U.S. Auto Industry Continues Growth Despite Economic Uncertainty

Overcoming economic uncertainty and the lingering effects of the Great Recession, the U.S. automotive industry in 2012 produced accelerated growth and profitability for dealers and other key industry players. New car sales exceeded expectations by 1 million units, rising to 14.5 million. Used car sales, meanwhile, rose to 40.5 million units, a 5% increase from a year ago. Wholesale prices remained at historically high levels, and the rental industry earned record profits.

At the heart of many of these positive developments was the smart use of technology, including digital tools that allowed retail customers to make more informed choices, wholesale sellers to remarket their inventory in multiple forums simultaneously, and wholesale buyers to make inventory management decisions anytime, anywhere from the palm of their hands.

2 A Note From Sandy Schwartz, Manheim President

3 Year in Review and Outlook
Once again, the auto industry performed well against a volatile economic backdrop. With wholesale supplies increasing and credit availability likely to remain good, used vehicle dealers should see increased sales again in 2013.

8 The Remarketing Industry
Wholesale prices remained at historically high levels, and volumes declined only slightly. Issues such as vehicle transportation, wholesale financing, and emerging technologies all played a role in buyer and seller performance in the wholesale market.

13 Dealers
Pent-up consumer demand led to 40.5 million used vehicle sales in 2012. Certified Pre-Owned sales rose 6% to a record 1.84 million units.
• Q&A with NADA • Q&A with NIADA

20 Rental
The rental industry had record profits in 2012 as lower per-vehicle revenue per day was offset by higher fleet-utilization, low depreciation costs, and reduced inventory-funding outlays.

24 Leasing
Lease originations increased for a fourth consecutive year, reaching 2.5 million units in 2012. Meanwhile, off-lease volumes dipped to a cyclical low of 1.5 million units.

28 Repossessions
Repossession volumes remained virtually unchanged in 2012, but the recent growth in loan originations and the easing of lending standards will likely lead to increased repossessions in 2013 and beyond.

32 Commercial and Government Fleets
With an increase of 7%, new vehicle sales into commercial fleets rose for the third straight year. Reversing a four-year slide, government fleet purchases increased by a modest 2% in 2012.

35 Salvage
The salvage market dealt with tight supplies, strong demand, and higher prices. Buyers of total-loss units had to work harder to find units that were competitively priced and allowed enough margin to turn a reasonable profit.
It seems like every January, we reflect on the events of the previous 12 months and say with conviction, “There’s never been a year quite like that one.” Well, 2012 was no exception.

Despite nature’s wrath – culminating in the devastation of Hurricanes Isaac and Sandy – and the political turmoil surrounding budget debates and tax policy, the automotive industry continued its steady climb out of the depths of the Great Recession. And no segment of our industry has shown more resilience than the used car market.

This year, we are proud to bring you the 18th edition of Manheim’s Used Car Market Report, which offers insights and observations about the used car industry, and takes a look at all of the different ways that remarketing continues to become more efficient and responsive to the needs of buyers and sellers.

Changes continue to come at an accelerating pace in our industry, but Manheim’s goals remain constant: to provide a trusted marketplace for buyers and sellers, in which they find ease doing business. We do this by providing an array of products that allow wholesale participants to appraise, finance, buy, sell, manage, and transport their inventory in the most efficient ways possible.

Important useful innovations are being made in a variety of digital products, but it is in the area of mobile access – smartphones, tablets, etc. – that we are seeing the fastest growth today. Dealers are taking advantage of these technologies to research, buy, and sell vehicles from the palm of their hands. Last year, nearly 10 million visits were made to the Manheim marketplace from mobile devices, up 140% from 2011.

Mobile access of another sort – bringing the auction to the seller – has also taken off in the past year. Manheim’s “Simulcast Everywhere” brings the auctioneer and live auction environment to the seller’s location, a significant development that allows sellers to remarket vehicles faster and allows dealers to search larger inventories and bid on more vehicles earlier in the remarketing cycle. Thanks to products like Simulcast Everywhere and other tools that expand and enhance buying and selling opportunities, our industry is evolving into a multiplatform model where inventory will be broadcast across all competitive platforms simultaneously.

For all of the positive change that our industry is experiencing, it is important to remember that the fundamentals remain solid. Marketplaces that enhance trust, transparency, and confidence still attract, and satisfy, the greatest number of customers. And in the process of efficiently redistributing vehicles while also establishing their true value in the marketplace, auctions provide the right mix of products and services needed to enhance customer confidence.

I look forward to continuing improvements in the used car marketplace in 2013. I also look forward to interacting with others in our industry, and learning more about how we at Manheim can help you succeed.

Sincerely,

Sandy Schwartz
President

Sschwartz@manheim.com
The Certainty of Uncertainty

It seems that the theme of uncertainty has dominated our Review & Outlook for years. Either we are fixated on it, or it truly has been omnipresent. Trust me – it’s the latter. Note, for example, we wrote that growth in 2011 “… was achieved even as businesses, financial markets, and consumers wrestled with the uncertainty created by the European sovereign debt issue and the inability of U.S. policymakers to provide an environment conducive to long-term planning or investing.” Couldn’t the same be said for 2012? And now, as we enter 2013, another debt ceiling deadline looms, a budget sequester remains on the books, and a “continuing resolution” (much less a budget) remains to be passed. As Yogi would say, “It’s déjà vu all over again.”

But, as we wrote last year, “Despite the self-imposed headwinds, the recovery became more self-reinforcing and more balanced in 2011.” That too could be said of 2012. And, barring outside risks, 2013 looks to be another year of sustainable growth. In fact, the mere continuation of the recovery has put us in a much better position. That’s because the lapse of time has finally allowed the housing bust to run its course. In 2013, housing will be a contributor to economic growth, not a drag.

No industry has benefited more from the unfreezing of the credit markets than new and used vehicles. Although the immediate goal of Federal Reserve actions was to lower long-term rates and support the mortgage market, it was auto financing markets that enjoyed the first boosts.

Used vehicle sales finished 2012 on a strong note with a 17% increase in December.

DID YOU KNOW?

New vehicle inventories (on a 12-month rolling basis) have remained below 60 days for 33 consecutive months, the longest stretch ever.
Housing: An Unprecedented Drag Now Becomes a Stimulant

The Great Recession, which was concentrated in the financial markets, was precipitated by, and then acutely felt in, the housing industry. Easy credit led to a housing bubble, which, when popped, led to underwater homeowners and a wave of foreclosures and short sales. That, coupled with a decline in the equity markets, reduced household net worth by $12 trillion between the peak in the third quarter of 2007 and the trough in the second quarter of 2010.

After walking away from more than a trillion dollars in mortgage debt (through foreclosures and short sales), household net worth is once again closing in on its all-time high. And debt-to-income ratios are at their lowest in decades in the household sector. Nevertheless, until recently, home sales and new construction have remained dormant, at best. That is in stark contrast to all previous business cycles when housing and autos moved in lockstep.

Finally, however, there are signs that housing has made a turnaround. The overhang of foreclosures has begun to clear, rent-to-payment ratios and cheap money have brought investors into the market, and now, with a modest rise in home prices, traditional buyers have been enticed back. Given that household formation rates are beginning to keep pace with the growth in employment, home construction (and the multitude of jobs it generates) will now join in the recovery. And, given the high leverage ratios entailed in home financing, the modest rise in home prices now under way will quickly push household net worth to its pre-recession high.

Employment Grows, But Remains Far From Peak

In 2012, net employment gains averaged 153,000 per month, virtually the same rate of increase that was experienced in 2011. Last year’s growth was clearly a disappointment since many were expecting monthly gains of 175,000 or more, and it is generally believed that gains more like 200,000 per month are needed to provide a self-reinforcing recovery. Even larger gains are needed to significantly reduce the unemployment rate.
Given that a total of 8.8 million jobs were lost from the peak in January 2008 to the trough in February 2010, total U.S. employment, even after 27 consecutive months of gains, is still 4 million short of the previous peak. Add in population growth during this time and you quickly realize there are now many fewer paychecks to feed, house, and clothe many more people. And, fundamentally, we know that employment is the primary driver of vehicles in operation and vehicle miles of travel (VMT). Those two factors, in turn, determine the underlying rate of demand for new vehicles.

U.S. employment and vehicle miles of travel each peaked at approximately the same time (employment in January of 2008 and VMT in November of 2007). Both have now been below their previous peaks for the longest stretch ever – more than five years. This suggests to us that the run-up in new vehicle sales was very much frontloaded during this recovery and that, for the sales gains to continue, other sectors of the economy will need to join in.

**Credit Markets Spur Vehicle Sales**

No industry has benefited more from the unfreezing of the credit markets than new and used vehicles. Although the immediate goal of Federal Reserve actions was to lower long-term rates and support the mortgage market, it was auto financing markets that enjoyed the first boosts. The search for yield – with safety – drew investors into the asset-backed securitization market for auto loans and leases. And it also created new capital flows to dealers involved in the self-financing market.

