Navigating Change

During the last decade, technology enabled remarketing companies to revolutionize how, when, and where dealers buy vehicles. In 2009, a shortage of used vehicles in the wholesale market and the dealer’s need to increase efficiency accelerated the shift to online buying and selling. Dealers can now access information on tens of thousands of vehicles, participate in Internet live and online auctions, and manage every aspect of their accounts anytime + anywhere.

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February 13, 2010

It’s hard to imagine life without email, a Blackberry, iPod, Twitter or text messages. These innovations have changed how we communicate, get information, and manage our purchases. The remarketing industry has also embraced technology and changed how it delivers information and enables transactions through physical and online channels. Dealers are no longer limited to the inventory at their local auctions and sellers can expect less variation in results due to local issues.

Even industry insiders are often surprised by the importance, scale, and pricing efficiency of the wholesale used vehicle market. The remarketing industry acts much like financial exchanges around the world by enabling buyers and sellers to do business with each other in total confidence and transparency.

Despite the unprecedented business challenges the industry confronted in 2009, every metric related to our online activity increased substantially. Visits and page views at Manheim.com, Manheim Simulcast bidding and OVE.com listings and sales soared, reflecting the fact that these resources save time and improve bottom lines.

Across the remarketing industry, we see the adoption rate of online channels accelerating. And, we know that by helping buyers feel more confident about the vehicles they view online, they quickly increase their reliance on these channels. At Manheim, we have focused on dealer training and strengthening our inspections, vehicle grades and arbitration processes in response to dealer concerns.

Our remarketing philosophy is “Anytime+Anywhere.” Those two words mean more than just enabling transactions 24/7; they mean a consistent experience in all of our operating locations, through OVE.com or using any Manheim service.

This is the 15th edition of Manheim’s Used Car Market Report (UCMR). The staff of Manheim Consulting prepared this report for our customers and automotive industry economists and analysts who rely on its objective analysis and insights into the state of the used vehicle market.

In addition to the comprehensive analysis of the business conditions that influenced the institutional suppliers of used vehicles and dealers, the 2010 report features two important and related topics: first, an overview of the interaction between the wholesale and retail used vehicle industries and, second, an assessment of how technology, data analysis, and dealer acceptance are transforming remarketing.

We hope that you find this Report useful in your business and in your understanding of the used vehicle industry. I welcome your comments and suggestions at deisner@manheim.com.

Sincerely,

Dean Eisner
President and CEO
There is a consensus that a low point in both the economy and the automotive industry was reached in 2009, and that a recovery is underway. There is great disagreement, however, as to the trajectory and nature of that recovery. It is our expectation that growth will be muted and uneven, even though in the past, deep recessions have generally produced strong and steady rebounds.

Forecasting, however, is fraught with peril and is an exercise that, at best, can only place probabilities around possibilities. So, rather than speculating on near-term scenarios, it is better to look for any long-term structural shifts that this recession may have produced. It is from that perspective that we review and analyze the trends in the:

- Economy,
- Credit Markets,
- Labor Markets,
- New Vehicle Sales,
- Used Vehicle Sales, and
- The Remarketing Industry.

**Economy: A Reticent Recovery or Roaring Revival?**

Real GDP grew at an annual rate of nearly 4% in the second half of 2009. That growth was greatly heralded since in the previous year and a half, the economy had suffered its steepest decline since the Great Depression. But, in historical context, growth in the second half of 2009 – and what is expected for 2010 – seems meager. Over the past six decades, real GDP growth has averaged 6.3% in the year following a recession. And, even over the following five years, growth has averaged a whopping 4.3%. Scarce are the forecasters who think those averages will be met in the current recovery. Why the difference? Primarily, it will be the necessary deleveraging of financial institutions, consumers, and – at some point – the federal government that will keep growth constrained.
In addition to the relative slowness, we also fear that economic growth may prove uneven. That would be the logical consequence of a recovery that is heavily dependent on government programs and supports, all of which will produce unknown results when wound down. Most illustrative of this will be the financial markets, where the Federal Reserve Board’s expansion of its balance sheet (especially the holdings of mortgage-backed securities) provides another tool (but a very blunt tool) to influence the economy’s direction.

**Federal Reserve Balance Sheet**

In Trillions

![Fed Balance Sheet Chart](chart.jpg)

Source: Federal Reserve

<table>
<thead>
<tr>
<th>U.S. Treasuries</th>
<th>Commercial paper and all other</th>
<th>Agency debt</th>
<th>Other loans</th>
<th>Mortgage backed securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1.50 Trillion</td>
<td>$1.00 Trillion</td>
<td>$0.50 Trillion</td>
<td>$0.25 Trillion</td>
<td>$0.25 Trillion</td>
</tr>
</tbody>
</table>

Source: Federal Reserve
Credit Markets: Improvements in Some Segments, But A Continued Stall in Others

For three years now, developments – or rather, dysfunction – in the credit markets dominated our year-in-review pieces. In 2009, we finally saw some relief. The Federal Reserve’s Term Asset-Backed Loan Facility (TALF) program increased flows and reduced spreads in the critical auto asset-backed securitization (ABS) market. By the end of 2009, the ABS market had recovered so much that the majority of deals were being done without the assistance of the program.

Mortgage markets were kept afloat not only by the government’s increased role in insuring these instruments, but also the direct buying of the resulting mortgage-backed securities. And, of course, the Federal Reserve’s near 0% interest rate policy pushed mortgage rates to generational lows. Commercial credit, however, remains a problem, with some academics arguing that government policies (a steep yield curve and higher capital requirements) are reducing the need and willingness of banks to make loans. But, as we progress through 2010, it could be that weak demand for loans will play a larger role than the lack of availability. Because, despite the slowdown in spending, increased saving, and a recovery of some of the net wealth lost during the recession, the household sector remains over-leveraged. Installment debt relative to disposable personal income remains well above the levels of earlier decades and the owner equity share of residential real estate sits at historic lows. This is a situation that can only be reversed by further spending restraint or a robust labor market that results in quickly rising incomes. The latter scenario seems unlikely.
Labor Markets: A Sharp Improvement At Year-End

Job losses averaged 753,000 per month in the first quarter of 2009. In the three months ending January 2010, the monthly job loss was only 35,000. Most economists expect to see significant positive job growth beginning in early 2010.

Going from massive job losses to employment gains is a big deal and one which will underpin an improvement in the automotive market. It is important to temper the optimism, however, since it will take a long time to make up past losses. The chart shows that it took four years to get back to the previous peak in employment in the last business cycle. In the cycle prior to that, it took 32 months. And, in the one prior to that, 28 months. This is not an encouraging trend.

Given that the percentage loss in employment in this cycle (6.1% as of January 2010) was so much larger than previous downturns, it will take several years to get back to the previous peak in employment. It also suggests that unemployment rates will remain high for a considerable period of time. This will not only depress used vehicle demand (after all, jobs provide both a need and ability to buy), but also create a less-favorable retail lending environment as job loss and underemployment are drivers of loan delinquency.
Another structural shift that is not favorable to the retail used vehicle market is the widening gap in unemployment rates based on education levels. The spread between college graduates and those with less than a high school education widened to ten percentage points in 2009, after averaging only five percentage points in the previous two decades. We suspect the widening chasm is the result of technology and globalization. Both are forces of good for the overall economy, but it appears that today’s labor market is not totally prepared. The resulting impact on the robustness of the recovery in the retail used vehicle market will not be good, given that a large segment of that market rests on the fortunes of those in the low-to-middle income classes.

**New Vehicle Sales: Returning to Past Levels May Take Considerable Time**

The new vehicle sales cycle, from the peak of 17.4 million in 2000 to the trough of 10.4 million in 2009, represented a swing of 40%. That percentage decline far exceeds previous cycles, but, given that the economic recession was the severest since the Great Depression, the magnitude of the new vehicle sales drop was not out-of-line. Indeed, a simple plot of the annual percentage change in real GDP versus the change in new vehicle sales shows that 2009 was right on the trend line.
Thus, again, the real question focuses on whether a structural shift has occurred and, if so, how will that impact new vehicle sales in the recovery. Many analysts speak of a “new normal” where it will take many years to get back to a 16+ million new unit sales a year level. We agree with their forecast, but disagree with their terminology.

A future moderation in underlying new vehicle demand would represent a continuation of decades-long trends, not a “new normal”. That is true whether you are looking at new vehicle sales per household, growth of vehicles in operation, or scrappage as a percent of vehicles in operation.

That last measure (graphed here) suggests that 12.5 million (250 million vehicles in operation times 5%) is a reasonable estimate of pure replacement demand. In considering these numbers, it is important to note that analysts often misinterpret reported “scrappage” each year as meaning vehicles that reached their useful life and were crushed. In fact, scrappage is simply a failure to re-register within the U.S., and is calculated as a residual: new vehicle sales minus the growth in vehicles in operation equals scrappage. From that perspective, we can correctly conclude that new vehicle sales often drive scrappage, rather than scrappage driving new vehicle sales.

A similar outlook is arrived at by looking at the ratio of new vehicle sales to the number of U.S. households. Since 1965 that trend has been decidedly down. Each successive cyclical peak has failed to reach the level of the previous peak, and most troughs have been lower than the one that preceded it.

If there will be 123 million households in the U.S. in 2015, a sales-per-household ratio of 13% would be needed to provide underlying new vehicle demand of 16 million. If the ratio moves to 12% (its current track), that would imply underlying demand of less than 15 million. Refining these numbers (by accounting for the size and age structure of the households, their income, their current stock of vehicles, the number of active drivers, and average miles driven) lowers, not raises, the estimates. Additionally, the reduction in the level of fleet sales, for the foreseeable future, should be factored in.
Used Vehicles: Recent Weakness Will Not Persist

In 2009, total used vehicle retail sales declined for the fourth consecutive year, according to CNW Marketing Research. But, the peak (44.1 million in 2005) to trough (35.5 million in 2009) swing was only 20%, just half of the 40% decline recorded in new vehicle sales. That is not surprising, since the used vehicle market is inherently less cyclical than the new vehicle market. In fact, in 24 out of the past 32 years, the absolute percentage change in used unit sales has been less than that for new vehicles.

Used Vehicle Sales Inherently More Stable than New Vehicle Sales

The stability in used vehicle sales stems from the massive size of the market and the diverse segments served, with customers ranging from buyers of nearly-new luxury units to customers in need of basic transportation. Used vehicle demand is supported by the 250 million vehicles in operation and the 113 million households that own them. Given that solid base, why did used vehicle sales fall so much? Blame it on the credit markets and the unprecedented loss of jobs.

For a longer-term perspective, consider the underlying trend in the number of used vehicles retailed relative to the number of vehicles in operation – “churn,” if you will. Like new vehicle sales per household, that ratio has been on a steady decline, but the drops in 2008 and early 2009 were more than normal. The reason for that is simple. The majority of used vehicle demand comes from households that already own a serviceable vehicle – they simply want to trade up to something a little better. But, with financing tight and incomes restrained by the weak labor market, many households found they couldn’t trade up, and, as a result, they didn’t trade at all.
The tremendous falloff in new vehicle sales also played a role in lower used vehicle sales since most new vehicle transactions beget at least one used vehicle retail sale as the new vehicle buyer’s trade-in must be retailed by that, or another, dealer. Likewise, on the commercial side, every one of the off-rental units will automatically produce at least one used retail sale in short order.

The Remarketing Industry: Online Continues to Grow

The total number of vehicles sold at NAAA-member auctions declined by an estimated 3.6% in 2009. That relatively modest number belies the large shifts that occurred in several segments. For example, off-rental and dealer consignment volumes were both down sharply, but off-lease and repossession volumes continued to rise.

With auction volumes in 2009 falling to their lowest level in more than a decade and extremely low levels of new vehicle sales promising to reduce potential wholesale supplies in the future, it is fair to ask whether the auction industry may have also undergone a structural shift that will result in permanently lower volumes.

We think not. And, in fact, we expect auction volumes will get back to a more normal level prior to new and used vehicle sales getting back to their previous strength. Our reasoning is based on the increased need that buyers and sellers have for auction services. No franchised dealer today can achieve a highly profitable operation without an efficiently run used vehicle operation. All dealers recognize the importance of having an inventory mix that matches the needs of their customers. And, when an immediate gap exists in fulfilling a specific customer’s desires, dealers appreciate the ability to close the deal by relying on the virtual inventory available in online auction channels.

Additionally, at any given point in time, dealers are always holding units in inventory that they don’t particularly want – or at least they know there are units that they would rather have. And, at the same time, there are other dealers for whom one dealer’s less-than-perfect unit would be just perfect. Thus, the key is to develop processes that make the inter-dealer trades as efficient and frictionless as possible. And, there is no doubt, as more fully explained in this report, that auctions are becoming increasingly efficient and easy to do business with.
Many of the trends and forces that we saw shape the auction industry in 2009 will remain in force for many years to come. For example, in 2009, the contraction in wholesale supply altered dealer acquisition strategies. No longer could a dealer fill inventory needs by simply attending the local auction on sale day. As a result, there was an accelerated movement towards online transactions. Additionally, with capital constrained and floorplan lines limited, dealers were less likely to take a chance on a vehicle just because it seemed to be priced right. Instead, dealers were buying vehicles on a need basis, filling specific gaps in their inventories, and concentrating on core product that their inventory management systems confirmed had done well for them in the past.

Those forces and trends will continue. Although we forecast total auction volumes will rise steadily in the years ahead, there will be major swings in certain segments. For example, off-lease volumes will drop quite sharply in 2011 and 2012. As such, there will always be various shortages depending on vehicle segment, market classes, price points, or vehicle condition. But, meanwhile, more dealers are fully utilizing used vehicle inventory management systems and the systems themselves are becoming more powerful. This increases the dealer’s desire to find inventory that closely fits very specific criteria.

The combination of these two forces will drive more dealers to online channels – at the very least to search for inventory. Already more than 37% of the dealers who purchased from Manheim in 2009 bought at least one vehicle online. That’s up from 24% in 2007.

Source: Manheim Consulting
Remarketing Links the Retail and Wholesale Markets

The used vehicle market consists of wholesale and retail segments that are linked through the remarketing process where the value of any vehicle, no matter its age or condition is driven by the forces of supply and demand. In the wholesale used vehicle marketplace, buyers base bids on their expected ability to retail the vehicle at an estimated gross margin within a certain period of time.

In 2009, 35.5 million used vehicles were sold at retail. That compares to 10.4 million new vehicle sales in 2009. The retail used vehicle transactions were handled by franchised dealers (12.8 million), independent dealers (11.7 million), and private party sales (11.0 million). In support of the retail activity in both the new and used vehicle market, there were more than 18 million wholesale used vehicle transactions, of which more than nine million were conducted by NAAA-member auctions.

Used Vehicles Retailed
In Millions

<table>
<thead>
<tr>
<th>Year</th>
<th>Franchised Dealers</th>
<th>Independent Dealers</th>
<th>Private Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>40.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>41.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>42.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>43.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>43.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>42.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>44.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>42.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>41.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>36.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>35.5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: CNW Marketing Research

Used Vehicle Retail Sales Are Inherently Stable

Of the 250 million vehicles on the road, approximately 14% changed hands as a used vehicle transaction in 2009. Typically the “churn” in the vehicle fleet is higher, but tight floorplan and retail credit and a weak labor market depressed used vehicle sales in 2009, especially between private parties. However, unlike new vehicle purchasers who can often easily defer replacing their vehicle in a recession, used vehicle buyers generally have less flexibility. Frequently, used vehicle buyers have to replace their existing vehicle because it is no longer worth repairing. In addition, changes in lifestyle related to work, relocation, family status, or other circumstances can prompt the need for an additional
or different type of vehicle. In 2009 and in previous recessions, many consumers who might have purchased a new vehicle during boom times shop for a less expensive used vehicle. As a result, the annual fluctuations in used vehicle retail sales are much smaller than those for new vehicles.

**AutoTrader.com Used Vehicle Visitor Traffic Rises in First Half of 2009**

Data from AutoTrader.com showed a rise in visitor traffic searching for used vehicles through July. AutoTrader.com’s daily visitor traffic provides a unique look at what shoppers are looking for, as well as what dealers are carrying in their inventory. As the economy stabilized, visitor traffic increased and reached record levels prior to, and during, the government’s cash-for-clunkers program. In 2009, the falloff in visitor traffic in the fourth quarter was consistent with previous years, attesting to the continued interest in used vehicles.

**Used Vehicle Display Pages**

While searches for used vehicles increased 14.2% through July, fewer listings reduced the number of pages viewed by shoppers, which declined 9.7% through July. There were fewer listings from private sellers as well as dealers in 2009. The data also underscores the importance of the Internet and third-party sites like AutoTrader.com in facilitating customer searches for both new and, especially, used vehicles. Used vehicle searchers typically spend more time on the site, do multiple searches before selecting a vehicle, and search a wider geographic area than new vehicle searchers. In 2009, the average time spent per visitor in a typical month increased more than 10% over 2008. Search activity spiked prior to and during the cash-for-clunkers incentive period and slowed late in the year, but still remained above 2008 levels.
Retail Used Vehicle Sales Fall to Lowest Level in 25 Years

Used vehicle retail sales declined by a modest 3% in 2009, according to CNW Marketing Research. But that decline came on the heels of a double-digit falloff in 2008 and small declines in both 2006 and 2007. As a result, the CNW numbers suggest that used vehicle sales in 2009 hit their lowest level in 25 years. This recent trend does not, however, belie the previously mentioned stability of used vehicle sales. Instead, it points to the uniqueness of the recession.

Previous post-war recessions were triggered by energy crises, Federal Reserve actions to curb inflation, and/or inventory adjustments. This time, however, there was a collapse of the financial industry that dried up credit for both used vehicle dealers and consumers. In addition, used vehicle sales are not counter-cyclical to new vehicle sales—they are just less cyclical. As such, the unprecedented plunge in new vehicle volumes naturally reduced used vehicle sales as well.

