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BLUE BOOK Market Report
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Analysis from Kelley Blue Book's Analytic Insights Team

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 Mgr
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:

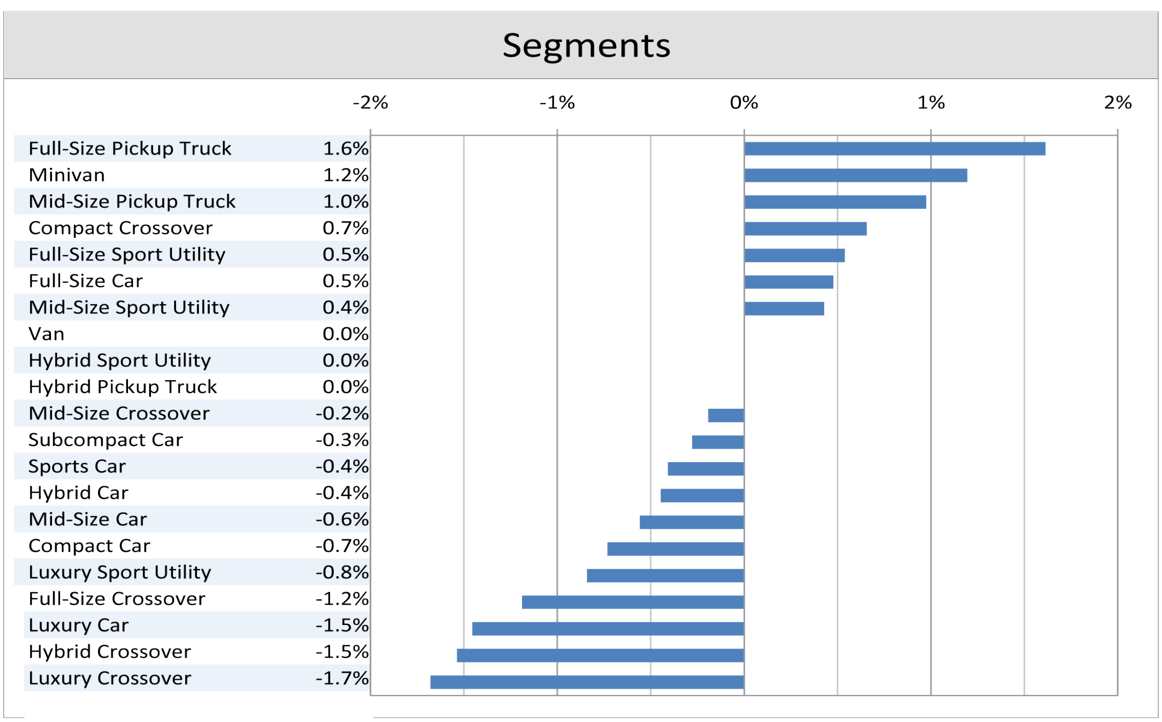
ARRIVAL OF 2010 MODEL YEARS PUTTING DOWNWARD PRESSURE ON LATE MODEL LUXURY VEHICLES

- Juan Flores, director of vehicle valuation, Kelley Blue Book
- Alec Gutierrez, lead analyst of vehicle valuation, Kelley Blue Book

The used-car market was relatively flat for July 2010 with a 0.2 percent overall increase in values. Although values were mostly stable, segment performance varied widely. Values for cars and crossovers depreciated 0.7 percent and 0.3 percent, respectively, while values strengthened for SUVs (0.2 percent) and trucks (1.5 percent). Although values for SUVs and trucks are strengthening today, Kelley Blue Book expects they will decline in the latter half of 2010 (as projected in the ***July 2010 Blue Book Market Report***).

