CHAIRMAN'S ADDRESS TO THE 103rd ANNUAL MEETING

Ladies and Gentlemen,

This will be my last address as Chairman of this Company, I retire from the board at the conclusion of this meeting. I have been with the Company for 47 years, since 1974 which spans some good times and some very tough periods. I have been a director for 29 years, since 1992, comparing that year with this shows a massive improvement. I have been Chairman for the last 11 years, a period of almost continuous growth in the trading profit. I have benefited from the accumulated efforts of a lot of good people, and very fortuitous timing.

The last 18 months has seen some very big swings, periods of despair and worry, periods of success and elation, some very good months, some plain awful.

So, I will start with the good news. The twelve months ending 30 June 2021 added up to an exceptional year, surpassing the previous record year in 2018. The Trading Profit After Tax, our preferred measure of performance was $27.9m, up 13% on the previous record year, 2018; and up 61% on last year. However, there was a component of luck involved. Our financial year happened to start after the 2020 level 4 lockdown had ended and before the 2021 level 4 lockdown started.

True to today's theme, a record year was never predictable, but gradually month-by-month, it all added up, actually it got better in the second half. The initial expectation in July 2020 was that we were experiencing a short-term bounce, that demand would soon taper off; but instead good export prices and massive economic stimulation created a frothy market.

The next problem was supply. Initially it was cancelled production as assembly was cutback in the first waves of Covid. Initially that was seen as a good thing against the worry of large volumes of inventory arriving and having to be funded, a repeat of the problems at the start of the Greater Financial Crisis in 2009. Very quickly, the reverse happened, supply became a constraint. Micro-chip shortages were the first to hit the headlines, but gradually the whole interconnected international supply network unwound.

The new vehicle market is now dominated by supply problems, with no end in sight. Normally when we as dealers run out of inventory, or the expectation to be able to supply very quickly, customers might wait for with us for a short time, but more likely they will go somewhere else. But what was considered normal has now changed, everyone has the same problem and consumers are now prepared to wait.

The used car market is also experiencing supply shortages. After an initial burst there are now few ex-rental cars available and less trade in's. Used car yards look empty simply because vehicles are sold before they get onto the yard.

Now, sales and ultimately profitability in any given month is not a reflection of that month's activity, instead it's a measure of that months shipping arrivals. It is very uneven between specific products, different brands, different months. The delays make the headlines, and in the first round, it slows our business down. But as time goes by some of the delayed production does arrive. In simplified terms this month's arrivals get delayed, but the delayed supply from some months back finally arrives.

The lockdowns that began in August this year add further complications. At level 4 the dealerships have to close and we take a significant financial hit. But the medium-term impact is very difficult to precisely quantify. Does consumer confidence hold up, does the supply of vehicles keep coming? The impact of lockdowns in 2020 was severe, both financially and mentally. Second time around in 2021, while still difficult, was far more nuanced.

In August the wage subsidies were claimed individually by the dealerships while they were fully closed under level four. During that time all employees received their usual pay. Under level three dealerships did not claim the wage subsidy, even when they qualified. In Auckland, wage subsidies were claimed for the longer period of full lockdown level four.

Lockdowns and very lumpy supply have had a major impact, especially when looking at short time frames, but behind those headlines, demand has remained strong.

We are in a very different market to 18 months ago. Lumpy supply, and suddenly changing restrictions puts unpredictable stresses on the people in the dealerships, especially those directly facing customers and management. Their effort and commitment makes a huge difference and must be recognised. Everyone is directly effected by lockdowns and has to cope with the inevitable stresses from home, but on top of that the management in the dealerships have had to cope with the significant stresses at work. The successes of this Company over the last 18 months can in large measure be attributable to the extra effort and commitment from the management at all levels of the organisation. The management in the dealerships is experienced and very capable; they have responded and adapted to the constant changes and uncertainty exceptionally well.

