Regional analysis
Car dealerships

Defending mid single-digit profit margins

Authors:

Ilija Nesic, Corporate Finance Analyst

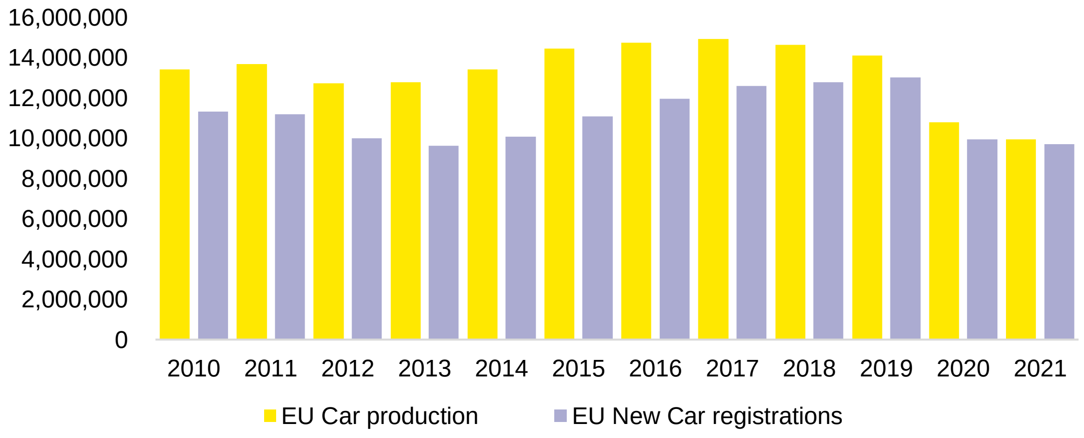
Industry highlights

Bloomberg Adria

In this report we are looking into performance of the local car dealers in order to display the origins of their profitability, magnitude of the effects of the global supply shocks and how the disconnections in the aggregate supply and demand affected car dealerships' business results. Indeed, highlight of the recent years is that car dealerships have been ailing from cascading supply shocks primarily due to semiconductor shortages. Supply shocks had a three-pronged effect:

1. Pushed production lower to historically conservative levels - passenger car production declined for four consecutive years in the EU, most notably decreasing by 23.5% in 2020. New car registrations also took a hit, falling by 23.7% in 2020 and 2.4% in 2021. This meant **low inventories for dealerships, especially in 2021 and 2022**-> supply could not keep up with demand, creating availability issues

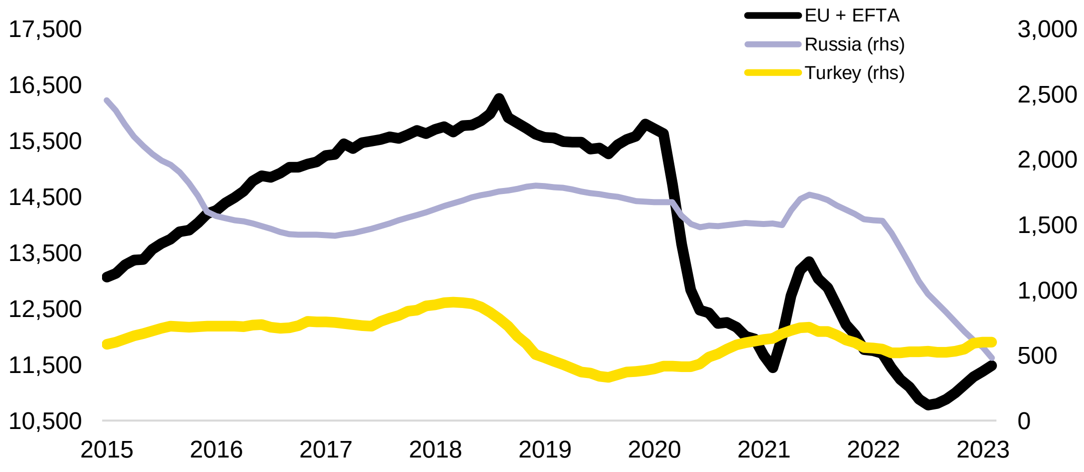
EU Passenger Car production, New car registrations 2010-2021



Source: ACEA, Bloomberg Adria analytics

2. Car sales are recovering only gradually in EU and EFTA. While car sales were affected by deteriorated sentiment and consequently more pronounced household saving during the pandemic, in the recent months car sales are indeed recovering, however this recovery is still curbed by consumers delaying decisions to buy cars amid persistently high prices, rising interest rates and recession fears. What's even more important is that mid-term inflation expectations are stabilizing only gradually, which then negatively influences the private sector's spending habits.

