

BLUE BOOK Market Report

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Automotive Insights from Kelley Blue Book

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NEW-CAR MARKET ANALYSIS:

New-Car Sales to Reach 14.4 Million Units in 2012; Consumers Driven by Need, Not Want

- Alec Gutierrez, senior market analyst, automotive insights, Kelley Blue Book

Sales in Q3 2012 improved 13.8 percent year-over-year, falling short of the 16 percent growth rate maintained through the second quarter. For September, industry sales increased by 12.8 percent, continuing the slow growth that began in July. The year-over-year growth rate decline is not unexpected, since it was this time last year that Toyota and Honda returned to full production after months of slow sales resulting from the effects of the tsunami. Kelley Blue Book expects sales to continue on a steady course through year-end, reaching 14.4 million units overall in 2012. This would mark an 11 percent improvement from 2011 and the third consecutive year of double-digit growth. This robust recovery comes on the heels of a 27-year low in industry sales that hit in 2009, when sales were a paltry 10.5 million units following the housing bust.

Since the economy hit bottom in 2009, consumers have been far more cautious with their budgets and have been delaying large purchases until absolutely necessary. As a result, a majority of consumers in the market for a new vehicle today are shopping to satisfy a need rather than a want. In fact, according to the Q2 KBB.com Consumer Sentiment survey from Kelley Blue Book Market Intelligence, approximately 68 percent of all respondents indicated that they were purchasing a vehicle to satisfy a need when asked why they were car shopping. Nearly 29 percent of all respondents indicated that their current vehicle had high mileage, while 19 percent were seeking a vehicle with better fuel economy. Only 13 percent said they enjoy driving a new vehicle every few years, in comparison to a scant 3 percent looking for a recreational or fun car.

While needs-based buyers will continue to drive sales growth, low interest rates, generous discounts and strong product redesigns also have played a significant role in the industry rebound. As consumers remain cautious with their purchases, sales growth will continue to come at a slow and steady pace as replacement demand continues to drive industry growth.

Sales to Surpass 15 Million Units in 2013

In 2013, Kelley Blue Book expects sales to surpass 15 million units overall, driven by replacement demand, low interest rates, and compelling product redesigns and introductions. These factors have kept vehicle sales moving forward despite powerful economic headwinds, and Kelley Blue Book analysts believe demand will remain strong enough to drive sales further along. Although the economy is expected to continue to grow slowly in 2013, there is plenty of evidence to support another strong year of auto sales. Below analysts have highlighted some of the key factors believed to play a large role in industry sales growth in 2013.

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Economic Conditions Continue Modest Improvement

The Conference Board's Consumer Confidence Index remains low from a historical perspective at 70.3, despite the 9 percentage point bump in September. Unemployment dropped to 7.8 percent in September and remains only 3 million jobs shy of the peak employment level of 146 million from 2006. These critical indicators are highly correlated to vehicle sales, and previous analysis has demonstrated consumer confidence needs to be above 100 with an unemployment rate well below 7 percent to support sales of 16 million units or more. Although economic conditions remain less than favorable, they are trending in the right direction and Kelley Blue Book believes consumer demand will remain sufficient to maintain the industry's forward momentum, despite a still-slow economic recovery.

Replacement Demand Remains Strong

With vehicles on the road today being 11-years-old on average, there will be plenty of consumers needing to trade-up to something new to replace a vehicle on its last legs. Further increasing demand will be a slew of buyers that are expected to reach the end of their lease contract in 2013. Kelley Blue Book expects anywhere from 300,000 to 500,000 additional buyers to enter the market in 2013, thanks to the rebound in leasing that began in 2010. Approximately 600,000 more vehicles were leased in 2010 compared to 2009 (when leasing nearly disappeared). Since the bulk of leases are written for two- or three-year terms, there should be a significant jump in consumers exiting their lease who likely will be in the market for a new vehicle.

