Grant Thornton

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Automotive Messenger

February 2017

2016 was a strong year for vehicle registrations; but it was also a year of political and economic upheaval that raised questions for 2017.

2016 will be remembered for a number of surprises and shocks, from Brexit to the victory of Donald Trump in the US presidential elections. The UK stock market rose to new heights and sterling fell to record low levels against numerous international currencies. The UK economy stayed well clear of recession; GDP growth was generally better than expected and consumer confidence remained robust – but what lies ahead in 2017?

There was also more evidence of trends in the automotive industry in 2017. Mobility became the hot topic of the year, as technology disruptor companies such as Uber made further strides into the mobility market, followed by a number of manufacturers such as General Motors invested over US$0.5 billion in Lyft.

A number of downstream markets experienced consolidation, including automotive retailing, commercial vehicles, parts distribution and bodyshops.

UK vehicle registrations once again were strong, and the two important registration months – March and September – were both record months. By the end of the year 2,692,786 passenger cars had been registered, making 2016 the highest year ever. However, there are still concerns over the high level of pre-registrations and the potential effect on new vehicle sales in early 2017.

Looking ahead into 2017, there are economic and political uncertainties that are likely to affect UK and global economic growth. By the end of March 2017, the UK is likely to have submitted Article 50, starting a very drawn-out Brexit process that could take more than a number of years.

Political developments in Europe may provide something of a distraction from Brexit-related uncertainties: French elections are being held in April 2017 and German elections in August–October 2017. Following the unexpected outcomes of some of the public votes in 2016, further surprises cannot be ruled out in 2017. Looking across the Atlantic, it is not clear how far the new US President Donald Trump will go; he has already abandoned the Trans-Pacific Partnership (TPP).

The IMF has predicted that global GDP growth will continue to rise during 2017 to 3.4%; most of this expansion will come from emerging

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markets, but growth is likely to receive support from developed markets such as the UK. In the UK, the rate of economic growth is expected to be moderate, dampened by Brexit. Nevertheless, the third quarter of 2016 provided a welcome surprise as the economy grew at a better-than-expected QoQ rate of 0.6%, compared with the forecast of 0.5%. This growth was stoked by activity in the financial and retail sectors. The Society of Motor Manufacturers and Traders (SMMT) has forecast (October 2016) that the new passenger car market is expected to decline to 2.544 million during 2017, representing a decline of approximately 5%. Putting this into context, this still means it will be the sixth biggest recorded year of new passenger car registrations.

Used car performance was robust in 2016, offsetting some of the decline in new vehicle margins. A guest section in this edition of Automotive Messenger will review developments in the used car market in 2016 and prospects for 2017.

We believe that consolidation will continue to take place in the UK as the public limited companies (PLCs) continue to seek earnings growth. The smaller players in the market will continue to take advantage of the valuation multiples currently being paid. During 2017, the PLCs will also aim to digest recent acquisitions and vehicle registrations lose momentum

We believe that registrations are likely to be weaker in the second half of the year, as the change in road tax may generate some buoyancy in the market up to 1st April.
A number of City analysts have recently downgraded earnings growth forecasts in the coming year. More news will be available as the PLCs update the financial markets in the full-year reporting season in February and March.

Although buying activity amongst PLCs may not grow, we believe this could be offset by international investors. An article in the FT – “Japan Inc. on the hunt for post-Brexit deals" – indicated this could be the case; Japanese companies have increased their interest in UK assets with the acquisition of 37 UK companies in 2016. However, we believe that there will be opportunities amongst downstream automotive assets, not only for Japanese investors, but also for other overseas bidders. If the US continues to increase interest rates, this is likely to undermine sterling further relative to the US dollar, potentially increasing attraction for US investors.

We also believe that there will be further international acquisitions by broader-based UK companies, as they seek out further distribution expansion opportunities across the globe.

2017 has already started with considerable excitement with Donald Trump stamping his mark on the US automotive industry and “encouraging” not only US companies, but also international manufacturers to invest in the US, rather than Mexico.
Although we cannot predict the future, uncertainty is likely to be a certainty in 2017. Nonetheless, companies in both the upstream and downstream automotive sectors of the market can continue to trade profitably and work for improved efficiency to enhance these positions in 2017. Who knows, we may even see diversification.

2016: a record year for vehicle registrations

Christmas is traditionally a time for excess – but some might be digesting this excess for some time

2016 was a year to remember, as the number of vehicles registered continued to rise, reaching an all-time high of 2,692,786. It remains unclear how many of these vehicles at the end of the year were pre-registered; however much like the Christmas turkey and trimmings, those who have pre-registered a large number of vehicles may be "digesting" this problem well into the New Year and towards the "new plate" change in March.

We understand from a number of sources in the market that many of the automotive manufacturers have set their 2017 targets at least at the equivalent to those levels seen in 2016, even though the forecast market is expected to be lower in 2017. This might cause some indigestion as we head towards the March 2017 plate-change, and we may expect a review of these targets later in the year.

New vehicle registration analysis

The month of December was only the second month in 2016 to be negative: year on year (YoY) the month of December was down 1.1%. However, this did not counterbalance the good news that 2016 was the highest year ever for the registration of passenger cars which increased by 2.3% to near 2.7 million units.

Growth was once again in the fleet and business market, with fleet and business accounting for 55.2% of total unit registrations year to date (YTD) 2016. Retail registrations year to date declined by 0.2%. German Premium Brands once again gained market share to the detriment of the volume brands. For the full year, the total market share of Audi, BMW and Mercedes Benz was 19.6% This compares to the EU where these three brands account for approximately 16.5% (Source ACEA).

Market leaders Ford and Vauxhall have continued to come under pressure from the Premium brands and also from Volkswagen (VW) which suffered at the end of 2015 and start of 2016 with its emissions issues. Ford and Vauxhall ended the year with market shares of 11.8% and 9.3%, down on 2015 YoY.

The best-selling model was once again the Ford Fiesta with a market share of 4.57%. The Vauxhall Corsa and Ford Focus were second and third, retaining the positions they held at the beginning of the year.

Light commercial vehicles

Light commercial vehicle (<3.5t) registrations rose 1.04% to 375,687 vehicles. The 2016 market was once again dominated by Ford which had a market share of 30.76% for the full year. Ford finished the year strongly in December 2016 with a 26.15% increase in vehicles sold YoY and market share of 33.54%. For the full year 2016, Volkswagen achieved 12.07% and with Vauxhall in third place with 10.04%.

The SMMT has forecast that the total commercial vehicle market (<3.5t and 3.5t to 6t) will follow a decline in 2017 similar to that of the new passenger car market, falling by approximately 5.9 % to 355,500 (source SMMT October 2016).

FLA statistics

The most recent statistics provided by the FLA are for October 2016. The total finance business written on new and used vehicles YTD increased by 10.4% to £35,054 million. YTD new vehicle financing accounted for 65% of total financing, while used vehicles accounted for the remaining 35 %, compared with 34% the previous year. The used car financing market increased by 13.0%, while new vehicle financing increased by 9%, a slower level of growth due to the maturity of the new vehicle financing market. Within the new vehicle financing market, consumer finance accounted for the majority of financing at 68%. In the new vehicle market, Personal Contract Purchase (PCP) still accounts for 76% of total new consumer vehicle financing. In the used consumer finance market, the majority of vehicle financing is accounted for by PCP (41%) and hire purchase (54%).

Automotive distribution – an untapped opportunity?

Automotive distribution, a sector which operates in relative isolation and continues to be an untapped source of value.

A guest article from Steve Young, Managing Director at ICDP

Automotive distribution is a massive business sector by any measure. The five largest distributor groups globally (two Asian, two US and one European) had revenues between US$12 and US$20 billion in 2014. LKQ, the largest – and highly acquisitive – independent parts distributor, had 2015 revenues of over US$7 billion and an EBITDA margin for its European business of over 10%. Most businesses in the sector have some degree of natural protection against business cycles as the aftersales business is relatively stable, and OEMs incentivise new car sales during downturns.

