BLUE BOOK MARKET REPORT

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Analysis from Kelley Blue Book's Analytic Insights Team

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IN THIS ISSUE:

Kelley Blue Book Public Relations Contacts:

ROBYN ECKARD
Director, Public Relations
949.268.3049
reckard@kbb.com

JOANNA PINKHAM
Senior Public Relations Manager
949.268.3079
jpinkham@kbb.com

BRENNA ROBINSON
Public Relations Mgr
949.267.4781
berobinson@kbb.com

REBEKAH KING
Consumer Communications Mgr
949.267.4982
rking@kbb.com

MARKET ANALYSIS

Toyota Recall Could Benefit Competing Vehicles

- Juan Flores, director of vehicle valuation, Kelley Blue Book

Quality and reliability are two words that come to mind when describing a typical Toyota vehicle. These traits have defined Toyota over the past several decades and have helped Toyota become one of the most trusted and well-respected automakers in the world. Unfortunately, Toyota's latest recall has the potential to erode their reputation for producing reliable vehicles, ultimately, leading to the possible devaluation of many of their most popular models. While it may be too early to determine the long-term impact, Kelley Blue Book is dropping recalled Toyota models by 1 to 3 percent this week.

Depending on the response time of Toyota to rectify this gas pedal situation with both the Department of Transportation and the public, there may be further devaluation ahead. With production shut down, sales halted, and rental car companies pulling affected vehicles from their fleets, Toyota's usually rock-solid reputation for quality has taken a hit in the minds of consumers. The potential demand lost as a result of these actions becomes more and more difficult to recover with each passing day. In addition to a drop in consumer demand for Toyota, there is a growing supply of used Toyota vehicles that could put further downward pressure on values. As leases come due and used Toyotas are returned to the manufacturer, the inability of dealerships to either sell or remarket these vehicles could add to an increase in overall supply of used Toyotas. Additionally, as manufacturers such as GM, Chrysler, Ford, and Hyundai continue offering additional conquest trade-in credit for used Toyotas, the supply of unsellable used Toyotas will continue to grow. A growing inventory of used Toyota vehicles, coupled with a reduction in demand, however slight, only leads to the potential for further devaluation. If a swift resolution is not implemented within the first few weeks, we expect to see a cumulative depreciation between 4 to 5 percent by the time this issue concludes, especially as the glut of inventory continues to build.

As Toyota's perceived quality continues to take a hit, there may be a substitution effect, in that in-market consumers previously considering a vehicle from Toyota begin to look for alternatives. This shift in demand could potentially lead to appreciation in vehicles that directly compete with the vehicles affected by Toyota's recall. Additionally, as rental-car companies adjust their fleets to account for their loss of Toyota inventory, vehicles that were to be sold at auction are being put back into service, reducing the supply of vehicles that directly compete with Toyota's recalled vehicles. While this reduction to the supply of used vehicles may be slight, Kelley Blue Book expects that an increase in the demand for Toyota alternatives coupled with the aforementioned supply reduction could possibly push used-car values upward, again, most noticeably on models that directly compete with recalled Toyota vehicles. **Continued on Page 2.**

MARKET ANALYSIS CONTINUED

Full-Size and Mid-Size SUV Value Strength Continues into the New Year

In January, values for most segments dropped slightly as dealers reentered the marketplace following a typical fourth-quarter lull in demand. As dealers begin to ramp-up inventory in anticipation of the spring selling season, they have increased overall demand, while strengthening values in a handful of segments in the process. On average, values depreciated 1.7 percent for the month, although many segments are showing signs of improvement year-over-year. Overall, retained values for one- to three- year-old used vehicles are currently up 2.4 percentage points year-over-year, based on a comparison of average auction value as a percentage of MSRP. Gas prices have played a significant role in the year-over-year performance of many segments, as evidenced by the segments that outperformed and underperformed the overall market average. Full-size and mid-size SUVs were two of the best performing segments year-over-year, showing improvements of 11.3 and 9 points, respectively. On the opposite end of the spectrum, values for subcompact and hybrid cars are down 8.2 and 7 points, respectively. The disparity between these segments can be attributed to their sensitivity to fluctuations in the price of gasoline.

First Quarter Outlook for Fuel-Sensitive Vehicles

While values either dropped slightly or remained flat for many segments in January, there were signs of improvement as values for popular late-model vehicles started to firm up in a handful of segments. Specifically, values for full-size trucks and full-size SUVs improved, up 0.1 percent and 0.8 percent, respectively. Although these segments have strengthened through the month of January, steadily increasing gasoline prices may begin to bring these values back down. In fact, Kelley Blue Book's own forecast indicates that values for full-size trucks and full-size SUVs will end the first quarter down 2.2 percent and 3.6 percent, respectively. Conversely, we expect a 3.3 percent improvement in the values for compact cars, offsetting the depreciation that has occurred over the past few months. Values for compact cars only dropped 1.6 percent in January, perhaps signaling the beginning of a turnaround. The rising price of gasoline and cost conscious consumers may prove to play significant roles in the strengthening of this segment. As the cost of fuel continues to rise, we could see values for compact cars improve as values for full-size trucks and SUVs soften.

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