Credit Conditions to Favor Consumers in 2013

Low interest rates also play a significant role in the current sales recovery, and according to the Federal Reserve's most recent Federal Open Market Committee statement earlier this month, the industry should expect interest rates to remain near zero through at least the middle of 2015. Not only are interest rates low, but banks also have been loosening lending standards. According to Experian's Q2 State of the Automotive Finance Market webinar, the average FICO score for a new-vehicle loan has declined from 774 to 753 since 2009 when financing all but dried up at the height of the recession.¹ Even subprime borrowers have re-entered the market. According to the same Experian data, subprime borrowers as a percentage of total car buyers have increased by 14 percent year-over-year, giving a strong indication that credit will remain widely available to those who need it.²

It's All About the Product

The industry has gone through a near complete rebirth during the past several years, with nearly every product category shaken up from top to bottom. Last year there was a complete rehash of the compact sedan and crossover segments, while this year the mid-size category has gone through its own renaissance. Next year Kelley Blue Book expects major redesigns in the full-size truck and sport utility categories. The redesigns that have come to market during the past several years have pushed the envelope in terms of style, amenities offered, and most importantly, fuel economy. Almost every subcompact and compact sedan is available with nearly 40 mpg on the highway, while mid-size sedans and small crossovers aren't far behind. The stellar product available today will continue to drive buyers to dealerships in 2013.

Demographic Trends Healthy, but Point to Continued Slow Growth

From a macro perspective, there is little evidence to support a sharp increase in sales in 2013. The number of vehicles currently registered in the United States to licensed drivers is a healthy 1.13, indicating that there is more than one vehicle registered for every person that currently holds a driver's license. The ratio of vehicles to total households also is impressive at 2.02 vehicles per household. While certainly below their respective peaks of 1.18 and 2.1 at the height of the real estate bubble, there is little indication of a shortage of vehicles per driver or household. While the demographics don't necessarily point to a sharp jump in 2013, there is nothing to indicate that sales won't at least hit 15 million units next year.

Mid-Size Car Discounts Driving Sales Volume

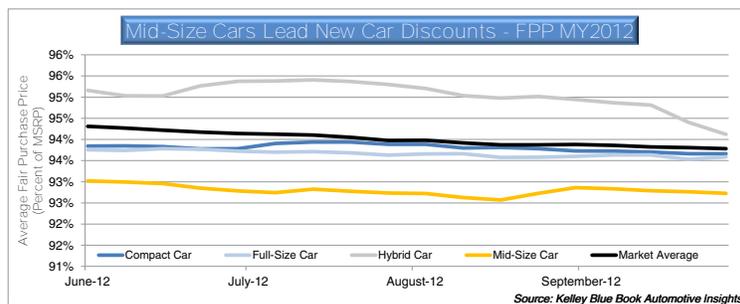
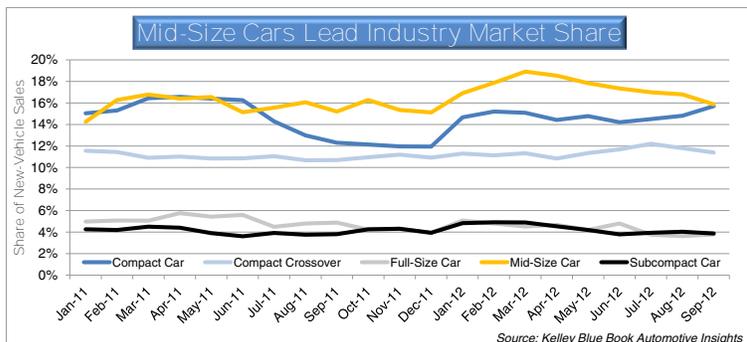
Mid-size cars remained atop the sales charts in September, maintaining 15.9 percent market share. Sales in the segment are up more than 26 percent year-over-year through the first nine months of 2012. Compared to 2007, widely considered the last 'normal' year of sales, mid-size car sales have improved by 8.6 percent, which is an impressive feat considering overall industry sales are currently 12 percent lower than sales volume in 2007. The robust sales growth taking place this year in the mid-size segment can be attributed to two factors.