Used vehicle dealers who relied on bank credit to floorplan inventory often found those lines cut back sharply or withdrawn entirely. And, on the retail side, subprime and even some nonprime customers, who previously could have gotten a conventional loan, were required to pay higher rates, make a larger down payment, or were unable to get financing at all. By the end of 2009, however, there had been some easing in credit availability for both dealers and consumers.

Many Luxury Brands Posted Higher Certified Sales in 2009

More than a decade ago, automakers created Certified Pre-Owned (CPO) programs for qualifying used models. These cars and trucks are late-models that meet mileage, condition and inspection requirements. There is a cost to the dealer that raises the retail prices of
certified models, but shoppers consider this a worthwhile premium for a factory warranty and the added peace of mind associated with these select vehicles. The typical certified unit is a late-model, low-mileage vehicle that has been thoroughly inspected and reconditioned to manufacturer standards.

Retail sales of certified used vehicles fell 10% to 1.53 million units in 2009. Luxury and Asian brands outperformed the overall market. The bankruptcies of General Motors and Chrysler and dealership terminations no doubt discouraged some of their potential CPO customers, especially after special finance incentives on CPO units were reduced or eliminated. Both companies recorded greater than average declines in certified used vehicle sales.

Automakers remain committed to used vehicle certification as a way of bringing more customers to their brands. AutoTrader.com search data confirmed the high level of interest in used CPO vehicles throughout 2009. Selling certified vehicles has educated many franchised dealers on the profit opportunity presented by used vehicles in general. In the future, the bigger challenge might be the supply of vehicles that easily qualify for certification rather than the demand for them. The sharp reduction in program rental units, the drop in lease originations for mass-market brands, and the overall decline in new vehicle sales is likely to restrict the supply of attractive certifiable vehicles in future years.

The Auction Industry: The Intersection of the Retail and Wholesale Markets

In 2009, the 360 Northern American members of the National Auto Auction Association (NAAA) sold more than 9.1 million vehicles in their lanes and in online channels. Another 700,000 vehicles, mainly late-model cars and trucks, were remarketed through third-party online channels that are not members of the NAAA. In addition, another 8.5 million transactions occur outside these channels. These primarily consist of direct dealer-to-dealer trades, non-member auctions, and dealer to wholesale sales.

Auctions Remarket More Higher Mileage and Higher-End Units

The age distribution of used vehicles remarked through auctions changed in 2009, with fewer current model vehicles running in the lanes. Overall, average age and miles increased in 2009 compared to prior years.
Average mileage at time of sale was up for vehicles in all market classes in 2009. But, given that the rise was primarily driven by the falloff in off-rental volume, the higher mileage was especially pronounced for compact and midsize cars. For example, in 2009, the average compact car sold at auction had 58,025 miles, representing a 4% increase, or 2,340 miles, from the average in 2008. From a cyclical trough in January 2009 to the peak in September 2009, the change was 23% or 11,537 miles. As such, straight averages that failed to account for that change in mileage consistently under-reported the strength in compact car pricing in 2009.

And, when it comes to market class, the share of auction volume accounted for by luxury vehicles continued to grow. That’s a simple result of luxury vehicles being a larger share of the vehicle parc, as well as the growth in off-lease volumes coming from that segment. In 2001, luxury vehicles (cars, SUVs, and CUVs) represented approximately 10% accounted for by luxury vehicles continued to grow. That’s a simple result of luxury vehicles being a larger share of the vehicle parc, as well as the growth in off-lease volumes coming from that segment. In 2001, luxury vehicles (cars, SUVs, and CUVs) represented approximately 10% of auction volume. In 2008 and 2009, their share was close to 20%.

**Auction Volumes Fall Again in 2009**

Wholesale auction volumes declined for the second consecutive year in 2009 as a result of the reduction in off-rental volumes and the decline in dealer consignments caused by fewer trade-ins (reflecting the 21% drop in new car sales). The number of repossessions and off-lease vehicles increased, but it was not enough to offset the drop in rental and dealer vehicles.

Dealers accounted for 41% of auction volume in 2009 compared to 42% in 2008, and 50% in 2007. Dealers remarket the broadest variety of makes and models, from current model vehicles to older units with 100,000 miles or more. As long as dealers believe they can recover...
costs, they will take even older units to auction to get the benefit from the exposure in the lanes. Both local used vehicle dealers and export buyers are always looking for affordable and reliable transportation, so older vehicles can generate active bidding.

**2009 Remarketing Volumes**

<table>
<thead>
<tr>
<th>Segment</th>
<th>Total number of vehicles needing to be remarked (in millions)</th>
<th>Number sold at auction (includes online as well as physical auctions) (in millions)</th>
<th>Percent sold at auction</th>
<th>Segment as a share of total auction volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dealer</td>
<td>10.10</td>
<td>3.73</td>
<td>37%</td>
<td>40.8%</td>
</tr>
<tr>
<td>Repossession</td>
<td>1.91</td>
<td>1.62</td>
<td>85%</td>
<td>17.7%</td>
</tr>
<tr>
<td>Off-Lease</td>
<td>2.65</td>
<td>1.68</td>
<td>63%</td>
<td>18.4%</td>
</tr>
<tr>
<td>Rental (Program and Risk)</td>
<td>1.28</td>
<td>0.87</td>
<td>68%</td>
<td>9.5%</td>
</tr>
<tr>
<td>Fleet</td>
<td>1.75</td>
<td>0.75</td>
<td>43%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Other*</td>
<td>0.70</td>
<td>0.49</td>
<td>71%</td>
<td>5.4%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>18.39</td>
<td>9.14</td>
<td>50%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

*Other includes Canadian sales of repossessions, off-lease, rental, and fleet units that could not be specifically segmented into each category.

Source: Manheim Consulting

Rental companies accounted for just under 10% of auction volume, down from 11% in 2008 and 13% in 2007. The preponderance of risk vehicles in the fleet resulted in a significant change in the condition, value, and buyers of end-of-service vehicles. Instead of franchised dealers bidding for rental vehicles in closed factory auctions, rental companies were remarketing vehicles in open sales. In 2009, fewer rental units came back to the auctions and those remarked had more miles and showed the wear associated with the higher usage. Used vehicle dealers, especially those specializing in nonprime customers, became important buyers for lower-priced rental units, which often still had some factory warranty remaining.

The recession resulted in a record number of repossessions. Most defaults occur within the first 18 months of a loan, so repossessed vehicles skewed toward late-model units when the contract was on a new vehicle sale. However, the vast majority of repossessions come from used vehicle contracts and, as such, the age and condition of the collateral varies widely. Buyers for repossessed vehicles cover the full spectrum of franchised and independent dealers.

Commercial fleets returned more units to the auctions in 2009 as fleet managers coped with the need to reduce fleets in line with corporate job cuts. In general, fleet vehicles attract used vehicle dealers who specialize in the subprime and Buy-Here, Pay-Here (BHPH) segments. Dealers like commercial fleet vehicles because they know the vehicles have been maintained according to manufacturer standards.
The rise in leasing in 2006 and 2007, and an uptick in early terminations in 2009, resulted in higher off-lease volumes. These late-model units are highly desirable for certification. Since luxury brands typically run 50% to 70% leases on new transactions, these dealers value off-lease units as a lower-price entry point for customers who could not otherwise afford their brand. Many off-lease units are remarketed to grounding dealers through company-branded online channels. The remaining units are remarketed through live and online auctions where they are available to both franchised and independent dealers.

**Market Conditions Determine Used Vehicle Values**

Auctions are the primary remarketing venue for buyers and sellers. As such, the data generated by their transactions is the primary source of information about price trends and the condition of the wholesale market. The data from each sale represents crucial information for anyone buying, selling, or financing vehicles.

Manheim has developed online pricing information, the Manheim Market Report (MMR) by make, model, and region so that buyers and sellers are able to access up-to-the minute information through any Internet connected device. In 2009, Manheim Canada launched an identical service for its clients.

Auction price data is the primary source for guidebooks that use the raw data to develop price guides for each make and model by region of the country. Some guidebooks and Internet services also estimate an appropriate retail selling price, based primarily on recent wholesale prices.

**Wholesale Pricing Was Strong in 2009**

Wholesale used vehicle prices showed a strong upward movement throughout 2009 for a variety of reasons. First, there was the inevitable bounce back from the plunge taken in the fourth quarter of 2008. But, after that, prices continued to rise on the basis of fundamental factors, such as supply/demand dynamics in the wholesale marketplace, relative stabilization in retail demand, and a fall in vehicle inventory levels.
On an annual average basis, wholesale used vehicle prices (mix and mileage adjusted) rose 5.1% in 2009. On a year-over-year basis, December 2009 was up 19.9%, due to the comparison being made against a very weak year ago period. In 2009, wholesale price statistics that were not mix and mileage adjusted, but instead simple straight averages, often showed a different trend than the Manheim Index. That’s because, as previously mentioned, auction sales showed big shifts in mix and mileage.
Seasonal Shifts in Pricing Subside Slightly

The Manheim Index is also seasonally adjusted, as otherwise it would be impossible to sensibly talk about month-to-month movements in pricing. The statistical process behind the seasonal adjustment factors also offers insight. For example, over time we have seen a slight moderation in the seasonal differences between months. Reasonable explanations for that would include:

- model year introductions being more evenly spread over the year,
- better management of carryover inventory in recent years,
- a more geographically diverse buyer base due to increased online buying, and
- a larger share of retail sales (and, thus, wholesale buying) coming from dealers located in less seasonally-influenced areas of the country.

Auctions See More Dealer Participation in All Channels

Finding the right inventory was high on the list of challenges confronting dealers in 2009. As the number of vehicles flowing through lanes decreased, auction participation increased. Starting in the second quarter, auctions noticed an uptick in dealers coming to operating locations and an even greater increase in the number of dealers logging on to Simulcast sales as well as fully online channels, such as OVE.com.

In the past, dealers often found what they needed at their local auction or by trading with other local dealers. But in 2009, dealers had to expand the number of auctions they visited and broaden their searches online. Dealers focused on buying the right vehicles for their lots and tried harder to avoid over-paying or buying the wrong vehicles that would eat into profits.

Manheim Consulting Assists Buyers and Sellers to Improve Results

The wholesale auction industry generates enormous amounts of data that can help buyers and sellers make smarter decisions when analyzed and interpreted by skilled professionals. By using this vast database of buyers, sellers, and individual vehicles, Manheim Consulting has been able to answer the broadest as well as the most granular questions.
Manheim Consulting utilizes the data generated by transactions in Manheim lanes and online to help clients optimize remarketing strategies. Manheim Consulting is able to monitor the price performance of individual vehicles and vehicle characteristics, including mileage, condition, color, features, and regional supply and demand. For example, Manheim Consulting tracked price behavior of General Motors and Chrysler vehicles on behalf of both buyers and sellers. Because of the speed of the bankruptcy process and high inter-brand cross-price elasticity, the impact on residual values from the bankruptcies was less than many feared. In addition, Manheim Consulting has tracked wholesale price changes for used hybrid vehicles for clients wanting to understand the impact that fuel prices, versus other market factors, have on values. Auction data also provides insights into dealer behavior so that live and online sales channels can optimize features to aid searches and for sellers to reach the right customers more effectively.

Examples of Manheim Consulting Case Studies in This Report:

- Understanding Dealer Adoption of Online Channels, pg. 35
- Factors that Impact Online Purchases, pg. 36
- Brand Discontinuation, Bankruptcy, and Residuals, pg. 37
- Franchised Dealers Embrace Online Channels, pg. 48
- Manheim Simulcast Widens Dealers’ Buying Range, pg. 49
- Canadian Dealers Access U.S. Vehicles Through Manheim Simulcast, pg. 91
Remarketing: Past, Present, and Future

Wholesale vehicle remarketing has been evolving since 1938 when J.M. “Martin” Rawls realized that the cattle auction model was applicable to used cars. Prior to this, vehicle owners and dealers had no way of valuing used vehicles whether as a trade-in or in wholesaling to another dealer. Until there was an open marketplace that enabled used vehicles to be turned into cash quickly, there was no efficient wholesale market.

The auction bidding process was ideally suited for used vehicles. Dealers could value each vehicle based upon its condition and desirability to retail customers. Competition among dealers resulted in price transparency for buyers and sellers and became a cornerstone in the development of automotive retail and finance industries. Buying dealers were able to assess condition by inspecting units before the sale, and, since sellers had access to many bidders, the process led to a faster conversion of vehicles into cash and with less variation from fair market value.

As volumes increased, auction operators continued to add services for buyers and sellers. They became partners in facilitating transactions by ensuring that sellers would receive payment in a timely manner and that buyers would quickly get clear titles. Bidders inspected vehicles before the sale, but they also depended on the red-yellow-green light system of the auctions to alert them to the vehicle’s status.

Ease of doing business, and confidence in the process, gradually transformed the auction industry. By 1970, whole car auctions remarked 1.25 million vehicles each year, the majority of which were consigned by dealers. In the 1980s and 1990s, the used vehicle marketplace changed dramatically as millions of late-model used vehicles poured into auctions. Automakers, financial institutions, daily rental, and fleet management companies had millions of used vehicles to remarket each year and how effective they were in remarketing those vehicles directly impacted their profitability. The auction industry scaled its facilities and services to the needs of these large volume consignors while, at the same time, continuing to service the needs of dealers selling to other dealers.

In 1963, Chrysler’s first ever “buy back” sale of rental and company cars via auto auction is held.

Source: NAAA

Auctions bring qualified buyers and motivated sellers together in an open, live, competitive environment. Professional auctioneers lead the bidding process. On average, a vehicle is sold about every 30 seconds in each lane.

Source: Manheim.com

In 2009, Manheim’s North American operating locations all adopted a “Manheim” first name to reflect the consistency of service throughout Manheim.

Source: Manheim Consulting
Remarketing

One-stop Shopping

Fully Integrated Remarketing Capabilities*

Almost 20% of all the vehicles Manheim sells are sold to an online buyer. Dealers and 55% independent dealers.

In December increased by 62% YTD in 2009 vs. 2008’s monthly average.

at Manheim in December increased 23% over each day via Manheim.com’s PowerSearch.

monthly volume average monthly volume

December 2009 was up 52% over 2008’s average monthly volume.

since 1996, transactions have taken place online at OVE.com buyers are approximately 45% of all vehicle buyers.

Average number of buyers purchasing online has grown further to 245 in 1995 and 317 in 2010 (in addition to these physical auction locations, there currently are 106 associate members).

Source: National Auto Auction Association

In 1963, Chrysler’s first ever buy-back sale of rental and off-lease cars as well as the same reconditioning and buyer and seller services found at every Manheim location. Hundreds of employees manage the massive paper flow associated with each transaction, assuring that sellers get paid promptly and buyers not only get titles but also that vehicles were correctly represented in the lanes.

These institutional consignors needed larger facilities and more comprehensive services. Marshaling, inspections, vehicle reconditioning, logistics support, pre-sale marketing, managing closed sales, managing payments and paperwork, handling arbitration and providing feedback on methods to improve sales percentages transitioned auctions from merely being an open venue for bidding into a partnership with buyers and sellers. By the mid-1980s, the auction industry could rightly be called the remarketing industry.

The presence of institutional sellers also attracted more franchised dealers to the auction lanes. Until the 1980s, franchised dealers often ignored used vehicles because of the steady growth and high margins on new vehicle sales. But, as auto companies scrambled for market share and cut new car margins, the appeal of used vehicles increased just as the automotive industry was creating millions of late-model units that were ideally suited for franchised dealerships.

These high-value one- to three-year-old off-lease, off-rental, and end-of-service commercial and government fleet units represented a new niche in the spectrum of used vehicles remarketed through auctions. In 1995, NAAA-member auctions remarketed 7.3 million units, of which 50% came from institutional sellers.

To accommodate this volume, many auctions expanded to 20 or more lanes with acres of storage capacity for as many as 20,000 vehicles. Each week, as many as three thousands dealers bid on 7,000 vehicles in the lanes of these large auctions. The Manheim network of 81 operating locations includes many with more than 20 lanes.

Examples include:

- **Manheim Pennsylvania**: 33 lanes and 446 acres
- **Manheim Orlando**: 25 lanes and 276 acres
- **Manheim New Jersey**: 22 lanes and 339 acres

These locations provide marshaling and storage for thousands of vehicles as well as the same reconditioning and buyer and seller services found at every Manheim location. Hundreds of employees manage the massive paper flow associated with each transaction, assuring that sellers get paid promptly and buyers not only get titles but also that vehicles were correctly represented in the lanes.
As the scale of the wholesale auto industry swelled, buyers and sellers increasingly used information and technology to improve their outcomes. Aggregated pricing data from auctions was used to create price guides. Wholesale price data generated by auction transactions was also crucial to non-auction remarketing. Dealer-to-dealer or dealer-to-wholesaler sales, selling fleet vehicles to employees, or pricing an off-lease unit to the grounding dealer or the lessee were all made more efficient by the pricing information generated in the lanes.

The Manheim Market Report was launched in 1994 to provide buyers and sellers with timely information on recent prices for individual makes and models. Originally the report was only updated monthly. The emergence of the Internet enabled Manheim Market Report to provide almost real-time price information by make, model, mileage, and region. Today, registered buyers and sellers access the Manheim Market Report an average of 77,000 times a day, through any device equipped with Internet service. As sellers became more aware of both seasonal and regional variations in price, they used that information to make informed decisions. For example, vehicles were often moved from areas where local demand was saturated to areas where the same vehicles sold for prices high enough to offset the transportation and additional holding costs. Fleets and leasing companies began to time fleet turnover and lease maturities to seasonal highs in demand and prices. Sellers learned how to "rep" their vehicles in the lanes to maximize their sales and make small investments in something as simple as washing a vehicle or more comprehensive reconditioning to attract more bids and higher prices.

