2015 USED CAR MARKET REPORT
LOOKING BACK, DRIVING FORWARD
20th Anniversary Edition
This Used Car Market Report includes forward-looking statements about the industry and the economy which are based on current expectations, assumptions, and information presently available to Cox Automotive. As with any projection or forecast, forward-looking statements are inherently susceptible to uncertainty and changes in circumstances. Actual results for future periods may vary materially from those expressed or implied in this report. The information in this report may not be accurate or complete, and is provided solely as a reference for the matters addressed in this report. Cox Automotive disclaims any liability for the use of the information in this report.
A Note from Janet Barnard

Year in Review and Outlook
The performance of the new vehicle side of the industry continued to outpace the overall U.S. economy, while the used car segment continued to provide unparalleled stability. Expect more of the same in 2015.

The Vehicle Remarketing Industry
Both auction volumes and wholesale prices rose in 2014, with NAAA-member auction volumes increasing by 5% (to 8.6 million units) and prices ticking up 1.4% after declines in both 2012 and 2013. The last four years have shown the least volatility in wholesale pricing since the Manheim Index was created in 1995.

Dealers
New vehicle sales increased for the fifth consecutive year; used vehicle operations yielded record profits, public dealership groups had a record year, and CPO sales reached an all-time high. It was a good year to be a dealer.
- Q&A with Dale Pollak, Founder vAuto & EVP, Cox Automotive
- Q&A with NADA Chairman William Fox
- Q&A with NIADA President Arlan Kuehn

Rental
Rental industry revenue increased for the fifth consecutive year. Meanwhile, rental companies purchased 1.6 million new vehicles, the highest number since 2007.

Leasing
New lease originations topped 3.5 million for the first time since 1999, and the rise in off-lease volumes in the wholesale market was only the beginning of a trend that will last for years.

Repossessions
Total repossession volumes increased by 8% to an estimated 1.5 million in 2014, and increases in coming years will be more substantial.

Fleet
Sales into commercial and government fleets increased for the fifth straight year; meanwhile, wholesale prices for fleet vehicles were at record highs in the first half of 2014, but declined steeply in the second half.

International and Export Market
China continues to be the largest new car market in the world. With U.S. new car sales expanding, the used car remarketing pipeline in 2015 and beyond will see significant spikes in global export sales.

Salvage
The salvage marketplace mirrored the whole-car market in 2014, where supplies increased and demand remained strong. Prices declined slightly due to a variety of global factors.
Welcome to the 20th anniversary edition of Manheim’s Used Car Market Report, our annual look at the trends and numbers shaping the vehicle remarketing industry. As we celebrate two decades of thought leadership, we also mark another important milestone at Manheim in 2015—the 70th anniversary of the founding of our company.

As a result, this year’s Report provides us the opportunity to reflect on the developments that have positioned us where we are as an industry, and to look ahead at the forces that will shape the wholesale vehicle business of tomorrow.

While a lot has changed in our industry since 1945, the founding principles that guide Manheim have remained consistent, namely a relentless focus on continuous improvement and a passion for customer service. Manheim is a company that has operated with a forward-thinking mindset since 1945, and that’s never been more true than today. Working collaboratively with our customers, our Cox Automotive partners and our employees on the front lines, we are committed to driving innovation, creating efficiencies and facilitating the smart use of data in our industry.

Driving Innovation
In 2014, we continued to invest in innovative solutions that deliver greater business value to customers, while enhancing their confidence when buying and selling. Our customers have told us they need more ways to source vehicles, to minimize sale time and to employ innovative tools to retail their inventory. Solutions such as on-site auction lanes at large dealerships and access to better vehicle images are helping them succeed. And, in conjunction with other industry partners, we are working toward a multi-platform selling solution that will allow consignors to post and receive bids on vehicles on multiple online venues simultaneously. This innovative solution is good for buyers, sellers and the industry.

Creating Efficiencies
To deliver the best customer experience possible, we are in the midst of a $100 million auction modernization effort. This multi-year project uses technology to redesign and streamline processes, enabling our employees to spend more time with customers. And as marketplace conditions demand, more efficient ways of conducting business, we are responding by delivering all-in-one mobile solutions, streamlining title management and creating self-service tools that provide customers greater choice and control.

Enabling Smarter Decision-Making
If data is power, then the most important service we can provide is to help our customers use it in meaningful ways. As a provider with the most comprehensive wholesale and retail data in the industry, our goal is to put these insights to work on behalf of our customers—ultimately driving smarter decision-making.

Even before the digital age, delivering data to our customers has been a key part of the value we provide. It’s why the Used Car Market Report exists, a valuable piece of a rich legacy and part of a dynamic future for our customers and our industry.

As always, we trust you will find the Report to be a valuable business resource, and we invite your feedback.

Sincerely,

Janet Barnard
President, Manheim North America
2014 HIGHLIGHTS

New vehicle sales rose for the fifth consecutive year—that’s only happened one time before. It’s expected that 2015 will provide the sixth straight year of increased sales.

At just over 42 million, used vehicle sales in 2014 were virtually unchanged from 2013.

The absolute change in the Manheim Used Vehicle Value Index has averaged only 3.1% per year over the past 19 years.

Given the escalation in new vehicle prices, it is only natural that the new car market has become increasingly skewed to high-income households. Manufacturers are adapting by attempting to shorten the trade cycle which increases the importance of the late-model used vehicle market.

The U.S. economy in 2015 looks good. If outside headwinds can be diverted or diminished, it might even be a great year.
FROM “IRRATIONAL EXUBERANCE” TO “IRRATIONAL SUBDUEDNESS”

It has been said that the seeds of the Great Recession were sown, in part, by the “irrational exuberance” of consumers, businesses, and—most of all—financial institutions. When the reality hit home that real estate and equity prices do not move inexorably higher and that financial leverage entails added risk, as well as added rewards, it wasn’t a pleasant adjustment period.

What fruits then will we reap in coming years from today’s “irrational subduedness”? Think the U.S. consumer is not subdued? Consider this:

- Total employment growth in 2014 was the highest since 1999,
- December 2014 marked a record 51 consecutive months of employment growth,
- Equity markets have nearly tripled from their lows,
- Historically low interest rates fell even further in 2014,
- Credit availability and terms remained extremely favorable,
- New vehicles sales rose for the fifth consecutive year, and
- Gasoline prices plummeted in the second half of the year.

Despite all that, surveys still showed that the majority of people believe the nation is on the “wrong track” and that the next generation will have a lower standard of living than they do. And, although business investment has picked up, it is nowhere close to where it should be at this point in the cycle. Nor has business investment been consistent with the level of corporate profits, liquidity, and cash flow. For the most part, low rates and high liquidity have led to financial re-engineering, not investment, expansion, or innovation.

The loss in confidence is partly the result of the recession (deep wounds leave lasting scars) and legislative and regulatory policies (attempts to tame the excesses of the past), but it is also true that the real economy is not as vibrant as some of the aggregate statistics suggest. The many households that have not directly benefited from the overall recovery are rightfully subdued. And their resulting actions have only reinforced the slow-growth scenario.

So, as we review the major trends in the economy last year and consider their impact on the auto industry, let’s also look at where some of the aggregate numbers may be painting a less-than-accurate picture.
EMPLOYMENT GROWS, MEDIAN INCOME DOES NOT

We projected in 2013 that total U.S. employment would hit a new high in mid-2014. It did—in May. But, we also noted that, although the topline number would be rightfully celebrated, the enthusiasm should be tempered by just how long it took to get back to that previous peak (64 months), the high number of low-quality and part-time jobs, and the disparate labor market environments faced by persons of various socioeconomic groups. All of those continue to be concerns.

Total U.S. employment exceeded its previous peak in May of last year and, at the start of 2015, was 2.0 million above that peak. However, the number of people employed full-time at the end of last year was 1.9 million below its all-time high. Relatedly, even though the number of persons employed part-time for economic reasons has declined rapidly in recent years, the total is still higher than during the peaks of previous recessions. The number of long-term unemployed is also in tune with what used to be considered recession levels, and the labor force participation rate hovers at a 37-year low. Not surprisingly then, higher employment has not led to higher real wages. Average hourly earnings have been growing at only slightly more than 2%. Average hours worked is barely budging.

There are, however, other indicators within the overall labor market that have been, and will continue to be, supportive to new and used vehicle sales. For one, the benefits of the recovery have clearly been skewed to high-income, asset-owning, well-educated households. New vehicle sales are skewed to those same demographics.

On the used vehicle side, the benefits have come more from the aggregate numbers since every increase in jobs provides both the need and ability to acquire personal transportation. Labor market conditions in 2014 were also supportive to the retail financing environment, which, in turn, led to a robust used vehicle market. Initial jobless claims (adjusted for employment levels) fell to record lows in late 2014. That means unexpected job loss—a primary cause of loan default—is at the lowest level ever. The resulting low auto loan delinquency rates led to greater credit availability.

PERCENT CHANGE FROM PREVIOUS PEAK

![Graph showing percent change from previous peak]

Source: Bureau of Labor Statistics
MONETARY POLICY SET TO PIVOT IN 2015
In October 2014, the Federal Reserve ended its bond-buying program (known as quantitative easing), which ballooned the bank’s balance sheet to more than $4.4 trillion. The Fed also communicated (fairly clearly) that rate hikes would likely begin in 2015. Nevertheless, the nation’s benchmark rate (the 10-year Treasury) declined for most of the year. This partly reflected international events—a flight to safety, the debasing of other currencies, and global economic weakness.

With the economy (and especially the labor market) showing better strength at year-end, it is likely that the Fed will indeed embark on a series of rate hikes that may last for years. Although this will be the first tightening move by the Fed in almost a decade, we expect no large or immediate impact on the interest-rate-sensitive sectors of autos and housing because, by any normal measure, credit will remain cheap and plentiful.

YEN/DOLLAR EXCHANGE RATES

Source: Federal Reserve Board
In recent years, however, the mere talk of Fed tightening has often led to turmoil in those emerging markets that have large dollar-dominated liabilities. That impact could now be compounded since there has already been a significant strengthening of the dollar and since, this year, it appears that the Fed will be moving in the opposite direction of the European Central Bank, the Bank of Japan, and the People’s Bank of China—all of whom may be loosening monetary policy. Higher rates in future years will also intensify our underlying structural budget deficit. A one-point increase in interest rates adds $1.1 trillion to the debt over 10 years.

**LOWER GAS PRICES PUMP UP HOUSEHOLDS**

It's only fitting that we close out this discussion of macroeconomic trends with a look at oil prices since that was the biggest story as the year itself came to a close. After trading in a relatively narrow range around $100 per barrel for more than three years, oil plunged by more $40 a barrel in the second half of 2014. There’s no doubt that the boost in household discretionary income resulting from lower gas prices is unambiguously good for the U.S. economy, especially since the decline has been driven primarily by increased supply, not global economic weakness—although that has played a role.

Gas prices influence both vehicle segment and total demand. Of the two, the latter is more important, especially when it comes to used vehicles. The share of household income spent on gasoline is often double for used vehicle purchasers versus what it is for new vehicle purchasers. Thus, the impact on spending patterns is much bigger. We also know that auto loan delinquency rates for low- and middle-income households are correlated with gas prices. Just as upside spikes push subprime borrowers into arrears, lower pump prices help them keep current. For new vehicle buyers, the impacts are more nuanced, but no less real.

**GAS PRICES PER GALLON**

Source: *Oil Price Information Service*
If there is a downside to lower gas prices, the biggest one will likely be the tension created with future CAFE standards. If current gasoline pump prices persist, manufacturers, in an effort to meet corporate fuel economy standards, will be forced to push customers into cars they don’t want to buy. That never works out well. The only alternatives would be a lowering in future CAFE standards (likely if gas prices remain low) or an artificial lift to pump prices (i.e., higher gas taxes).

NEW CAR AND LIGHT-DUTY TRUCK SALES

Seasonally Adjusted Annual Rate: 3-month moving average

NEW VEHICLE SALES VERSUS NEW HOME SALES

SAAR, 3-month Average, in millions

Source: Automotive News

Source: U.S. Census Bureau & Automotive News
NEW VEHICLES CONTINUE TO OUTPERFORM THE OVERALL ECONOMY

In 2014, new vehicle sales rose for the fifth consecutive year. That’s happened only one time before—and the annual increases during this cycle have not been puny. The first three years of the upswing were all double-digit gains, and the increases in 2013 and 2014 were 8% and 6%, respectively. As a result, the total rise from 2009’s trough of 10.4 million to last year’s 16.5 million was 60%.

Compare that to the paltry gains made in housing—an industry that used to move in lockstep with autos. Differences in the financing environment between the two have been the primary cause for the difference in performance. Auto lending has returned to pre-recession standards. Mortgage lending has not—and hopefully won’t, since that is where the excesses lay.

It is expected that this year will provide the sixth consecutive year of increased new vehicle sales. We would then look for a plateauing of sales at today’s level, rather than a run up to new highs. Lifestyle and demographic shifts indicate an underlying rate of demand for new vehicles that is not significantly above 16 million. Manufacturers could certainly use their increased production capacity to push annual sales to 18 million units or higher, but it would require an aggressive push. One which would entail higher incentives, loose financing, subvented leases, and forced fleet sales. All of which would be detrimental to the longer-term health of the industry, and all of which we hope are not pursued.

A leveling-off in new vehicle sales does not mean the auto industry is “mature.” Far from it. The auto industry has been, and will be, part and parcel of the overall technological revolution.

It is the advancement in product that has made consumers willing to pay ever-higher transaction prices for new vehicles. And, of course, lower rates and longer loans have enabled buyers to digest those price increases.

Given the recent escalation in new vehicle prices, it is only natural that the new vehicle market has become increasingly skewed to high-income households. Manufacturers are adapting to this shifting environment by attempting to steady, or even shorten, the trade cycle through leasing and quicker product refreshes. To the extent they are successful, it will only increase the importance of the late-model used vehicle market. Manufacturers will have a heightened interest in protecting residual values, securing additional finance opportunities, and helping their dealers establish strong CPO programs.

USED VEHICLE SALES AND RESIDUALS EXHIBIT STABILITY

Throughout this report, we discuss in detail the sales and pricing trends for various segments of the used vehicle market. So, for here, let’s simply reinforce the notion of stability in both sales and pricing.

At just over 42 million, used vehicle retail sales in 2014 were virtually unchanged from 2013. Even during the Great Recession, the peak-to-trough swing in used vehicle sales was only 20%. That compares to a peak-to-trough swing of 42% for new vehicles.

The stability in sales volumes has long been recognized by analysts (and appreciated by dealers), but the history of residuals showing only modest movements is not understood as well. The absolute change in the Manheim Index has averaged only 3.1% per year over the past 19 years. The change in each of the past three years has been less than 2%.
As a result of the desire to develop brand loyalty among used car purchasers, the manufacturers have instituted a number of used car certification programs that have become the price of admission to the top tier of the used car business. Virtually every manufacturer has a certification program … Consequently, used car purchasers are expressing a greater interest in “certified” used cars.

For 2005, it is not hyperbole to say that the economy experienced once-in-a-lifetime shocks and that the auto industry underwent seminal shifts that will change the manufacturing and retailing landscape forever. From the largest bankruptcy filing in automotive history (Delphi) to three-dollar-plus per gallon gasoline, 2005 offered numerous challenges.
That stability has been achieved even though it is normally the used vehicle market that is forced to rectify any imbalance that may exist with the new vehicle market. Additionally, the bulk of commercially consigned units (off-rental, off-lease, and repossessions) represent supply that was created years ago and that now must be wholesaled regardless of price.