First, consumers will find the most significant discounts on mid-size cars before considering incentives. Model-year 2012 mid-size cars sell for 92 percent of manufacturer's suggested retail price (MSRP) on average, according to Kelley Blue Book's Fair Purchase Price, which is indicative of what consumers can expect to pay for a new vehicle today based on transactions collected from across the United States. Through much of this year, the mid-size segment has provided consumers with some of the best discounts among non-luxury cars. The average mid-size sedan typically sells for two percentage points below the industry average sale price of 94 percent of MSRP. Beyond the standard discount measured by Kelley Blue Book's Fair Purchase Price, consumers also will find attractive lease offers advertised at \$250 per month and lower, as well as generous cash incentives, especially on remaining 2012 models that were redesigned for 2013.

¹ Experian, *State of the Automotive Finance Market, Second Quarter 2012*

² Experian, *State of the Automotive Finance Market, Second Quarter 2012*

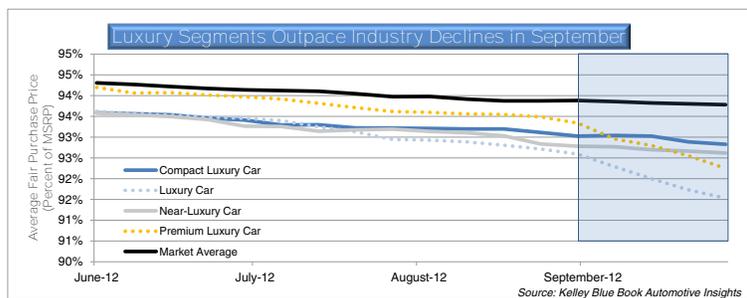
Secondly, and perhaps most importantly, the mid-size segment has seen more complete redesigns than any other segment during the past several model years. This year we saw an all-new Toyota Camry, Nissan Altima, Ford Fusion, Honda Accord and Chevrolet Malibu. This is in addition to the game-changing redesigned Hyundai Sonata and Kia Optima, which were launched last year. The latest redesigns in the segment have upped their game significantly when it comes to style, performance and fuel economy. The average mid-size sedan now offers fuel economy nearly comparable to the best subcompact and compact sedans in the industry. The Altima leads the segment with 38 mpg highway, while the others aren't far behind.



New Luxury Vehicle Prices Lead Market Declines in September

New-vehicle transaction prices were flat in September, declining a scant 0.1 percent overall. Although the market was relatively stable, the average Fair Purchase Price for the luxury segment declined by more than 1 percent. The decline in luxury vehicles likely is due to the model-year change-over which is occurring now. As of October 1, approximately 60 percent of all luxury vehicles on dealers' lots were 2013 model-year vehicles. This is well above the industry average of 42 percent. As the 2013 models continue to arrive, Kelley Blue Book expects pricing to continue to soften.

The biggest drops in the segment were among the Jaguar XJ, Acura RL, Mercedes-Benz S-Class and BMW 7 Series. Each of these models declined by more than \$1,000 through the month, as dealers began slashing prices in order to move product in anticipation of newly arriving 2013 models. The RL in particular has required significant discounts to maintain its modest sales volume of 30 to 40 units per month. A 2012 RL currently is available at less than 90 percent of MSRP, well below the average of 92 to 93 percent of MSRP maintained by the rest of the luxury segment. The RL is expected to be replaced for the 2013 model year by the new RLX concept that debuted at the New York International Auto Show. The Audi A6 has been among the best performers in the segment, maintaining 94.5 percent of original MSRP and a steady selling price throughout the month of September. The A6 had its best sales month in September, as consumers scooped up more than 2,000 units.