Lenders, whether they be prime or subprime, enjoyed a record-low cost of funds. They passed those savings on to dealers, who did likewise for their retail customers. Subprime customers, who would have been rejected a year ago, received approvals in 2012 – and at a lower APR. Buyers found they could borrow more, for longer terms, and that is exactly what they did.
New Vehicle Sales Continue Their Rise in 2012

New vehicle sales in 2012 reached 14.5 million units. This was fully 1 million units higher than what the consensus forecast called for at the beginning of the year. The fact that sales surprised to the upside explains how inventory levels were kept in check during the year. Although the days’ supply rose at year-end, new vehicle inventories (on a 12-month rolling basis) have remained below 60 days for 33 consecutive months, the longest stretch ever.

Disciplined new vehicle inventory management in 2012 explains much of the strength in wholesale used vehicle pricing during the year. As such, it is a welcome fact that the consensus forecast for sales in 2013 points to around 15.5 million, since that is a sales rate that was almost achieved in the fourth quarter of last year.

Used Vehicle Retail Sales Top 40 Million in 2012

Used vehicle sales finished 2012 on a strong note with dealers having a 17% increase in sales in December, according to CNW. For the year, dealer used vehicle retail sales rose 5%. Although dealers faced margin pressure throughout the year, faster inventory turns, operating efficiencies, and strong F&I income kept used vehicle operations very profitable.

With wholesale supplies increasing in 2013 and credit availability likely to remain good, used vehicle dealers should see increased sales again in 2013. But, of course, economic risks remain. For example, although the temporary avoidance of the fiscal cliff was a positive, the fact remains that 77% of all U.S. households will face higher taxes this year relative to 2012. That’s a result of the loss of the temporary 2 percentage point reduction in the payroll tax. To be sure, no one expected the payroll tax holiday to be extended (and it wasn’t great economic policy); but that doesn’t mean that households now experiencing a $75 to $100 loss in after-tax monthly income won’t alter their behavior. Furthermore, with businesses having shifted bonuses, stock options, and special dividends into the latter part of 2012, economic activity this year may exhibit an abnormal seasonal pattern.
Wholesale Prices and Processes Enter a New Era

We have long suggested that wholesale used vehicle prices have entered a new era where markets are comfortable with relatively higher valuations. That’s because the bad practices of the past that destroyed residual values (like excessive lease subvention, heavy incentives, short rental cycles, and high dealer inventories) have been stopped.

Remarketing processes have also entered a new era. Gone is the bright-line distinction between in-lane and online. Simple multiple-platform selling is quickly becoming simultaneous multiple-platform selling. The term “channel management” lost its cachet when the channels lost their boundary lines. 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.”

Certain truths remain, however. Foremost, open and transparent competitive bidding with equally knowledgeable players remains the truest form of price discovery. And, buyers and sellers need a trusted marketplace built on efficiency that effectively transfers vehicles to their optimal owners.

Cliffs and Ceilings Create Confusion and Caution

The “fiscal cliff” (expiration of the Bush-era tax cuts and imposition of automatic spending cuts) was precipitated by the inability of Congress to reach a budget deal in the middle of 2011, but it did not attract 24/7 media coverage until the waning days of 2012. The resulting uncertainty, however, put many businesses on hold throughout 2012. Executives delayed hiring and investment decisions because they did not know what the rules of the game would be in 2013 and beyond. As a result, employment growth was slow, and capital spending lagged the recovery despite businesses having record levels of cash and facing historically low borrowing costs.

Some improvement in this situation should occur in 2013 under the assumption that even a bad budget deal is better than no deal. Given that the last-minute mini-deal to avert the fiscal cliff allowed the 2-point reduction in the payroll tax to expire, some pullback in consumer spending might be seen in the first half of 2013. That, along with some delays in income tax refunds, may cause growth in early 2013 to disappoint. After all, almost all observers believe that the deal to avoid the fiscal cliff will knock off more than 1 percentage point from GDP growth. As such, it is all the more important that the pickup in housing and business spending that we foresee actually occurs.

In closing, we can again quote from last year’s Review & Outlook:

“This year, our chief threat is once again ourselves. Although our debt and deficit issues need not – and cannot – be solved in the short term, there is a limited window of opportunity to rationally address the issue. Failure to do so will simply make the necessary choices harder and the easy alternatives all the more harmful in the long run.”

Yes, in 2013, our economic fortunes will once again be overly influenced by policymakers – by both their actions and their inactions. And, since another year has passed, that “limited window of opportunity” has gotten smaller. When it comes to sovereign debt issues, “great nations are given greater grace periods, but not blank checks.”
Auction Volumes Set To Grow in 2013

Estimates of NAAA-member auction sales in 2012 range from down 2% to virtually no change. Thus, total sales were in the range of 7.5 million to 7.7 million units. Dealer consignment volumes rose more than 5%, but that was offset by an 8% decline in commercial consignment.

Looking ahead to 2013, we believe auction volumes will increase by 5% to a level of approximately 7.9 million units. With close to 10 million units sold in 2003, compared to 7.5 million in 2012, the surface-level decline of 25% could be alarming to some. It is critically important, however, to understand the underlying factors that contributed to those high volumes in 2003. They were the result of prior years when leases were written with inflated residuals, loans were made to subprime borrowers who simply passed a “mirror-test” and were given a loan-to-value ratio of 150% or more, incentives were dispersed willy-nilly to attract buyers, and manufacturers used rental car companies as a relief valve for excess production. While these practices supported new vehicle sales at the time, and boosted auction volumes shortly thereafter, they were destructive to the health of the auto industry. In fact, they brought two manufacturers to bankruptcy.

Looking ahead, we believe industry growth will be built on solid business practices. Leasing is being done right, lenders have become more aggressive, new vehicles are being sold with an upfront profit, and inventories are being kept in check.

We expect used vehicle inventory from all sources will increase in 2013. Off-rental supplies will grow by more than 200,000 units, with a greater-than-ever mix of diversified inventory. Off-lease supplies will increase by close to 200,000 units, driven by the earlier rise in lease originations from the trough of 2008. Repossession volumes will grow by approximately 100,000 units. And dealer consignment will grow for the fourth consecutive year in concert with the continued growth in both new and used vehicle retail sales.

Manheim Used Vehicle Value Index Declines by 1% in 2012

Wholesale used vehicle prices, as measured by the Manheim Index, increased in the fourth quarter of 2012 as Hurricane Sandy reduced supply and increased demand in the market. Although full-year prices softened for the first time in three years, they remained at historically high levels.

Three segments saw year-over-year price increases with mid-size cars and pickups having the biggest gains, at 2.0% and 2.6%, respectively. Van prices were nearly flat, posting a 0.2% price increase, and compact cars had the greatest annual decline at 2.8% from 2011.

Age of Vehicles Sold at Auction Moves Higher in 2012

Vehicles from seven or more model years prior accounted for more than 38% of total sales. That’s up dramatically from less than 18% a decade ago, and reflects the fact that dealer consignments have been growing at the same time commercial volumes have declined. It also reflects the sales cycle; we first saw the decline in auction share accounted for by 1- and 2-year-old models immediately following the recession; but last year that decline moved into vehicles from three model-years past.
Transportation: Keeping Our Industry Moving

Over the past several years, buyers have grown comfortable buying units from a wider geographical area. As a result, they have become more reliant on transportation solutions that streamline business processes and maximize profits. The average distance between buyers and the vehicles they purchase is about 190 miles for physical sales. Online buyers, however, reach much farther for inventory, with Simulcast buyers averaging 439 miles and OVE.com buyers averaging 552 miles.

Companies that move vehicles between sellers, auctions, and buyers are being recognized more and more as critical business partners. Similarly, marketplace players are working to provide tools and processes that better integrate transportation to help both buyers and sellers. Tighter integration allows these players to give buyers a more complete picture of the total cost of a vehicle during bidding by including estimated transportation costs. After the sale, vehicle information can then be provided directly to transporters to help simplify communications between buyers and transporters.

An example of this tighter integration occurred this year, when Manheim acquired Ready Auto Transport. The two companies had long partnered to provide online shoppers with a full-service transportation solution. This partnership has created an open marketplace for shippers and transporters to directly connect and negotiate for routes, the 1Dispatch platform.

Wholesale Financing Remains Plentiful for Dealers

As the used vehicle industry has expanded and dealers acquire more of their inventory from sources outside of trade-ins, the availability of wholesale financing has become increasingly important. Inventory-secured financing (as opposed to the use of general lines of credit or personal funds) enables dealers to expand their operations while maintaining liquidity. Wholesale financing plans, which can be geared to the particular needs of a dealer, can also make the settlement and titling process more efficient at both the wholesale and retail levels. As has been the case with retail financing, the unfreezing of the financial markets in recent years has been very beneficial to both borrowers and lenders. In particular, the asset-backed securitization market is providing a ready flow of funds at low-risk premiums, which is only fitting for an industry that generally runs with portfolios that are 99% current.

As an example of the industry’s adapting to a growing market with changing needs, Manheim Financial Services (MAFS) and Dealer Services Corporation (DSC) formed a combined wholesale financing company in 2013. Consistent with the industry at large, executives at both companies noted increasing dealer demand for tools that provide leading-edge technology, mobile and digital tools, and greater wholesale credit availability. The combined company is expected to provide industry-leading access to wholesale credit lines and enhanced technology solutions to streamline dealers’ financial operations.