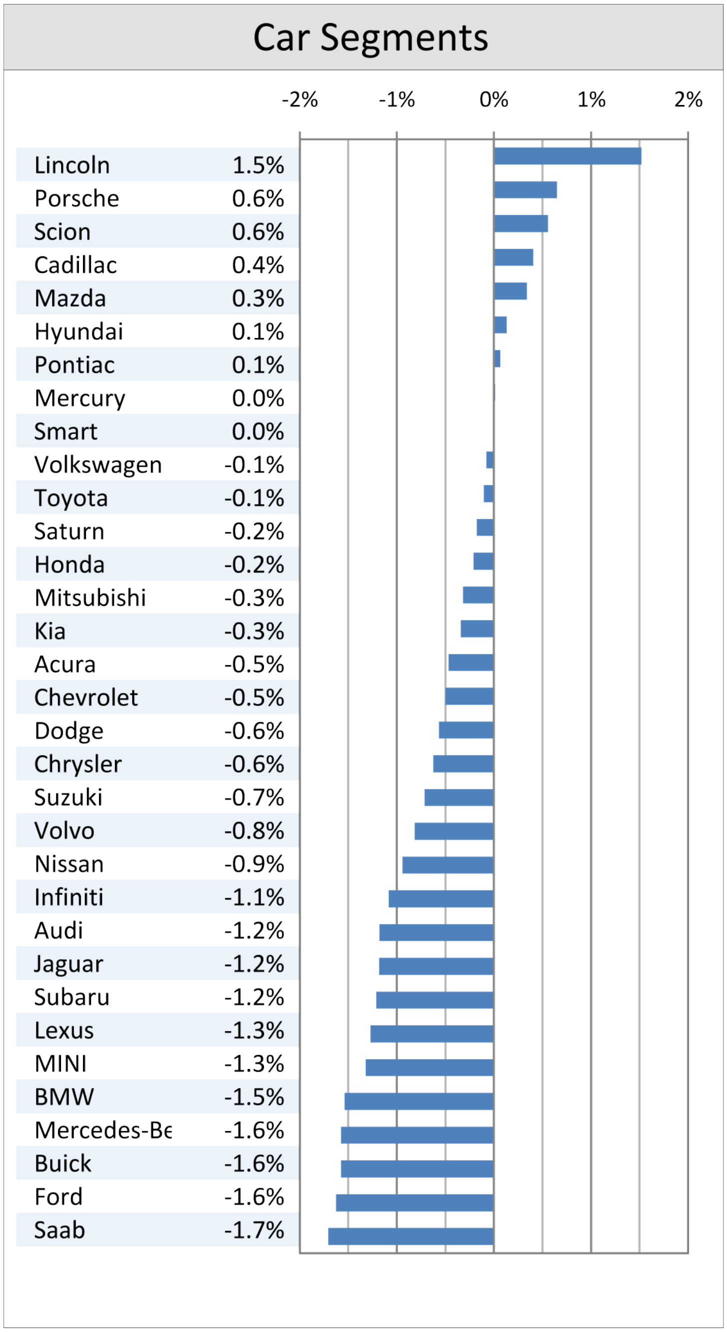
Among depreciating segments, luxury cars and crossovers dropped more aggressively than their non-luxury counterparts, each depreciating 1.5 percent on average. As 2010 model-year luxury vehicles have started to arrive at auction, the value of 2009 and 2008 model-year vehicles have dropped to accommodate the arrival of these newer vehicles in the marketplace. While common in most segments, this phenomenon is typically more pronounced in luxury segments due to the typical luxury buyer's preference for the latest and greatest model. As newer luxury vehicles begin to appear at auction, demand typically shifts away from two- and three-year-old vehicles, putting significant downward pressure on values for these vehicles.