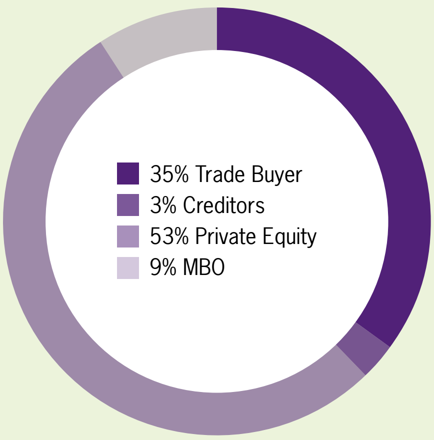
But despite this, the sector operates in relative isolation. In a sample of 116 deals in European automotive distribution on the Dealogic database over the last 12 years, 35% were trade investors expanding through acquisition, and 9% were management buyouts (MBO) with external funding. Most of the remaining deals – 53% – were private equity investments, although 28% of these were deals between funds. The primary focus for PE was the aftermarket, with 74% of investments being in either repair chains or parts distribution.

Non-financial investors from other sectors have been largely absent in Europe, despite the success of Circuit City in the US – a consumer electronics retailer – who set up and subsequently spun off CarMax, now the most successful used car retailer globally. Strategies based on vertical integration have also faced difficulties. Royal Bank of Scotland built up a significant portfolio of automotive interests in order to tap into the related finance and insurance business, but exited most of them within five years, having incurred heavy losses. Daimler, who have had significant wholly-owned retail activities for many years, are progressively selling them off to outside investors, mainly existing dealer partners.

Against the incestuous backdrop of automotive investors trading assets between themselves, Warren Buffet stole the headlines in March 2015 when he acquired the US Van Tuyl Group for a rumoured $3 billion,

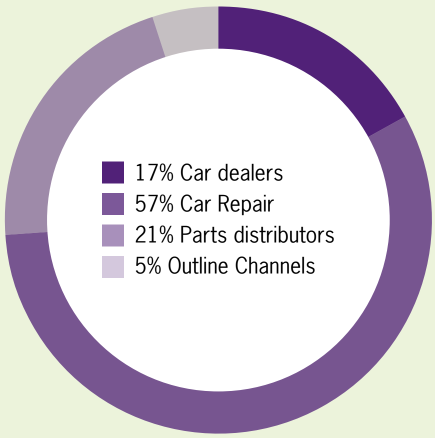
The primary focus for PE was the aftermarket, with 74% of investments being in either repair chains or parts distribution

Automotive distribution investors by type



Source: ICDP

PE investment focus by sector



Source: ICDP

saying "This is just the beginning – we could scale up a lot". Berkshire Hathaway has a record of favouring investments in businesses which operate in relatively stable, some would say unexciting, sectors such as insurance and railroads. But if that is what they are looking for in dealerships, we suggest that they could be in for a much more exciting ride than expected

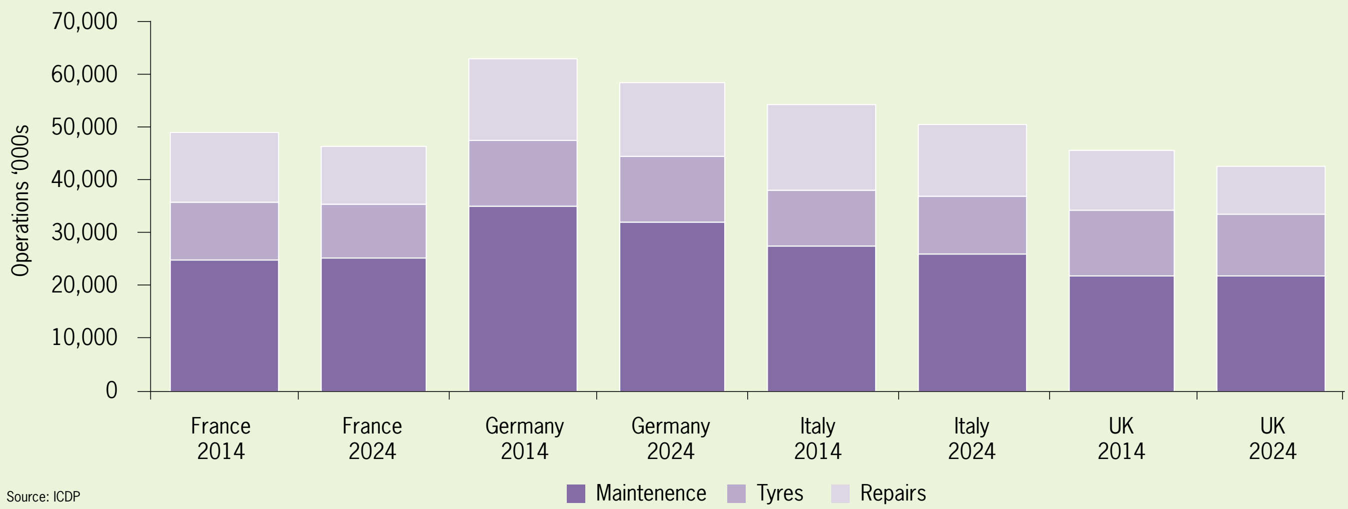
The sector faces disruptive change, the type of modest YoY evolution that cumulatively creates a total change in the business model. It happened with the arrival of smartphones and low cost airlines, it has started in automotive distribution, and it will create opportunities and risks for investors that may not be immediately obvious today. The source of disruptive change is a combination of structural factors and the impact of digital, changing customer behaviour and creating new opportunities.

The most certain of the structural factors is the long term decline in the aftermarket *(see below)* – until now a significant and stable source of profits. More reliable cars, longer service intervals, lower annual driving distances and new technologies all result in reduced requirements for service and repair.

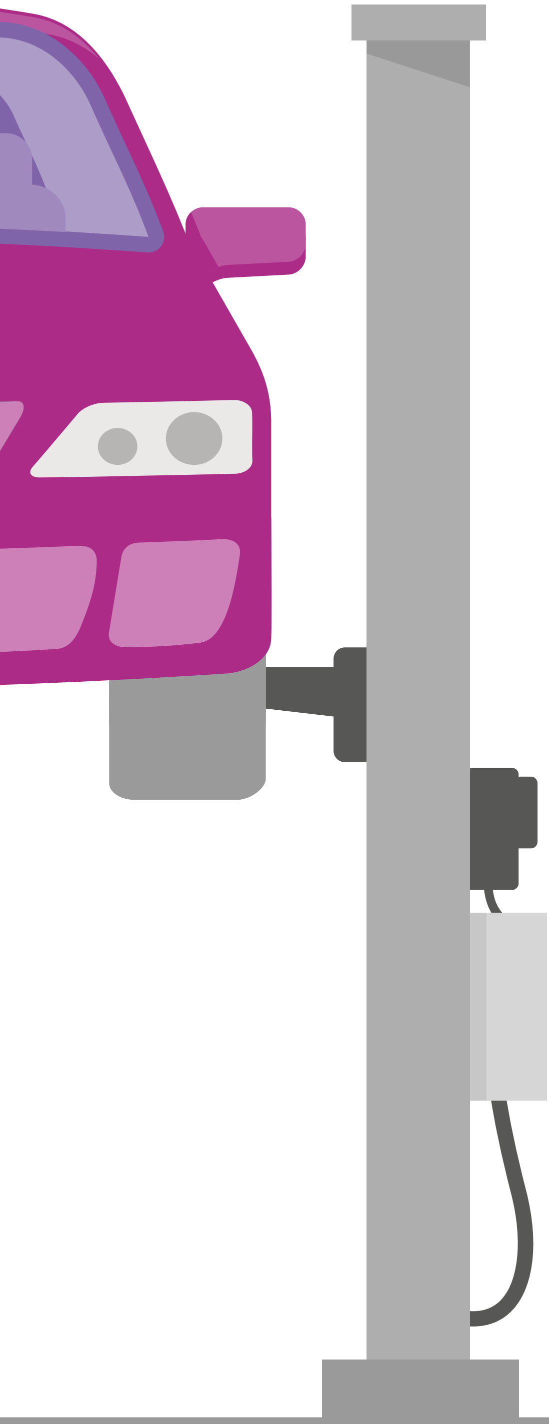
The new car market in Europe and the US is mature, with growing pressures from the move from ownership to usage, as services such as Zipcar, Uber and BlaBlaCar potentially displace a growing

The new car market in Europe and the US is mature, with growing pressures from the move from ownership to usage, as services such as Zipcar, Uber and BlaBlaCar.