Brian Geitner, president of NextGear Capital, noted that in 2012, the company saw a significant gain in new customers as well as an expansion in the dollar amount and utilization of existing credit lines.

Looking ahead to 2013, we expect that wholesale financing will remain plentiful for dealers, allowing them to take advantage of the anticipated rise in auction volumes. These gains should be enabled through the increased use of technology to efficiently buy, sell, manage, and finance inventory. We anticipate that additional process and technology enhancements will be brought to market to ease the transactional burden for all dealers in...
Technology in the Automotive Wholesale Industry

The facilities, processes, people, policies and tools that have for decades facilitated the exchange of vehicles in the auction industry are experiencing new growth opportunities through technology innovations. Buyers and sellers are using a growing set of tools to buy, sell, and manage inventory. While the value of live, competitive bidding remains the core of the auction business, technology is increasing efficiencies and expanding sale and purchase opportunities.

Auctions and dealers continue to invest in technology to optimize remarketing strategies. For nearly 75 years, auctioneer-led sequential bidding helped buyers and sellers achieve real-time values. This remains the primary channel through which used inventory is remarketed today, despite a growing number of alternative channels.

Today, used vehicles can enter the marketplace through several different methods. In addition to traditional channels, such as physical auctions, sellers can use third-party services to electronically image, inspect, and list inventory on one, or multiple, online platforms. Manheim recently launched a third entry method, myMobileListing, where sellers can use a guided approach to collect images and condition information, and then generate a whole-number AutoGrade™. The increased transparency will help digital buyers have greater confidence in buying units without a traditional condition report.

Sellers can present their inventory for sale using multiple sale formats, including listed-bid 24/7 auctions, time-bound online event sales, buy-it-now listings, and live bid sales. In 2012, Manheim launched a new auction platform, Simulcast Everywhere. Buyers and sellers alike have adopted this new sales channel, bringing the power of a physical auction and auctioneer directly to the seller. Using a standard electrical outlet and a few pieces of equipment, a physical auction environment can be recreated in any conference room, dealership office, or alternative location nationwide.

Manheim Digital Statistics for 2012

> In 2012, more than 125,000 customers logged in each month to Manheim websites and apps, representing a 6% increase over 2011.

> In 2012, Manheim’s independent auction partners sold 40% more vehicles on OVE.com, compared with 2011.

> Manheim received nearly 10 million visits to its mobile website, iPhone and Android apps in 2012. The iPhone and iPad accounted for 57% of mobile visits, and Android devices accounted for 42% of mobile visits.

> More than a quarter of all Manheim sales came from Simulcast or OVE.com in 2012, representing a 4 percentage-point increase over 2011.
Throughout all sales channels, condition reports continue to be a critical tool for buyers, especially for vehicles sold via digital channels. Our studies have shown that a vehicle with a condition report is five times more likely to sell via a digital channel than is a vehicle without a condition report.

Mobile applications have served as the foundation for several industry-leading technologies. Manheim launched a mobile platform in 2010, which was primarily used as a research tool where dealers used VIN scan technology to retrieve MMR values at the dealership, auction, or distribution center.

In 2012, Manheim partnered with Nissan/Infiniti to launch the industry’s first mobile-enabled grounding tool. Dealers are able to use a smartphone or tablet device to process the grounding transaction utilizing a paperless process. Customers are able to sign all lease documentation via the smartphone or tablet device and receive an email confirmation receipt of the entire transaction.

In 2013, Manheim will support the ability to bid and buy in a Simulcast sale via a mobile device. This feature is the next in a stream of significant investments in the Simulcast product line to expand capabilities for live sale broadcast of vehicles in any location to buyers using any type of browser or device, taking the price-setting mechanism of live-bid sales “anywhere.”

Recent trends in the industry include:

**Multiplatform Selling**

Historically, sales events occurred at a specific time and place – and often at a physical auction location. Sellers would send their inventory to the marketplace with the greatest buyer reach, and buyers would attend sales that attracted the largest inventory. Auctions “won” by attracting that inventory, and the marketplace was insulated by a lack of technology and high barriers to entry. Over the past 10 years, technology eliminated those barriers to entry. Units can now be bought and sold worldwide using technology to search, evaluate, and buy vehicles 24/7. In fact, Manheim’s OVE and Simulcast platforms are now facilitating purchases from more than 120 countries.

Looking ahead, our industry is quickly evolving to a distributed model where inventory will be broadcast across all competitive platforms simultaneously. Some sellers have already adopted this approach by posting used vehicles on multiple platforms via home-grown or third-party-powered solutions. These solutions are often built upon a “first bid wins” methodology where the platform that secures the first bid is able to sell the vehicle to the highest bidder. In this scenario, the other platforms are asked to deactivate and remove the listing. Such a process is not optimal for either buyer or seller. Many buyers prefer to purchase vehicles from platforms that simplify their experience and provide research tools and transparency to ease their purchase risk. Similarly, sellers want to achieve the highest retention for their units, irrespective of the remarketing partner they use.

Our industry has begun a move to adopt standard processes where sellers can post units simultaneously in multiple marketplaces and buyers can place bids facilitated through an independent platform that will distribute bids to all marketplaces. In this scenario, high bids would be updated
immediately to ensure that sellers always achieve the highest market price for their vehicles, and that buyers have access to a greater selection of inventory on the platform that combines a tailored customer experience with research tools to facilitate a transparent exchange.

Anytime, Anywhere, Any Device

In 2012, nearly 10 million visits were made to the Manheim marketplace with a mobile device, growing nearly 140% from 2011. In fact, one in three visitors to Manheim's digital properties in 2012 used a mobile device. The Pew Internet Research Center noted that nearly one in two American adults have a smartphone, with those ages 18 to 49 driving that percentage to more than 60%. Microsoft reported in 2012 that mobile device Internet traffic will eclipse traditional desktop Internet traffic by 2014. Participants in our industry have mirrored these trends, demanding solutions and tools that allow them to research, manage, buy, and sell inventory on any device, whenever and wherever they wish. Mobile listing tools, mobile-enabled Simulcast platforms, and mobile research tools will see continued growth in 2013.

Inventory vs. Trust and Confidence

Historically, industry players differentiated themselves by focusing on which auction company or Internet platform had the most inventory. These laurels were built upon inventory exclusivity agreements where sellers were bound to post inventory in a single marketplace. Our earlier view of multiplatform listings will reduce the dependence on this approach, giving rise to a new point of differentiation. Marketplaces that provide buyers with trust and confidence tools will attract a growing customer base. These tools will include enhanced condition report solutions, certification programs, next generation mediation, transactional guarantee products, and increased transparency on marketplace participants.

Analytical Decision-Making To Buy, Sell, and Manage Inventory

In 2011, vAuto launched its Provision service, which blends the resources of AutoTrader and Manheim to provide a comprehensive inventory solution that addresses the key questions of what cars to stock, what to pay, and where to find them. Provision and other Inventory Management Systems (IMS) combine market data and technology to optimize each dealer's inventory mix and facilitate the vehicle search and bidding process. Dealers using these systems are able to mitigate purchasing risk, moving away from the traditional golden gut and toward a fact-based approach where data powers their decision-making process.

Dealers are not the only marketplace participants using data to make smarter decisions. In 2012, Manheim Consulting provided more than 100 account reviews for commercial and dealer clients. During these reviews, many customers provided their entire wholesale remarketing data set to the Manheim Consulting team and asked for an independent performance review. In many cases customers discovered that they could make data-driven decisions on where to distribute auction-bound inventory, moving away from their traditional “business-as-usual” approach and leveraging analytics to determine auctions that delivered the highest retention for their inventory.

Increased Focus on Simplifying the Customer Experience

Our industry is no different from the macro-consumer view at large. We all demand and seek simplification when buying goods and services. We expect that new solutions and processes will be developed to simplify customer experiences at physical and digital auctions, and other remarketing industry segments. This may include the proliferation and exchange of data among wholesale and retail platforms, vehicle and transactional information that is customized, relevant and delivered to the customer on multiple devices and platforms, and a simplified account settlement process where current-day technology facilitates payment and checkout via kiosk or mobile device.
The recession, and the related reduction in credit availability, pushed annual used vehicle sales, which are inherently very stable, from a pre-recession high of more than 44 million units to just 35.5 million units in 2009. Thus, the normal “churn” in the market (used vehicle retail sales as a percent of vehicles in operation) was lowered to unsustainable levels, which created pent-up demand. So, as the availability of retail financing improved (and total employment made modest gains), the level of retail used vehicle sales climbed back to 40.5 million in 2012. Importantly, recent sales gains have been accompanied by strong dealership profits. That’s true whether the dealer was a large-volume, high-end luxury retailer selling manufacturer certified pre-owned units or a small Buy-Here, Pay-Here operator.