Brand	New-Car Inventory by Model Year				Model Year Distribution		
	2011	2012	2013	Total	2011	2012	2013
Acura	234	19,164	14,646	34,044	0.7%	56.3%	43.0%
Audi	79	4,048	12,830	16,957	0.5%	23.9%	75.7%
BMW	1,283	9,860	27,261	38,404	3.3%	25.7%	71.0%
Cadillac	562	19,721	18,701	38,984	1.4%	50.6%	48.0%
Infiniti	178	8,918	9,856	18,952	0.9%	47.1%	52.0%
Jaguar	68	2,004	264	2,336	2.9%	85.8%	11.3%
Land Rover	132	4,573	1,758	6,463	2.0%	70.8%	27.2%
Lexus	362	10,913	17,992	29,267	1.2%	37.3%	61.5%
Mercedes-Benz	545	10,483	30,263	41,291	1.3%	25.4%	73.3%
Volvo	192	4,175	11,652	16,019	1.2%	26.1%	72.7%
Luxury Total	3,635	93,859	145,223	242,717	1.5%	38.7%	59.8%
Industry Total	29,751	1,228,141	924,946	2,182,838	1.4%	56.3%	42.4%

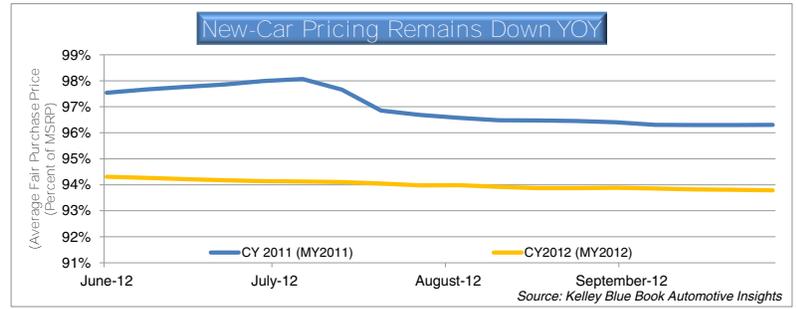
Source: AutoTrader.com New-Car Inventory as of 9/27/2012

New-Car Pricing Expected to Remain Affordable in 2013

A significant driver of the new-vehicle sales recovery has been the availability of affordable pricing and financing options for most vehicles. The average brand-new model-year 2013 vehicle is currently retailing for approximately 94 percent of original MSRP before incentives or other promotions, and as low as 92 percent of original MSRP for the popular mid-size segment. Inventory remains sufficient for most brands and models, keeping pricing steady and affordable, while there also are generous incentives available for a handful of highly competitive segments such as mid-size cars and full-size pickup trucks.

Kelley Blue Book expects pricing to remain relatively flat through the rest of 2012 and likely into 2013. New cars are transacting approximately 3 percentage points below the levels at this time last year, likely due to high prices related to inventory shortages as well as record-high used-car values at this time last year. With the expectation that used-car values will continue to ease in 2013 as supply improves at auction, this could open the door to further price declines on new cars.

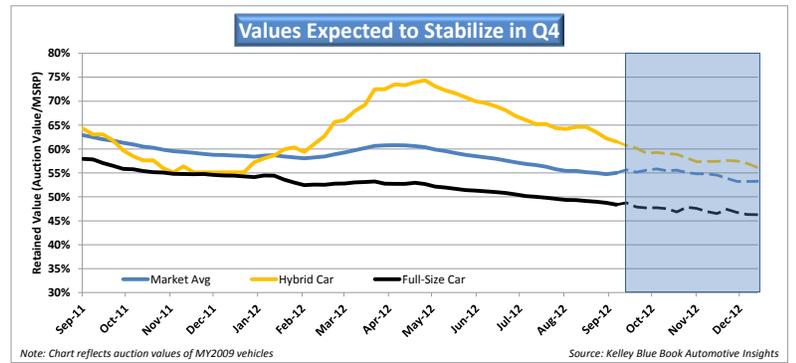
While Kelley Blue Book's outlook calls for price stability in 2013, as we begin to look further down the road, it appears as though new-vehicle prices will increase. As the dollar continues to weaken relative to the Yen and Yuan, prices could increase as manufacturers are forced to pay more for components sourced from Japan and China. Rising Corporate Average Fuel Economy (CAFE) standards (expected to hit 54.5 mpg by 2025) also will drive vehicle prices up, as carmakers invest in new technologies and lightweight materials to drive and improve fuel economy. These price increases will play themselves out during the course of the next several years. In the meantime, prices will remain stable and affordable for most consumers.



