Survey on car dealers’ market in Hungary

2009
## Table of Contents

### Introduction

1. CEE Report Summary 7
2. Country Report Summary 10

### Country Report

3. Basic features of dealers participating in the research 13
4. Economic characteristics of dealers 15
5. Market environment of dealers operations 19
6. Future 21
7. Opinions 24
8. Contacts 25
Dear Readers,

Please find enclosed the results of the first independent research ever carried out on the car dealer market, delivered by PricewaterhouseCoopers.

The objective of the research was to determine the condition of this market segment in Hungary - in terms of its present condition, anticipated direction of development, and foreseeable threats. According to our observations and discussions with market practitioners, up to now no credible studies have been available, incorporating the voices of the most interested participants, i.e. the dealers themselves. For this reason we asked them to relate to us the most important matters associated with their operations and to identify the impact of the most recent events on the market upon their business operations.

Hence, what is the true picture of the Hungarian passenger car dealer segment? How are they coping under the new circumstances? Is the situation still as good or as bad as it seems to be?

Are they threatened with bankruptcies due to increased competition? Can we still talk about generating profits in this business? Or is, perhaps, the financial condition of car dealers not as bad as it seems, while new European regulations, appropriately applied, will contribute to the development of this market? We are convinced that you will find the answers to at least some of these questions in our Report. Please let us express our hopes that the subsequent issues of our report, which we plan to publish annually, will be produced with the participation of more dealers than was the case with the present report, which will make future reports even more interesting.

We hope you find our report both informative and interesting.

Armin Krug
Partner
Automotive Industry Leader
Global financial crisis

2008 has been without doubt the most difficult year for the global automotive industry since World War 2. The economic crisis which started with the United States sub prime mortgage market has now swept through the financial sector. This has led to a sudden reduction in consumer confidence which has had a devastating impact on the new cars market and the automotive sector in general. Clearly, the American market has been the hardest hit with a reduction of 40% of sales in light vehicles in 2008 and as at the date of writing this report the long term financial future of the Detroit 3 looks to be in some doubt unless there is intervention by the United States Government. The crisis is also evident in Europe, particularly Western Europe. There, the demand for new passenger cars fell by 15.5% on average in October – a decrease of 6% in year-to-year comparison. The recorded drops in sales ranged from 7-8% in France and Germany to 40% in Spain. In view of these numbers it is clear that the crisis has spread to Europe.

Impact on Central and Eastern Europe

The deteriorating economic situation is now also affecting Central and Eastern European (CEE) countries which are the focus of this year’s edition of our report, however the overall impact on 2008 may not be significant given that the first three quarters of the year were relatively good in terms of new vehicle sales with 18% growth compared to 2007 according to ACEA. In the largest markets in Eastern Europe (Russia, Poland, the Czech Republic, Slovakia, Hungary and Romania) the full impact of the financial crisis is therefore not likely to be felt until 2009.

So far, Hungary (-6%) and Romania (-2%) have experienced the biggest declines in sales, yet these are still much lower than those observed in Western Europe. The passenger car market in Hungary has been declining for a couple of years now, witnessing a 5.8% drop of new passenger car sales in 2007. The outlook for 2008 was already rather pessimistic and further forecasts will be additionally impacted by the current global financial and economic crisis. In fact, the numbers of passenger car registrations for the third quarter of 2008 were the lowest of any quarter since the turn of the century.

For the last 2 years, Romania has been experiencing the fastest growth in sales of new vehicles among the European Union Member States. A total of 312,532 new vehicles were sold in 2007, an increase by 26.3% as compared to 2006. The growth has been attributed to Romania’s first year of EU membership and to an increased consumption. However, changes took place on the automotive market during the last year, triggered by the increase of used car import and by the recent credit restrictions. These new conditions have led to stagnation and even a decrease in new car sales. In order to counter that tendency Romania’s Government approved the suspension of the pollution tax for new Euro 4 cars with less than 2,000 cmc engines until December 31, 2009.
Automotive industry representatives believe that the effect of the financial crisis on loans was the main factor negatively impacting the car sales, since, for instance, approximately 60% of Dacia cars are being bought on credit or leased. It is estimated that the Romanian automotive market will face further decreases in sales during the next two years.

