SPECIAL DEALER REPORT

MANHEIM CONSULTING

Auto Industry Brief

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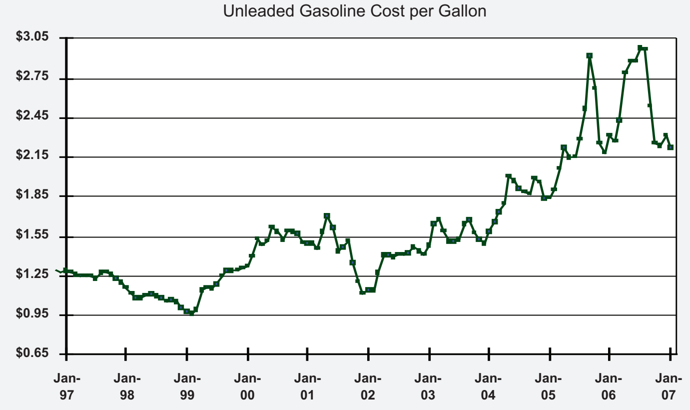
IN THIS ISSUE

USED VEHICLE PROFIT OPPORTUNITIES TO GROW IN 2007

After advancing at a rate in excess of 3 percent in 2004, 2005, and undoubtedly for 2006 when the final numbers are released, economic growth in 2007 will likely slip to just over 2 percent. Housing and autos will remain the major drags. Indeed, if it were not for the windfall to discretionary income provided by falling energy prices, the housing "correction" (i.e., "bubble popping") would have likely led to recession.

The repercussions of the housing slowdown (no instant money to extract from equity lines or refinancings, and no boost to consumer confidence provided by the paper wealth effect) are long-term, while the benefits of gasoline price declines might prove fleeting. Even so, the fundamentals of the economy, notably, job growth accompanied by sustainable and non-inflationary wage gains, greatly diminish, if not eliminate, any possibility of recession.

Falling Gas Prices Boost Discretionary Income



Source: Oil Price Information Service

Never has the economy tanked without an accompanying substantial weakening in labor market conditions. In early 2007, weekly jobless claims fell below 300,000. The four-week moving average will begin testing new lows not seen on a sustained basis since 2000, when the labor force had 4 million less people. This stability in labor has been a key factor in keeping used vehicle financing readily available to customers in all credit tiers.

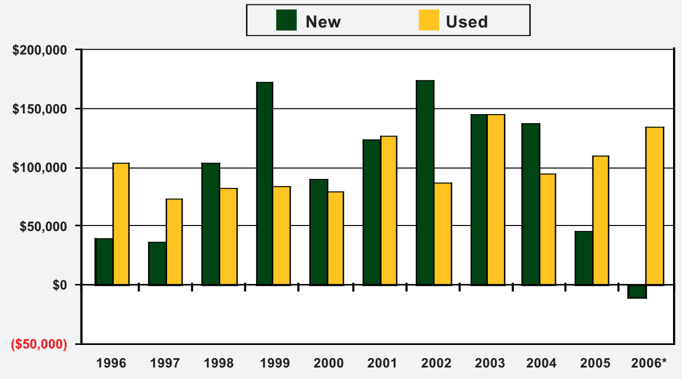
New vehicle sales to ease in 2007. Despite the strong labor market and availability of good credit, a pullback from fleet sales, coupled with less-aggressive retail pricing and incentives, will cause new vehicle sales in 2007 to slip to around 16 million, versus 2005's sales of 16.56 million. And, it is a given that the Detroit Three will lose further market share while the major Japanese manufacturers gain.

Manufacturers and dealers will not have "pricing power", but no longer will it be "price giveaways". New products and rationalized production capacity will keep net pricing slightly positive in 2007. And, although it is unlikely that dealers will enjoy any significant reduction in floorplan interest rates, their actual holding costs should decline due to lower inventory levels. Roughly speaking, in today's market, a half-point rise in the floorplan interest rate can be offset by a five-day reduction in days supply.

Thus, from the new vehicle department perspective, 2007 is setting up as one of easing unit sales, stable pricing and possible cost reductions. That may enable the average dealer to pull the new vehicle department out of the red, but the bigger profit opportunities will remain in used vehicles. Here dealers will enjoy an ample and diverse supply in the wholesale market, readily available retail financing and solid demand driven by the fundamentals of favorable labor market and credit conditions.

Used Vehicles – A Safe Harbor in Stormy Seas

New versus Used Vehicle Departmental Net Profit – Average Dealership



Source: NADA, 2006 estimated

A Look at Wholesale Vehicle Supply in 2007

Each year, beginning with what was once traditionally called new-model introduction and lasting well into the new year, the automotive press and financial analysts review the new vehicle product pipeline. A manufacturer's product cadence (percent of its total sales volume accounted for by new or totally redesigned models) and the expected popularity of those models, provide analysts with a sense of future shifts in market share, pricing power and overall profitability of the manufacturer and its dealer network.