In the auto industry, new and used vehicle values are always working to seek balance, as are used vehicle values and used vehicle supply. They always find that balance. Sometimes the journey is difficult; but, more often than not, the efficiency of the remarketing industry allows a smooth transition from one cycle to the next.

A WORLD CONNECTED BY CAPITAL AND CONFLICT

So, to answer our opening question: in theory, subdued consumers in the midst of an ongoing recovery should result in slower-than-average, but very sustainable, growth. Exactly what we have had. In 2015, the consensus outlook calls for accelerated growth as the improvements in the labor market broaden to touch the households that have, to date, been left behind. That’s a reasonable assumption. And, if the U.S. were an economic island, we would say that forecast is almost a sure thing. But, we are not.

To be sure, export/import activity as a share of GDP is considerably less for the U.S. than for other major developed countries, but that simple accounting doesn’t capture the critical importance of international capital flows or the dollar’s role as the world’s reserve currency. Our financial markets are not immune to foreign economic forces, and those outside influences will likely be negative in 2015 as many of the other major world economies slow and as other foreign central banks pursue policy that is opposite from that of our own Federal Reserve.

Neither, of course, are we immune from the world’s territorial conflicts and outbreaks of terrorism. Here too, 2015 looks to provide more negatives than positives.

The U.S. economy in 2015 looks to be good. And, if the outside headwinds can be diminished or diverted, it might even be a great year. The entire automotive ecosystem (manufacturers, dealers, lenders, and the many other auto-centric industries) is currently in a good place. Aggressive innovation, while avoiding the temptation to force growth, can keep us there.
2014 HIGHLIGHTS

NAAA volumes rose an estimated 5% to 8.6 million units in 2014, and volumes are expected to continue to grow in 2015 and 2016.

After declining in both 2012 and 2013, wholesale used vehicle prices (mix- and mileage-adjusted) ticked up 1.5% in 2014, contrary to the expectations of analysts who thought prices would ease due to rising wholesale volumes.

Statistically speaking, the last four years have shown the least volatility in wholesale vehicle pricing since the inception of the Manheim Used Vehicle Value Index in 1995.

After increasing over the last several years, the average age and mileage of units sold at auction in 2014 was little changed from 2013.

The U.S. used vehicle market is valued at $390 billion.
AUCTION VOLUME INCREASES FOR THE THIRD CONSECUTIVE YEAR
The National Auto Auction Association (NAAA) estimates that member auction sales rose 5% to 8.6 million units in 2014. (The final tally will be reported in the first quarter of 2015.) The association further forecasts that volumes will continue to grow in 2015 and 2016, as a result of increased retail activity driving dealer consignment and past growth in new lease originations, finance contracts outstanding, and business fleet purchases pushing higher commercial consignments.

Total wholesale transactions in a given year are more than two and a half times the NAAA-member number. Other channels include direct sales between dealers (sometimes with a wholesaler as an intermediary), commercial accounts selling directly to dealers or retail customers, and non-NAAA-member auctions. Despite the large volumes in the other channels, it is the real-time, competitive-bid, price discovery in the auction channel that serves as the benchmark for pricing in the other venues.

But, although commercial wholesale supplies increased sharply in percentage terms in 2014, the actual volume remained low compared to past levels and certainly in comparison to the larger retail used vehicle marketplace of today.

Additionally, in 2014, new vehicles continued to be sold at higher average net transaction prices and retail credit conditions remained quite favorable. Both factors were supportive of used vehicle values.

Statistically speaking, the last four years have shown the least volatility in wholesale vehicle pricing since the Manheim Index’s inception in 1995. Many macroeconomic and industry factors contributed to that stability; but we also give credit to better and more efficient remarketing practices, which enabled commercial consignors to anticipate, respond to, and, thus, minimize impending swings in wholesale pricing.

Within the year, wholesale pricing did show some noticeable ups and downs—even after adjusting for seasonality. Prices rose in the first four months of 2014 as harsh weather and other temporary factors disrupted auction throughput. Rental car companies, for example, delayed de-fleeting since there was a need for the units in their insurance replacement businesses. In addition, tax refunds in 2014 were higher than in 2013, and they came back at a quicker pace.

WHOLESALE PRICING BETTER THAN EXPECTED IN 2014
After declining on an annual average basis in both 2012 and 2013, wholesale used vehicle prices (mix- and mileage-adjusted) ticked up 1.5% in 2014. The rise was contrary to the expectations of many analysts who thought pricing would ease due to rising wholesale supplies.

Tax refund monies support retail sales, which, in turn, stimulate dealer bidding at auction, especially for lower-priced units.

NAAA MEMBER AUCTION VOLUMES

![NAAA Member Auction Volumes Graph](source: NAAA Annual Survey)
After that initial run-up through April, wholesale prices declined in each of the following five months. That brought seasonally adjusted prices down almost 3% from the April high and created fears that the correction in wholesale pricing might accelerate. But what was really happening was simply a reversion in pricing back to trend levels after being temporarily lifted by various factors. And the decline in wholesale pricing was not unwelcomed by dealers.

In any event, wholesale pricing never moves in a straight line. And, in each of the last three months of the year, wholesale prices increased. As a result, wholesale prices ended the year slightly higher than where they started.

**AGE AND MILEAGE OF AUCTION SALES REMAIN STABLE IN 2014**

After increasing over the past several years, the average age and mileage of units sold at auction...
in 2014 were little changed from 2013. The faster growth in commercial consignment volumes, which consist of younger, lower-mileage units, was offset by higher average mileage for dealer-consigned units and off-rental vehicles. The continuing up-trend in new vehicle sales means that dealers are now receiving newer trade-ins than they did at the beginning of this cycle; but used car managers are retailing a greater share of these units, as well as holding on to more of their older trade-ins.

**INFORMATION EQUALS SUCCESS**
Successful used car dealers know more about the cars they buy and sell than ever before, a necessity due to the significant increase of information available to consumers via digital and mobile channels. To stay ahead of the curve, dealers need to better understand everything about the vehicle they are buying in the wholesale environment.

In a world where time is money, it is vital that dealers have easy access to all available vehicle information to efficiently make purchasing decisions. This information needs to be accurate, complete, and consistent. The more information sellers supply, the better: Studies have shown that transparency leads to increased sales conversions, bids per vehicle, and increased sales price while decreasing average days to sale and arbitration. This ultimately impacts the seller’s bottom line.

**Which products and tools enable this efficiency and what are the benefits?**

- **Vehicle Options**—Options and option packages can greatly impact the value and desirability of a vehicle. Whether selling, trading in, or just curious about what a vehicle is worth, it is important to know how to obtain an accurate appraisal.

- **Vehicle History Reports**—Consumers want to know; so should dealers. Accident information can drastically sway the market value of a vehicle, and protects all parties involved up-front in the transaction.

- **Condition Report**—Vehicle History Reports let buyers know what has happened to a vehicle, but what is it like now? Condition reports provide unbiased documentation of the current state of the vehicle. This gives the dealer vital information on what the “all-in” cost of the vehicle will be prior to offering it at retail.

- **AutoGrade Score**—To determine which vehicles are the best in a sea of inventory, the industry-standard vehicle condition score makes it easier than ever. Graded on a scale from 0.0 to 5.0 and based on NAAA condition reporting standards, the AutoGrade Score
CNW Marketing/Research found that 6.1% of new car buyers used the Internet during their purchase, while only 1.3% of buyers of one to three-year-old used cars used the Internet… In summary, the Internet is becoming a more important factor in automotive retailing, primarily as a supplement to the traditional retail process.

Last year’s economy is something all of us would like to “seal in a box and bury under a mountain.” Unfortunately, we can’t. Additional damage from the credit crunch-induced recession is sure to come. And, the after-effects from the damage already inflicted will be long-lasting.
provides consistency across the industry for dealers to quickly assess the condition of a specific vehicle relative to similar vehicles across the marketplace.

- **High-Definition Images**—Seeing is believing. Images provide dealers the ability to quickly evaluate a car and validate that it is what the seller says it is.

Together, the products and tools above provide transparency and thus increase trust and confidence in the purchase decision. When the right information is available, dealers are more willing to pay the market value of a vehicle, and it allows them to purchase more in the time they have.

**PRICED TO SELL**

Access to vehicle information is only part of the equation. Valuation and pricing play an equally important role in the buying and selling of vehicles. Sellers that price vehicles properly sell more and sell faster. What a buyer is willing to pay is ultimately driven by their expectation of what they can retail the car for.

**So what are the principal “all-in” costs of getting cars retail-ready?**

- **Wholesale Valuation**—The expense associated with the purchase of a vehicle. Buyers use many industry tools to help them determine this value, including: MMR, Black Book, NADA, Kelley Blue Book, Galves, and others. The more accurate and complete the vehicle information is, the more accurate the appraisal will be.

- **Transportation**—The expense (time and money) associated with moving a car from its purchase location to the retail lot or customer location. There are two transportation options: full-service and self-service. Full-service transportation handles all the deal logistics when saving time is critical. The self-service model allows buyers to shop around for price and terms that meet their specific needs.

- **Reconditioning**—The expenses associated with repairs to bring the vehicle to a retail-ready state. Historically, this has been done at a dealer location. As margins were squeezed out of used vehicle sales, high-margin dealer services became increasingly important to the profitability of dealerships, and their shops were often capacity-constrained. This has led some dealers to look to others to provide these retail-ready repairs.

**MAKING IT EFFICIENT TO INCREASE REVENUE**

Today the lines between physical and digital worlds are blurring. Being able to seamlessly move between the two enhances the ability to efficiently increase revenue.

Both buyers and sellers are utilizing mobile devices as an integral part of the physical shopping experience. New products and tools are enabling more self-service options every day.

Mobile applications continue to provide buyers with the ability to buy whenever and wherever they want, while sellers are posting vehicles on multiple online platforms simultaneously. Technology improvements and continued adoption (and ease-of-use) will lead to an even greater degree of automated buying and selling. In addition, mobile access to tools that provide comprehensive vehicle information and real-time access across wholesale and retail markets will be necessary in increasing market efficiency. The move to mobile is undeniable, not only in the auto business but in every corner of the globe. Worldwide combined shipments of devices (PCs, tablets, ultramobiles and mobile phones) are projected to reach 2.5 billion units in 2014, a 7.6 percent increase from 2013, according to Gartner, Inc.

While these advances add convenience, customer service cannot be sacrificed because sellers and buyers are also expecting a personalized experience. (Just like the small business owner who uses the ATM for self-service but expects to walk into his local branch and speak with a person.)

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**MANHEIM MOBILE SNAPSHOT:**

- The first car purchased from Manheim on a mobile device was in 2009—it was a Porsche Turbo
- Manheim’s Mobile offerings receive 1.1 million visits per month
- Nearly 57% of customers at any given time connect with Manheim via mobile devices
- On average, Manheim’s websites and apps attract more than 125,000 users per month
- Vehicles with an Electronic Condition Report (ECR) are three times more likely to receive a bid, and are twice as likely to sell as a vehicle without an ECR.
What are some trends in personalization that drive efficiency?

- **Localization** — Many dealers have built trusted relationships within their local areas and are most confident doing business locally. Mobile auctions are a means of bringing the auction experience to more locations. A mobile trailer is pulled onto a lot and a full lane experience is brought to life—with the trailer acting as the block, a live auctioneer calling the sale, and cars driven down a mock lane. Dealers are discovering another option for conducting business, one that extends their market reach and includes all the excitement of a physical auction—but hosted locally on their own lots. Participating sellers are finding sales by attracting customers from previously underserved markets—buyers who now have access to inventory in their local area.

- **Preferences and Profiles** — Buyers and sellers can store their individual preferences and profiles online. These records are used to create a personalized experience that best suits their needs, reducing time and increasing satisfaction.

- **Decision Tools** — These tools come in many shapes and sizes. Desktop programs and services, mobile apps, and dashboards. These tools provide sellers and buyers the information needed to run their business (inventory management, vehicle information, valuation, vehicle location, transportation estimates, floor planning information, and more).

- **Imaging** — High-definition images in online listings provide buyers with added confidence to make purchases online at any time of the day. They also allow buyers to quickly evaluate vehicles prior to coming to an auction or during a Simulcast sale.

- **Multi-Platform Selling** — Buyers and sellers are becoming more demanding as there is increased pressure on their margins and time. Several remarketing companies have come together and are actively developing a Multi-Platform Selling (MPS) solution. MPS is a cross-industry solution that will facilitate the listing of vehicles across multiple digital marketplaces and facilitate active bidding across them all. MPS will efficiently maximize vehicle visibility and provide a “true” representative market dynamic. Providing a one-size-fits-all experience is not an option. A seamless customer experience across all touch points regardless of channel type is a must.

**Consignors continue to see reconditioning programs yield healthy ROI**

Consignors employ reconditioning programs to differentiate their inventory and to offer frontline-ready vehicles to wholesale buyers. While reconditioning can add additional time into the days-to-sell metric, it often produces an additional return on investment (ROI). To achieve a worthwhile ROI, vehicle grades usually need to be improved more than one-tenth of a grade. Progressive consignors have used data and analytics to take often-ignored inventory graded below 3.0 (average), make small targeted investments, and drive significant incremental value. Sellers who invest less than $150 in the right areas can increase a vehicle grade by 0.3 points. Depending on the initial grade and vehicle value, this can drive the sale price up significantly.

Additional ROI opportunities exist with vehicles graded a “high 2”—as many individuals and dealership buying centers filter searches for vehicles graded 3.0 and higher. Investing the same $150 on a vehicle graded 2.7 to achieve a grade of 3.0 can yield $500—an ROI of more than three times that amount. Captive finance and manufacturers have a special interest in reconditioning higher-grade units, seeing benefits in terms of residual values and brand protection. Further, if a seller has a high market share of a particular vehicle, the seller can influence MMR values by heavily reconditioning and offering a higher-than-average grade unit to the market.
Opportunity
Many vehicles are moved long distances over their life cycles, whether from auction to dealership, dealer to retail customer, or any number of other scenarios. As a result, there is a high demand for transportation logistics providers to create timely and affordable solutions.

Size and Scope of the Industry
There are approximately 14,000 asset-based carriers, of which 70% are small independent owner-operators. The balance are composed of larger carrier groups (ranging anywhere from 50 to thousands of trucks). The smaller operators tend to focus on the used car market, while larger carrier groups focus on the new car industry.

Rail plays a significant role in the movement of new vehicle inventory for the OEMs. Railways are also adapting their business models to use available rail capacity to accommodate shipping consignors with smaller volumes (investing in locomotive, terminal, and track capacity, and purchasing more auto racks to keep up with demand). When truck carrier capacity gets tight and costs rise, rail can provide both the capacity and competitive rates to ship vehicles in the used car market.

Capacity
While consignment volume has steadily increased in recent years, the capacity of truck carriers has not kept up. Smaller independent owner-operators have found it difficult to acquire expensive equipment because of limited financing sources. While larger asset-based carriers are acquiring record numbers of car-haulers, the difficulty for them is finding qualified drivers to fill the seats of this new equipment. According to Department of Labor statistics, while there were 39,000 open driver positions in the transportation sector, just under 1,900 were actually filled (August 2014). To address this issue, asset-based carriers (independent and large carrier groups) must consider paying higher salaries and benefits to attract, and retain, qualified drivers. Additionally, innovative automotive transport and logistics brokers and carriers are also learning new ways to engage rail capacity to meet increased demand. Until the strain on truck capacity eases, it is likely that costs to deliver vehicles will increase.

