

Kelley Blue Book Public Relations Contacts:

Chintan Talati | Sr. Director, Public Relations
949.267.4855 | chintan.talati@kbb.com

Joanna Pinkham | Sr. Public Relations Manager
404.568.7135 | joanna.pinkham@kbb.com

Brenna Robinson | Sr. Public Relations Manager
949.267.4781 | brenna.robinson@kbb.com

Samantha Hawkins | Marketing Coordinator
949.268.2760 | samantha.hawkins@kbb.com

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Mid-Size Car Competition Impacting Residual Values

- Eric Ibara, director of residual value consulting, and Akshay Anand, senior insights analyst

The mid-size car segment has long been the mover of the American automotive industry. From the dominance of the Accord and Camry, to the recent rise of several solid competitors such as the Fusion, Sonata, and Optima; options abound for the car-buying public.

Lately, however, the mid-size sedan segment has been relatively stagnant in terms of sales. Through September, sales of mid-size sedans are flat when compared to the first nine months of last year, while the industry overall is up by 5 percent. What happened, and will the segment rebound as so many people assume it will?

A trend we are seeing is shoppers are looking at the compact and mid-size crossover segments more than ever. The compact utility segment is up 16 percent compared to last year, and the mid-size utility segment is up 12 percent. If a shopper feels comfortable about gas prices and the economic situation, both segments make sense. We're America. We love our SUVs. Compact crossovers give us the utility we desire, a little more fun than the average big hauler, the fuel efficiency we want, and the safety perceptions we need. Look at the sales movers this year: Jeep, Subaru and Nissan. Does anyone doubt that they're moving up in sales because of the respective Cherokee, Forester and Rogue launch and redesigns?

This has resulted in an extremely competitive environment for anyone selling mid-size sedans. While the top five nameplates in the segment have seen sales growth this year, the others, unless recently redesigned, are all down. To achieve this growth, all of the top five nameplates are spending more in incentives (averaged throughout the year), with three of the five increasing spending by \$900 per sale or more. Eight of the 12 nameplates in this segment have averaged \$3,000 per unit or more in

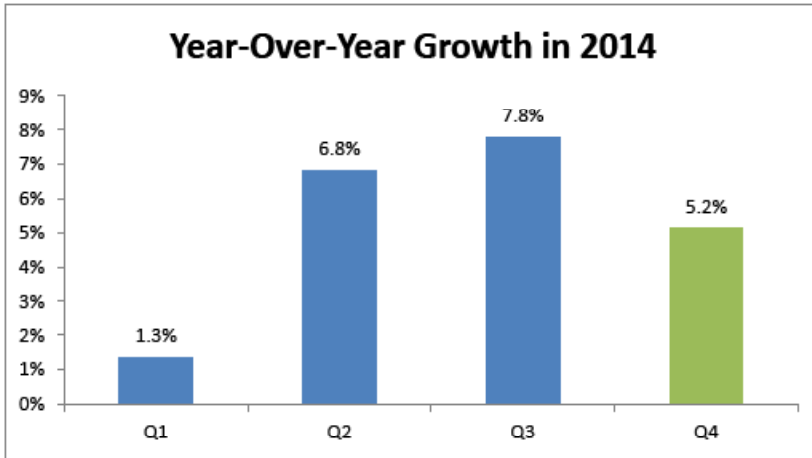
incentive spending year-to-date through September.

Not surprisingly, we see the effects of competition in the vehicles' residual values. Projected 36-month residual values for the 2014 model year are highest for the Mazda6, Subaru Legacy and Honda Accord. All three of these models have held year-to-date spending under \$3,000 per unit this year, with Legacy and Mazda6 under \$2,000 per unit.