In Russia, Poland, the Czech Republic and Slovakia, an increase in new car sales during the last nine months was reported, stemming primarily from robust GDP growth. The sales trend started to change mid-year, as the markets started to show signs of being affected by the global economic slowdown. Currency fluctuations and problems with access to credit facilities were the main factors influencing the market. Customers have been finding it harder to obtain a car loan – the number of loan applications rejected by banks is increasing sharply, while those who can get a credit are forced to contribute a bigger down payment and to pay higher interest rates.

In Russia, constituting the biggest market in Eastern Europe, foreign passenger car sales increased by just 9% in October – the slowest rate of growth since January 2007. At the end of June 2008, the sales of foreign makes were still up by over 40% in unit terms as compared to the previous year. However, since then the rapid growth rate has been slowing down sharply, and for the first time in recent months, some foreign OEMs have recorded drops in year-on-year sales. In addition, the sales of Russia’s largest car manufacturer AvtoVAZ also decreased during the same period, falling by 19% in October – a drop by 1.6% as compared to January. Moreover, the rouble has fallen from approx. 23.5 to 27.5 in relation to the USD, and Russians are being more cautious when it comes to taking buying decisions. And finally, there is also a perception that prices could come down – particularly for locally manufactured foreign brands priced in roubles – and Russians are postponing purchasing decisions in the hope of obtaining the bargain. As a result of all the above factors the Russian market will experience significantly lower growth in the final quarter of 2008 and in 2009.

Our survey results reflect these trends and in each of the surveyed countries (Poland, the Czech Republic, Hungary, Slovakia), the majority of dealers believe that there is little prospect for increasing sales in 2009. Banks are introducing stricter lending criteria and consumers are being very cautious. In Poland, it is anticipated that there will be a significant reduction in bank lending. The great unknown here remain the currency rates as the majority of Eastern European countries still operate outside the Euro Zone, with their volatility rendering forecasts as unreliable. The situation will also depend to a large extent on whether consumer confidence can be restored.

Despite the current events on the CEE markets new car sales should in the longer term maintain their upward trend, owing to the larger numbers of first-time car buyers and a still higher economic growth than in Western Europe.

**How does it translate into everyday dealers’ operations?**

As our regional research demonstrates, dealers are becoming more aware of both the risks and opportunities on the market, and are able to ever more quickly and effectively translate them into specific actions for their businesses. Thus, changes in the dealers’ behaviour in individual countries of the region are becoming more visible, and – in the face of an economic slowdown and approaching crisis – it is likely that many dealers have already started taking steps to protect their businesses from the market downturn.

In their activities, dealers used mostly short-term rolling loans for financing of inventory. Due to the present economic situation, that particular finance source has become restricted and more expensive, leaving many dealers in a very difficult position in terms of cash flow. Where credit lines are still available financing companies are demanding ever more stringent conditions for financing. Moreover, sales volumes decline, profit margins shrink, interest rates are higher and the incidence of bad debt is going up. This is quite a handful for any business to manage. The dealers who have highest chances of survival will be those who have diversified product portfolios, e.g. servicing centres, repair shops, and after sales products.
Although the dealers participating in the study (except for Hungary) perceived their financial situation as reasonably good, the dramatic slowdown in sales was neither predicted nor on their radar screen. Those dealers who do not address the revenue gap from new car sales will decrease their chances for survival.

**Consolidation**

Overall though, there is a sense that next year is going to be very difficult and that there will probably be more consolidation in the industry – in our view this will not be via acquisition of smaller dealers by larger ones, but through dealers waiting for the collapse of their competitors to pick up their assets and brands at bargain basement prices. This could be a very painful process for many players on the market. It is reasonable to believe that dealer groups, emerging after consolidations, will play a more significant role on the international stage. We believe that the new players in the CEE, including Russia, could rapidly outgrow their Western European counterparts by taking advantage of acquiring businesses at the bottom of the market.