Aftermarket in Volume 2014 to 2024 in '000s operations



Source: ICDP



So does this make the sector 'uninvestable' due to high risks, or does it instead show that inevitable restructuring will create opportunities for those who see value in backing winners? We would argue that the upside opportunities outweigh the downside risks for the informed investor.

proportion of individual cars. OEMs have entered this sector, such as Mercedes' Car2Go service and GM's $500 million investment in Lyft, and through this will at least secure some business supplying cars. However, downstream, these new low margin fleet operators replace high margin private customers, and the total number of cars required will reduce.

Digital is driving changes in customer behaviour throughout the purchase journey. New intermediary players have entered the field, and whilst none have yet captured significant market share, they have introduced more transparency, and driven price erosion. OEM and dealer operated online new car sales channels have had limited success so far, but those that do exist have proven popular with customers, and increasing use of finance to turn a 20,000 capital purchase into a perceived 150 per month utility bill will increase their appeal significantly. But at the same time, investments in physical dealerships have been increasing, with a new site now often costing over 10 million. Used cars are already a largely online business, if not for the final deal, then for the initial location and evaluation of what is on offer, with players like Autoscout24 dominating the initial purchase stages and capturing a fee for every car. Parts are now also moving online, offering distribution efficiencies, and when linked to a fitting service provided by partner repairers, proving very successful. Some of these new channels are backed by OEMs and other industry players, others by tech giants, some are entrepreneurial start-ups, others are owned or supported by private equity and venture capital. The common story is that many are gaining some degree of success, but none has yet driven systemic change.

'Connected cars' create both opportunities and threats. Many cars now have the potential to transmit data related to condition and usage, typically to the OEM. They can summon the emergency services, send an alert that the brake pads need replacing, or receive information ranging from traffic alerts to system upgrades. Logically these services need to be operated by the OEM, potentially turning the dealer into a service provider rather than the primary owner of the customer relationship.

However, nobody yet has the strategy or resources in place to make use of a fraction of this data. But connectivity is also attracting the attention of players whose interest is more in the customer than the car. In China, e-commerce giant Alibaba plans to launch its own connected car, not so as to retain aftersales business, but in order to create a captive audience, sat in traffic jams, who will buy more goods and services from them.

So does this make the sector 'uninvestable' due to high risks, or does it instead show that inevitable restructuring will create opportunities for those who see value in backing winners? We would argue that the upside opportunities outweigh the downside risks for the informed investor. Together these changes are moving the sector away from a trading model, highly dependent on the instincts and experience of a few experts, towards one which is much closer to broader retail models, with defined operating processes which can be deployed easily and quickly. The industry as a whole will benefit from new investors bringing in new approaches and some injection of new talent to create the businesses of the future. Others have demonstrated that the opportunity exists – the combination of new thinking and new capital can make that a reality.

Steve Young is Managing Director of ICDP, an international research-based organisation focused on automotive distribution, including the supply and retailing of new and used vehicles, after sales, network structures and operations. Through its research activities, consulting, and data services, ICDP works with vehicle makers, dealers, suppliers, and related organisations to improve the quality and effectiveness of the distribution model. www.icdp.net

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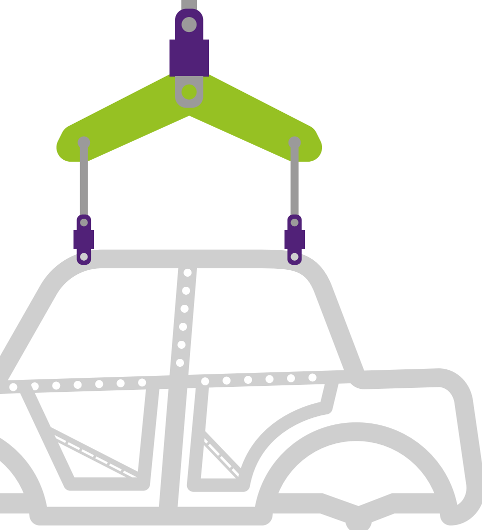

Lotus

Innovation in the pursuit of performance and success

One of our most well-known UK manufacturers, Lotus is distinguished for both its success on the race track, and for its lightweight high performance sports cars.

A pioneering approach

Lotus is renowned for cutting-edge design and innovation, underpinned by decades of pioneering development. The Company's origins are modest: Lotus founder Colin Chapman constructed his first Lotus, the Mark 1 from the foundation of an Austin Seven in 1948. The success of this car in racing encouraged Chapman to produce more cars and, in 1952, the Lotus Engineering Company was born.

In 1957, Lotus introduced the world's first composite monocoque production car, the Lotus Elite and the Lotus 7. The following year, the company commenced its long and prestigious presence in Formula One racing with the Lotus 12, with a Lotus winning its first F1 Grand Prix in 1960. Over Lotus' historical presence in Formula One, the brand would win a further 80 races and 13 World F1 Championships.

The 1960s were a momentous decade for Lotus: with wins in the Indy 500, European Touring Cars and F1 Championships, and the introduction of the legendary Lotus Elan and Lotus Europa and the group's move to its new home in Hethel, Norfolk. This was followed in the 1970s by the launch of the iconic Lotus Esprit (which starred in two James Bond films, the Elite and Eclat and more world championship successes in F1). The 1980s were punctuated by the sad death of founder Colin Chapman; nevertheless, Lotus continued to find success on the road, with the Lotus Esprit Turbo, and on the track with racing drivers such as Ayrton Senna.

The 1990s saw the launch of the Lotus Elise, which revolutionised the sports car industry with its Aluminium chassis, light weight, efficiency and purity of the driving experience. In 1996, PROTON – a member of DRB-HICOM – acquired Lotus and investment led to a new manufacturing facility providing the company with greater capacity, a new Engineering and Design centre, and


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powertrain testing facility, all at Hethel.

As Lotus moved into the new millennium, the company has continued to grow and innovate, launching a great number of new models and variants, the Lotus Exige series, the Lotus Evora series, and the Lotus 3-Eleven.

Company structure

Group Lotus plc has two principal divisions: Lotus Cars builds world class, high performance sports cars including the Evora, the Elise and the Exige.

Lotus Engineering provides comprehensive and versatile consultancy services to many of the world's OEMs and Tier 1 suppliers; and is an internationally recognised automotive engineering consultancy.

Lotus Cars USA Inc. is the distributor and importer of Lotus cars in North America, based in Ann Arbor, Michigan.

Lotus Engineering Inc. is also based in the same Ann Arbor facility.

Staying at the cutting edge

From the moment Colin Chapman produced his first car from the garage of his girlfriend's parents, to the present day, Lotus' strategy has focused on the development and production of lightweight, benchmark handling sports cars. Lotus has remained at the cutting edge of technology, pioneering the use of lightweight carbon fibre, aluminium and composites while the main automotive manufacturers used steel.

Under the current leadership of visionary CEO Jean-Marc Gales, the company is much more agile and fast

acting. In addition it has increased revenue, reduced costs and launched a completely refreshed product line-up. Lotus is EBITDA positive and is on target to make a profit for the first time in many years.

The launch of new models has raised revenues, and the Company has reduced overheads by 40% over the last two years. The line-up of vehicles has been refreshed and the brand is once again focusing on the Company's fundamental characteristics of "lightweight, benchmark handling and efficiency". This strategy has been underlined in 2016 through the launch of the Evora Sport 410, Exige Sport 380, Elise Cup 250 and the Lotus 3-Eleven – each one lighter and faster than its predecessor.

Each world class Lotus car is hand crafted at the Lotus Headquarters in Hethel, Norfolk and has received five star reviews and critical acclaim from the key publications around the world. Staff are highly skilled with the company putting emphasis on harnessing and developing local talent and engaging and working with UK based suppliers.

