonomous cars, electric vehicles, telematics, and other in-car technologies are making headlines, they have a long road to travel to mainstream adoption. Consumer perceptions of vehicle safety, affordability, and privacy—not to mention, acceptance by the insurance industry—will

determine the pace of change. Similarly, online retail is a growing and legitimate business model, but still has its limitations due to the highly experiential nature of purchasing a car.

Dealer owners and principals should focus on adapting their core business to the changing market. This automotive outlook looks at the most important areas for business growth and stability: your dealership structure and operations, your customer relationships, and your legacy and succession plan. Our report outlines the key issues that are affecting your dealership now and in the near future, and provides actionable strategies to accelerate your business.

YOUR DEALERSHIP

Technological innovation, rising real estate costs, and the growth of online retail are affecting the way dealerships operate. Business owners must adapt to changing times in order to stay competitive.

TECHNOLOGY AT THE DEALERSHIP LEVEL



New tech trends are emerging to help improve day-to-day operations and customer outreach. Digital records and tablets have become more common, while some auto retailers are incorporating social media and augmented reality (AR) into their strategy. Toyota dealerships in B.C., for example, introduced a Facebook AR app that allows shoppers to visualize their vehicle in everyday settings.

Financial technology, or “fintech,” is also gaining ground. Platform providers like AutoFi are working with dealerships to take the purchase and financing process online, via desktop or mobile devices. This could be a welcome change for today’s consumers as they increasingly look to streamline the car-buying process.

INNOVATIVE COMPETITORS

Online retail has been slower to take hold in the automotive industry, but is bringing new competitors to the table. Startups like Carvana and Vroom are redefining conventional purchasing expectations, with e-commerce and direct-to-consumer business models that bypass traditional dealerships. Amazon has also made moves into the auto retail sector. In addition to parts and accessory sales, the retailer has launched Amazon Vehicles and taken first steps towards online car sales in Europe.

THE HIGH COSTS OF REAL ESTATE

Rising property prices and decreasing land availability are putting pressure on both single and group dealerships. Real estate has become one of the biggest assets and one of the biggest challenges for dealership owners. Large dealerships are still possible, but space is scarce and the cost for land alone can add up to millions of dollars.

To counteract this issue, brands such as Tesla and Downtown Auto Group in Toronto are moving to mixed-use developments as part of their urban strategy. Dealerships are setting up shop in malls and the ground floors of condominium buildings in an attempt to save costs and provide a unique experience. Others are employing a “build up, not out” strategy to optimize limited space.



AUTO ACTION PLAN

With so many external factors affecting a dealership, auto retail owners need a big picture mindset to stay ahead of the competition. Innovative business and technology strategies can help drive revenue, cut costs, and position your dealership for growth.



Invest in digitization and business intelligence

With OEMs dictating in-car technology and inventory management systems, owners and principals should focus on technology that brings shoppers to the dealership, improves the car-buying experience, and centralizes operations. Predictive data analytics, artificial intelligence, and a customer relationship management (CRM) system can provide a deeper understanding of your customer base. Working together, these tools can help generate revenue by anticipating buying patterns or the need for aftermarket services.

A centralized data and CRM program can also optimize digital records and help business owners strengthen their operations across multiple locations. Accurate, real-time data provides dealerships with powerful benchmarking and analytical insights that lead to stronger business decisions.



Rethink your dealership's purpose

Urban dealerships will be at the forefront of changes to bricks and mortar retail, but all dealers should give thought to the design and operation of their stores. An experiential strategy could help revitalize auto retail. For single dealerships and smaller groups, this could be as simple as an event that educates shoppers on the OEM's line of electric vehicles. On a larger scale, developing an experiential showroom and moving service to a separate, less expensive site could help amplify brand presence and foot traffic, while reducing real estate costs.



Develop an omnichannel strategy

E-commerce faces barriers when it comes to the auto sector, but dealership owners should take heed of the lessons learned by the larger retail industry. An omnichannel strategy provides car buyers with a much-desired frictionless retail experience—the idea that all shopping should be quick, convenient, and seamless across channels. It's also an opportunity for dealerships to optimize their physical footprint by reducing on-site inventory and moving some aspects of the purchasing process, such as colour and optional feature selection, online.

47% of dealership owners believe the number of owned or leased vehicles will decline over the next ten years.





THE IMPACT OF USMCA ON AUTO RETAILERS

The USMCA agreement has alleviated much uncertainty over trade relations in North America, but questions remain for Canada's auto industry. Vehicles must meet new labour and material content thresholds to qualify for duty-free entry, which could lead to higher manufacturing costs and eventually, higher sticker prices at the dealership.

Owners and principals should be proactive in preparing for this change. To stay competitive, develop a business and financial plan that addresses inefficiencies and minimizes the impact to consumers.