Succession

At last year's AGM it was announced that Graeme Gibbons would be retiring from his position as CEO in the next year. In May of this year a letter was sent to shareholders confirming that Graeme would be retiring on 30 September 2021, and announcing the new management team of; Alex Gibbons, CEO; June Gibbons, Group Manager People, Process and Technology; and Paul Stephenson, Group Manager Finance. Graeme had been CEO since 1990, 31 years, and so not surprisingly, succession after that length of time is a more complex job than just putting a new person into the office. Over his 31 years in the job Graeme successfully guided the Company through good times and bad, and naturally developed a huge depth of experience and judgement. One of the things that is hard to replace is the accumulated experience around what to follow up on and what to ignore. Transition to a new team included a review of the work done by CMC Group Office and what it did not do. Succession included engaging a new younger generation with a different outlook and very different computer literacy. An early decision was to not attempt to replace with one person, but to spread the work around a small team. The four months between the announcement and actual changeover were always going to be very busy, which was further compounded by the August level four lockdowns.

At the board level, the annual planning meeting was expanded to integrate the hopes and aspirations of the new team with the experience of the old. The Company's broad strategic direction is outlined in the annual report, page 5. The purpose of the board planning meeting was not to rewrite this, but to explore with the new management how it might be implemented. This Company at its core is a specialist franchisee operator. Being a franchisee brings opportunities and constraints, we are in partnership with someone else who owns and controls the brands that we sell. The planning session identified the areas that we need to focus on to maintain our existing business, it identified where opportunities to grow could be found and graded them by complexity against potential reward. We need to keep our focus on maintaining our strengths, evolving and adapting to change and at the same time, be able to identify and grow opportunities. The new team actively contributed to this in July, August, and September.

In the first week of October, the period of transition ended, Graeme went on holiday, and the new team took over. It has been a successful transition. From my perspective as Chair, the new team know what they are doing, they are well grounded in the fundamentals of this business and are addressing matters that arise. Most importantly they bring fresh energy and ideas. They have a plan. The future under the new team looks good.

The mid-term economic future is uncertain. The stresses and uncertainties opened up by Covid in the last 18 months will continue to deepen. The last time there was this level of macro level uncertainty was back in 1990 when the NZ economy went through a lengthy period of structural reforms. But a period of uncertainty is a good time for a new team to take over. It will be stressful, it will be difficult, but it's the right time for a fresh new team to begin. Many of the big picture risks and challenges are totally beyond our control, what we can control is to have a management team that have the capacity to respond and thrive.

Developments

The building industry is suffering from severe constraints and delays, which is having an impact on the various projects that are under way. In simple terms, they now cost a lot more than initially budgeted and they take a lot longer to complete than initially expected. Two long running projects, Capital City's new hub in Lower Hutt and Team Hutchinson Ford's greenway project, are nearing completion. Both have extended over several years and ideally should have been completed many months ago. The rebuild of MS Motors Ford workshops in Nelson is also nearing completion. This follows the fire there in January 2019. It's a leased facility, but the impact on the business from delays is the same. The pipeline of development projects, small and large, now face major cost increases and delays. The Company needs to maintain its profitability to keep up with the cost increases of these projects. Some are centred around expansion, some renewal and upgrading, others are brand identity upgrades.

The franchise model

The basic franchise model has been around for decades, and it's always under review; can the supplier expand its own profitability by taking out the franchisee, or is there a better way to deliver the product to the customer.

Tesla is a brand that makes a point emphasising that it does not need dealers, instead customers order on line and in due course the vehicle is ready to be picked up at a warehouse near you. This can work while the product is sufficiently unique with no competing alternatives. But what happens when there are equal or better alternatives, available very quickly. What happens when the product is in the second half of its life cycle and no longer unique. Over a broader period of time, spanning product life cycles, dealers fulfil a necessary role.

Toyota in New Zealand, and in Australia, Mercedes, have altered the traditional franchise business model to what is known as the agency model. This is driven by the desire to have a fixed price and fixed margin. At first glance it appears to be a desirable business model, but it's very centralised and prone to bureaucratic control. There is a need for dealerships with this model, but their investment is less, their engagement is less. The car companies risk losing the outlets if there is insufficient returns to the dealer.