Distribution and Retail network

At present, Lotus has 203 dealers globally in 55 countries, of which 18 in the UK sell and service vehicles, and 11 are service-only providers. Lotus prefers to work with dealers and distributors who have values which are aligned to those of Lotus.

Suppliers

In 2016, Lotus exported over 85% of all its sports cars, with the biggest markets worldwide now being the USA followed by UK, Germany, France, and Japan. Two thirds of Lotus' suppliers are based in the UK with a quarter of these in Norfolk and the surrounding areas. Lotus is continuing to build upon its UK and local supplier base as it replaces, where possible, its overseas suppliers with UK based ones, especially in areas such as light-weight materials and composites.

Looking to the future

Lotus is perfectly positioned to thrive in the increasingly competitive automotive industry, historically where other small British car manufacturers have not succeeded.

Looking ahead, Lotus' strategy remains true to its history and heritage with lightweight, high-performance, efficient sports cars with benchmark handling and a pure driving experience. In a recent interview, Jean-Marc Gales indicated that the future strategy would include new vehicles, ranging from derivatives of the current line-up, such as a roadster version of the Lotus Evora, and new Elise range from 2020 onwards – with all containing that crucial Lotus DNA.

The used car market in 2016 –what does 2017 hold?

The automotive industry in 2016 had much to celebrate, strong fleet and consumer demand. However in 2017, the used car market will become even more important source of profits for the dealers.

A guest article from Philip Nothard, Black Book Editor, Cap Hpi

The automotive industry had much to celebrate in 2016. A second record year of new registrations and a used car market characterised by strong fleet and consumer demand.

In a benign market, used prices remained stable through 2016 and rode seasonal fluctuations with more resilience than seasonal norms.

Pre-registration continued to grab headlines. Estimates of pre-registration volumes run from 1% to 20% and rise and fall through the calendar year. It could be time for a fresh look at the process. It is often described in pejorative terms, and this doesn't reflect the reality of the situation.

Research undertaken by Cap Hpi showed that through the peak sales period of September, one in four dealers expected volumes of pre-registered vehicles to exceed 21% of total new sales.

According to the SMMT, the 66 plate saw new car sales hit 469,696 in September. This would mean almost 100,000 vehicles sold through the pre-registration channel.

It is clear that pre-registration volumes vary widely between brands, and while pre-registration helps drive some impressive new car figures, it can place pressure on the nearly new values.

How the industry copes with increasing volumes of vehicles returning to the market, and 'forced registrations' into pre-registration channels, will underpin the stability of the used market into 2017.

With the challenges of the referendum result and ensuing political instability – 2016 proved an interesting year. One may have expected this to cause some disruption to the motor industry and potentially lead to increasingly volatile used car values.

The weakening pound has made the UK market far less profitable for many manufacturers, and new car price increases are likely. We believe that there will be less push into the UK new car market as vehicles are routed through other, more profitable, European countries. Should this happen, we are unlikely to see the same high volumes of nearly new vehicles that have been experienced over the last few years.

As we look into 2017, the industry faces some known unknowns. Uncertainty around the UK economy and sterling will likely make the coming year more volatile. The SMMT estimates new car registrations will drop by 5% in 2017. Fewer new cars could help to balance demand and minimise the impact on values.

With larger volumes of vehicles anticipated to return to the market, following three years of new registrations, consumer demand will continue to be key over the coming 12 months.

Cap Hpi expect values to continue to be affected by the seasonal market into 2017. Pressure will remain on nearly new city car and supermini as supply continues to exceed used demand.

In the retail sector, uncertainty around the UK economy and sterling will likely make the coming year more volatile. Dealers of all sizes have proven to be resilient in a rapidly changing market and highly adaptable to trends like the growth of PCP and tactical registrations.

The used market will play a key role in dealer profitability. Strong demand characterised a market that supported record used volumes in 2016. The market is set to hit 7.7 million vehicles in 2016, beating last year's figure of 7.2m.

A strong final quarter of 2016 supported unseasonably strong demand, and as we move into 2017, there is no evidence that demand is weakening in the used market.

The last 18-months have seen continual growth and acquisitions across the sector, and we will no doubt see this continuing through 2017.

The UK's love affair with the car

continues to reach unprecedented levels. Both the new and used car markets are up in 2016 on last year's record figures.

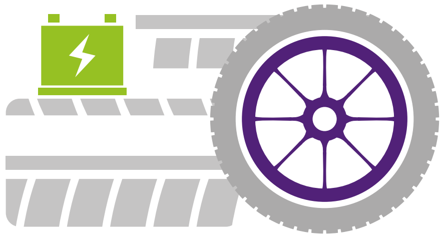
The availability of cheap finance and a growing acceptance of 'cost to drive' over 'cost to own' models of ownership in the new and used markets are driving up the frequency of purchase.

While the weakness of the pound will put pressure on price increases, various finance models have the ability to absorb some of the shock. It is worth keeping in mind that a 5% drop in the market, mooted by the SMMT, would still make 2017 the sixth biggest year on record for new car registrations.

Dealers can create a more transparent relationship with the buyer through better use of data, and this should be embraced. Understanding that consumers are information hungry will improve both sales and customer service.

Buyers and sellers are using the internet to both research and transact purchases. The abundance of information and pricing data is driving retailers to become more efficient. A digital strategy should sit at the heart of every business.

The industry is well placed to respond to a potentially more volatile 2017. Advances in data mean fleets are better able to predict what's next and then have the flexibility to evolve.



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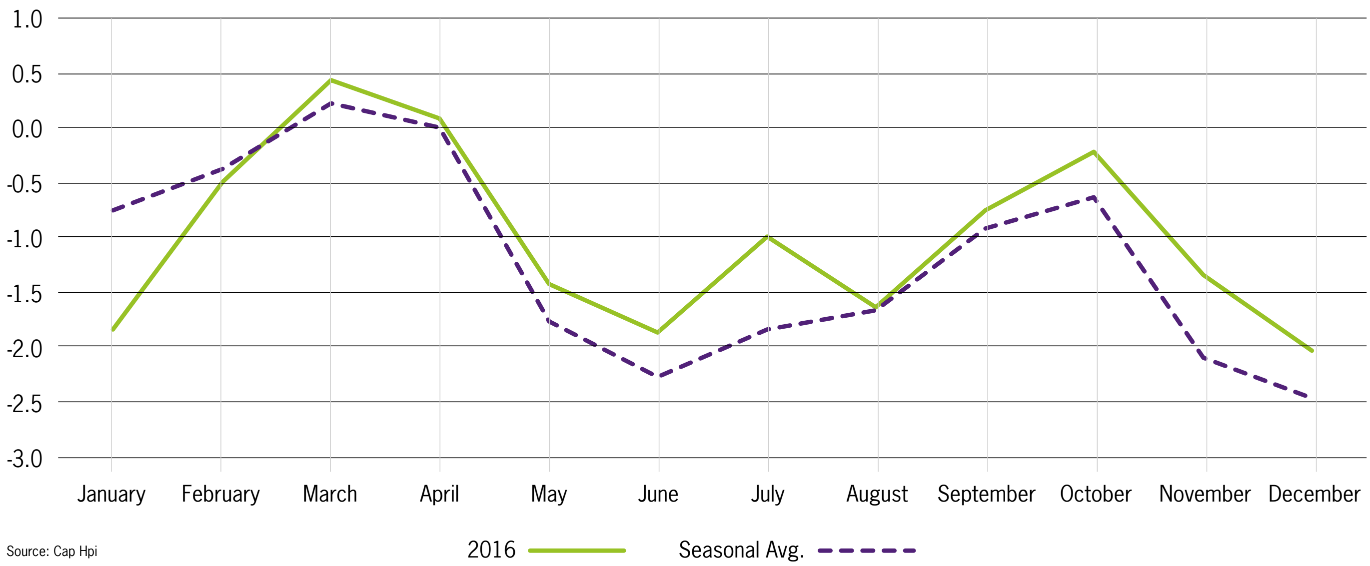
2016 Monthly used value movements vs. seasonal averages



Source: Cap Hpi

News snippets

Trump is here – and he's building!

