SPECIAL FORECAST ISSUE

January 7, 2015

A CNW Research Newsletter

Retail Automotive Summary

Clarity. Context. Vision.

Is There Room for the Auto Industry to Grow or is it Overextended?

Sales have significantly rebounded in the past two years, but can the auto industry maintain the momentum or has it become overextended, selling more vehicles than a mature market can absorb?

By all measures, cy2000 was phenomenal. More than 17.4 million vehicles were sold, the most in history.

That translated into 6.2 percent of the population making an acquisition.

But that wasn't the highest per-population sales figure – a record set in 1986 when 7.5 percent of the population purchased a car or truck. And that was without multi-thousand dollar incentives.

Is 20 Million Units 'Do-able?'

In cy2014, sales of 16.5 million units were sold to 5.35 percent of the population. So the indication is there should be quite a bit of room to expand (the difference between '14's 5.35 and '00's 6.2 percent).

Should the industry be able to convince 7.5 percent of the population to buy a car or truck (as was done in 1986), sales would exceed 20 million units.

That is highly unlikely for a number of reasons.

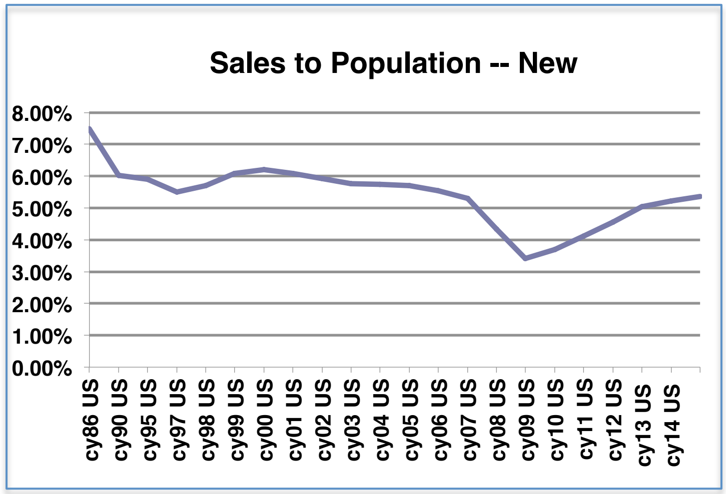
The average over the past 22 measured periods is 5.39 percent. So in reality, the industry could sell 17.12 million units in 2015 and remain on trend line with 5.35 percent of population making an acquisition.

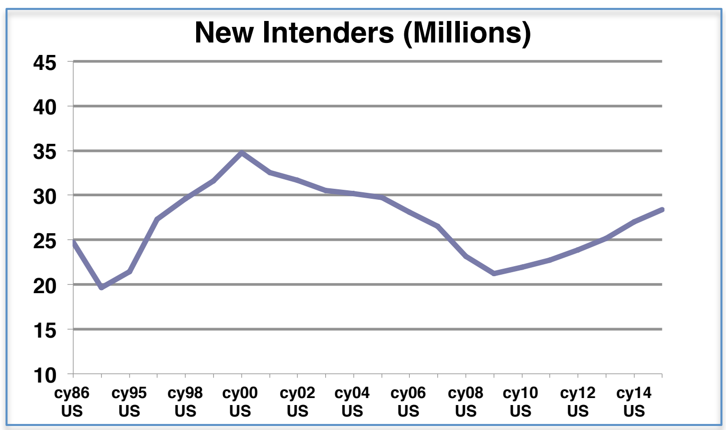
Key Market and 2015 Sales Forecast

A second, and equally important component in finding the true annual ceiling for new-car sales, is the Key Market, defined as those consumers who are financially capable, fully able from a credit/work standpoint, and at least somewhat willing to make a new-vehicle acquisition.

Based on CNW's Purchase Path Studies, that figure for 2014 was 41.82 million consumers or 13 percent of the U.S. population. That is below the cy2000 high as well as the 22-year average (see table at right).