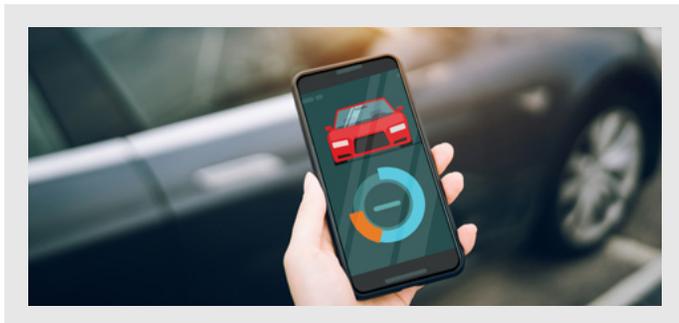
YOUR CUSTOMERS

The way people buy cars is changing. Consumers are more tech-savvy and informed than ever and dealerships must respond accordingly.

THE DIGITAL JOURNEY

Gone are the days when a customer's first step was a visit to their local dealership. Shoppers now begin their car-buying journey online. According to Google, 95% of automotive consumers use digital sources to start their research, while 60% begin with a search on mobile.⁽¹⁾

Videos, social media, and online review sites are all key steps on the road to a purchase, as consumers seek out brands that fit both their needs and values. Millennials are leading digital adoption trends, and dealership owners would be wise to pay attention. While some experts once worried the demographic would put an end to car ownership, Millennials are projected to account for 40% of new car sales by 2020, according to J.D. Power and Associates.⁽²⁾



NEW MOBILITY OPTIONS

Ride sharing, car sharing, and vehicle subscription services are changing how people think about transportation and mobility. For many drivers in suburban and rural communities, car ownership is still essential to daily life, but consumers everywhere are increasingly receptive to alternate options. A recent survey of drivers by Jim Butler Auto Group⁽⁵⁾ revealed that almost half of respondents would consider vehicle subscription services.

While these disruptors may not significantly affect the volume of cars on the road, dealerships could see an impact to the size of their customer base, with fewer people making a purchase. In fact, 47% of dealers surveyed by Cox Automotive believe the number of consumers who own or lease a vehicle will decline in the next 10 years.⁽⁶⁾

Dealership owners should focus on lead generation strategies and educating consumers on the benefits of car ownership, but may also wish to consider new mobility services and partnerships to diversify and strengthen their business.



AUTO ACTION PLAN

Consumers are looking for a trust-based relationship and a personalized experience. They want and expect the car-buying process to be simple and convenient. Achieving this type of relationship can take time, but will have long-term benefits.



Deliver the right customer experience

By the time today's consumer steps inside a dealership, they have likely already decided what kind of car they want. The experience you provide will determine whether they buy from you or a competitor. Owners and principals should look to retailers like Apple for inspiration and employ a consumer-centric and service-oriented approach. Emphasize the experience of a car and allow customers to interact with the product and technology in a low-pressure environment.



Develop a digital marketing strategy that includes mobile

The next generation of car buyers—Millennials and Gen Z—will interact with your dealership through their smartphone. A digital marketing strategy that focuses on mobile is one of the most important

investments a business owner can make. With 87% of Canadian car buyers saying that a good online experience would influence their purchase decision,⁽⁷⁾ dealerships cannot afford to make mistakes.

Invest in digital tools and platforms that align with your business goals, such as search engine optimization for your website, social media listening, or beacon technology, to help increase foot traffic.