Since coming into office – in only a matter of days –President Donald Trump has opened up two oil pipelines vetoed by Barack Obama. Creating jobs seems to be his top priority, having also signed off the building of the Mexico wall and insisting they will pay for it. By the time we publish, it may have been started, all US workers, bricks and mortar. This man is deadly serious about the US looking after its own, and one has to ask how on earth the environmental lobbyists are going to react to more heavy fuel and potentially more disregard for global warming etc.?

WARNING: This is not the only reference to Trump in these snippets…

2008 revisited – but with a very different angle

We have referred many times to the infamous Lear Jet incident when, following the 2008 global economic crisis then President of General Motors, Rick Waggoner, summoned to see President Obama, failed to see the significance of turning up by way of Lear Jet and not using one of his branded products, found himself in essence fired by a politician who could be said to have no authority to do so! Well, the big three US Auto chiefs found themselves inside the oval office in less than a nano-second of Trump's appointment to 'have a chat'. Sadly, being 'trumped' is already allocated to selected card games, but someone is inevitably going to find a word to describe his approach to open dialogue.

Messrs Fields representing Ford, Ms Barra General Motors and Sergio Marchionne Fiat Chrysler were given a straight talk around creating jobs through manufacturing in the US. Previously Trump has threatened those who seek to manufacture in low-cost markets (such as Mexico) with a hefty, 35% border tariff. Could this see the phoenix of Detroit rise again – the state of Michigan was one that backed Trump, whose simple message 'invest for jobs and you will get less red-tape and lower corporate taxes', is a dream for most. Mark Fields was also one of the ten US business leaders who met with Trump the day before and he made incredibly positive statements to the press after that meeting, re-affirming the strategy. It seems the US industrialists have been given 30 days to devise and submit a series of actions designed to boost US manufacturing to Trump. One cannot ignore the whole theatre of this approach, leaning on the hit TV series the US Apprentice (UK export number one) – we wonder if the industrialists who least please Trump are told "you're fired"! Heavy stuff, potentially impacting global stock markets either way.

Integrated transport solutions

This may no longer be top of the US agenda given Donald Trump's manufacture at home strategy. However, in the grand scheme of things we anticipate this approach gaining ground – and there are no reasons why it should not be global. A small sign of that is here in the UK with the Italian state-owned train operator Trenitalia both acquiring the c2c business operated by National Express and teaming up with First Group to bid for two rail franchises.

Although not vehicles, it still fulfils the objective of getting customers from A to B. Given a number of the rail groups are, or have been, bus and coach operators, then the integrated market must appeal, even down to the ride-share, disruptive businesses we see at the moment. When something shows itself working well, increased interest will follow. Ownership will cross borders where profit opportunities exist, so expect some of the short term consolidation to be cross border and cross sector.

Changing the shape of the future

Talking about the disruptors, they have all flitted in and out of the news over the last three months, with Uber taking the lion's share of publicity. After receiving punishment, for 'misleading' their drivers, Uber announced a new senior recruit from Google. In itself this is not news that headlines are made of, but Amit Singhai did post a blog saying that the attraction of Uber was 'how the company is reshaping society in numerous ways'.

Now that is a big statement. He also added a techy note by saying Uber was challenging computer science problems that are present as a result of the many complicated, interconnected systems powering the seemingly simple app. Indeed, there is much to nod one's head at in the latter, but the former is a real eye-opener. We understand this individual was a very early recruit to Google so he has seen everything develop out of the tiny acorn. But if he sees Uber as reshaping society, then integrated transport solutions are just the start. IT capability delivers endless possibilities – we just don't know what they are yet!

How to forecast the weather?

Another obtuse heading has a very real meaning as we try to understand where the future is heading? In mid-January, we held our annual breakfast for lending contacts where we present our update on the automotive sector and try to make sense of what is likely to happen next. This meeting was very exciting because it enabled us to present the full spectrum of service lines we can provide, both upstream with production and downstream with distribution. It was also the opportunity to introduce a new face to our team, Bob Joyce, who has recently retired as Director of Engineering and Executive Director of Product Creation/Delivery at JLR, a main Board appointment and the person responsible for a number of the strong products in JLR's current model line-up.

But back to the reference to the weather. We are seeing a shift in the way retail is executed, how customers are demanding better and cleverer technology as standard and how new entrants to the market are challenging the pre-conceptions of how to transact which have existed almost since the Model-T Ford first rolled off the production lines. We now have websites which empower buyers with better information and the ability to compare with absolute clarity. We see consumers able to afford more premium brand products because we have fully embraced PCP and PCH and no, cash is no longer purchase king – far from it, the monthly budget for the vehicle of choice is sacrosanct and we have in the UK a phenomenal process to clear through the resulting used cars to end customers and for a decent profit return.

What next we ask – well, back to the strap line, and against any principles we have held against this very analogy, the easiest way to forecast the weather is to 'look out of the window', which suggests change is potentially around every quarter and taking the long view is all fine and dandy, but there is likely to be a change somewhere along the way. Long term has indeed become short term, and the best performers will be those who can adapt, be vigilant and 'on trend' and who have an understanding what is happening around them. Sounds quite deep, but every day sees new change and challenge – embrace, benefit and steer your path!

Emissions, Volkswagen and just about everyone else

After we commented on the Volkswagen situation in our last

edition, we have now established that the US criminal settlement will be $4.3 billion as agreed with the US Department of Justice. In early January we saw a plethora of articles written on the subject, looking at why and how this happened and what was trying to be achieved. The total cost has been enormous - $15.3 billion to settle civil action involving 475,000 two litre diesel vehicles, $1.2 billion to resolve a class-action by its US dealers and $1 billion to buyback/recall three litre vehicles. Adding up to the grand total of $21.8 billion, WOW!

On top of this, is still other potential financial actions and the cases against Executives at all levels, including the very top of Volkswagen, very harrowing. Arrests have been made and $4.3 billion goes some way towards settling these – Volkswagen has pleaded guilty to three felonies in the process. The US Attorney-General put it very simply – 'For years, Volkswagen advertised its vehicles calling them 'clean diesel'. Our investigation has revealed them to be anything but.' But other brands are not immune, the French Government has focussed on domestic brands and Fiat Chrysler has been accused by the US Regulator of emissions cheating. If proven, more massive fines ensue, so how will it all end? Nobody knows, but as Bob Joyce said at our recent event, "it's all about sleeping easy at night" – so look for drawn and tired - Auto Executives for your answer! This has been the massive 'wake-up' call that maybe the industry has invited on?

Volkswagen has set off with renewed vigour - setting new strategies to develop cleaner products and being at the cutting edge of technology and mobility change. Indeed, they are already heavily-invested in Gett, an Uber rival, which creates a platform for multi-channel supply. Most commentators and industry officiandos we have spoken to recently – and dealers – remain firmly positive and can see a strong future. As a brand, Volkswagen Group has created far stronger portfolio brands in Skoda and Seat, a fabulous premium brand in Audi and what appears to be a massively strong captive Finance Company. Consumers are ready to go again, maybe the US will be more of a challenge, but then again, it always has been.

Statistics, damn statistics and lies

Everyone knows this famous old saying, and we thought it applied quite well to some headlines we saw recently in relation to China and the retail vehicle market. Statistics grab the headlines – they tell us that the growth in China car sales are slowing sharply. That seems quite clear, evidently there has been a large amount of Government stimulus and tax incentives on smaller cars and this is all due to end in 2018. Vehicle tax was halved on anything under 1.6 litres.

So that is the statistic, the damnation could be the growth has been especially strong in the 25 to 35 age category, mainly in the country's smaller cities. Think China and you inevitably focus on the bigger cities of Beijing, Shanghai whereas there are many others. Property prices have risen and consumers are becoming less cautious – does that sound familiar? SUVs are the big hit (same comment!) and China own brands have done well, exceeding the average market growth.