Pricing
In the transportation industry as a whole, the base cost for shipping is usually determined by cost per mile and distance traveled. Other things that can impact shipping costs include volume to be shipped, vehicle size, operability, inclement weather, and carrier configuration.

The biggest impacts to pricing are: weather and supply versus demand. The best example of this was the first quarter of 2014; record numbers of new vehicles in the North Central/Northeast U.S. from the OEMs coupled with the heaviest snowfalls in years. This combination of heavy volume and fewer available carriers (truck and rail) caused prices to soar by more than three times their normal rate, and it took several months to normalize. During this period of time, only those willing to pay more moved freight, creating a backlog that impacted manufacturers, dealers, and auctions. The biggest impact was an increase in “days to deliver,” the most important metric to car dealers who want to buy and sell vehicles quickly.

Key Customer Metrics
While distance to travel is a key factor in determining the time it takes to deliver a unit to its destination, the most critical business metric for carriers and brokers to focus on is the amount of time it takes to pick up and deliver a vehicle once it has been consigned for shipment.

In recent years, delivery times have taken on added importance as more buyers and sellers use physical and online channels to buy and sell inventory in a “just in time” environment. Where it was once acceptable to
deliver units in a seven- to 10-day time frame, today carriers and brokers must compress that time to three to five days to meet customer expectations. The majority of commercial customers have delivery times that can vary between three and seven days spelled out in their service level agreements with transportation vendors. Auctions are looking for delivery averages in the four- to-five day range, depending on the vehicle (repo, operable, specialty units). Just-in-time buying and selling strategies and cost to hold inventory influence consignors’ decisions on acceptable delivery times. What consigners should understand is that geography of the units, weather, the distance the vehicle needs to travel, and the availability of carriers during high demand all can increase delivery time and cost.

Technology
In an effort to meet customer expectations on delivery times, carriers and brokers have to find new ways to increase efficiency and minimize cost. To accomplish this, many transportation logistics providers must leverage data and new Web-based, agile, smart technologies, including mobile, and then look for ways to create customer order integration into their delivery systems to drive efficiency and reduce delivery times. As an example, companies such as Ready Auto Transport are making significant investments in technology to automate vehicle assignment, dispatch, invoicing and follow-up to meet this expectation.
One of the most important trends in the used car market over the past decade has been the increased volume of retail used vehicle sales by dealers at the expense of casual sales by individuals...This is primarily due to the rise of consumer leasing of new vehicles, to which franchised dealers have preferred access when these vehicles come off-lease.

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.
**AUTOMOTIVE REMARKETING AND SUSTAINABILITY**

Sustainability continues to drive innovation in the automotive industry. This is apparent from the plethora of innovative “green” (hybrid electric, plug-in electric, and hydrogen) vehicles that are coming to market. According to a recent report from Navigant Research, worldwide sales of electric and alternative-fuel vehicles will grow from 6.6 million in 2014 to nearly 12.4 million in 2022.

Automakers will continue to introduce new plug-in electric vehicle (PEV) models—from small city cars to higher-priced luxury vehicles, offering consumers unprecedented choice in emissions-free driving. Hybridcars.com conservatively forecasts a million global PEVs by August or September 2015.

For Manheim, 2014 sales of hybrid and electric vehicles averaged 4,200 per month. This was a 13% increase over 2013 volumes.

Manheim’s parent company, Cox Enterprises, distributed the first nationwide survey to examine sustainability opportunities and challenges for small- and medium-sized business (SMBs) leaders.

Here are a few key findings:

- Cost reduction and company values are the top factors driving sustainability.
- Monetary considerations are both the largest adoption driver and barrier of entry for sustainable business practices.
- Business leaders in certain regions of the United States are more likely to participate in sustainable activities than others—the Pacific region leads the way in participation.
- Half of all business leaders believe that sustainability is good for the bottom line.

*Go to www.CoxConserves.com/Survey to learn about the findings and sustainability best practices that can help your business.*
2014 HIGHLIGHTS

Despite narrowing gross margins, used vehicle operations at franchised dealerships produced record profits.

In the third quarter of 2014, the publicly traded dealer groups posted their 21st consecutive quarterly increase in same-store sales volume.

Certified pre-owned sales totaled a record 2.3 million units in 2014, the fourth straight year that sales reached a new high.

For the third consecutive year, independent dealers underperformed the overall used car market, with unit volumes declining nearly 3%.

Dealer consignment volumes at wholesale auctions remain at historically high levels, totaling an estimated 57% of overall auction volume in 2014.
ANOTHER SUCCESSFUL YEAR FOR DEALERS

In 2014, dealers faced many of the same opportunities and challenges that they did in 2013. And that was a good thing. Experience enabled them to seize the opportunities and conquer the challenges.

For franchised dealers, five consecutive years of higher new vehicle sales would have in the past created a challenge to keep focused on used vehicle operations. Not so in 2014. Dealers fully understood that an efficient used vehicle department is not only an important profit center in its own right, but also key to maximizing new vehicle and fixed operations.

Independent dealers in 2014 once again found themselves wrestling with inventory acquisition challenges as the usually strong and steady flow of units from franchised dealers remained lower than in the past as new car dealers retained more of their older, higher-mileage units received as trade-ins. By year-end, however, independent dealers were beginning to benefit from the increased flow of units into open auction channels. This will certainly continue to be the case in 2015. What was most beneficial to independent dealers in recent years was the ready availability of retail financing at attractive terms. That too should continue as a tailwind in 2015. Increased credit availability has been especially helpful for independent dealers operating in the subprime arena, as those lenders continued to buy deeper.

That, however, created a challenge for Buy-Here, Pay-Here (BHPH) dealers as they saw a large swath of their customer base picked up by subprime lenders. But, as with independent dealers, the increased availability of capital across the board provided a benefit to BHPH operators. And that’s because BHPH dealers also utilized the better credit availability from floorplan lenders, from banks for general lines of credit, and from financial institutions buying notes at a discount.

FRANCHISED DEALERS GROW SALES, PROFITS, AND THEMSELVES

Despite narrowing gross margins, used vehicle operations at franchised dealerships produced record profits. Credit quicker inventory turns, reduced selling expenses, and strong F&I income. In 2015, franchised dealers will benefit from growing off-lease volumes, which means that quality used vehicle inventory will literally be driven to their door. And that’s not to mention that the majority of returning lessees will buy or lease another new vehicle from that dealer.

The sales and profit support provided by readily available retail financing is also likely to continue in 2015. To be sure, rates will probably rise. But, as the industry saying goes, “The availability of credit is more important than the cost of credit.” Given that any tightening of credit generally follows a deterioration in loan performance and given that portfolios are currently performing extremely well, the availability of retail financing should not be a problem in 2015. Do, however, expect for dealer finance income to come under direct, and indirect, regulatory pressure and for compliance costs to rise. And, with residual values trending down, it is likely that lenders will be looking to book lower loan-to-value ratios.

Strong past financial performance and bright prospects combined with readily available capital to enable and entice existing dealers to grow through acquisition in 2015 — and to pay top

USED VEHICLE RETAIL SALES BY FRANCHISED DEALERS
dollar for the stores bought. In the first 10 months of 2014, the pace of store acquisitions was running twice the pace of the prior year. And there were some large transactions. Most notably, Lithia’s acquisition of the DCH group and Berkshire Hathaway’s purchase of the Van Tuyl group.

The strength of auto retail sales overall and the ability of individual operators to improve cash flow through efficiencies led to dealership purchases having higher blue sky multiples. And, with the lagging auto manufacturers of the past having now caught up in terms of product offerings and solid financial outlooks, the blue sky multiples between franchises has evened out, as well as rising overall.

PUBLIC DEALER GROUPS HAVE A RECORD YEAR
Financial reports from the seven publicly traded dealership groups provide a good reflection of trends within the franchised dealer body. Yes, the largest of the publicly traded dealers (CarMax) is an independent, but their product offerings and price points are similar to those of a mainstream franchised dealer.

With respect to unit volumes, the trend has been very good. In the third quarter of 2014, the dealer groups posted their 21st consecutive quarterly increase on a same-store basis. The gains in the second and third quarters of 2014 were only 3%, but after 21 consecutive quarterly gains the year-over-year comps are naturally getting harder. And, as noted earlier, these dealer groups are also growing through acquisitions. In total, these seven dealership groups retailed more than 1.3 million used units in 2014.

With higher throughput, quicker inventory turns, higher prices, reduced expenses, and good F&I income, reduced margins did not prevent record profits.

With respect to gross margins, however, the trend is not as pretty. These same dealer groups experienced declining gross margins (on a year-over-year basis) for almost as long. With higher throughput, quicker inventory turns, higher transaction prices, reduced selling expenses, and good F&I income, the reduced margins did not prevent record profits. The narrowing of margins will, however, present a problem to dealers who have not yet adapted to the changing marketplace.

Increased price transparency in the used vehicle market, in addition to narrowing margins, also

MANHEIM CONSULTING STUDY REVEALS THAT TITLE-READY UNITS ARE TWICE AS LIKELY TO SELL AT AUCTION
Approximately 58% of dealer units do not have a title present on auction sale day. While dealers may be encouraged to have the title present on sale day to be promptly paid for a vehicle, a Manheim Consulting study confirmed that vehicles sold with title average a conversion rate of 86%, while those that did not have a title present average 42%. Potential wholesale buyers who wish to retail a vehicle quickly depend on the selling dealer’s ability to promptly sign over the title.

For those units without titles that do sell, 57% of the titles arrive within a week. For the remaining 43%, buying dealers incurred increased carrying costs associated with the tied-up asset. Using a conservative discount rate of 3.25%, this equates to only $18/unit for 20 days. However, this can add up considerably over a large portfolio and as interest rates increase.

View the complete case study, along with others, by visiting www.manheim.com/consulting and search under the “Publications” tab.
% CHANGE USED UNITS RETAILED—SAME STORE BASIS
(Publicly traded Dealership Groups)

Weighted average for KMX *, AN, PAG, SAH, GPI, ABG, and LAD

*KMX shifted forward one month to correspond with calendar quarter

Source: Company filings

USED VEHICLE RETAIL GROSS MARGIN
(Publicly traded Dealership Groups)

Sales-weighted average for KMX *, AN, PAG, SAH, GPI, ABG, and LAD

*KMX shifted forward one month to correspond with calendar quarter

Source: Company filings
reduced the range of grosses on individual transactions. Lacking “home-run” (high-gross) deals, dealers can now ill afford the outsized losses associated with buying the wrong car at the wrong price. Hence, the need for dealers to take a more data-driven approach to inventory acquisition. And, for commercial consignors, who often benefited from that one dealer’s paying too much in a speculative bid, the need of getting their portfolio in front of right buyer — the first time — takes on added importance.

**CPO SALES: ANOTHER YEAR, ANOTHER RECORD**

In 2014, sales of manufacturer certified pre-owned (CPO) units totaled a record 2.3 million units. It was the fourth consecutive year in which sales reached a new high. 2015 promises to be the fifth such year as growing off-lease volumes provide both the need and ability for further growth. And there is also the desire to grow CPO sales since they enable dealers to protect gross margins, improve turn rates, and boost F&I and service income. And, when CPO programs are properly structured and effectively marketed by manufacturers and dealers, the programs can provide all three of those benefits simultaneously.

But, is there a natural limit for future CPO sales? After all, the ratio of CPO sales to the number of new vehicles sold in the prior four years rose from little more than 2% a decade ago to more than 4% today. And the share of total franchised dealer used vehicle sales that were CPO units rose from 4% in 2000 to 23% in 2014.

Note, however, that manufacturers who have long-established CPO programs, high lease rates, and remarketing processes that keep a large share of returning units within their dealer network often have CPO-to-prior-sales ratios close to double digits. And their dealers often have used vehicle operations where more than half of all used sales are accounted for by CPO vehicles. This means that the CPO market has at least the potential to more than double. It will be a matter of how much marketing muscle the manufacturers want to put behind the programs — and, of course, the dealer’s ability to continue to earn good profits on the sales.

**INDEPENDENT DEALERS: SET FOR GROWTH**

For the third consecutive year, independent used car dealers under-performed the overall used car market, as unit volumes declined nearly 3%
according to CNW Marketing Research. But
that statistic belies what has been, for many
independent dealers, a reasonable recovery from
the recession. For one, a drop in the dealer count
means that fewer operators are sharing the 19%
growth in total sales that has occurred since the
recession. More important, greater wholesale
and retail finance opportunities have made that
growing unit volume very profitable.

To be sure, high wholesale prices hurt gross
margins and forced some dealers to alter either
their inventory or customer profile; but these
were changes that most dealers made smoothly.
This means that independent dealers are well-
positioned for 2015, when wholesale supplies are
expected to flow more normally and the upward
pressure on wholesale prices is relieved. In
particular, independent dealers should experience
larger, and better, inventory acquisition possibilities
from lenders selling repossessions.
BHPH DEALERS ADAPT TO CHANGING CONDITIONS
The biggest challenge for Buy-Here, Pay-Here (BHPH) dealers the past two years has been deep subprime lenders’ buying down into the traditional BHPH customer base. The customers left behind were the ones least likely to pay. To handle this and other challenges, individual BHPH operators have developed a multitude of different business models. No longer is there a “traditional BHPH model.” Some operators significantly increased the price point of the vehicles they offer, others kept their price point and built in more goodwill policy work as a reserve, some moved to the Lease-Here, Pay-Here model, others adjusted interest rates to coincide with subprime lenders, and some worked diligently to capture more up-front money in the deal.

WHAT $5,000 WILL BUY
To give a sense of just how much wholesale prices have gone up over time in the lower price tiers, we have looked at the average mileage on auction vehicles that sold between $4,000 and $6,000 over the past 15 years. As seen in the graphic, if you spent, on average, $5,000 for a vehicle at 2007, the average mileage was around 60,000 miles. However, by 2014, the average mileage had increased to over 120,000 miles. This trend is likely due to the overall increase in vehicle prices over time, as well as the shift towards lower-mileage vehicles in recent years.

TOP 5 MODEL-YEAR/MAKE/MODEL
Auction Sales Between $4,000 and $6,000

<table>
<thead>
<tr>
<th>SEPT 2014</th>
<th>SEPT 2013</th>
<th>SEPT 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008 Nissan Altima</td>
<td>2007 Dodge Caliber</td>
<td>2005 Nissan Altima</td>
</tr>
<tr>
<td>2007 Nissan Altima</td>
<td>2006 Nissan Altima</td>
<td>2007 Dodge Caliber</td>
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<td>2004 Toyota Sienna</td>
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<td>2008 Chevrolet Impala</td>
<td>2004 Nissan Maxima</td>
<td>2006 PT Cruiser</td>
</tr>
<tr>
<td>2005 Honda Odyssey</td>
<td>2005 Toyota Camry</td>
<td>2003 Toyota Corolla</td>
</tr>
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</table>

Source: National Auto Auction Association Surveys, 2001-2012
auction in 2000, you got, on average, a vehicle with 84,541 miles. That average mileage slipped over the following three years as wholesale supplies grew and the overall pricing environment was weakened. But, since 2003, average mileage for the typical $5,000 auction purchase rose every year, except for the recession of 2008-2009. In 2014, the average $5,000 auction purchase had more than 122,000 miles.

