When the Only Constant Is Change

Although 2011 has introduced unprecedented domestic and international economic challenges, auto dealers have continued to demonstrate a remarkable ability to adopt new and successful strategies in a volatile marketplace.

“Dealer’s Recipe for Success: Equal parts adaptation, flexibility and creativity.”

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A Note From Sandy Schwartz, Manheim President

For more than a decade, the Manheim Used Car Market Report has been a valuable resource for the remarketing industry and the automotive industry as a whole. This year, as in the two previous years, volatile economic and vehicle market conditions warranted the publication of a Mid-Year Used Car Market Report. In preparing this report, our chief economist Tom Webb and the staff at Manheim Consulting had one goal: to provide our clients with an interpretation of events so that they could apply that information to their remarketing strategies, whether buying or selling used vehicles.

It is fair to say that few of us have ever witnessed a period like the first half of 2011. Early in the year, it seemed that the economy was following a predictable, if slow, recovery path. Credit was easier, and as more customers could afford to buy a used vehicle amid tight supply, wholesale prices moved higher. In the second quarter, we witnessed the combined impact of high fuel prices and the Japanese earthquake and tsunami on the used vehicle markets.

The Manheim Used Vehicle Value Index, the most accurate indicator of wholesale market conditions, set new highs. While sellers often remarketed their vehicles faster and at prices higher than they anticipated, our buying dealers had to scramble to find the right vehicles for their lots.

For many dealers, that meant accessing and bidding in an online auction for the first time. The proprietary research presented in this report documents the rapid acceptance by dealers of our online auctions. Simulcast and OVE.com, Manheim’s digital channels, have proved their value, especially under our present market conditions. We are leading the industry in rolling out applications for smartphones and tablets, including giving customers the ability to bid, buy and manage accounts through their mobile devices.

When I arrived at Manheim just a few months ago, I quickly learned that this is an organization of talented and highly motivated individuals at all levels. With their help, and through conversations with our customers, I’ve developed an appreciation for both the challenges and opportunities we have in better serving your needs.

We have a lot of exciting things happening at Manheim that emphasize strong customer relationships, technology, and services that make it easier to do business with us. I look forward to sharing our initiatives with you over the coming months. I welcome your comments and invite you to contact me at sschwartz@manheim.com.

Sincerely,

Sandy Schwartz
President
It would be incorrect to say that all aspects of the economy have proceeded along the lines we anticipated when writing last year's review and outlook. The “soft patch” was expected; its timing – and apparent stickiness – were not. It is now critical that the economy and jobs pull out of their current stall. Otherwise another downward spiral will ensue. We remain optimistic (but less confidently so) that employment growth will resume. After all, some of the recent weakness was the result of one-time natural shocks – from tsunamis and tornadoes to floods and fires.

But, we also still believe in our oft described “upward-slanted W.” Namely, an economy that improves in the second half of 2011 and into 2012, but one which, at some point, enters another recession before making it back to the previous peak in employment, new vehicle sales, and a host of other important economic metrics.

To provide the reasoning behind our outlook, let’s review the major forces behind the economy, new and used vehicle sales, and wholesale vehicle valuations.

**Payrolls Grow Nicely, But Then Stall**

In April 2011, employment growth finally moved above the 200,000 mark on a three-month moving average basis. Unfortunately, that didn’t last long. May’s job report (a gain of 25,000) was horrible. June’s report (a gain of only 18,000) was shockingly horrible. “Shockingly” because other indicators such as the ADP report, ISM indices, and initial jobless claims were pointing towards an improvement.
Some of the reversal in the labor market can be attributed to global supply chain disruptions resulting from the Japan earthquake. There was also the ongoing pressure of higher material and energy costs, which forced businesses to keep payrolls in check. But with Japan’s production capability coming back on stream faster than expected and with energy prices having retreated somewhat, those excuses won’t work in the second half. Hopefully, excuses won’t be needed.

Tamping down improvement in the labor market is the unhealthy level of uncertainty created by legislators, regulators, politicians, and the markets themselves. Meaningful hiring requires certainty as to future need. Thus, the Catch-22 nature of today’s employment problem. Employers need to see increased consumer demand before hiring, but that demand won’t come without job growth. The classical response to this situation would be monetary and fiscal stimulus. But we’ve already been down that road – in fact, too fast and recklessly. As such, it was especially disappointing to see job growth slip below that 200,000 mark, which, in some respects is a self-reinforcing level.

The scope of the jobs issue is depicted in the accompanying chart that shows employment losses in each of the post-World War II recessions and how long it took to regain them. The magnitude of the job loss during this last recession – the Great Recession (which has now been officially over for more than two years) – was staggering. The peak to trough swing was 6.3%, or the loss of 8.75 million jobs. After two years of economic recovery the net job loss is still almost seven million. Simply put, the worst recession since the Great Depression has been followed by the worst recovery.

**Job Losses in Post-WWII Recessions**  
Percent Job Losses Relative to Peak Employment Month

![Job Losses in Post-WWII Recessions Chart](image-url)

Source: S&P/Calculated Risk
Retail Sales Stall Also

Given the economic backdrop, it is not surprising that retail sales, which were rising early in the year, stalled in May and June. The payroll tax cut, a strong tax refund season, and record government assistance kept retail sales rising through April. But, as always, higher gas prices stifled discretionary spending on other goods. And that impact was compounded by the deteriorating labor market.

As might be expected, high-end retailers were less impacted by the second quarter slowdown. Meanwhile, discount retailers saw their sales increasingly tied to the paycheck cycle. The next test for retailers will come during the important back-to-school season. It will be especially interesting this year as many stores will be attempting to pass on price increases resulting from higher material costs and import prices. Again, without job growth, the resulting outcome is not likely to be good.

Retail Sales Begin Another Summer Slowdown

With the reduction in mortgage debt as the result of foreclosures and lower credit card balances as a result of lender writeoffs, household debt as a percent of after-tax income is now 119% versus a peak of 135% in the third quarter of 2007. This provides some wiggle room to increase borrowing, which will be needed to boost retail sales since it will take time to turn incomes around. But, with the condition of the real estate market, there will be no support from mortgage equity withdrawals. Indeed, refinancings today tend to be “cash-in,” not “cash-out.”

New Vehicle Sales Improve Significantly Year-Over-Year

One area where consumers have not shown reluctance to increase borrowing is for new vehicles. The seasonally adjusted selling rate was above 13 million for the first four months of 2011, before slipping in May and June due to inventory shortages. First half sales were up 13%, for
an annualized sales rate of 12.6 million. All of the increase was accounted for by retail sales. Total fleet sales were down 0.2%, as a 17% increase in commercial fleet sales was offset by a 5% decline in rental sales. Sales to government fleets were unchanged in the first half of 2011.

The peak-to-trough swing in new vehicle sales during this cycle was also staggering. Forty percent to be precise. It is clear that the underlying rate of demand for new vehicles is less than the near- or plus-17 million range that the industry achieved from 1999 through 2005. It is unclear whether the underlying rate of demand for used vehicles has moved as much. Probably not. Thus, we have shifted future used vehicle supply down (i.e., new vehicle sales) without a commensurate reduction in demand (used vehicle sales).

**Used Vehicle Market Produces Growing Profits**

The used vehicle market proved to be a bright spot in the economy during the first half of 2011. To be sure, reported total sales may have only been up 3.5% according to CNW, but there were pockets of exceptional strength. For example, Certified Pre-Owned (CPO) sales rose 8.5% in the first half despite a significant reduction in available inventory. And this is a segment of the market that showed little decline during the recession. As a result, first half CPO sales were on pace to set a new record.

Similarly, numbers reported by the seven publicly traded dealership groups showed remarkable increases in same-store used vehicle retail sales. As a group, on a sales-weighted basis, they were up 13% in the first quarter of 2011. That marked the fifth consecutive quarter of double-digit gains.
But, more important, used vehicle sales were more profitable in 2011. Sure, dealers said it was difficult to find inventory, but when they did find units they were able to quickly retail them. And sure, dealers complained of margin compression because of higher wholesale values, but dollar grosses were up along with the faster inventory turn. Add in the fact that retail financing was not only more available, but also provided dealers with better F&I opportunities, and you get record profits. Thus, although the first half of 2011 provided challenges to used vehicle operations, almost all dealers would love a repeat of their bottom-line performance.