New car sales 12-month rolling sum (000)

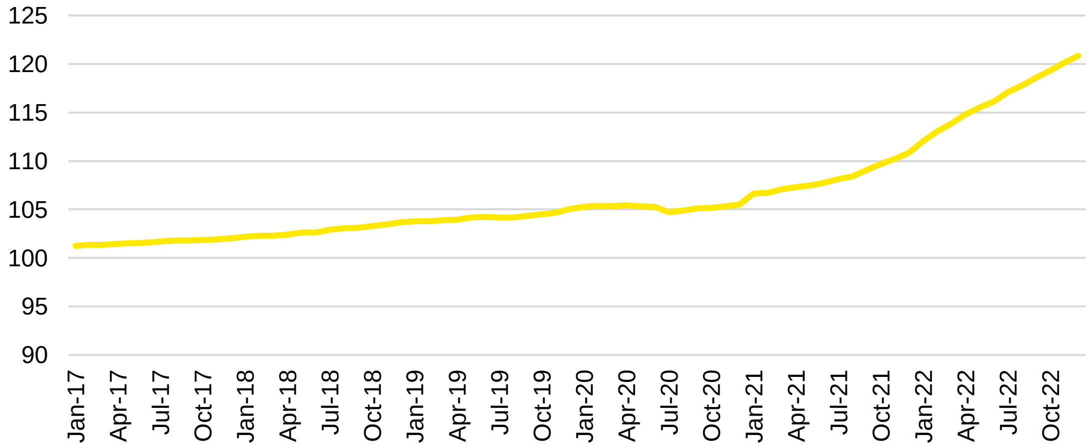


Source: Bloomberg, Bloomberg Adria analytics

Industry highlights

3. Decreased affordability of new cars for the end consumer. The motor cars price index rose by 8% in 2022. The increase in 2021 amounted to 4%. The five-year period between 2017 and 2022 saw a 19% increase. As the chip shortage progressed, car makers prioritized high price, high margin luxury models as these were the most profitable models short-term. More expensive models (higher levels of trim and options) also got priority in terms of delivery times. Slow moving, cheaper cars are gradually being weeded out from model rosters. However, overburdened customers are switching to lower cost cars with fewer options, used cars, extending their car replacement cycle, or even selling their current vehicles. Inflated input costs pressured margins for both auto manufacturers and dealers and raised the selling price for cars.

Motor Cars - Indices of consumer prices (2017-2022)*



*Euro area (changing composition) - HICP - Motor cars, Monthly Index, Eurostat, Neither seasonally nor working day adjusted, Unit - 2015=100
Source: Eurostat, European Central Bank, Bloomberg Adria analytics

There are close to 800.000 car dealerships in Europe. The dealer sector is highly consolidated. The top ten dealerships in Europe sold close to 2 million vehicles in 2021 and offer a plethora of related services. **Aside from new car sales as their primary activity, car dealerships are also focusing on servicing/maintenance, which is a more profitable business line than new car sales – indeed, new car sales are traditionally the least profitable operation for dealerships**. This is also where the aftermarket for parts comes onto play, as dealerships also sell car parts/use them for servicing. Parts availability is strongly tied to new vehicle production. In other words, supply chain snags also significantly impacted this revenue stream for dealerships because parts were generally less available.

Car dealers also sell used cars. The current headwinds in supply have the short-term effect of increasing used car prices and lowering availability as more consumers are opting for used. In the US there are cases that used cars are sold above the manufacturer's suggested retail price (MSRP) or sticker price for a new vehicle. Due to tight inventories, consumers are paying premiums just to get their hands on a vehicle (as there aren't waiting lists for new cars, while popular new cars have a minimum of 12 month wait time). There are consumers in the US that were willing to pay well over the sticker price, leading to overpriced vehicles. The US is extremely car-centric therefore the demand for cars is stickier than in the rest of the world. **Nevertheless, the long-term effect manifests itself as a persisting imbalance between supply and demand and uncertainty in the overall automotive market.**