Also presented here, for the past three years, are the top five years, makes, and models of vehicles sold between $4,000 and $6,000.

**DEALER CONSIGNMENT REMAINS THE CORE OF AUCTION OPERATIONS**

After reaching a high of nearly 59% of all NAAA-member auction sales in 2013, the dealer consignment share slipped to an estimated 57% in 2014. That’s still high by historical standards, and, even as commercial consignments grow more rapidly in the years ahead, it is likely that dealer sales will remain a high and a key component of auction volumes. In past cycles, commercial volumes sometimes pushed out dealer consignments due to limited physical capacity, as well as prime lane and time slots. Not so today. Online sales, multiblock selling, Simulcast Everywhere, and other online options have put all sellers on equal footing and broaden the whole definition as to what is a “prime” slot.

Likewise, several years ago it was argued that traditional auctions would be disintermediated as new and improved online options enabled dealers to more easily bypass the traditional auction process. After all, dealer wholesale transactions outside the traditional auction have always been twice as big as the number going through auction. And technology was promising to make those informal networks more efficient. What evolved, however, was a stronger partnership between dealers and auctions. For example, with Dealer Trade Networks dealer groups can leverage Manheim’s online auction platform, OVE.com, to conduct internal auctions that redistribute vehicles within their family of dealerships to the store that can best retail them. And with Manheim’s Dealer Match, dealers can use Web and mobile tools, as well as trade desk and networking specialists, to conduct more business with existing dealer trade partners and to further build a network of trusted trading partners. DealerMatch is a subscription service that allows members to buy or sell as many vehicles as they want for a flat monthly fee.

**DEALER CONSIGNMENT SALES AS % OF NAAA-MEMBER AUCTION VOLUMES**

*2013 is a Manheim Consulting estimate based on both internal and industry sources

*Source: National Auto Auction Association Surveys, 2001-2013*
AVERAGE AUCTION PRICE— DEALER-CONSIGNED VEHICLES

$8,500
$9,000
$9,500
$10,000
$10,500
$11,000
$11,500

Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec

2012 2013 2014

Source: Manheim Consulting

AVERAGE MILEAGE— DEALER-CONSIGNED VEHICLES

110,000
105,000
100,000
95,000
90,000
85,000
80,000

Jan 08 Jan 09 Jan 10 Jan 11 Jan 12 Jan 13 Jan 14 Jan 15

Source: Manheim Consulting
NATIONAL MARKET FULLY RECOVERED; REGIONAL PERFORMANCES VARY

GDP, consumer confidence, employment, and real estate markets all reached post-recession highs in 2014. Those market trends, however, varied significantly from region to region and market to market. On a regional basis, the economic recovery in the U.S. has been stronger in the West, the Rocky Mountains, the Southwest, and the Southeast. Since 2009, these regions added jobs at a faster rate thanks to expanding industry sectors like health care, technology, auto manufacturing, and energy. A revival of home construction and benefits from international trade (mainly for the West Coast) also buoyed these regions. As a result, the rebound in the new vehicle market since 2009, as measured by local vehicle registration data from IHS Automotive, has been stronger in these same regions.

RETAIL NEW LIGHT VEHICLE REGISTRATIONS 2009 & 2014 COMPARISON

<table>
<thead>
<tr>
<th>REGION</th>
<th>5 YEAR CAGR*</th>
</tr>
</thead>
<tbody>
<tr>
<td>West</td>
<td>12.9%</td>
</tr>
<tr>
<td>Rocky Mountains</td>
<td>11.9%</td>
</tr>
<tr>
<td>Southwest</td>
<td>10.9%</td>
</tr>
<tr>
<td>Southeast</td>
<td>10.6%</td>
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<tr>
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<tr>
<td>Mid-Atlantic</td>
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</tr>
<tr>
<td>Northeast</td>
<td>7.6%</td>
</tr>
<tr>
<td>NATIONAL</td>
<td>9.7%</td>
</tr>
</tbody>
</table>

*CAGR 2009-2014

Source: IHS Automotive
LOCAL ECONOMIC FACTORS STRONGLY IMPACT THE NEW VEHICLE MARKET

The chart below illustrates the strong relationship between the local economy and the new vehicle market in the top 25 largest metro markets by new vehicle volume. The relative economic health of the local market is measured as an index based on a basket of indicators such as GDP growth, employment change, income change, and housing starts (with the U.S. national average equaling 100). Markets where the local economy has performed above the national average generally saw above-average growth in new vehicle registrations. Likewise, markets where the economy lagged in performance saw slower growth in new vehicle sales. Outliers of note include the Boston, New York, and Washington, D.C., metropolitan areas, where the local economies performed well, but growth in the new vehicle market was below the national average. These markets likely stand apart due to factors that may have limited local new vehicle demand even when the economy was doing relatively well. These factors could include: good availability and heavily utilization of public transportation, a vehicle market that didn’t fall as steeply during the recession, and a large population of debt-burdened students and older millennials who have stayed out of the new vehicle market.
USED VEHICLES ARE LESS SENSITIVE TO LOCAL ECONOMIC SWINGS

The influence of economic factors on the local used vehicle market is less pronounced than for new vehicles. Aside from the issue of supply (are there enough late-model used vehicles available appropriate to local tastes to satisfy demand?), there is the fact that outside of a few large metropolitan centers in the United States, car ownership is almost a necessity. Thus, even in less robust local economies you may see significant vehicle transaction volumes; but financial realities may cause households to move from a new vehicle purchase to a used one, or to purchase an older used vehicle at a lower price point. The need for reliable transportation means that even in tough economic times most households find a way to replace a vehicle that is at the end of its serviceable life. Looking at the top 25 markets for used vehicles, a significant number with underperforming economies actually experienced above-average growth in used vehicle registrations. Similarly, several markets with relatively robust economies saw used vehicle registration growth trail well below the national average (negative in some cases). Given the short supply of late-model used vehicles and historically high used valuations, it is likely that in such stronger markets many households that would have purchased a used vehicle opted for new instead, especially when low rates and longer loans enabled them to keep monthly payments affordable.

5 YEAR CAGR* USED VEHICLE REGISTRATIONS

Local economies are outperforming, but used vehicle registration growth has underperformed…

Local economies are underperforming, but used vehicle registration growth exceeds the national average

*Compound Annual Growth Rate

Sources: IHS Automotive and AutoTrader
AN OVERVIEW OF “TOTAL GROSS” DEALERSHIP DYNAMICS

In recent years, a growing number of dealers have shifted their emphasis on the front-end gross profit each used vehicle generates to carefully managing the “total gross” profit potential inherent in every car.

This “total gross” mindset reflects the understanding that a dealer’s used vehicle department is the only department that significantly touches and brings benefits to all other dealership departments.

For example, when a dealer acquires a used vehicle for retail, the parts and service department earns additional gross profit through reconditioning. As the dealer retails a used vehicle, the dealership’s F&I department benefits from the financing and sale of any F&I products. In addition, the retail sale often gives dealers an opportunity, through a trade-in, to repeat this cycle of department-to-department synergy.

The used vehicle department also provides benefits for the dealer’s new car department by creating an outlet for trade-ins and, in some cases, the flexibility to accommodate lost new car margins due to discounts that result from the negotiations with a customer for the price of the new vehicle.

In this scenario, a “total gross”-minded dealer is better able to absorb these costs because the dealer correctly accounts for the additional costs in the trade-in’s retail exit strategy. This accounting includes recognizing the unit’s higher cost position in determining the amount of reconditioning and setting the vehicle’s competitive price position to maximize its gross margin potential.

Dealers who have adopted this “total gross” mindset also typically follow a “turn and earn” or Velocity® strategy as they manage their retail used vehicle operations. Unlike traditional dealers in the past, these dealers do not fixate on maximizing front-end gross profit and avoiding losses. Instead, they focus on efficiencies and processes that help them maximize “total gross” for every used vehicle they retail, while minimizing inventory age and other factors that create risks for their return on investment.

With the “total gross” and Velocity® imperatives in place, dealers come to view their used vehicle business for exactly what it is—an engine that, when it’s humming on all cylinders, drives profitability and sales for the entire dealership.

Dale Pollak
Founder vAuto & EVP, Cox Automotive
Dealers know that making the right calls on wholesale inventory acquisition can make all the difference in their profitability. In your opinion, what prevents some dealers from making the right decisions in this key remarketing practice, and how can they improve?

Dealers make bad wholesale acquisition decisions when they fail to fully or properly answer two key questions—“Is this particular car right for my dealership?” and “What’s the right price to pay for the vehicle given its unique characteristics and my goals for profitability and inventory turn?”

The best dealers answer these questions by using technologies that allow them to access real-time, market data-based metrics, such as market days supply, cost to market and price to market, to assess whether a vehicle is a good fit for their market and dealership goals.

There are multiple factors that can impede a dealer’s ability to conduct this two-question analysis in the objective, scientific manner today’s market requires. Some dealers prefer to rely on their experience and instinct, rather than market data, to judge a vehicle’s retail merits. Other dealers lose the benefit of their analysis as they get caught up in the heat of bidding battles at auctions and overpay for the wrong car.

In the end, dealers who apply a consistent, disciplined analysis to every wholesale acquisition bring home more retail winners than losers.

What are some emerging trends in used vehicle department operations that dealers can apply to increase profitability?

Three broad trends—Internet-driven pricing transparency, a higher level of competition, and rising operational costs—are combining to compress dealer profit margins in used vehicles.

In light of this margin compression, dealers really only have one choice: They must retail a greater number of vehicles in less time, and at a lower per-car cost, to maintain an acceptable level of profitability and return on investment for every vehicle.

On a day-to-day basis, this more profit-challenged environment obviously requires dealers to stock the right vehicles for their market. Beyond that, however, dealers should strive to reduce the cost and time of reconditioning vehicles, price retail vehicles in a manner that balances gross profit and inventory turn expectations, increase the efficiency and speed of their acquisition processes, and adopt a less costly sales process that rewards sales associates when they minimize discounts and sell more vehicles.

Dealers who have adopted these efficiency- and cost-minded operational changes tend to be more profitable and successful than those who have yet to adjust to today’s more margin-challenged retail landscape.

What are some attributes of successful dealers?

You could sum up the attributes of today’s most successful dealers as the “four P’s”:

PEOPLE. The best dealers recognize that their people are their biggest (and most costly) asset. They understand that employee satisfaction leads to lower turnover, increased productivity, higher levels of customer satisfaction, and improved profitability. These dealers strive to keep employees satisfied by investing in the technology, tools, training, and resources that help them excel in their jobs. They provide career pathways, compensation plans, and in-store cultures that give employees every reason to want to show up for work and make a positive difference, day in and day out.

PROCESS. The best-performing dealers are sticklers for efficient processes, in both their variable and fixed operations. Their goal is to provide a level of cost-effective consistency to satisfy customers and employees alike—e.g., everyone knows what to expect, every time. At a recent industry event, a dealer described how he and an employee team review all of their in-store processes twice a year to find ways they can better serve each other, their customers, and the dealership. The dealer adopted this exercise in recognition that the car business never stands still, and dealers can always do better.
PLANNING/PREPARATION. It’s easy for dealers to continually focus on the short term or, more specifically, the results in the current month. The best dealers, however, look further into the future to plan and prepare their operations for the changes that will inevitably arrive. In tandem with this focus on the future, these dealers are also more adaptive to change than their in-the-moment peers, an attribute that typically helps them retain their competitive edge.

PASSION. At some level, all dealers have a passion for selling cars. For the best dealers, this passion extends to all aspects of their business, and fuels the desire, determination, and discipline required to lead their teams to ever-higher levels of success.

What do you think the dealership of the future will look like?

In several ways, the dealership of the future is already taking shape today. At some dealerships, technology has replaced people as dealers make their sales processes more efficient and transparent. Likewise, we’re seeing some evidence among larger groups of shared inventories and fixed operations to drive efficiencies and profitability. Over time, the size and scale of many dealerships will likely shrink as factories streamline their vehicle ordering, production, and distribution processes, and dealers make more efficient use of less costly locations. The wild card, of course, will be factory facility requirements, which many dealers believe are out of step with the realities of today’s retail environment.

What do you see as the biggest opportunities for dealers in 2015?

In used vehicles, I believe we can expect to see strength in the Certified Pre-Owned (CPO) segment. Buyers appear to be increasingly receptive to the value proposition these vehicles offer, and dealers have an opportunity for additional sales and profits as they actively court this important market niche, especially as wholesale supplies increase and late model used vehicles are more plentiful.

There’s also a big opportunity in new vehicles, as new technologies give dealers the ability to efficiently price and promote their inventories in a manner that’s more satisfying for today’s buyers and the dealership’s bottom line. More broadly, I also believe dealers who move away from traditional negotiation-based new/used vehicle pricing and sales processes will reap the rewards of being among the first to offer vehicle shoppers a better way to buy cars. This opportunity will be even more profound for dealers who take advantage of technologies that shift more aspects of the sales transaction online, thereby reducing the expense and time dealers currently invest to sell every vehicle.

Do you feel that dealers who deliver a better customer experience versus their competitors can create loyal customers?

I do. But I would submit that dealers must earn this loyalty in ways that extend far beyond just giving someone a good deal on a new or used vehicle. Tomorrow’s customers will expect dealers to engage them (and their friends) in a consistent, personal, relevant, and respectful manner across multiple media platforms, as well as in the dealership. In this way, the dealership’s brand, and its people, will do as much, if not more, to fuel loyalty as the factory brand they represent.

For those outside the used vehicle business who don’t have a good understanding of its level of sophistication, what would you tell them about the way dealers are running their operations and how it contributes to the overall automotive industry?

I believe we’re fast approaching an era when the old stereotypes about car dealers no longer apply. The best dealers run their businesses at a level on par with retailers like Apple or luxury hotels — where technology and customer comfort play equal roles in providing a positive, transparent experience buyers will want to repeat. In the past, it would be highly unusual for a dealership to be considered a “Best Place To Work;” but it’s happening today. Over time, such positive strides will help our industry’s reputation become defined by the good things dealers do day in and day out to help their customers and broader communities.
William Fox, chairman of the National Automobile Dealers Association, is a partner in Fox Dealerships, Inc., which comprises three dealerships in Auburn and Phoenix, N.Y. Fox, who is also an attorney, represents New York state’s franchised new-car dealers on the NADA board of directors.
How would you describe business conditions for franchised dealers in 2014?

The overall economy continued to gain momentum in 2014. NADA’s sales forecast was 16.4 million new cars and light trucks in 2014, an increase over the previous year. Low interest rates on auto loans, rising employment and pent-up demand, and aging vehicles on the road all were key contributing factors in the rise of auto sales in 2014.

The number of vehicles entering the wholesale marketplace will grow significantly over the next several years, due primarily to high off-lease volumes. What will this mean for franchised dealers and their customers?

The Manheim auctions have been a cornerstone in providing high-volume, off-lease vehicles that car buyers want to help balance the used-vehicle inventory at dealerships throughout the country. The result is faster sales turns for dealers and more competitive prices, which benefits car shoppers.

How is technology influencing the daily activities of franchised dealers when it comes to growing their businesses and moving units?

New-car dealers have been at the forefront and a catalyst for change. Technology has expanded auctions and forced dealers to be better at managing wholesale inventory compared to the past. It has provided us with more opportunities in a cost-effective way. Today, we can manage our entire dealership operations online. Technology will always continue to evolve, but our success will always be measured by how well we take care of our customers.