Another factor that can impact residual values is the amount of volume directed to rental companies. Here again the Mazda6, Legacy and Accord stand apart from the rest of the segment, as the rental penetration never exceeds 12 percent for these three models (rental penetration is calculated from the cumulative volume sent to rental agencies for the 2014 model year compared to the total volume for that nameplate). For seven of the remaining nine vehicles in this segment, rental penetration ranges from 20 percent to a high of 50 percent.

So what can we expect for the mid-size car segment in the future? In addition to redesigns of the Chrysler 200, Hyundai Sonata and Subaru Legacy, Toyota is refreshing its Camry. But anyone who's seen the Camry inside or out knows this goes beyond a typical refresh. This is basically a mini-redesign which may become more common, whether it's a true mini-redesign or simply an 'emergency/major refresh' like we've seen with the Civic and Malibu. The Altima and Passat are due for refreshes soon. Will they simply change the front fascia and call it a day? Not likely. Cash-flush manufacturers have the ability to essentially keep drumming interest in their volume vehicles by effectively shortening generational timelines with refreshes. It will be really interesting to see how this affects the mid-size car segment and whether that will be sufficient to get it back on pace with the rest of the market.

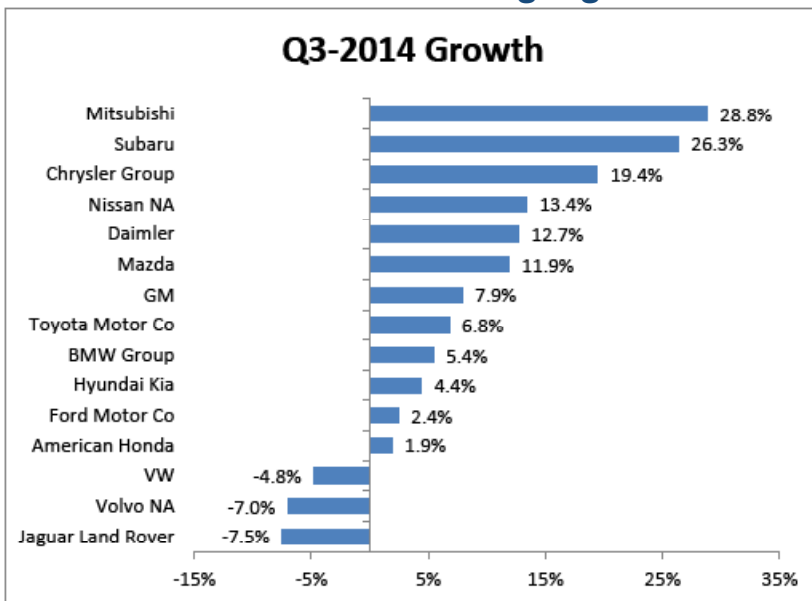
Third Quarter Overview



- Q3 2014 was a strong quarter for the industry, with sales increasing by 7.8 percent year-over-year.
- 4.26 million units were sold in Q3 2014, making this the best third quarter since 2006.
- In the fourth quarter this year, we expect to see the growth pace stabilize as is typical in any given year due to seasonal buying patterns.
- Despite a slight slowdown in Q4, we expect to see industry sales top 16.4 million units overall in 2014.