**Diversification**

In their attempt to be proactive and avoid going out of business, many car dealers have decided to expand their scope of activities and invest in new areas. Bearing in mind the changes affecting the global market, this attitude has been recognised as a proof of dealers in understanding that continuous growth is necessary for survival. 16% of the Czech, 32% of Hungarian, 34% of Slovakian and 27% of Polish dealers plan to convert their showrooms into multi-make ones. This alone is evidence of how the dealers’ attitude to changes has evolved in the last few years and what the future directions in this industry are. We believe that the traditional distribution model will be more and more often challenged by multi channelling, stemming from the evolving consumers’ preferences and the hard product push driven by the supply not meeting the market demand. Thus, small independent dealers are expected to gradually go out of business due to multichannelling and low economic viability – or they may be bought out by bigger players interested in their land assets.

Dealers have started to explore new business ideas, such as buy-back schemes and hourly rent-a-car services. These activities still require refinement but are good examples of creative thinking to adapt to the market situation. The current leading European dealers, who already achieved a cross-border presence, will continue to expand, adding new business streams (such as real estate, rental and leasing options, financial services) to their offer, enlarging their geographic scope, and accepting new members in their partnerships.

**Summary**

In summary, Central and Eastern European dealers are likely to face some stiff challenges over the coming year with respect to a very difficult market situation. As in all crises there are likely to be winners as well as losers. The winners will be those dealers who adapt both structures of their businesses e.g. placing less reliance on new car sales and more on services as well as reviewing the financial situation in their business e.g. by taking out non value added costs, renegotiating agreements with suppliers and keeping a very close watch on the cash flow situation. We predict the sector will emerge from the economic crisis with fewer but potentially stronger dealer networks offering more variety and providing greater levels of quality and professionalism.

David Green
Partner
CEE Automotive Retail Leader
Country Report Summary

Where are we on the Hungarian market?

Our first annual report on car dealers is being released at one of the most difficult times ever in the history of the automotive sector. The Detroit 3 are going through a period of rapid change which has had a significant impact on their financial resources, and the slowdown of vehicle sales that started last year in North America has extended to Europe and the rest of the world over the last six months.

The credit crisis has, therefore, come at the worst possible time for an industry which was already going into a significant slowdown.

The passenger car market in Hungary has been declining for a couple of years now with a reduction of new passenger car sales in 2007 of 5.8%. Outlook for 2008 was already rather pessimistic and will be further impacted by the global financial and economical crisis.

The turmoil in October on the credit markets will be felt for some time to come, however the early signs are that this will result in significant decreases in world wide sales until consumers are able again to obtain credit from financial institutions and until corporate customers regain the confidence that their business are over the worst of the crisis. As the automotive industry is global the issues affecting markets in North America and Western Europe will surely have an impact on the market in Central Europe and in Hungary.

Nevertheless, the reasons for the recent downturn on the Hungarian market are “home-made” rather than driven by international developments. The focus of the Hungarian government is reducing the budget deficit which is having a negative impact on both GDP growth and private consumption. Disposable income for private households decreased by 3.5% in 2007 and will be further cut down in 2008. As a matter of fact, passenger car registrations in the third quarter 2008 were the worst of any quarter since the turn of the century.

On the other hand, there are still a couple of positive factors that might help to re-launch new passenger car sales to a level of 200,000 units in 2010 and beyond as projected in early 2008.

Car density in Hungary is still below the level of other countries in the region. In Hungary, the number is 316 passenger cars per 1,000 inhabitants, whereas this ratio is 338 in Poland or even 404 in the Czech Republic (2006).

Considering per capita GDP, new cars are still cheaper in Hungary compared to other markets in the region. In addition, the trend in car sales in Hungary is moving from smaller to medium-sized cars or even luxury cars, giving car dealers an opportunity to earn higher margins if they are active in that market. Luxury brands such as BMW or Mercedes-Benz showed sales increases of about 20% in the first three quarters of 2008 compared to the same period of 2007.
In the light of recent events, it is difficult to foretell the result of car sales in the nearest future. The largest unknown is the forint exchange rate. The Hungarian currency’s fluctuations render it impossible to make exact forecasts. The situation will also depend, to a large extent, on the mood of the consumer, and on whether it will be feasible to calm consumers’ frequently panicky and irrational behaviours in these difficult times.

What did the car dealers tell us?

Although our survey was performed well before the current crisis materialized, the specific Hungarian market conditions had already hit the passenger car dealers.