What trends are you seeing in inventory sourcing practices among franchised dealers?

Fifty years ago, the primary source of used vehicles was trade-ins. Technology has changed this. Today, there are more options to acquire inventory. In my market, trade-ins make up about 40 to 50 percent on the inventory that we offer for sale. The rest comes from multiple sources, such as auctions, off-lease or online buying services.

There is much talk of an auto lending “bubble” pushing subprime and long-term loans. Are your dealers concerned that this cycle may have run too far?

According to outside industry experts, when analyzed in a historical context and looking at the data, the numbers do not indicate that a subprime bubble is forming in the auto financing sector. Responsible lending to consumers who are struggling financially is a social good. Cars are essential for many people to drive to work. Credit offered by new-car dealers routinely carries lower interest rates than credit offered by other lenders to similarly situated borrowers. New-car dealers deliver widely available and low-priced credit to a broad array of consumers, including those most in need of a car to start their way up the economic ladder.

What tactics are franchised dealers using to increase customer satisfaction?

From sales and service to financing, successful dealers will do everything possible to improve customer satisfaction. The customer is what matters, and you have to provide a better customer experience than the dealer down the street or you will lose that customer to a competitor. Some tactics to increase customer satisfaction include surveys, employee sales and service training, and expanding lines of communication, such as an effective website with live chats as well as traditional email and phone support.
NIADA president Arlan Kuehn is the owner of Kuehn Auto Sales in South Sioux City, Nebraska. Kuehn is an NIADA Certified Master Dealer and was named Nebraska IADA's Quality Dealer of the Year in 2009.
How would you describe business conditions for independent dealers in 2014?

Like everyone else this year, independent dealers were in kind of a “wait and see” mode during most of 2014 — sales were good, but there was still a lot of concern about the economy. NIADA’s most recent quarterly business confidence survey showed dealers were more concerned about the economy than about any other factor, with government regulation second. Although most dealers are seeing better sales, they are still cautiously optimistic. Now that the midterm elections are over and there is certainty about which party will lead Congress, I think most of our members (and customers) are encouraged and are looking forward to what changes may come out of the 114th Congress beginning in January.

What best practices are independent car dealers using to source inventory?

NIADA’s Used Car Industry Report shows that more than 90% of NIADA member dealers buy inventory from auctions, so while they certainly use other sources, that’s by far the most important. Part of that is because auctions today offer so many services and online purchasing opportunities that have not only made using auctions easier but have also expanded the market. Dealers are no longer limited to the auctions they can drive to, making them better able to find the right vehicles for their inventory.

More consumers are qualifying for conventional loans. How has that impacted independent used car dealers and their profit margins?

Having more qualified car buyers is great for everyone in the auto industry, and we’ve certainly seen automotive finance companies rebound and grow over the last year or so. It has definitely helped improve profit margins, and has made it good for the consumer because the market is more competitive. Subprime lending has ballooned recently, and that’s had a big impact on the Buy-Here, Pay-Here (BHPH) market. When subprime lenders buy more deeply than normal, they start cutting into the BHPH and deep subprime markets, culling many of those customers out of those traditional niches. That said, given the recent regulatory and media scrutiny on subprime auto lenders, as well as higher-than-expected repo rates, 2015 could bring a softening of subprime lending, which would position BHPH dealers for a strong tax season.

Some franchised dealers are establishing stand-alone used car operations. What does that mean for traditional independent dealers?

Well, obviously it adds more competition in an already competitive marketplace. But it also makes finding the right inventory more critical now than ever before. As franchised dealers expand their presence in used cars, they’re holding onto their trade-ins in-house, which shrinks the pool of inventory for independents. That’s why online services like the ones Manheim offers are so important — they allow independents more ways to access the inventory they need to compete.

Many Buy-Here, Pay-Here dealers are starting leasing operations. Can you talk about the benefits of leasing for dealers?

If it’s a “true” lease, there are a lot of tax and cash flow advantages to the leasing model. With this approach, you don’t have to set up a separate related finance corporation, and you can depreciate the asset as you’re leasing it. Additionally, you don’t have to show the income until you actually receive it, so you’re not paying taxes before you’ve collected payments. There are also advantages if you find yourself dealing with a customer bankruptcy. It’s not a model for everyone, but it adds a lot of options for car buyers and the dealers who understand the various laws that govern Lease-Here, Pay-Here by state.
The year 2000 was a blockbuster for the auto industry. New car sales soared and used vehicle sales also ramped up, reaching near-record levels…Total (new and used) sales reached a record 59 million units, reflecting the strong economy, price competitiveness and a highly efficient remarketing system.

After declining for three consecutive years, auction volumes in 2010 were estimated to be 12% below 2007’s level. Facing the loss of more than 300,000 off-lease units in both 2011 and 2012, the auction industry will continue to face a tough environment from a volume standpoint. Although the auction industry itself has not yet fully benefited from the economic and automotive recovery that is underway, auctions have contributed to the success of others.
INVENTORY FINANCING CRITICAL TO REMARKETING INDUSTRY

Inventory financing (or “floor planning”) continues to be a viable source for dealers to floor their units. Floor planning allows dealers to expand their new and used offerings, frees up capital for other uses, and lets dealers focus on what they do best: sell cars. What’s more, advances in technology have made it easier than ever for dealers and auctions to efficiently take care of inventory finance needs.

Recent advances in technology—such as the use of mobile devices—have made floor planning an easier to use and more powerful tool for dealers by saving time and simplifying the process of buying and selling inventory. Mobile technology allows dealers to conduct business anywhere and at any time, making floor planning easy and efficient.

NextGear Capital, the Cox Automotive inventory finance company, has paved the way with the cutting-edge technology it provides to dealers, including solutions such as document imaging of titles, a Web portal, and a mobile app that provide customers the ability to handle their account on the go. NextGear Capital customers a simpler way of doing business.

Swift changes in technology have also benefited the wholesale auction industry by bringing buyers and sellers closer from all over the country and the world. Technology solutions for auctions have fueled the success of many Internet-based auction offerings. These sales channels have grown by leaps and bounds and are living proof that online continues to show promise for the wholesale industry. The retail side of the business is also recognizing growth online, with multiple success stories from companies like AutoTrader.com to smaller channels across the landscape.
RENTAL
2014 HIGHLIGHTS

Rental industry revenue grew for the fifth straight year, to a record $26.1 billion.

The fastest growth came from off-airport discount brands and insurance replacement.

The number of new vehicles purchased by rental companies increased 2% to 1.6 million units in 2014, the highest purchase volume since 2007.

The total number of vehicles operating in rental fleets rose 3% to 1.97 million units, an increase of more than 50,000 units from 2013.

The influx of off-lease units in 2015 and beyond may dampen pricing for off-rental units; the biggest factor, however, will remain manufacturer practices around incentives and inventory levels.
RENTAL INDUSTRY REVENUE REACHES NEW RECORD

Rental car companies in 2014 had a good, but challenging, year. The good—better pricing power—was a direct result of the challenge—a harsh winter and auto-maker recalls that increased insurance replacement demand while at the same time sideling units in the rental fleet. The net result was a fifth consecutive increase in industry revenue growth, which brought 2014’s total to a record $26.1 billion. Revenue per unit in service in 2014 also increased after slipping slightly in 2013. This gain was achieved even as recalls diminished the ability to maximize fleet utilization.

Despite the increase in revenue per day, the rental industry has lagged behind the sorts of increases that hotels and airlines have been able to achieve in revenue per room and revenue per seat mile over the past several years. This suggests the industry may be able to offset what is likely to be rising depreciation costs with better pricing power in coming years. And, in fact, history suggests there is a positive correlation between fleet costs and rental rates. But, as we note later, the traditional rental revenue stream is not immune to some skimming-off by new entrants and new business models.

Revenue growth in 2014 came from all segments of the rental industry; but as in recent years, the fast growth came in off-airport discount brands and insurance replacement. Revenue growth for the major on-airport brands was less than 3% in 2014.

NEW VEHICLE SALES INTO RENTAL REACH 1.6 MILLION IN 2014

The number of vehicles purchased by rental companies increased 3% to 1.6 million in 2014. It was the highest purchase volume since 2007, but well below the 2.1 million new vehicles that were sold into rental in 2005 and 2006. Given the shift from program to risk units (and a longer average service life for risk vehicles), rental company purchases of new vehicles are not expected to reach 2 million units a year any time soon.

Vehicle sales into rental in 2014 were not as front-loaded into the first half of the year as they were in 2012 and 2013. This plus delayed defleeting as a result of strong insurance replacement demand and major recall campaigns meant the volume of rental risk units sold into the wholesale market in the first half of the year was markedly lower in 2014 than it was in 2013. In the latter part of 2014, however, auction sales of rental risk units were considerably higher than a year ago.

The shifting pattern of purchasing, rental demand, and remarketing enticed some rental car companies to buy more used vehicles at auction to supplement their fleets. And, of course, with all of the majors now involved in all segments of the business, there is a greater opportunity to cascade vehicles down from premium brands to value brands as the units age.

The share of new vehicles sold into rental accounted for by domestic manufacturers fell for the fourth consecutive year in 2014. It marked their lowest share ever—save for 2009 when the GM and Chrysler bankruptcies forced rental companies to shift their purchasing patterns. The biggest increase in new vehicle sales into rental in 2014 was accounted for by Hyundai, up 21%, and Nissan, up 18%. Off a smaller base, Mazda sales into rental increased 30% in 2014. Generally speaking, over the past decade, the mix of manufacturers and models comprising the rental fleet—as well as the option
95% SHARE OF THE TOTAL RENTAL FLEET OWNED BY THE BIG THREE RENTAL CAR COMPANIES.

U.S. CAR RENTAL MARKET

<table>
<thead>
<tr>
<th>Year</th>
<th>Fleet Size (in thousands)</th>
<th>Revenue (in billions)</th>
<th>Revenue (per unit)</th>
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<td>1,665</td>
<td>$17.64</td>
<td>$10,593</td>
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</tr>
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<td>1,768</td>
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</tr>
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<td>2,073</td>
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</table>

Source: Bobit Business Media
RENTAL CAR COMPANIES REMARKETED VEHICLES WITH 3,303 DIFFERENT YEAR, MAKE, MODEL AND BODY CONFIGURATIONS IN Q3 2014

NEW VEHICLE SALES INTO RENTAL BY MONTH

Source: Bobit Business Media

DISTRIBUTION OF NEW VEHICLE SALES INTO RENTAL BY MANUFACTURER

Source: Bobit Business Media
contenting of the vehicles—has become more representative of overall retail new vehicle sales.

For individual rental car companies, the shift toward a more diverse fleet has been even more striking since, in earlier times, some of the companies had major supply agreements with only one or two manufacturers. The greater mix of models in the off-rental supply has had several implications for remarketing—most of them positive. Most important, it has helped protect residual values since one rental company is no longer forced to sell large numbers of any one model at any one point in time. The wider mix of off-rental units has, however, required that rental companies (and their auction partners) work harder to ensure specific vehicles get exposed to the dealers most interested in those particular products.

Manheim data indicate that in the third quarter of last year, rental car companies remarketed vehicles with 3,303 different year, make, model, and body configurations. In the third quarter of 2014, it took 86 unique year, make, model, and body configurations to account for 50% of all rental risk sales at auction. As recently as the third quarter of 2011, it took only 31 such unique configurations.

RENTAL REPURCHASE PROGRAMS WILL GROW IN 2015

The total number of vehicles operating in rental fleets in 2014 rose 6% to 2.01 million units, an increase of more than 123,000 units from the prior year, according to Auto Rental News. The growth in the fleet has been consistent with growing rental demand as evidenced by company reports of stable or rising fleet utilization rates, save for the hampering impact of last year’s recalls.

Those recalls, plus changing industry dynamics and pricing, will lead to a greater share of the rental fleet being composed of repurchase (program) cars in 2015. Avis anticipates that program units will rise to 50% of its fleet in 2015, up from 36% in 2014. Hertz expects purchases to shift from 85% risk in 2014 to 70% risk in 2015. Enterprise, as well as the small independent rental companies, have always operated fleets that are close to 100% risk. When rental repurchase programs are properly designed and executed, they can be beneficial to both the manufacturer and the rental car company. The key for the manufacturer is getting the right model mix and right volume in the rental mix at the right price. That, plus effective remarketing, will keep rental repurchase programs cost-effective. For rental car companies, program cars can increase fleet flexibility and utilization, and provide the opportunity to offer a younger fleet of vehicles to customers.

RENTAL RISK PRICING AT AUCTION EASES SLIGHTLY

In 2014, prices for rental risk units sold at auction started out the year at record highs, then eased as the year progressed. The strong pricing at the beginning of the year reflected low volumes as rental companies delayed de-fleeting due to high demand for insurance replacement units. The subsequent ease in pricing was reflective of the decline in overall wholesale prices as well as higher volumes being offered.

Although our index of rental risk auction prices appears to have significantly outperformed the overall wholesale market, we would caution against such simple comparisons. Yes, auction prices for end-of-service rental units have been strong; but those vehicles represent a unique slice of the overall
wholesale market. It is a segment which is susceptible to swings in new vehicle inventory levels and pricing — both of which have been favorable of late.

For example, the Bureau of Economic Analysis (as part of national income accounting) produces a monthly series of average prices for new vehicles bought by businesses. If we take that series and relate it to the mix- and mileage-adjusted price series for rental risk units produced by Manheim, we find that off-rental auction prices are indeed performing well; but the results are not outside of historic norms.

There is some justifiable concern that the influx of off-lease units in 2015 and beyond may dampen pricing for off-rental units. Although these two wholesale segments are not exactly great substitutes for each other (the distribution of model years, makes, and contenting are very different), there is the issue of “share of the dealer’s mind and wallet.” In coming years, returning lessees will be driving high-quality inventory right to the dealer’s door, and lessors will be enticing grounding dealers (with carrots and sticks) to buy these units at fair market value (or sometimes even less) with no buy fee. Each such acquisition will mean the dealer has need for one less unit from other sources.
However, the biggest influence on off-rental pricing will, as always, be manufacturer practices with respect to incentives and inventory levels. On that front, manufacturers, of late, have been better at equating production with demand. But the real test will come in future years when the pace of new vehicle sales slows.

RENTAL CAR COMPANIES GROW DIGITAL REMARKETING

Rental car companies have been quick to adopt, as well as develop, innovative technologies and strategies to remarket end-of-service units. The reason is simple—fleet depreciation is a major determinant of company profitability. When it comes to upstream remarketing, the rental companies have advantages and disadvantages. On the plus side, rental companies are long-established sellers in the wholesale market (which builds buyer trust), their end-of-service fleet is large, it is concentrated in a relatively narrow mileage and price range, and it often needs only modest reconditioning.

The disadvantage that rental companies face in selling upstream is that their time pressures are acute, and they certainly don’t want to marshal unproductive units. As such, the companies have developed strategies to pre-offer units while they are still in service as rental units.

Digital remarketing of off-rental units is also driven by the fact that fleets are often concentrated in a particular geography—so much so that they can swamp local demand. Digital remarketing allows the seller to efficiently bring the buyer to the car rather than having to guess where to move the car.

In 2014, 33% of all purchases of rental risk units at Manheim auctions were made online; that’s consistent with online purchase percentages of 32% and 31% in 2013 and 2012, respectively. For these online purchases in 2013, the average distance between buyer and car was 366 miles, with 34% of the purchasers located more than 500 miles from the vehicle. For in-lane purchasers, the average distance was only 199 miles, and only 19% located more than 500 miles away.