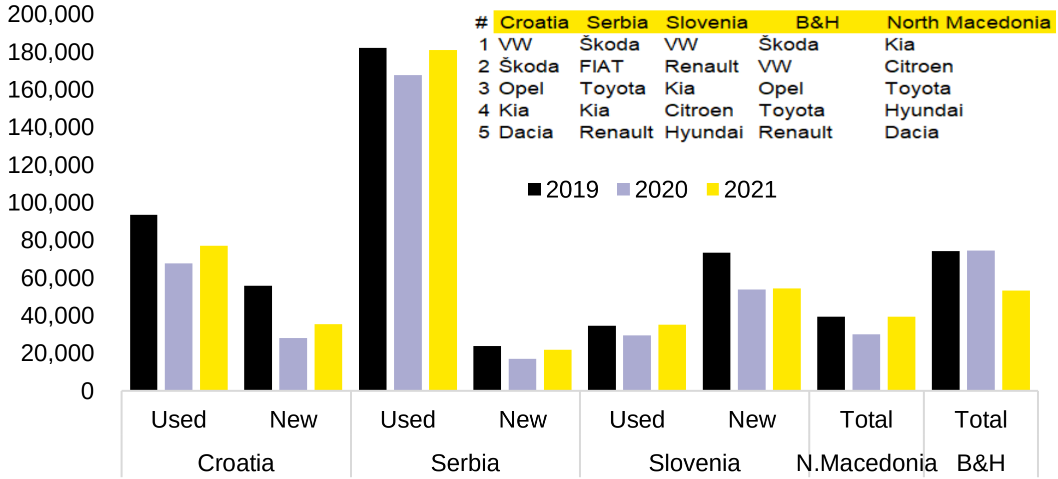
#	Name	Home country	Brands	Franchise points	New wholesale vehicles	New Retail Vehicles	Used Vehicles	Total vehicles
1	Emil Frey	Switzerland	44	816	125,000	250,000	180,000	555,000
2	Penske Automotive (Europe)	USA	23	162		69,225	161,947	231,172
3	Inchcape Europe	UK	17	152	40,000	80,000	70,000	190,000
4	Arnold Clark	UK	27	191		46,509	204,627	251,136
5	Lookers	UK	32	150		86,555	78,341	164,896
6	Pon Holdings	Netherlands	10	38	74,824	22,860	18,088	115,772
7	AMAG	Switzerland	8	187	30,350	45,000	31,350	106,700
8	MoellerBil	Norway	5	71	14,087	39,389	31,863	85,339
9	Pendragon	UK	20	142		56,804	91,865	148,669
10	D'Ieteren Auto	Belgium	9	21	96,010	9,292	1,809	107,111

Source: autoactu.com, Bloomberg Adria analytics

Industry highlights

The Adria Region predominantly buys used cars. Slovenia is the only exception, where the number of new cars equals 61% of total first registrations in 2021. Serbia has the highest share of used cars in first registrations, amounting to 89% in 2021. Disaggregated data for new and used is not available for Macedonia and B&H. The sales structure of new cars is also given in the graph below - we compiled a list of the top 5 best-selling car brands for the Adria Region.

Number of First registrations
New and Used Passenger cars 2019-2021



#	Croatia	Serbia	Slovenia	B&H	North Macedonia
1	VW	Škoda	VW	Škoda	Kia
2	Škoda	FIAT	Renault	VW	Citroen
3	Opel	Toyota	Kia	Opel	Toyota
4	Kia	Kia	Citroen	Toyota	Hyundai
5	Dacia	Renault	Hyundai	Renault	Dacia

Source: Croatia: Croatian Bureau of Statistics, Agencija Promocija Plus, Revija Hak Serbia: Statistical office of the Republic of Serbia, Asocijacija Uvoznika i Auto delova Slovenia: Republic of Slovenia Statistical Office, bestselligcarsblog North macedonia: Republic of Macedonia State Statistical Office, bestselligcarsblog B&H: AMKBiH, Bloomberg Adria analytics

Financing is among the main activities for global dealers. In the Adria region financing for cars is fairly standardized. Financing is not offered directly by dealerships but through leasing companies that handle the transaction. The leasing company buys the vehicle in its name and collects monthly payments with interest from the customer. At the end of the lease period, ownership is transferred to the customer. Another common form of financing is through a bank loan. In the US for example, car dealerships offer in house financing. Loans can be given through finance companies owned by car manufacturers (large car manufacturers usually have an entity or separate business line that handles financing such as Ford Credit or GM Financial), the car dealership directly or a third party. In house financing is convenient and a relatively quick way to obtain a vehicle, where car dealerships are a one stop shop for test driving, financing and car purchase. However, dealers mark up rates (compared to rates offered through bank loans), an in house financing is often more expensive. Outside financing options are plentiful; such as banks, credit unions or online lenders. **As interest rates rise, and consumer confidence vanes due to uncertainty, cash transactions are a safer bet**.

Peer comparison

The key criteria of our sample selection were sales levels, which are also primary KPIs for car dealers. The largest peers by sales in the region are licensed distributors (franchise dealerships) for global car brands such as VW, BMW, Mercedes, Renault Nissan, Hyundai and Kia. Market consolidation is driven by margin pressures and to achieve economies of scale. **The dispersion of sales also reflects regional consumer preferences regarding car brands.** The same car brands were chosen in different countries in the region in order to outline potential differences in peer financial performances. The **key takeaway of our peer analysis – car dealers defended their profit margins in low single-digit area in the recent years despite high fluctuation in sales. This is the reflection of their P&L structure, with the stickiness in profit margins implying that other P&L items e.g. costs other than COGS are less significant in the overall profitability**.