Although new product and its popularity will always reign king in determining the long-term value of a franchise network, an individual dealership's current profit performance is more influenced by used product. In recent years, dealers have earned considerably more money selling used vehicles than new ones.

Thus, here's our analysis of some of the shifts, trends, and opportunities that will be available to dealers in the wholesale market in 2007. We offer this not as a way for dealers to anticipate price movements, but rather as a way to formulate medium-term marketing plans and business objectives for the coming year.

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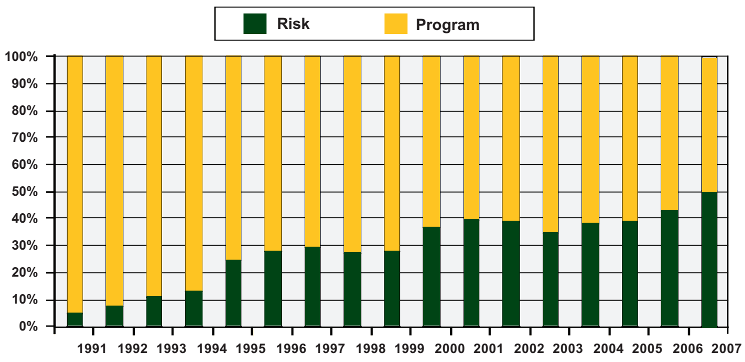
OFF-RENTAL VEHICLES

Program car volumes will fall; risk cars will rise. Beginning with the 2006 model year, and accelerating in the 2007 model year, domestic manufacturers restricted the availability and raised the cost of vehicles supplied to the rental car companies under guaranteed buyback programs. These program cars, which have been a reliable generator of both front-end and back-end gross for the used vehicle department, will be in shorter supply in 2007.

Domestic makes down, Asian makes up. GM reduced new vehicle sales into the rental fleet by 76,000 units in 2006, and plans another 100,000 unit reduction this year. If achieved, it will mean that GM sales into rental will be nearly 200,000 units, or 25 percent, fewer than the peak reached in 2004. Ford's sales into the rental fleet increased slightly (1.2 percent) in 2006, but remained below earlier peaks, and it will certainly fall in 2007 due to the discontinuation of the Taurus. Chrysler, meanwhile,

Rental Fleet Shifts From Program to Risk Vehicles

Risk / Program Split by Model Year



Source: Bobit Business Media, Manheim Consulting estimate for 2007

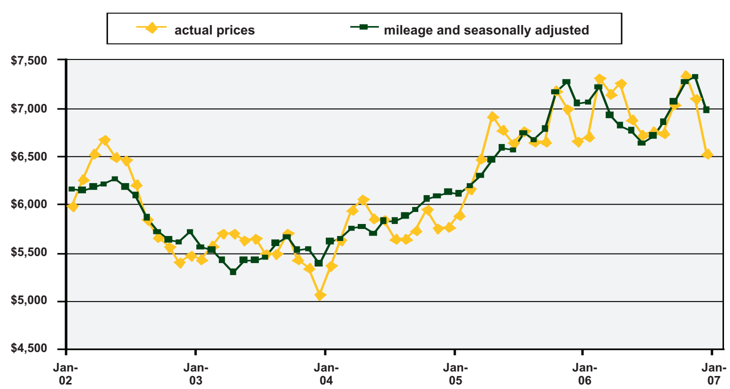
COMMERCIAL FLEET UNITS

An opportunity to expand your customer base. Ever wanted to expand your used vehicle sales down into the lower price points? This may be the year. The number of new vehicles sold into business and government fleets increased from 768,000 in 2003 to over a million in 2006. As a result, the number of end-of-service fleet vehicles has started to rise and it will accelerate for years to come.

Value proposition remains despite higher prices. The average price for a mid-size car commercial fleet car sold at auction was just under $7,000 in 2006. That's an increase of 27 percent from 2003. Although that valuation may seem a little expensive, it still represents an attractive price point that many franchised dealers do not