Buyers also became market savvy and traveled to larger regional auctions or used wholesalers to find the right vehicles at the right price. Picking up the tone of the market by absorbing the action in the lanes gave seasoned bidders a sense of what was hot as well as insights into overall business trends. Developing bidding strategies that won the units at fair prices became both art and science. Dealers prided themselves on their ability to assess vehicle condition and understand which features brought the highest returns on their lots.

A vehicle transport industry evolved to move vehicles into and out of auctions. With millions of used vehicles on the move, large auctions have to accommodate hundreds of haulers each week, transporting vehicles to and from auctions.
Up to the late 1990s, vehicle remarketing focused on improvements in physical and administrative processes and personal skills and expertise. In 1999, auction sales volumes moved above nine million units. Technology was applied to registering tens of thousands of bidders and managing the massive paperwork associated with tens of thousands of sellers and buyers.

Auctions extended their business models to recreational vehicles, specialty equipment, commercial vehicles, and agricultural and construction equipment. Salvage vehicle auctions were developed to serve the needs of insurance companies.

The logic of using auctions as a way to remarket otherwise difficult to value products had, by the 1990s, been transformed into a multi-billion dollar industry that extended beyond the auctions into transportation logistics, financing, reconditioning, inspections, and exporting. The underpinning for all of this was the open live-auction competitive bidding process, supported by facilities, trained personnel, and an administrative infrastructure needed to manage millions of transactions each year.

**The Internet Transforms Remarketing**

The physical world of the auto auction and the virtual world of the Internet began to converge in the late 1990s. However, bold assumptions about how fast buyers and sellers would migrate online were wrong. It wasn’t just the limits of the technology (and there were many), but rather the speed at which buyers and sellers would embrace the virtual experience. Full adoption awaited remarketing companies replicating the physical auction experience online, or creating new services to improve buyer confidence in bidding on a vehicle which they couldn’t personally inspect.

Every used vehicle is unique in terms of age, miles, condition, color, and features. Dealers prided themselves on being able to adjust their bids to individual vehicles. Not inspecting the vehicle in person was (and, for some dealers, still is) an obstacle to buying online. Dealers had confidence in the physical auction, with its predictable processes, access to vehicles prior to a sale, and quick resolution of problems.

The early online auctions struggled to find inventory to sell and to find bidders willing to take a chance on a vehicle they hadn’t seen. Few dealers even had high-speed Internet connections that would have enabled them to download stock photos accompanying descriptions of available vehicles.
Through Manheim.com, Users Can Access:

- PowerSearch – the starting point to find vehicles and their values – daily access to 100,000+ vehicles
- Auction pre-sales inventory
- Condition Reports
- Manheim location information
- Manheim Simulcast
- OVE.com
- Manheim Market Report (MMR)
- myAccount
- Post-sales results
- Ad Manager

Source: Manheim

Online Traffic

- More than 3 million wholesale vehicle transactions have taken place online at Manheim since 1996
- Manheim.com currently receives almost 900,000 visits per week
- Manheim’s average monthly online volume through December 2009 was up 21% over 2008’s average monthly volume
- OVE.com’s average monthly volume through December 2009 was up 52% over 2008’s average monthly volume
- Simulcast transaction volume December YTD increased 13% over 2008’s average monthly volume

Source: Manheim

Sellers were disappointed by the limited number of bidders for their inventory, and the fact that the Internet buyer often wanted a bargain price compared to physical auctions to compensate them for the uncertainty surrounding the vehicle. In the early days of the Internet, bidders expected eBay-like bargains, while vehicle sellers thought that more bidders would push prices higher than in the lanes.

Sellers also quickly realized that their heavy and valuable vehicles still had to be moved and safely stored, most often to a physical auction. Off-lease, end-of-service fleet vehicles, and unwanted trade-ins could not remain on rental lots or dealerships very long. The owners had to turn them into cash as fast as possible. Because online search capabilities were often rudimentary and there was too much variation in vehicle inspection standards, early attempts to create online auctions underperformed expectations.

Although online auctions were slow to catch on, buyers and sellers embraced the Internet for its ability to communicate and distribute information that allowed them to make smarter decisions, faster. Manheim upgraded the content and functionality of its web site so that dealers could search upcoming sales for the vehicles they needed. Manheim Market Report enhanced its services to buyers and sellers with greater real-time access and more detailed price information. And, dealers could manage every aspect of their account through the Manheim.com portal.

Sellers could market their upcoming events through online pre-sale advertising. They began to identify their regular customers and alert them to upcoming sales. Current market information helped them set more appropriate reserve prices. Inspections, reconditioning work, and run schedules could be arranged online for each vehicle, bringing greater efficiency to the selling process.

Simulcast Marries the Internet to the Physical Auction

In 2002, Manheim began a significant investment in communications and video equipment that transmitted live auctions into any dealership with a high-speed Internet connection. Remote bidders could view the action in the lanes and bid on vehicles. Manheim Simulcast was an immediate success because all processes were unchanged, except that dealers could make bids through the Internet.
Sellers paid a premium for the service, but saw an immediate payback in terms of higher sell rates. Dealers could inspect vehicles prior to sale, and, on sale day, focus on the cars and trucks they wanted from their offices. All administrative and support services of the auctions were unchanged and online bidders could view the bidding action in the lanes, giving them the same feedback they would get by being there in person. In short, dealers were comfortable using Simulcast because it brought the physical auction into their office. They had peace of mind because the auction stood behind each transaction. They could work smarter, save time, and travel expenses and access more vehicles as the number of Manheim Simulcast events climbed each year.

Like all technologies, Manheim Simulcast continuously evolved. Not long after launch, dealers were able to participate in up to four Simulcast sales simultaneously, get reminders when the units they were interested in were nearing the block, and place proxy bids ahead of sales.

Auto companies were among the first to embrace Manheim Simulcast because it enabled them to increase the number of franchised dealers who could participate in closed sales. The relationship between the auto company and its dealers and the relative predictability of the vehicles helped to overcome a dealer’s natural hesitation about buying vehicles without being physically present in the lanes.

Manufacturer sales resulted in a rapid growth in the number of sales broadcasted via Manheim Simulcast. This, in turn, led to greater dealer participation and a higher number of units sold to remote bidders. Even though total auction volumes fell more than 3% in 2009, Manheim Simulcast volume increased 17% as more sellers hosted events and dealers sourced more vehicles through this channel. In 2009, dealers had to search harder to find the vehicles they needed and Simulcast allowed them to efficiently expand their searches.

Manheim Simulcast sales have been a boon to export buyers who can access the events from anywhere in the world and enter bids as long as they are registered with Manheim and have credit lines that assure payment. In addition to proving its effectiveness in selling used vehicles in the U.S., Manheim Simulcast has an even higher penetration rate in many overseas markets and in remarketing specialty equipment, commercial vehicles, other equipment, and salvage vehicles. These auctions typically remarket smaller volumes to widely dispersed buyers, which has made Manheim Simulcast the ideal technology to link buyers and sellers.
Franchised Dealers and Automakers Pioneer Online Sales

Several automakers including Honda, through the former AutoTradeCenter, and Ford, through Ford QUIC (Quality Used Internet Cars), were early to use the Internet to facilitate sales directly to their franchised dealers. SmartAuction became the first inhouse remarketing platform that began hosting online auctions for GM dealers in 2000. The closed system enabled GM dealers to buy two- and three-year-old vehicles from GMAC with full recourse. SmartAuction's dealer proposition mimicked the company's closed physical auction. GMAC knew it would get paid since it floorplanned most of the dealers, who in turn expected that GMAC would stand behind the vehicles they sold. A high percentage of the transactions were to grounding dealers who had the opportunity to inspect the vehicle and purchase it through SmartAuction. One of the primary benefits of the system was a reduction in the days needed to remarket off-lease vehicles. By standardizing the turnback process and giving grounding dealers a specific period to purchase those vehicles, SmartAuction shortened the time to sell, thus improving its return. Today, many GM dealers purchase a high percentage of their used vehicle inventory from the late model units sold in SmartAuction.

By 2006, Manheim Simulcast and online auctions remarketed an estimated 1.7 million vehicles, mainly by institutional consignors selling to franchised dealers. The bulk of their volume consisted of current model to three-year-old vehicles. While this was a small fraction of the total 9.6 million units sold through physical auctions that year, it demonstrated that when buyers had confidence in the seller, as in the relationship between the auto company and its franchised dealers, and the vehicles were predictable, bidding would follow. But replicating the fully open electronic auction where any buyer and seller can successfully remarket any vehicle, as they do in a physical auction lane, is only now emerging.

OVE.com’s Open Auction Enables 24/7 Remarketing

Manheim launched OVE.com in 2004 following several years of development. The online channel aimed to bring all buyers and sellers together in a single marketplace. But the challenge for sellers and buyers that were not linked through business relationships, such as auto companies and their franchised dealers, was how to overcome the natural fear of buying a vehicle from an unfamiliar seller when the buyer couldn’t physically inspect that vehicle. Sellers were also limited by the fact that they had to transport and store vehicles before they were remarkeated. They needed physical auctions to store vehicles and perform services to enable online remarketing.
Sellers quickly learned that they had to provide much more information about their vehicles online than in the physical auction in order to overcome the dealers’ natural reluctance to spend thousands of dollars for something they hadn’t touched. Inspection reports are very useful for lane and Simulcast bidders, but they are essential in the online marketplace. Experience has shown that those sellers who provide comprehensive condition reports and detailed interior and exterior photographs that highlight condition issues attract more bidders and sell more vehicles than those who skimp on information. Just as in the lanes, online sellers are developing reputations for reliable disclosure and appropriate reserve prices. OVE.com now offers dealers access to more than 25,000 vehicles at any time.

**Online Auctions Continuously Improve to Address Buyers and Sellers Needs**

In the virtual world, OVE.com has continuously developed, tested, and implemented changes to the buyer and seller propositions. The feedback on the effectiveness of these changes is also immediate. As the operator of the largest open auction platform, Manheim’s OVE.com has continuously upgraded functionality by understanding what buyers and sellers valued in the physical auctions, emulating that online.

**Manheim Monday Brings the Excitement of In-Lane Sales Online**

In 2008, Manheim introduced “Manheim Monday” sales as a way to give dealers a chance to replenish inventory sold during the prior weekend on a day that previously was light on regularly scheduled sales. The success of these events helped propel OVE.com volume by more than 50% in 2009 following a double-digit increase in 2008. Institutional sellers have embraced Manheim Monday. These special sales emulate physical auction lanes where well-known sellers attract large numbers of bidders. The popularity and success of Manheim Monday has now
led to additional headline sales events throughout the week and even over weekends. Such blockbuster events, including those sponsored by larger public and private dealer groups, attract bidders to OVE.com, which benefits all sellers, no matter how few vehicles they list.

**Small Dealers Are Successful Sellers on OVE.com**

The issue for every auction, whether physical or online, has been how to increase the success for smaller dealers that have only a few vehicles to sell at any time. However, dealers found out quickly that listing inventory for sale during Manheim Monday events on OVE.com, that featured similar inventory, gave these lower volume sellers a much needed boost in exposure. Since an online visitor searches by make, model and other criteria, any seller has the same chance of meeting those requirements. The special event attracts visitors to the site, but once there, the sellers with the right inventory just as often make the sale.

“Manheim Monday” replicates the effect of institutional sellers in physical auctions. OVE.com attracts the bidders and every seller large and small can benefit. But on OVE.com the dealer can essentially pick his lane and run time by how he presents his inventory. When a bidder searches for a specific make and model, the search function brings up matches irrespective of the seller. Small sellers can overcome their lack of name recognition by providing detailed information about their vehicles.

**“If Bids” Improve Chances of Making a Sale**

In the physical auction, sellers participate directly and can accept a bid lower than their reserve price. By watching the action in the lanes, sellers make on the spot decisions that result in an immediate sale or listing unsold vehicles in the auction’s online channel at the same or an adjusted buy-it-now price.

In 2009, OVE.com added an important price feedback feature for sellers. Using “if bids,” sellers see the highest price offered in the auction for the vehicles that failed to meet reserve prices. As in the case of the physical auction, “if bid” information enables the seller to decide to make an immediate sale or wait in hopes of getting the reserve price.

In the auction lanes, unsold vehicles had to wait another week or be moved to another location where prices for a particular make might be higher because of local shortages. In the virtual world, the price feedback mechanism of “if bids” is immediate and sellers can make instant changes to reserve prices while the vehicles remain listed in the online auction.
Online Auctions Generate Detailed Information

Every action, whether page views of vehicles, bids or final prices, can be analyzed to understand market trends and provide feedback to buyers and sellers. Data gathering takes place in the physical auction as well, but in online channels, it is easier to track searches, bids, and other behaviors as well as seller listings, pricing, and other success factors. OVE.com and other online auctions aim to increase not only the chance of success for both parties, but also their satisfaction with the experience by analyzing this data to understand the factors that increase success for online buyers and sellers and enable them to optimize their strategies.

Realizing the Full Benefits of Technology in Remarketing

The evolution of remarketing from the physical auction lanes to today’s multi-channel strategy reflects the advances of technology, the experience and expertise of dealers and sellers, and the nature of the vehicles remarked by institutional sellers. Remarketing companies will continue to upgrade online channels to increase confidence in buying online. However, during the next five years, and perhaps longer, the mix of vehicles for sale in the wholesale market will change. That could impact the number of vehicles listed and sold through online auctions.

Auto company off-lease and program rental units have been the easiest vehicles to sell online. These late model, highly predictable vehicles are offered directly by auto companies and their finance arms to their franchised dealers. The close ties between these buyers and sellers and the predictable vehicles underpinned their success. Much of the reduction in volume in physical auction lanes has been related to the shift of vehicles from closed factory auctions to proprietary manufacturer online channels.

The available supply of executive, off-lease and program vehicles will drop from 3.3 million in 2009 to an estimated 2.1 million in 2012. Auto companies have reduced the number of vehicles sold under rental buyback programs, and lease originations by independent and captive finance companies fell in 2008 and again in 2009. Even as the percentage of these vehicles remarked through closed online channels increases, the total number of manufacturer-sold vehicles is going to decline online as well as in the lanes. In short, the supply of used vehicles from these important institutional sellers will decline.
That has tremendous implications for all forms of remarketing but especially online auctions where these vehicles dominate the inventory in manufacturer sponsored channels.

As a percentage of total auction volume, dealer trade-ins and over-aged units will increase from 41% in 2009 to at least 50% by 2012, assuming a modest rebound in new vehicle sales.

Dealer vehicles are not predictable by age, condition, or value. However, online demand for these units is increasing. With the national infrastructure of Manheim’s 81 auctions to provide an extra measure of confidence for both buyers and sellers, more dealer vehicles will gradually migrate online. Small dealers are learning how easy it is to upload vehicle listings and manage online remarketing, which gives them the opportunity to reach more buyers. The Wholesale Institute’s (TWI’s) workshops step in here to help make the process simple, and to instruct dealers on the steps they have to take to participate in the online wholesale marketplace by giving them a basis of knowledge in using the Internet. In addition, OVE.com’s relationship with more than 70 independent auctions remarketing dealer vehicles will increase the supply of dealer vehicles in online auctions.

**Integration, Optimization, and Automation: Improving the Experience for Everyone**

The future of remarketing, especially as it relates to the changing used vehicle population, can be summed up in a few words: integration, optimization, and automation. In 2008, Manheim launched the new Manheim.com as a portal to all remarketing services and channels for buyers and sellers. Manheim.com receives an average of 900,000 visits
per week as 90,000 registered customers log on to the site to view their accounts, search for vehicles, check MMR pricing, participate in a Manheim Simulcast sale or list a vehicle on OVE.com. Sellers, including institutional sellers, are able to access their inventory, view bidding, reset reserve prices, and assign vehicles to live and online auctions.

By integrating every channel and service through a single portal, visitor traffic on Manheim.com has soared and time spent on the site has risen. It would have been impossible to deliver so much information and features for millions of vehicles and thousands of users without a plan to continuously evolve the site to meet the needs of Manheim's clients.

The functionality built into Manheim.com is evolving to better understand buyer behavior. Manheim.com is able to serve up comparable vehicle listings to unsuccessful bidders on Manheim Simulcast or OVE.com. This feature includes vehicles awaiting sale in every Manheim operating location or running in Manheim Simulcast sales as well as listed on OVE.com. Modeled after the way consumer sites such as Amazon.com are able to offer up additional purchase options to customers searching for products or services, Manheim knows precisely what losing bidders want and will search all Manheim channels to try to match their criteria. The experience is immediate, integrated, and automated to ensure that all inventories are continuously exposed to the exact individuals who just lost the vehicle they wanted. With the increased variability of vehicle inventory online and in the lanes, this feature is of great value to buyers as well as sellers.

Similarly, dealers checking vehicle price information on Manheim Market Report will be asked if they want to see current inventory in all Manheim channels that match their search criteria. The instant link between MMR and the actual vehicles not only allows the dealer to buy efficiently, but also to see seller pricing relative to MMR data.

**Seller Ratings Protect the Marketplace**
*(see page 34)*

Even though Manheim encourages sellers to use either Manheim-sanctioned inspections or inspections from any other reputable vendors, there are bound to be occasional disagreements between buyer and seller over vehicle condition. This is a particular issue for dealer vehicles because the online buyer doesn’t want to risk the expense to transport the vehicle only to discover an undisclosed defect. Manheim's national network already allows any buyer to return the vehicle to any Manheim operating location where the condition issue can be arbitrated. Manheim Direct is a new program that sends independent, third-party inspectors directly to dealers’ lots to inspect and upload vehicles onto OVE.com.
The ultimate goal is to avoid arbitration by presenting bidders with full disclosure of a vehicle’s condition. Some of the ways that Manheim and other wholesale marketplaces are helping this process are to implement “seller ratings” systems into their Web sites, like those found on sites such as eBay, and to implement strictly enforced policies that protect the marketplace and both buyer and seller.