**Wholesale Used Vehicle Prices Continue to Show Exceptional Strength**

Wholesale used vehicle prices continued to rise in the first half of 2011. The Manheim Used Vehicle Value Index (which is a mix-, mileage-, and seasonally-adjusted measurement of wholesale prices) reached a new high in May and retreated only slightly in June. The Index reading for June was 127.5, which represented 6.1% increase from its year-ago level and a gain of 30.1% from the trough that occurred in December 2008.

![Manheim Used Vehicle Value Index](image)

It is the magnitude of that rise since 2008 that prompted talk of a “bubble” in used vehicle pricing. That characterization is incorrect. Indeed, we would argue that a true bubble can never form in a market that has no real speculation or actual hoarding. In addition, bubbles are precluded by the wholesale used vehicle market’s inherently short cycle time – about 30 days. With the bubble notion destroyed, some then resorted to describing the market as an air mattress that would slowly lose air. We find that analogy wanting also. “Air” implies something less than substantive, while wholesale used vehicle values have been held up by very real forces (some of which will persist for an extended period of time).
In addition to the basic issue of declining wholesale supplies and rising retail demand (fully discussed in this report), wholesale used vehicle values have been supported by the new vehicle market’s low inventory levels and higher transaction prices. The new vehicle component of the Consumer Price Index (CPI) represents transaction prices (net of incentives) for a fixed basket of new vehicles that is both quality and seasonally adjusted. After more than a decade of declines, the new vehicle CPI began to rise in 2009. The rate of increase over the past two years is now faster than anytime in the past 15 years. The relevance of this to used vehicle values is shown in the graphic here that compares dollar changes in the new vehicle CPI to dollar changes in the Manheim Index. Since the Manheim Index is not quality-adjusted, it should show larger gains than the new vehicle CPI (and it does), but the overall correlation is both clear and natural.

**Dollar Change Over 3½ Years in New Vehicle CPI and Manheim Index**

Likewise, and related, the rundown in new vehicle inventories levels has supported pricing for late-model used vehicles. As a result of the supply disruption caused by the Japan earthquake, total new vehicle inventories slipped to a 50 days supply, the days supply of cars fell below 40 days, and for several models in the small car segment the supply fell below 25 days.

There is no bigger influence on the residuals of late-model used vehicles than the amount of new inventory that sits on dealership lots. We believe that even after the supply disruptions dissipate, the industry will continue to practice the more disciplined inventory management that was instituted following the restructurings and bankruptcies.
And, from a longer term perspective, we note that today’s 127.5 reading of the Manheim Index represents a compound annual rate of growth of less than 1.5% over the past 16 years. And, again, since the Index is not quality-adjusted, it should show an upward drift. Accordingly, what is regard as abnormally high pricing today might better be described as abnormally low pricing during the decade when manufacturers were aggressively pushing sales with incentives and flooding their dealer network with inventory.

A Forecast Based on Hope, and Discounting Fears

In the Review & Outlook section of last year’s report, we, after many years of being pessimistic, turned optimistic. But, to temper that section we also added a sidebar entitled A Cautionary Note. Unfortunately, the sidebar, which cited European sovereign debt as the number one problem, was more prescient than the bulk of our outlook. At mid-year there was a flare up in Greece, which was temporarily damped down, but it surely will arise again by mid-September, if not earlier. More troubling was the contagion – this time to the much larger Italy, but all of the PIIGS (Portugal, Ireland, Italy, and Spain) have serious issues. At least one default is inevitable (although it might be given a more euphemistic name when it occurs).

With hope – and discounting fears, we believe the U.S. recovery will withstand the shocks from overseas. But, we still need to get our own house in order. As of this writing, there still had been no increase in the debt ceiling in order to prevent default. Sure, it’s all a game of chicken, but sometimes in that game there really is a crash.

More optimistically, we remember the recovery pattern of earlier this year. That growth was carrying a heavy load of uncertainty piled onto it by policymakers, was wrestling with financial deleveraging, and was no longer being supported by additional monetary and fiscal stimulus. Despite that, growth occurred. It wasn’t strong enough to withstand several negative transitory events, but that doesn’t mean growth won’t resume.
The new and used vehicle markets were impacted by volatile economic conditions in the first half of 2011. Early in the year, vehicle demand was rising, but in the second quarter it turned negative as higher gasoline prices and the weakening housing and labor markets dampened consumer confidence. In addition, shortages of Japanese-brand vehicles, attributable to the earthquake, played out in dealerships and in the auction lanes.

**Vehicle Sales Climb Through April, But Then Retreat**

New and used vehicle sales increased in the first half of 2011 as lenders made credit more available to non-prime customers and overall economic growth improved, albeit at a tepid rate compared to past recoveries. New vehicle demand rose 13% through June, while used vehicle sales increased 3.5% to an estimated level of 18.6 million units. Both the new and used markets responded to higher gasoline prices in the second quarter. Small cars and fuel-efficient powerplants garnered premiums, while prices for large sport utilities fell. Nevertheless, retail and wholesale prices of large models held up better than in 2008 when gasoline first hit $4 a gallon.

The biggest story of the year was the impact of the Japanese earthquake on new and used vehicle markets. Lack of new inventory caused Japanese brands to post double-digit sales declines in May and June, leaving many dealers to rely on used vehicle sales. Japanese-brand dealers, already carrying low inventory of some fuel-efficient models, quickly saw their new vehicle stock depleted. These dealers tried to compensate by adding more units to their used vehicle lots. AutoTrader.com listings reflected the drop in available new vehicle inventory during this period.

**AutoTrader Vehicle Listings**

Percent of Total

<table>
<thead>
<tr>
<th></th>
<th>Dec 10</th>
<th>Jan 11</th>
<th>Feb 11</th>
<th>Mar 11</th>
<th>Apr 11</th>
<th>May 11</th>
</tr>
</thead>
<tbody>
<tr>
<td>New</td>
<td>43%</td>
<td>44%</td>
<td>45%</td>
<td>46%</td>
<td>47%</td>
<td>48%</td>
</tr>
<tr>
<td>Used</td>
<td>49%</td>
<td>48%</td>
<td>47%</td>
<td>46%</td>
<td>45%</td>
<td>44%</td>
</tr>
<tr>
<td>CPO</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

**CPO PERCENTAGE**

|       | 4.75% | 5.00% | 5.25% | 5.50% | 5.75% | 6.00% |

Source: AutoTrader.com
The seasonally adjusted sales rate for new vehicles was 13.1 million in the first quarter and then dropped to 12.1 million in the second quarter. The same pattern was seen in the used vehicle market. Even though new and used vehicle demand slowed in the second quarter, full year sales should mark a second year of gains for both categories.

AutoTrader.com Visitor Activity Reflects New and Used Vehicle Demand

AutoTrader.com provides visitors the largest online inventory of new and used vehicles from franchised and independent dealers as well as private sellers. AutoTrader.com monitors the tone of the marketplace through visitor behavior. For example, the types of vehicles they are researching as well as the number of times (and how long) they visit, provide insights into the overall strength of the market as well as shifts in model and brand preferences.

AutoTrader visitor traffic set a record at 17.4 million in January 2011, up more than 9% from January 2010. In 2011, AutoTrader.com noted a significant shift in favor of mobile devices as opposed to laptop or desktop computers. Searching AutoTrader.com through the iPad or smartphone enables the visitor to compare prices and vehicle information even as they shop for a vehicle. The website is seeing month-to-month increases in the number of visitors accessing the site through a mobile device.

Used vehicle sales, which typically exhibit smaller year-to-year changes than new vehicles, rose 9% through April before slowing in May and June, according to CNW Research, bringing the six-month total to 18.6 million, 3.5% above the same period last year. Retail used vehicle transactions comprised:

- franchised dealers (6.7 million, up 6.3% from 2010),
- independent dealers (6.8 million, up 4.4% from 2010),
- private party sales (5.1 million, down 1.1% from 2010).

For many years, private party transactions increased as websites like Craigslist and eBay allowed owners to sell directly. Private parties have more options today. Dealers will often appraise and buy used vehicles separate from a purchase, and AutoTrader.com’s Trade-In-Marketplace is another way to obtain fair value for a vehicle without the hassle of a private party sale.
Supply of Late Model Used Vehicles Shrinks

Although used vehicle buyers in every credit class found it easier to get financed this year, used unit sales in 2011 were held back by higher prices as demand exceeded supply. The population of vehicles three years old or younger will contract by 14.4 million units since only 35.3 million new vehicles were purchased between 2008 and 2010 compared to 49.7 million in the prior three-year period. At the same time, a longer service life for rental and commercial fleets and the reduction in off-lease volumes contributed to shortages.