Source: KBB.com Automotive Insights

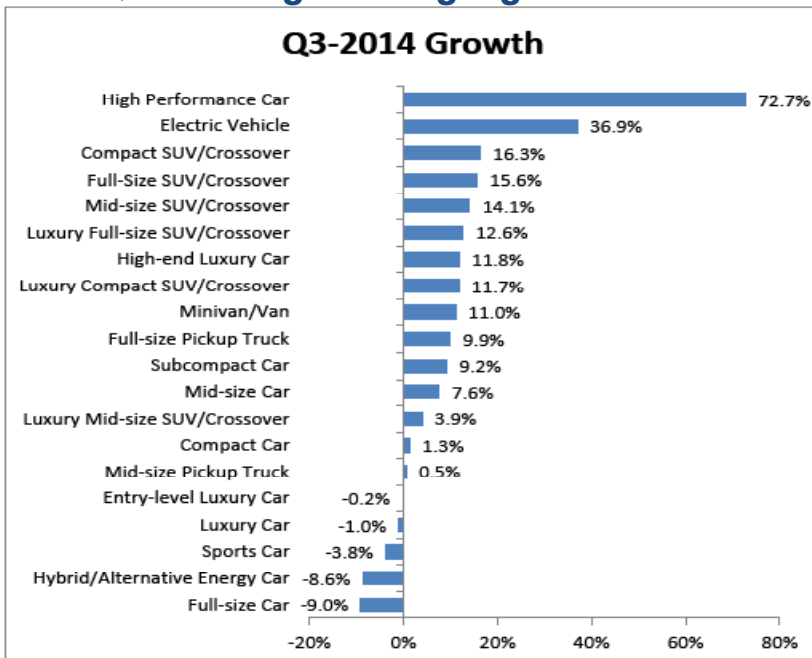
Third Quarter Manufacturer Highlights



- In the third quarter, Chrysler Group built upon what already has been a strong year, riding the success of its Jeep and Ram brands, which were each up by more than 30 percent.
- Subaru also continues to impress, growing market share in the third quarter to 3.2 percent. This is up a half-percentage point from last year, and one full percentage point from two years ago.
- Nissan built a strong quarter on the success of its small cars, the Sentra and Versa, which were each up by more than 48 percent.

Source: KBB.com Automotive Insights

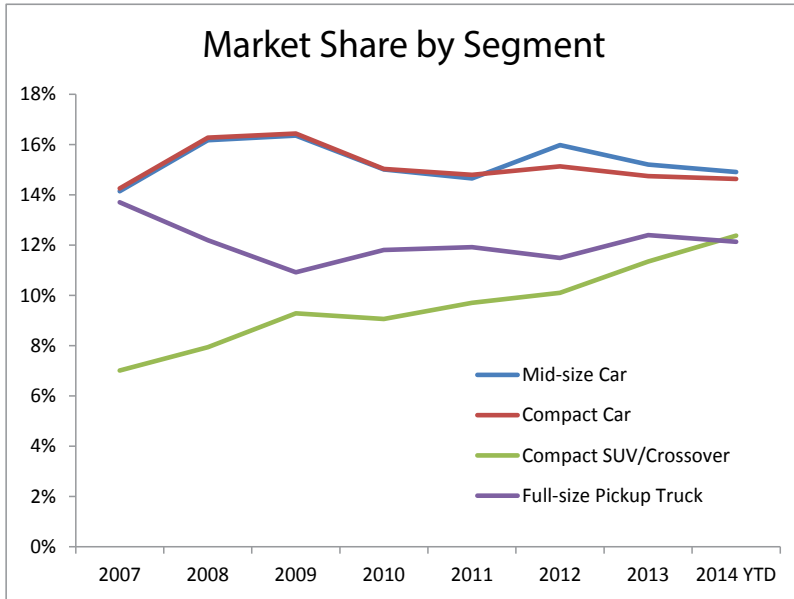
Third Quarter Segment Highlights



- Utility vehicles were very popular in Q3, with combined sales up 14.2 percent. All SUV/crossovers combined accounted for 34 percent of the market, up from 32.1 percent in the third quarter 2013.
- Full-size car sales continue to struggle as they find competition from multiple segments, including mid-size cars, mid-size SUVs and entry-level luxury cars. Third quarter sales are less than half of segment sales prior to the recession.
- The mid-size car segment grew in line with the industry; however, it was propped up by just a few models. The Accord was up 25 percent (+23,862 units), Fusion up 15 percent (+9,940 units), Sonata up 18 percent (+8,895), and Legacy up 70 percent (+6,921 units).

