

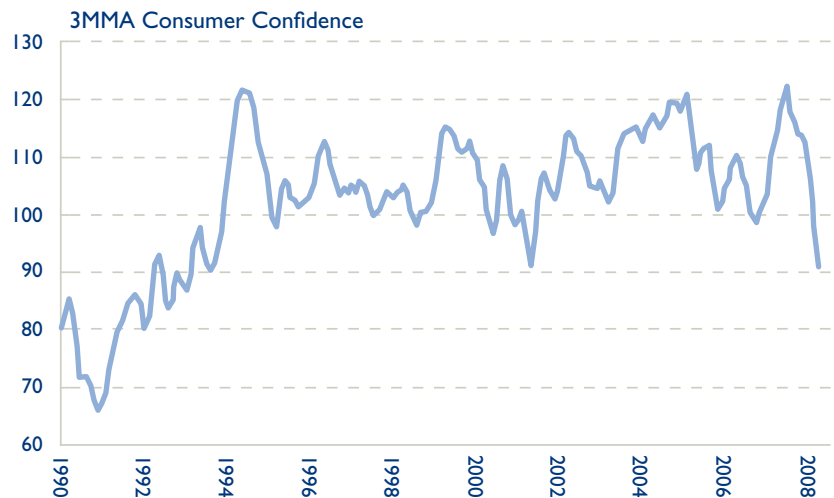
Viewpoint

The economy in focus

The Economy – Market Profitability: Staying in the fast lane

The Australian share market is experiencing significant volatility at present. The fall out from the US sub prime melt down is continuing to impact the Australian Market. It seems just when all the bad news has finally been aired another round of write offs by the banks plunge the markets into further uncertainty.

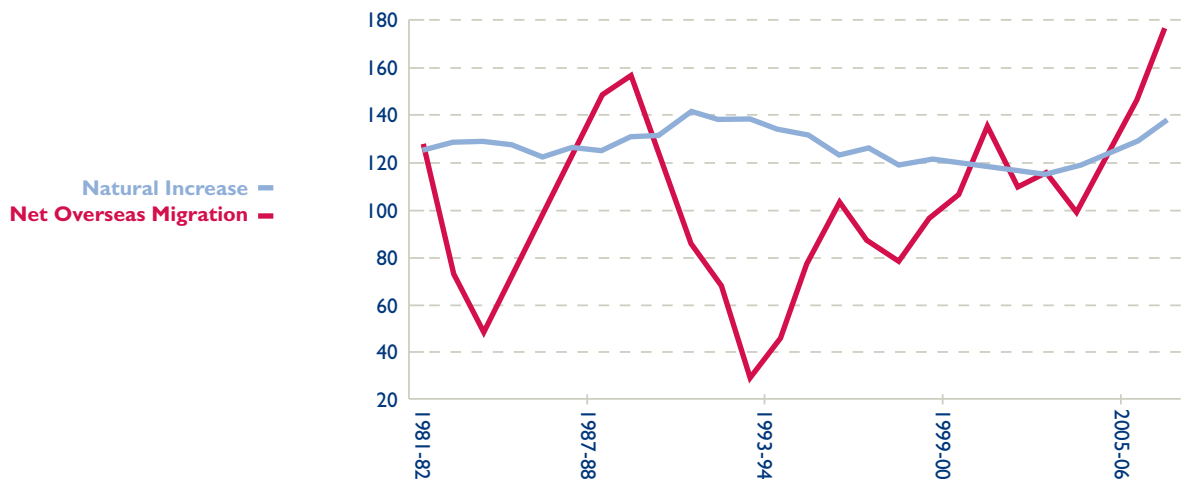
This reduction in household wealth and continued uncertainty has had a significant affect on consumer confidence. Confidence has been further eroded with the recent news of the worst returns in 16 years for superannuation funds. In fact consumer confidence is being battered on many fronts: high petrol prices, increased food costs, increased interest rates and inflation.



This decline in consumer confidence has impacted private new vehicle sales and new vehicle finance rates.

However there are also many positives to support a continuation of the strong vehicle sales market.

1. Vehicles sales forecasts still remain buoyant with sales tracking at above last years record levels.
2. Underlining that is Australia's growth in the terms of trade. Global commodity demand has pushed up prices and these are expected to remain high for some time. The strong terms of trade has contributed to a growth in Australian incomes.
3. Supporting the sales growth potential is the increase in population. This growth is occurring principally through immigration but also there is an increasing maturation of the population to driving age. The population of driving age is growing by more than the total population growth.



Market Profitability

Generally speaking, with a few notable exceptions, higher volumes have not translated into higher profitability. The economies of scale promised have not occurred, in fact, expenses are their highest ever levels.