Another remarketing technique that some rental car companies have used successfully is the offering of specific makes in conjunction with the factory sale of that brand on auction day. To be successful at that, rental car companies need to ensure that their offerings blend better with the other units in the lane. In other words, they need to do more reconditioning and strive for a consistently higher conversion rate.
Immediately after September 11 and throughout October, the natural uncertainty among buyers and sellers in the marketplace was exacerbated by a unique confluence of supply-side factors—the remarketing industry’s version of the “perfect storm” (heavy off-lease returns, rental car de-fleeting, large supply of trade-ins).

The auto industry’s revenue growth in 2011 was, in large part, a simple bounce-back from deep recession lows, but the improvement in profitability was the result of business restructurings, productivity gains, effective use of new technologies good old-fashioned customer service and selling.
REMARKETING VOLUMES CONTINUE TO GROW

In 2014, more than 1.5 million off-rental vehicles entered the wholesale market. Of these, approximately half, or 750,000 units, were sold at NAAA-member auctions. Another 200,000-plus were sold directly to retail customers, and the remainder were sold to dealers outside the traditional auction process.

In 2015, off-rental volumes are expected to increase to more than 1.6 million units and continue to grow in years following. The future growth in off-rental volumes will likely mirror the growth in the total rental fleet size, as we foresee no significant change in holding periods.

Source: Manheim Consulting
2014 HIGHLIGHTS

Lease originations exceeded 3.5 million for the first time since 1999. It will take only a slight increase in 2015 to push new leases above the all-time high reached in 1999.

The sheer volume of new lease originations could pose a challenge to remarketers in future years; the key will be the level of subvention entailed in the original lease.

Since new lease originations grew by 2.4 million between 2009 and 2014, the rise in off-lease volume last year was only the beginning.

With off-lease volumes rising in 2015 and wholesale prices likely to ease, lease return rates should begin to rise.

High volumes of upstream “take rates” means volumes remaining at auction are often higher-mileage vehicles, which impacts residual values and Manheim Market Report values.
NEW LEASE ORIGINATIONS SOAR TO HIGHEST LEVEL IN MORE THAN A DECADE

A continued rise in new vehicle sales and a higher lease penetration rate pushed new lease originations in 2014 above 3.5 million for the first time since 1999. New lease originations last year were more than three times greater than during the cyclical trough in 2009. And it will take only a slight increase next year to push new leases above the all-time high reached in 1999.

From the recession low, lease penetration rates for GM, Ford, and Chrysler products have risen the most. Their lease penetration rates are now close to the industry average after falling to the low single digits in 2009. Major Japanese brands have also kept pace with the overall increase in lease penetration rates. And Hyundai/Kia, relatively new to leasing, went from a 2% lease rate in 2009 to 22% last year. In the luxury segment, lease penetration rates have always been more than twice the overall industry average.

LEASING GROWS FOR THE RIGHT REASONS

Some analysts have argued that recent increases in new vehicle sales have relied too heavily on leasing and are worried that lessors may be setting themselves up for potentially large residual losses, but a look at actual underwriting suggests otherwise. Contract residuals, for the most part, have not been aggressively set, and when there has been subvention, lessors usually did it knowingly. As such, one would hope that they set aside reserves and made plans for the additional remarketing effort that will be needed at end-of-term. Lessors have also been putting the right mix of vehicles out on lease, that is, the ones they don’t mind getting back. And, most important, they are putting the right customer into the lease.

As new vehicle sales become increasingly skewed to high-income households, it is only natural that lease penetration rates rise. That’s because these are the very households that want to trade on a short, and regular, cycle. Putting this type of customer into a 72- or 84-month loan may garner near-term profits, but it will breed long-term customer dissatisfaction. Remember, residual risk is present in all transactions—whether they be retail finances, leases, or cash deals. It is just a difference of who holds that residual risk.

RETURNING LESSEES SUPPORT NEW VEHICLE SALES

Pent-up demand was the principal driver of new vehicle sales increases between 2010 and 2012. But, by definition, that is not a long-term sustainable force. We are now beginning to transition to a market supported by returning lessees. And not just any type of lessee—a satisfied one. From a dealer’s perspective, that’s pretty much automotive retailing’s utopia—happy customers returning on a regular cycle.

The current bifurcation in the retail finance market—short-term leases and longer-term loans—is a good thing if dealers and salespeople are correctly putting the right customer into the right finance option. And the higher lease penetration rate will help offset some of the lengthening in the trade cycle that naturally occurs with longer-term loans.

That said, the sheer volume of new lease originations (set to approach 3.2 million this year) could pose a challenge to remarketers in future years. The key will be the level of subvention entailed in the original lease. When not overly subvented at origination, a lease return is viewed by the lessor and grounding dealer as an opportunity to sell a satisfied customer another car. But, if overly subvented, that lease return can start a downward spiral in both residual values and customer satisfaction.

OFF-LEASE VOLUMES WILL RISE SIGNIFICANTLY

Since new lease originations grew by 2.4 million between 2009 and 2014, we can be assured that the rise in off-lease volume we saw last year was only the beginning. Bigger increases are yet to come. And since the increases in lease penetration rates were not consistent across manufacturers, neither will be the changes in off-lease volumes. Note, for example, that although total lease originations in 2014 were more than three times higher than in 2009, new lease volumes have grown by a factor of 10 or more at GM, Chrysler, and Hyundai/Kia.

The industry’s ability to absorb these off-lease volumes has been questioned by some. There is no doubt all of these off-lease units will be subsequently retailed in the used vehicle market—and in short order at a profit—but the question is ‘to what level will prices need to adjust to effectuate these transactions?’

The needed residual adjustments in 2015 will be greater than in 2014, but they should be manageable. This year’s off-lease volumes will still be coming back into a favorable retail market, and one which is considerably larger than in the past cycle. Consider, for example, that in 2002 the CPO market was less than 40% as big as total off-lease volume. Even with rapidly rising off-lease volumes, the CPO market in 2014 was larger than the off-lease total. The two should be about the same size in 2015.

Off-lease volumes and CPO sales have always been beneficially linked. End-of-term vehicles are generally a perfect fit to be sold as CPO units. In turn, CPO sales help support wholesale values and thus mitigate the lessor’s residual risk. And the lessor has further opportunities to moderate the residual risk by providing additional marketing muscle or incentives (like reduced rate financing) behind the CPO programs.
NEW VEHICLE LEASE ORIGINATIONS

Source: Manheim Consulting

NEW LEASE VOLUMES HAVE GROWN BY A FACTOR OF 10 OR MORE AT GM, CHRYSLER, AND HYUNDAI/KIA

LEASE PENETRATION RATES BY MANUFACTURER

<table>
<thead>
<tr>
<th>Manufacturer</th>
<th>2009</th>
<th>2013</th>
<th>2014*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chrysler</td>
<td>3.0%</td>
<td>15.0%</td>
<td>19.4%</td>
</tr>
<tr>
<td>Ford</td>
<td>5.4%</td>
<td>20.2%</td>
<td>22.5%</td>
</tr>
<tr>
<td>GM</td>
<td>2.1%</td>
<td>21.0%</td>
<td>23.5%</td>
</tr>
<tr>
<td>Honda</td>
<td>19.1%</td>
<td>27.3%</td>
<td>30.5%</td>
</tr>
<tr>
<td>Toyota</td>
<td>15.9%</td>
<td>23.4%</td>
<td>25.6%</td>
</tr>
<tr>
<td>Hyundai / Kia</td>
<td>1.9%</td>
<td>22.7%</td>
<td>22.1%</td>
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<tr>
<td>BMW</td>
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<tr>
<td>Total Industry</td>
<td>13.2%</td>
<td>24.0%</td>
<td>25.7%</td>
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Source: J.D. Power and Associates
SOME LESSORS CONTINUE TO POST END-OF-TERM GAINS

Lease remarketers are well-acquainted to cyclical swings in their portfolio performance. For example, they went from large losses on end-of-term units in 2008 to record gains on units sold in 2011. End-of-term gains remained in place in 2012, but then began to diminish in 2013 and 2014. They will likely vanish in 2015. (There is no aggregated data on the performance of all lease portfolios, but the nearby graphic depicting results for Ford Credit is not atypical.)

These swings in portfolio performance are an inherent, and unavoidable, risk contained in the lease business model. New lease originations generally peak at the top of the economic cycle when residual value projections are lofty (since they are based, in large part, on past experience). That means that the peak in off-lease volumes will often come back during an economic down cycle when used vehicle valuations are low. Swings between gains and losses are also amplified by the fact that lease return rates (i.e., the share of off-lease units not bought by either the lessee or grounding dealers) are strongly and inversely correlated to used vehicle values. When wholesale prices were at their lowest in 2008, lease return rates were often well above 80%. As wholesale values reached new highs in 2011 and 2012, return rates fell well below 50%. With off-lease volumes rising in 2015, and wholesale prices likely to ease, lease return rates should begin to creep back up; but it is unlikely they will approach earlier highs. That’s because lessors have a greater variety of tools (both carrots and sticks) to help, and entice, grounding dealers to purchase a reasonable share of returning units.

OFF-LEASE REMARKETING PRIORITIZES THE GROUNDING DEALER

All captive finance companies, as well as the major independents, utilize at least one Internet upstream platform that offers end-of-term vehicles to an ever-widening audience of dealers prior to sale at physical auction. And those technologies, platforms, and processes have improved significantly in recent years.

Most of the captives are using these technologies to keep a large share of the returning lease volume within their dealer network — and, most notably, the grounding dealer. Securities and Exchange Commission filings show that Toyota Dealer Direct accounted for 49% of all Toyota off-lease sales in its fiscal year ending March 31, 2014. Most of those sales were to the grounding dealer. As off-lease volumes grow in coming years, it is likely that the share of off-lease units bought by the grounding dealer will decline, but probably not by much since the captive lessor will still put priority on that first possible sale — and offer an attractive price to achieve it.
AVERAGE GAIN OR LOSS ON LEASE RETURNS

Source: SEC Filings

DISTRIBUTION OF TOYOTA FINANCIAL SERVICES
OFF-LEASE SALES IN U.S. (PERCENT)

For fiscal year ending March 31

Source: Toyota Financial Services and SEC Filings
2014 HIGHLIGHTS

Asset-backed securitization issuance in the auto market has totaled over $90 billion a year the last three years after falling to less than $60 billion in 2009.

The dollar amount of auto loans outstanding totaled $934 billion as of the third quarter of 2014.

Retail financing has low levels of lender concentration: The top 10 lenders on the new car side control 55% of the market, while the top 10 used vehicle lenders control only 28% of all financing.

In 2014, loan-to-value ratios for used vehicle financing increased for all types of lenders, and in every risk segment.

Total repossession increased by about 8% in 2014 to an estimated 1.5 million—increases will likely be more substantial in coming years.
RETAIL CREDIT: FACT, FICTION, AND FANTASY

FACT. The availability and cost of retail financing has always played an integral role in determining new and used unit sales levels, used vehicle values, customer satisfaction, and dealership profitability. And auto financing is a big industry in its own right, with more than $1 trillion in contracts outstanding.

The linkage between credit and sales was clearly exposed in the last economic cycle. When the credit markets froze up in 2008, an already weak environment for vehicle sales quickly turned dismal. There were still borrowers with the willingness and ability to pay; but, with no access to funds themselves, lenders could not lend. Or, at least not in the quantity they were used to. After all, most lenders had become accustomed to funding their operations by packaging loans and selling them in the asset-backed securitization market. A market which, in late 2008, for all practical purposes, did not exist.

By the second half of 2009, however, the auto financing environment was already beginning to improve. The quick turnaround had a lot to do with the fact that auto loans performed much better than other types of lending during the depth of the recession. Fast-forward to 2014, and we saw Wall Street virtually throwing money at lenders (it is only natural as everyone seeks yield in a zero-interest-rate environment) and then lenders enthusiastically offering that money to dealers.

FICTION. It is incorrect to say that auto lending has already entered “bubble” territory. Continued low delinquency rates and charge-offs are hard evidence that underwriting standards have not gone by the wayside. It is also a fiction to assume that the coming uptick in interest rates and narrowing of credit spreads will suddenly curtail auto credit availability. After all, interest rates will still be exceptionally low by historical standards, and improving economic fundamentals (the reason rates would rise) means lower credit risk.

FANTASY. Nevertheless, it would be fantasy to assume that retail credit conditions can continue to improve as they have over the past several years. It would also be incorrect to think that the lengthening in loan terms, which has already occurred, does not entail some negatives.

ASSET-BACKED SECURITIZATION MARKET KEEPS GROWING
Asset-backed securitization issuance in the auto market has totaled over $90 billion a year for the past three years, after falling to less than $60 billion in 2009. This higher issuance came even as many large banks relied heavily on deposit-back funding for auto loan originations. The terms of the securitization deals (for example, the amount of over-collateralization needed to achieve a given credit rating) were favorable to issuers, and investor interest in these instruments was high, in the first half of 2014. As the year ended, deal terms became a little tougher, and some lenders set aside larger loss reserves. This represented an efficient market correcting itself.
AUTO LENDING: A BIG BUSINESS WITH MANY PLAYERS
The dollar amount of auto loans outstanding totaled $934 billion as of the third quarter of 2014, according to the New York Federal Reserve. That’s an increase of $89 billion over the past year and is the result of both more, and larger, loans. There were 90.9 million auto loans outstanding as of September 30, 2014. Unlike the lease market, retail financing has low levels of lender concentration. On the new vehicle side, the top 10 lenders control 55% of the market (it’s near 90% for leasing). And, on the used vehicle side, the top 10 lenders account for only 28% of all financing. As a result there are many banks, finance companies, and credit unions with small auto loan portfolios and, thus, few repossessions. This has created an opportunity for third-party providers to handle the collateral collection and remarketing needs of these lenders.

LOAN TERMS LENGTHEN AND LOAN-TO-VALUE RATIOS RISE
In 2014, loan-to-value ratios for used vehicle financing increased at all types of lenders and in every risk segment. So too did the length of loan terms. By the third quarter of 2014, more than 54% of all used vehicle loans were for 61 months or longer. Nearly 15% were for 73 months or longer. Lenders report that longer loans, in and of themselves, do not materially impact repossession rates. It is, however, inarguable that longer loans increase the severity of loss on credit defaults. And, since the equity point is reached further out in long-term contracts, it is reasonable to expect that more repossessions will also take place further out in the contract. Longer loans can also be detrimental to customer satisfaction as some owners find they can’t afford to trade out when they would like.

AUTO ABS ISSUANCE BY YEAR

Source: Securities Industry and Financial Markets Association

BY THE THIRD QUARTER OF 2014, MORE THAN 54% OF ALL USED VEHICLE LOANS WERE FOR 61 MONTHS OR LONGER.
TOP TEN NEW VEHICLE LENDERS BY MARKET SHARE

- Ford Motor Credit
- Toyota Financial Services
- Ally
- Chase
- Honda Finance
- Nissan/Infiniti
- Capital One
- Wells Fargo
- Chrysler Capital
- TD Auto
- All others

Source: Experian Automotive

TOP TEN USED VEHICLE LENDERS BY MARKET SHARE

- Wells Fargo
- Ally
- Capital One
- Chase
- Santander
- Toyota Financial Services
- CarMax
- Credit Acceptance
- Bank of America
- Fifth Third Bank
- All others

Source: Experian Automotive
SUBPRIME LOANS GROW
In the third quarter of 2014, used auto loans to persons other than prime borrowers accounted for 54% of all contracts, according to Experian. That is within historic norms and suggests a healthy flow of credit to all types of borrowers.