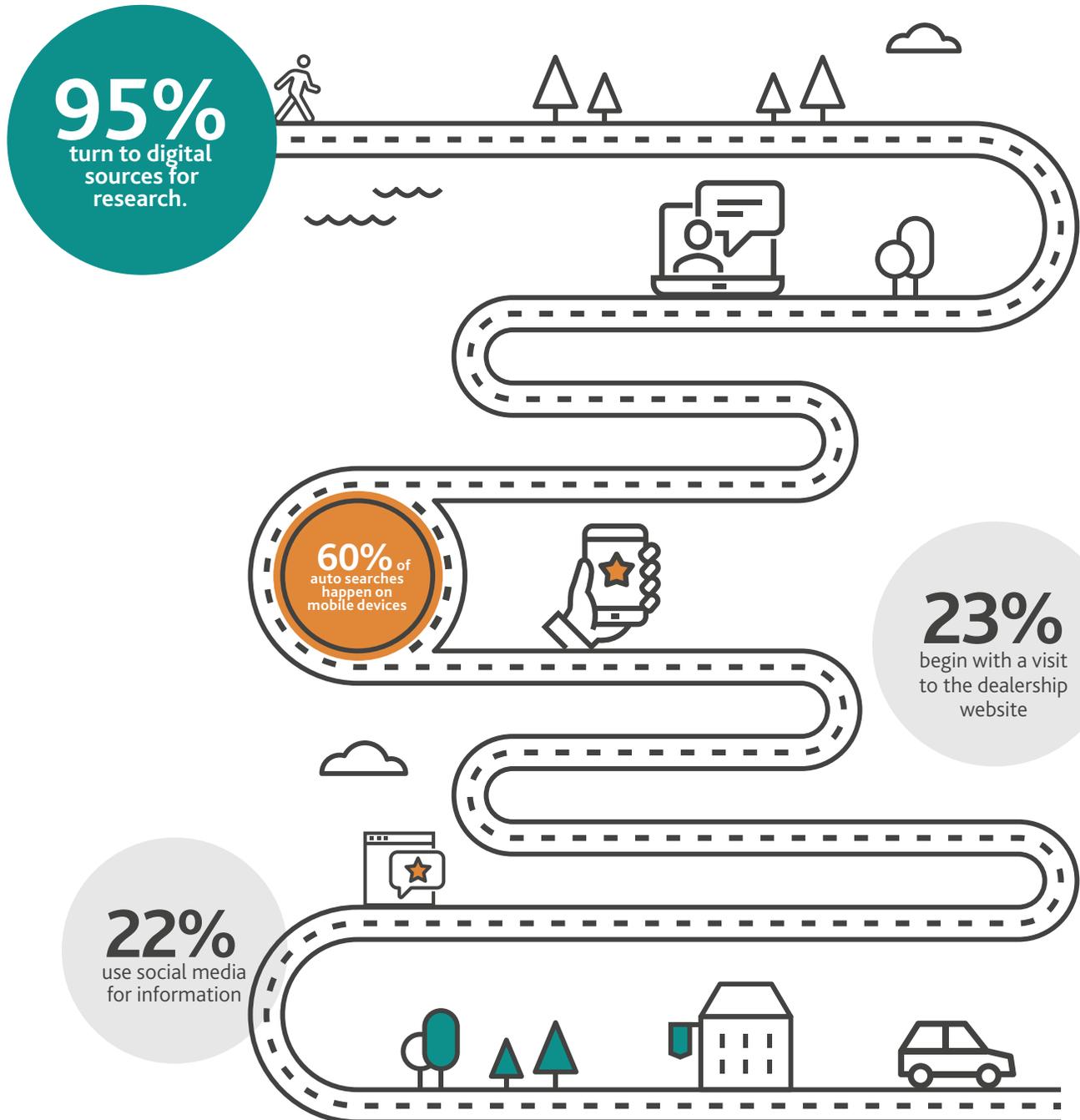
Hire with a customer-focused mindset

Part of providing the right experience means hiring the right employees. Some of the most critical roles for your dealership include the general manager, salespeople, and technicians—these members of your staff will play an important role in building and retaining a healthy customer base.

A shift towards a new type of workforce may also be the answer. As consumers become more empowered and educated on brands and vehicle technology, product specialists may be the key to building stronger customer relationships. Similarly, hiring dedicated personnel or external partners to manage your digital marketing and IT strategy can help drive bottom-line profit and increase your competitive advantage.

THE DIGITAL CAR CONSUMER

HOW ARE TODAY'S CAR SHOPPERS NAVIGATING THE PATH TO PURCHASE?



Sources: Google, Canadian Black Book, J.D. Power and Associates (1, 3, 4)

YOUR LEGACY



Consolidation has accelerated considerably in the automotive world, at a pace unheard of in other retail sectors. As large-scale dealership groups continue to grow, owners must act quickly to determine the future of their business.

OWNER PRINCIPALS ARE MAKING THEIR EXIT

With the average dealership principal nearing retirement age, the trend towards consolidation has largely been driven by Canada's changing demographics, but other causes are also at play. Growing OEM demands for costly showroom upgrades and operational investments have been a deciding issue for many dealers making their exit. For others, the last few years of high sales, available capital, and rising values simply created the perfect environment for a strategic move.

While the market is shrinking in favour of large dealership groups, there may still be room for smaller groups and family-owned businesses — but the time to act is now. Owners must be proactive and realistic in today's highly competitive market. Ensure that the next generation, be they family or a management team, possess the right combination of skills, energy, and financial resources to maintain the business.

VALUATIONS ARE HIGH, BUT MAY HAVE A PEAK

The market is ripe with opportunity, but owners should take note: there will come a time when consolidation has had its day. Average multiples are at some of their highest levels in recent years, but unpredictable market conditions and fluctuating interest rates will impact the value of a dealership. Owners who conduct a formal valuation through a third-party professional, rather than relying on anecdotal evidence of sale prices, will find themselves in a more secure financial position.

Consolidators are looking at two key considerations: a solid brand and geographic diversification. Dealer principals who wish to sell should be prepared to show a minimum of three years of growth in revenue, margins, and bottom-line profit.