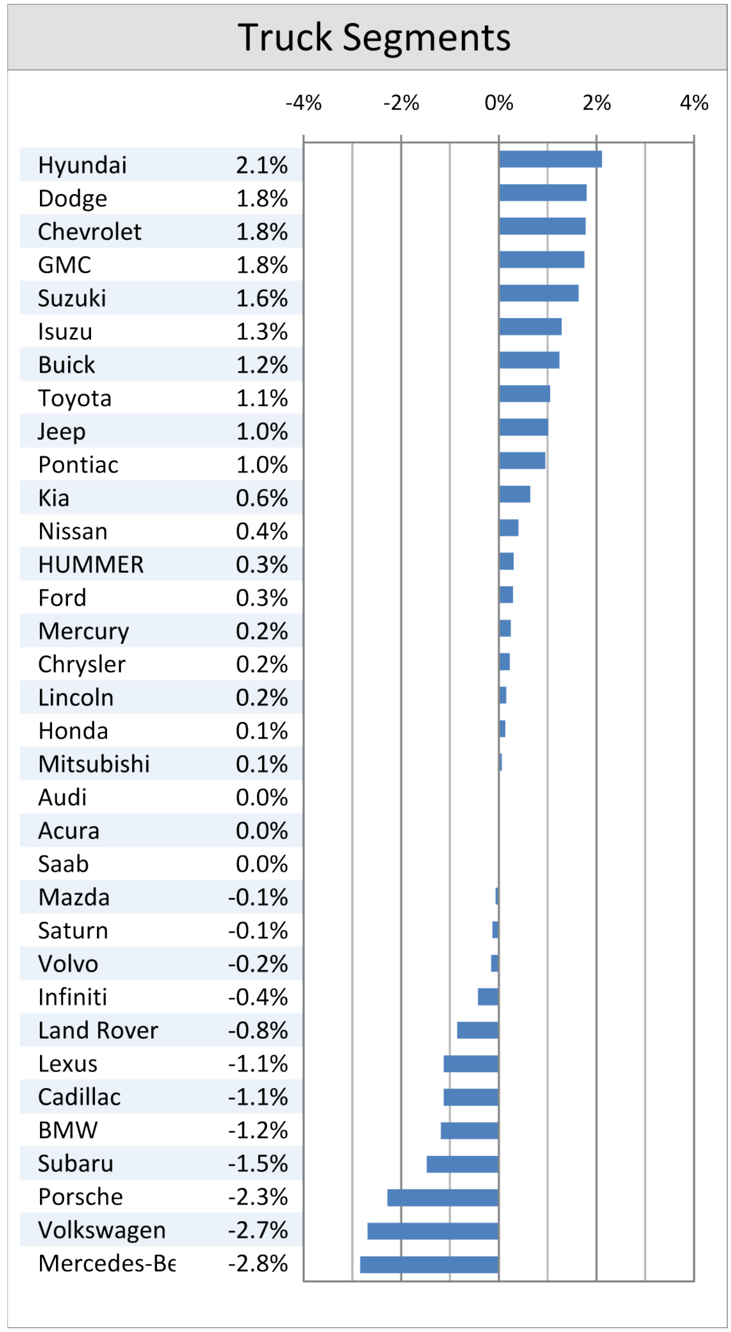
Leading the depreciation in the luxury segment are values for the BMW 7 Series (-3 percent), and the Mercedes-Benz CLS-Class (-3 percent), ML-Class (-4.1 percent), R-Class (-3 percent) and GL-Class (-3 percent). Mercedes-Benz' leading depreciation of 1.8 percent for the month has resulted from the aforementioned trend; arrival of 2010s at auction and increased volumes of two- and three-year-old vehicles returning from lease. This has contributed to an increasing supply of vehicles, ultimately lowering transaction prices for Mercedes-Benz products. It should be noted that although Mercedes-Benz is down significantly for the month, they remain up 3.5 percent year-over-year.



The above chart displays month-over-month used-vehicle depreciation percentages by segment. The depreciation percentages shown are not indicative of the retention percentages or relative positions of the included segments.