Nearly 60% of the car dealers who answered our survey reported worse financial conditions compared to 2007. Only a small minority of 8% had been able to improve their financial situation. This is also reflected in the fact that 90% of the dealers had suffered reduced margins.

A number of dealers have invested over the last few years in new facilities or in expanding the scope of their activities. Dealers are becoming more aware of the threats and opportunities observed on the market and are able to ever more quickly and effectively translate them into specific actions for their businesses.

The next year will be crucial for those who use external financing to ensure that they meet the terms of their bank borrowings. It is quite possible that a number of dealers will go out of business, but at the same time there will be many good deals on the market for those still willing to invest. It is key that the lessons learnt from the past are applied in the current market situation and that dealers focus on providing outstanding levels of service whilst focusing on their finances, managing cash flow, developing more profitable business lines and taking a prudent approach to costs.

It can be assumed then that dealers and buying groups which are gaining in strength will take advantage of that moment to strengthen their market positions. Although more than 75% of surveyed Hungarian car dealers have been in business for more than 10 years, the consolidation forced by market conditions is going to push a lot of these dealers out of business.

What we also see is that larger, multi-brand dealers are in better financial condition than smaller dealers that sell only one brand.

The number of car dealers will inevitably decrease. In the future larger dealers with more than one outlet selling more than one brand are going to dominate the market.

This change in the dealership business model was and is unavoidable and will be beneficial to everyone in the long run. It will lead to an improvement in the quality of services, lowering of costs of dealers’ operations and thus to decreasing the prices for cars and services offered. Unfortunately, under current market circumstances, this is not an easy way to go for the Hungarian automotive market, and particularly for dealers operating on this market.
Area: 93 036 km²

Capital: Budapest
(Number of inhabitants: 1.83 million)

Population (million): 10.043

Median age: 40 years

Nominal GDP (HUF billion): 27,000
Basic features of dealers participating in the research

**DEALERSHIP MANAGEMENT METHOD**

30% of dealers do business in Budapest

**FORM OF COOPERATION WITH NATIONAL DISTRIBUTOR**

90% contract with national distributor

---

Graph 1. Locations of car dealerships under professional management

Over half of Hungary’s professionally managed dealerships are located in smaller cities with populations between 10,000 and 100,000. This is closely followed (45%) by cities with more than 100,000 residents. Slightly less than a third of professionally managed dealerships are in large cities with more than 500,000 inhabitants.

Graph 2. Form of cooperation with national distributor

The overwhelming majority of dealers surveyed (90%) operate under a contractual agreement with their national distributor, and only 6% are actually owned by the national distributor. The remaining 4% operate under some other form of cooperation such as individual import, or being a sub-dealer.
Graph 3. For how long has the dealership/dealership network been in operation?

More than three-fourths of all dealers in Hungary (76%) have been in the business for more than ten years, and a majority (51%) has had dealerships for more than 14 years. There are very few (4%) that have been around for more than 17 years, and less than a quarter of them (24%) have come onto the market in the last nine years.

Graph 4. How many sales outlets are you running?

A little more than half (57%) of all dealers operate more than one outlet, though slightly more than one-third of multiple outlet operators only run two outlets. More than a third (34%) of all dealers has more than two outlets.

Graph 5. How many of your outlets are multi-brand?

There is a strong presence of multi-brand outlets on the Hungarian market, with only 34% of surveyed dealers reporting that they do not run any multi-brand outlets at all. Of those dealers selling more than one brand, the largest group (25% of those surveyed) have only one multi-brand outlet, slightly fewer (24%) having two or more multi-brand outlets, and less than a tenth (9%) running more than three multi-brand outlets.

Multi-brand dealers are quite independent in choosing their suppliers, although different brands are not usually sold in the same showroom.
Graph 6. What is your financial condition compared with the previous year?

Dealers’ finances were obviously being negatively impacted at the time the survey was taken (late summer of 2008); even considering that it was well in advance of the severe financial crisis that hit in October. Only 21% of all respondents perceived their financial conditions to be better than the year before, and fully 75% of all dealers said their situation was either unchanged or worse. Well over half (58%) of those surveyed thought their financial situation was worse, with over a quarter (28%) characterizing their financial condition as “much worse”.

Graph 7. What percentage of the revenues from your activities did the following items constitute in 2007?