Lies? - well, not quite, more 'slight of hand'. Total sales were stated to be 28 million for 2017, an enormous volume, way ahead of the US and Europe. It was not more than 6/7 years ago that the number was more like 7 million. China is critical, whilst domestic manufacturers registered a record 10 million plus of the vehicles sold, that means the remaining 18 million went to the recognised players. This is a far more relevant statistic to us.

Autonomous transport – what is the weather forecast?

If you have steadily worked your way through the snippets so far, you will know that predicting change is getting more difficult as events overtake and disrupt on a daily basis. There is further evidence of progress from the

comment made by the CEO of the Toyota Research Institute at the recent Consumer Electronics Show (again, regular readers know this January event in Las Vegas is heavily populated by motor manufacturers) – the car industry is "not even close" to fully autonomous cars.

We also noticed a piece written recently around the Southern Rail conductors dispute – headline 'UK rail network still a long way from fully automated trains'. The reason for this was the regular musing that driverless trains were a real (and near term) possibility – the DLR already fulfils that criteria, one of our colleagues uses it regularly and its low speed, purpose design/build criteria mean it generally works.

So surely we would expect the rail system to achieve autonomous ahead of the road, stands to reason as trains run on pre-set railway tracks? Well, not quite, and here is why; infrastructure. The UK has a wide variety of train, signalling and operating patterns on the mainline railways – even the tube system has challenges around tunnel escape routes in an emergency, plus many miles of track above ground.

You will never guess it, but weather plays a role! Slipping on wet leaves, stopping for downed obstructions are all common issues. Our complex infrastructure on rail-based transport almost makes it more difficult than roads. But they too have massive complexity issues and you get the sense that without those issues being resolved, the technology will be too advanced for its environment. Road traffic laws in the developed world are based on the Geneva Convention 1949 and the Vienna Convention. Major amendments will be needed except China is not part of the regulations having never signed up! The US has grid roads and we have Milton Keynes, so expect more localised autonomous travel rather than across-the-board.

Autonomous will happen, it will change everything and it will require infrastructure change. It feels to us like an integrated approach across all transport systems will work best, but this has previously been a notorious holy grail or dead man's project, whichever way you prefer to describe it. A case now of the technology demanding the infrastructure. After all, no use having the smartest 'smart' phone and then not having a signal!

The state of Tesla

Talking technology, neatly segways to Silicon Valley's own rising star Production in Q4 of 2016 fell behind target by around 10% and for the full year Tesla missed out by around 3,000 vehicles. High Finance dictates that as a downer, so off drops the share price by 2% in trading after close on the day announced. This is a bump, not a disaster, but the harbingers of doom get their way once again.

Tesla blame a hardware problem, not software. We see such an innovative company more in the light of a true disruptor – the Model 3 is a mass-market vehicle, not a play toy. 2016 saw full year deliveries at 76,230 across more than one model – surely that is strong news and worthy of credit. Tesla may not replace the traditional OEMs, but it is giving them all the incentives to replicate and change – and that is no mean achievement.

BMW joins the world of geek – a step on from geniuses

Tesla may be grabbing headlines, but here is a simple example of business adapting to the challenge. BMW has come up with 'augmented reality technology' which will allow customers to take a three dimensional tour of their product via a smartphone. Meaning you can open doors, boots and turning the radio on and off from the comfort of your own front room.

This core technology uses Google Tango technology – and, of course, was demonstrated at the Las Vegas Consumer Electronics Show! Tango-capable smartphones are only just coming to market. Strategy appears to be selected showrooms with the i3 and i8 models, and then followed by the good old Google Play store.

We were, however, somewhat puzzled by the comment from Google that whilst bricks and mortar stores had suffered from internet shopping, the augmented reality technology could bring them (consumers) back. Specifically, "We've gone full circle. …come to the dealership and imagine any BMW car in the actual environment". Sounds a sop comment – this surely has to be another piece in the buy-on-line evolution"?

Is there a quiet Volvo revolution?

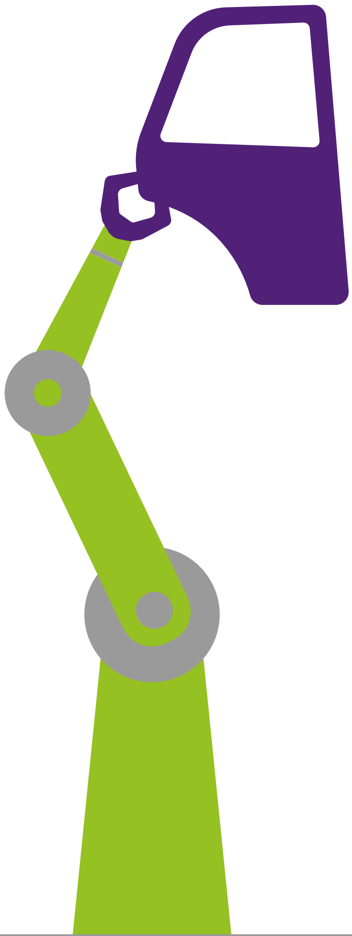
Steady as she goes was always the impression of Volvo and Saab (whilst it existed) with careful and precise Swedish engineering but lacking that final piece of flair and/or excitement. Perhaps that tag is now being ripped off, fundamentally down to the Geely acquisition of Volvo back in 2010. Volvo raised $533 million in December 2016 from its Swedish investors, primarily as convertible preference shares, which can convert to listed Ordinaries subject to Geely's decision. Things appear to be going well; Europe is a fertile ground, but the US and China (Volvo has factories in both) are storming ahead with double-digit volume growth. The achilles heel of (out of) cost control does not seem to apply, and we understand from the press that operating margins exceed 6%, which is great news. Given the investment plans, smart money seems to be on an IPO to generate funds – that would count as quite a return to former glories!

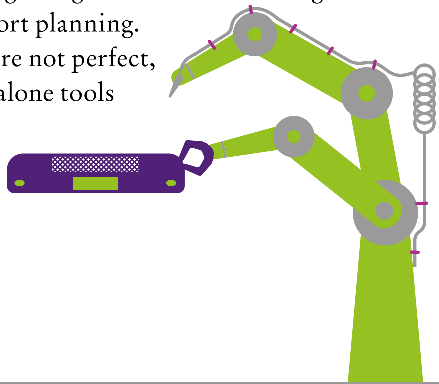
Big data is rubbish – or so it seems

To finish on a lighter but still serious note, we have been reading about transport data in emerging cities and markets. The light part, is the new installation of mobile phone technology into rubbish trucks in the Nigerian city of Nairobi where their investment in new trucks was not achieving any improvements. The mobile data collected as a result, when followed up, revealed slow speeds caused by traffic calming by locals impacting flow and damaging the trucks. Nairobi City Council was able to sort the problem.

Big data is everywhere, Oyster cards in London and Octopus in Hong Kong have started to change transport planning. They are not perfect, stand-alone tools just yet but they have revealed so much about habits and movements. Taxi drivers in Cebu, Phillippines are using mobile phone tracking aimed at resolving traffic congestion.

The message is clear – big data, small technology; or at least existing technology, still gives masses of potential to cover developing countries with transport-changing outputs.





UK new passenger car registrations

2016 was the best year ever for new passenger car registrations. Fleet registrations were strong, while retail registrations marginally declined.

Even the decline in the new passenger car registrations in the month of December 2016 did not dampen the 2016 figures, which were the highest on record. YTD 2016 growth was up 2.25% YoY to 2,692,786 vehicles. The premium segment of the market continued to gain market share at the expense of the volume manufacturers. Over the year, the three German premium brands (Audi, BMW, Mercedes Benz) gained market share to 19.6% versus 2015 which was 18.2%. Providing further evidence that these premium brand vehicles were "eating" the volume manufacturers' core market, Mercedes Benz E Class joined the Audi A3 in 2016 as a top ten vehicle registered in the UK. Therefore in 2016, two of the top ten models registered in the UK were German premium brands.