USED-CAR MARKET ANALYSIS:

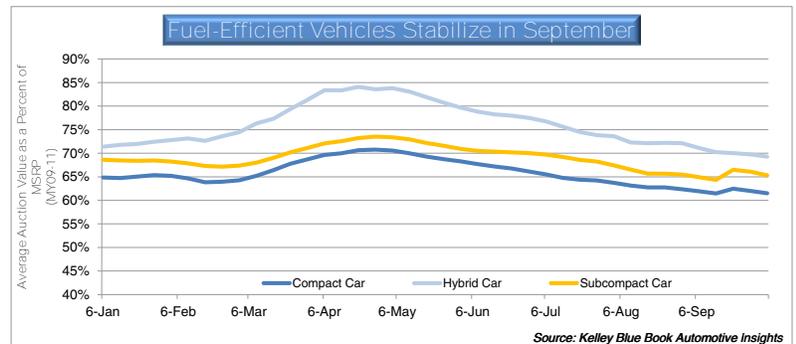
Used-Car Values Continue to Ease

Used-car values declined 1 percent in September, resulting in the mildest decline in more than three months. Kelley Blue Book expects values to continue to drop at auction through year-end, in accordance with traditional seasonal depreciation patterns. While the rest of the year isn't expected to offer many surprises at auction, we expect a bump in supply early in 2013 when a jump in off-lease volume returns to market. As previously stated, we could see as many as 300,000 to 500,000 additional vehicles hit the lanes in 2013, which is a welcome influx of vehicles for dealers that continue to struggle with sourcing desirable supply at auction. However, the additional volume likely will not benefit the entire market, as most of these vehicles will end up being remarketed via upstream channels that only will be available to franchised dealers of that particular brand.



Used Fuel-Efficient Vehicle Values Stabilize as Fuel Prices Begin to Ease

Fuel prices have finally started to ease, dropping more than \$0.10 per gallon nationally since mid-September. Although we are getting some relief at the pump after the highest summer fuel prices on record, gas prices remain on pace to set the record for the highest yearly average of all-time. Interestingly, while fuel prices increased from \$3.40 per gallon in July up to \$3.86 per gallon in September, values of fuel-efficient subcompact, compact and hybrid cars did not suddenly increase as with previous fuel spikes. In fact, these segments led market depreciation through that time period.



Through the month of September, values of fuel-efficient vehicles began to stabilize, ending several months of market-leading declines. Values of compact cars were down a scant 0.6 percent, while subcompact cars increased by 0.5 percent on average. Interestingly, hybrid cars continued to decline, dropping nearly 3 percent and perhaps signaling that consumers remain unwilling to pay the premium for a hybrid vehicle when there are more affordable gas-powered cars that achieve 40 mpg on the highway. As fuel prices continue to ease, expect values of fuel-efficient vehicles to resume mild depreciation at auction. Through the rest of the year, Kelley Blue Book anticipates declines of 1 to 2 percent overall for the bulk of these vehicles before stabilizing prior to the typical seasonal uptick during spring.

While fuel prices are dropping nationally, we should note that California has seen a rapid increase in fuel prices during the past week related to power outages at a major refinery in Torrance. Fuel prices have jumped close to \$0.50 per gallon since September 27, and have shown no signs of slowing down thus far. Dealers in California should be prepared for a jump in demand, even if only temporary, for fuel-efficient vehicles on their lots. While the jump in fuel prices will not last for long, a jump of \$0.20 per more in a day can certainly prompt consumers who already were in market to buy a vehicle to switch to something more efficient.

Used-Car Value Declines Outpace Declines of New Cars

Through much of this year, high used-car values have prompted consumers to consider new vehicles rather than used. Shoppers made the switch in consideration earlier this year when 2011 model-year used cars were only 4 percentage points more affordable than a new vehicle. Since May, values of used vehicles have declined at a greater rate than new vehicles. Today, the average 2011 model-year used car has a retail listing value that is approximately 12 percentage points below a comparable 2012 vehicle. Part of the widening gap can be attributed to typical used-car depreciation associated with the time of year, and increasing mileage of the 2011 model year.