Hungary’s dealerships continue to make the lion's share of their revenue (48%) on retail sales of new cars. Fleet sales (10%) and car servicing (23%) still have potential for growth. Used-car sales make up 19% of revenues, which is in the high end of the range for Central Europe.
Buying cars on credit is already an essential part of Hungary’s automotive market, with that preference being nearly twice as popular as the preference to the now old-fashioned mode of buying with cash. Leasing is not far behind cash purchase in popularity, with long-term renting being, as expected, the least common consumer choice.

Table 1. Segmentation by sales preferences

<table>
<thead>
<tr>
<th>Preferences</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Medium class</td>
</tr>
<tr>
<td>2</td>
<td>Small class</td>
</tr>
<tr>
<td>3</td>
<td>SUV</td>
</tr>
<tr>
<td>4</td>
<td>Off-road</td>
</tr>
<tr>
<td>5</td>
<td>Luxury</td>
</tr>
<tr>
<td>6</td>
<td>Sport class</td>
</tr>
<tr>
<td>7</td>
<td>Convertible</td>
</tr>
</tbody>
</table>

Car sales in Hungary are dominated by Medium class and Small class cars, with a combined market share of 86.9%. Medium class cars form the most preferred group with a share of 46.4%. Based on a quite low market share, Luxury cars show the highest increase, whereas Small class cars show a significant downturn in 2008 so far. This is opposite to the trend in Western Europe where smaller and more fuel economic cars are gaining consistently higher market shares.

Graph 9. Origins of used cars sold in your dealership?

A very high percentage of Hungarian dealerships obtain their used-car stock as trade-ins from their customers, with more than four-fifths of respondents reporting that they acquired used cars in this manner. Also, more than two-thirds of the dealers (70%) bought back cars they had previous sold to customers. In contrast, slightly less than a fifth (19%) actually actively bought cars on the domestic used-car market. None of the car dealers responding to the survey imported used cars into the Hungarian market, although legal conditions for import of used cars have been more favorable since 2007.
Margins are under pressure …

It is very evident that Hungarian dealers’ margins suffered in 2008, with an impressive 87% of respondents reporting that their margins were down, and over two-fifths of respondents (42%) answering that their margins had “strongly decreased”.

When asked why their margins had changed, nearly half of those surveyed said it was because the sector had become more competitive. Nearly as many said they were impacted by a decrease in demand on the market. Both of these reasons made tax matters, legal complications and other causes nearly insignificant in comparison.

The labor situation at dealerships appeared to be relatively stable in 2008, with over two-fifths (43%) of respondents reporting that the size of their workforce had not changed, and 53% reporting that their employee numbers had either increased or decreased slightly.
The larger the dealer, the more service is provided.

Recruitment of sales staff is most difficult.

Graph 13. Employment level in the following service functions

At dealers who employ a small workforce, sales and administration staff seem to dominate, whereas at larger dealers the number of service staff gets more and more important.

Graph 14. Problems with recruitment of new employees in 2007

Overall, the respondents give the impression that it is not too difficult to recruit staff for their operations. The standout response is that over 40% reported they have either “medium problems” or “big problems” recruiting sales staff. Over 20% of those surveyed said they had “medium problems” hiring service personnel, which are the most technically qualified staff outside of upper management.
Market environment and dealership operations

PREFERENCES FOR GENERIC INSTEAD OF ORIGINAL PARTS

No generics during guarantee term ...

... but afterwards

Graph 15. What percentage of your clients prefers to use generic parts during guarantee service?

Nineteen percent of respondents report that customers prefer to use generic parts during guarantee service, which is in the low range in Central Europe. And of those respondents, the vast majority reports that 25% or fewer of their customers request the use of generic parts.

Graph 16. What percentage of your clients prefers to use generic parts past guarantee service?

After guarantee terms have expired, customers tend to use generic parts. Only 6% of dealers report that their customers do not at all consider using generic spare parts after that period.
Graph 17. How do you assess cooperation with national distributor?

National distributors are best rated regarding marketing support.

Graph 18. How do you assess the impact of BER?