Sales were driven by the following elements: i) demand component - rebounding demand in 2021 after the COVID-19 pandemic ii) price component – new car prices are inflated due to rising input costs and limited supply. iii) due to limited inventories and an increase in used car values (used car values are depreciating slower than expected), new car discounts were reduced, driving prices up. **Dealers in the Adria region are relatively profitable**. Margins are predominantly single digit, with EBITDA margin averaging 6.6% in 2021 (up by 1.17 p.p. compared to 2020) and EBIT margin averaging 5.6% in 2021 (up by 1.37 p.p. compared to 2020). The industry is relatively decentralized. **Many players in the region margins carry thin due to tight competition. Price competition is the name of the game and dealers do not have much wiggle room in price. Cost of inventory is the largest cost for dealerships, accounting for around 80-90% of total operating costs**.

Company name	Sales EUR in millions			Sales growth %			EBITDA margin %			EBIT margin %			ROE %			Net debt/EBITDA			Cash Converson Cycle		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
AS Kramar (BH)	29.9	19.1	18.7	9.8	(36.3)	(2.3)	6.9	5.7	9.4	6.5	5.3	9.0	60.4	27.8	34.6	2.3	3.9	2.9	67.6	99.9	108.9
Auto Lijanovići (BH)	19.4	11.3	20.2	46.9	(41.9)	78.6	3.7	4.8	4.8	3.0	3.5	4.0	28.0	17.8	39.8	1.3	1.1	0.0	38.6	62.3	23.8
Hyundai-Auto (BH)	11.8	8.5	10.9	27.4	(28.4)	29.1	7.2	6.3	8.2	5.3	3.9	6.4	15.3	7.1	15.5	1.9	3.0	1.2	44.9	49.3	42.8
MRM Export Import (BH)	14.5	13.9	13.6	8.9	(4.1)	(2.0)	6.4	6.5	6.9	4.9	4.9	5.4	34.7	37.5	34.5	4.1	3.6	2.3	29.5	49.8	44.4
Porsche Inter Auto (BH)	28.8	29.9	34.3	n.a.	3.9	14.7	3.3	2.3	3.2	0.9	(0.1)	0.9	6.9	9.2	22.6	0.8	0.9	0.4	(3.0)	14.4	13.1
GA Croatia (HR)	172.2	101.1	128.5	4.6	(41.3)	27.2	3.1	1.9	2.2	3.0	1.7	2.0	33.7	8.3	17.8	(4.7)	(10.9)	(5.2)	(19.0)	(25.2)	(15.3)
KIA Croatia (HR)	29.7	32.9	56.2	0.9	10.8	70.8	12.5	10.5	14.7	11.0	8.8	13.4	18.6	14.7	28.4	0.1	(2.3)	(1.2)	107.5	93.3	27.7
Hyundai Croatia (HR)	88.6	44.3	52.6	40.8	(50.1)	18.9	2.8	2.7	3.6	2.7	2.5	3.5	17.6	2.4	18.5	8.1	14.3	1.5	167.3	186.4	124.7
Porsche Croatia (HR)	397.5	288.7	324.5	10.1	(27.4)	12.4	6.0	8.8	6.6	5.9	8.6	6.4	69.6	50.4	29.2	0.3	(1.1)	(2.4)	68.4	82.0	54.0
Zubak (HR)	124.4	103.7	105.1	3.1	(16.6)	1.3	3.6	2.7	4.3	2.2	1.1	2.5	3.4	0.8	2.5	1.3	(1.4)	(2.1)	74.6	65.8	52.9
Automakedonija AD (MKD)	9.9	8.5	8.3	18.1	(13.5)	(2.5)	7.5	8.2	9.7	3.7	3.7	5.6	4.1	2.5	6.4	4.2	4.9	2.8	117.1	164.4	169.8
BMW Slovenia (SI)	74.5	50.7	70.2	n.a.	(31.9)	38.6	3.4	4.2	4.2	3.0	3.5	3.9	56.7	20.0	37.1	(1.9)	(5.8)	(1.4)	14.7	20.9	(0.8)
GA Adriatic Slovenia (SI)	557.2	426.4	437.1	4.2	(23.5)	2.5	1.8	1.4	2.0	1.6	1.1	1.7	39.4	25.8	72.5	(6.4)	(7.6)	(3.5)	(28.3)	(35.8)	(29.4)
KIA Slovenia (SI)	99.5	93.8	104.1	(1.0)	(5.7)	11.0	7.4	5.9	9.1	5.4	3.8	7.7	18.2	9.9	21.1	1.0	(1.2)	(1.7)	55.2	66.6	33.0
Porsche Slovenia (SI)	565.7	496.5	503.4	6.5	(12.2)	1.4	3.2	3.9	4.0	3.0	3.7	3.8	44.6	45.8	46.9	0.9	0.6	(1.0)	49.0	53.6	36.5
Toyota Adria Slovenia (SI)	154.7	104.6	177.3	15.8	(32.4)	69.5	2.0	2.5	4.0	1.4	2.0	3.8	28.3	48.6	50.0	11.3	8.0	0.0	67.2	94.3	35.9
Auto Čačak (RS)	103.9	80.6	104.1	14.6	(22.5)	29.1	9.1	9.3	9.1	8.2	8.1	7.0	17.1	11.7	11.1	(0.2)	(1.4)	(0.3)	97.3	127.6	74.7
Delta Motors (RS)	53.3	50.7	66.7	27.7	(4.9)	31.6	6.6	8.7	9.9	6.1	8.2	9.6	23.9	23.4	29.6	1.3	0.2	(0.1)	61.5	81.4	72.6
Hyundai Serbia (RS)	34.1	32.3	48.0	16.2	(5.3)	48.7	6.9	5.2	6.2	5.3	4.1	5.4	20.2	13.1	20.9	(0.3)	(0.3)	1.0	63.7	82.7	71.4
KIA Auto Doo Beograd (RS)	16.2	17.0	39.1	29.7	5.3	129.7	9.1	7.7	10.8	9.0	6.3	10.2	15.7	9.1	28.6	(1.3)	(3.6)	(2.4)	28.6	20.7	(2.6)
Star Import Serbia (RS)	140.6	125.7	156.5	10.2	(10.6)	24.5	3.7	4.2	5.3	3.3	3.4	4.5	39.7	29.4	44.0	(0.4)	0.0	(0.4)	36.2	41.7	38.1
Median	**74.5**	**50.7**	**66.7**	**n.a.**	**(31.9)**	**31.6**	**6.0**	**5.2**	**6.2**	**3.7**	**3.7**	**5.4**	**23.9**	**14.7**	**28.6**	**0.9**	**0.0**	**(0.3)**	**55.2**	**65.8**	**38.1**
Average	**129.8**	**101.9**	**118.1**	**n.a.**	**(21.5)**	**15.9**	**5.5**	**5.4**	**6.6**	**4.5**	**4.2**	**5.6**	**28.4**	**19.8**	**29.1**	**1.1**	**0.2**	**(0.5)**	**54.2**	**66.5**	**46.5**