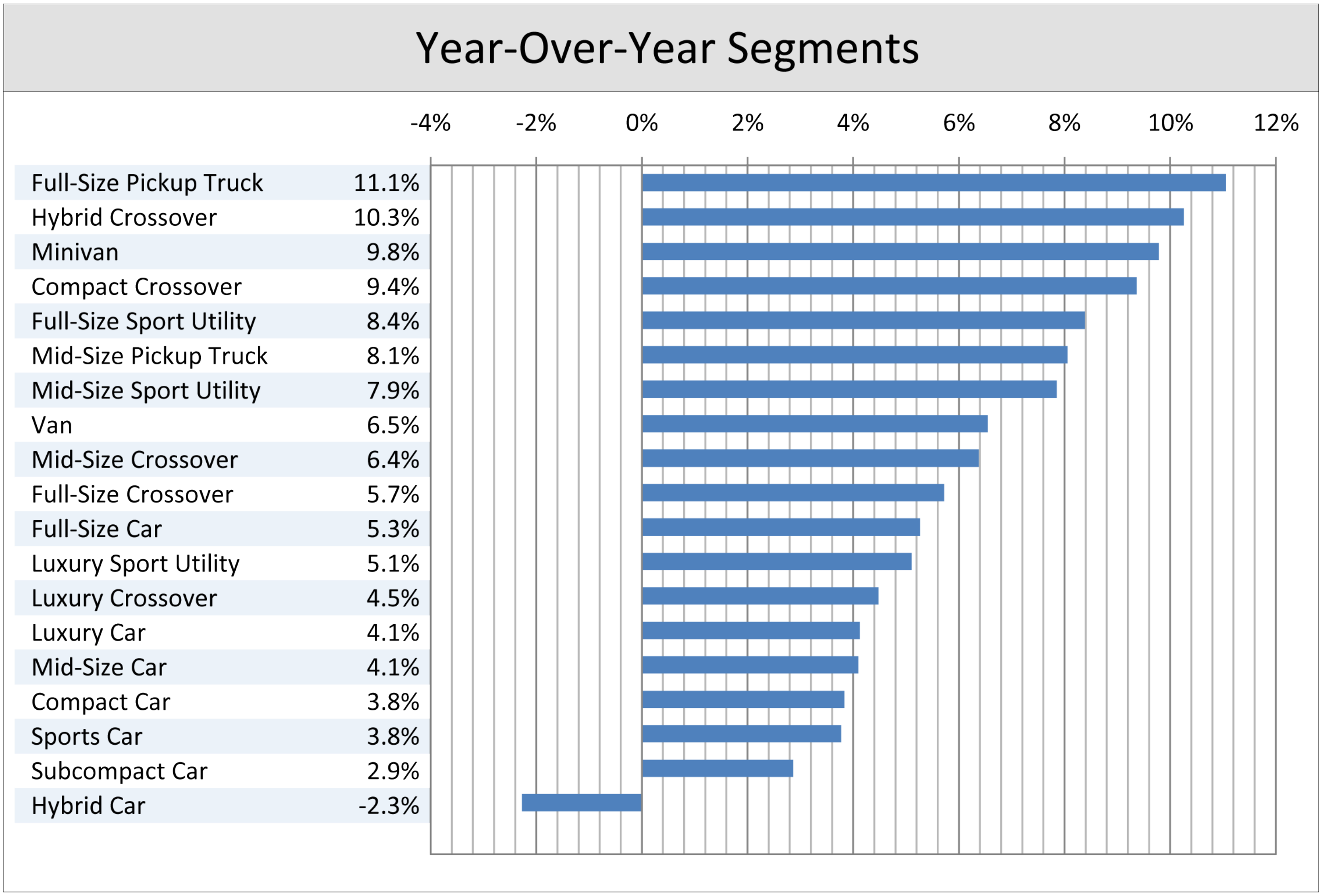
Car & Truck Segment Overview





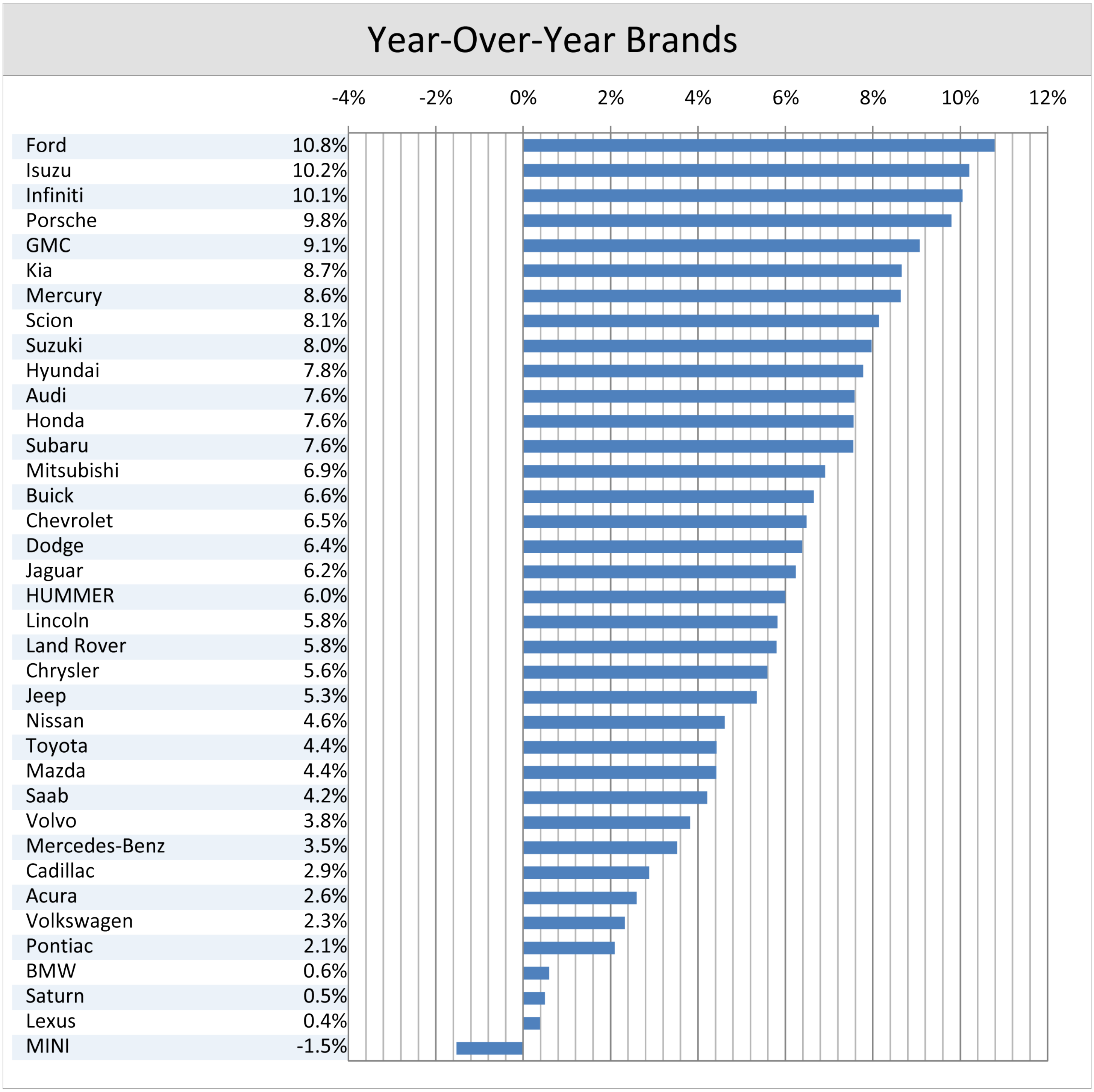
The above charts display month-over-month used-vehicle depreciation percentages by brand. The depreciation percentages shown are not indicative of the retention percentages or relative positions of the included brands.

Year-Over-Year Segment Overview



The above chart displays year-over-year change with respect to retained value (auction value/MSRP). This change reflects the average retained value of MY 2006-2008 vehicles in the current period compared with average retained value of MY 2005-2007 vehicles for the same period in the prior calendar year.