“AS TIME GOES ON, EXPECT THE GAP BETWEEN NEW AND USED VEHICLES TO CONTINUE TO INCREASE, AS USED-VEHICLE VALUES DESCEND FROM THEIR CURRENT LEVELS WHILE SUPPLY IMPROVES AT AUCTION.”

- ALEC GUTIERREZ

When examining the used 2012 models that are starting to appear at auctions, we see a tighter spread between new- and used-vehicle transaction values. The average used 2012 model with approximately 16,500 miles is about 8 percentage points more affordable than a brand-new 2012 vehicle available for sale at a dealership. This gap likely would be even wider if we were to compare these used cars with the all-new 2013 model-year vehicles that aren't as heavily discounted as their 2012

counterparts. Although the gap between new and used vehicles is widening, Kelley Blue Book believes pricing will remain close enough to continue to prompt consumer consideration for a new vehicle rather than a late-model used vehicle. In addition, the numbers quoted so far are merely averages and the gap between new and used pricing can vary by model.



By digging a little deeper, Kelley Blue Book found that several vehicles are bucking this trend where the price of a used vehicle is still quite close to that of a new vehicle. Shoppers considering a used 2011 Toyota 4Runner, Jeep Wrangler or Subaru Impreza may be able to buy a brand-new 2012 for only a modest premium. These vehicles have been known to hold their value extraordinarily well due to their strong following and reputation for long-term reliability. Consumers should be sure to check values of both new and used vehicles as they conduct research to ensure they are getting the best deal possible. As time goes on, expect the gap between new and used vehicles to continue to increase, as used-vehicle values descend from their current levels while supply improves at auction. In the meantime, there still is a compelling reason to consider new vehicle rather than a one- to two-year-old used vehicle in many cases.

This commentary focuses on model years 2009-2011. The statements set forth in this publication are the opinions of the authors and are subject to change without notice. This publication has been prepared for informational purposes only. Kelley Blue Book assumes no responsibility for errors or omissions.