Franchised Dealers Remain Focused on Used Vehicles

In 2012, franchised new car dealers enjoyed their third consecutive year of double-digit growth in new vehicle deliveries. That, coupled with attrition in the dealership count, meant that the number of new units sold per dealership reached an all-time high.

Nevertheless, franchised dealers did not lose focus on their used vehicle operations simply because of booming new vehicle sales. In fact, with wholesale supplies remaining tight, many dealers considered the provision of used vehicle inventory through trade-ins to be the most important function their new vehicle departments played in 2012. Total used vehicle retail sales by franchised dealers increased 8% in 2012 to 15 million units, their highest level since 2005.

CPO Sales Reach Record Level in 2012

In 2012, manufacturer CPO sales rose almost 6%, to reach a record 1.84 million units. With the help of a revamped program that extended the basic warranty and increased financing incentives, Ford Lincoln/Mercury CPO sales surged by 30% in 2012. GM, because of a significant reduction in potentially
certifiable units and the wind-down of the Saturn, Pontiac, and Hummer programs, had a 3% decline in CPO sales. But, with sales approaching 275,000 units (excluding Cadillac), GM remained the second largest CPO program behind Toyota, which had CPO sales of 330,000 units in 2012.

Increased supplies from a growing off-lease portfolio and greater marketing effort pushed Hyundai CPO sales up 45%, while Kia CPO sales more than doubled. Also notable in 2012 was the 18% increase in CPO sales for Volkswagen. In the luxury segment, Mercedes was the leader with CPO sales of more 80,000 units, up 7% from 2011.

With the supply of potentially certifiable units growing in 2013, for the first time years, total CPO sales will surely rise again. Indeed, the 2 million mark will be quite reachable.

Franchised Dealers Broaden Their Offerings

As has been the trend in recent years, many franchised dealers in 2012 built or bought separate used vehicle lots to handle inventory that did not quite match with the offerings on their franchised lots, which had become increasingly skewed to manufacturer CPO units. By offering a wider array of ages and price points, franchised dealers were able to retail a greater share of the trade-ins they received. The increased volume allowed them to more effectively spread overhead costs related to technology, capital costs, and marketing. In addition, Internet marketing sites such as Autotrader.com enabled franchised dealers to better merchandise out-of-brand vehicles since visitors more often search by make and model rather than specific dealerships.

Independent Dealers Post Modest Rise in Unit Sales

Independent dealers also had a good year in 2012, even though, as suggested earlier, their franchised dealer counterparts became more direct (and better) competitors. Indeed, the biggest impediment to increased independent dealer sales in recent years has been the reduced flow of vehicles from franchised dealers.
Dealers

In 2012, franchised new car dealers enjoyed their third consecutive year of double-digit growth in new vehicle deliveries. That, coupled with attrition in the dealership count, meant that the number of new units sold per dealership reached an all-time high.

to them as new car dealers kept more of their trade-ins to retail themselves. As evidence of this, note that independent dealers accounted for a greater share of all auction purchases in 2012, even though their increase in retail sales (+2%) was substantially less than for franchised dealers (+8%).

The reduced flow of vehicles from franchised dealers created robust auction bidding from independent dealers and, thus, strong wholesale pricing. As a result, retail margins were compressed. But, with the availability and cost of both retail and wholesale financing the best they have been in years, the margin compression was offset by a faster inventory turn and reduced operating expenses.

Buy-Here, Pay-Here Dealers Faced a Challenging 2012

Finding inexpensive units that can run the term of the note without a major repair has always been a challenge for BHPH dealers. Furthermore, with shortages in the wholesale market and a rise in commodity prices, the task of holding down inventory acquisition costs became even more difficult in 2012. Dealers who did not want to take on the added risk of providing longer-term loans for larger amounts were forced to sacrifice volume. Nevertheless, BHPH dealers still accounted for more than 14% of total financing in the used vehicle market in 2012.

Tax refund season, which is the biggest selling period for BHPH dealers, was less than robust in 2012. In fact, for the first time in many years, both the number and dollar amount of individual income tax refunds declined from the previous year. The dollars that did come arrived in a lumpy fashion, which made it difficult for BHPH dealers to maximize inventory turns.

Another challenge facing BHPH dealers in 2012 was subprime lenders buying further down the credit scale, thereby picking up customers who previously would have used their services. Add all these factors together and you get a situation where BHPH dealers were forced to put more money on the street, for a longer period of time, with a lower down payment, and to a customer with a riskier credit profile. Not exactly an ideal situation.
On the plus side, however, BHPH dealers enjoyed greater access to capital – whether it be for wholesale financing or for selling notes at a discount. That, coupled with what is always robust underlying demand for their services, meant that BHPH dealers who did a good job on the collection side had a profitable 2012.

BHPH sales in early 2013 might be lowered because many dealers who used down-payment deferral programs from tax preparation services to pull sales into November and December of last year. In addition, tax refunds in 2013 will once again be delayed and probably small.

**Succeeding on Reduced Margins**

Used vehicle retail gross margins for the top seven publicly traded dealership groups have trended down in recent years, and that is not atypical for the industry as a whole. One thing we can be sure of is this: Although the pace at which margins decline over time varies with economic conditions, those margins rarely widen back to their previous levels. And, as average margins narrowed, the range of grosses on individual transactions clustered increasingly toward the norm.

Thus, to succeed, dealers have had to become more efficient and increase inventory turns. In addition, lacking “home-run” (high-gross) deals means that dealers can ill afford the outsized losses caused by buying the wrong car at the wrong price. So, what has always been a time-consuming task – finding, evaluating, and pricing inventory acquisitions – had the potential to become all-consuming for the used vehicle manager. Fortunately, technology-enabled tools, such as a vAuto and Auction Genius, allow managers to quickly search pre-sale lists across multiple platforms, retrieve vehicle history reports, and obtain data on current pricing and supply dynamics in their market areas.

Simply put, analytics have allowed dealers to better answer the questions of what to buy, what to pay, and where to buy. Technology has enabled them to come to those answers more efficiently. Combined, they have enabled dealers to prosper in today’s margin-compressed world.
Dealer Consignment Dominates the Auction Lanes

With commercial consignment volumes down for the fourth consecutive year, and dealer consignment up for the third consecutive year, the share of auction volume composed of dealer consignment vehicles rose to a record of 57% share of auction volume in 2012. With demand for used vehicles high and supply low, franchised dealers and others who in the past bought only from the commercial consignment lanes became active bidders on dealer cars. This had the virtuous effect of bringing truer market pricing to the dealer lanes, which in turn stimulated further consignment growth.

It also meant that selling dealers had to adopt new remarketing practices. For instance, since all Manheim dealer consignment sales are now Simulcast, the importance of the condition report has increased. And, of course, the condition report is critical in any pure online selling venue. In 2012, the percent of dealer vehicles offered with a condition report rose to more than 26%, up from 20% in 2011.

That percentage will jump higher in 2013 as Manheim enhances myMobileListing, which allows dealers to easily self-prepare and upload a condition report for vehicles on their lots. In addition, Manheim has offered its trademarked Insight ECR process to third-party providers for mobile off-site inspections in an effort to provide standardization to the industry.
David Westcott will become chairman of the National Automobile Dealers Association at the 2013 NADA Convention and Expo in February. He is the owner of David Westcott Buick GMC Suzuki in Burlington, N.C., and was the 2012 vice chairman of NADA. He represents North Carolina’s franchised new-car dealers on the NADA’s board of directors.

How would you describe business conditions for franchised dealers in 2012?

The economy continued to improve, led by stronger sales of both new and used vehicles. Low interest rates on auto loans, an aging fleet of vehicles on the road that need to be replaced, and exciting new vehicles on display at U.S. auto shows are all positive signs for the auto industry. Paul Taylor, our chief economist, predicts that new-car sales in 2013 will be better than 2012, up nearly 1 million cars and light trucks. The theme of the 2013 NADA convention is Momentum. I’m optimistic by nature, as are most car dealers.

Can you give us your perspective on how digital technology has changed both acquiring used car inventory and remarketing used vehicles?

Transparency has increased in all stages of the car buying and selling process. Consumers have information on what dealers are selling vehicles for on both a regional and national basis. Dealers also have many digital tools to give them insight on what to pay in the wholesale market. The NADA Used Car Guide offers guidance on both short-term and longer-term price performance for virtually any used vehicle. This helps give dealers guidance on what price to pay at auction and the depreciation they can expect for vehicles in their inventory. Use of mobile devices, such as smartphones, iPads and other tablets, continues to grow. NADA’s mobile or digital platforms provide AuctionNet data through an agreement with the National Auto Auction Association.

How have franchised dealers responded to the shortage of used vehicles and the need to control inventory?

We have seen faster turn rates and asking prices in line with market demand. As far as obtaining inventory, the use of online channels is more prevalent, and dealers are also contacting their customer base, informing them of deals on new vehicles as well as what their trade-ins are worth. Dealer investments in their used-vehicle operations have changed dramatically over the past decade, particularly as they relate to technology. Dealers now purchase used inventory online and can have a listing, along with photos, posted to the dealership website while the vehicle is en route. Dealers are also using third-party data to identify vehicles that sell best and which units have lingered on the lot for too long, and are setting used-vehicle prices based on what has taken place in their respective markets.