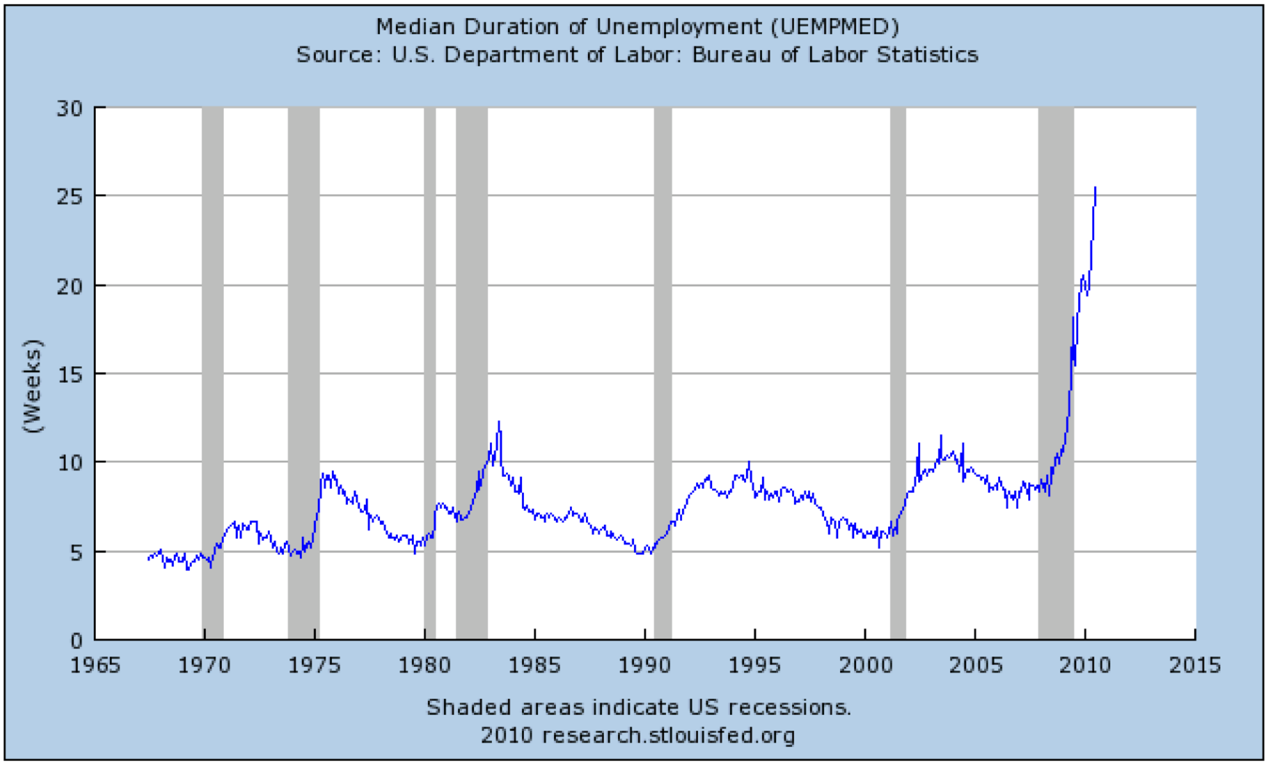
Year-Over-Year Brand Overview



The above chart displays year-over-year change with respect to retained value (auction value/MSRP). This change reflects the average retained value of MY 2006-2008 vehicles in the current period compared with average retained value of MY 2005-2007 vehicles for the same period in the prior calendar year.

WEAK ECONOMY DRIVES PROFITABLE USED-CAR MARKET

Continued weakness in the economy should keep demand for used cars healthy. Consumer confidence dipped again in July, down 3.9 points to 50.4 (1985=100). A lack of confidence in short-term economic recovery could continue to keep new-vehicle sales depressed, while sustaining used-vehicle demand. At the time of this analysis, the unemployment rate stands at 9.5 percent; however, this number is understated as large numbers of workers are giving up on their job search, so they are no longer included in the official government unemployment statistic. More telling is the median duration of unemployment, which currently sits at a 50-year high (25 weeks). With more shoppers out of work longer and with expectations for unemployment to remain high, demand for used cars should remain stable. While out of work, most consumers will be unwilling to replace a vehicle until it becomes necessary. This trend has the potential to keep the sales of new cars soft and demand for used vehicles steady for some time.



RESURGENCE IN USED-CAR DEMAND

With consumers continuing to seek affordability, subcompacts and compacts should be in demand, while demand for costly hybrids and electric vehicles remains questionable. The upcoming Chevrolet Volt and Nissan LEAF have successfully sparked conversation on the future of the automobile, but will this translate into sales? According to June 2010 data from Kelley Blue Book Market Intelligence's EcoWatch study, half of in-market car shoppers remain skeptical about both plug-in hybrid-electric and battery-electric vehicles (49.8 percent of respondents were skeptical about plug-in hybrid electrics, and 51.4 percent of respondents were skeptical about battery-electric vehicles). However, 18 percent said they were definitely interested in plug-in hybrid electrics, and 17 percent said they were definitely interested in battery-electric vehicles.