Jaguar, Land Rover and Bentley performed well over the year with an increase of 45.37%, 19.47% and 41.26% respectively. Jaguar benefited from the launch of new vehicles which included the F-Pace, Jaguar's first move into the SUV market. Over the year, both Jaguar and Land Rover "pushed" for more market share; this appears to have been a successful strategy that has paid off. Growth in Bentley registrations is expected to increase in 2017 with the introduction of the Bentley Bentayga, Bentley's first SUV.

Although the price of petrol and diesel remained relatively low over the year the level of growth in Electric Vehicles (EV) and Hybrid vehicles increased by 22.1% (all EV and Hybrid vehicles). The total number of EV and Hybrid vehicles registered in 2016 increased from 77,764 in 2015 to 88,909

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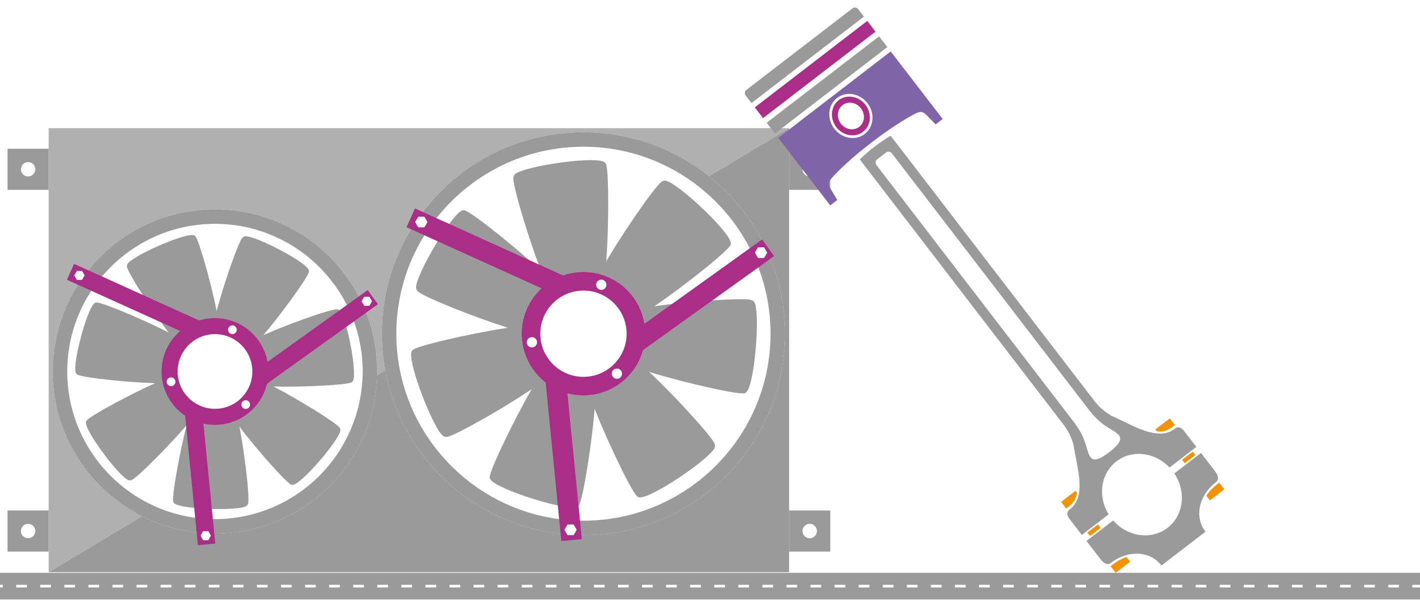
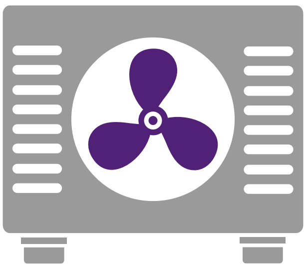
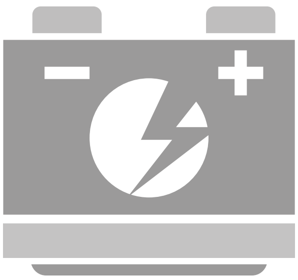
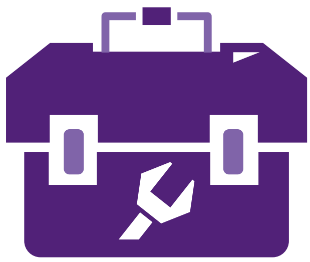


UK New Car Registrations for twelve months to December 2016 (YTD)

Brand	FY2016 Units	Share (%)	FY2015 Units	Share (%)	2016/2015 % Change	FY2014 Units	Share (%)	FY2013 Units	Share (%)
Ford	318,316	11.8%	335,267	12.7%	(5.1)%	326,643	13.2%	310,865	13.7%
Vauxhall	250,955	9.3%	269,766	10.2%	(7.0)%	269,177	10.9%	259,444	11.5%
Volkswagen	207,028	7.7%	223,784	8.5%	(7.5)%	214,828	8.7%	194,085	8.6%
BMW	182,593	6.8%	167,391	6.4%	9.1%	148,878	6.0%	135,583	6.0%
Audi	177,304	6.6%	166,709	6.3%	6.4%	158,987	6.4%	142,040	6.3%
Nissan	152,525	5.7%	153,937	5.8%	(0.9)%	138,338	5.6%	117,967	5.2%
Mercedes-Benz	169,828	6.3%	145,254	5.5%	16.9%	124,419	5.0%	109,456	4.8%
MINI	68,984	2.6%	63,581	2.4%	8.5%	53,661	2.2%	51,933	2.3%
Renault	85,102	3.2%	75,618	2.9%	12.5%	66,334	2.7%	46,173	2.0%
Peugeot	98,529	3.7%	104,249	4.0%	(5.5)%	103,566	4.2%	105,435	4.7%
Skoda	80,372	3.0%	74,692	2.8%	7.6%	75,488	3.0%	66,081	2.9%
Hyundai	92,419	3.4%	88,117	3.3%	4.9%	81,986	3.3%	76,918	3.4%
Land Rover	79,534	3.0%	66,574	2.5%	19.5%	56,200	2.3%	54,699	2.4%
Toyota	96,746	3.6%	98,709	3.7%	(2.0)%	94,012	3.8%	88,648	3.9%
Fiat	60,581	2.2%	64,257	2.4%	(5.7)%	67,162	2.7%	60,198	2.7%
Kia	89,364	3.3%	78,489	3.0%	13.9%	77,525	3.1%	72,090	3.2%
Volvo	46,696	1.7%	43,432	1.6%	7.5%	41,066	1.7%	32,666	1.4%
SEAT	47,456	1.8%	47,654	1.8%	(0.4)%	53,512	2.2%	45,312	2.0%
Honda	59,106	2.2%	53,417	2.0%	10.7%	53,544	2.2%	55,660	2.5%
Citroen	78,889	2.9%	88,626	3.4%	(11.0)%	83,397	3.4%	78,358	3.5%
Jaguar	34,822	1.3%	23,954	0.9%	45.4%	18,401	0.7%	16,210	0.7%
Suzuki	38,167	1.4%	34,437	1.3%	10.8%	37,395	1.5%	33,088	1.5%
Mazda	46,609	1.7%	45,504	1.7%	2.4%	37,784	1.5%	31,228	1.4%
Dacia	26,499	1.0%	26,228	1.0%	1.0%	23,862	1.0%	17,146	0.8%
Other	104,362	3.9%	93,857	3.6%	11.2%	70,270	2.8%	63,454	2.8%
Total	**2,692,786**		**2,633,503**		**2.25%**	**2,476,435**		**2,264,737**	

Source: SMMT



Registrations of new commercial vehicles

The light commercial vehicle market saw growth for a fourth consecutive year with a 1.0% increase in the number of vehicles registered.