**Intelligent Decisions Made Easier for All Buyers and Sellers**

For many years we have used the phrase “Intelligent Remarketing” to describe how remarketing strategies were increasingly based on data analytics. Buyers, and especially sellers, were able to test various price, pre-sale marketing, and reconditioning decisions, among others. The Internet has exponentially increased the granularity of the data that remarketers can access to make smarter decisions.

Institutional sellers now routinely answer questions about their remarketing strategies based upon Manheim Consulting analytical studies. Dealer behavior as buyers has been the subject of much of their analytical work. But dealers themselves have not yet fully embraced data-driven decisions with respect to when, where, and how to remarket their unwanted vehicles.

Large dealer groups, both private and public, have started to monitor their remarketing performance to make better remarketing decisions. More frequently, dealers are simultaneously posting over-aged units on their own web sites, as well as on independent search sites such as AutoTrader.com, and OVE.com. The ease with which vehicle data can be transmitted among various web sites has made this possible and allows the dealer to maximize his return on those units, which might otherwise produce a loss.

We aren’t far from the time when system intelligence is in place to monitor and integrate the data generated by clicks and views to enable buyers and sellers to optimize their strategies. The remarketing industry has come a very long way in more than 70 years of operation. But the rate of change in the last decade, fueled by economic need, technology, and a focus on building dealer confidence, has been unprecedented. But unlike the book shipped from Amazon to your home overnight, used vehicles pose unique challenges that have and will continue to require the adaptation of real world facilities, personnel, and services to continue the migration online.
Understanding Dealer Adoption of Online Channels

This study analyzed all purchases in all Manheim channels between 2003 and mid-2009. The objective was to understand the difference in individual dealer purchasing preferences between physical and electronic auctions. During this period, Simulcast and OVE.com were continuously upgraded to improve the buyer experience. At the same time the supply of vehicles available in these channels increased.

The analysis concluded that:

There was a strong correlation between the number of vehicles purchased and the rate of adoption of multi-channel sourcing;

Franchised dealers showed the earliest adoption of online channels and reduced their attendance at physical auctions as they filled their needs through Simulcast and OVE.com;

Independent dealers who purchased the lowest priced vehicles have been slow to adopt online channels. Their auction attendance rates were essentially unchanged during the study period;

Independent dealers who focused on mid-price used vehicles have been gradually increasing their participation in online auctions while still maintaining their presence in the lanes;

For the majority of dealers, online channels supplemented live auction participation.

Source: Manheim Consulting
Factors that Impact Online Purchases

Online sales are attracting more vehicles and more bidders. Sellers appreciate the opportunity to expose their inventory to more buyers, which could reduce the time to sell.

Manheim Consulting conducted an analysis of Simulcast sales by category of seller. The objective of the study was to understand how much specific factors influenced the likelihood of a vehicle being bought online.

The analysis confirmed the importance of age, mileage, and condition to online buyers. Newer, lower-mileage, high-grade units offer an implied guarantee of reliability. In addition, the supply of these units is relatively small and, often in auctions some distance from buyers.

More than 20% of the vehicles graded a 5, the highest level, were sold online, more than double the level of the vehicles graded 0, 1, and 2. It was not surprising that more than 20% of the best vehicles were sold online. But the fact that more than 9% of the lowest quality vehicles also attracted online bidders suggests that vehicles with an accurate representation of condition, even when rough, or luxury vehicles bought for export, will still attract bidders. The analysis also showed a high correlation between age and the percentage of vehicles sold online. Within the same seller segment, newer vehicles had a higher online sales percentage than older units. Likewise, online sales had lower mileage than in-lane sales by the same seller group.

![Simulcast Sales Percent by Grade](image-url)
The trend in residual values for midsize cars from GM’s discontinued brands (non-core), GM’s core brands, and all non-GM makes is shown in the chart below. The data considers only 2008 and 2009 model-year vehicles since it is late-model units that show the quickest and most pronounced reaction to issues such as brand discontinuation and bankruptcy.

The trend in residuals for GM’s core brands is similar to the non-GM makes, but GM’s non-core brands significantly underperformed both groups. As Manheim Consulting has documented fully in other reports (along with a more rigorous statistical analysis), bankruptcy had less of an impact on GM residuals than many had feared. High inter-brand cross-price elasticity in the wholesale market was one reason. In addition, GM’s bankruptcy was an extremely quick process. That, plus the large dealer base and guarantees from the government, meant there was little concern over the future availability of parts or the honoring of warranties.

The significant underperformance of residuals for the discontinued brands cannot be solely attributed to their phasing out per se. Those brands were already out-of-favor. Indeed, that is why they were eliminated.

The mechanism by which a brand’s elimination hurts residual values is often through the impact on the dealer network. This was clearly seen in the case of Saturn. Used Satmars have always retailed better from a Saturn dealership than from a non-Satmars store. As such, being an exclusive network and one which was going through great uncertainty in 2009 (would the brand be resurrected or would it not?) meant that the primary wholesale buyers of used Satmars (i.e., Saturn dealers) were forced to the sidelines. On the other hand, a used Pontiac will often sell as well as from a Chevrolet store as from a Pontiac dealership. Given that, it is not surprising that the residual impact of brand closure was greater for Saturn than for Pontiac.
Dealership Closures Accelerate in 2009

For the second consecutive year, a record number of franchised and independent dealers closed. The combination of low sales, curtailment of floorplan lines, the shutdown of Saturn and Pontiac, and the termination of dealerships by General Motors and Chrysler turned 2009 into a nightmare.

Although the majority of franchise closures were domestic brands, even European luxury and Asian mass-market brand dealers struggled to maintain profitability in the first half of 2009. Among the most vulnerable were dealers in California, Florida, Arizona, and other large, once red-hot, vehicle markets where sales collapsed amid home foreclosures and rising unemployment.

Those dealers who acquired franchises at peak valuations or invested heavily in their facilities found it tough to overcome debt costs while revenues were falling. Lack of credit for working capital and inventory forced many independent dealers out of business. The dealers with credit often paid higher rates and had to quickly downsize inventory. Some of the dealerships terminated by General Motors and Chrysler tried to convert to used-only operations, but often found that their implied facility and location costs were too much to be profitable. And, of course, most of these dealers had to scramble for alternative sources of credit as they lost access to their GMAC and Chrysler Financial flooring lines.

Dealers’ Financial Outlook Brightens in Second Half of 2009

As dismal as 2009 was, franchised and independent dealers proved again how resilient and adaptable they could be. By the second half of the year, the financial picture for the majority of dealers brightened as the new vehicle sales rate improved and they reaped the benefit of earlier cost reductions. With lower fixed and variable expenses, the uptick in sales flowed to the bottom line.

Independent dealers also cut advertising, personnel, and other operating costs. With a single profit center, used vehicle dealers concentrated on finding and stocking the right vehicles and avoiding mistakes. The upturn in used vehicle values provided an unexpected benefit and allowed dealers to minimize losses when they wholesaled out of their unwanted vehicles. In fact, by the third quarter some dealers broke even or made a small profit on the vehicles they wholesaled at auction.
Fears that a glut of unsold new vehicles from terminated dealers would depress new and used prices didn’t materialize. Chrysler dealers were able to sell their new vehicles to other dealers and either retail out of their used vehicle inventory or remarket those vehicles at auctions as wholesale prices climbed.

**Franchised Dealers Gained from Revival of Leasing and Cash-for-Clunkers**

Higher trade-in values and a slight loosening of consumer credit, including a return to leasing by domestic captive finance companies, boosted the second half new vehicle sales rate to 11.2 million compared to 9.6 million in the first half of the year. Cash-for-clunkers was a boon to franchised dealers that boosted gross margins as well as unit sales. The sales rate in August soared to 14.1 million before falling back to 9.2 million in September. At year-end, the sales pace rose above 11 million.

**New Vehicle Sales Seasonally Adjusted Annual Selling Rate (SAAR)**

Profit margins on new vehicles, even for some luxury and near luxury makes, were non-existent in 2009. Thus, many dealers had to sustain their operations with profits from parts, service, and used vehicles. Used vehicle retail sales by franchised dealers fell 3% in 2009, compared to a 21% decline in new vehicles. Franchised dealers have long recognized the profit opportunity in used vehicles. But, in 2009, a well-run used vehicle operation often made the difference between survival and closure.
Inventory Diversification Brings in More Used Vehicle Buyers

In 2009, a high percentage of vehicles taken in trade by franchised and independent dealers that would have normally been wholesaled were held for retail sale. Dealers retained more of the competing brands traded-in and also stocked older, less-expensive vehicles that appealed to price-sensitive shoppers. In effect, these dealers regarded their used vehicle operation as a separate profit center rather than just an adjunct to the new vehicle department.

Diversification by age and brand was apparent in mass-market franchises where dealers found it convenient to stock competing brands that they acquired at auctions or through customer trades. Luxury brand franchises, on the other hand, continued to primarily sell the same brand used vehicles. For them, competing brand trades were quickly remarketed through wholesalers or in live and online auction channels.

Used Vehicle Sales by Independent Dealers Were Stable in 2009

Used vehicle retail sales by independent dealers fell only 0.3% in 2009, according to CNW. Although this marked the fifth consecutive yearly decline, sales trends at independent dealers have generally outperformed the new and used vehicle sales of franchised dealers.
It is very difficult to generalize about independent used vehicle dealers. They range from the largest retailer of used vehicles (CarMax), to private multi-store regional chains, to small single store businesses that sell only a handful of units a month. What typically differentiates independent used vehicle dealers is how they define their business through inventory. Some stores sell only luxury brands, others aim at specific price points or market classes of vehicles, while still others focus on the credit tier of customers, such as subprime or Buy-Here, Pay-Here (BHPH).

In 2009, one of the most frequently mentioned problems for all used vehicle dealers was finding the right inventory to serve their customers. Every dealer, irrespective of customer focus, size, or location spent more time and effort to locate the right inventory.

In 2009, many former new vehicle buyers bought used vehicles instead. Independent dealers benefited from this shift, in addition to steady demand from nonprime and subprime customers. Despite the double-digit unemployment rate, BHPH dealers saw increased customer traffic. Many subprime borrowers were shut out of traditional financing and were forced into BHPH stores. Those BHPH dealers with adequate lines of credit were able to grow their businesses and their profits. But, for most BHPH dealers, access to capital was a significant challenge.

Like other providers of auto credit, BHPH dealers saw an increase in customer defaults in 2009. BHPH dealers will typically work with the customer to keep them in the vehicle when the cause of the default is a repairable, mechanical problem. These dealers will often make repairs and change loan terms to keep customers from defaulting. However, rising unemployment, more than mechanical failures, resulted in higher repossessions by this group of dealers in 2009.

**Used Vehicle Shoppers Turn to Online Searches**

For many years, shoppers have been turning to online web sites such as AutoTrader.com to enable them to find the makes and models they want. Dealer listings on AutoTrader.com for both used, and more recently, new vehicles, have proven to be important sources of customer leads. In 2009, visitor traffic continued to reflect the increasing importance of the Internet in linking retail buyers to the dealers who have the models they want.
Everyone knows that the local franchised dealer is likely to have or can readily obtain a specific new vehicle. But every used vehicle is unique, creating a challenge for used vehicle shoppers. Although used vehicle listings declined slightly in 2009 as dealers had to limit their inventory, the number of visitors logging on and searching for used vehicles increased. At the same time, visitors spent more time researching and locating the vehicles they were interested in. The data also indicates that as used car values rose, more shoppers turned to new cars after cash-for-clunkers. So, instead of a prolonged payback, new vehicle demand improved as the economy and credit conditions stabilized.

**Inventory Management Takes Center Stage**

Irrespective of their market focus, successful dealers must have a keen sense of local demand trends and reflect that in their used vehicle inventory. Although margins on used vehicles are generally two to three times higher than on new vehicles (percentage-wise), depreciation on over-aged units can quickly wipe out hard-earned profits.
Since mid-2008, dealers have had to do more with less when it comes to inventory. Previously, dealers had ample credit at low rates and that sometimes encouraged lax inventory management since the financial penalty for carrying too many over-aged units wasn’t burdensome. With the credit crisis came reductions in credit lines and higher effective interest rates. So the combination of challenging market conditions, rising wholesale prices, and limited inventory financing forced dealers to manage inventories more efficiently.

**Finding the Right Inventory Becomes More Challenging**

Dealers provide nearly half of the vehicles remarketed through auctions, and an even greater portion of wholesale supply when sales to local dealers and wholesalers are included. Of course, dealers are also the primary buyers of used vehicles in all wholesale channels. Whereas institutional sellers account for the majority of one- and two-year-old vehicles remarkeled at auctions, dealers remarket the majority of the vehicles in all other age categories.

Low new vehicle sales reduced the supply of trade-ins in 2009. That, plus the decline in dealer wholesaling percentages reduced dealer consignment volumes at auction by 7%. Dealer vehicles accounted for 41% of total auction supply in 2009, down from 50% in 2007. Dealers did take advantage of higher wholesale values in the second half of 2009 and remarkeled more vehicles through auctions than they did in the first half when lower prices tilted the scale toward retailing out of more of their trade-ins.

The average dealer vehicle remarkeled through auctions in 2009 was valued at about $8,000. This compared to the average rental risk unit at $11,500 and that average off-lease vehicle at more than $17,000. Independent dealers are the primary buyers for older and more affordable dealer vehicles at auctions. Independent dealers have been somewhat slower to embrace online channels for buying vehicles, perhaps due to the lack of predictability among the vehicles they seek. However, market pressures prompted even the most reluctant dealers to search for vehicles online. Manheim recorded a very high number of first time bidders in both OVE.com and Simulcast sales which was evidence of the accelerated move to online channels.
The Wholesale Institute (TWI) Teaches Dealers to Buy and Sell Online

Manheim’s TWI conducted 60 workshops in 2009 offering an expanded curriculum of topics related to both buying and, for the first time, selling vehicles online. TWI moved its venue from conference centers in hotels to the auctions and expects to conduct more than 80 seminars in 2010. Dealer participation increased sharply in 2009 because of the easy access to the courses and the growing realization that buying and selling online was a necessity. Even dealers who had previously been trained by TWI returned to keep current with the expanded content of the 2009 program.

TWI is also seeing more independent dealers at its seminars. While most franchised dealers have the experience of searching for and bidding on vehicles on manufacturer and auction channels, the majority of independent dealers have yet to buy a vehicle online. However, as soon as they are successful winning an online auction and are satisfied that the vehicle they bought meets their standards, independent dealers steadily increase their participation in online channels.

TWI workshops initially focused on building dealer confidence in buying vehicles online. But in 2009, TWI focused on dealer sales through OVE.com. Dealers represent the largest pool of used vehicles that have yet to migrate online. With new search features, special sales such as Manheim Monday events, and more bidding options, TWI always had more to talk about.
Virtual Inventory Increases Retail Sales

OVE.com’s Retail View feature was rolled out in 2008. It became an important topic in TWI seminars in 2009 as dealers struggled with more expensive and restricted floorplan lines. OVE.com’s Retail View feature enables dealers to present online inventory to customers to increase sales beyond units in stock. Manheim has seen a substantial increase in bids on vehicles presented through Retail View.

In 2009, TWI included instruction on dealers remarketing unwanted vehicles online. Dealers traditionally remarket vehicles locally to other dealers and wholesalers, or at local auctions. Small dealerships were often intimidated by the idea of uploading inventory onto OVE.com, thinking that the process was too complex for them. But online channels are learning from their clients how to improve their platforms and systems so that any dealer can successfully buy and sell online. The combination of easier to use processes and education is helping to overcome dealer hesitancy to use these platforms. TWI takes dealers through the steps to upload vehicle information and stresses the importance of photos, Condition Reports (CRs), and correct pricing so that even the dealer with just a few units to sell can be successful.

Another avenue for dealer vehicles on OVE.com are the small independent auctions that mainly remarket dealer units. More than 70 independent auctions list vehicles on OVE.com on behalf of their consignors, most of whom are dealers.

Dealers Broaden Their Searches to Find the Right Vehicles

In 2009, buyers had a tougher time finding the makes and models they needed because of the decline in overall auction volumes that resulted from fewer off-rental and dealer cars. Accessing just one or two live sales events might have sufficed a couple of years ago, but not so today.

Source of Used Vehicle Inventory for Franchised Dealers
1998 vs. 2008

Source: NADA
(2009 data not yet available; due in April)
Manheim has tracked bidder behavior in live auctions, on Simulcast, and on OVE.com. The evidence is overwhelming: dealers, both franchised and independent, invested more time and effort in finding the right inventory in 2009 than in previous years. More dealers attended multiple live auctions weekly in 2009 than in 2008. And participation in online sales through Simulcast and OVE.com soared. Manheim data also noted an acceleration in the percentage of vehicles purchased online.

Traffic to Manheim.com, the portal to inventory in all Manheim channels, averaged 900,000 visits per week in 2009 with sequential monthly increases noted throughout the year. Dealers continued to participate in their local or regional weekly auctions, but a very high percentage of these same dealers also bought vehicles through Simulcast sales. Participation on OVE.com climbed rapidly as more dealers used the site as virtual inventory. Necessity caused many dealers to overcome their hesitation about buying online. The data also shows that once dealers have made a successful purchase, they are likely to continue to shift more of their buying to online channels such as OVE.com and Simulcast.