While some of those in Key Markets are "soft" targets for auto marketers – expensive to convince to make a purchase – others are less so. The "hard" Key Market numbers are actual intenders – those who say they





	cy2000 High	cy2009 Low	Avg
Sales (Millions)	17.4	10.5	15.4
Key Mkt % Pop	19.20%	11.30%	15.55%
Key Mkt (Millions)	53.8	34.72	44.55
Intenders (Millions)	34.8	21.24	26.9
Sales to Pop	6.21%	3.40%	5.39%

anticipate making a new-car purchase within a year.

But even these intenders are only so likely to make an acquisition. Many will be rejected for credit reasons, others will simply drop out for homecentric issues or job-related changes.

The net of all these numbers results in about 17.12 million who will actually make a purchase.

That is CNW's new-vehicle forecast for 2015.

Incentives' Part in Sales Forecast

For the industry to hit 17.12 million units, however, will require a significant boost in incentive spending on top of new models. The sales gains and conversion of Intenders to Buyers can be traced to a booming lease effort in the middle to late 1990s and early 2000s. CNW calculates that it was also a time the industry, in a single year, lost more than $10 billion because of inflated residual values.

The past two years have seen a similar boost in incentives, especially in 2014, with more than 95 percent of all models offered having some significant dealer or consumer enticement.

There was a huge bulge in the number of vehicles sold that had an incentive attached in cy2002-2005 as the industry attempted to dig its way out of the leasing quagmire. And while the decline in the percentage of vehicles covered by an incentive diminished in '06, the trend line upward continued (graph at right).

Transaction Prices vs. MSRP

Yet another measure of the strength of intent to buy a vehicle can be seen in the transaction prices when compared to the actual MSRP of the cars and trucks purchased. This excludes fees, add-ons, aftermarket products or other additional costs.

In 2005, transaction prices came to around 80 percent of MSRP. After erratic year-over-year changes with the industry able to at least stabilize MSRP-Transaction Price differences, the industry once again saw the ratio climb to excellent levels. But competitive pressure resulted in the industry offering higher discounts with transaction prices returning to below 85 percent in 2013 and 2014 with this trend continuing into 2015.

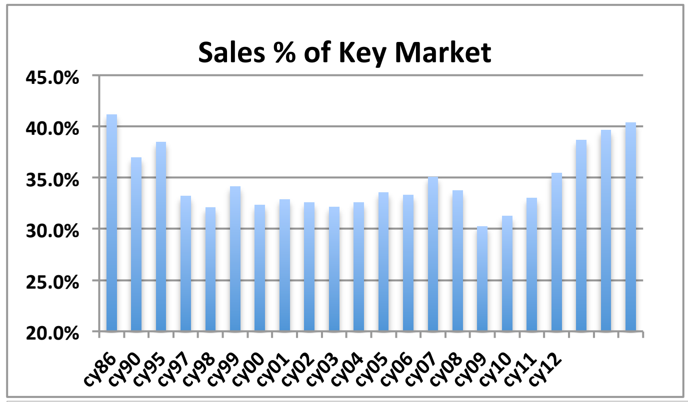
CNW is forecasting that Transaction Prices this year will sink to 81 percent of MSRP from the current 84 percent, brought about by higher incentives and bigger dealer trade-in values.

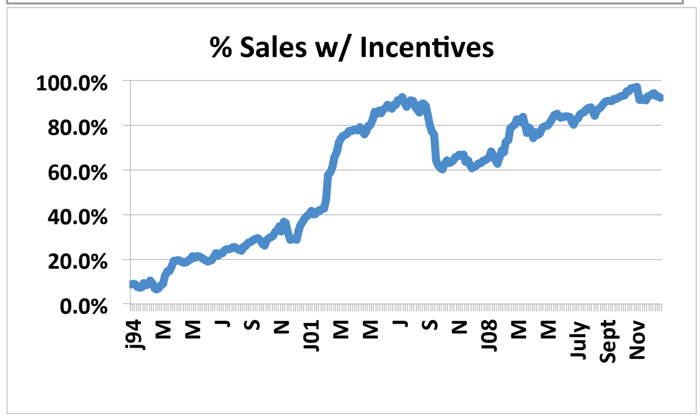
SUMMARY – The industry has reached a point of razor-thin balance that can easily tip either way. Just as lower fuel prices encouraged many consumers to transition to larger vehicles, a dramatic rise in fuel prices would and has resulted in a boost to other types of high-fuel-economy vehicles such as hybrids.