The light commercial vehicle market (<3.5t) increased in registrations by 1.04% YTD 2016, while the commercial vehicle market >3.5% to <6.0t declined by 3.95% YTD 2016. Growth in the market came from smaller commercial vehicles of which pickups grew by 17.6%.
December was a poor month, being only the fourth month in 2016 to suffer a decline YoY. Moreover, the drop for December 2016 was large at 10.43%. This drop was generated by a 42.7% decline in Vauxhall vehicles; meanwhile, Mercedes Benz declined by 15.15%, and Citroen and Renault fell by 33.88% and 48.33% respectively.
For the full year 2016, Ford continued to dominate both the <3.5t and the >3.5t and <6.0t markets. In the <3.5t market, Ford increased its market share to 30.76% for the full year 2016, up from 26.96%. This was driven by strong sales of the Ford Transit Custom, which registered 49,744 and the Ford Transit, which registered 29,965. Of the total Light commercial vehicle market (total <0t to <6.0t) these vehicles combined accounted for a remarkable 20.77% of the market.

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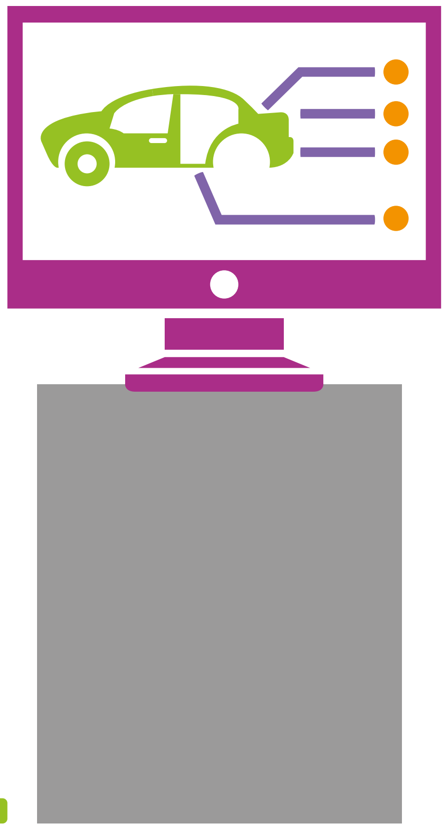

Registrations of new commercial vehicles in the United Kingdom

Commercial vehicles < 3.5t

Brand	FY2016 Units	Share %	FY2015 Units	Share %	FY2014 Units	Share %	FY2013 Units	Share %	FY2012 Units	Share %	FY2011 Units	Share %
Ford	115,554	30.8%	100,262	27.0%	82,519	25.7%	68,054	2,400.5%	62,372	2,705.9%	70,226	3,144.9%
Volkswagen	45,358	12.1%	43,091	11.6%	40,238	12.5%	36,925	1,302.5%	30,956	1,343.0%	31,716	1,420.3%
Vauxhall	37,727	10.0%	41,736	11.2%	32,619	10.1%	29,736	1,048.9%	26,524	1,150.7%	33,514	1,500.9%
Peugeot	33,187	8.8%	33,695	9.1%	31,867	9.9%	21,230	748.9%	21,272	922.9%	19,328	865.6%
Mercedes	32,029	8.5%	31,887	8.6%	30,464	9.5%	25,667	905.4%	21,055	913.4%	19,495	873.0%
Citroen	27,771	7.4%	30,119	8.1%	27,228	8.5%	22,989	810.9%	18,379	797.4%	17,275	773.6%
Renault	25,773	6.9%	25,371	6.8%	18,170	5.6%	12,978	457.8%	14,710	638.2%	19,382	868.0%
Nissan	15,728	4.2%	11,621	3.1%	10,270	3.2%	10,619	374.6%	10,136	439.7%	10,854	486.1%
Fiat	10,185	2.7%	11,704	3.1%	12,629	3.9%	12,019	424.0%	7,060	306.3%	8,130	364.1%
Mitsubishi	8,655	2.3%	9,006	2.4%	6,946	2.2%	5,927	209.1%	4,853	210.5%	7,341	328.8%
Toyota	7,275	1.9%	10,124	2.7%	9,611	3.0%	8,063	284.4%	7,747	336.1%	8,391	375.8%
Isuzu	5,718	1.5%	6,220	1.7%	5,502	1.7%	4,112	145.0%	2,762	119.8%	2,431	108.9%
Iveco	4,083	1.1%	4,326	1.2%	2,769	0.9%	3,275	115.5%	3,593	155.9%	3,628	162.5%
Land Rover	3,934	1.0%	10,266	2.8%	8,344	2.6%	6,644	234.4%	5,917	256.7%	6,209	278.1%
Other	2,710	0.7%	2,402	0.6%	2,510	0.8%	2,835	100.0%	2,305	1.0%	2,233	0.9%
Total light CV	**375,687**		**371,830**		**321,686**		**271,073**		**239,641**		**260,153**	

Source: SMMT

Commercial vehicles >3.5t and <6.0t

Brand	FY2016 Units	Share %	FY2015 Units	Share %	FY2014 Units	Share %	FY2013 Units	Share %	FY2012 Units	Share %	FY2011 Units	Share %
Ford	2,446	31.8%	2,722	34.0%	1,852	27.2%	2,767	40.8%	2,879	40.4%	1,381	25.0%
Fiat	1,802	23.4%	1,954	24.4%	1,313	19.3%	1,231	18.1%	1,416	19.9%	1,171	21.2%
Mercedes	1,734	22.6%	1,858	23.2%	1,889	27.8%	1,485	21.9%	1,367	19.2%	1,458	26.3%
Peugeot	699	9.1%	673	8.4%	401	5.9%	200	2.9%	359	5.0%	354	6.4%
Iveco	446	5.8%	316	3.9%	402	5.9%	420	6.2%	444	6.2%	567	10.2%
Volkswagen	265	3.4%	195	2.4%	386	5.7%	342	5.0%	251	3.5%	221	4.0%
Vauxhall	183	2.4%	140	1.7%	135	2.0%	99	1.5%	73	1.0%	51	0.9%
Renault	69	0.9%	87	1.1%	74	1.1%	117	1.7%	215	3.0%	113	2.0%
Other	41	0.5%	56	0.7%	345	5.1%	127	1.9%	122	1.7%	218	3.9%
Total heavy CV	**7,685**		**8,001**		**6,797**		**6,788**		**7,126**		**5,534**	

Source: SMMT

EU and EFTA passenger car registrations

2016, the third consective year of growth in the passenger car registrations market.

In 2016, new passenger car registrations increased by 6.5% to 15,131,719 units across EU and EFTA countries. This was a robust performance considering the level of political and economic uncertainty in a number of the large EU markets. The growth was sustained across most of the EU countries, Italy (15.8%) and Spain (10.9%) grew the strongest of the major passenger car markets. France, Germany and the UK continued to grow with 5.1%, 4.5% and 2.3% respectively.

VW Group maintained its leading market share with 24.1%, however this was down on 2015's market share of 24.8% which can be potentially attributed to the decline in Volkswagen and its emission troubles (Western European EU28 + EFTA Countries). Renault Group is the second largest manufacturer represented in Western Europe with a market share of 10.1%, again the manufacturer's market share declined YoY.

EU and EFTA passenger car registrations December 2016

Country	FY2016 Units	FY2015 Units	2016/2015 % Change	FY2014 Units	FY2013 Units	FY2012 Units
Germany	3,351,607	3,206,042	4.5%	3,036,773	2,952,431	3,082,504
United Kingdom	2,692,786	2,633,503	2.3%	2,476,435	2,264,737	2,044,609
France	2,015,177	1,917,226	5.1%	1,795,885	1,790,456	1,898,760
Italy	1,824,968	1,575,737	15.8%	1,360,578	1,304,648	1,403,010
Spain	1,147,007	1,034,232	10.9%	855,308	722,689	699,589
Belgium	539,519	501,066	7.7%	482,939	486,065	486,737
Netherlands	382,825	448,927	-14.7%	387,565	416,730	502,479
Others	2,687,467	2,397,067	12.1%	2,155,721	1,941,817	1,936,369
Total EU	14,641,356	13,713,800	6.8%	12,551,204	11,879,573	12,054,057
EFTA	490,363	488,473	0.4%	455,681	457,310	474,036
Total EU + EFTA	**15,131,719**	**14,202,273**	**6.5%**	**13,006,885**	**12,336,883**	**12,528,093**

Source: ACEA

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