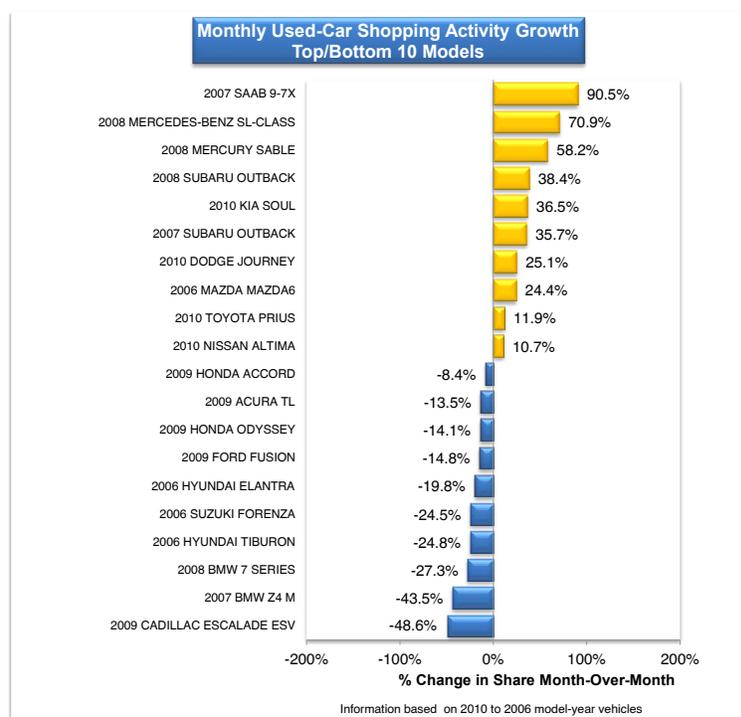
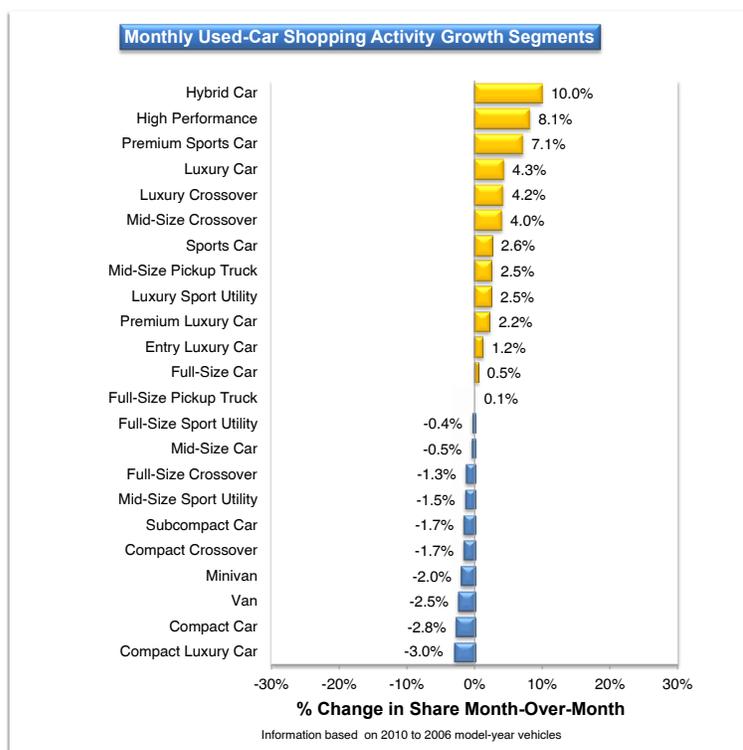
Used Hybrid Cars a Hot Commodity

- Arthur Henry, manager of market intelligence and market analyst, Kelley Blue Book

Kelley Blue Book's Hot Used-Car Report captures monthly used-car shopper activity on kbb.com, including a list of the top and bottom movers in the same time period. Results are provided by the Kelley Blue Book Market Intelligence Team, in an effort to help dealers better understand which used vehicles consumers are looking at most each month.

Hybrid vehicle interest typically fluctuates accordingly with decreasing and increasing gas prices. This concept reigned true as hybrid cars increased 10 percent in share month-over-month, a direct response to the recent jump in national gas prices. The primary beneficiary to this amplified interest in used hybrids is the 2010 Toyota Prius, which qualifies as one of the top 10 hot used cars this month.

In general, hybrid cars comprise a small percent of used-car shopping research, as most consumers are drawn to traditional gas-powered vehicles. One such vehicle gaining notice among consumers is the 2010 Nissan Altima because of hype surrounding the recently redesigned new model. The new 2013 Nissan Altima currently has had a major ad campaign focused on its fuel efficiency. There has been increased shopping activity toward the new Altima, and some of that interest is spilling into the used-car market. In addition, this month the Honda Accord and Ford Fusion redesigns will be entering the market, which also should impact relative used models.



About Kelley Blue Book (www.kbb.com)

Founded in 1926, Kelley Blue Book, The Trusted Resource®, is the only vehicle valuation and information source trusted and relied upon by both consumers and the industry. Each week the company provides the most market-reflective values in the industry on its top-rated website www.kbb.com, including its famous Blue Book® Trade-In and Suggested Retail Values and Fair Purchase Price, which reports what others are paying for new cars this week. The company also provides vehicle pricing and values through various products and services available to car dealers, auto manufacturers, finance and insurance companies as well as governmental agencies. Kbb.com provides consumer pricing and information on cars for sale, minivans, pickup trucks, sedan, hybrids, electric cars, and SUVs. Kelley Blue Book's kbb.com ranked highest in its category for brand equity and was named Online Auto Shopping Brand of the Year by the 2012 Harris Poll EquiTrend® study. Kelley Blue Book Co. Inc. is a wholly owned subsidiary of AutoTrader Group.