A Manheim Consulting analysis of dealer transactions on Simulcast showed a significant increase in the physical distance between the dealer’s store and the location of the purchase compared to similar transactions in live auctions. This demonstrates that online channels widen dealers’ search areas.

Selling Vehicles Online Gains Traction With Dealers

Dealers have been the last group of sellers to move to the online remarketing of vehicles. Compared to institutional sellers with their relatively homogenous portfolios of used vehicles, remarketing staffs, and multi-channel strategies, dealers have fewer vehicles to sell at any time and what they have to sell is entirely unpredictable. Unlike institutional sellers who can time their remarketing programs to price trends in the wholesale market, dealers rarely have the luxury of time. Since so much money is tied up in a used vehicle, whether it is an unwanted trade or an over-aged unit, their primary objective is to convert the vehicle into cash as quickly as possible. That is why so many dealer vehicles are sold locally, or to wholesalers, at prices lower than they might fetch at auction.
It is the predictability of the institutional seller’s vehicles and flexibility with respect to remarketing that made them good candidates for online selling. The reputation of a nationally-known seller and a product mix of one- to three-year-old vehicles resonate well in online channels.

Despite the distinctions between dealer and institutional sellers’ vehicles, more dealers are opting to use online remarketing, especially 24/7 channels like OVE.com.

A typical online strategy for a dealer is to simultaneously list an over-aged unit on AutoTrader.com for retail customers and on OVE.com for wholesale buyers. The same vehicle condition information and digital photographs would be used on both sites so the dealer would have little incremental cost associated with the dual listing.

In the online world, being a small seller is less of a disadvantage than it is in the real world. Buyers search by make and model so every seller has an equal chance to make the sale as long as they set realistic prices and provide potential buyers with enough information to value the vehicle.
Franchised Dealers Embrace Online Channels

Manheim Consulting’s analysis of online purchasing activity in 2009 revealed that franchised dealers bought 23.1% of their total purchases through Simulcast events compared to 13.4% for independent dealers. Although the data confirms that franchised dealers have become more comfortable buying online, the percentages are skewed by several factors. Franchised dealers focus on late-model vehicles and historically rely on closed auction sales for a meaningful portion of their inventory.

Importantly, franchised dealers favor one- to three-year-old vehicles that have been inspected and graded. These vehicles are most commonly remarked by captive finance companies in closed factory auctions that are linked to bidders through Simulcast. The relationship between the auto company’s captive finance company and its franchise dealers, along with the predictability of the vehicles, ensures that a high percentage will be sold online. In addition to captive finance company sales where more than a third of their vehicles carry the highest quality grades, franchised dealers are important buyers of commercial fleet units and off-lease vehicles remarketed by banks.
Manheim Simulcast Widens Dealers’ Buying Range

Manheim Consulting undertook an analysis of buyer behavior to determine what factors influence increased participation in Manheim Simulcast sales. The sample consisted of more than 2.5 million physical lane and Manheim Simulcast transactions from 2003 through 2008 for vehicles with between 15,000 to 21,000 miles.

One of the study’s objectives was to determine if Manheim Simulcast substituted for physical auction attendance or increased the number of sales that dealers participated in. The study also assessed how Manheim Simulcast participation related to the types of vehicles purchased and the distance from the buyer’s store. The study compared buyers who made half of their purchases via Manheim Simulcast with those who bought no vehicles in Simulcast sales.

The Simulcast buyers:

• purchased from 12% more auctions yearly than those who did not purchase through Simulcast;

• purchased from a 64% larger geographic distance between the buyer’s location and the auction compared to those who bought no units through Simulcast. Simulcast buyers favored high MMR vehicles that offered a higher potential gross profit. The extra profit made it economically attractive to transport the vehicles a greater distance between the auction and the dealership.

The data showed that Manheim Simulcast buyers often bid on vehicles not available in their local auctions. As such, the study anticipated dealer behavior in 2009. Since finding the right vehicles became more challenging, dealer participation in multiple Simulcast and local auctions increased.
2010 Used Car Market Report

2009 was a difficult year for all franchised dealers. Tell us what dealers did to cope with the recession.

Dealers have experienced business cycles in the past and have proven how resilient they are. Every dealer had to bring variable and fixed costs in line with the changed market revenues. That meant painful cuts in personnel, lower advertising outlays, and reduced inventory levels to contain flooring expense.

What role did used cars play in franchised dealer profitability?

Used cars played a key role in generating profits in 2009 because the return on investment is much higher than on new vehicles. Because the new car department rarely makes money, franchised dealers are increasingly relying on their used car departments to support their businesses. Out of this necessity, I predict a much greater emphasis will be placed on the used vehicle business in the coming years.

What impact did cash-for-clunkers have on franchised dealers?

Cash-for-clunkers was very successful. It put consumers and dealers back in the game after a long drought. It cleared away inventory and allowed auto companies to restart production. It was profitable for dealers, although we experienced delays getting paid by the government, which strained cash flow.

What has the recession taught dealers about used vehicle inventory management?

The recession, and limits on floorplan credit for used vehicles, made dealers more aware of profit leaks in the store, such as stocking too much or too many of the wrong vehicles, which creates wholesale losses. Profit requires turning the right inventory quickly. Dealers seem to use auctions more often instead of selling vehicles to wholesalers or trying to retail out of over-aged inventory.

How have dealers coped with limits on floorplan lines?

Floorplan credit was a huge issue in 2009 and, in extreme cases, dealers were forced out of business when they lost their access to inventory credit lines. NADA worked around the clock to find solutions for dealers. The TALF program was extended to cover flooring loans, and Small Business Administration loan guarantees have helped some dealers stay in business.

Have you seen any improvement in the retail finance picture?

Leasing all but dried up in the first half of 2009 for many makes. And lenders refigured their tiers and qualifications, resulting in fewer consumers qualifying for a loan. The retail financing picture improved in the second half of 2009 and, with higher used vehicle values, fewer consumers were upside down in their existing loans. Higher residuals also encouraged some captive finance companies to return to leasing.

What are your goals for NADA?

NADA and dealers faced unprecedented challenges in 2009 and those challenges will continue. Many dealers lost their livelihoods due to manufacturer bankruptcies, credit lines being pulled, and the significant falloff in revenue due to the depressed market. My priorities are to fight for dealers to ensure they are not inadvertently hurt by legislation, by varying emissions or fuel standards, or by unfair dealer terminations. NADA has been in a difficult position with a bifurcated network of “wind down,” or terminated dealers and “going forward” dealers. I am determined to listen to everyone and to communicate with our membership.

Given what you’ve been through, are you optimistic about the future?

Dealers are going to be smarter and more resilient after what they’ve experienced. The economic and industry turmoil will pass and the dealership business will be fun and rewarding.
Charles Teel was named president of NIADA in June 2009 after serving as Secretary of the organization. Charles has been a member of both the Georgia IADA and NIADA since 1990. He has completed NIADA’s Certified Master Dealer training.

His professional career spans more than 30 years, much of that time involved in used automotive retailing and dealership finances. He has extensive experience in the area of dealer-provided retail finance. He is presently Chief Financial Officer of Savannah International Motors in Savannah, Georgia, in addition to overseeing other business interests in wireless communications. Charles is active in many local business and community organizations.

**How has the credit crisis impacted your members in 2009?**

For the past several years, dealers could obtain financing for retail contracts that often didn’t make much sense. As lenders turned cautious about auto loans, they developed new underwriting criteria and that changed our business. Consumers aren’t going to get 100% financing with a little negative equity thrown in. Instead, customers are having to come up with a significant down payment to qualify for a loan. In addition, some lenders used loan values that were below true market values. That too, resulted in a larger necessary down payment and priced some customers out of the market.

**How have dealers responded to reductions in their floorplan lines?**

Those dealers who have seen their floorplan lines cut have had to stock fewer vehicles. This forced them to put more emphasis on inventory turnover. Turning inventory faster boosts the bottom line. Always having new merchandise to sell works to the dealer’s advantage. Instead of having 100 vehicles on the lot, the same dealer needs 50 of the right models that he can sell in 30 days.

**Have independent dealers seen a change in today’s used vehicle customers?**

First, today’s used car buyers are well informed. They have researched the vehicles they might want, reviewed pricing information, and have considered their financing options. Second, in 2009, dealers saw customers who previously bought new vehicles. Selling to these customers requires having the right inventory and a well-trained sales staff.

**How have independent dealers responded to the shortage of late-model used vehicles?**

When new vehicle sales dropped from 17 million to 10 million, it had a huge impact on trade-ins, which are an important source of supply for used car dealers. The shortage is across the board and covers all makes and models, not just one-to three-year-old units. Our members are tapping into every potential source for the vehicles they need. There has been a significant increase in searching for the right inventory in online channels, in addition to participating in more live auctions.

**What was NIADA’s response to the cash-for-clunkers program?**

NIADA opposed cash-for-clunkers because we believed it discriminated against used vehicle dealers. More than 700,000 vehicles, many of them representing affordable and reliable transportation, were removed from the population.

**What are some of your goals as NIADA President?**

NIADA has played an important role in helping our members operate successful businesses. The retail auto industry is changing faster now than in the past and we have to be responsive to both the opportunities and challenges. We have to communicate this to our members through NIADAs world-class education and compliance programs and through our regional and local affiliates. Our goal is to help our members be more successful.
**Rental**

**2010 Used Car Market Report**

**Rental Companies Adjust to Reduced Rental Activity**

Since the second quarter of 2008, the rental industry has experienced a slump in business and leisure travel, higher fleet financing costs, and a further shift from program to risk vehicles. Nevertheless, the financial health of the industry turned around in the second half of 2009. Cost cutting and fleet rightsizing, combined with higher rental rates and strong used vehicle prices, boosted operating margins. The improved profit picture, and a slight thawing of the credit markets, enabled rental companies to obtain sufficient credit, though on more costly terms than in the past.

**Rental Companies Purchased 1.1 Million New Vehicles in 2009**

An estimated 10% reduction in rental demand was partially offset by higher rates in 2009. As a result, the rental industry generated revenues of $20.5 billion, only 4.6% below 2008. The drop in rental activity was accompanied by the shift to risk vehicles, which remain in service approximately twice as long as manufacturer buyback units. As a result, the industry purchased only 1.1 million new units in 2009 compared to the 2005 and 2006 peaks of 2.1 million vehicles. Although fleet turnover will normalize in 2010, vehicle purchases will remain below historic levels as companies right-size fleets.

Risk vehicles now account for close to 70% of purchases and those vehicles typically stay in service close to 40,000 miles to achieve budgeted monthly depreciation. Although Asian manufacturers still offer program vehicles, the economics just as often favor risk units where the rental company can actively manage the purchase, operating, and remarketing decisions.

**Rental Fleet Composition Diversifies Across Many Brands**

Historically, domestic brands have dominated rental fleets. General Motors, Ford, and Chrysler had long-standing supply agreements with major rental companies that established volume and price targets along with repurchase terms and prices. These contracts absorbed excess capacity, but were unprofitable for automakers. Beginning in the 2007 model year, U.S. auto companies reduced program vehicle allocations.
In 2009, the combined rental market share of GM, Ford, and Chrysler fell to 60%, down from 69% in 2008 and 80+% in the years prior to 2007. This was the lowest share for domestic brands on record and partly reflected lower deliveries during the bankruptcies of GM and Chrysler along with the desirability of sourcing vehicles from several manufacturers. Ford and Asian automakers gained market share at the expense of GM and Chrysler. Several rental companies highlighted the fact that no automaker had more than 25% of their business. Although this diversity presents operating challenges, it also enables the companies to better manage the mix of vehicles in their fleets, reduce residual exposure, and attract more dealers to their auction sales.

**Fleet Financing Pressures Ease in the Second Half of 2009**

Rental companies use various forms of short- and medium-term debt to finance vehicle purchases. The industry was frozen out of the ABS market during the credit crisis. That, along with reduced demand, necessitated defleeting in the first half of 2009. But, by the third quarter, higher used vehicle values, the improved financial prospects of the rental industry, and easier credit, enabled rental companies to stabilize fleet size and return to a more normal replacement cycle.

Fleet financing typically requires a level of enhancement from the rental companies to manage interest expense. Because of the uncertain financial health of some rental companies and the challenging credit markets, enhancements, usually in the form of cash reserves or letters of credit, soared in 2009. Even though there has been some easing of enhancement levels, it is unlikely that the industry will return to the low financing costs of the past when program units dominated purchases.
Program Vehicles Decline in All Remarketing Channels

Program vehicles, which now represent less than 30% of the fleet, are typically taken out of service after about 20,000 miles or six months and remarked mainly to the automakers’ franchised dealers. The rental company has no remarketing responsibilities for these units except fulfilling the automaker’s mileage, condition, and marshalling requirements. Many of these vehicles are remarked through automakers’ proprietary upstream channels and in closed factory auctions. Program units are ideally suited for manufacturer certification, so the reduced supply online and in the auction lanes contributed to the decline in CPO retail sales for some brands.

Risk Vehicles Remain in Service Twice as Long as Program Units

Risk vehicle purchases are negotiated with several automakers to get the right price, brand, and model selection for their business. Because of very high depreciation in the early life of a car, risk vehicles stay in service at least twice a long as program units, often well into their second year.

Operating a mixed-brand fleet of risk vehicles complicates warranty and service and necessitates continuous analysis of vehicle costs. Rental companies must balance higher maintenance expenses and lower customer satisfaction as units accumulate miles against the need to manage depreciation.

Companies are now diligent in charging customers for mechanical and body damage as well as cigarette smoke to compensate for loss of value. For an industry that operates on narrow profit margins, any factor that directly impacts depreciation is under review.

Although some companies have experimented with mileage caps on minivans, which are often rented to take the family on a long distance vacation, this has yet to become standard in the industry. Nevertheless, rental companies appreciate the fact that heavy-use customers cost them money by shortening the service life of a vehicle that is not compensated for by a flat daily rental fee.
Fleet Turnover Accelerated as Used Vehicle Prices Rose

Rental companies responded to the upturn in used vehicle values late in the second and third quarters of 2009. The shortage of inventory in the auction lanes produced month-to-month price gains for late model vehicles, delaying the normal seasonal softening of prices into November. Rental companies took advantage of favorable pricing and remarked some vehicles ahead of plan. By monitoring wholesale values for the models in service, rental companies were able to reduce fleets in the seasonally slow fourth quarter while locking in favorable depreciation on these units. These actions reflected the increasing sophistication of rental companies in adapting remarketing strategies to the price changes for specific makes and models in the wholesale market.

Rental Volumes Fell At Auction Again in 2009

The volume of program vehicles at auctions, which declined by more than 30% in 2008, fell another 27% in 2009. Rental risk volumes at auction also fell in the first half of 2009, but increased in the second half. The combined volume of program and risk units sold at auction fell approximately 10% in 2009, making it harder for franchised dealers to find low-mileage, attractively-priced units.

In 2009, the average program vehicle was remarketed with more than 17,100 miles and sold for an average of $15,500. This compares to the 2008 levels of 18,500 miles and $14,400. These averages, however, were significantly impacted by shifts in the makes and models of vehicles sold. Generally speaking, the mix of vehicles sold in 2009 included more high-end models than in 2008.
The average mileage on risk vehicles sold at auction increased 35% to nearly 40,000 miles in 2009. In spite of the higher mileage, the average risk vehicle sold for $11,500, fairly similar to the average price achieved in 2008.

### Rental Companies Embrace Multi-Channel Remarketing

Brand diversity, higher mileage, and heightened awareness of wholesale pricing by make and model are contributing to data driven, multi-channel remarketing by rental companies. When risk units accounted for a minor share of the fleet, remarketing often consisted of selling a large number of vehicles to local dealers and wholesalers. Auctions were the channel of choice in regional markets like Florida where there were large concentrations of risk units that were often sold in auctions alongside manufacturer program units.
Now that risk units dominate rental fleets, remarketing has to reflect greater volume and brand diversity. Along with physical auctions and direct sales to dealers, rental companies are focusing more on selling online and experimenting with ways to sell vehicles while still in service. Sellers have to reach a broader range of buyers, including multiple franchise dealer networks and, for the first time, large numbers of independent used vehicle dealers who are attracted by the lower price points of their high-mileage, late-model units. In addition, the rental companies have had to establish their “brand,” or reputation as a seller, in the auction environment.

Manheim and its rental clients are experimenting with services that allow companies to offer vehicles for sale on OVE.com while they are still at the rental locations. If successful, this would minimize loss of revenue, depreciation risk, and potentially even transportation costs. The challenge to make such a proposition work is not technology, but rather identifying, inspecting, and segregating vehicles held for sale in busy rental locations. Nevertheless, rental companies are anxious to test remarketing propositions that convert their vehicles into cash faster and avoid extra expenses. Several major rental companies have been very successful in using Manheim Monday event sales that attract a large audience of buyers and reduce days-to-sell.

These events shorten days-to-sale for vehicles awaiting sale in the lanes. Dealers have embraced these events because they get to bid on fresh inventory.
Lease Originations in 2009 Hit Multi-Decade Low

As the credit markets froze in late 2008, new vehicle lease penetration rates dropped back sharply. That, coupled with an 18% decline in total new vehicle sales, pushed new lease originations in 2008 below the two million mark (but barely at 1.96 million). Then, in the first nine months of 2009, new unit sales and lease penetration rates plunged further. So, even with a moderate pickup in lease penetration rates and total vehicle sales in the fourth quarter of 2009, new retail lease placements for the full year fell to an estimated 1.1 million – a level not seen since leasing’s infancy back in the early 1980s.

Most of the pullback in leasing came from those lessors who were suffering huge residual losses or those who, because of their financial situation and the state of the credit markets, were unable to secure funding at reasonable rates. Financially-sound and long-established players, like the captive finance companies of many foreign manufacturers, did not pull back from leasing. This was especially true in the high-end segments of the import market, where lease penetration rates were little changed.