Source: KBB.com Automotive Insights

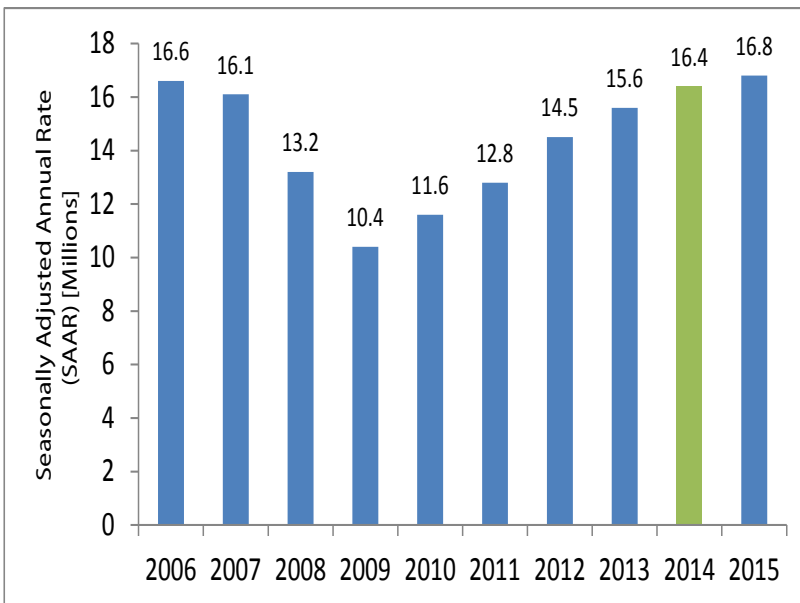
Full-Year/Fourth Quarter 2014 Sales Projection



Source: KBB.com Automotive Insights

- Looking into Q4, we expect sales growth to temper slightly, but still to remain above 5 percent, putting the full year total between 16.4 and 16.5 million units. This would also represent year-over-year growth in the 5 percent range.
- The compact SUV/Crossover segment could surpass full-size pickup trucks as the third largest segment behind mid-size and compact cars.
- 2014 looks to be the third straight year of market share losses for GM and Hyundai/Kia. Conversely, 2014 looks to be the third straight year of gaining market share for Toyota and Subaru. 2014 will be the fifth straight year of market share gains for Chrysler Group.

Looking ahead to 2015



Source: bea.gov

- Sales are likely to continue to grow in 2015 to as high as 17 million units overall. As of now, we believe industry sales will end up between 16.5-16.8 million units overall in 2015.
- This would mark a sixth consecutive year of industry growth, the longest growth streak in the United States dating back to at least 1967.
- Although there is some concern that interest rates may rise at some point in the future from their current historic low, we do not believe that this will have a significant impact on industry momentum.
- Leasing will continue to be an important part of the equation, as the lease penetration rate remains above 25 percent overall. In addition to new lease activity, we expect to see a surge in consumers reaching the end of their lease term in 2015, which should also fuel additional growth.
- It should be noted that while the rise in lease activity thus far has been a positive for the industry, there is risk in the long term that rising off lease volume will detrimentally impact used car values. If used car values take a hit, expect to see a dip in residual values, which at today's current highs are one of the main reasons leasing is so attractive today.