Peer comparison

Bloomberg Adria

When peers are exclusive or general distributors (franchises) of a certain brand, they are obligated to buy vehicles and spare parts from their respective groups, and their incentive is to move vehicles from showrooms/lots as fast as possible. **The largest regional dealerships have similar revenue structures, generally deriving around 85% of their top line through new car sales. However, further value is added through services offered before/after buying the vehicle** - direct customer interaction (where dealerships take on a consultative role in the car buying and maintenance process), warranties (service, spare parts sales and maintenance) and customer support (loyalty programs, buyback programs – old for new). This also creates the opportunity for repeat business.

Average ROE for 2021 stands at 29.1% in 2021 and marks an increase of 47 p.p. compared to 2020. High ROE levels indicate good returns, however as car dealerships opera te on low levels of capital, these values are to be taken with a grain of salt. Most capital is concentrated on the group level.

Indebtness is at a very favourable level. Net debt to EBITDA stood at an average of -0.5 in 2021. However as many of the peers in the Adria region are franchise dealers of large global car groups, they do not have much control over their level of indebtness. They are financed principally through intra company loans.

The average cash conversion cycle improved in 2021. It fell from an average of 66.5 in 2020. to 46.5 days in 2021. Pent up demand drove car sales, decreasing day needed to convert inventory to sales.

The best-selling car brand in the region is Škoda, which is owned by VW Group. This is also reflected in the peer group. VW distributors in the region have the highest sales in the region compared to distributors of other brands. VW products are attractive to Adria region consumers as the aftermarket for parts is large for Volkswagen products, both from OEM's and other equipment manufacturers. Parts are readily available and there is a strong service network for VW. Volkswagen products also retain a lot of resale value – their value depreciates much slower than for example luxury cars. Porsche (company name for the bigger dealer) is a large market player in every Adria Country.

Segment contributions

Porsche sells VW Group car brands including VW, Audi, Porsche, Seat and Cupra. In Croatia, with ~30% market share in total car sales. In Slovenia, ~ 30% of vehicles on the roads are VW Group products. Around 85% of Porsche Croatia's top line is generated by new car sales, while the second largest revenue generator is from spare parts, tools and oils accounting for 12% of total sales. Porsche Slovenia has a similar revenue structure, with the share of new car sales in total top line being 88%, while spare parts account for 11%. MRM is a franchise dealership for VW In Bosnia. Auto Čačak is a licensed Škoda distributor in Serbia, with 91% of sales revenue is generated through new car sales. Spare part sales are second in terms of sales – 7% share in top line. Third by share in sales is used car sales (7% share in total revenue). Margins were steady yoy, and sales grew 29% in 2021. Auto Čačak supplies Škoda's for Serbia's state institutions through tenders. Škoda is a fleet favourite in the region, being the vehicle of choice for a large number of companies.