Certified Pre-Owned sales broke all-time records in 2012. Why have franchised dealers been able to sell so many CPO vehicles?

Market demand has driven CPO sales. Several factors have made this possible: (1) Better-quality vehicles across the board have made CPO models more attractive; (2) Manufacturers and dealers have done a great job marketing CPO vehicles as an extension of their lineup compared to new, instead of viewing CPO as cannibalizing new sales; and (3) Affordability. Surveys indicate that most CPO buyers are actually new-vehicle intenders. CPO vehicles offer the assurance of a new vehicle at a lower price point, including coverage through factory warranties, which is very important in the current economic environment. The NADA Used Car Guide also provides values for qualified, manufacturer-CPO vehicles at the time of sale.

The market today is driven more by data than ever before, and we’ve heard about NADA’s data plan with J.D. Power and Associates. Please share some of the details.

NADA and J.D. Power and Associates have created an alliance that helps improve the flow of actual transactional aggregated data and how it’s used to improve the accuracy of used-vehicle valuations. NADA members receive valuable reports that benchmark their operations against the competition as well as month-over-month for their dealership. Currently, about 9,500 dealers participate, and together NADA and J.D. Power have a goal to increase this sample size. NADA uses the data internally to help its analysts value vehicles. The data is used in the NADA 20 Groups, by the Dealer Academy, on Capitol Hill, and when we speak with the automakers. It’s a game-changer for us.
How would you describe business conditions for independent used vehicle dealers in 2012?

In a word: challenging. We continued to endure high wholesale prices, increased compliance and regulatory issues, a sluggish economy, and a tight commercial banking environment. However, I am extremely excited about 2013. It looks like we will see inventory prices soften slightly; we didn’t fall off the fiscal cliff, and retail finance sources started to get considerably more aggressive as we came to the end of 2012.

Given your background in finance, what are your thoughts on how the small used vehicle dealer stays profitable in this environment?

When I said that finance sources have started to loosen, I was talking about third-party indirect financing for our retail customers. If your business has a need for operating capital or you are considering the purchase of a fixed asset or real estate, it is currently more difficult than I can ever remember to get this type of financing. We have all had to work harder and make some very tough decisions since the fall of 2008. Unfortunately, I don’t see this changing dramatically in the next year, but I am hopeful that things will slowly improve. Simply adapting to your market as it experiences change won’t be enough anymore. To excel in our industry, it will be a must to get ahead of your market – and stay ahead of the market. Whether it is technology, locating inventory, compliance, legislative changes, financing, personnel, or any of the other issues we deal with, NIADA will be there providing its members with the training and education to stay ahead and not just adapt.

Do you see NIADA members buying more of their inventory in digital auctions, and how has the way they use digital sources changed over the last couple of years?

Fortunately, NIADA does an outstanding job of keeping its members aware of changes in technology and how those changes affect their businesses. Because of this, I certainly think you will continue to see those dealers who keep up with new technology stay one step ahead of their competition. There are so many great new tools out there that make you a better buyer and a better seller. Additionally, digital auctions have made so many improvements over the last several years from condition reports to working multiple lanes and auctions at one time; I am sure auctions will continue to improve their digital offerings, and you will be at a disadvantage if you are not using them.

How are independent dealers coping with the relative shortage of used vehicles?

The dealers who are thriving in this environment are the ones using technology and developing relationships with new buyers and sellers to deal with the supply shortage. Technology is allowing us to work multiple auctions and fleet sources from our desks while we have outside buyers looking for supply through auctions and other channels.

You have described independent used car dealers as the backbone of the auto industry. Why do you say this?

Independent dealers totally permeate the automobile industry. There are roughly 35,000 independent dealers nationwide. We range from “mom-and-pop” businesses to franchisees to multiple-location dealer groups. We inject a tremendous amount of capital into our economy by: buying and selling vehicles at auction; buying cars from and selling cars to individuals, businesses, and dealers (franchised and independent); financing vehicles for customers; financing vehicles through banks and finance companies; financing our inventory and real property; purchasing and providing cars and parts to recyclers; advertising through every medium available; and offering and using thousands of tools and products provided by thousands of vendors to serve businesses and customers every day. The independent dealer is vital to the auto industry in every segment. That is why I believe the independent dealer is the backbone of the auto industry.
Rental Industry Revenues Approach $24 Billion in 2012

Total rental industry revenues reached a record $23.6 billion in 2012, up nearly 4% from 2011. Strong growth in off-airport rental activity, combined with more modest (but steady) growth in the on-airport segment, propelled a significant increase in rental transaction days. Total revenue growth, however, was kept in check by competitive pricing that reduced average rental revenue per day. Nevertheless, higher fleet utilization rates, low fleet depreciation costs, and reduced inventory funding costs resulted in record rental industry profits in 2012.

New Vehicle Sales Into Rental Rise by 11% in 2012

The number of new vehicles purchased by rental car companies increased 11% in 2012 to 1.55 million units. This was the highest total since 2007, but still well below the 2.1 million new units sold into rental in 2005 and 2006. Given the shift from program cars to risk units (and a longer average service life for risk vehicles), rental car company purchases of new vehicles will not reach 2 million units a year again anytime soon. In 2012, new vehicle sales into rental were front-loaded into the first half of the year, with sales through June accounting for 60% of full-year purchases.

The Japanese nameplates that had supply disruptions in 2011 as a result of the earthquake and tsunami had the largest year-over-year percentage increases of sales into rental in 2012. Over the past decade, the mix of manufacturers and models comprising the rental fleet has become more representative of new vehicle sales overall.

For individual rental car companies, the shift toward a more diverse fleet was 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 available in the off-rental supply has had several implications for remarketing. 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 and, oftentimes, mostly in one color – white. The wider mix of vehicle models available as off-rental units has, however, required that rental car companies (and their auction partners) work harder to ensure specific vehicles get exposed to the dealers most interested in that particular product.

Risk Units Account for a Growing Share of a Growing Fleet

The total number of vehicles operating in rental fleets increased to 1.857 million units in 2012, according to Auto Rental News. This was just shy of the peak of 1.861 million units operated by rental car companies in 2006. Consistent growth in rental demand has meant that fleet utilization rates have risen in recent years even as the fleet size has grown.

Hertz reports that 86% of its fleet was composed of rental risk units in the third quarter of 2012, up from 70% a year ago and only 31% in 2005. At 60%, Avis/Budget has the smallest share of its fleet composed of risk units; but that percentage is up from only 1% in 2005. Enterprise, Dollar/Thrifty, and most small rental car companies operate fleets that are almost 100% risk units.

Competitive Pricing and Consolidation

In 2011 and 2012, average rental revenue per day trended down, despite industry consolidation and periods of high vehicle utilization rates. According to industry participants, price increases in the rental industry normally stick only when driven by increases in fleet costs – and, recently, fleet costs have been at record low levels. In 2013, fleet costs will likely rise; but pricing power over rental rates might not. Consolidation in the industry should have a marginal impact on pricing, since Hertz will be better able to differentiate its premium and value brands. But, brands such as Fox, U-Save, and Sixt are looking to take some market share from the Big Three (Enterprise, Hertz, and Avis).

Rental

Recon ROI Recognizing the increased importance of reconditioning in today's marketplace, Manheim Consulting studied which units returned the greatest Return on Investment (ROI) per dollar of reconditioning investment. The study found that the greatest return occurs when reconditioning units with a grade of 2.7 to 2.9 such that they achieve a final grade of 3.0 or higher. Manheim analysis indicates that the average cost to increase grade by 0.3 points is less than $150. Additionally, the study revealed the repairs that had the most impact on grade included major body panel repair/replacement, interior repair, windshield repair, bumper cover, and hail damage repair.
Car-Sharing Melds With Traditional Car Rental

Although car-sharing services satisfy a very different set of buyer needs and demands than traditional business and leisure car rental, the major rental car companies have recognized the advantages of entering this market, which is now estimated to be a $400 million business in the U.S. Hertz and Enterprise have separately branded car-sharing services, and in early 2013, Avis made an offer to purchase Zipcar, the world's largest car-sharing network, with more than 770,000 members and approximately 11,000 vehicles. Although small relative to the $24 billion car rental business, car-sharing is believed to have significant growth potential. And car rental companies believe there are synergies to be had through technology-sharing and greater fleet utilization. For example, car-sharing often experiences its peak demand on the weekends, whereas that is a slack time for traditional rentals, especially on-airport rentals.

Strong Used Vehicle Prices Lead to Low Depreciation Costs

Wholesale pricing for rental risk units sold at auction was exceptionally strong throughout the past three years. In 2012, the average auction price of rental risk units sold at auction showed a pattern very similar to 2011 – in other words, record strength. In 2010 and 2011, part, if not most, of the pricing strength could be attributed to low supplies. In 2012, it could not. The availability of off-rental units increased dramatically in the first half of 2012, yet prices remained strong. Attribute that to strong retail demand and, relatedly, the absence of program units that rental risk units used to compete with.