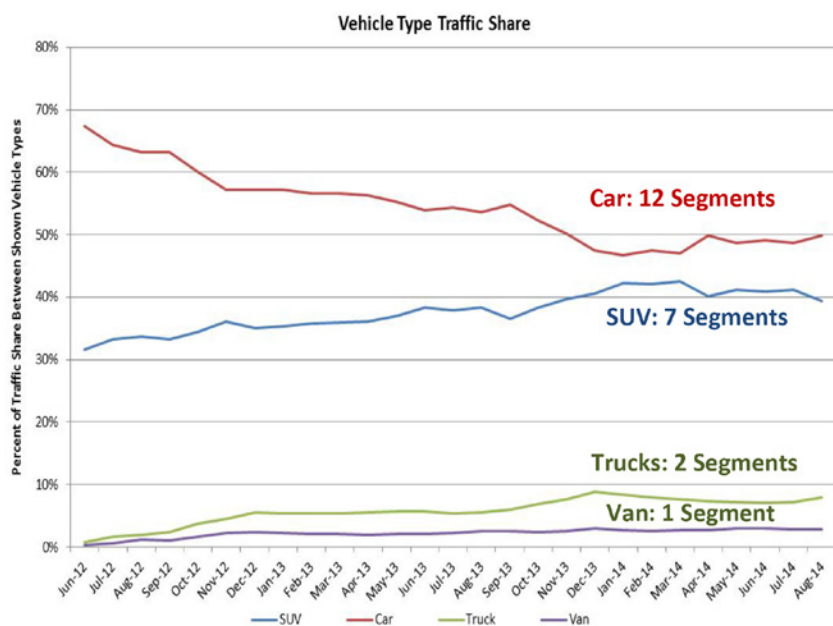
Shopper Loyalty

Considering	Q314 Loyalty	Pt. Δ
TOYOTA	55.4%	3.1
CHEVROLET	47.8%	3.0
FORD	50.8%	2.2
HONDA	50.6%	1.4
HYUNDAI	47.6%	3.3
KIA	43.5%	1.1
MAZDA	38.3%	3.6
NISSAN	42.9%	5.5
SUBARU	52.8%	4.6
VOLKSWAGEN	38.2%	2.0

- Toyota has increased 3.1 percentage points over the past year.
- Toyota's brand loyalty continues to be significantly driven by the Camry and Tundra, however the top ranking in loyalty can also be contributed to the recent redesign and advertising support for the Highlander.
 - 54 percent of Highlander owners are shopping a new Toyota model.

Source: KBB.com's Market Intelligence Shopping Activity Q2 2014 to Q3 2014.

New-Car Segment Traffic Share



- SUV traffic is growing along with the number of SUV segments, with the Compact SUV being the most shopped segment on KBB.com.

Growth is spurred by:

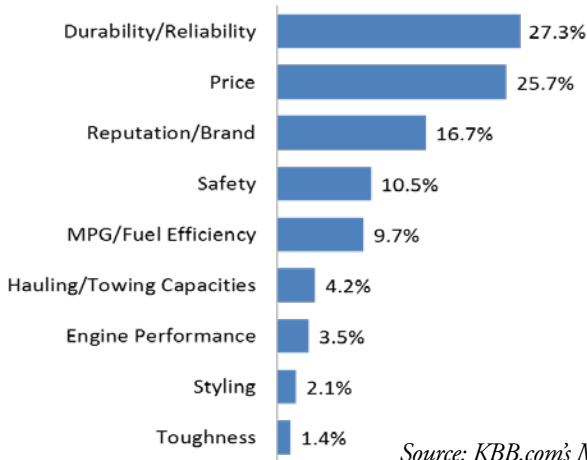
1. Total vehicle sales have been trending upward since 2009.
2. Shoppers are now willing to pay more to purchase or lease a new vehicle .
3. Greater emphasis on safety.

Source: KBB.com's Market Intelligence Shopping Activity

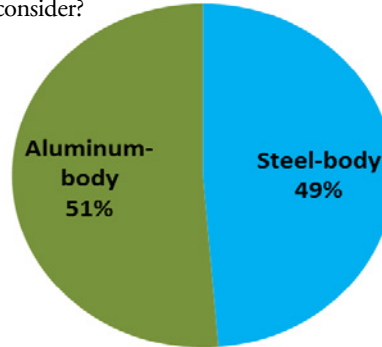
Truck Shoppers Next in Line to Join Fuel-Efficiency Bandwagon

Most Important factor to Truck Considerers

Most Important to Truck Considerers



Question asked: If the truck model that you're considering came in both a steel-body and an aluminum-body version, which would you be more likely to consider?