Korean brands KIA and Hyndai are rapidly gaining popularity in the region. In 1998, Hyundai bought out Kia with a 51% stake in the company. Now, that share has reduced to about a third, and the two are considered sister companies. Hyundai and Kia share vehicle platforms. **Kia is consistently among the 5 best-selling car brands in the region and is the best-selling new car in North Macedonia for 2021**. KIA distributes vehicles in the region under the name KMAG – Kia Motors Adria Group. KIA also has the highest margins in the peer group. KIA dealerships boast a 14.7% EBITDA and 13.4% EBIT Margin in Croatia, 10.8% EBITDA and 10.2% EBIT Margin in Serbia and 10.8% EBITDA and 10.2% EBIT Margin in Slovenia. KIA also posted the largest percentual top line growth in the peer group – 129.7% in 2021, in Serbia. Top line growth in Croatia is also impressive – 70.8% in 2021. **KIAs are affordable due to low labour costs and the use of plastic as the primary raw material for the body**. Product quality has increased through economies of learning, while unit costs were curbed by increasing output i.e. economies of scale, supporting competitive price strategy.

Peer comparison

Renault Nissan vehicles are distributed through GA. GA Slovenija had a below average sales growth in 2021 (2.5%). Their best-selling model is the Clio, which is produced in Slovenia by Revoz Novo Mesto. Revoz accounts for 18% of costs with related parties, and is a significant supplier. Revoz acquires vehicles from Automobile Dacia (accounting for 48% of costs/acquisitions from related parties) and Nissan International s.a. (accounting for 27% of costs/acquisitions from related parties). On the revenue side, the most significant buyer is GA Croatia (63% of revenues from related parties) and Renault Nissan Srbija d.o.o. (33% of revenues from related parties). Revoz significantly downsized their production – 32% decline in output between 2020 and 2021. Renault is also the second best-selling new car brand in 2021 for Slovenia, after VW. Globally, Renault also sold less vehicles in 2021 compared to 2020 – 4.5% less. GA Slovenia derives 87% of revenue from new car sales and 12% from spare parts..

Dealers of luxury vehicles saw double digit percentual top line increases. Manufacturers and dealers prioritized these vehicles due to higher margins. These vehicles are not sold in high volumes in the region as they cater to a more niche market. Target buyers are high income consumers and fleets for large companies. For example, Delta motors is the general distributor for BMW and Mini vehicles. Star Import is a general distributor for Mercedes Benz vehicles in Serbia and is part of the Emil Frey group. Auto Lijanovići is a licensed distributor for Mercedes Benz in B&H. Premium vehicles ask premium prices, parts and servicing are costlier and these vehicles depreciate quicker due to their complexity. Nevertheless, dealers of luxury brands saw solid, single digit margins.

The peer group also contains "all-rounder" dealerships. Players such as Zubak or AS Kramar. These dealers are not a specific franchise and/or they offer a broad roster of services. For example, new car sales for Zubak account for 48% of total sales revenue in 2021 (compared to 91% share that characterizes Auto Čačak). Zubak primarily focuses on VW products but also sells used vehicles of all brands. Used cars account for 21% of total revenues followed by sales in service (13%), servicing (6%) and technical inspections (2%). Revenue from sales of new vehicles fell by 6% and revenue from the sale of new vehicles fell by 3%. Conversely, revenue from services increased by 18%. There is value in diversification as top line growth in the service end of the business compensated for the fall in new and used car sales, leading to a 1.3% sales growth in 2021.

Global peers

In order to benchmark the results of regional peers, we looked into financials of the global car producers. **Conclusion is simple – Adria region car dealers' results correlate strongly with financials of the global producers, however with somewhat lower profitability as displayed in margins**. **The latter we link mostly to car dealers' pricing power in the local markets, being apparently somewhat weaker than in bigger markets.** KIA is the only car maker in the peer group that did not have a negative sales growth rate in 2020. Other manufacturers saw double digit percentual declines in 2020. KIAs top line stayed relatively flat in 2021, displaying a slight increase – 1.8%. The highest margins were posted by VW Group, followed by luxury car manufacturers Mercedes and BMW. VW had the highest sales in terms of value in the global auto manufacturer peer group.

