Bank of Ireland Sectors Team Motor 2020 Insights / Outlook 2021

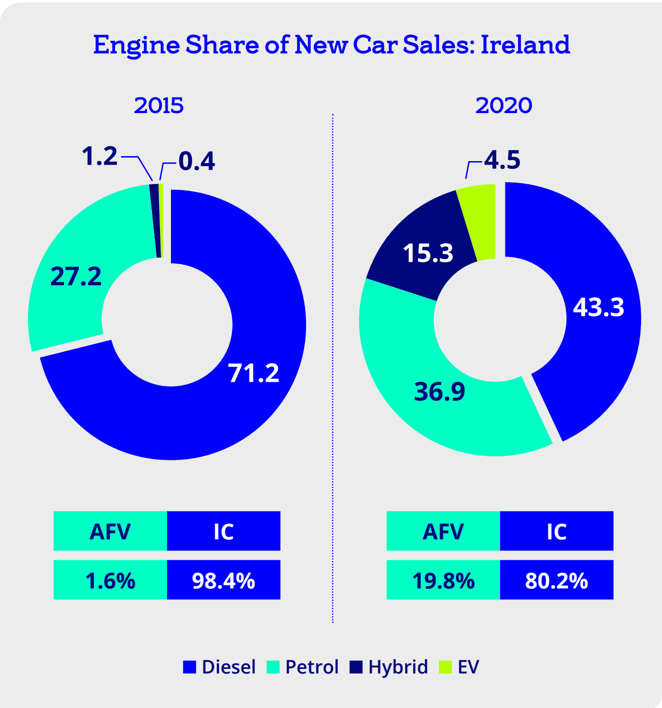
February 2021

Bank of Ireland

Classification: Green

Pre-COVID Environment

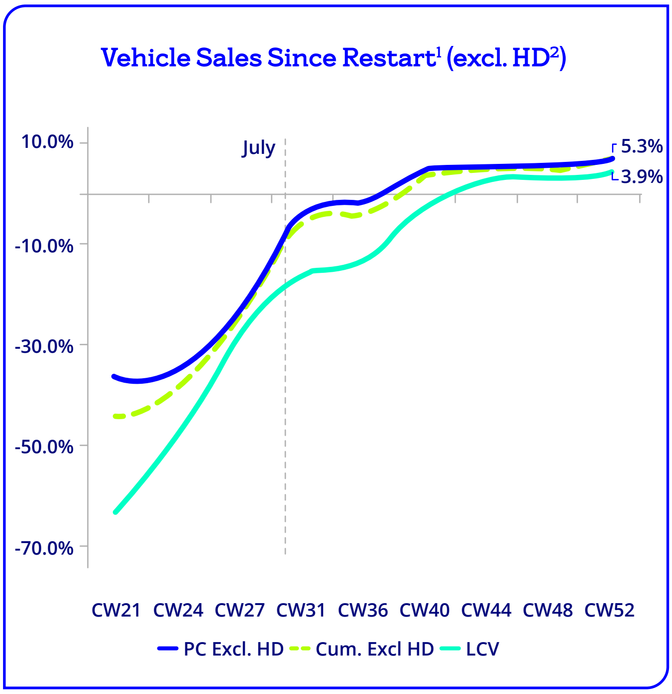
The new car market peaked in 2016 at 146,600 units following strong growth from a low base. Demand for new cars in Ireland has been in decline since 2017 as the industry felt the impact of Brexit. By the end of 2019, new car sales declined ca. 20% to 117,100 units from peak sales in 2016. Due to a weakened sterling, used passenger car imports from the UK market surged in the same period. Prior to the Brexit referendum in 2016, used car imports averaged ca. 50,000 units per annum and increased each following year, reaching record levels in 2019 at ca. 114,000 units. This dampened new car demand in Ireland as used car values were impacted by cheaper imports from the UK. The effect of this increased Irish consumers cost to change when purchasing a new car. During the same period, consumer confusion began to rise concerning which engine type to choose in their next new car. This follows considerable EU-wide media reporting on hybrid and electric vehicles and the future of petrol and diesel engines. There has been a shift toward increased consumer uptake of hybrid and electric vehicles (EV's) in recent years. In 2020, the Hybrid/EV combined share of new car sales has risen to c. 20% compared to 1.6% in 2015.