Source: KBB.com's Market Intelligence Truck Survey Q3 2014

According to a truck study conducted by Kelley Blue Book Market Intelligence in 2014, the No. 1 reason truck shoppers are in-market is because they want improved MPG/fuel efficiency, closely followed by replacing an older vehicle. In the same study, Kelley Blue Book also found that truck shoppers value reputation higher than any other segment shoppers when shopping new, so it's no surprise that Ford, followed by Chevrolet rank high on shoppers' consideration lists. Looking at it from owners perspective, the results showed Ford and Chevrolet have high loyalty with owners returning to the brand repeatedly.

Ford is in a good place with their new F-150 launch with 47 percent of truck shoppers that said they were aware of the launch of the Ford F-150 aluminum body. Furthermore, more than half are open to considering aluminum for their next truck purchase.

All-New Ford F-150 Could Revolutionize the Truck Segment

-By Allyson Harwood, associate features editor for Kelley Blue Book

The Ford F-Series has been the best-selling truck in America for 37 years. However, its dominance is even stronger than that, as it has been the best-selling vehicle in America for 32 years. So it would seem making a dramatic change to Ford's volume truck would be a big gamble.

But there are external forces that have been changing the entire truck segment--specifically fuel economy regulations and changing consumer buying patterns--and the question becomes, how does a truck maker improve fuel economy and appeal to lifestyle truck buyers without sacrificing capability? In the case of the new F-150, the answer is to reduce weight by moving to an all-aluminum body, improve efficiency by moving toward smaller-displacement engines and make the interior more connected and more comfortable.

Weight Loss

The use of military-grade aluminum makes the manufacturing and repair process more complex, but that and use of more high-strength steel in the frame means up to 700 pounds in weight savings. And since the gross vehicle weight rating (GVWR) hasn't gone down, that also translates to increased payload capacity. We took it off-road and towed with it, and it felt rock solid and just as tough as if it were made of steel. The changes also make the Ford feel light and agile, a feeling that's reinforced by the quick response of the new EcoBoost engine.

However, there are some potential issues with the new construction. Ford has done extensive work to make producing and repairing the new F-150 as easy a transition as possible. Some buyers will still have concerns, but most are going to be attracted by the benefits the F-150 has to offer and will see this as buying a new F-150, not as buying an aluminum F-150.

It is currently the only full-size truck to use an aluminum body, but Ram, Chevy/GMC, Toyota and Nissan may have to consider making the switch as well, both to stay competitive with what the Ford has to offer and to deal with increasingly strict fuel economy regulations.

New Power

The aluminum body also means smaller engines can realistically power a large truck. The best example of this is the new 2.7-liter EcoBoost engine. While the 3.5-liter EcoBoost returns--now said to be more fuel efficient--and can now give buyers up to 12,200 pounds of towing capacity, most people will be very happy with the smaller EcoBoost, which can still competently tow and haul. It makes the F-150 fast, with highly spirited throttle response. Unless someone plans on towing 12,000 pounds, the bigger EcoBoost almost isn't necessary. The 2.7 also isn't an expensive option, said to cost only \$795 over the base engine, making it a much easier initial investment than a diesel engine, but with nearly 400 lb-ft of torque and an impressive fuel range.

Neither Ford nor the EPA has announced fuel economy ratings for the new F-150. All Ford has said is that they expect fuel economy to improve 5-20 percent over the 2014 models. While our own evaluations of a SuperCrew XLT powered by the 2.7-liter provided fuel economy in the mid-20s, this was in a prototype truck.

Built for Work and Comfort

The F-150 has gotten more people-friendly and more modern. The cabin is noticeably quieter than it had been. The seats have been redesigned and are very comfortable on long drives, greatly reducing fatigue. But the Ram 1500 still has the most comfortable ride in its class. The Ford has new features, such as a 360-degree camera (making it easier to park), the ability to have text messages read to you as you drive and an easy way to reconfigure the driver information center. Other impressive innovations make it easier to work, such as ramps integrated into the tailgate, the next generation of Ford's tailgate step, new pop-out bed steps and smart LED lighting. Many of these are exclusive to the F-150 and should resonate with full-size truck buyers.