What are our issues:

- A very competitive market
- Large numbers of dealers, especially in metro areas
- High transience of staff
- Significant reliance in fleet & govt sales to maintain throughput (both at retail and wholesale)
- Significant reliance on F&I as a profit saviour (poor sales performance masked by F&I returns)
- Increased competition between finance companies
- Competition from private to private sales in used cars
- Non vehicle franchise competition for Aftersales \$
- Significant increase in expenses/cost especially facilities
- Salesmen performance significantly below benchmark
- Little or no reinvestment into dealership personnel – training strategy
- Failure to elevate work practices to best practice

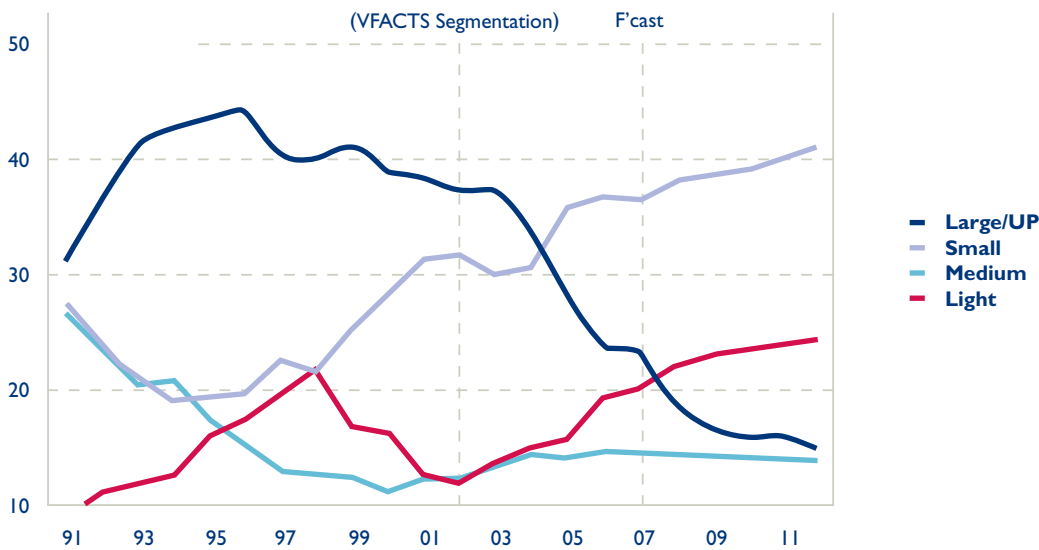


The Industry

The most significant issue currently seems to be oil prices. This is having broad reaching affects on a significant number of other issues, local manufacturing, environment, manufacturer profitability, product development cycles and so on.

Sales year to date

Vehicle Sales by Segment



Current consumer concern over rising fuel prices will do little to affect the trends in the increased sale of vehicles from the small and light segments and a decline in sales of vehicles in the large and medium segment. This trend has been occurring for many years. In a reactionary move some manufacturers have moved to address this change in consumer preference. But this seems to be the reaction globally to the change in consumer preference. "Truck" plants in North America are closing as demand shifts back to sedans and smaller vehicles. Producers without North American lineage seem to more nimble and better able to respond to this change in customer preference. This change is both very slow and very painful. The cessation of local production for Mitsubishi was a very painful and drawn out affair however the improvement in performance has been immediate and there is a strong sense of optimism in the Mitsubishi camp.

Half way through the year and sales of locally produced vehicles are down almost 15%, with Commodore accounting for over a third of these.

How are local producers going to be able to modify their production options to satisfy the change in customer preference?

In the past the issue has been one of design and appearance or the addition of a feature or accessory. Now the issues are much more fundamental - floor plan and size and fuel economy.



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Has the current oil prices consigned the Great Aussie to the status of myth or has it just accelerated the change in customer preference?

Significant media space has been devoted to alternative fuels, hybrid vehicles and diesel. While this has increased the interest in alternative energy cars, supply is unable to meet demand. Manufacturers are unable to build alternative energy vehicles in significantly greater numbers, so petrol powered smaller cars fills the void between big petrol guzzling cars and the energy saving alternatives.

If we look towards Europe as an indicator for the direction of the market in Australia, we see that smaller more economical transport alternatives are the vehicle of choice. It is not a fad but the new (some would say new) direction of the market

It is by no coincidence that the most critical issues to be addressed are the issues that most difficult fix and those that are difficult to measure.

The next major shake up is likely to be in the structure of the retail market which will revolve around which dealers are the most professional. In years gone by where margins were a little fatter, mediocre business practices could still produce significant profits.

Margins are thinning and profitability will not be as easily secured. Significant changes to businesses practices are on the horizon. The theory of Keynesian economics is proving itself. High profits attract many players, many players compete and drive down the price and profits, many players become fewer players as only the strong (read professional) survive.

More information

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