START
STOP
ENGINE

AUTO ACTION PLAN

The first step for any owner or principal is to decide whether they will invest or divest. To build and protect your legacy, develop a plan that aligns with both your business and personal goals.



Create a proactive succession plan

A well-crafted succession plan can help owners achieve the best possible sale for their dealership and financial security for themselves and their family. In addition to mapping out assets, timelines, and leadership roles, your plan should address future financial decisions and detail an ongoing wealth management strategy.

Even if retirement is not yet on the table, a succession plan can help owners make strategic decisions for business growth by assessing operations, formalizing procedures, and identifying workforce gaps.



Consider your M&A options

For owners who wish to expand, the market is challenging but not impossible. Single dealerships in urban centres have been in high demand and priced accordingly. Strategic, forward-thinking buyers are considering alternate options for growth:

- **Bring in new brands.** Diversifying your OEM portfolio can have a number of benefits, particularly if the acquisitions bring in a broader customer base. In addition to expanding the service business, operations could benefit from new programs and processes.
- **Look at secondary markets.** Values can differ according to regional market conditions and competitive landscapes. Dealerships in suburban or rural areas may offer ideal acquisition opportunities, even if some additional business or workforce investment is needed.
- **Acquire complementary businesses.** With a shrinking market and the threat of declines in vehicle ownership, dealers need to rethink and reinvent their business model. Obtaining related businesses, such as tire or auto glass shops, can help increase market share and provide the necessary scale for future investments.



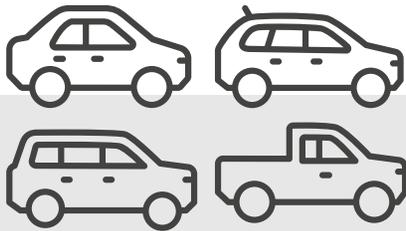
Assess your real estate

The land your dealership is sitting on could be your most valuable asset. As the demand for both commercial and residential real estate grows in Canada, your property may be worth more than the business itself. Decide how your real estate aligns with your business model and wealth goals and conduct a formal assessment of the land value. For dealers who want to divest, selling or leasing to a developer could be a smart long-term investment strategy.

KNOW YOUR VALUE DRIVERS

WHETHER YOU'RE PLANNING TO RETIRE, SELL, OR EXPAND, IT'S CRUCIAL TO UNDERSTAND AND STRENGTHEN THE VALUE DRIVERS FOR YOUR DEALERSHIP. THESE CAN INCLUDE:

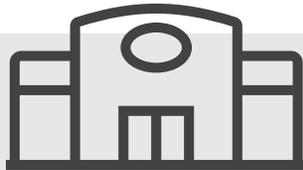
INVENTORY



BRAND PORTFOLIO



REAL ESTATE



LOCATION



TECHNOLOGY



HUMAN CAPITAL



ABSORPTION RATE



BUILDING A ROADMAP FOR YOUR AUTO BUSINESS

Dealerships have an important role to play in the auto industry and will continue to have a significant presence, contrary to those who predict their demise. Those that survive and thrive will evolve along with the market, and the cars themselves, to serve customers in new ways.

OWNERS AND PRINCIPALS SHOULD CONSIDER THE FOLLOWING STEPS:

▶ Start with a business review

Take a step back for a big picture view of your dealership. Identify key strengths and weaknesses and build a plan to address gaps and opportunities, including tax minimization, internal controls and procedures, budgets and expenses, financing capabilities, and risk management.

▶ Conduct a formal valuation

A valuation is the starting point for any succession or liquidity plan and provides a concrete benchmark for growth. As a best practice, engage in this process every two or three years to ensure an accurate, up-to-date snapshot of your business's market value.

▶ Develop an IT strategy

Technology investments should align with your overall business plan. A robust IT infrastructure should consider data analytics and cloud capabilities, CRM software, benchmarking and corporate performance management (CPM) tools, and cybersecurity.

▶ Invest in your people and your property

A multi-million dollar brand refresh can help increase the value of your business, but is not always necessary. Establishing a strong, agile team that can help run the business and maintaining a fresh, modern retail store can help to increase your bottom-line profit and entice future buyers.

▶ Consider new services

While the long-term viability of some recent disruptors remains to be seen, they are undoubtedly influencing the way we buy cars. Innovative business models and alternate services could be the key to attracting new customers and differentiating yourself from your competitors.

Engage a team of professional consultants

The automotive industry team at BDO provides comprehensive services and industry knowledge to help dealership owners navigate the dynamic and complex auto market. Our advisors work to develop a deep understanding of your business strategy and operations, with customized solutions that include:

- Accounting advisory services
- IT solutions and strategy
- Mergers and acquisitions
- Business valuations
- Business succession and wealth management
- Real estate advisory
- Cloud bookkeeping and corporate payroll services
- Human resources advisory
- Tax planning and optimization

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