Strong wholesale pricing pushed monthly depreciation costs for rental car companies to very low levels in 2011 and 2012. In 2013, depreciation costs will likely increase as wholesale values level off and rental car companies face higher up-front acquisition costs. Remarketing efficiencies will be key to keeping fleet depreciation costs in check. Interestingly, all three publicly traded rental car companies report very similar monthly fleet depreciation costs, despite having different remarketing strategies and channel usage.

Average Auction Price – Rental Risk Units

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 reasoning is simple – fleet depreciation is a major determinant of company profitability. When it comes to upstream remarketing, the rental car companies have some unique advantages and disadvantages. On the plus side, rental car companies are long-established sellers in the wholesale market; their end-of-service fleet is large, it is concentrated in relatively narrow mileage and price points, and often it needs only modest reconditioning. The disadvantage that rental car companies face in selling upstream is that their time pressures are acute, and they certainly do not want to marshal unproductive units. As such, the companies have been strongly supporting strategies that better enable them to pre-offer units soon after they go into service as rental units.
Rental car companies often have fleets that are so concentrated in a particular geographic area that they surpass the demand of local buyers. In the past, this meant physically moving cars to the buyers. Today, there is greater emphasis using on digital remarketing to bring remote buyers to the cars.

In 2012, 31% of all Manheim auction purchases of rental risk units were made online, up from 22% in 2011. For these online purchases, the average distance between buyer and car was 439 miles, with 43% of the purchasers located more than 500 miles from the vehicle. For in-lane purchasers, the average distance was only 190 miles, with only 17% located more than 500 miles away.

Overall, the member auctions of NAAA remarked 42% of the rental vehicle supply in 2011. With replacement levels expected to rise in 2012 and 2013, the number of off-rental units, albeit with high mileage, will also increase.
New Lease Originations Increase 16% in 2012

The number of new vehicle leases written in 2012 increased to 2.5 million, up from 2.1 million in 2011 and substantially up from 1.1 million in the trough year of 2009. Why this dramatic shift? In recent years, the projected future residual values used in lease contracts have risen to reflect strong past price performance in the wholesale market, more disciplined new vehicle marketing by manufacturers, and better end-of-term remarketing practices. Higher residuals made leasing a more attractive product from both the customer’s and the lessor’s viewpoints. Furthermore, in 2012, as was the case with retail lenders, lessors enjoyed greater access to capital at historically low costs.

Leasing

New Lease Originations

Lease penetration rates for GM, Ford, and Chrysler products have all risen back to double-digit levels after falling to the low single digits in 2009. Hyundai/Kia vehicles have also shown significantly higher lease rates in recent years. This is reflective of product offerings that have moved upscale, greater access to lease funding through their captive finance arm, and a history of strong residual performance. In the luxury segment, lease penetration rates have always been more than twice the level of the overall market.

Lease Penetration Rates by Manufacturer

<table>
<thead>
<tr>
<th>Manufacturer</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chrysler</td>
<td>3.0%</td>
<td>8.5%</td>
<td>12.6%</td>
<td>11.1%</td>
</tr>
<tr>
<td>Ford</td>
<td>5.4%</td>
<td>9.8%</td>
<td>15.3%</td>
<td>16.8%</td>
</tr>
<tr>
<td>GM</td>
<td>2.1%</td>
<td>9.1%</td>
<td>13.3%</td>
<td>14.7%</td>
</tr>
<tr>
<td>Honda</td>
<td>19.1%</td>
<td>29.2%</td>
<td>29.5%</td>
<td>28.5%</td>
</tr>
<tr>
<td>Toyota</td>
<td>15.9%</td>
<td>24.6%</td>
<td>19.4%</td>
<td>18.4%</td>
</tr>
<tr>
<td>Hyundai / Kia</td>
<td>1.9%</td>
<td>10.9%</td>
<td>15.3%</td>
<td>17.3%</td>
</tr>
<tr>
<td>BMW</td>
<td>50.9%</td>
<td>48.4%</td>
<td>46.9%</td>
<td>46.4%</td>
</tr>
<tr>
<td>Mercedes-Benz</td>
<td>46.4%</td>
<td>51.9%</td>
<td>53.8%</td>
<td>54.2%</td>
</tr>
<tr>
<td>Total Industry</td>
<td>13.2%</td>
<td>19.1%</td>
<td>20.1%</td>
<td>20.5%</td>
</tr>
</tbody>
</table>

Source: J.D. Power and Associates
Off-Lease Volumes Set for a Multiyear Rise

As a result of the past pattern in new lease originations, total off-lease volumes hit a cyclical low of only 1.5 million units in 2012, down from an all-time high of nearly 3.5 million units a decade earlier.

It is uncertain as to how many of the off-lease units will make it to auction as opposed to being bought by the grounding dealer or lessee. It is a safe assumption, however, that the share going to auction will be low relative to earlier years. That’s because contract residuals are still in tune with market values and a growing number of captive finance companies have put in place both carrot and stick incentives to encourage grounding dealers to buy end-of-term units. So, as noted last year, the message to dealers is clear: You want to be that grounding dealer.

Lease “Pull-Aheads” Continue To Work Well for Dealers, Lessors, and Customers

With wholesale vehicle values at record levels, dealers and lessors have found it an ideal time to pull customers out of their leases early in order to secure both a new sale and a needed

Projected future residual values used in lease contracts have risen to reflect strong past price performance in the wholesale market, more disciplined new vehicle marketing by manufacturers, and better end-of-term remarketing practices. Higher residuals made leasing a more attractive product from both the customer’s and the lessor’s viewpoints.

Total Off-Lease Volumes

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>New Lease Originations</td>
<td>3.8</td>
<td>3.4</td>
<td>2.9</td>
<td>2.5</td>
<td>2.1</td>
<td>1.7</td>
<td>1.4</td>
<td>1.1</td>
<td>1.0</td>
<td>1.5</td>
<td>2.0</td>
<td>2.5</td>
<td>3.0</td>
<td>3.5</td>
<td>4.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Off-Lease Volumes</td>
<td>3.2</td>
<td>3.0</td>
<td>2.7</td>
<td>2.5</td>
<td>2.3</td>
<td>2.0</td>
<td>1.8</td>
<td>1.6</td>
<td>1.5</td>
<td>1.6</td>
<td>1.7</td>
<td>1.9</td>
<td>2.0</td>
<td>2.1</td>
<td>2.2</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Manheim Consulting
piece of used vehicle inventory. Customers, meanwhile, are pleasantly surprised to find that they can get into a new vehicle for the same, or lower, monthly payment.

As such, we expect the high level of pull-ahead programs and dealer-initiated early terminations to remain strong in 2013. Beyond the lessor's desire to cement customer loyalty and the dealer's desire for quality used vehicle inventory, pull-aheads can help quicken the trade cycle. The economics of monthly payments make 24-month leases a difficult sell, but it is possible to put customers in a 36-month lease and then pull them out after 30 months.

End-of-Term Residuals: From Big Losses to Big Gains

Lease remarketers are accustomed to cyclical swings in their portfolio performance. Recently, they went from large losses on end-of-term units in 2008 to record profits in 2011. And, strong gains on lease returns continued in 2012. There is no aggregated data on the performance of all lease portfolios; but the graphic below, which depicts the results for Ford Credit and Ally leases, is not atypical.

![Ford and Ally End-of-Term Gains](source: SEC filings)

Ironically, these swings in end-of-term gains and losses are often built into the current leasing business model. That’s because “projected” residuals are heavily influenced by history. Thus, the losses incurred in 2008 resulted in overly pessimistic residual forecasts for vehicles put out on lease that year. And, when those vehicles came back to market in 2011, wholesale pricing was at an all-time high. Swings between gains and losses are also amplified by the fact that lease return rates are strongly and inversely correlated to used vehicle values. When wholesale prices were at their low in 2008, lease return rates were often well above 80%. As wholesale values reached new highs in 2011 and 2012, return rates fell to 50% or less.

Data from Ford Credit shows that the spread between actual contract residuals and projected ALG residuals has declined somewhat in recent years, but remained relatively constant prior to that. This proves that in the last cycle, the swing

---

Nissan Grounding

In 2010, Manheim partnered with Nissan to launch an enhanced lease-termination and vehicle grounding platform. The initial deployment included solutions to capture signatures electronically and to enable electronic funds transfer, as well as dedicated customer care support. 2012 brought further enhancements, including a Manheim-developed application called RPM Mobile which allows all Nissan and Infiniti U.S. dealerships to complete a lease return using a mobile phone or tablet. The employee simply scans the Vehicle Identification Number and pulls the customer’s information onto the screen. The customer confirms information on the screen and electronically signs a return receipt, which is immediately imported into Nissan’s lease return systems. Dealers can also use the app to sell the car back to the customer if desired.

---

2013 Used Car Market Report
between end-of-term losses and end-of-term profits was the result of market forces and inaccurate residual forecasts. It was not the result of changes in the level of subvention.

Off-Lease Remarketing Continues To Shift Online and Upstream

All captive finance companies, as well as the major independents, have at least one Internet upstream platform that offers end-of-term vehicles to an ever-widening audience of dealers prior to sale at physical auction. The technology, platforms, and tools available for electronic remarketing of off-lease vehicles have improved significantly in recent years.