The Federal Reserve’s Term Asset-Backed Securities Loan Facility (TALF) program played an important role in freeing up the auto ABS market and enabled many lenders to increase their leasing activity. And, of course, GMAC’s approval for bank holding company status along with the direct infusion of federal bailout money allowed that lender to re-enter the leasing market, after being totally out of leasing in the first seven months of the year. But, it was the improvement in wholesale used vehicle prices that increased the lenders’ desire to grow their lease portfolios.

Off-Lease Volumes Grow in 2009, But Sharp Declines Are Ahead

Off-lease volumes continued to grow in 2009, reaching a level of almost 2.7 million units. That, however, represents the peak in this cycle. A modest decline in off-lease volumes will occur in 2010 and that will be followed by large declines in 2011 and 2012.

Although the unit decline in off-lease volumes during this cycle will be slightly less than what occurred between 2002 and 2006, percentage-wise the falloff will be greater. And, it is important to note, in the last cycle, lower lease originations were solely the result of lower lease
penetration rates – total retail new unit sales remained high. Thus, although off-lease volumes were down, the total supply of three- and four-year-old vehicles was little changed. In this cycle, there will be a substantial reduction in the potential supply of three- and four-year-old vehicles simply because overall new vehicle sales have been so low recently. From 2008 through 2010, an estimated 35.4 million new vehicles will be sold. Contrast that to the 51.4 million that were sold from 2000 to 2002.

**Remarketing of Off-Lease Units Continues to Shift to Online Channels**

The percentage of off-lease vehicles sold at auction remained steady at approximately 63% in 2009. (This number includes those vehicles sold to non-grounding dealers in manufacturer and third-party upstream channels.) All captive finance companies, as well as the major independents, have at least one Internet-upstream platform that offers end-of-term vehicles to an ever-widening audience of mainly franchised dealers prior to sale at physical auction.

The technology, platforms, and tools available for electronic remarketing of off-lease vehicles have improved significantly in recent years. And, as the upstream channels have flourished, so too has the importance of offering traditional auction services on an à la carte basis – for example, professional third-party inspections, marshalling, and reconditioning. Traditional auctions have also been the major supplier and developer of upstream and midstream platforms.

Securities and Exchange Commission filings show that GMAC’s Internet sales of off-lease vehicles exceeded sales at physical auctions for the first time ever in 2007. And, in 2008, the Internet sale share was nine percentage points higher than for physical auctions. Sales on Toyota Dealer Direct accounted for 41% of all Toyota off-lease sales in the fiscal year ending March 31, 2008. The overwhelming majority of these were sales to the grounding dealers at fixed prices.

We expect the relative demand for off-lease units to increase, just as the potential supply declines. As such, the share of sales accounted for by upstream and midstream channels will continue to grow and captive finance companies will continue to improve the processes that enable them to protect residual values, enhance brand image, and provide profit opportunities for their dealer networks.
End-of-Term: From Loss-on-Sale to Gain-on-Sale

In 2008, most lessors suffered large losses on end-of-term units even though most of the contracts when written were well-structured and not overly subvented. Blame it on the weakness in the overall wholesale market. Large disparities in price performance between individual market segments and models, as well as larger-than-normal seasonal fluctuations, also drove residual losses higher in 2008. From a residual setting perspective, lessors need to be accurate to the model, trim, and option level. Being right only on average, across the whole portfolio, is never good enough. That’s because lessors suffer large losses on those models out-of-favor, but experience little offsetting benefit from outperforming vehicles, since those units are more likely to be bought by the lessee or grounding dealer.
GMAC Sales Proceeds as Percent of ALG – U.S. Lease Terminations

Ford Credit Auction Values at Constant Fourth Quarter 2009 Mix

New Vehicle Lease Penetration Rates

To see just how the residual picture changed in 2009, consider the first two graphics depicted here. The first shows GMAC’s end-of-term sales proceeds as a percent of the ALG residual used at contract inception. In the fourth quarter of last year, losses of close to 25% were being taken. In the third quarter of 2009, there was a gain of nearly 10%.

The second graph shows the average price of vehicles coming off 24-month and 36-month leases at Ford Credit. Note that, in the fourth quarter of 2009, these mix-adjusted prices for 24-month and 36-month leases were up 23% and 30%, respectively, from their year-ago level.

**Leasing Has a Solid Future**

Leasing illustrates the various interactions that occur between the new and used vehicle markets better than any other segment of the industry. Indeed, leasing, as a business model, is based on the assumption that residuals can be predicted with a measurable, and insurable, level of risk. Thus, true success in leasing is achieved only when lessors fully understand how current and future vehicle values are influenced by:

- lease subvention and other incentive activity – both theirs and their competitors;
- vehicle-specific factors such as condition, options, mileage, and color;
- industry trends and seasonal factors;
- macroeconomic conditions; and,
- the lessor’s ability to utilize Intelligent Remarketing, combined with professional end-of-term remarketing processes, to save both time and money.

And, from the consumer’s standpoint, leasing makes clear that total vehicle ownership cost is dominated by depreciation. After all, depreciation, plus the money factor, determines the monthly lease payment.

For all of these reasons, and more, we welcome the recent uptick in leasing activity. And, when properly structured, leasing represents a winning proposition for customers, dealers, and lessors. There will, however, invariably be instances when lessors overly subvent their leases and offer them to customers with less than adequate credit quality. Indeed, there were instances of that in late 2009. We suspect, however, that the losses inherent in those contracts will be mitigated by the used vehicle pricing support provided by the industry’s overall reduction in off-lease volumes in 2012.
Leasing also has the ability to better market unique and technologically-advanced products. For example, both Lexus and Mercedes are offering their high-end SUV hybrids as lease only, due to limited supplies and a residual exposure that many customers would not like to assume. Lease only can also be used for very high-end, limited production vehicles (like the Lexus LFA supercar) to take speculators out of the market and get the vehicle in the hands of real car enthusiasts. Similarly, BMW has indicated that the Mini E will also be offered as lease only, and that the company will set up customer homes for 220-volt recharging.

Another interesting twist on leasing is proposed for the Nissan Leaf EV. Nissan has indicated it may sell the vehicle, but lease the battery separately. By doing so, customers would be relieved of any concern over battery life and also be offered the opportunity to upgrade the batteries as the technology improves.
Credit Contracts

The seeds of the recession were uniquely concentrated within the financial markets and, as such, it was known that financial deleveraging by businesses and consumers would not only intensify and prolong the downturn, but also define the recovery. With auto loans and leases accounting for the bulk of all non-revolving consumer credit, the automotive industry was strongly impacted by shifts in the credit markets.

As of November 2009, consumer installment credit outstanding had declined for ten consecutive months. That’s the longest such streak since the Federal Reserve Board began tracking the data back in 1943. Outstanding consumer vehicle loans and leases made by finance companies (including loans held within securitized assets) declined from $498 billion at the end of 2007 to $369 billion at the end of November 2009. This contraction in credit was both a cause and a consequence of weak new vehicle sales. Low new vehicle sales reduced the demand for auto financing, but, by the same token, new vehicle sales would have been higher if credit were more freely available.

TALF Program Succeeds in Thawing the Retail Credit Market

The lack of financing available for retail auto loans was a direct result of the freezing up of the ABS market, which started in late 2007 and reached a climax in the fourth quarter of 2008. The TALF program was aimed at unfreezing the auto ABS market (as well as the securitization markets for credit cards and student loans). The first offerings under the program began in March 2009 and included mostly packages of retail auto loans from banks and captive finance companies. In May, the first TALF-supported offerings of auto lease deals were made. By summer, TALF-eligible offerings had expanded into the subprime arena. And, by the end of 2009, the auto ABS market had improved so much that the majority of deals were being done without the assistance of the TALF program. That was a good sign since the TALF program is scheduled to wind down in March 2010.
**Origination Shares by Lender Type Shift**

The financial strain felt by several major auto lenders meant that the share of loan and lease originations amongst financial institutions shifted sharply and dealers often had to seek out new lending sources. For example, GMAC has traditionally financed close to half of the new vehicles sold by GM dealers. But, with access to capital limited, GMAC’s share fell to a mere 17% in the first quarter of 2009. And, even after the infusion of government funds and the granting of bank holding company status, GMAC’s share of new vehicle loans made by GM dealers improved to only 30% for the first nine months of 2009. The number of used vehicle contracts financed by GMAC dropped from 399,000 in first nine months of 2008 to only 95,000 in first nine months of 2009. And, although GMAC became the preferred finance provider for Chrysler dealers and their customers in April 2009, the number of non-GM new vehicles financed by GMAC was lower in 2009 than in 2008.

Shifts in the banking industry were also dramatic. There were 140 bank failures in the U.S. in 2009. Some of these small and midsize banks were major retail auto lenders within their communities. Although credit unions and financially-sound regional banks picked up some of the retail lending share vacated by others in 2009, the loan terms often were not as favorable to either the dealer or buying customer.

BHPH dealers continued to play a vital role in providing credit to a large segment of the used vehicle buying population. But, BHPH dealers faced their own access-to-capital issues. Most have dealer-related finance companies that operate on lines of credit from regional banks. Although well-established BHPH dealers didn’t have their credit lines cut, few had the opportunity to increase total borrowings and grow their business.

**Auto Lenders Look for Bigger Down Payments**

As the ABS market continued to perform better throughout 2009, lenders loosened lending standards. The Federal Reserve Board does a quarterly survey on changes in standards and terms for bank lending. These measures of “tightness” give insights into lending practices not only at banks, but also at other lenders. Standards for non-credit card consumer loans (primarily auto loans) tightened significantly, and reached a record level in 2008. However, as shown on the graph to the left, the net percentage of banks tightening declined significantly as 2009 progressed.
The biggest challenge for dealers in 2009 was getting adequate upfront money from customers. That problem is always compounded in a period of rapidly rising wholesale prices since the guidebooks that lenders use to set loan amounts smooth trends, and thus initially fail to keep pace with the rise in dealer acquisition costs. Thus, effective loan-to-value ratios are lowered even further. The rise in wholesale values in 2009 did, however, reduce the problem of customers having large amounts of negative equity in their trade-in.

In addition to tightening requirements on borrowers, many lenders in 2009 took into consideration the credit risk imposed by the dealer in retail financing. With the financial situation at many dealerships shaky, lenders did greater due diligence of dealer processes to ensure, for example, that titles were being quickly and properly perfected.

### Loan Performance Deteriorates in 2009

Loan portfolio performance remained poor in 2009. The 60-day delinquency on prime auto ABS loans peaked at 87% at the start of 2009, according to Fitch Ratings. Delinquencies slowed in the spring, but moved back close to the peak in August and September before easing in the fourth quarter. The nonprime delinquency rate peaked at 4.97% in September 2009. Although the surge in wholesale used vehicle values in 2009 improved recovery rates, the higher frequency of loss drove loan loss rates higher. Fitch’s annualized net loss index for prime loans was above 2% in the first four months of 2009, before beginning its descent. The net loss index for nonprime averaged more than 10% in the first quarter of 2009.

For the most part, poorer loan performance was not the result of lax underwriting. Indeed, given the 10+% unemployment rate and loss of more than 8.4 million jobs since the recession began, one could argue that auto loan performance held up very well in 2009.

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### Prime Auto Loan ABS Performance Indices

- **60+ Day Delinquency Index**
- **Annualized Net Loss Index**

Source: Fitch Ratings

### Subprime Auto Loan ABS Performance Indices

- **60+ Day Delinquency Index**
- **Annualized Net Loss Index**

Source: Fitch Ratings

Fitch indices are based mainly on Fitch rated transactions, but do include some transactions not rated by Fitch. Subprime indices include a fewer number of transactions than the prime indices and, thus, are susceptible to being periodically influenced by the performance of a small number of issuers.
Repossessions Reach Record High

Total repossessions in the U.S. reached a record 1.9 million in 2009, an increase of 5% from 2008. This came after double-digit increases in 2007 and 2008.

As is typical in a recession cycle, the initial increase was driven by defaults on subprime loans, whereas, the more recent rise came from prime contracts. Reduced loan originations and the tighter lending standards imposed in 2008 and 2009 are expected to reduce total repossession volumes in the coming years.

Special Challenges in the Remarketing of Repossessions

The remarketing of repossessions often presents special challenges as state and local laws influence the process of both collateral recovery and liquidation. Obtaining clear titles in a timely matter is often difficult. And, the recovery lots to which vehicles are taken are not set up for (and, thus, charge exorbitantly for) vehicle storage. This increases the need for the marshalling services of auctions.

Taking full advantage of online selling opportunities is also hampered in the case of repossessions since the initial inspections and photos are often done under poor conditions. For example, heavy dirt and trash in the car render photos less revealing to online buyers – there may be a cigarette burn under that hamburger wrapper!

These challenges – and the fact that some lenders have relatively low repossession volumes, a very diverse mix of vehicles, and collateral that could be far away from their base of operations – have led some lenders to outsource remarketing functions to third-party providers. In some respects, this places the lender in a position similar to the relationship between a fleet manager and the fleet management company. In both instances, the one with direct financial exposure (lender or fleet manager) must ensure that the remarketing company is providing adequate feedback and that best practices are being employed to achieve maximum net returns.
Removing the Stigma of Repossession Through Reconditioning

Although some lenders consider the reconditioning of repossessed collateral as a case of “throwing good money after bad,” a larger number of lenders recognize that buyers are looking for some sort of assurance as to the vehicle’s basic reliability. As such, these lenders have found it worthwhile to segment their pool of vehicles, perform strategic reconditioning, and then “certify” vehicles to one or more levels. Over time, the three-prong approach of strategic reconditioning, the “certification” of vehicles into special categories, and the marketing of what these certification levels mean has proven very effective at improving remarketing results.

Future Trends in Retail Financing

Given the sizable shocks absorbed by the credit markets over the past two years, it is logical to anticipate that retail auto financing will undergo some long-term changes. Capital constraints and new regulations will make retail auto financing seem tighter, but the real effect will be small compared to other industries where there actually were abusive practices and inefficiencies. The indirect auto lending model has proven to be not only efficient, but also customer-friendly and dealer-profitable over the years.

Look for technology to increasingly enhance both the lender’s and the dealer’s ability to develop contracts that fit the needs of specific customers and vehicles. And, with loan-to-value ratios playing such an important role in allowing the dealer to profitably get the customer into a vehicle, dealers will increasingly appraise inventory not only from the potential customer’s perspective, but also from that of the lender.
Commercial and Government Fleets Acquire Fewer Vehicles and Downsize the Number of Units in Service

Irrespective of the number of vehicles in service, the pressures on all businesses and fleet managers in 2009 were unprecedented. Employee cuts that triggered rapid reductions in units in service eased in the second half of 2009, but fleet managers remained under pressure to curb expenses. In the past, fleets benefited from large manufacturer incentives, low interest rates, and easy credit. However, the credit crisis raised borrowing costs and reduced credit availability, especially to small businesses. The bankruptcies of GM and Chrysler reduced industry excess capacity, which contributed to higher average vehicle prices by lowering incentives.

During the first half of 2009, fleet downsizing meant that commercial and government fleets remarketed more vehicles than they purchased. In the second half of 2009, fleet purchases and remarketing volumes were approximately equal as fleets took advantage of high used vehicle values to remarket high-mileage units.

Major commercial and government fleets purchased 588,000 new vehicles in 2009, down 33% from 872,000 in 2008. Purchases of 2009 model-year vehicles declined even more dramatically as many fleets deferred all purchases during the spring buying cycle. Buying picked up in the fourth quarter of 2009, but still remained well below 2008 levels.

New Vehicle Sales into Commercial and Government Fleets
In Thousands

![Bar chart showing new vehicle sales into commercial and government fleets from 2001 to 2009.](chart.png)

*Source: Bobit Business Media*
Vehicle Purchases Will Remain Well Below Historic Peaks in 2010

The drop in purchases was greatest in companies with traveling sales staffs. Corporate downsizing and consolidation reduced personnel in pharmaceutical, high tech, and industrial companies. Falling tax revenues led to job cuts and subsequent reductions in local and state government fleets, but the federal government purchased an additional 25,000 vehicles in the second half of 2009 as part of the stimulus program. Even as the economy slowly recovers and lenders ease credit, it is unlikely that total fleet purchases will rebound to a million vehicles a year because fleet budgets have been under pressure since 2007. Fleet managers have already eliminated surplus vehicles and shifted fleets away from SUVs into less expensive models. The recession further reduced units in service. And, the extension of service lives has some fleets running vehicles for four years or 90,000 miles. Nevertheless, fleets are expected to buy more vehicles in 2010 as more units reach their maximum service life.

Fleet Selector Lists Increased Brand Choices

Despite the bankruptcies of GM and Chrysler, the three domestic automakers maintained a dominant share of the fleet market in 2009. Fleet customers have been known for their loyalty to a single manufacturer. However, Ford picked up share at the expense of the other domestic manufacturers. Recent additions to the lineup, like the well-received Fusion and new Taurus, contributed to Ford’s gain. Chrysler’s choppy restart of production after emerging from bankruptcy, along with its greater dependence on SUVs and trucks contributed to a lower share of the fleet market.

Domestic automakers still dominate the fleet sector because they understand and accommodate the needs of their customers. Domestic models are often assembled without features such as navigation systems, which raise prices and offer little, or no, additional resale value. Foreign manufacturers have historically not been as adaptable to the special requirements of fleet operators.
Even though General Motors and Chrysler experienced prolonged plant closings prior to, and during, their bankruptcies, both manufacturers worked with fleet customers to ensure that their orders were filled after production resumed. Weak retail demand and excess dealer inventory gave assemblers some flexibility in responding to fleet orders. Nevertheless, fleets did encounter delivery delays as railcars and truckers waited for full loads.