Franchised dealers fared better than independent dealers in the first half of 2011, in part, because they had greater access to late-model vehicles through closed factory auctions, trade-ins, and other channels. Japanese-brand dealers acquired as many late model used vehicles as possible in March through May to offset their temporary shortage of new vehicles.

Media Curve Measures “Gas Price” Search Engine Browser Activity

Kelley Blue Book examined the impact of media coverage of the spike in gasoline prices in 2008 and in the first half of 2011. In 2008, media coverage intensified through the crisis in terms of the duration of reporting and the number of stories on the subject. By contrast, in 2011 media coverage of gasoline prices was less frequent. A KBB quantitative analysis concluded that intense media coverage of gasoline prices had a greater impact on shoppers in 2008 and contributed to the sharper spike in small car prices and the greater decline in large vehicle values in 2008 compared to 2011.

Media Effect Estimation by Unleaded Gas Price

![Graph showing Media Effect Estimation by Unleaded Gas Price](source: Kelley Blue Book)
Certified Pre-Owned (CPO) Vehicle Sales Rose 8.5% in the First Half of 2011

Automakers realized years ago that they could build brand loyalty by introducing future new car buyers to their brands with high-quality used vehicles sold with factory warranties. In 2011, automakers restored special financing incentives for CPO vehicles along with more media support. General Motors relaunched its CPO program to emphasize individual brands (rather than the GM brand) and added two years of free maintenance to the purchase proposition.

With interest in CPO vehicles at an all-time high, dealers have been hard-pressed to find qualifying units. The drop in off-lease and program rental vehicles, both ideal for factory certification programs, contributed to tight supply this year.

CPO sales rose to 800,201 units in the first half of 2011, which represented an 8.5% increase from a year ago. Luxury brands have historically sold a high percentage of their off-lease vehicles through factory CPO programs since these lower-priced units provide an affordable entry point into the brand. Although luxury brands post consistently high CPO sales, mass-market brands like Honda, Toyota, Volkswagen and Hyundai had the largest year-over-year gains through June.

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

The total volume of AuctionNet transactions declined by nearly 10% in the first half of 2011. Since AuctionNet accounts for the vast majority of vehicles remarketed through NAAA-member auctions, it appears those totals will decline for the fourth consecutive year and slip below 8 million.

In any given year some 10 million wholesale transactions occur outside of the auction system. These include dealer purchases of grounded lease vehicles, lessee purchases of their leased vehicles, dealer-to-dealer trades, rental risk sales to dealers, fleet vehicles sold to employees, and dealer-to-wholesaler sales.

Auction Volume Again Skews Toward Higher-Mileage Vehicles

The natural consequence of the aging of the vehicle population, and the shift to factory-controlled upstream channels for off-lease and program vehicles, raised the average age of used vehicles remarketed through auctions to older units. As the overall number of vehicles remarkedeted through auctions fell and a higher percentage represented dealer consignments, average age and mileage increased again in the first half of 2011.
Dealers Remarket the Broadest Range of Vehicles in Auction Lanes

Dealers accounted for nearly 55% of auction volume in the first half of 2011, up from 44% in the same period a year ago. Dealers remarket the broadest range of makes and models, from current-year units to older vehicles with more than 100,000 miles. The improvement in vehicle quality over the last decade means that even high-mileage units find buyers in the auction lanes. Dealer vehicles are 35% more likely to sell online when sellers provide a condition report or seller disclosure.

Supply and Demand Determine Used Vehicle Values

Because of the scale of auctions and the open bidding environment, each transaction produces a wealth of information about vehicles, bidding histories, seller strategies, and buyer preferences. Manheim Consulting analyzes this information to answer specific client questions and to address issues of broader interest to the remarketing community.

The data generated by auction transactions is the primary source of used vehicle price trends and, most importantly, the current values for individual makes and models. Manheim offers customers online access to the Manheim Market Report (MMR), which enables buyers and sellers to review current market prices by make, model, trim, and region. This information, updated daily, is available through any Internet-connected device, including smartphones, iPads, and other tablets, and enables dealers to use this information in valuing trade-ins or buying used vehicles from non-auction sources.

Manheim Online Site Traffic

*Data is indexed

Source: Manheim Consulting
Sellers Embrace Multichannel Remarketing

Wholesale used vehicle transactions, which enable the efficient functioning of both new and used vehicle markets, declined because of the drop in commercial consignments that was only partially offset by higher dealer consignments. For several years, buyers and sellers have been adopting multichannel remarketing strategies, but as supplies tightened this year, searching multiple live and online auctions became essential. Dealers dedicated more resources and time to finding the right inventory for their stores. Instead of spending one day a week at a nearby auction, dealers participated in multiple live and online sales each week.

Visitor traffic to Manheim.com continued to increase this year over 2010 with some months at or above 5 million visits. Dealers have a variety of digital tools available to them to facilitate their searches. Manheim digital data shows the rapid adoption of online features not only related to inventory searches, but also with respect to the adoption of mobile web and Internet MMR.

Sellers also expanded their remarketing strategies to include more digital channels to get the highest price while minimizing time-to-sale and associated expenses, especially transportation costs. Vehicle shipping charges rose nearly 13% over the last year due to shortages of vehicle hauler capacity and higher fuel costs. As a result, sellers tried to sell vehicles from grounding locations rather than transport them long distances, which adds time and costs to the process.

These trends encouraged more consignors to adopt 24/7 remarketing strategies that allow them to list vehicles on online auctions such as OVE.com the moment they come out of service, often before they are moved from their grounding location, and to keep them continuously exposed to potential buyers.

Sellers are also learning that setting reserve prices closer to MMR increases both the number of bidders and the likelihood of a sale. Markets determine the selling price of every vehicle, not the channel through which the vehicle is remarketed. In 2011, sellers moved their listing prices closer to MMR and generated more online transactions.

Manheim Sees Changes in Buyer and Seller Behavior Online

Manheim has seen a steady increase in the number of online bidders and the number of vehicles they purchase. The largest gains have come on OVE.com, as buyers and sellers become more comfortable with the online marketplace. Of note has been the increased percentage of bidders opting to place bids rather than accept the “Buy It Now” Price. The recent addition of the “Make an Offer” feature on OVE.com allows direct interaction between buyers and sellers to try to reach a negotiated price.
Used vehicle market conditions presented many challenges for franchised and independent dealers during the first half of 2011. Nevertheless, well-run used vehicle operations increased sales and profits over last year.

Although greater credit availability for non-prime customers boosted retail sales, high prices produced sticker shock for many shoppers. The change from a buyer’s market to a seller’s market caught shoppers by surprise, especially for those who didn’t have a trade-in.

Many dealers saw margin compression as retail used vehicle prices failed to keep pace with wholesale prices. In an environment of rising prices, gross profit dollars often increase at a slower rate than revenues. To compensate for both escalating wholesale prices and the normally higher rates charged on used vehicle loans, dealers often sacrificed some profit to reach a customer’s monthly payment target. And customers sometimes settled for a higher-mileage, older, or less luxurious model than they expected to buy.

On the other hand, all dealers benefited from slower depreciation of sitting inventory, which was much more forgiving of lax inventory aging policies. Dealers also made a better return on their wholesaled units.

Floorplan Access Improves for Financially Sound Dealers

Access to floorplan lines was a major problem for many independent dealers after regional banks withdrew en masse from the business in 2008 and 2009. The combination of bank failures and the recognition that lax lending policies contributed to past losses remains an impediment to obtaining floorplan lines without personal guarantees.

Many used vehicle dealers didn’t survive the recession. And, though at a slower pace, that weeding out process continues. This has been especially true for dealers who lost their floorplan lines and now have to depend on their own capital to fund inventory. With used vehicle prices at an all-time high, a fixed borrowing capacity means fewer units in stock.

Independent dealers who made it through the recession and demonstrated operational and financial discipline have been able to rely on floorplan financing from Manheim Automotive Financial Services (MAFS) and other lenders that understand, and work exclusively with, dealers. These lenders have proven to be a reliable source of funds to dealers, even as others come and go.
In the first half of 2011, MAFS boosted its receivables outstanding by offering new lines or expanding lines to more than 1,500 dealers. Nearly two-thirds of that number represented new customers for MAFS. The average MAFS floorplan line in the first half of 2011 was about $200,000, up more than 10% from pre-recession levels. Since 2009, MAFS has posted quarter-to-quarter increases in every important metric, including the number of borrowers, the size of average lines, units financed, and total receivables.