New entry-level products could help alleviate demand for used vehicles with the availability of more affordable subcompacts such as Ford's Fiesta, spurring new-vehicle sales as shoppers seek new ways to save money. With fuel prices steady (around $2.75 nationally on average), expensive hybrids and electric vehicles, like the upcoming Tesla Model S, Toyota Prius and Chevrolet Volt, do not provide significant fuel savings to be a viable alternative to less expensive fuel-efficient compact vehicles. On the other hand, Lincoln's recently announced MKZ Hybrid pricing could generate some additional interest.

On the used-car side, hybrids have not fared as well as the majority of other vehicles. Toyota's Prius is down 5.7 percent year-over-year, slightly in excess of the average 2.3 percent year-over-year drop of all hybrid cars. In addition, the Toyota Camry Hybrid dropped 4.5 percent from this time last year, while Nissan's Altima Hybrid fell 3 percent year-over-year. Until fuel prices rise more significantly, Kelley Blue Book expects to see demand for hybrid vehicles remain soft. With that being said, long-term expectations are for fuel prices to continue to increase steadily, so in fact, today may be the best time to pick up a used hybrid due to their currently attractive values.

USE MARKET TRENDS TO HELP MEET CONSUMER DEMAND

With regard to market trends, dealers should consider looking at affordable compacts and crossovers to meet consumer demand. These vehicles offer great fuel economy at an affordable cost of entry in an uncertain economic environment. The following are two- or three-year-old bargains under $13,000 for which dealers should be on the lookout to maximize profits (Auction Value – Good – Typically Equipped). Please keep in mind that the values listed represent entry-level trims for each model and that retail customers should expect to add reconditioning costs and dealer overhead expenses to provide a closer estimate to what they can expect to pay on a dealer's lot.

Model-Year 2008 Compacts
Ford Focus ($7,500)
Toyota Corolla ($8,500)
Mazda3 ($10,000)

Model-Year 2007 Crossovers
Chevy Equinox ($11,000)
Jeep Patriot ($11,000)
Subaru Forester ($12,500)

FOUR-CYLINDER DEMAND REMAINS QUESTIONABLE ON LARGER VEHICLES

As an example of OEM anticipation of continued consumer belt-tightening, Ford is expected to charge a slight premium on its EcoBoost four-cylinder engine over the more powerful V6 model of the redesigned 2012 Explorer. Ford is betting that consumers will be willing to pay more for the improved fuel economy made available by Ford's turbocharged four-cylinder engine. With this in mind, Kelley Blue Book poses three questions:

1. Can we expect to see a continued emphasis on smaller, turbocharged, fuel-efficient motors?
2. Will vehicles shrink in size and price, or will expensive electric vehicles pave the way to the future?
3. With gas prices well below 2008 highs, will consumers be willing to pay more for less-powerful, more gas-sipping motors?