Securities and Exchange Commission filings show that GMAC’s Internet sales of off-lease vehicles first exceeded sales at physical auctions in 2007. In 2011, the ratio was almost four Internet sales for every one sold at auction. Likewise, sales on Toyota Dealer Direct accounted for 63% of all Toyota off-lease sales in the fiscal year ending March 31, 2012. Most of those sales were to the grounding dealer.

Given that demand for off-lease units continues to grow at the same time that potential supply remains low, the share of sales accounted for by online and upstream channels will surely increase further. In addition, captive finance companies will continue to improve the processes that enable them to protect residual values, enhance brand image, and provide profit opportunities for their dealer networks.

When leasing is done right, it is a financial product that offers benefits to consumers, dealers, manufacturers, and lessors. In recent years, leasing, for the most part, has been done right. It was targeted to customers with good credit who like to trade on a regular cycle, and projected residuals were not overly inflated.
Auto Lenders Enjoy Greater Access to Funds

The increased availability of retail financing was the major force behind the rise in new and used vehicle sales, strong wholesale pricing, and growing dealership profits in 2012, and in that sense it was the story of the year. Auto lenders had tremendous access to funds as the auto-backed securitization market attracted investors in search of any sort of yield in a near-zero interest rate environment. In total, more than $90 billion in auto-backed securitizations were sold in 2012, up from $68 billion in 2011 and only $36 billion in 2008. By issuing short-term notes, auto-backed securitizations attracted monies from money market funds and corporations with cash-heavy balance sheets. Google, for example, shifted part of its $40 billion cash hoard out of Treasuries and into securitization deals from Honda and Hyundai. Similarly, private equity bought into existing, or helped establish new, lenders in the subprime auto lending arena.

In addition to increased issuance, auto ABS funding in 2012 came at reasonable terms, and spreads that reflected the overall strong performance of these instruments, even in times of recession. That superior performance is the result of overcollateralization, strict reserve requirements, and a term structure that is consistent with the underlying capital. In addition, the indirect lending model, in which the vast majority of these loans were originated, incorporates a strong professional, and mutually beneficial, relationship between the dealership F&I office and the underwriting lender.

Auto Lending Trends in 2012: Higher Lender Concentration, Lower Credit Scores, and Lower Credit Risk

Lender concentration in loan originations is much greater in the new vehicle market than it is for used vehicles. The top five lenders accounted for 40% of all new vehicle loans in the third quarter of 2012, according to Experian. The top five used vehicle lenders, on the other hand, accounted for only 21% of the loans
Repossessions

in that segment. Likewise, research by Experian has documented the importance of Buy-Here, Pay-Here (BHPH) financing in the used vehicle market. In the third quarter of 2012, BHPH financing represented 14.3% of all the loans made in the used vehicle market.

Experian data also confirms that the lengthening of used vehicle loan terms continues. In the third quarter of 2012, the average loan term on a used vehicle was 60 months – not substantially different from the average term of 64 months on a new vehicle. Loans of three years or less represented only 10% of the used vehicle finance market.

Although all types of lenders were buying deeper and broader, the changing nature of borrowers and the true makeup of credit scores continued to keep auto loan delinquencies exceptionally low. Households increased the priority they placed on making auto payments relative to other monthly obligations. In addition, the very nature of the Great Recession created many households with significantly lower credit scores, but with the ability to make future monthly payments. For example, through a record number of home foreclosures and short sales, homeowners walked away from almost $1 trillion in mortgage debt over the past three years. Many of those households did not suffer a significant, if any, loss of income. So, in 2012, they were borrowers with lower credit scores, but better payment-to-income ratios. As such, one should expect the delinquency rates to be lower than simple credit scores would suggest. And they have been.

**Repossession Volumes Will Grow Modestly in 2013**

In 2012, repossession volumes were virtually unchanged from the prior year. The number of vehicles repossessed is a function of the number of contracts outstanding, their aging, and their static pool loss performance. Those forces combined to produce a record number of repossessions in 2009, and then a steep decline in both 2010 and 2011. The peak-to-trough swing was from an
estimated 1.9 million units in 2009 to 1.3 million in 2011, for a decline of 32%.

Given the recent growth in originations and an easing in lending standards, repossession volumes will likely grow in future years. But, as noted earlier, households have increased the priority that they associate with making their monthly car payments, and as such, delinquencies and default rates will be lower than they otherwise would be for any given set of economic circumstances. In addition, the strength in wholesale used vehicle pricing (a condition which we think will persist for some time) has meant more borrowers have positive (or only slightly negative) equity in their vehicle loans and, thus, are less likely to default. These two factors, which substantially reduced repossession rates in 2009 and 2010, will keep repossession volumes from returning to their 2009 peak anytime soon.

**Repossession Remarketing Struggles To Move Substantial Volume Upstream and Online**

Lenders are always focused on converting repossessed units into cash as quickly as possible. Although the biggest stumbling block to a quick sale often lies outside the control of the lender or auction (such as state laws that dictate the process of collateral collection and liquidation), auctions and lenders have been successful in streamlining the processes that they do control. Still, there are several hurdles to overcome when remarketing repo units upstream. The most critical factor is to ensure that units are listed on a platform that aggregates a large buyer base and is governed by transparent policies that protect both buyer and seller. First, units must be quickly inspected, usually by a third party, for posting online. The condition report is critical to help online buyers assess the condition of the repossessed unit and make a smarter buying decision.
Understandably, third-party inspection companies can struggle to staff inspectors at many repo satellite locations due to the unpredictability of recurring volume. This creates an artificial delay in the upstream listing and posting process, which in turn, can contribute to a higher propensity of the repossessed unit incurring additional lot damage while waiting on an inspection. The cost of timely and accurate inspections continues to erode margins for both dedicated repo remarketers and third-party remarketing companies. Emerging seller-initiated mobile listing applications such as Manheim’s myMobileListing tool, may ease this burden in the coming months.

Additional process challenges occur when selling units upstream, as many repossession agent locations are not staffed to support vehicle pickup and release functions. Many of these facilities are not designed to facilitate post-sale transactional processes, including vehicle pickup. Many repossession lenders have adopted a hybrid approach, listing units for sale while in transit to a physical auction location, or using a midstream listing approach where repo units are posted for sale in recurring online event sales prior to running in a physical lane. This strategy has proved to be very successful for many dedicated repossession companies, third-party remarketers, and larger institutional lenders.

Finally, it should be considered that repossessed units are typically remarketed with no reconditioning; they are often purchased by wholesalers who do some cosmetic work and then re-wholesale the unit. This arbitrage should not be looked at as a lost opportunity by the remarketing lender, but rather as the wholesale market efficiently getting vehicles to dealers in the condition they desire.
New Vehicle Sales Into Fleet Increase 7%

With an increase of 7%, new vehicle sales into commercial fleets rose for the third consecutive year in 2012. At just under 570,000 units sold, the total was one of the best years ever, save the boom times of 2005 to 2007 when commercial fleets purchased, on average, more than 700,000 new vehicles per year. Government fleet purchases rose a more modest 2% in 2012, but that was after falling in each of the four prior years as state and local budget constraints restrained purchases. Sales of medium and heavy-duty trucks, most of which are, for all intents and purposes, fleet transactions, rose to 736,500 units in 2012, an increase of 9% from 2011.

Fleets Continue To Become More Fuel-Efficient

Unlike the rental industry, which has greatly broadened the manufacturer mix within its fleet, commercial and government fleet purchases remain dominated by domestic nameplates. Although Ford is, far and away, the largest seller into commercial fleet, Chrysler achieved a strong gain – more than 20% – in commercial fleet sales in 2012 as fleet managers became more confident in the manufacturer’s finances and the future residual value of its products.

Most notably, in 2012, fleet operators continued to shift their purchases toward fuel-efficient models, and within those models, they often selected the most fuel-efficient options. In fact, commercial fleets have been at the forefront of helping to increase the fuel efficiency of the total U.S. fleet. While corporate environmental sustainability goals often forced managers to acquire alternative-fuel and hybrid vehicles, fleet managers have also worked hard to determine, and place in service, the most fuel-efficient vehicles for each individual task.

Their choices not only significantly reduced annual operating fuel expenses, but also supported residual values. In 2012, fuel
Fleets

efficiency still commanded a premium in the wholesale market. Although gasoline prices in 2012 never hit the peak reached in 2011, on an annual average basis gasoline prices in 2012 were the highest ever.

Mileage on End-of-Service Units Increased in 2012

During the recession, corporate fleet managers operating on tighter budgets were forced to extend the service life of vehicles in their fleets. Now, as the economy has improved somewhat, fleet managers can take a more analytical and unbiased look at the optimal hold period for each vehicle in the fleet. As vehicle quality has increased and routine service cycles have lengthened, the trend has been to extend average service life. In 2012, however, some fleets took the opportunity of record-high wholesale prices to cycle out early.