Dealers Focus on Inventory Management as Prices Rise

Dealers continued to emphasize faster inventory turns in the first half of 2011. For many, that meant stocking fewer units, buying vehicles more frequently, and utilizing more sources.

As the monthly payment on a three-year-old car approached that of the same model new, used vehicle demand slowed and retail consumer caution was reflected in wholesale values. In addition, with full-scale Japanese production set to resume earlier than expected, dealers began to question whether the upward march of prices would reverse. Softening new and used vehicle sales in June raised the likelihood of higher incentives on new vehicles. Clearly, the actions of vehicle manufacturers in the second half of 2011 with respect to pricing and incentives will influence the direction of wholesale market values.

Franchised Dealers Have Inventory Sourcing Advantages

Access to the most desirable categories of used vehicle supply has been an important factor in the superior retail performance of franchised dealers. Not only do franchised dealers have better access to late-model vehicles, they can often acquire them at lower prices than can independent dealers. A high percentage of off-lease vehicles were bought by grounding dealers from the automaker’s captive finance operation at attractive residual values and without the added fees and transportation charges. That same model might sell for $2,000 to $3,000 more in the auction lanes plus have the additional expenses associated with purchasing and moving the vehicle.

The search for qualified vehicles prompted AutoNation, the second largest auto retailer as measured by units sold, to solicit specific models from its service customers. AutoNation’s “Winning Trades at the Door” program has service employees alerting customers that the dealership will pay 120% of the current book value for their vehicle. Employees target specific vehicles in good condition that are less than four years old and with fewer than 50,000 miles.

“There are signs that gasoline prices may also be leveling off and the supply interruption from Japan may not be as bad as originally reported. These combined conditions could very likely cause wholesale prices to moderate. Under this scenario you don’t want to be caught long and wrong at the top of the market.”

Dale Pollack
CEO, vAuto
Over the years, the practice of dealers directly buying a customer’s vehicle outside the trade-in process became a rarity. But now many dealers actively promote in-store appraisals, separate from the vehicle purchase, knowing that the vehicles can either be wholesaled or retailed profitably.

**Franchised Dealers Hold On to More Trade-Ins**

In the first half of 2011, franchised dealers chose to retail out of more of their trades rather than wholesale them – even when the trade-in was a different brand from the franchise. Franchised dealer used vehicle lots have traditionally emphasized the same brand as their franchise. Today, many dealers are taking advantage of market conditions to sell a broader brand mix of used vehicles at their existing used vehicle location or in a location away from the franchise store. As a result, franchised dealers sold 6.3% more used vehicles through June compared to an increase of 4.4% for independent dealers, according to CNW.

Used vehicles generate higher margins than do new vehicles and expand the dealership customer base for service and future vehicle sales. Although some dealers are expected to return to wholesaling out of more of their trades as new vehicle sales rise, other franchised dealers are treating these vehicles as incremental and profitable sales. For example, AutoNation now operates more than 25 Vehicle Value Centers that are co-located with their franchise stores. These outlets retail inexpensive used cars and trucks taken in trade that would otherwise have been wholesaled.

**Independent Dealers Find Sourcing Used Vehicles Requires More Time and Effort**

Independent used vehicle dealers have always been creative in overcoming inventory-sourcing challenges. Compared to franchised dealers, they have less access to late-model vehicles and acceptable trade-ins that can immediately be retailed. As a result, they rely on a local network of dealers, wholesalers, and auctions. Most independent dealers participate in at least one auction sale each week.

But, in 2011, local sources often had less supply as franchised dealers either retailed more of their trade-ins or took them to the auctions knowing that the vehicles would bring top dollar in the weekly sale. Many dealer-constined vehicles were also listed in online channels, as dealers embraced the idea of multichannel remarketing. With prices rising, dealers felt that they had little risk in waiting a few extra days to sell their unwanted units as auction prices were strong enough to compensate for any added costs.
“Manheim has developed special training programs for dealers who are new to online buying and selling. Dealers learn techniques to determine the vehicles they should bid on, how to value those vehicles, and different bidding techniques. With fellow dealers leading discussions, participants have the opportunity to learn from their peers.”

Susie Heins
Vice President, Manheim Major Dealers

“Prestige prices its vehicles aggressively, counter bids and accepts reasonable offers. This strategy has paid dividends and has earned them the title of industry leader for online dealer sales.”

Joe George
Group Vice President, Manheim Digital

“Dealers have learned that they can successfully sell vehicles through online channels when they represent them in the sales, provide condition reports, and set price expectations in line with the market.”

Susie Heins
Vice President, Manheim Major Dealers

Some independent dealers were slow to utilize online channels but, in 2011, out of necessity many got on board. OVE.com has more than 115 independent auction partners who list dealer inventory online prior to live sales. As a result, the volume of dealer consignments on OVE.com has increased even as total auction volumes declined.

**Auctions Focus More Attention on Dealer Consignment**

Auction operators, large and small, made no secret of their desire to sell more dealer vehicles and they instituted special sales for different dealer segments. Simulcast and dealer-only events encouraged dealers to list their inventory online prior to moving it to the auction location.

The top dealer seller on OVE.com in 2010 was Prestige Management Services. In 2010, Prestige sold 1,519 vehicles on OVE.com to 368 buyers from 36 states. According to the group’s vice president, Chris Turner, “to be successful in the current remarketing cycle, online auctions must be a key component of our business plan.” Prestige aggressively pursues bids during and after a sale. They review every offer and typically send counter-offers, enabling them to achieve a high success rate. In June, Prestige moved from one sale every other week to weekly sales on Wednesdays with inventory available for preview starting the previous Friday. Prestige sold more than 1,300 vehicles through OVE.com as of early June.

Dealer consignment was the only segment of auction sales to rise in the first half of 2011, according to AuctionNet statistics. During this period, the average price of a dealer consignment vehicle sold during the first half of the year increased 8% to just over $9,900, and the average mileage rose 4% to 94,000.

**Percentage Distribution of Dealer Consignment by Vehicle Age**

Source: Manheim Consulting
Both franchised and independent dealers had to devote more time and resources to finding the vehicles they needed. Just a few years ago, most dealers could count on stocking inventory by attending one physical auction sale a week. Today, out of necessity, dealers, even small operators, have increased their reliance on digital remarketing channels to source vehicles.

Digital channels enable dealers to participate in more live sales and to access online listings 24/7. They also provide dealers with virtual inventory even as many have reduced the number of used vehicles at their stores.

Online auctions have continued to improve the experience and outcomes for participants. Last year, the member auctions of the National Auto Auction Association adopted condition report and arbitration standards. Increased bidder confidence in the vehicles, and the ability to resolve disputes fairly, across all member auctions, is essential to boosting confidence in the transaction. Auction companies, often led by Manheim, are playing a critical role in ensuring that online bidders have consistent and complete information about each vehicle and the ability to efficiently arbitrate disputes when they arise.

**Transportation Issues Increased for All Dealers**

Dealers have loosened vehicle criteria and shown a greater willingness to transport vehicles longer distances to their stores, but many small dealers find that managing the logistics when they buy one or two cars from multiple locations is hard and expensive. Most floorplan lines limit the number of days that a vehicle can age before curtailments or a full payoff is required. As a result, dealers are reluctant to use too much of that time on transportation.

Despite the added time and cost of transporting used vehicles, Central Dispatch, a company that links dealers with vehicle transporters around the country, noted steady year-over-year increases in units shipped by dealers. However, early in the second quarter, the month-to-month trend turned negative as transportation costs soared due to rising diesel prices. As more transactions take place online, dealers will have to coordinate deliveries of vehicles from multiple locations rather than a single auction.

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* “If you have 10 cars scattered across the Southeast, you’ve got a problem trying to get them back in a reasonable time or getting a good price on getting them back.”

  Anthony Underwood
  President of NIADA, Auto Remarketing
  May 23, 2011
Buy-Here, Pay-Here Dealers Impacted by High Prices

Buy-Here, Pay-Here (BHPH) has been a growth segment of the used vehicle business for many years. As more potential buyers developed credit issues, dealer-provided financing became a necessity for many buyers.

As a group, BHPH dealerships were impacted by easier credit and rising used vehicle prices. This year, more subprime shoppers were able to obtain loans from financial institutions. At the same time, rising vehicle acquisition costs meant that smaller BHPH dealers reported lower unit sales in the first half of 2011.