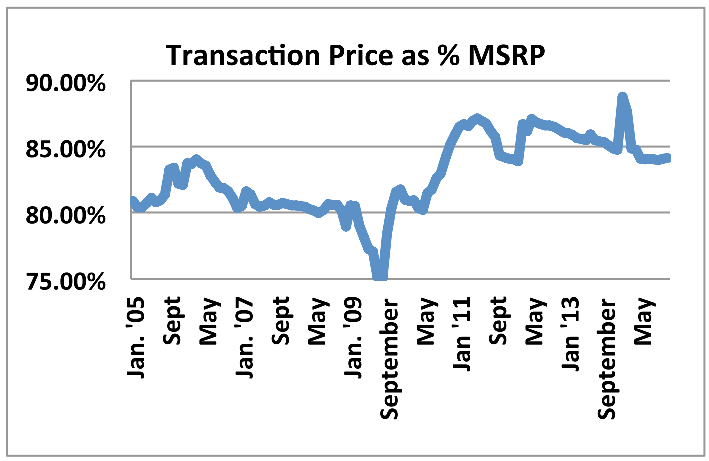
The point is, the industry actually is not guaranteed year-over-year increases because news, views and attitudes can change on a whim resulting in lower Key Market numbers.

Smaller Key Markets result in fewer intenders and softer sales unless otherwise incentivized.

Assuming higher sales rates, as many in the auto industry project, is foolish because it will come ONLY if incentives continually expand. This includes lease offers that seriously undermine actual residual values, which is already happening.







So in reality, this current "boom" in sales is the auto industry **OVEREXTENDING** itself.

Without the current incentive packages, CNW estimates sales in 2014 would have been 16.1 million (not 16.5 million) and 2015 would come in somewhere around 16.4 million instead of the likely 17.12 million.

The true measure of auto industry strength must include an economic component for the mass market.

With better than a third of sales going to high-income households that used stock and other paper-investment gains to make the acquisition and another third to fleets/business, the vast middle class has been left to buy CPO and used vehicles. As recently as cy2000, this was the core of auto industry sales representing 60 percent of retail.

Until wages are naturally higher (not mandated by government), a true economic recovery for the auto industry – based on net profits, not units delivered – cannot occur. Until that time, incentives will artificially boost auto sales.

Full cy2015 Projections: Foundation is Hard Pan, Not Concrete

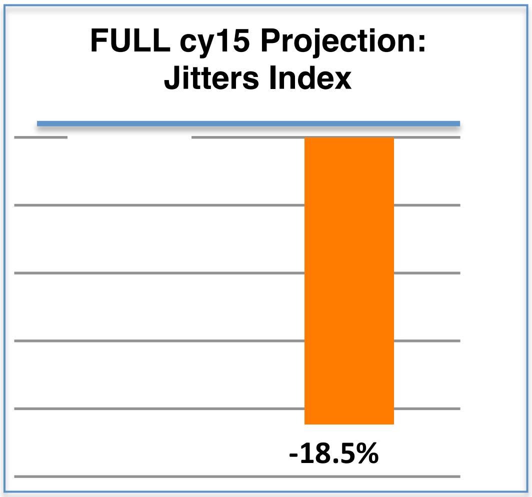
It's called "hard pan" and in some parts of the country it is just below the surface. Dry, it feels like rock, but when you add rain, it become mushy and as slick as snot.

The 2015 auto industry is being built on Hard Pan, according to CNW's annual Purchase Path study (to be released shortly). Everything is resting on hard pan that even the slightest economic rain could easily upset.