We exist because we are needed, we connect the customer to the supplier. In a perfect world we are not necessary, but it's not a perfect world.

Future products

We are a franchisee company. We can express our hopes and desires, but the reality is that we can only sell what is available to us. Good franchise relationships are long term partnerships, where both respect the contribution of each with neither party only cherry picking the best from the other. This applies to products, some are easy to sell, others not so easy. All of our major suppliers are investing heavily in future products, but they come at it from different backgrounds and different strategies. There are a range of technologies that have better emission outputs than what we have now, but the headlines revolve around full electric vehicles, or BEV's as they are known.

Some countries have made headlines with announcements that imply they will be fully electric at some not too far off future date. In this context the NZ government has announced two separate schemes, the Clean Car Discount and the Clean Car Standard. There will be change, but it's a bigger subject than just substituting BEV vehicles in place of petrol.

New Zealand has a large fleet of private vehicles, with one of the highest densities of cars per thousand people in the world. A feature of the NZ fleet is the age, the average age is over 14 years and it's getting older as we keep old cars going rather than scrapping them. Half of the vehicles coming into NZ now are new, and half are second-hand imports from Japan. The macro policy setting ensures that most people can afford. In the last few years housing has become very expensive, with that in mind what would be the social consequences of eliminating cheap vehicles, replacing them with expensive high technology vehicles.

Electric vehicles do some things better than conventional engine vehicles, but it’s not a seamless swap converting from petrol to battery. They are ideal as a second vehicle for a person living in their own suburban home with good off-street parking, where daily distances are not large and recharging while parked up is available. It’s different in rural New Zealand.

Future products must have lower emissions than what we are have now. The profile products are fully electric BEV’s, but as outlined above they do not fit every requirement. What is better, to stay with old high emission vehicles because full battery electric vehicles don’t do what is required, or bring in better but not perfect products. It will take time for the necessary social changes to work through.

The governments Clean Car Discount scheme, better known as a ‘feebate’, is a scheme that will encourage consumers to buy lower emitting vehicles. The framework is simple to understand, consumers will know what they are paying. The scheme is open to criticism with the implementation details, but consumers will know the emission tax or rebate that applies to their choice.

The other scheme however, the Clean Car Standard, is fundamentally flawed. Given our distance from the point of manufacture, the large number of second-hand imports, and the complexity of product development timetables, it’s simply incredulous to expect importers to be able to balance their sales over 12 months to meet pre-determined and rapidly falling averages. They will have to build in pricing reserves to balance the risk. The result will be arbitrary and unpredictable price movements, resulting in confusion and resentment.

Ford and Mazda have a range of new product coming through, full battery electric, plug in hybrid, petrol hybrid, mild hybrid.

Outlook

The last year, to June 2021, was very good. It spanned the gap between two major lockdowns. When the results for the year were announced in August the outlook was positive; a couple of days later we went into a national level four lockdown. In September when the CEO’s report was written, Auckland was still in tight lockdown and the outlook was uncertain. Optimism and pessimism swap almost daily. The month-by-month swings are considerable. The underlying demand for vehicles, especially light and heavy commercial vehicles, is strong. Forward orders of heavy trucks are robust, reflecting confidence in the underlying economy. But the expectation of more disruption is also strong. The first quarter this year is ahead of the same period last year. If there are no further major shocks, then we can expect to see a strong run for the short to medium term, with a little extra push coming from the desire to buy ahead of the April 2022 taxes.

One last comment

Before I step down I want to say a few personal words. The Company has been a large part of my life for a long time, obviously I have enjoyed working here. I am not a car person in the sense of a collector or motor sport enthusiast. What I do enjoy is the network of people that I have worked with. For me it's the people rather than the product that I find fascinating. It's a people business.

I also want to thank Diana, we met and married while at university. She has been with me all through this journey, she has kept me grounded when success came easily, she has supported me when the opposite occurred.

J P Gibbons
November 2021