BHPH dealers have to be just as careful about the vehicles they stock as they are about evaluating the likelihood of default. For well-run BHPH operations, defaults declined slightly over the last 12 months due to better collection efforts, a tighter screening of potential buyers, a higher credit quality of customers in 2010, and the modestly improving labor market. BHPH dealers focus on affordability and mechanical soundness when selecting vehicles. Mechanical breakdowns typically require BHPH dealers to assist their customers by absorbing all or some of the cost of repair.

With wholesale prices at record levels, finding reliable units that could be financed at an affordable monthly payment was difficult. In the first half of 2011, BHPH dealers often paid $2,000 more for the same type of vehicle they bought a couple of years ago. Unless dealers had the capital to buy these more expensive vehicles and carry the financing, they often ended up selling fewer units in 2011.
BHPH dealers are generally reluctant to lengthen loan terms to hold down monthly payments, fearing that defaults will increase. Longer loans increase the likelihood of costly repairs and the probability of default-triggering events, such as the loss of income.

BHPH dealers typically retail out of 60% to 80% of the vehicles they repossess, and the remainder are in such poor condition that they, along with any vehicles taken in trade as a customer convenience, are disposed of in salvage auctions.

### Average Credit Scores by State for BHPH Financing

<table>
<thead>
<tr>
<th>Credit Score Range</th>
<th>State Abbreviation</th>
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</thead>
<tbody>
<tr>
<td>519 and Below</td>
<td>520 to 524</td>
</tr>
<tr>
<td>525 to 533</td>
<td>534 to 539</td>
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<td>540 to 555</td>
<td>556 to 560</td>
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<tr>
<td>561 to 575</td>
<td>576 and above</td>
</tr>
<tr>
<td>Not Available</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Experian Automotive*
What is the significance of the formation of Manheim Digital?

Manheim Digital reflects the growing use of digital technology throughout the remarketing industry. A few years ago, there was a clear demarcation between the online and physical realms with respect to how dealers interacted with us. Today, that distinction has blurred. For example, dealers in the lanes can, simultaneously, be connected to Manheim services online. “Digital” is more than “online,” and our name reflects the direction we are taking.

How have smartphones and other mobile devices influenced remarketing behavior?

Smartphones and other mobile devices are transforming how dealers access information and manage the buying and selling of vehicles. Our customers want to connect with us anytime, and that requires adapting our services to meet those needs.

Nearly two years ago, Manheim responded to the rapid growth in these new mobile devices. We have steadily rolled out a number of services available through these devices. Manheim Mobile allows dealers to manage their accounts, access MMR, conduct searches, and read condition reports. We will soon roll out applications that allow dealers to bid on OVE.com (and shortly afterward in Simulcast sales) via their mobile devices.

Can you give us an example of how dealers are integrating digital tools into their remarketing strategies now?

I love to visit our auctions because I learn so much from observing dealers. I’ve seen the rapid transition from conventional cell phones to smartphones and now iPads. These devices are part of the dealer’s gear in the lanes because they provide the dealer with instant access to essential information. For example, dealers standing in the lane can scan VINs on their smartphones and immediately access data about the vehicle. They can personally inspect the car while reading the condition report.

We are agnostic with respect to how dealers access our data, services, or buy and sell with us. We just want to be sure that however, and whenever, they interact with Manheim they will find what they need quickly and are able to conduct their business more efficiently.

Can you share some insights about Manheim Mobile users?

Manheim.com is the portal through which customers conduct business with us. Each month Manheim.com has more than five million visits. The number of visitors accessing our mobile site, m.manheim.com, while still small compared to the total, is growing exponentially. More importantly, there is a greater “stickiness” with our mobile visitors. They typically log on more often and stay on longer.

We know that mobile devices are also changing dealers’ attitudes about bidding online. They are becoming more comfortable with viewing photos and information, and we know from our research that they are eager to take the next step and place bids from their mobile devices. I know that I will soon see dealers in front of the block bidding on vehicles via their smartphones.
What do you see as the biggest obstacle to maximizing the power of the digital marketplace?

The thorniest barrier to achieving the promise of a digital marketplace is not technology or management commitment; it is vehicle logistics. We have made it easy to bid on a vehicle anytime and for consignors to list cars still at remote locations. So buyers have access to tens of thousands of vehicles online, but transporting vehicles over long distances, in less than truckload quantities, is difficult and expensive.

Our data shows that in the first half of 2009, less than 40% of the vehicles bought on OVE.com were moved more than 500 miles. In the first half of 2011, approximately 45% were moved more than that distance.

Simulcast also attracts a high percentage of buyers who move vehicles long distances. In contrast, lane buyers are predominantly local dealers with more than 70% only having to transport their vehicle less than 200 miles.

In the digital world, bidders are likely to buy vehicles from multiple sellers in several different locations each week. It is a challenging puzzle for dealers and for us at Manheim to assist in the transport of vehicles from thousands of buyers and sellers. Any analogy between buying a book from Amazon and buying a vehicle at wholesale falls apart, because you can’t put a vehicle in a box and ship it over night. Protecting the vehicle, guaranteeing a delivery time, and doing it at an affordable cost are things the remarketing industry has to focus on.
Manheim Consulting analyzed bidding behavior of dealers across the United States to determine the acceptance of online auctions and the concentration of online sales activity by state. The relationship between distance from a Manheim auction and sales levels to online bidders was also analyzed.

**Methodology**

The analysis studied online sales percentages in Manheim Simulcast and OVE.com during the first half of 2007, 2009, and 2011. The analysis covered a long enough time span to provide an accurate reading of the acceptance of online bidding and the success of bidders in actually purchasing vehicles. During this five-year period, more consignors embraced online auctions, so the number of vehicles available in Simulcast sales and on OVE.com increased and the functionality of these digital marketplaces improved. Buyers were given more disclosure about each vehicle, which resulted in greater confidence in online channels. The important metric, however, was the success rate of online bidders in winning an auction.

**Results**

In 2007, dealer behavior was not influenced by external forces, such as a low supply of used vehicles. Online bidding and the highest success ratios were concentrated in closed channels operated by automakers for the remarketing of off-lease and program vehicles. Other commercial consignors also saw active bidding in their Simulcast sales.

The heat map for the first half of 2007 shows the highest sales success for online bidders in states with low vehicle populations and far from a major Manheim auction location. Those regions of the country where dealers had access to ample supply in physical auctions had the lowest online bidding sales percentage.

Dealer online bidding climbed rapidly between 2007 and 2009. The credit crisis and the recession, as well as a rapid rise and then decline in fuel prices, increased volatility in wholesale vehicle values.

Heat map 2, which covers the first half of 2009, indicates that only two states (Arizona and Nevada) had low online sales percentages. Rising levels of dealer participation occurred even in Florida, New Jersey, Pennsylvania, and Texas, where Manheim operates multiple large auctions.

Heat map 3 illustrates the dramatic increase in online sales in the first half of 2011.

By 2011, dealer acceptance of online bidding had increased due to previously successful experiences in buying online. Many dealers had gone through training by The Wholesale Institute (TWI), and that gave them the confidence to supplement attendance at physical auctions with online purchases. In 2011, dealers had more confidence in the vehicle’s condition report, and, more importantly, they had to search further and in more channels due to lower wholesale supplies.
Vehicle supply challenges, tighter budgets, and delivery delays were a problem for all fleet managers in the first half of 2011. Automakers devoted more output to their dealer networks as retail demand picked up. As a result, fleets were disproportionately impacted by the electronic and mechanical parts shortages that caused automakers to miss production targets on selected vehicles. Parts shortages worsened following the earthquake in Japan and placed additional limits on fleet orders in the second quarter. That forced fleet managers to shift to other makes or delay replacing some units in service.

With production concentrated within a group of models, fleet vehicles are particularly vulnerable to delivery delays, as the shortage of even one part for a model heavily bought by fleets will have a disproportionate impact.

And even when parts shortages were not an issue, automakers struggled with the lack of rail car and trucking carrier capacity. Rail car capacity declined after automakers shifted to enclosed cars to reduce damage and eliminated three-level storage due to the height of SUVs. Shipment delays to dealers and fleets worsened in the first half of 2011 as General Motors and Chrysler stepped up production.

In addition to the shortage of rail car capacity, several car haulers and a manufacturer of car trailers went out of business during the recession. Auto companies sometimes resorted to employees driving cars from assembly plants to railheads, but getting them from railheads to customers continued to be a problem even though total auto production remained well below pre-recession levels.