AFV = Alternative Fuel Vehicles; IC = Internal Combustion Engines

Strong Underlying Demand

Overall, in 2020, new passenger car sales declined by 24.6%, light commercial vehicle sales declined by 14.2% and used imports declined by 29.8% due to the impact of COVID-19. These headline figures hide the underlying trend in the recovery of vehicle sales since restarting the economy on May 18th 2020, following the first lockdown. In the period since restart to the end of 2020, new passenger car sales increased c. 5% year on year (excluding hire drive registrations) and light commercial vehicles increased c. 4%. Hire Drive sales collapsed by c. 85% in 2020 and are excluded in in the following chart to highlight underlying consumer demand. Motor dealers reported strong demand for used cars throughout the same period, and largely experienced stable gross profit margins. This trend is mirrored in the UK and across Europe as consumers sought alternatives to public transport and used additional savings made during the period to put toward a new car. The brisk trade of both new and used vehicles since restart is encouraging for the sector outlook in 2021.



PC = Passenger Cars; LCV = Light Commercial Vehicles
[1] Restart: 18th May; [2] HD: Hire Drive

Budget 2021

The sector anticipated changes to motor taxation in Budget 2021 due to the full introduction of the Worldwide Harmonised Light Vehicle Test Procedure (WLTP) across all EU countries in 2021. WLTP is a new laboratory test to define carbon emissions (C02) for motor vehicles and involves more "real world" testing. WLTP produces higher C02 emission results with the effect of higher retail prices for consumers without government intervention. The EU recommended that WLTP is introduced in each market in a revenue neutral manner. With the arrival of COVID in 2020, and subsequent steep decline in new car sales, the sector lobbied strongly for a reduction in Vehicle Registration Tax (VRT) to stimulate new vehicle sales. Budget 2021 brought with it an extraordinary, and welcomed, €18bn spending package to support the Irish economy. The strong lobby from the motor sector was, however, unsuccessful and the Irish Government made extensive changes to VRT bands and electric vehicle (EV)/ Hybrid reliefs. These changes result in retail price increases for newly registered vehicles in the State from January 2021.

A temporary reduction in VAT (from 23% to 21%) will exist in January and February and this will partially offset price increases resulting from Budget 2021. A greater number of vehicle sales may be forced into the first two months (usually c. 40% of annual sales), but this will be dependent on developing COVID restrictions. European restrictions have the potential to impact vehicle production and supply. It is also possible these new taxation measures will change buyer behaviour in 2021 and beyond. These measures could, for example, result in lower SUV sales volumes (as they generally attract higher C02) and/ or greater volumes of Hybrids/EV's (which attract lower or zero C02). Hybrid/EV's will be in demand across all EU countries as new C02 targets for vehicle manufacturers take effect in 2021 and supply could be constrained. Ironically, early indications are such that taxation measures introduced in the Budget will favour many diesel cars as they typically produce lower levels of C02 than petrol cars, particularly with premium franchises and generally with SUV's.

Electrically Chargeable Vehicles

Sales of electrically chargeable vehicles (ECV = EV + PHEV[1]) across the EU ticked up in 2020 as demonstrated in the table below, depicting ECV share of total vehicle sales. In 2021, consumer incentives offered by countries such as France and Germany are likely to accelerate the demand for EV's in those countries and this may create supply shortages in the EU. This might impact supply for Ireland to some degree but is more likely to impact supply of left-hand drive markets.

	FY 2019		Q1-Q3 2020	
Engine Type	**EU**	**ROI**	**EU**	**ROI**
BEV (battery only)	**1.9%**	**2.9%**	**4.1%**	**4.3%**
	(v 1.0% PY)	(v 1.0% PY)	(v 1.0% PY)	(v 1.0% PY)
[1]PHEV (plug-in chargeable)	**1.1%**	**1.2%**	**4.0%**	**2.8%**
	(v 1.0% PY)	(v. 0.6% PY)	(v. 0.9% PY)	(v. 1.1% PY)
Total ECV (total electrically chargeable) Engine Type	**3.0%**	**4.1%**	**8.1%**	**7.1%**
	(v. 2.0%PY)	(v. 1.6% PY)	(v 2.6% PY)	(v 3.7% PY)

EV technology is expensive to produce and will remain high in the mid-term according to the European Automotive Manufacturers Association (ACEA). The implication is that electric vehicles are likely to remain outside the means of many consumers and will require continued government subsidies to incentivise sales. Current projections by the ACEA in Europe forecast the Total Cost of Ownership (TCO) of an EV could reach parity with the internal combustion engine by 2025 (TCO takes account of initial investment cost, fuel costs, servicing etc. for the full life of the vehicle). The implication here is that EV's will remain expensive in the mid-term but the cost of running a vehicle with internal combustion engines is likely to rise due to EU regulation, government taxation measures and the rising cost of fossil fuels. Nonetheless, many EU governments have "hitched their wagons" to electric vehicles as a solution to reducing carbon emissions so their growth in Europe is inevitable over the mid to long term.