So here goes, as of January, 2015:

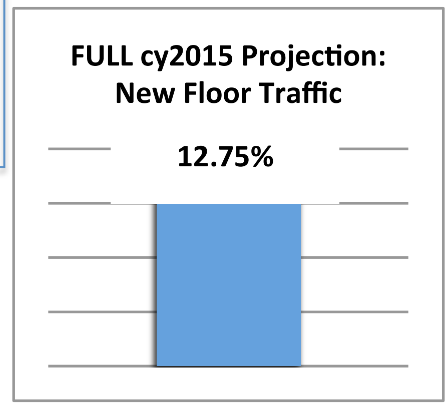
Jitters Index

A key component is the willingness to make big-ticket purchase such as automobiles. We're expecting a significant decline in these homecentric Jitters laying the foundation for a solid sales year.



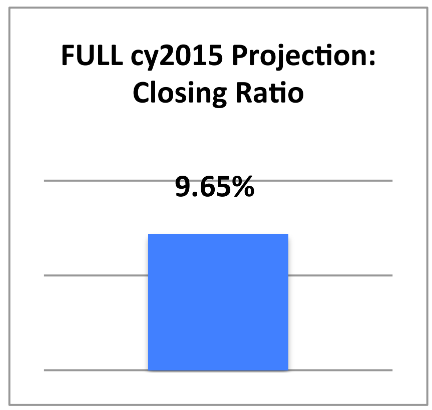
Floor Traffic

A near 13 percent increase in floor traffic is likely for the full calendar year as a growing percentage of consumers become "Key Market" participants. (See cover story for definition.) As the Key Market grows, so does floor traffic.



Closing Ratios

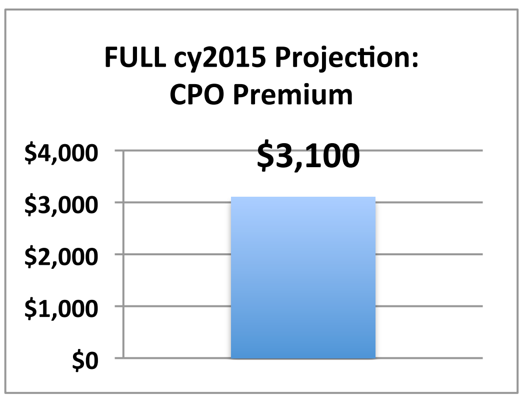
For the calendar year, we're expecting closing ratios to jump 9.65 percent from cy2014, again laying the groundwork for a 17.1 million unit year. A more stable sales force at dealerships, heavier incentives at the dealership and a rebound in used-car prices will all aide in that increase.



CPO Premium

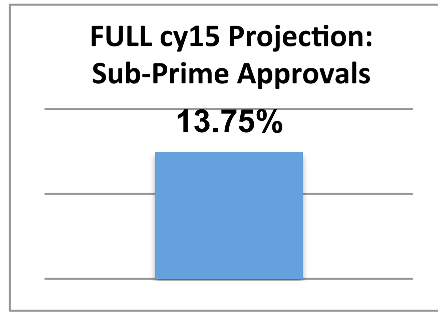
Because many in the middle class are being squeezed out of the new-car market because of higher prices and soft wage gains, CPO becomes a solid alternative. And it's one that consumers believe provides the new-car smell without the new-car payment.

That said, in 2014 consumers paid about $2,800 more for CPO models than comparably aged non-CPO used cars. We see nothing in the way of a significant gain in 2015 and are projecting the average premium will be in the $3,100 range for the full year.



Sub-Prime Approvals

The year-over-year increases registered in 2014 vs. 2013 will continue, driven in large part by automakers' captive finance companies looking to expand sales. While not as large as the 2014 gain, 2015 is likely to see a 12.75 percent increase in sub-prime approvals.



Retail Sales vs. Business/Fleet

We're expecting retail (to consumer) new-car sales to remain in the 62 percent range of all new-vehicle deliveries in 2015. Not much change from cy2014. The main reason: businesses and larger fleets have pretty much met their target fleet sizes and the growing use of the Internet for purchasing has resulted in lower demand for vehicle-delivery of goods. This also applies to B2B.