**Rental Fleets**

The daily rental industry has been shifting from program to risk vehicles for more than a decade. The U.S. rental fleet is now more than 75% risk, with Hertz at 77% risk, Dollar Thrifty and Enterprise close to 100% risk, and Avis Budget Group at around 55% risk.

Rental companies concentrate their program units in more expensive models and those that have high seasonal demand, such as minivans and convertibles, so that they can be returned to automakers at the end of the summer vacation season.
Small rental companies and franchisees of the major brands obtain vehicles in a variety of ways. Major rental companies often lease vehicles to their franchisees. Many operators also acquire late-model vehicles through auctions. Others purchase new vehicles directly from local dealers. As a group, small rental operators had a harder time finding affordable vehicles in the first half of 2011. Not only did they experience order cancellations, but they also had to pay top dollar for late-model vehicles in the auctions where they bid against major rental companies as well as dealers.

In the first half of 2011, rental companies purchased 788,400 units, down 5% from last year. Purchases would have been higher if parts shortages had not led to delivery delays and cancellations. The rental industry will increase purchases in the second half of 2011 and in 2012, since a large number of the vehicles currently in operation will reach the end of their service life. As a result, the supply of risk vehicles in all remarketing channels will increase modestly in the second half of the 2011. That should continue into 2012.

On average, risk vehicles are kept in service approximately 40,000 miles, or 15 to 18 months, in order to minimize monthly depreciation. Program units, by contrast, are typically taken out of service after six months or less and usually with fewer than 20,000 miles. Customer service issues regarding higher-mileage vehicles in the rental fleet have abated now that the practice has become the industry norm. In addition, the companies have become smarter about ordering vehicles with more durable interiors and thoroughly cleaning vehicles between rentals.

Rental companies incur greater maintenance for higher-mileage vehicles, mainly tires and brakes, but these expenses are more than offset by the lower monthly depreciation. For example, the combination of longer service lives and high residual values lowered monthly vehicle depreciation for Hertz from $311 per unit in the third quarter of 2009 to $281 in the first quarter of 2011.

However, the longer service lives of risk vehicles limit management’s ability to adjust fleet size to demand. Rental demand is highest from June through August, with smaller peaks around winter holidays and spring vacations. When program vehicles dominated rental fleets, it was easier to match fleet size to seasonal demand.

In the second quarter of 2011, rental rates dropped across the country because the industry had more vehicles than needed. Last year, as credit conditions eased for rental companies, the industry expanded the number of units in service in anticipation of higher demand in an improving economy. This year, seasonal over-fleeting was exaggerated because
companies held back units from auctions in April and May on fears that Japanese orders would not be fulfilled ahead of peak demand. Although shipments of Japanese-brand vehicles were off sharply in May and June compared to last year, the industry had enough vehicles from other sources, including late model used vehicles, for summer demand.

The supply of risk vehicles in auction lanes dropped sharply during the first half of 2011, not only because companies remarketed fewer vehicles in total but also because they shifted more units to upstream channels, including OVE.com. In addition, dealers bought more vehicles directly from rental companies. For example, in January of 2011, Hertz launched a dealer-direct online buying channel that allows dealers to bid on Hertz units that are still in service. In the first quarter of 2011, the company remarkedeted 45% of their units directly to dealers, 12% directly to retail customers, and 43% through physical and digital auctions. In 2007, wholesale auctions accounted for 85% of Hertz’s total remarketing volume.
Auction demand for rental risk units was very strong through May, with prices easing only slightly in June. The average price of a rental risk unit was more than $14,000 from March to June. Meanwhile, average mileage stayed around 40,000. Even though the supply of risk vehicles is expected to increase in the second half, prices are likely to track overall industry trends.

The shortage of vehicle hauler capacity in some parts of the country delayed deliveries of rental units and limited the ability of rental companies to shift end-of-service vehicles from regions with high supply (e.g., Florida) to areas with higher demand. Online auctions provide inventory and price visibility across the country, but regional price differences still exist when sellers and buyers can’t ship vehicles economically and efficiently. This localized problem could worsen as units are taken out of service in vacation markets in the third quarter.

**Commercial and Government Fleets**

Commercial and government fleets combined bought 388,508 vehicles, up 11.1% in the first half of 2011 compared to last year. Demand was especially strong for commercial vehicles above Class 3. These vehicles stay in service longer than cars, and many fleets took advantage of the extension of the bonus depreciation under the tax law of 2010 to refresh their fleets. Auction demand for end-of-service fleet vehicles was strong during the first half, especially for fuel-efficient models.

Commercial fleets would have purchased even more passenger vehicles if not for the inability of the automakers to fill special orders and meet delivery schedules. Some commercial and government fleet managers shifted orders to the 2012 model year buying-cycle as it became apparent that orders would not be filled prior to the early build-out dates for 2011 models.

**Fleet Right-Sizing Continues as Purchasing Shifts to Smaller Vehicles**

During the recession, commercial and government fleet managers reduced the size of their fleets and downsized to smaller cars and engines whenever possible. Staff cuts and reductions in the personnel eligible to use a company car resulted in rapid de-fleeting in 2009. Even though units in service have stabilized, fleet managers are still under pressure to reduce both fixed and variable costs.

Although the industry bought more vehicles in the first half of 2011 than last year, these purchases generally represented replacements rather than increases in units in operation. Fleet budgets were constrained by higher vehicle-acquisition prices and fuel costs, but were boosted by the fleet manager’s ability to post a gain-on-sale for vehicles coming out of service.

“We’re seeing an increase in wholesale prices as buyer demand outpaces supply due largely to fewer repossessed units than in recent years. This trend is consistent across most Specialty categories including Boats, Motorcycles/PowerSports and Heavy Trucks & Equipment.”

Karen Braddy
General Manager, Manheim Specialty
More fleets experimented with hybrids and electric vehicles, but the cost-effectiveness of these technologies is still not proven. Nevertheless, many municipal and state government agencies, as well as corporations, have mandates to increase the share of alternative fuel vehicles in their fleets. In addition, manufacturers of these vehicles view fleets as a stepping stone to increased rental sales.

New small and mid-size sedans from the Detroit 3 have been well received by the public and often come equipped with the same options as larger vehicles. While there is still some driver resistance to small cars, fleet managers are designating vehicles based upon utility, such as distance traveled, towing requirements, or cargo carried, rather than driver preference.

Even fleets composed mainly of pickup trucks and large vans are being scrutinized with an eye toward selecting smaller, more fuel-efficient models. The planned elimination of the Ford Ranger and Chevrolet Colorado will pose a challenge for fleet operators who are looking for smaller, cheaper alternatives to full-size pickup trucks. But, the introduction of new, fuel-efficient 6-cylinder engines in full-size pickups will reduce future fuel consumption and they are already outselling V-8 engines in some full-size models.

The surge in commodity prices resulted in a huge increase in the cost of some replacement parts, such as tires. In the past, this issue was not on the fleet manager’s radar screen, but, with the price of some tires increasing eight or nine times in the last year, fleet managers often specify models with 16-inch tires to help control costs.

2012 Fleet Ordering Intentions

- The overall strengthening of the national economy is influencing some companies to revert back to their traditional vehicle-replacement cycles.
- The ongoing trend to downsize to smaller displacement engines and right-size to smaller classes of vehicles continues.
- One factor causing an uptick in new vehicle orders is a strong used vehicle market, which is prompting short-cycling strategies by some fleets.
- There continues to be ongoing pressure to control capital expenditures.

Fleet Managers Take Advantage of Strong Wholesale Prices

The number of commercial and government vehicles sold at auction has increased recently. Last year, and in the first half of 2011, fleet managers directed a significant number of their end-of-service vehicles to auctions. Strong demand and prices in the lanes made auctions the most effective and profitable remarketing channel, even though many of the vehicles offered for sale had high mileage.

In the first half of 2011, record wholesale values enticed some fleets to cycle out of vehicles earlier than planned. Instead of running vehicles 36 months or longer, some fleet managers opted to sell vehicles after 24 months of service. High residual values on younger models with fewer miles and lower maintenance costs more than offset the lower monthly depreciation that is generally associated with a longer service life.
Auctions are a popular and steady method for remarketing vehicles and equipment. Whether conducted in-house or outsourced through a physical auction or online, auctions remain a valuable tool for fleet managers.