**Dealership Terminations Posed Logistical Challenges for Some Fleet Managers**

Chrysler terminated 789 dealers by the end of the third quarter, so fleet vehicles scheduled for delivery to those dealerships had to be rerouted to other stores. That added time to the order-to-delivery schedule. In addition, Pontiac and Saturn dealerships closed as the brands were discontinued.

In all, General Motors and Chrysler might terminate more than two thousand dealers by the second half of 2010. By streamlining their distribution networks, both companies expect to save money and raise the profitability of surviving dealers. Fleet managers, however, value these large dealer networks, which allow drivers to take delivery and get warranty service anywhere in the country. With fewer dealers, especially outside of metro areas, access to courtesy deliveries and warranty service might be less convenient.

Fleet managers are also concerned that the incentive payments that were once common practice for exceeding volume targets with a given manufacturer will shrink, resulting in much higher effective pricing for fleet vehicles. Given the elimination of excess capacity and price hikes on imports due to the weak dollar, these fears are well-founded.

**“Green” Initiatives Mean Smaller Vehicles, Not Necessarily Alternative Fuels**

Although “green” initiatives were already pushing fleet purchases toward smaller vehicles and sedans instead of minivans and SUVs, higher vehicle and fuel prices and greater choices will accelerate this trend. “Green” goals had been implemented by 63% of the companies surveyed in PHH’s study of environmental fleet issues. However, only 24% said that they achieved lower costs.
**Tips for Going Green**

- Observe the speed limit. 10 mph above speed limit reduces fuel economy 10%.
- Avoid start-and-stop driving when possible.
- Reduce weight. For every extra 100 pounds, fuel economy is reduced by one percent.
- Use cruise control over long distances.
- Use air conditioning as sparingly as possible.
- Keep your car in the garage in winter and summer.
- Maintain your vehicle and keep tires properly inflated.

Source: Excerpted from FleetWeek, December 20, 2009
Published by Wheels Inc.

Many large corporate and government fleets include hybrids and alternative fuel vehicles (AFVs) as part of a mandate to “green” their fleet. However, with the exception of the Toyota Prius, Ford Escape, and Ford Fusion hybrids, “green” currently means a smaller vehicle rather than alternative power. Limited choice, high prices, and evolving technology that could impact residual values have discouraged a faster transition to AFVs. Many delivery vehicles, however, have already migrated to alternative fuels, such as diesel, bio diesel, and compressed natural gas.

Driver monitoring and education have proven to be among the most effective ways to curb fuel consumption. Route planning is now the norm for delivery and service providers such as utility, cable, and communications companies. Instilling good driving habits to avoid speeding, jackrabbit starts, and excessive engine idling have also been huge fuel savers.

**End-of-Service Fleet Vehicles Are Sought After by Used Vehicle Dealers**

Commercial fleet vehicles in the wholesale market are highly desired by used vehicle dealers. They generally average about three years old and have more miles than usual for their age. That means a lower wholesale price, which results in an affordable retail price. As a commercial fleet vehicle, dealers know that it has undergone scheduled maintenance during its service life.
Common Sense Tips for Maximizing Residual Values at Resale

- Smart reconditioning adds value. High line units, low mileage vehicles and those with more equipment have a greater opportunity for cost-effective reconditioning. But all vehicles benefit from a general wash and vacuum.
- Avoid major collision repair, though paintless dent repair is generally cost-effective.
- Replace tires with less than 50% tread life. Many auctions provide reconditioning services to fleet operators regardless of whether the vehicle will be sold at that auction.
- Time vehicle disposals to the seasonally strong spring market and before the winter doldrums.

Fleet managers order vehicles in neutral colors like silver, tan, and white rather than colors that can go out of fashion in a few years. In addition, these sophisticated buyers configure sedans with the options necessary to protect resale values, such as climate control systems and power door locks, windows, and seats (at least the driver’s side). Higher-end cars often have upgraded interiors and sound systems, but basic compact and midsize models are standard equipped, which keeps their end-of-service resale price within the sweet spot for many used vehicle customers.

It’s impossible to generalize about the retail customers for end-of-service commercial fleet vehicles. Individual contractors and small business owners often buy used pickup trucks and cargo vans with mileage of a hundred thousand miles or more. Passenger vehicles appeal to a broad array of customers and, thus, to every type of used car dealer, including franchised dealers. The lower-priced units are popular with BHPH dealers who know that the maintenance history of the vehicles will make them reliable units for their customers.

Drivers and Company Employees Bought Fewer Vehicles in 2009

Most commercial fleet managers use multiple channels to remarket end-of-service units. Passenger vehicles are usually offered to drivers and employees at the time a replacement unit is ordered. In 2009, the purchase rate by employees dropped because of job cuts and the difficulty in obtaining retail financing.

Fleet managers typically price the vehicle to employees at the time that the replacement vehicle is ordered. Pricing is based upon wholesale values at the time and administrative fees. The normal expectation would be for the vehicle to depreciate modestly until title is transferred to the employee. However, used vehicle values soared in the second and third quarter so those vehicles were often sold to employees below what they would have fetched at auction.
Commercial Fleets Increased Their Reliance on Auctions

The supply of fleet vehicles increased in the auction lanes in the first half of 2009. In the second half of 2009, fleet replacement followed a more normal pattern; however, the vehicles were remarketed with higher mileage due to service life extension. Used vehicle dealers actively sought commercial fleet vehicles in auction channels throughout the year.

The average midsize sedan remarketed at auction had 66,125 miles and sold for $7,125 in 2009. On a mileage and seasonally-adjusted basis, prices rose in the second half of 2009, which was consistent with the overall strength in the wholesale market.

Approximately 43% of fleet units are remarketed through auctions where they are guaranteed to find active and varied bidders. In 2009, the share of fleet vehicles sold at auction was above previous levels because auctions had the ability to accept large numbers of vehicles as defleeting took place early in the year. And, in a period of financial stress, the auctions’ guarantee of payment to sellers was an important benefit.

The major fleet management companies generally co-mingle vehicles from several clients to attract maximum attention from bidders. These sellers are also active in online auctions, such as OVE.com, to provide 24/7 exposure for their inventory. Although midsize sedans dominate many fleets, a typical fleet auction can include everything from a relatively new hybrid, to a luxury import, or to a heavily-used cargo van. Effectively remarketing such a wide array of vehicles poses special challenges to fleet managers.
Commercial Fleet Vehicles Remarked Through Salvage Auctions Often Attract Foreign Bidders

Vehicles that are heavily damaged, or a total loss, are remarked through salvage auctions. With fewer drivers on the road, the number of heavily-damaged fleet units remarked through salvage auctions in 2009 declined. In declaring a vehicle a total loss, fleet managers factor in the cost of providing the driver with a replacement unit, the loss of value due to the accident, and the cost of repair. As a result, fleet vehicles consigned to salvage auctions often have less damage than those from other sellers. Thus, it is repairable dealers and exporters who often buy fleet vehicles from salvage auctions.

Medium- and Heavy-Duty Truck Fleets Delay Replacements

There was a significant contraction in medium- and heavy-duty truck sales in 2009, which reduced the supply of used trucks at auctions. With industrial production and retail sales slow, large and small fleets deferred replacements as existing units logged fewer miles.

In contrast to the sharp recovery in wholesale values of used passenger vehicles, commercial vehicle auction volumes remained weak and price trends trailed the rebound in passenger vehicle values. Low retail sales of new commercial vehicles in 2008 and 2009 means less supply of used vehicles and the likelihood of better pricing in the coming year.

Used Government Vehicles Are Actively Sought by Dealers

Most government fleets are required to remarket end-of-service vehicles to the public as well as to dealers and other buyers. The replacement of an additional 25,000 vehicles as a result of the American Recovery and Reconciliation Act boosted auction volumes and attracted more bidders. General Services Administration vehicles are typically 3- and 4-year-old units with moderate mileage. Because of the shortage of certain models in wholesale channels, dealers actively bid on these attractively-priced units, often in online, open to the public, channels.
Chris Amos was elected president of NAFA in 2009. He was involved in fleet management prior to being elected Commissioner of Equipment Services for the City of St. Louis, Missouri, in 1995. In his role, he oversees a diverse fleet of more than 2,500 vehicles. Chris completed NAFA's Certified Automotive Fleet Manager program in 1994. He is a recipient of both NAFA's Distinguished Service Award and the inaugural Excellence in Education award. Chris has written extensively on fleet management issues, taught at seminars and conferences, and served on federal rule making committees.

How did fleet managers respond to the business and economic pressures they confronted in 2009?

Four times as many fleet managers reduced the number of units in service as reported an increase, according to NAFA's 2009 Economic Survey. In addition, two-thirds of survey respondents extended vehicle service lives, purchased less expensive models, and negotiated harder for discounts.

Did domestic auto companies maintain their historic market share of the commercial fleet market?

Competition among manufacturers for fleet business was intense in 2009 as the car companies vied for a shrinking pie. Domestic auto companies maintained their dominance with Ford, GM, and Chrysler ranked in that order of popularity. Toyota/Lexus was the strongest foreign manufacturer.

Most fleets diversified their selectors and no longer rely on a single source. With life-cycle costs playing such a key role in fleet decisions, managers are factoring in likely residuals in making their decisions.

How are fleet managers changing the types of vehicles in their fleets?

Fleet managers are aiming to find the right vehicle for each task. Often the critical factor is the amount of cargo the vehicle must carry. Small crossovers that offer about 60 cubic feet of cargo space can usually replace larger vehicles. The job of the fleet manager is to find the best vehicle for each task while taking into consideration driver comfort, image, and safety.

Do hybrids have a role in corporate fleets?

When gasoline prices are below $4 a gallon, life-cycle analysis doesn't support hybrids. Nevertheless, many fleets have added a small number of hybrids to gain experience with them. If their vehicles do a lot of stop and go urban driving, the operating costs for hybrids are more competitive.

Has used vehicle price appreciation impacted remarketing decisions?

No one anticipated the collapse of used vehicle values in the fourth quarter of 2008 and no one imagined the sharp recovery in 2009. Those managers who delayed replacements fared very well when they remarketed their vehicles. Fleet managers are expecting less volatility in used vehicle values in 2010 and are incorporating that into their vehicle purchasing decisions.

What is NAFA doing to help it members cope with these turbulent times?

NAFA's E-Communities are online forums where members share ideas and experiences. This has been a great tool that allows learning from each other. NAFA educational offerings include desk references, seminars, and university accredited professional fleet certification programs. Local NAFA chapters are another excellent source of information and enable networking with peers, which is priceless.
Salvage Auction Volume Declines for a Second Consecutive Year

There are no precise statistics on the number of vehicles remarketed each year through salvage auctions. It is estimated, however, that the combined volume of national chains and numerous local operators was in the neighborhood of 3.5 million units in 2009, but below 2008’s level. Salvage volumes were influenced not only by accident frequency and severity, but also by recession related factors, including smaller commercial and rental fleets and an increase in the percentage of drivers who elected to accept cash from their insurer instead of surrendering their damaged vehicle.

Some regional and national operators, including Total Resource Auctions (TRA), reported higher volumes in 2009. Large auction chains have dedicated staff, sometimes located within large insurance companies, to help insurers reduce the time between total loss declaration and the completion of paperwork to permit disposal of the vehicle.

12 to 13 Million Vehicles Fail to be Re-registered Each Year

Each year, approximately 10 to 12 million vehicles fail to be re-registered. Many of these vehicles are directly dismantled, recycled, or sent to junkyards without passing through an auction. Some are exported and some simply remain with their owner, but unregistered. Then, there is the salvage auction industry, which is involved in remarketing approximately a third of the vehicles. These are typically the higher-value, insured vehicles where determining the fair value in an auction setting is essential for dealers, fleets, charities and especially auto insurance companies and their customers.

Because salvage vehicles are damaged or might not be driveable, they are often disposed of locally. So, having a national footprint is important for partnering with rental fleets, fleet management companies and insurance companies. Transporting a salvage unit a long distance might not be worth the extra cost of moving, special equipment, and handling. Salvage auctions provide support services such as transportation, specialized vehicle protection, and long-term secure storage until all paperwork, including variations in titles among states, has been completed and the vehicle can be sold.
Repairable Vehicles Account for About 30% of Salvage Units

Salvage vehicles generally fall into two categories: those that can be repaired and rebuilt and those that will be dismantled and shredded. Repairable dealers and rebuilders, including exporters, purchase about 25% to 30% of salvage auction volume. These bidders benchmark off the value of comparable vehicles in whole car auctions and factor in the cost of repairing the vehicle, their profit margin, and the likely retail price. When whole car prices fall as they did in the second half of 2008, repairable dealers reflected that decline in their bidding. Likewise, the upturn in used vehicle values in 2009 favorably impacted pricing of salvage units, albeit with a lag. In 2009, many salvage auctions also saw an increase in the number of used vehicle dealers searching for vehicles with good titles and those that could be affordably repaired.

The remaining vehicles are heavily damaged and will be dismantled. The value of these vehicles is determined by the value of recoverable parts, components, and remaining metals. Dismantlers and recyclers have a sharp eye for assessing damage and estimating values. High-volume models and those that have been in production for several years are often more valuable because of higher parts demand than low-volume models. Newer models have more value than older models because of the likelihood of a limited supply of recycled parts. The engines are the single most valuable component so vehicles in front-end collisions are worth substantially less than those in rear-end collisions. Luxury vehicles, if they can’t be repaired, are always valuable for their recoverable content.

Each vehicle is unique in terms of the attributes it has and the value it represents. Dismantlers and recyclers are sophisticated bidders who monitor commodity price trends, exchange rates, demand for specific parts, and values in the whole car auctions.

Rising Repair Costs and Aging Vehicle Population Underpin Salvage Auction Volume

Until the recession, the number of vehicles sold through salvage auctions had increased for more than a decade. With more vehicles on the road, the number of accidents rose. At the same time, the cost of vehicle repair climbed due to more complex design and expensive electronic systems that were often placed at the ends of the vehicle. The use of new lightweight materials and the addition of multiple airbags also added to repair costs. In addition, original equipment prices have steadily climbed, adding to total repair costs.
The aging vehicle population means that the value of vehicles on the road is declining at the same time that repair costs continue to rise at 2% to 3% a year. Thus, fewer vehicles are worth repairing after an accident whether the vehicle is covered by collision insurance or not. More than 80% of the vehicles remarked through salvage auctions have been damaged in accidents, thefts, or in weather related incidents, such as floods.

**Salvage Auction Values Lag Whole Car Auctions**

Whole car auction values influence the prices paid by repairable dealers, including exporters, for vehicles they intend to fix and later retail. Even though whole car values rebounded sharply in the second and third quarters, the value of repairable units lagged. Salvage vehicle values, especially for repairable units, generally lag whole car prices by one or more months, but the lag was longer in 2009. Salvage values plummeted in the fourth quarter of 2008 and then began to recover for repairable units in the fourth quarter of 2009.

**Percent Change in Average Valuation Amount from Same Month Prior Year**

The weak dollar continued to attract foreign bidders and used car dealers scoured salvage auctions for affordable vehicles with clear titles. Although exports to Mexico and Russia fell dramatically because of higher tariffs, bidders from other countries were active in salvage auctions. Attractive prices and the weak dollar supported foreign interest. Speculators were sidelined by a lack of credit but real bidders from Southeast Asia and Eastern Europe continued to focus on late-model and luxury units, while buyers from the Middle East favored lighter colored, late model Japanese makes.
Global economic trends were more important to prices of salvage vehicles in 2009. Approximately 70% of salvage vehicles are dismantled for their parts and scrap metal. Prices for these vehicles were relatively weak in 2009 because of lower commodity prices. The recession reduced demand for scrap metal relative to supply.

In every market, there are exceptions. Insurance companies declared thousands of new vehicles damaged by hail as total losses in 2009. Dealers aggressively bid for these otherwise brand new vehicles and valued them against whole car auction prices.

**Salvage Auctions Play a Key Role in Holding Down Insurance and Vehicle Repair Costs**

The cost of vehicle repair is an important element in the cost of collision coverage. The salvage auction industry plays a crucial role that both values salvage vehicles and then recovers crash parts that help hold down the cost of repairs. In addition to the economic importance to insurance companies and their customers, the salvage auction industry facilitates the environmentally-friendly recycling of materials. Approximately 84% of the scrapped vehicle, by weight, is recovered and recycled for use in all types of products, including new vehicles.

**Cash-for-clunkers Sends Vehicles to Salvage Auctions and Recyclers**

Cash-for-clunkers sent almost 700,000 drivable vehicles to salvage auctions and government approved dismantlers and recyclers. About 1% of 1984 to 1999 model year vehicles were traded in during the program. Domestic pickup trucks and sport utility vehicles represented a disproportionate share of the vehicles traded in under the program. All parts, other than the engine block and drivetrain, could be sold to dismantlers and metal recyclers. Anything remaining had to be shredded or crushed which added to the supply of scrap metal.

**Miles Driven Rebound**

Vehicle miles traveled correlates with accident frequency. In early 2008, drivers cut back sharply on travel because of high fuel costs, which resulted in lower accident frequency. In 2009, vehicle miles traveled stabilized and then finished the year with a modest increase of less than 1%. Thus, miles traveled on both urban and rural roads remained well below the 2007 peak. The recession, and its impact on manufacturing and retail sales as well as 10% unemployment, continues to limit vehicle miles.
Insurance Companies Declare Higher Percentage of Damaged Vehicles a Total Loss

Even though consumer behavior with respect to collision coverage changed during the recession, the majority of drivers with liens on their vehicle are required by the lien holder to carry coverage. Drivers without liens on their vehicles often increased the deductible or eliminated collision coverage on older models to save money during the recession.