Climate Action Plan

Transport accounted for c.20% of Ireland's Greenhouse Gas (GHG) emissions, measuring 12.0MtC02eq in 2017, according to the governments Climate Action Plan. The 2019 Climate Action Plan (CAP) is targeting a reduction of c.40% in GHG emissions to 7-8MtC02eq. by 2030. Taxation changes announced in Budget 2021 provided a clear signal to the sector of government intentions to reduce GHG emissions from transport in Ireland. The government has also committed to gradually increasing carbon tax to €100 per tonne by 2030 (increasing from €26.50 in 2020 to €33.50 in 2021) with the intention of making fossil fuels more expensive. Furthermore, in October 2020, the Irish government published a new climate action bill committing Ireland to net-zero carbon emissions by 2050.

Current data from the Department of Transport (December 2019) depicts a national fleet ca. 2.2m passenger cars in Ireland comprising c. 8,500 EV's (+500 e-vans). Adding 2020 EV sales brings the national fleet to c. 12,500 EV's (+1200 e-vans) accounting for just c. 0.6% of total passenger vehicles on the road. The CAP proposes a target of 840,000 passenger ECV's in the fleet by 2030 (840k ECV = 550k BEV + 290k PHEV). This is widely seen as unachievable by the sector as it would require over 80,000 new ECV's to be registered each year to 2030. Put another way, c. 60% of annual new car sales would need to be ECV's for the next ten years to achieve this goal. The Irish government has provided clear signals of intent in both the 2019 CAP and Budget 2021 with regard to reducing carbon emissions.

Forming part of the European Green Deal, the EU will implement strict C02 emission targets over the next ten years that encourage/force manufacturers to produce greater numbers of low emission vehicles. To put this in perspective, motor manufacturers must meet a new C02 target of 95g/km per vehicle sold in 2021 (v 122.4g/km[2] sold in 2019). Ireland compared favourably at c. 114g/km in 2019 and in 2020, emissions here fell further by c. 7% to 106.2g/km. *[2]Provisional figure from EEA.*

Regulation (EU) 2019/631 sets out new CO2 emission targets for the years 2025 and 2030, with 2021 as the revised baseline. Emission targets for newly registered cars must reduce 15% from 2025 and reduce 37.5% from 2030 (from 2021 levels). To achieve these targets, a blended mix of Hybrid and EV vehicles will exist alongside traditional internal combustion engines produced with lower emissions. Due to the high cost of production of fully electric vehicles, and subsequent higher retail prices for consumers, we are likely to see a greater number of Hybrid and Plug-In Hybrid (PHEV) models coming to market in the years ahead.