Top Five New Vehicle Lenders by Market Share

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<thead>
<tr>
<th>Lender</th>
<th>Market Share</th>
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<tbody>
<tr>
<td>Ally</td>
<td>14.5%</td>
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<tr>
<td>Toyota</td>
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<tr>
<td>Honda</td>
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<tr>
<td>Ford</td>
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<tr>
<td>Chase</td>
<td>6.0%</td>
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<tr>
<td>All others</td>
<td>53.3%</td>
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Source: Experian Automotive

Top Five Used Vehicle Lenders by Market Share

<table>
<thead>
<tr>
<th>Lender</th>
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</thead>
<tbody>
<tr>
<td>Wells Fargo</td>
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<tr>
<td>Ally</td>
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<tr>
<td>Chase</td>
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<tr>
<td>Capital One</td>
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<td>Toyota</td>
<td>2.7%</td>
</tr>
<tr>
<td>All others</td>
<td>79.9%</td>
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</table>

Source: Experian Automotive

In the fall ordering cycle for 2012 model year vehicles, fleets are again likely to accelerate replacement without increasing the number of units in service. Vehicles put into service in 2009 and even 2010, with the intention of running them longer than in the past, will be replaced with new models. As long as wholesale values remain high, the industry is likely to remarket more cars after 60,000 or 65,000 miles instead of 75,000 to 80,000 miles.

In the first half of 2011, the average auction value of a mid-size commercial fleet vehicle was over $9,700, up 18% from 2010. At the same time, the average mileage declined 7% to just under 65,000 miles. Fleet vehicles are increasingly sold in Manheim online auctions, where they attract buyers who appreciate that these vehicles were maintained to factory specifications.

Repossessions and Leasing

Retail financing, and more particularly its availability, has long been a key ingredient to the health of new and used vehicles sales as well as the profitability of dealers. Over time, that financing took on added importance as:

- sellers employed retail and lease terms to market product, build brand loyalty, and shorten the ownership cycle,
- the growth of the securitization market allowed new lenders to grow rapidly, and
- automotive lending became more sensitive to swings in the overall financial market.

In the first half of 2011, the improvement in the retail automotive financing market, which started way back in the early part of 2009, continued. Indeed, retail financing today can only be described as completely supportive to new and used vehicle sales, dealer and leader profitability, and customer satisfaction. With lenders enjoying greater access to funds (at a lower cost), reduced frequency of delinquencies and defaults, and a lower severity of loss due to high wholesale prices, there is every reason to believe that retail financing will remain supportive to a healthy automotive marketplace for the remainder of 2011 and into 2012.

There were $640 billion in auto loans outstanding at the end of the first quarter of 2011, according to Experian. This represented only a modest increase from a year ago, but a significant reversal of trend from the sharp run-down in portfolios that occurred in 2009 and 2010. With both new and used vehicle sales continuing to increase from the trough in 2009, new loan originations should continue to exceed the runoff in old loans. In fact, the difference should widen, which means that total loans outstanding should increase at a faster rate.
With respect to originations it is important to note that lender concentration is much greater on the new vehicle side than on the used vehicle side. The top 20 lenders account for more than 77% of all new vehicle loans, according to Experian. The top 20 used vehicle lenders account for only 39% of the loans in that segment.

**Auto Asset-Backed Securitization Market Continues to Grow**

Total auto asset-backed securitization (ABS) issuance remained healthy at more than $37 billion in the first half of 2011. This volume occurred even though there was more deposit-based funding from bank lenders.

The ability of auto lenders to quickly resume their ABS funding, after the total freeze-up in that market in the second half of 2008, is a reflection that historically, even during recessions, these instruments have performed well. Their superior performance is the result of overcollateralization, strict reserve requirements, and a term structure that is consistent with the underlying collateral. In addition, the indirect lending model, in which the vast majority of these loans are originated, incorporates a strong professional, and mutually beneficial, relationship between the dealership F&I office and the underwriting lender.

**Auto ABS Issuance**

![Graph showing Auto ABS Issuance in Billions]

Although auto lenders were able to tap the ABS market as early as 2009 in order to stay in business, the terms were often onerous; for example, requiring heavy levels of upfront credit enhancement. Today, lenders are able to secure funds at adjusted rates and spreads that are comparable with pre-recession levels.
Repossessions Fall Sharply in the First Half of 2011

Total repossessions peaked at 1.9 million units in 2009 and then declined by 19% in 2010 to 1.55 million units. Results for the first half of 2011 suggest that repossessions will fall by a similar percentage this year. That would push repossessions to 1.3 million units, or to their lowest level in more than a decade.

Auto loan delinquency rates have been reduced as a result of an earlier implementation of stricter underwriting standards and today’s slightly better labor market. Actual repossession volumes have been further reduced by high wholesale used vehicle values, which means customers are upside-down in their loans for a considerably shorter period of time. For a delinquent customer with the inability to pay – but with positive equity – the proper course of action is to simply sell the vehicle, pay off the loan, and pocket the remainder. In reality, however, some drivers let the repossession occur, and as a result, lenders in 2011 often found themselves with no severity of loss. In fact, in more than a few cases, lenders had to cut checks back to customers after wholesaling the unit at auction.

Credit Default Rates

Source: S&P/Experian
With auto loan portfolios expected to grow and with delinquency rates already at record lows, repossession volumes should rise modestly in 2012. Aiding in that assumption would be the financial market’s current willingness to fund auto lenders. That usually suggests another credit cycle ahead in which lending becomes too loose. To date, however, lenders have shown restraint in their origination growth strategies.

**Repossession Remarketing Moves Upstream**

Even though wholesale used vehicle pricing has been exceptionally strong (meaning that used vehicles are depreciating less rapidly), lenders remain focused on converting repossessed units into cash as quickly as possible. Generally speaking, the biggest stumbling blocks to reduced days-to-sale are outside the control of auctions and lenders, as state and local laws dictate the processes of both collateral collection and liquidation. And, obtaining clear titles in a timely matter can sometimes be difficult. Nevertheless, in recent years, auctions and lenders have been successful in streamlining the processes that they do control and, thus, reducing overall days-to-sale.

In 2010 and 2011, repossession remarketing followed other commercial consignments and moved upstream. In June 2011, Renovo Services partnered with Manheim to begin selling repossessed vehicles directly from secure storage facilities across the country. Renovo is a nationwide company that offers vehicle transition services in recovery management, direct repossessions, skip tracing, and collections on behalf of financial services companies. Renovo will list its repossessed vehicles directly on OVE.com, allowing dealers faster access to vehicle inventory. Once a vehicle is purchased, it will be transported directly from Renovo’s storage facility to the dealer’s lot.

**New Vehicle Lease Penetration Rates**

![New Vehicle Lease Penetration Rates Graph](source: J.D. Power and Associates)
New Lease Originations Continue Their Sharp Rise

After falling to a cyclical low of 1.1 million in 2009, new vehicle lease originations grew by more than 50% in 2010 to 1.7 million units. In the first half of 2011, that growth continued with an estimated 25% increase in originations. The full-year total is on pace to exceed 2.2 million units.

Gains continued to be recorded by GM and Chrysler (both of which had to exit leasing in 2009) and by Japanese nameplates, which find leasing an attractive way to sell product when exchange rates restrain their ability to stimulate sales by other methods.

Lessors Use “Pull-Aheads” and “Push-Backs”

With the rise in wholesale used vehicle values, lessors and dealers have found it an ideal time to pull customers out of their leases early in order to secure a new sale as well as a needed piece of used vehicle inventory. In the second quarter, however, we also saw some Japanese OEMs offering to extend the customer’s lease (at an attractive rate) until such time as new vehicle inventory levels improved. A prime benefit of leasing is that it builds customer loyalty. You don’t want to lose a returning customer simply because of a temporary lack of inventory.

Off-Lease Volumes Begin Their Steep Descent

Given that the average lease term is in excess of 40 months, the reduction in wholesale supplies from this source is just now beginning to be felt. It is a reduction that will continue well into 2012. Additionally, a growing number of the off-lease units are bought by the grounding dealer. The message to dealers is clear: You want to be that grounding dealer.
Leasing Has a Solid Future

Although new vehicle lease originations will have more than doubled between 2009 and 2011, this is not a repeat of the aggressively subvented lease deals of the past that pushed product no one wanted to buy and destroyed residuals when the units flowed back into the wholesale market. This is, instead, a return to normalcy after the credit crisis.