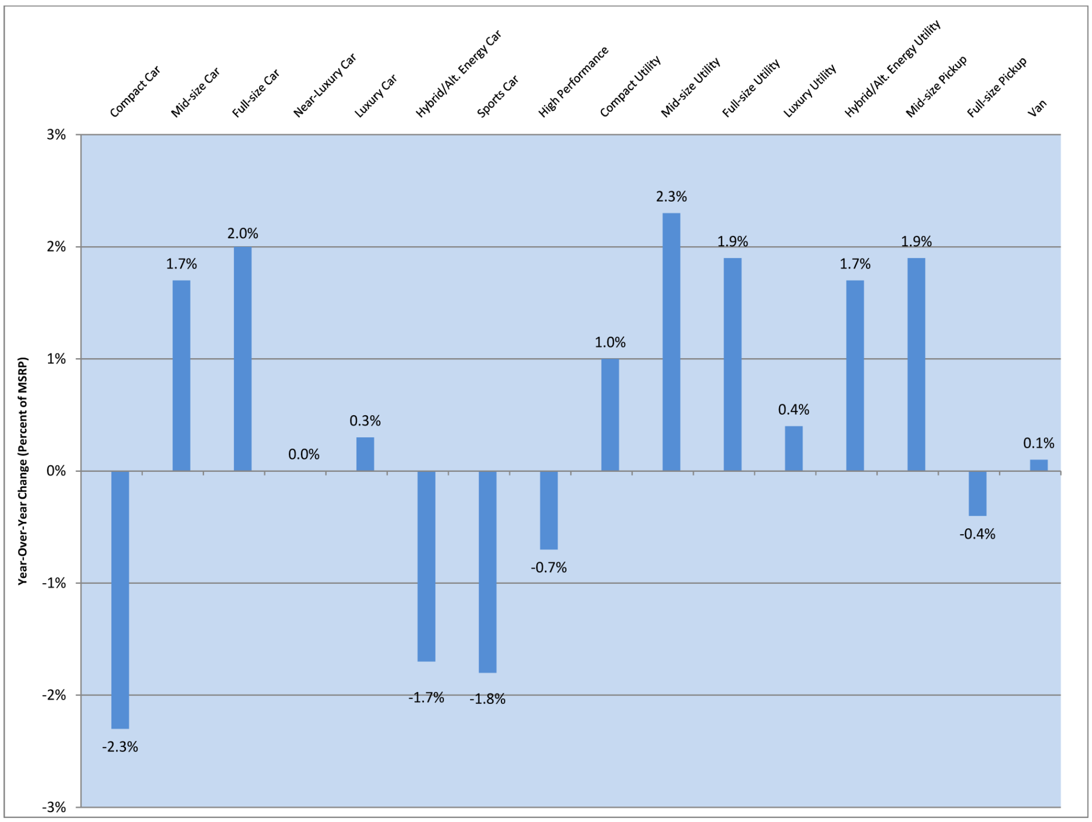
Current fuel prices are not supporting this move, and unless there are significant increases in fuel prices, larger engines will reign. To that point, Toyota recently announced it will be discontinuing the four-cylinder 4Runner after only one year of production, possibly indicating that consumers in larger vehicles still prefer a more fuel-thirsty, powerful engine. Perhaps Toyota came out of the gate too quickly with a smaller engine in a large SUV, but with the long-term expectation that fuel prices will continue to rise steadily, it may only be a matter of time before consumers are willing to pony-up some extra cash to pay for smaller, more fuel-efficient engines.

This commentary focuses on Model Years 2006-2008. 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.

MID-SIZE, FULL-SIZE VEHICLES OUTPERFORM MARKET

- Eric Ibara, director of residual value consulting, Kelley Blue Book

Overall, the year-over-year change in total industry 60-month residual value was flat, declining a mere 0.1 percent of manufacturer's suggested retail price (MSRP). The largest year-over-year drops by segment occurred in the compact car (- 2.3 percent of MSRP) and sports car (-1.8 percent of MSRP) segments. Leading declines in the compact car segment were the Mitsubishi Eclipse (-8.0 percent), Smart fortwo (-7.4 percent), Scion xB (-6.5 percent) and Hyundai Accent (-6.3 percent). Declines in the compact car segment are a continuation of a trend Kelley Blue Book has been forecasting for the past several months. Softness in the future value of these vehicles is due to the increased number of models entering this segment and the anticipated moderate rise in fuel prices. Declines in the sports car segment were primarily driven by the Nissan 370Z and Porsche's Cayman, down 5.9 percent and 5.5 percent, respectively. The Audi TT and the Infiniti G37 also fell 4.8 percent and 4.6 percent, respectively, as demand for these vehicles declines.



The largest gains were seen in the mid-size utility (+2.3 percent), full-size car (+2.0 percent), full-size utility (+1.9 percent) and mid-size pickup (+1.9 percent) segments. The mid-size utility segment gains were due largely to the Hyundai Santa Fe (+5.3 percent), Dodge Journey (+5.3 percent) and Jeep Liberty (+4.7 percent), in spite of a large drop in the Hummer H3 (-8.0 percent). The full-size car segment increased due to stronger residuals projected for the Chrysler 300C, Chrysler 300 and the redesigned Ford Taurus, climbing 8.0 percent, 6.9 percent and 5.3 percent, respectively. The performance in full-size utility vehicles was led by the Mazda CX-9 and Honda Pilot, up 4.0 percent and 3.3 percent, respectively. Both vehicles have seen strong auction values over the past 12 months. Lastly, mid-size pickups benefitted from a higher forecast for the Nissan Frontier and Suzuki Equator, up about 3 percentage points each.