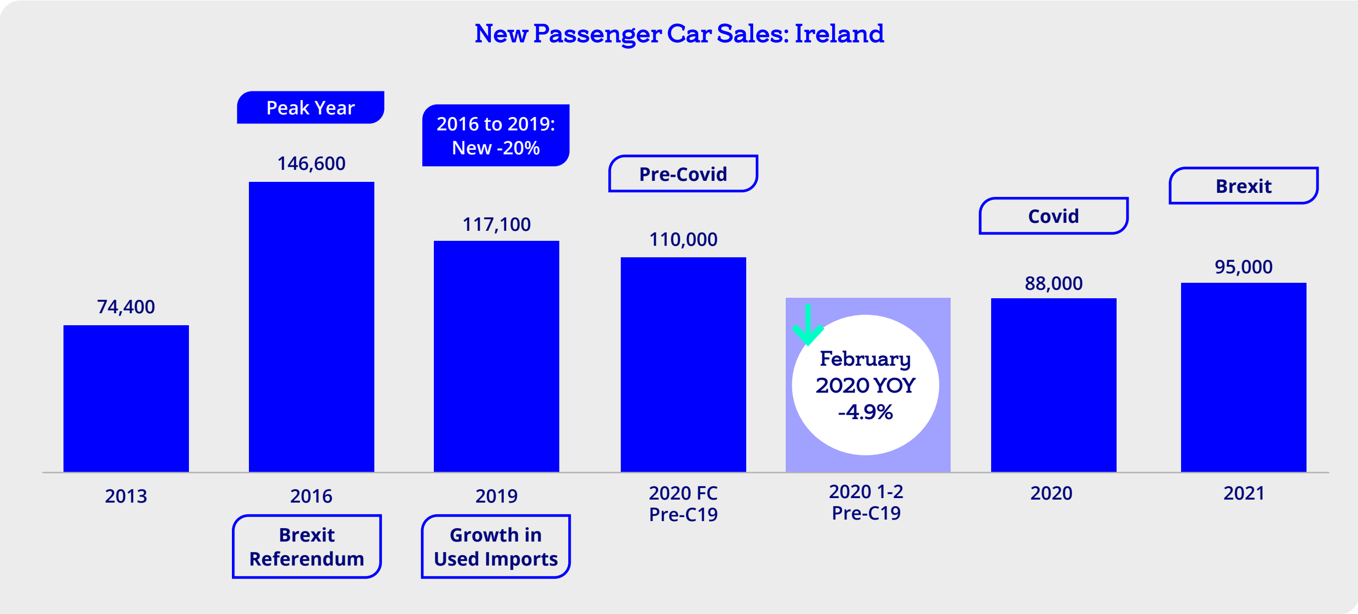
Brexit

After more than four years, we finally have a deal. Non-tariff related delays may exist as part of life after Brexit. Supply chains will be impacted with delays/increased costs and it will take a number of months before the full impact is known. Welcoming the deal, the ACEA (European Automobile Manufacturers Association) said it can only make a full assessment of the deal when all technical details are publically available. As the UK is now considered a third country, the process of importing vehicles from the UK to Ireland from 1st January 2021 has changed. This is likely to reduce the inflow of privately imported vehicles by consumers in Ireland. A potential decline in used imports would be supportive to the recovery of new car sales in Ireland.

Outlook

Despite pessimism that has pervaded our lives due to COVID, there is positive news on the horizon. If we were told just a few months ago that vaccine roll out would commence, that a Brexit trade agreement would be reached and that Biden would take over from Trump as US President, and all by January, we would have taken it with both hands. The sector is not without its challenges and the mid-term horizon is difficult to predict. The European Green Deal along with our national Climate Action Plan poses threats to the sector in the mid-term. Plans to reduce carbon emissions in the transport sector have been in place for many years, and the motor sector has reacted through planning increased volumes of Hybrid and EV's. Consumers are confused due to the uncertainty caused by these measures. The reality is that the internal combustion engine (ICE; petrol, diesel) will exist alongside increasing volumes of Hybrid and EV's over the mid to long term. ICE engines will not disappear overnight as there are c. 2.2million passenger cars licenced on the road in Ireland. The mix will change gradually over time.

The potential for further lockdowns due to COVID-19 will remain as a threat in 2021. The sector could, however, continue to experience a COVID-related bounce due to commuters choosing to avoid public transport and purchasing cars and a potential reversal of non-ownership among younger consumers. For those fortunate enough to maintain their employment and income, savings levels have increased. The sector may experience a benefit from those seeking to upgrade their vehicles.



Underlying demand for retail sales of new (and used) cars have been stable and robust since restart on May 18th 2020, and this trend is expected to continue into 2021. Restrictions on international travel due to COVID-19 dampens the overall market potential as the hire drive sales channel typically accounts for c. 17k cars p.a. or 15% of the market (down 85% in 2020). The sector expects new passenger car sales to be in the region of 95,000 units in 2021. This compares to a new car market of 117k in 2019 (and 147k in the peak year of 2016). The current base case is that new car sales return to 2019 levels by 2022, however, that it dependent on how quickly COVID-19 is resolved. Roll out of the vaccine at pace is critically important so that stability can return to businesses as fast as possible.

It should be noted that the sector is not just about new vehicle sales. Franchised motor dealers benefit from multiple income channels including used cars and aftersales channels (service and parts). Aftersales channels attract strong margins and can account for c. 40% of total income contribution. Many motor retailers focus on developing profitability in their workshops as this gives protection against volatility in new car sales. A key industry KPI is the Absorption ratio where the benchmark is 80%. A ratio of 80% indicates that direct profit produced from aftersales will absorb 80% of administrative overheads, thus providing comfort to a dealer during times of instability.

Finance Opportunities

We expect that trends existing pre-COVID will carry into 2021. Consolidation of single operators into larger dealer groups is likely to continue and may accelerate. We also note an increased take up in SBCI working capital loan facilities in recent months. Refinance opportunities will present themselves from time to time and we welcome the opportunity to discuss these needs with both current and new customers.

Supporting our Customers

Bank of Ireland Finance (BIF) supports 13 motor franchises representing c. 41% of annual new car sales and we remain committed to our customers. Bank of Ireland and the Irish Motor Sector is open for business.

Stephen Healy
stephena.healy@boi.com
085 289 8600

Stephen joined Bank of Ireland in 2018 and brings over 20 years Motor Sector experience developed in both Retail and National Distributor positions. He comes to us direct from industry having previously been employed as General Manager for a multi-franchised retail motor group for 7 years.

He opened a new retail operation in 2011 in a very challenging economic environment and was responsible for building both Sales (new and used) and Aftersales (Service and Parts) functions of the business. In addition to a first class honours BA in Business Studies (Hons) from Griffith College Dublin, Stephen holds a Certificate in Transport Engineering from Dublin Institute of Technology.

Sources: SIMI, ACEA, EEA, Dept of Transport, IRL Gov.ie