Company name	Sales EUR in millions			Sales growth %			EBITDA margin %			EBIT margin %			ROE %			Net debt/EBITDA			Cash Converson Cycle		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Renault SA	55,537.0	43,474.0	46,213.0	(3.3)	(20.7)	6.3	10.6	4.6	11.5	3.8	(4.6)	3.0	(0.4)	(27.0)	3.4	(1.2)	0.9	1.3	265.5	339.1	293.8
Hyundai	81,077.3	77,369.7	86,885.0	9.2	(1.7)	13.1	7.2	6.5	9.7	3.4	2.3	5.7	3.3	1.6	5.3	7.5	9.2	6.7	123.9	136.3	125.0
KIA	44,581.0	44,018.5	51,611.1	7.3	1.8	18.1	7.1	7.2	10.4	3.5	3.5	7.3	6.5	5.1	14.7	(0.6)	(1.1)	(1.2)	22.8	15.4	6.1
BMW	104,210.0	98,990.0	111,239.0	7.6	(5.0)	12.4	17.5	16.9	17.9	7.1	4.8	12.0	8.4	6.3	18.3	3.1	2.9	2.6	171.7	177.6	149.0
Mercedes Benz Group	172,745.0	121,778.0	133,893.0	3.2	(29.5)	9.9	6.9	12.0	15.9	2.4	4.7	10.7	3.8	5.9	34.7	(1.1)	(1.3)	(1.1)	169.2	229.2	170.7
VW Group AG	252,633.0	222,884.0	250,200.0	3.1	(11.8)	12.3	19.8	18.0	19.2	5.8	4.6	7.4	12.5	7.6	12.3	(0.9)	(1.1)	(0.9)	149.0	168.0	143.8
Median	**92,643.7**	**88,179.9**	**99,062.0**	**n.a.**	**(4.8)**	**12.3**	**8.9**	**9.6**	**13.7**	**3.7**	**4.1**	**7.4**	**5.2**	**5.5**	**13.5**	**(0.7)**	**(0.1)**	**0.2**	**159.1**	**172.8**	**146.4**
Average	**118,463.9**	**101,419.0**	**113,340.2**	**n.a.**	**(14.4)**	**11.8**	**11.5**	**10.9**	**14.1**	**4.3**	**2.6**	**7.7**	**5.7**	**(0.1)**	**14.8**	**1.1**	**1.6**	**1.2**	**150.4**	**177.6**	**148.1**

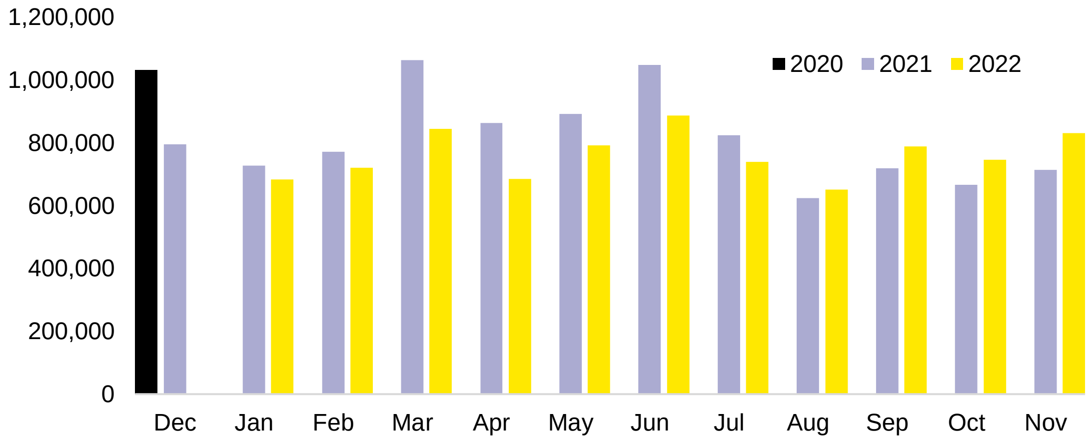
Outlook

Outlook for the car industry is grim and we think that recession fears, high interest rates, weak consumer confidence, and inflated input costs will remain the principal headwinds for the industry at least through 2024. Pricing was before the car makers' strong side, however now with used car prices falling Europe-wide we see downward potential to new car pricing as well. Car dealers will remain profitable mostly thanks to better supply situation, however the profitability will be in a low single-digit area as spending fundaments are deteriorating.

New car registrations are recovering in 2022. August 2022 marks the first month where new vehicle registrations surpassed 2021 levels. New registrations are strengthening as a function of:

- **a gradual recovery in the global supply chains after the COVID-19 tightening and auto manufacturers catching up and putting out more inventory as the chip shortage eases**
- unwrapping backlog of orders during the supply-affecting pandemic periods.
- **fuel prices falling** from summer 2022, but fuel is still not cheap with low potential for much more reduction in the near term affecting consumer confidence.