In 2014, average interest rates on both new and used vehicle loans remained close to their year-ago levels. Loan amounts reached all-time highs, which pushed monthly payments up slightly despite longer loan terms.

REPOSSESSION VOLUMES RISE IN 2014
Total repossessions increased by 8% in 2014 to an estimated 1.48 million. In the coming years, the increases will likely be more substantial, but they will be driven primarily by the higher number of contracts outstanding and the mix shift toward lower credit tiers—not any major, or unexpected, deterioration in portfolio performance.

In fact, on a credit-adjusted basis, default rates should remain below historic norms. In addition to a secular shift wherein households have placed a high priority on auto debt relative to other obliga-

TERM DISTRIBUTION OF NEW AND USED VEHICLE LOANS ORIGINATED IN THIRD QUARTER OF 2014

![Term Distribution Graph](source: Experian Automotive)

RISK DISTRIBUTION OF USED VEHICLE LOANS THIRD QUARTER 2014

![Risk Distribution Chart](source: Experian Automotive)
tions (witness the S&P default indices), there are also current short-term economic forces that will better enable customers to make their monthly car payment.

Most notable is the higher level of job security enjoyed by workers. Initial jobless claims adjusted for employment growth show that the likelihood of an employee’s being laid off is now the lowest in history. And, of course, job loss is a primary cause of loan default. In addition, the rapid fall in gas prices in the second half of 2014 will provide households with more discretionary income and will help them keep up with monthly obligations.

Of longer-term importance is the significant deleveraging in the household sector. The Financial Obligation Ratio (the sum of mortgage, rent, auto lease and loan, and property tax payments as a percent of disposable personal income) is currently running at 30-year lows. This clearly indicates that most households are operating from a very solid financial base.

**REPOSSESSION REMARKETING: QUICK CONVERSIONS FOR HIGH RETURNS**

Lenders are naturally focused on converting repossessed units into cash as quickly as possible. Various laws and regulations dealing with the processes of collateral collection and liquidation often present a stumbling block to that quick conversion, but lenders and their auction partners have been successful in streamlining the processes that they do control.

Pure upstream selling is sometimes hampered by various obstacles to the efficient production of quality condition reports for repossessed units. But, after crossing that hurdle, repo remarketers can easily avail themselves of many opportunities to offer units 24/7 while in transit to, or awaiting sale day at, the auction.

Given the lender’s strong focus on time-to-sale, they generally strive for, and achieve, high conversion rates. That, coupled with little or no reconditioning, means that wholesalers are often the buyers of repo units. Sometimes they will do some light cosmetic work and then re-wholesale the unit. That arbitrage should not be regarded as a lost opportunity, but rather simply the wholesale market’s efficiently getting vehicles to the ultimate end dealer in the condition desired.
**CREDIT DEFAULT RATES**

![Credit Default Rates Graph](image)

- **Auto Index**
- **First Mortgage Index**

Source: S&P and Experian

**FINANCIAL OBLIGATION RATIO**

*Total household mortgage, rent, auto loans & leases, and property taxes as % of disposable personal income*

![Financial Obligation Ratio Graph](image)

Source: Federal Reserve Board
2014 HIGHLIGHTS

New car and light-duty vehicle purchases into commercial and government fleets increased by 7% to 850,000 units in 2014.

In 2015, fleet purchases should continue to rise, due to improved business conditions and profits.

Over the past seven years, the average fuel economy of vehicles sold in the U.S. increased by 24%, from 20.4 mpg to 25.3 mpg.

The top five car models account for 44% of all new commercial fleet vehicles.

Wholesale prices for end-of-service fleet units were at record highs in the first part of 2014, but a steep decline in the second half of the year pushed prices below 2013 and 2012 levels.
NEW VEHICLE FLEET PURCHASES INCREASE FOR FIFTH CONSECUTIVE YEAR

New car and light-duty truck purchases by commercial and government fleets increased by 7% to 850,000 units in 2014. It was the fifth consecutive annual increase, but deliveries were still well shy of the million-plus units that were sold into fleets in both 2006 and 2007.

In 2015, commercial fleet purchases should continue to rise due to improved business conditions and profits. In addition, the short-cycling that many fleets did between 2010 and 2012 to take advantage of high wholesale prices has created a large number of fleet vehicles that will enter their normal replacement cycle over the next two years. Even excluding businesses that operate fewer than 15 vehicles, commercial and government fleets had more than 5.9 million vehicles in operation in 2014, according to Automotive Fleet. That’s a foundation for steady, and healthy, replacement demand.

Over the longer term, however, we see the ongoing employment shifts between industries, the changed occupational distribution within industries, and the continued tight rein on both private and public fleet budgets holding back vehicle sales into fleet below the 1 million mark.

FLEET OPERATING COSTS IMPROVE IN 2014

Most surveys indicate that fleet managers had flat fleet operating costs in the first half of 2014. With fuel prices falling rapidly in the second half of the year, it is likely that many fleets had reduced per-vehicle costs for the full year.

Fleet expenses have been kept in check by the reduced maintenance and repair costs associated with today’s higher-quality vehicles and, in some cases, extended powertrain warranties. When repair incidences do occur, however, they are significantly more expensive than in the past as the diagnosis is often more complex and the part prices higher.

NEW VEHICLE SALES INTO COMMERCIAL AND GOVERNMENT FLEETS

[Bar chart showing sales data over the years]

Source: Bobit Business Media
Similarly, the prevalence of synthetics has made oil changes more expensive, but it has lengthened service intervals. Additionally, fleet operators, like retail consumers, have benefited from manufacturer programs that cover first-year oil changes and tire rotation.

After years of significant increases, tire prices were stable in 2014. Oil prices, which were a main contributor to past increases in tire costs, declined sharply at the end of 2014. That should keep 2015 tire prices from rising. And the shift toward more expensive, larger-diameter tires appears to be a trend that has now played out.

One area of fleet operating expense that is bound to rise in coming years is funding costs. Interest rates are expected to begin a multiyear rise in 2015.

**FLEET FUEL-EFFICIENCY CONTINUES TO IMPROVE**

For many years, fleet managers have worked hard to right-size the vehicles in their fleets to precisely meet needed requirements. After achieving the proper market class mix, they then strived to purchase the most fuel-efficient models and equip them with the proper options. This practice not only lowered annual fuel costs, but, in many instances, also protected resale values, as consumer interest in fuel economy was also high in the used vehicle market. In 2015, this may not play out as well since in early November unleaded gasoline prices at the national level fell below $3 per gallon for the first time since 2009. And prices kept declining from there.

Even though current fundamentals suggest that pump prices will remain low, fleet managers will still work to increase the overall efficiency of their vehicle portfolio. After all, fuel costs are by far the largest operating expense in fleet budgets—and there is no guarantee that today’s lower fuel costs will persist or that gas taxes might not be hiked. As such, fleet managers have been quick to adopt technologies that reduce fuel expense—for example, telematics that promote route optimization and reduced idling. Fleet managers have also benefited from the fact that new vehicles across the board have become more fuel-efficient. Over the past seven years, the average fuel economy of vehicles sold in the U.S. increased by 24%, from 20.4 mpg to 25.3 mpg.

Alternative-fuel vehicles have often been placed in fleet service due to corporate sustainability dictates, not because of expected savings. Nevertheles, the total cost of ownership for these vehicles has sometimes been in line with, or even better than, conventionally powered vehicles. For example, vehicles powered by natural gas already have a favorable total cost of ownership in many fleet situations.

The major drawback of alternative-fuel vehicles has been their higher acquisition cost, not their depreciation rate. But, of course, alternative-fuel vehicles do open up the fleet manager to greater residual risk since the end-of-service value is much less predictable and subject to large short-term swings.

**SALES-WEIGHTED MPG — NEW VEHICLE SALES**

Source: University of Michigan Transportation Research Institute
CONCENTRATED, BUT COMPLEX, BUYING DECISIONS

Unlike rental, commercial and government fleet purchases are generally concentrated within a few makes and models. Registration data from R.L. Polk show that the top five car models accounted for 44% of all the new cars registered to commercial fleets in calendar year 2012. In the van and multi-purpose vehicle segment, the top five models accounted for 83% of all registrations.

Part of this concentration is a result of historic buying patterns geared toward domestic manufacturers that are fleet-friendly with respect to order-to-delivery times, custom up-fitting, and incentives. But, it also reflects the fleet manager’s conscious decision to limit the number of models available to drivers on fleet selector lists.

More concentrated buying has not meant less complicated buying. In particular, the practice of staggered new model introductions throughout the year has made the fleet manager’s task more difficult. It’s impossible for the fleet manager to do model-to-model comparisons when the final specs of a potential buy have not yet been released. And, staggered new model introductions invariably lead to staggered purchasing and remarketing cycles, something the fleet manager would prefer to avoid.

FLEET RESALE PRICES FALL SHARPLY IN SECOND HALF OF 2014

Wholesale prices for end-of-service fleet units were at record highs in the first half of 2014, but went into a steep decline during the third quarter. Prices rebounded in the fourth quarter, leaving the sales-weighted average for the full year above 2013’s level. And that was despite harsh weather and delayed new fleet deliveries precluding fleet managers from taking full advantage of the higher spring prices. Indeed, auction volumes of commercial fleet units in the first quarter of 2014 were considerably below those of prior years as fleet managers couldn’t sell end-of-service units since the replacement unit had not yet arrived. Volumes picked up in the latter part of the year, resulting in higher full-year sales. The average auction price of a midsize fleet car is now more than $1,000 higher than that of the average auction unit. It used to be thousands less. That change occurred as auctions sales shifted toward more dealer consignment sales, which are typically older, less expensive, units. With the average fleet unit now priced right in the mix with many other types of auction units and sellers, the fleet reseller faces more competition in attracting buyers. Additionally, since the average wholesale price of a fleet unit has risen so much over time, it is important for fleet remarketers to recognize that their buyer base has also changed.

TOP FIVE VEHICLE SHARE COMMERCIAL FLEET SALES*

*Based on “Top 5 Vehicle Registrations by Segment.”

Source: Polk Automotive
In 2004, the auction industry experienced something it had not had to deal with in over a decade—a decline in the number of units sold. It was an occurrence, however, that was not unexpected … The industrywide drop in total lease terminations was nearly 700,000 units.

Remarketing processes have entered a new era. Gone is the bright-line distinction between in-lane and online. Simple multiplatform selling is quickly becoming simultaneous multiple-platform selling … Even the distinction between retail and wholesale has blurred. New entrants into an old industry are now expected, and sometimes even welcomed, even as they bypass what used to be considered “the rules.”
ONE AREA OF FLEET OPERATING EXPENSE THAT IS BOUND TO RISE IN COMING YEARS IS FUNDING COSTS. INTEREST RATES ARE EXPECTED TO BEGIN A MULTIYEAR RISE IN 2015.

**AVERAGE AUCTION PRICE—MIDSIZE FLEET CARS**

Source: Manheim Consulting

**AUCTION PRICE FOR FLEET CARS MOVES ABOVE OVERALL AUCTION AVERAGE**

Source: NAAA and Manheim Consulting
In 2011 and 2012 and, to a lesser extent, in 2013, fleet managers availed themselves of opportunities to cycle out of fleets early to take advantage of higher wholesale prices. Interestingly, at the same time, some fleets were extending the service life of their vehicles. As a result, the mileage on fleet units being remarketed became more dispersed. In 2014, patterns returned to normal.

On average, however, mileage has continued to trend up. The average end-of-service fleet car sold at auction now has more than 75,000 miles, whereas a decade ago the average mileage was 65,000 miles. For pickup trucks the average mileage has risen from 100,000 miles to more than 115,000 miles.

**AVERAGE MILEAGE—COMMERCIAL FLEET UNITS SOLD AT AUCTION**

Source: Manheim Consulting

CERTIFICATION SIGNIFICANTLY INCREASES VEHICLE VALUE FOR COMMERCIAL FLEET SELLER

When a commercial fleet seller expressed an interest in certification, Manheim Consulting partnered with an auction to analyze the impact of a 90-day certification trial. The 90-day trial was conducted during the fourth quarter, a time when wholesale values generally decrease.

The control group was established comparing the seller’s retention (%MMR) results at other locations within the same market. The analysis revealed that monthly retention averages at the seller’s control group locations declined throughout the quarter, while the seller’s retention increased 2.6 percentage points for the location certifying units. This equated to an approximate price increase of $300 per unit, yielding an ROI of $6 on every dollar spent.

*View the complete case study, along with others, by visiting www.manheim.com/consulting and search under the “Publications” tab.*
FLEET MANAGEMENT COMPANIES DRIVE REMARKETING IMPROVEMENTS
Fleet management companies (FMC) have been pioneers in using analytics to protect residual values. For example, studying the impact that various vehicle options have on resale value or determining the optimal service life for particular types of vehicles. FMCs have also been innovators as well as catalysts in moving the whole remarketing industry forward. For example, upstream selling and multiplatform listing.

All of this belies the common myth that fleet management companies are less interested in resale value since, generally, they do not carry the residual risk. The FMC/fleet manager client relationship, like most others in the remarketing world, is built on a true partnership working toward mutually beneficial goals.

TOP 10 FLEET MANAGEMENT COMPANIES

<table>
<thead>
<tr>
<th>Fleet Management Company</th>
<th>Vehicles Funded &amp; Managed</th>
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<tbody>
<tr>
<td>GE Capital Fleet Services</td>
<td>829,731</td>
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<td>ARI</td>
<td>803,002</td>
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<td>PHH Arval</td>
<td>457,000</td>
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<tr>
<td>LeasePlan</td>
<td>385,000</td>
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<td>Enterprise Fleet Management</td>
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<td>Wheels</td>
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<td>Penske Truck Leasing</td>
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<td>Emkay</td>
<td>86,350</td>
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<td>Mike Albert Fleet Solutions</td>
<td>38,900</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>3,614,707</strong></td>
</tr>
</tbody>
</table>

Source: Automotive Fleet 2014 Fact Book

Funded and Managed Vehicles — Top Ten Lessors

Source: Automotive Fleet 2014 Fact Book
Continuing vehicle quality improvements mean that the average age of vehicles in operation is increasing, and the “churn” of those vehicles through the remarketing process is slowing. Nevertheless, used vehicle sales should continue to increase into the next century.

The ability of consumers to buy more vehicle for less money has been a defining characteristic of the automotive industry for more than five years, but it took on new force in 2002 … The end result is that new vehicles are more affordable than at any time in the past 25 years.
2014 HIGHLIGHTS
The overall global new car market reached 43 million units during the first half of 2014, 3.6% higher than the same period in 2013.

China continued to be the largest new car market in the world.

During H1, Brazil lost its fourth-place position to Germany, and the U.K. overtook Russia to become the seventh-largest new car market in the world.

More than 1.4 million vehicles are sold at auction in the U.K. each year.

GLOBAL
The overall global new car market was reported to reach 43 million sales during the first half of 2014, which was 3.6% higher than same period in 2013. China continued to be the largest new car market in the world, while some notable changes during this half included Brazil, which lost its fourth-place position to Germany, and the U.K. — which overtook Russia to become the seventh-largest new car market in the world.

U.K. MARKET
Consumer-facing brands include motors.co.uk — the U.K.’s second-largest online classified business, and WeWantAnyCar.com consumer car buying service.