End-of-Service Midsize Fleet Cars Command Top Dollar

Average Auction Price – Midsize Commercial Fleet Car



Source: Manheim Consulting

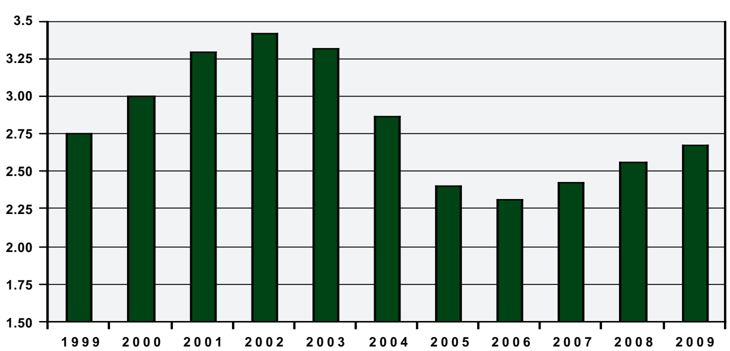
OFF-LEASE UNITS

The dearth is over. New vehicle lease originations have risen in each of the last three years. As a result, the volume of off-lease units, which plummeted by more than a million units between 2002 and 2005, leveled off in 2006 and is poised to grow by more than 100,000 units per year from now until 2010.

Increase in volume will vary by manufacturer. Virtually, all makes and models will show an increase in off-lease volumes in the years ahead, but for some, the gains will be substantially larger than for others. According to SEC filings, Ford Credit increased new lease originations by 33 percent in the first nine months of 2006 versus the

Decline in Off-lease Volumes is Over

Off-lease Volumes – Millions of Units



Source: Manheim Consulting

picked up some of the slack left by GM and Ford and increased sales into the rental fleet by 10 percent or almost 50,000 units (even here, there was a significant shift away from program units to risk units).

Increasing sales into rental in 2006 were: Hyundai (with almost a doubling of sales into rental since 2002), Kia (a tripling since 2003) and Toyota (an increase of 31,000 units, or almost 30 percent, since 2004).

What it means for dealers? The shift from program to risk units naturally means a shift in sellers. GM, Ford, and, to a lesser extent, Chrysler, will be selling fewer off-rental cars. Avis/Budget, Hertz, National/Alamo and Dollar Thrifty will be selling more. As a result, expect more late model vehicles to show up on the lots of non same-make franchises or even at independent dealerships.

Although manufacturer Certified Pre-Owned programs will still make it profitable to keep many late-model vehicles within the franchise network, dealers should keep an eye out for opportunistic purchases outside of their franchise and make note of where the "new" sellers will be selling their off-rental units.

What does it mean for pricing? Auction prices for program cars were steady in 2006 and will likely strengthen in 2007 due to the reduced supply. The vehicles that have been put into program service recently include a much wider mix of models with higher option contenting. In that environment, the cap imposed on the wholesale value of program cars by like models in new vehicle inventory will become more transparent and restrictive. And, it is a cap not imposed by the dollar price of the new models, but rather by the monthly payment at which they can be financed. As such, to profitably retail program cars, it will be more important than ever for dealers to line up attractive retail finance sources for these vehicles.

presently serve. And, as with off-rental vehicles, today's end-of-service fleet vehicle represents a much wider mix of models with higher contenting. Additionally, both dealers and consumers have increasingly recognized, and are willing to pay for, the value proposition entailed in a vehicle that has a complete service history attached.

Subprime market will support retail profits. The subsequent retail profit on the sale of end-of-service fleet units is closely tied to the availability and attractiveness of subprime financing. Right now, the subprime industry is continuing to expand despite a narrowing in loan spreads and a slight uptick in delinquencies. Dealers should take advantage of the current market, as credit cycles never last forever.

Keeping abreast of the market. Dealers should build contacts with the fleet management companies and auctions to get a heads up on future fleet returns in their area. For example, last summer one manufacturer offered a major fleet account a substantial incentive to cycle out of its fleet of full-size vans early. As a result, auctions had supply of full size vans with only 40,000 miles as opposed to the more typical 90,000+ mile units. Dealers who were aware of this coming supply and developed marketing plans to retail these rather unique vehicles, earned substantial profits.

same period a year ago. Toyota Credit originations increased by 15 percent, and GMAC was up 10 percent. Additionally, many major bank lessor significantly increased their lease originations in recent years.

For the most part, unlike the leasing of the past, the vehicles put out on lease recently were also selling well with retail financing. Since they were popular as new models, and more likely to have been put out on a short-term lease, these off-lease units will also be popular in the used vehicle market.

Knowing what to pay. The simple advice is to follow the market and don't worry. After all, auction prices represent true market value and whether a model is deemed to have strong or weak pricing is generally immaterial to the dealer's subsequent retail gross margin. There are, however, general instances in which pricing disparities can offer opportunities. For example, it is often the case that guidebooks (and thus dealer bidding) place too much penalty for high-mileage, when, from the retail customer's perspective, "condition trumps all else". Likewise, in 2007, some models will have the simultaneous return of both 2- and 3-year leases. In that situation, the older models often fare poorly in terms of retention. But again, it may be a case of professional buyers placing more importance on model year than does the retail customer.

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