New passenger car registrations in the EU



Source: ACEA, Bloomberg Adria analytics

Dealerships are a very established, conventional way to buy cars. However, some consumers are opting for alternatives, to potentially circumvent wait times and ease the car buying experience, which is then affecting car dealers' financial results. The options are:

- **Online car sales –** apps like Carvago in Europe or Carvana, Carwow in the US offer an alternative platform to buy cars. However, these apps are facing a downturn as traditional channels gradually catch up
- **Car sharing –** still underdeveloped in the region compared to EU Countries.

Still, we do not see a big risk for Adria region car dealers in this respect in the near term, with the local buyers focused on conventional car sale channels - dealerships, used car lots and buying and selling privately.

Regarding the used car market segment, we believe that the extension of the vehicle replacement cycle along with tighter regulations will cause further shrinkage for this market end. For example, Serbia is planning to offer subsidies amounting to EUR 2,000 to buy back ageing diesel cars. The average age of cars on Serbia's roads is 17 years and cars are mainly imported from abroad. Serbia still has the loosest emission requirement in the region. The main aim of the subsidy is to reduce pollution through giving consumers a direct incentive to switch to newer, more ecologically sound models. The US had a similar initiative after the 2008 market crash – the program known as "cash for clunkers" was a US scrappage program designed to incentivize customers to switch to more fuel-efficient vehicles and to jump start the auto industry and stimulate the auto business. The program had the intended consequence of increasing car sales short term and steered people to dealerships and newer cars. However, cars that were traded in were scrapped and crushed instead of sold on the used car market, slamming used car inventory levels and sending used car prices soaring. The policy in Serbia may have a similar effect of increasing car sales short term. However, as the country is dependent on used cars, people may be unwilling to trade in their still driveable old cars or simply unwilling to buy new. The policy might also backfire and downsize an already shrinking supply of used cars.

Outlook

The global EV market is red hot, however regional demand and supply is slow to catch up, meaning that the business potential out that is yet to be reaped. Global EV stock rose by 61% in 2021. The highest growth rates in 2021 were in China (77%) and Europe (67%). The EV stock doubled compared to pre-pandemic 2019. However, EV adoption by regional dealers is choppy. **The main challenges are a still underdeveloped infrastructure, limited range (of autonomous driving) and high cost of EVs**. Adoption in the region is lagging as charging infrastructure is very sparse and EVs are still cost prohibitive for region's consumers budgets in most cases. However, as the whole auto industry is steering long term strategy toward EVs and there is significant regulatory pressure, we see significant opportunity in early market entry and EV Adoption. Dealers can take a proactive approach towards EV adoption such as installing and running battery-charging stations, gradually adding more EVs to their model roster etc. Another threat looms from the East - China spearheaded EV stock growth in 2021 and is seeking to utilize the expertise developed domestically in other markets. Therefore, an influx of Chinese BEV's is expected on the European car market.

We also see the post-sale service and maintenance segment of car dealerships gaining more traction. As consumers are delaying decisions to purchase and keeping their current vehicles (amid affordability and availability issues), a higher demand for servicing and maintenance is expected.

As in the auto industry, consolidation in auto retail is well underway, and we see opportunities for increased investment in the region targeting market consolidation. European dealer sector is highly consolidated e.g. the largest European car dealer group Emil Frey has been investing heavily in broadening both its new and used car operations. Most recently the Swiss group Bought Renault Nissan Bulgaria. In October 2022, the group also acquired the distribution of Renault and Dacia in Serbia under the new company name Keos. The regional dealer structure is still relatively decentralized, fragmented, and regionalized (especially for the used car market). Auto manufacturers prefer to deal with larger dealer groups, therefore smaller players are being bought out. Furthermore, one of the main risks faced by dealerships is losing their franchise. **Groups usually set ambitious KPI targets, and if they are not met, exclusive distribution rights could potentially be lost, or costs of obtaining inventory can surpass revenues.**

Tightness in supply and prioritizing high-end, high-margin vehicles created a positive price/volume mix in 2021-2022, driving sales levels and margins up for both manufacturers and dealerships. However, it drove inventory to historical lows. As supply constraints ease and inventory catches up to demand, pricing discipline will be paramount in 2023 as production stabilizes. The main downside is timid demand amid prolonged inflation which means further price increases may not materialize due to weak consumer confidence.

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Bloomberg Adria Team Analytics

Andrej Knez, Chief Markets Analyst
andrej.knez@bloombergadria.com

Ivan Odrcic, Lead Financial Markets Analyst
Ivan.odrcic@bloombergadria.com

Marina Petrov, Senior Financial Markets Analyst
marina.petrov@bloombergadria.com

Jelena Zindovic, Senior Corporate Finance Analyst
jelena.zindovic@bloombergadria.com

Matteo Mosnja, Corporate Finance Analyst
matteo.mosnja@bloombergadria.com

Ilija Nesic, Corporate Finance Analyst
Ilija.nesic@bloombergadria.com

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