Almost 2/3 of the respondents do not see the Block Exemption Regulation (BER) as a negative factor for their business.
Future

CHANGES IN THE NUMBER OF DEALERSHIP OUTLETS OWNED

Expansion is put on hold

Graph 19. Are you planning to increase the number of dealerships held in the coming year (2009)?

At the time the survey was taken, fully a quarter of dealerships saw opportunities in expanding their territory with new dealerships. Over half had no plans to invest in new sales locations, and only 10% were unsure what they would do.

Cutthroat Competition

Graph 20. How am I planning to expand my dealership?

Acquisition of other dealers and opening new brand dealerships are the most viable expansion alternatives, whereas only 1/3 of the dealers consider organic growth to be the most preferred strategy. As a matter of fact this indicates cutthroat competition, most likely resulting in a reduced number of car dealers in Hungary.
Unlike other Central European countries, which showed stronger trends, respondents were spread across the board on this issue. It seems to be a difficult question for decision-makers at Hungarian dealerships whether it is better for them to be single-brand or multi-brand. Nonetheless, more than a quarter of the dealerships seem to believe multi-brand would be to their advantage.

Of those dealerships that plan to become multi-brand outlets, more than two-fifths (42%) are doing it as a means of reacting to increasing competition on the car sales market. Better than a third of those planning to expand their offerings do not feel they are doing as much business as they could selling only one brand.

Of those respondents who said they do not plan to sell more brands in the near future, a surprisingly large proportion (78%) is inhibited by the perceived or estimated cost of introducing those brands. More than three times as many respondents cite this as grounds for not expanding as those not allowed to go multi-brand by their domestic distributor.
EXIT FROM THE SECTOR

Only 4% want to exit

CHANCES FOR SALES GROWTH

There might be light at the end of the tunnel

Graph 24. Are you reconsidering the possibility to sell your outlet in the coming year (2009)?

Despite the fact that answers to other questions on the survey indicate that business conditions in Hungary have been tough for dealerships lately, nearly two-thirds of them do not plan to withdraw from the market. Only a scant 4% are ready to give up.

Graph 25. How do you assess your chances for sales growth in the course of:

As can be seen in other Central European countries, what is remarkable about the responses to this question is the stark contrast between the short-term pessimism and the long-term optimism expressed by the respondents. It must, again, be noted that these results preceded the financial crisis that came in the autumn of the year.
Opinions

**AREAS OF STRONGEST IMPACT UPON DEALER BUSINESS**

Market consolidation impacts the dealership most

**DEALER CONSOLIDATION**

Small dealers might disappear

---

**Graph 26. Which of these factors bear the strongest impact upon dealer business?**

(1-lowest, 5-highest impact)

<table>
<thead>
<tr>
<th>Factor</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Used cars import</td>
<td>2.8</td>
</tr>
<tr>
<td>Block Exemption Regulations</td>
<td>2.4</td>
</tr>
<tr>
<td>Entry of foreign dealership groups into market</td>
<td>2.4</td>
</tr>
<tr>
<td>Market consolidation</td>
<td>3.4</td>
</tr>
</tbody>
</table>

The response to this question shows different pressures in Hungary than on some other Central European car markets where the greatest impact comes from used car imports. Hungarian dealerships perceive that they are more greatly affected by the shrinking of the number of businesses involved in the selling of cars. Both of these factors weigh more heavily than the effects of either Block Exemption Rule or new competitors from abroad.

**Graph 27. How may the consolidation of dealers influence the situation in this segment?**

Car dealers expect a trend towards market consolidation. Lots of smaller dealers are going to disappear from the market resulting in a less competitive market looking forward.

This perception of the car dealers is also supported by other market observers.
Contacts

**Armin Krug**
Partner
Automotive Industry Leader
Phone: +36 1 461 9552
E-mail: armin.krug@hu.pwc.com

**Tamás Lőcsei**
Partner
Tax and Legal Services
Phone: +36 1 461 9358
E-mail: tamas.locsei@hu.pwc.com

**Tünde Kis**
Senior Manager
Advisory Services
Phone: +36 1 461 9472
E-mail: tunde.kis@hu.pwc.com

**Dieter Joachim Böhm**
Senior Manager
Assurance Services
Phone: +36 1 461 9933
E-mail: dieter-joachim.bohm@hu.pwc.com