The declining value of the vehicle population and the cost of repair contributed to an increase in the percent of vehicles declared a total loss. According to CCC’s Crash Course third quarter report, the percentage of vehicles flagged as total loss increased to 14.2% from 12.6% between mid-year 2006 and mid-year 2009. The average age of vehicles deemed a total loss was nine years in 2009, a full three years older than vehicles repaired. The average market value of the totaled vehicles was $6,999 compared to $12,528 for repairable vehicles. Because the value of a vehicle falls with age, it is likely that the insurance industry will continue to declare a higher percentage of vehicles a total loss even if repair cost inflation slows.

Average Vehicle Age in Years

<table>
<thead>
<tr>
<th>Vehicles</th>
<th>Q1 2007</th>
<th>Q3 2007</th>
<th>Q1 2008</th>
<th>Q3 2008</th>
<th>Q1 2009</th>
<th>Q3 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Convertible</td>
<td>9.48</td>
<td>9.94</td>
<td>9.67</td>
<td>10.24</td>
<td>10.01</td>
<td>10.82</td>
</tr>
<tr>
<td>Coupe</td>
<td>9.92</td>
<td>10.24</td>
<td>10.09</td>
<td>10.41</td>
<td>10.37</td>
<td>10.71</td>
</tr>
<tr>
<td>Hatchback</td>
<td>10.74</td>
<td>10.56</td>
<td>10.10</td>
<td>9.97</td>
<td>9.69</td>
<td>9.84</td>
</tr>
<tr>
<td>Wagon</td>
<td>9.30</td>
<td>8.99</td>
<td>8.63</td>
<td>8.75</td>
<td>8.50</td>
<td>8.61</td>
</tr>
<tr>
<td>Other Passenger</td>
<td>10.54</td>
<td>10.84</td>
<td>11.08</td>
<td>11.10</td>
<td>10.19</td>
<td>11.43</td>
</tr>
<tr>
<td>Pickup</td>
<td>9.68</td>
<td>9.83</td>
<td>9.74</td>
<td>10.01</td>
<td>9.77</td>
<td>10.52</td>
</tr>
<tr>
<td>SUV</td>
<td>8.07</td>
<td>8.26</td>
<td>8.29</td>
<td>8.38</td>
<td>8.50</td>
<td>8.81</td>
</tr>
</tbody>
</table>

In 2008 and 2009, insurance companies noted an increase in the number of drivers who accepted cash (determined by their loss less any deductible and the salvage value of the vehicle). Many drivers opted to make some repairs to their damaged vehicle rather than spending more money on a replacement. This meant that fewer units declared a total loss were actually remarketed through salvage auctions.

Fleets, Charities, and Dealers Send Fewer Vehicles to Salvage Auctions

Salvage auctions handled fewer vehicles from government, commercial, and rental fleets in 2009. Smaller fleets and fewer miles traveled reduced accidents. Commercial and rental fleets apply sophisticated logic in deciding whether to fix or scrap a vehicle. They take into consideration the cost of a replacement unit while the damaged vehicle is repaired, the loss of value due to the repair, the cost of the repair, and the current wholesale value of a comparable unit.

In recent years, drivers often turned to charities to get rid of old vehicles with little value as transportation but which could result in a tax deduction equal to the salvage value. With so many charities soliciting donations, they became a new and important source of vehicles in salvage auctions in the last decade.

In 2008 and 2009, the recession caused drivers to hold onto their old cars rather than trading for something better. In addition, many potential donations were traded-in during the cash-for-clunkers program. This reduced the number of vehicles remarkeeted by charities and by used vehicle dealers, who took these marginal vehicles in trade as an accommodation for their customers.
Salvage Vehicles Are Readily Sold Online

With smaller volumes (than whole car auctions) in any sale and diverse bidders and sellers, salvage auctions and their customers have embraced online remarketing. In fact, the percentage of salvage vehicles remar- keted through online channels is significantly greater than it is for whole cars. There are still thousands of bidders, especially repairable dealers, who prefer to participate in person. However, the majority of buyers search online inventories for upcoming sales and bidding from the conve- nience of their offices.

Despite the fact that salvage vehicles are heavily damaged, knowledgeable bidders can access valuable information from insurance reports, title information, and photos. They can rely upon Internet-connected channels, including Simulcast, to give them access to multiple sales without being physically present. Bidders are often looking for specific vehicles and can never be sure when or where that vehicle they seek will show up in a sale. The Internet is a critical tool that allows bidders to review inventory anywhere in the country.

Manheim’s Total Resource Auctions (TRA) Records Double-Digit Growth in 2009

Manheim’s TRA operates 72 auctions throughout the United States and Canada. TRA is co-located with 51 Manheim whole car auctions. As a result, TRA is uniquely positioned in the salvage industry to optimize the remarketing channel for each specific vehicle. Another 21 salvage-only auctions provide TRA with a network of locations to service national and major regional accounts.

Co-location of whole car and salvage auctions allows vehicles with non-salvage titles to be remarke ted in either sale. This is especially appealing to dealers who have end-of-life units taken in trade that might bring more value in the salvage sale. At the same time, co-location also enhances the whole car buyer’s access to salvage vehicles.
Total Resource Auctions, Manheim’s Salvage Division, Includes 72 Locations
Many Countries Show Similar Used Vehicle Trends

The scale, sophistication, and efficiency of used vehicle remarketing varies greatly from country to country. In mature markets, such as the United States, Canada, Great Britain, or anywhere where a large percentage of the vehicle population turns over each year, professional remarketing services are essential. Auctions and related remarketing services help dealers find the vehicles they need and enable buyers and sellers to transact quickly at market prices. The wholesale vehicle market provides instant feedback on business conditions. Real-time price information by make and model is available from Manheim in the U.S., Canada, Great Britain, Australia, and elsewhere.

There were many similarities between used vehicle market conditions in the United States and other countries around the world in 2008 and 2009. Volatile fuel prices followed by tight credit, recession, rising unemployment, and cash-for-clunkers incentives impacted wholesale and retail used vehicle prices. In those countries with a professional remarketing infrastructure, buyers and sellers quickly reflected these and other factors into their auction bids.

Used Vehicle Prices Are an Important Indicator of Business Conditions

Manheim’s international operations often provide clients with real-time and aggregated wholesale prices by make and model, as well as online access to inventories, remarketing channels, and other vital services. Because used vehicle prices are determined in an open market, they immediately reflect economic and business information. In effect, the price and volume data are important indicators of broader economic and auto industry trends.

Professional remarketing, whether in the United States, Thailand, Turkey or China, tailors it services (consignment, reconditioning, transportation, inspection, titling, and others) to fit the unique attributes of each country. In addition, in many countries, Manheim provides consumer services aimed at helping dealers increase retail used vehicle sales.
Wholesale Used Vehicle Prices Rebound in 2009

Record high fuel prices depressed the prices of larger, less fuel efficient used vehicles in auctions around the world in 2008. This was most evident in the United States with its huge light truck population and bargain priced fuel. But other countries recorded similar drops in the values of big cars and light trucks in early 2008. This was followed by relative stability as crude oil prices eased in the second half. By the fourth quarter of 2008, economic concerns had dominated wholesale markets. Prices plummeted as the global credit crisis reduced consumer spending on new and used vehicles.

Although market conditions were challenging, used vehicle sales stabilized early in 2009 throughout Western Europe, Australia, and other countries. Meanwhile, the supply of used vehicles remained tight, which caused prices to recover quickly.

Average Auction Selling Price: Passenger Cars

In Pounds

Used vehicle prices rebounded strongly in early 2009, and this strength continued throughout the year.

The speed with which prices rebounded from the collapse in late 2008 caught many by surprise. Conditions in Great Britain and elsewhere mirrored those in the United States. Dealers entered 2009 with very low inventories because they were reluctant to carry stock while prices were falling and future demand was uncertain. In early 2009, shoppers responded to bargain-priced used vehicles. While new vehicle demand collapsed, dealers saw increased interest in affordable used vehicles. Again mirroring the U.S. experience, franchised dealers in Great Britain looked to used vehicles as a profit lifeline. Conversion rates at British auctions soared to 85+% in the first quarter of 2009 and, by March, wholesale prices had risen 18%. By the end of the second quarter, British used vehicle prices had recovered the entire loss in value posted in 2008.
Canadian Auction Activity Mirrors U.S.

American and Canadian consumers essentially purchase nearly identical cars. As such, wholesale used vehicle markets are impacted by demand for used vehicles in both countries and relative exchange rates. Whenever the U.S. dollar was stronger than the Canadian dollar, American dealers flocked to Canadian auctions. Likewise, Canadian dealers in recent years have taken advantage of their country’s stronger currency, and attractive U.S. prices, to export used vehicles back to Canada.

Canadian Used Vehicle Value Index

Canada’s wholesale market trends were nearly identical to those of the U.S. in 2009. Prices climbed early in the year and auction attendance and sales percentages rose. The supply of vehicles from auto companies, fleets, and dealers was lower, which stabilized values and caused dealers to search multiple auctions to find the models they needed. The average age of vehicles sold through Manheim Canada auctions increased from 4.7 years in the second quarter of 2008 to 5.2 years in the same period in 2009. This was mainly due to the sharp drop in current and late model program and other vehicles sold by auto companies.
As the Canadian dollar strengthened in 2009, cross border buying in the U.S. by Canadian dealers increased. Canadian dealers favor late model SUVs, luxury makes, and some mass-market Japanese brands. They are also active in specialty equipment sales, where they are buyers of snowmobiles. Because the U.S. new vehicle market has been seven to ten times larger than the Canadian new vehicle market in recent years, the supply of certain used vehicles is much greater in the U.S., and their prices lower. As a result, Canadian buyers often search the U.S. for luxury and near luxury models that are in short supply locally.

**Canadian Buyer Purchases – Cross Border Buying**

The high conversion rates at auctions in Britain, Australia, and other countries reflected both the higher demand for used vehicles and constrained supply. With new vehicle sales plunging, dealers had fewer trade-ins to remarket and commercial consignors often extended service lives of fleet vehicles to avoid losses while prices were low.

Wholesale market conditions improved in the second half of 2009 as higher used vehicle values increased supply in the auction lanes in many markets. For example, Australia’s commodity-based economy saw a rebound in economic growth and new vehicle demand. That, in turn, increased the supply of dealer trade-ins coming back to auctions. In other countries, fleets and other large sellers took advantage of high prices and increased the number of vehicles they remarke ted.
Cash-for-Clunkers Incentives Impact Markets

Germany, Spain, and other European countries, along with Japan, enacted cash-for-clunkers incentives to boost production of automobiles. Some of these programs, in particular Germany’s, increased new vehicle demand so much that it raised concerns about a significant payback in 2010. The duration and relative financial benefits of the program influenced consumer choice between replacing their old used vehicle with either a late-model used vehicle or a new one. In Germany, buyers taking advantage of the scheme could either purchase a new vehicle or used vehicle less than a year old. Although some forecasters predicted more volatility in used vehicle demand and prices, without exception, wholesale vehicle markets saw only a short-term impact from these incentives.

In Great Britain, the campaign to promote new vehicle sales began in May and lasted into early 2010. Fears that the program would sharply impact used vehicle values were unfounded. However, used vehicle values flattened in the second half of the year and auction conversion rates, though still seasonally high in the fourth quarter, were down from the record levels early in the year. Removing 250,000 used vehicles out of the population is thought to be keeping the values of older used vehicles somewhat stronger.

China Outsells the U.S. to Become the World’s Largest Market in 2009

Asian economies outperformed the West, resulting in relatively strong vehicle sales throughout much of the region. China became the world’s largest new vehicle market, with sales of more than 13 million units in 2009 compared to 10.4 million in the U.S. China is just now beginning to see an increase in the turnover of the vehicle parc. Vehicle owners are trading in for new models at the same time that economic growth is expanding the total number of households that can afford a vehicle.

In much of Asia, with the exception of Thailand, used vehicle remarketing has been informal, primarily done dealer-to-dealer. However, as vehicle populations increase, the need for professional remarketing, based on the transparent auction process, becomes essential.
Currency Fluctuations Impact Used Vehicle Flows Throughout the World

Manheim Consulting has monitored the increase in the international trade of used vehicles over the last decade. Demand for affordable transportation has been growing and used vehicles, mainly from developed countries, fill that need. As a result, used vehicles from the United States and Western Europe are exported to Eastern Europe, the Middle East, South and Central America. Specific U.S. auctions, especially those close to ports, often reported that 20% or more of some sales are to overseas buyers.

Average U.S. Wholesale Used Vehicle Price Measured in Euros

As U.S. vehicle inventory becomes cheaper relative to other currencies, demand for U.S. used vehicles increases overseas.

Simulcast and online auctions like OVE.com have made it easy for international buyers to access vehicle inventory without leaving their home countries. Exporters are generally searching for very specific vehicles at price points that will still allow a profit after factoring in transportation and other costs. Middle Eastern buyers tend to favor late-model Japanese models in neutral colors. Eastern European buyers often search for European mass-market and luxury makes. Asian brands are exported throughout the world, mainly from U.S. auction locations. Even older, driveable vehicles are exported.
Exporttrader.com Provides Insight Into Overseas Buying

Manheim provides export services through www.exporttrader.com which enables international clients to view and bid for vehicles in live and online auctions. The operation also prepares the specific paperwork for each vehicle and country and arranges transportation to ports and final destinations.

Used vehicle exports represent a dynamic sector that is dependent not only on local demand, but also on exchange rates, tariffs, and regulations. Until recently, Mexico and Russia represented the largest export destinations for used vehicles from the U.S. Russian buyers were also active in the wholesale markets in continental Europe. In 2009, however, exports to both countries contracted, which resulted in a drop in overall whole and salvage vehicle exports.

Mexico had been a major market for low priced whole and salvage vehicles, a portion of which transited into Central America. The Mexican government enacted legislation that limited imports to ten-year-old models only. Russia also responded to the growing number of used vehicle imports from the U.S. and Europe by significantly increasing tariffs. The combination of lack of access to capital for many small importers, some of whom were caught by Russia’s sudden enactment of higher tariffs, and government actions in Mexico and Russia, sharply reduced the number of bidders from those countries in U.S. and European auctions. Recent activity into Central America has increased as importers adjust their export strategies.

Nevertheless, the U.S. is still a major exporter of used vehicles to the Middle East, South America, and Eastern Europe. Export activity to many countries increased in 2009 as exchange rates favored importers.

**Top 25 Destinations for American Used Vehicles in 2009**

<table>
<thead>
<tr>
<th>#</th>
<th>Destination</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United Arab Emirates</td>
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<tr>
<td>2</td>
<td>Germany</td>
</tr>
<tr>
<td>3</td>
<td>Poland</td>
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<td>4</td>
<td>Nigeria</td>
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<td>5</td>
<td>Canada</td>
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<td>6</td>
<td>Taiwan</td>
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<td>7</td>
<td>Netherlands</td>
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<td>Bolivia</td>
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<td>9</td>
<td>Russian Federation</td>
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<td>10</td>
<td>Paraguay</td>
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<td>Libya</td>
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<td>United Kingdom</td>
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<td>Ghana</td>
</tr>
<tr>
<td>25</td>
<td>Costa Rica</td>
</tr>
</tbody>
</table>

Source: Manheim Consulting
Canadian Dealers Access U.S. Vehicles Through Manheim Simulcast

The location of buyers influences their likelihood of buying vehicles online. In 2009, Manheim Consulting analyzed the behavior of Canadian dealers bidding on vehicles in the United States. Canadian dealers favor highline cars and late-model trucks, most of which include Condition Reports (CRs) and grades that increase the confidence of online bidders. The relative scarcity of these vehicles also challenges geographically remote bidders to find the models they want. Internet searches of auction inventory and bidding online have helped Canadian dealers overcome distance.

Bidders located in Canada, who purchased vehicles from Manheim’s U.S. locations, embraced Manheim Simulcast and purchased 61% of their vehicles through Manheim Simulcast events in 2009. Although this study focused on a select segment of buyers, it proved the value of Internet-connected auctions in helping remote dealers acquire the vehicles they need. Canadian dealers took advantage of Manheim Simulcast to remotely participate in multiple auctions to find specific models.
Services and Publications

**Manheim Used Vehicle Value Index (MUVVI)**

The most widely quoted indicator of the trend in wholesale used vehicle values is updated on the fifth business day of each month at www.manheim.com/consulting. In addition, Tom Webb, the developer of the MUVVI, hosts a quarterly conference call open to all auto industry professionals.

If you would like to receive press releases and email reminders of upcoming conference calls with Tom, please send your name, affiliation, and email address to laurie.kuspiel@manheim.com.

**Industry Presentations**

Tom Webb, Manheim’s chief economist, and other members of Manheim Consulting are frequent speakers at industry conferences. Presentations on industry and economic trends that influence new and used vehicles are posted on www.manheim.com/consulting.

**Case Studies**

Manheim’s vast database provides the analytical basis for helping clients refine their remarketing strategies. In addition to the proprietary analyses done exclusively for clients, Manheim Consulting periodically studies issues of broad industry significance. Selected case studies can be found on www.manheim.com/consulting.

**Publications**

Manheim Consulting publishes a variety of reports, offering readers a comprehensive view into the largest wholesale automotive marketplace in the world. The monthly Auto Industry Brief discusses recent economic news and events and their influence the used vehicle sector. The Canadian Auto Brief is a quarterly report that includes discussions of auction activity and prices, vehicle trade between the U.S. and Canada, and economic trends in Canada.

The Mid-Year and Full-Year “Used Car Market Report” provide readers with a comprehensive review of the used vehicle marketplace from the perspective of buyers, sellers, and remarketing professionals.

To order a copy of any of these publications, visit www.manheim.com/consulting.

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