Conclusion

We expect the F-150 to continue to be a strong seller for Ford. It is clear the company has done its homework. If there are any manufacturing delays, that could jeopardize the F-Series' No. 1 sales status in the United States. But the 2015 F-150's pricing is competitive, as is the range of available equipment. The truck is set to start at just above \$26,000, an increase of only \$395. Ford is likely to keep its top sales status, likely influencing the rest of the full-size truck market along the way.

Camry Refresh Checks All the Right Boxes

-By Jason Allan, managing editor for Kelley Blue Book

Attracting buyers with its renowned reliability, excellent resale value and comfortable, easy driving manners, the Toyota Camry has been the best-selling car in the country for most of the third millennium.

But exclude fleet sales and the Camry played second fiddle to the Honda Accord as America's favorite car last year. Camry's longtime rival offers a similar reputation for quality, but the Accord is widely regarded as more stylish inside and out, and a bit more engaging from behind the wheel.

Even Camry buyers have expressed an affinity for more personality, with almost half opting for the sportier-themed Camry SE. So even though plain-Jane styling and unremarkable driving feel have served the Camry very well over the years, Toyota's decision to unleash a more stylish, more responsive Camry for 2015 was actually a pretty safe bet.

We're predicting a big win, in fact.

Stylish New Sheetmetal

An uncommonly comprehensive refresh, the Camry is completely redesigned outside, save the carryover roof. It's not as gorgeous as the Mazda6 or as boldly styled as the Ford Fusion, but the Camry's nicely detailed design -- punctuated by an eye-catching front and refined rear -- promises to attract new buyers without scaring away longtime Camry devotees.

We also suspect the look will stand the test of time better than some of the segment's more novel styles, which tend to age faster. The previous-generation Sonata benefitted greatly from its distinctive design, but the look got pretty stale by the end of its run.

Upgraded Interior

The inside of the 2015 Toyota Camry isn't as new as the outside, but nicer materials, new technologies and a variety of design upgrades give the passenger cabin a markedly fresher feel. Gone, for instance, is the outmoded LED clock module that sat front-and-center at the top of the center stack in the outgoing model. It doesn't feel like a W Hotel, but the new vibe is definitely less grandma's house.

More Responsive on the Road

The rethought Camry still qualifies as one of the most comfortable, easy-to-drive sedans in the segment, but it's also a little livelier now thanks to some structural reinforcements and revised steering, braking and suspension tuning. The changes haven't shaken up the segment's fun-to-drive rankings, but the 2015 Camry definitely offers a more direct, more satisfying connection between car and driver.

Given the popularity of the sportier SE trim, the addition of a new, better-equipped XSE makes great sense. But the XSE's more stylish 18-inch wheels force a bigger compromise in ride quality than many Camry buyers might be willing to make. For the handful of midsize sedan shoppers who will actually put their car through its paces every once in a while, the Camry would still be an odd choice.

Toyota says increased insulation helps make these the quietest Camrys ever, a claim we found easy to believe while on the road.

Pricing Notes

The 2015 Toyota Camry has a starting sticker price just under \$23,000 and tops out closer to \$35,000 for a fully loaded XLE V6 model. While those prices are essentially on par with the outgoing 2014 Camry, the appealing redesign will allow Toyota to back off from the heavy incentives it was using to support sales volume of the outgoing model.

Last Words

Inside, outside and on the road, the significantly refreshed Toyota Camry is now more competitive with its contemporaries, while maintaining a reputation few (one?) of its competitors can match. The Camry faithful will like the changes, and many would-be rejecters of past Camry models will soon wake up pleasantly surprised as proud new Camry owners.

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