Although the U.K. showed strong signs of recovery following the global financial crisis, it was not generally expected that the 2014 new car sales result would reach pre-recession levels. In the period from 2004-2013, new car registrations peaked at 2.6 million in 2004 but in 2009 dropped to under 2 million. A surge in new car registrations during early 2014 prompted The Society of Motor Manufacturers and Traders in the U.K. (SMMT) to revise its full year forecast in October to 2.46 million units (up 8.5% on the 2013 volume) and attributed improved economic conditions. This was considered optimistic by some, however the 2014 results show the highest volume of registrations in 10 years at 2,476,435. In fact, it was the fourth-largest record in history following 34 consecutive months of growth. The U.K. is now the second-largest new car market in Europe behind Germany.

It is generally agreed across the industry that the rise in sales can also be attributed to the sheer volume of financial packages and auto incentives available from independent and franchised dealers. Some analysts question the sustainability of these deals. It is suggested that the manufacturers are now stuck in a vicious circle where incentives need to continue in order to remain competitive, and this could potentially have an impact on used car values in the future.

Looking to the used car market, sales reached a high of 7.7 million in 2004, and fell to 6.7 million in 2012. 2013 showed a 0.9% YOY growth to 6.8 million, and the 2018 forecast expects sales to steadily increase to reach 7.4 million.

In the auction market, the National Association of Motor Auctions (NAMA) claims 1.4 million vehicles are sold through auction every year in the U.K. (43% of the total wholesale market). Manheim has seen the stock profile change dramatically as an impact of recession where the primary source of stock has shifted from fleet vendor disposals to become primarily dealer vendor, part exchange stock.

CONTINENTAL EUROPE & TURKEY
The car market in Europe has experienced a six-year slump during the global recession, with new car sales falling from 16.1 million (2007) to 12.3 million (2013).

However, 2014 has shown signs of recovery across most major markets, driven by auto incentives and easier access to financial borrowing with preferential rates. It should be noted that the overall growth across Continental Europe during 2014 has been driven in part by the success seen in the U.K. — which had the largest increase in total car parc for a decade.

For the Manheim markets of Spain, Portugal, and Italy; all are in recovery following recession, showing growth in 2014. Spain in particular has shown consistent strong growth.

Turkey did not see growth in the new car market during the first half of 2014, with sales down 24.9% compared to 2013. The decline in the automotive market was attributed to increases in interest rates and exchange rates, increases in car taxes, bank credit restrictions, and a slowdown in private sector investments.
ASIA PACIFIC
Looking at the market as a whole, sales in the first half of the year were slightly lower than the midpoint for 2013. 559,951 new vehicles were sold by the end of June 2014, down 2.4% on the same period in 2013.

Sales volumes for new cars are expected to slow over the next five years, as consumers who are already benefiting from low fuel costs after purchasing small cars have less need to purchase another new vehicle. Compact SUVs are expected to be the major area of growth for the industry, as they are still relatively new to the market. The motor vehicle tariff is expected to be abolished over the next three years as local motor vehicle manufacturers exit Australia, but a depreciating Australian dollar will force prices up.

Consumer sentiment is expected to increase in 2014-15, providing an opportunity for the industry to continue to grow steadily.

The estimated size of the used car market in Australia is approximately 3 million units per annum. Annual growth in used vehicle wholesaling has been 3.7% over the past five years, with the annual growth for 2014-19 expected to be 5.2% per annum.

BRAZIL
Physical auctions are well established in the market, primarily selling vehicles from banks and finance companies. Brazil offers huge potential for the remarketing industry with the number of vehicles on the road estimated to be around 35 million. Brazil has low levels of car ownership compared to mature markets—187 cars per 1,000 people. In comparison, the U.S. ratio is 787 cars per 1,000 people. New car sales growth is expected to be driven by a growing middle class. New car registration results were recorded at 3.58 million units in 2013 and expected to reach over 4 million sales by 2018.

As the new car market stagnates, the used car market is expected to grow at CAGR of 4% over the next five years. Used car registrations were suggested to be around 9.6 million units (2013) with a new-to-used car ratio of 1-to-3.

DEVELOPING MARKETS
For the remaining BRIC countries, the results have varied.

In China, the world’s largest car market, growth continues albeit at a slower pace than the last few years. New car sales reached 19 million last year, and the 2020 forecast now expects new car sales to reach almost 30 million units. Used car sales were estimated around 5 million, which demonstrates how ‘immature’ the market is. The current vehicle parc is estimated to be 87 million cars in use and 22 million vans.

Barriers to growth include government restrictions to combat congestion and pollution in major cities (driving restrictions on certain days based on license plate). In addition, there is a restriction on sales of these compulsory license plates, and these can only be bought via lotteries. The government is also focused on the growth of “green” vehicles and has announced tax incentives for buyers.

In India, 2013 saw used car sales figures of 3 million overtake the 2.6 million new car sales for the first time, and is now becoming an area of focus for future growth potential. The new-to-used 1-1 ratio is expected to quickly shift to 1-to-2.5, and by 2020, 5 million used cars are expected to trade hands. The negative perceptions around used cars are starting to change, and a recent trend shows increased sales of luxury used cars, as a growing population of young middle class see this as an acceptable alternative to the high depreciation associated with luxury new car sales (approximately 30% after six months).

Our final BRIC, Russia, has seen its 2014 full-year new car sales forecast reduced from a 2% decline to a 12% decline. August alone showed a 26% decline compared to August 2013. The crisis in the Ukraine and the sanctions imposed have resulted...
in drastically reduced consumer confidence, and market commentators highlighted a fear that the sanctions could lead to a collapse of the domestic car market. And, at year-end, there was even greater pressure as the plunge in oil prices created economic turmoil and a collapse of the ruble. Some auto manufacturers even had to suspend sales to dealers until the dust settled. Major OEMs have reduced production throughout the year, resulting in job losses. However, the Russian government has reacted to the crisis by introducing finance deals and a scrappage scheme to encourage new car sales through a financial reward for trade-in of old cars.
GLOBAL TRADE

STATE OF THE EXPORT MARKET
With U.S. new car sales expanding in 2013 and 2014, the used car remarketing pipeline in 2015 and beyond will see a significant spike in U.S. used car exports globally. Demand is also on the rise as economies in developing countries begin to strengthen.

In addition to supply and demand, certain countries that rely heavily on the U.S. export market are also relaxing their import requirements, further enabling the supply chain. The North American Free Trade Agreement (NAFTA), which currently restricts the age limit of cars imported into Mexico to 8 years of age and older, will relax the age requirement by two years every year until 2018, when the age restriction will be completely lifted and all cars may be imported. China has also announced that it will relax some of its used car import requirements, but details have not yet been released. Similarly, countries across Africa are also relaxing import requirements, further enabling the fastest-growing U.S. export market.

While the U.S. used car export market has been traditionally dominated by a large number of smaller dealers, there has been a paradigm shift in the supply chain, bringing much larger dealership groups and global companies into the used car export realm. Due to the financial resources and capabilities of these large competitors, their ability to quickly capture market share will create new opportunities globally.

According to ExportTrader, the top 5 Markets for U.S. used vehicle exports are: United Arab Emirates, Saudi Arabia, Germany, China and Nigeria.

Along with all of the used car supply chain enablers comes a host of challenges. Many countries around the world are paying closer attention to the environment and making strides in becoming “greener.” As a result, increasing restrictions on import requirements, namely the sizes of engines and emissions, are limiting the supply chain. Many countries have placed higher tariffs on large-engine vehicles, making it more costly to import muscle cars and large SUVs while reducing, or in some cases eliminating, tariffs on hybrid vehicles, 4-cylinder, or 1.8-liter engines.

Another changing dynamic that is also enabling the export supply chain is the increasing confidence of the foreign-based buyer on the Internet. International dealers are relying more heavily on Web platforms to buy used cars from the U.S. and other markets globally. They are becoming much more comfortable and trusting online condition reports, car history reports, and grading of vehicles to make their purchasing decisions. What this also means is that accessibility to data, analytics, comparative pricing, and intelligence has also become prominent. Foreign-based dealers are just as resourceful and educated about all aspects of the supply chain as domestic-based exporters.
2014 HIGHLIGHTS

Average cash value for total-loss vehicles increased in 2014, a trend that should continue in 2015 to stay in line with increasing average new car transaction prices.

Prices for salvage units at Manheim auctions rose modestly in 2014, and volumes increased by more than 8,000 units.

Overall values for crushed auto bodies have been on a downward trend for several years; in 2014, prices started at about $275 per ton and fell to $200 by year end.

The trend of international buyers sourcing vehicles from salvage auctions continued in 2014, driven primarily by the increased adoption of digital sales platforms abroad.

Salvage auctions are increasingly co-located within traditional auction sites, giving buyers additional exposure to and familiarity with these units.
SALVAGE AUCTIONS: A SOURCE FOR VARIED INVENTORY

In 2014, the salvage marketplace followed trends similar to those in the whole-car market, where supplies increased and demand remained strong. Other factors influencing the salvage market were a decrease in scrap metal prices, led by softening Chinese demand and an increase in platinum and palladium prices during the first half of the year, which then retreated in the second half. The trends counterbalanced each other and contributed to stable salvage prices. Buyers of total-loss units continued to work harder to find units that were competitively priced with enough room for a reasonable profit.

The trend of higher supplies and strong demand should continue in 2015. We expect that healthy demand will ease the downward pressure on prices in the salvage marketplace caused by other factors. In particular, the higher off-lease, off-rental, and repossession volumes that impact pricing in the whole car auction space. We also expect that the number of units “scrapped” next year will rise markedly, since preliminary numbers for 2014 indicate that scrappage was low relative to new vehicle sales. Note that scrappage is calculated as a residual (new vehicle sales minus growth of vehicles in operation equals scrappage), as such scrappage is better defined as a vehicle’s failure to re-register in the U.S.

As noted in earlier sections, the average age of vehicles sold at auction increased again in 2014, with more than 40% of the units being sold 7 years old or older. While franchised dealers continue to source inventory from upstream remarketing channels, inventory sold at auction from three or four model years past increased for most major brands. The independent dealer played a bigger role in the off-lease vehicles bought at auction in 2014. That trend will continue in 2015 as extensive lease penetration rates will funnel significant volumes that many franchised dealers will be unable to absorb. On the opposite end of the spectrum, we continue to see vehicles older than 7 model years as a growing segment. The increase in the average age of vehicles on the road will push more vehicles into this segment at auction as they are repossessed, sold to a broker, donated, or involved in accidents.

ACTUAL CASH VALUES RISE FOR MOST MARKET SEGMENTS

Recognizing increased buyer familiarity and Actual Cash Values (ACV) for total-loss vehicles increased in 2014. The increase in ACV is partly from the vehicles, having more safety content (increase in number of airbags) and telematics, which increase overall vehicle value. This trend should continue in 2015 to stay in line with the trend of increasing average new vehicle sales transaction prices.

NEW VEHICLE SALES & SCRAPPAGE

Source: Based on IHS, Automotive News data, and Manheim Consulting estimates
AVERAGE VEHICLE AGE IN YEARS

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SALVAGE AUCTIONS REMARKET MORE CLEAN-TITLED VEHICLES
Dealers continued to focus primarily on clean-titled vehicles; however, they have become increasingly comfortable purchasing salvage-titled units. Units will typically receive a salvage title when the cost of repairs exceeds 75% of the vehicle’s actual cash value, but there are notable exceptions. Units that are stolen or are excessively older with higher mileage could receive a salvage-title brand. Such units are typically very attractive to the wholesale buyer.

DEALER PARTICIPATION INCREASES IN SALVAGE AUCTIONS
Salvage sales are increasingly co-located within traditional auction sites, allowing buyers to gain additional exposure to and familiarity with these vehicles. Independent dealers, in particular, have found salvage units to be a profitable source of inventory. While off-lease volumes will become more plentiful to independent buyers in coming years, the salvage segment will retain much of the favor it has garnered. As dealers become more comfortable recognizing that these units can often be repaired and sold to retail buyers, bidding activity increases, including activity from digital sales channels such as Simulcast.

FOREIGN BUYERS COMPETE FOR LATE-MODEL REPAIRABLE UNITS
The trend of international buyers’ sourcing inventory from salvage auctions continued in 2014, driven primarily by the increased adoption of digital sales platforms abroad. Indeed, Manheim’s Export-Trader reported that it shipped vehicles to more than 170 countries. Mexican importers continue to favor more affordable non-luxury units and often compete with domestic buyers, leading to increased bidding activity. Mexican buyers played a significant role in markets located in border states and are using Simulcast more frequently. Buyers from the Middle East and Europe continue to favor late-model vehicles, particularly those from luxury manufacturers. The demand from China slowed down in 2014, reflecting the cooling-off of the Chinese economy.

2014 BRINGS HIGHER SALES VOLUMES
Salvage auctions remain one of the most varied marketplaces within automotive remarketing. These facilities remarket many different products, from recovered-theft inventory to late-model rental units to vehicles with catastrophic loss. Recognizing increased buyer familiarity and demand, 2014 prices for salvage units at Manheim sales increased modestly, and volumes rose by more than 8,000 additional units. As in previous years, values were affected by the ultimate disposition of the unit. Some buyers intend to part-out the vehicle and sell the remaining recyclable components for scrap, while others intend to invest in repairs to ultimately resell the unit to a retail buyer.

Global commodity prices always heavily influence this industry segment, and in 2014, it was somewhat of a roller coaster. Palladium prices started the year at about $725 per troy ounce, rose to more than $900 in August, and then moved back.
down to finish the year around $775. Platinum prices showed a more modest rise in the first half of the year and then fell more rapidly to finish the year lower than where they started.

While month-to-month volatility occurs in the scrap metal marketplace, overall values for crushed auto bodies have been on a downward trend for several years. In 2014, prices started at about $275 per ton and fell to just $200 by year end.

Foreign demand from China, Turkey, South Korea, Taiwan, and Japan varied throughout 2014. Similar to events in 2013, foreign exports affected values by introducing more low-priced steel into the marketplace, depressing prices for scrap steel and crushed auto bodies alike. With most currencies weakening appreciably against the dollar in late 2014, similar pricing pressure can be expected in 2015.

Non-insurance vehicles continued their run of strong pricing at salvage auctions in 2014. These units are bought by dealers and exporters alike, and the price trends mirror those of the whole-car auction.

SALVAGE BUYERS RELY ON TECHNOLOGY
As in the whole-car business, salvage buyers have become increasingly dependent on technology to buy, sell, and manage their inventory. Multiple purchasing options exist, including real-time sequential bidding via Simulcast, 24/7 bidding and buy-now sales via OVE.com, and new mobile bidding technology allowing buyers to place live bids in Simulcast sales via a mobile device. Buyers often attend physical sales and purchase their vehicles at one location, while purchasing vehicles from a second location using their mobile devices. Online tools present the buyers with information, timely market trends, and greater access to inventory. Sellers benefit from the dynamic of an expanded buyer base ready to do business.

AVERAGE PRICE OF CRUSHED AUTO BODIES 2012-2014

Source: ARS
ABOUT COX AUTOMOTIVE

Cox Automotive is a leading provider of products and services that span the automotive ecosystem worldwide. We've built the strongest portfolio in the industry with more than 20 brands that together provide end-to-end digital marketing, wholesale, and commerce solutions for customers large and small. Our goal is to simplify the trusted exchange of vehicles and maximize value for dealers, manufacturers, and car shoppers.