For midsize end-of-service fleet cars remarketed at auction, average mileage increased to slightly more than 75,000 miles in 2012 after averaging about 65,000 over the past decade. The average mileage on end-of-service fullsize pickups rose back above 110,000 miles in 2012, after being pulled down in recent years as some fleets de-fleeted early in the recession (no more need for the vehicle) and others cycled out early as manufacturers offered attractive incentives for new purchases.
End-of-Service Resale Values Reach Record Highs

Even with end-of-service vehicles hitting the wholesale market in 2012 with higher mileage, fleet managers enjoyed record high prices for these units. That was true whether the vehicle was a basic midsize sedan, specially equipped pickup, or alternative-fuel vehicle. The strongest pricing (and the segment easiest to show a consistent time series) was for midsize passenger cars, where, over the course of eight years, the mileage-adjusted price rose more than 70%.

The recent accelerated run-up in wholesale pricing for end-of-service fleet vehicles is attributable to two special factors. First, the bulk of vehicles being remarketed by fleet managers falls into what has been the strongest segment of the wholesale market – vehicles priced between $8,000 and $11,000. Second, and related, the significant increase in the availability of subprime financing has spurred the subsequent retail sale of these units and, thus, stoked dealer demand for them.

Source: Manheim Consulting

### Top 10 Fleet Management Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Vehicles Funded &amp; Managed</th>
</tr>
</thead>
<tbody>
<tr>
<td>GE Capital Fleet Services</td>
<td>755,180</td>
</tr>
<tr>
<td>ARI</td>
<td>665,000</td>
</tr>
<tr>
<td>PHH Arval</td>
<td>493,000</td>
</tr>
<tr>
<td>Donlen</td>
<td>492,000</td>
</tr>
<tr>
<td>LeasePlan</td>
<td>385,000</td>
</tr>
<tr>
<td>Wheels</td>
<td>295,000</td>
</tr>
<tr>
<td>Enterprise</td>
<td>273,046</td>
</tr>
<tr>
<td>Emkay</td>
<td>84,250</td>
</tr>
<tr>
<td>Mike Albert</td>
<td>38,735</td>
</tr>
<tr>
<td>Merchants Leasing</td>
<td>32,183</td>
</tr>
<tr>
<td>Total</td>
<td>3,513,394</td>
</tr>
</tbody>
</table>

Source: Automotive Fleet

### Funded and Managed Vehicles – Top 10 Lessors

<table>
<thead>
<tr>
<th>Year</th>
<th>Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>2.6</td>
</tr>
<tr>
<td>2009</td>
<td>2.7</td>
</tr>
<tr>
<td>2010</td>
<td>2.9</td>
</tr>
<tr>
<td>2011</td>
<td>3.1</td>
</tr>
<tr>
<td>2012</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Source: Automotive Fleet
Salvage Auctions Survive Shortages, Look To Grow in 2013

In recent years, salvage auctions have faced marketplace conditions similar to those of whole-car auctions: namely, tight supplies, strong demand, and higher prices. Thus, buyers of total-loss units have had to work harder to find units that are competitively priced and allow enough margin to turn a reasonable profit.

This situation is expected to continue in 2013. The salvage industry continues to feel the impact of the 2009 cash-for-clunkers program, where more than 750,000 units were removed from service – most of them prematurely. Recently, however, there has been a widening gap between the number of new vehicles sold and the number scrapped. The fallout from Hurricane Sandy will put between 250,000 and 350,000 vehicles into the salvage market in the Northeast in 2013, mostly in the first three or four months of the year. In addition, the large number of very old vehicles on the road is setting up a situation for an accelerating scrappage rate.

Age of Total-Loss Vehicles Continues To Rise

In last year’s UCMR, we noted that in 2011 the average age of total-loss units increased in every high-volume vehicle segment. The same trend continued in 2012, as the average age for total-loss units reached a three-year high in all high-volume segments with the exception of hatchback units, which reached their three-year peak of 9.66 years in the third quarter of 2010. Actual cash values (ACV) softened a bit from their high-water-mark in 2011. ACV softening was noted in the SUV and wagon segment, and a smaller decline occurred in the van segment. Some ACVs rose again in 2012 with the most notable gain in the coupe segment.

DID YOU KNOW?

Manheim’s ExportTrader shipped vehicles to 185 COUNTRIES

Buyers from Middle East and Europe prefer late-model, luxury vehicles.

Buyers from Mexico prefer affordable non-luxury units.
Salvage

Salvage Auctions Remarket More Clean-Titled Vehicles

The trend of charitable, subprime reposition, and lightly damaged rental fleet units being sold within traditional salvage auctions continued in 2012. This can be explained by the increased co-location of salvage sales within traditional auction sites. As buyers of whole-car units gain exposure and familiarity with these vehicles, their comfort and interest levels rise, which ultimately leads to more robust bidding. As mentioned in earlier sections, franchised dealers kept more trades for their retail needs, increasing the need for independent dealers to source more inventory from auctions. If whole-car auctions failed to satisfy all their demand, dealers quickly turned to salvage auctions to fulfill their immediate needs.

Buyer Base for Salvage Vehicles Broadens

Though buying dealers continued to focus primarily on clean-titled units, they have become increasingly comfortable purchasing salvage-titled units. As a result, they are increasingly competing against recyclers and rebuilders – the traditional buyers of salvage units. Units will typically receive a salvage title when repair costs exceed 75% of the vehicle’s actual cash value; however, there are notable exceptions. Units that are stolen or are excessively old with higher mileage can receive a salvage-titled brand, even though they are very operable. Near-term historically high demand has made these units very attractive to wholesale buyers.

Foreign Buyers Compete for Late-Model Repairable Units

The trend of international buyers sourcing inventory from salvage auctions continued in 2012, driven primarily by the increased adoption of digital sales-platforms abroad. Indeed, Manheim’s ExportTrader saw its volume increase 36%, and now

Salvage buyers have become increasingly dependent on technology to buy, sell, and manage inventory. Multiple purchasing options exist, including real-time sequential bidding via Simulcast, 24/7 bidding, buy-now sales via OVE.com, and new mobile bidding technology that allows buyers to place proxy and live bids in both Simulcast and OVE.com sales.
Salvage

Salvage auctions remain one of the most varied marketplaces within automotive remarketing. These facilities remarket many different products, from theft recoveries to late-model rental units to vehicles with a catastrophic loss. At Manheim’s TRA auctions, prices declined by just over 3% from the highs seen in 2011; however, total units sold increased more than 11% in 2012. Similar to previous years, values are affected by the ultimate disposition of the unit. Some intend to part out the vehicle and sell the remaining recyclable components for scrap, while others will invest in repairs and will ultimately resell the unit to a retail buyer.

Global commodity prices thus heavily influence the value of crushed auto bodies. In 2012, we finally saw a break in the nearly three-year run of increasing prices. In fact, scrappage prices for crushed auto bodies hit a two-year low in August 2012, for a year-over-year drop of nearly 30%. This sharp decline was brought about by reduced demand and an increase of foreign steel exports. The surge of foreign exports was driven by decreased domestic demand in China, Turkey, South Korea, Taiwan, and Japan. As higher exports brought more low-priced steel into the marketplace, prices for scrap steel and crushed auto bodies fell. However, steel demand began to increase in the fourth quarter of last year, allowing scrappage prices to rebound and end the year nearly where they started.
A Unique Resource for the Remarketing Industry

Manheim, the leading wholesale vehicle auction and remarketing company in North America, formally established Manheim Consulting in 2005 as a separate research unit. Manheim recognized an opportunity for commercial consignors and dealers to develop remarketing strategies around data-driven research. Wholesale vehicle transactions through all Manheim channels comprise a historic and real-time database that permits clients to examine any aspect of their remarketing strategy.

For nearly a decade, Manheim Consulting statisticians, mathematicians, and consultants have conducted research and performance studies for Manheim clients, while providing a broader perspective on the industry at large for those who follow the automotive sector. Using the data generated from every vehicle listing, every visit to a live or digital auction, every bid, and every outcome, our team helps clients execute effective remarketing strategies as technology, market conditions, and buyer and seller expectations change.

Clients have examined seasonal, regional, and national pricing behavior for their vehicle portfolios in addition to more granular questions related to the value of specific vehicle features, condition, setting reserve prices, and impact of channel selection. Manheim Consulting provides periodic performance reviews for customers and conducts one-of-a-kind research tailored to specific client objectives.

Our services include:

- Proprietary client research, including remarketing performance studies for dealers;
- Client and industry presentations on economic and used vehicle industry conditions; and
- Case studies and white papers on topics important to remarketing and automotive professionals.

Manheim’s annual Used Car Market Report examines the economic underpinnings of the entire used vehicle market and sector-specific trends that influence the supply and pricing of used vehicles. The Manheim Used Vehicle Value Index is the most reliable and widely followed indicator of wholesale used vehicle values. The Index is updated on the fifth business day of each month. Additionally, in January, April, July, and October, Manheim’s chief economist, Tom Webb, hosts a conference call during which he responds to participant questions and provides supplemental data on the used vehicle marketplace.

For more information on these and other services provided by Manheim Consulting, visit manheim.com/consulting.