Leasing is the ideal financial product for customers who want to trade on a regular cycle and who do not want to assume the residual risk entailed with a purchase. Leasing provides dealers and lenders with a more predictable, and shorter, trade cycle as well as greater customer loyalty to the make, dealer, and financing source. Leasing also leads to a better-educated consumer since it makes it very clear that total vehicle-ownership cost is dominated by depreciation.

Distribution of ALLY (GMAC) Off-Lease Sales in U.S.

<table>
<thead>
<tr>
<th>For calendar year ending December 31st</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auction</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Physical</td>
<td>44%</td>
<td>39%</td>
<td>38%</td>
<td>25%</td>
<td>18%</td>
</tr>
<tr>
<td>Internet</td>
<td>38%</td>
<td>43%</td>
<td>47%</td>
<td>57%</td>
<td>60%</td>
</tr>
<tr>
<td>Sale to grounding dealer</td>
<td>12%</td>
<td>12%</td>
<td>10%</td>
<td>11%</td>
<td>12%</td>
</tr>
<tr>
<td>Other (including sale to lessee)</td>
<td>6%</td>
<td>6%</td>
<td>5%</td>
<td>7%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: ALLY

Distribution of Toyota Financial Services Off-Lease Sales in U.S.

<table>
<thead>
<tr>
<th>For fiscal year ending March 31st</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>At Auction</td>
<td>51%</td>
<td>51%</td>
<td>59%</td>
<td>48%</td>
<td>45%</td>
</tr>
<tr>
<td>Toyota Dealer Direct</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To grounding dealer</td>
<td>36%</td>
<td>41%</td>
<td>33%</td>
<td>42%</td>
<td>43%</td>
</tr>
<tr>
<td>Not to grounding dealer</td>
<td>13%</td>
<td>7%</td>
<td>8%</td>
<td>10%</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source: Toyota Financial Services
Case Study: The Effect of Color on Auction Sales Results

Rental and commercial fleets are focused on factors that influence the value of a vehicle. The profitability of rental companies and the ability of fleet managers to meet budgets depends upon minimizing vehicle depreciation. In response to questions from rental car companies, Manheim Consulting conducted an initial study of the influence of color on value. This analysis is a first step in a subject that deserves more attention, but even this work has produced meaningful results that sometimes confirms, and sometimes contradicts, previously held assumptions.

Methodology
Manheim Consulting analyzed sales data for rental and commercial fleet vehicles sold in the first quarter of 2011 to determine the connection between color and retention (the percentage of MMR achieved by specific vehicles). Analysts classified colors within families as having standard, unusual, or dark hues. It was not surprising that 95% of the vehicles were classified as having “standard” hues.

Results
Within each grouping, there were colors that recorded higher or lower retention performance. Among standard colors, red, white, and silver had the highest retention levels while tan, beige, and green had the lowest. Green vehicles had, on average, 1.3 percentage points lower retention (the equivalent of $135 per unit) in value, compared to red vehicles, which posted the highest retention rate.

Among unusual colors, orange and yellow scored well above variants of red, which posted the lowest retention. Again, these colors are associated with low-volume specialty models rather than compact and mid-size sedans. In the dark category, brown, purple, and burgundy scored higher than charcoal or navy. Both unusual and dark colors had lower retention rates than did standard colors.

The study did not try to separate out other influences that might have played a role in the price performance. For example, some colors might show wear more than others. And, of course, buyers often impose their own color and hue preferences on the vehicles they bid on. Nevertheless, the initial findings confirm that fleet buyers are economically better off when they select more conventional colors and hues, except on sporty models where bright colors bring the highest retention rates.
Case Study: Depreciation Trends for Hybrid and Diesel Vehicles

There is heightened interest in alternative fuel vehicles among Manheim clients, so Manheim Consulting undertook this study to understand how these vehicles fare in wholesale markets after accumulating the wear and tear and mileage associated with several years of use.

Methodology

The analysis studied specific makes and models with both a gas and alternative fuel option (the Toyota Prius was an exception because there is no gas option. It was compared to the Toyota Corolla). Depreciation for vehicles of each fuel type was measured as a percentage of MSRP at different mileage bands. These depreciation curves were compared against each other to illustrate the pattern of depreciation as the vehicles accumulate miles.

Results

Diesel vehicles account for a small percentage of U.S. sales compared to Europe where, in many countries, they are the dominant powerplant.

Diesel penetration is largely limited to German sedans and heavy-duty pick-up trucks as well as class 4 and higher commercial vehicles.

Diesels are more expensive than gasoline engines, but they are less expensive to maintain and have a longer life expectancy.

These points are demonstrated by the depreciation curves for a representative sedan and large work truck. In the case of the sedan, the diesel version dropped from 89% of MSRP at 5,000 miles to 56% after accumulating more than 90,000 miles. By contrast, the gasoline-equipped version fell to 77% of its value immediately after purchase and then dropped to 37% of MSRP at 90,000 miles.

A similar depreciation curve was observed for the work truck with the diesel version worth 56% of its original value after 95,000 miles compared to 41% for the gasoline-powered truck. Although diesel engines and their fuel cost more than gasoline, favorable depreciation can offset much of these factors over the life of the vehicle.
The Prius was introduced in the U.S. in July 2000. Now, even though most automakers currently offer one or more hybrid models, total hybrid sales are still a small percentage of overall vehicle sales.

The depreciation curves of comparable hybrid and non-hybrid passenger vehicles are distinctly different. The popularity of the Toyota Prius, Toyota Camry hybrid, and Ford Escape have provided them with favorable depreciation rates compared to the slower-selling hybrids. For the popular models, depreciation rates are superior to their comparable gasoline versions until the 70,000-mile mark. At that point depreciation accelerates.

In the case of limited volume hybrids compared to their gasoline counterparts, low sales, less marketing support, and sometimes higher purchase incentives contribute to a larger initial depreciation of the hybrid compared to the gasoline engine. The initial depreciation penalty continues throughout the life of these hybrids where issues of battery life and obsolescence impact values.
Manheim Consulting:
Analytical Resources for Remarketing and Automotive Industry Professionals

Our experienced research team supports Manheim customers by undertaking analytical studies that address specific questions. Our goal is to let the data speak for itself so that our clients can execute their remarketing strategies more effectively. While maintaining the confidentiality of our remarketing customers’ data, Manheim Consulting also performs analytical studies for non-client businesses. Visit our website (www.manheim.com/consulting) to learn more about the scope of our capabilities, sample case studies, and contact information.

Lynn Morgan
Vice President, Marketing and Consulting

Publications and Data Services
Our chief economist, Tom Webb, is a noted authority on the economics of the automotive industry and especially on the wholesale and retail used vehicle markets. Visit our website to review Tom’s recent presentations at industry events. Tom is the author of Manheim Consulting’s award-winning publications: the Auto Industry Brief, the Mid-Year Used Car Market Report, and the annual Used Car Market Report. Information about all of these publications can be found on our website or by emailing amanda.roberts@manheim.com.

Auto Industry Brief: This monthly publication keeps readers up-to-date on the economic and automotive conditions that impact demand and pricing for used vehicles.

Mid-Year Used Car Market Report: For the third consecutive year, volatile conditions warranted the publication of a mid-year report to help clients and industry professionals understand the behavior of vehicle markets.

Annual Used Car Market Report: Each year at the NADA convention, Manheim Consulting unveils its annual review of used vehicle market conditions during the previous year. The detailed report analyzes supply and demand for used vehicles, remarketing trends, strategies of buyers and sellers, and the movement in used vehicle prices.

The next edition of the Used Car Market Report will be released at NADA on February 4, 2012. Visit our website to reserve your copy.

Keep up with Tom:
www.Twitter.com/TomWebb_Manheim
www.manheimconsulting.typepad.com

Manheim Used Vehicle Value Index
In 2001, Manheim launched the Used Vehicle Value Index to foster greater understanding of the used vehicle marketplace. This Index is the most widely quoted and highly regarded measure of wholesale used vehicle prices. On the fifth business day of each month at 9 a.m. Eastern time, Tom Webb updates both the Index and supporting documentation.

Quarterly Index Conference Calls
Manheim Consulting invites you to join Tom Webb’s quarterly conference calls, during which he goes behind the numbers to explain those conditions that impacted used vehicle values. Following the formal presentation, Tom takes questions from participants.

Conference calls are at 11 a.m. Eastern time on the same day that the Index is released in January, April, July, and October. Call-in information is posted on the Manheim Consulting website. Previous participants automatically receive an email reminder a week before the call.