Industry Report

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INDUSTRY TRENDS

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RENTAL FLEET PENETRATION IMPACT ON RESALE VALUES

Fleet sales have served many functions over time; some manufacturers used rental fleet sales to help gain exposure for a new product by offering limited vehicles to reputable fleet companies, while others used rental fleet as a channel to off-load excess inventory when actual demand was below production levels. Historically, through proprietary modeling and research, ALG found that high rental fleet penetration levels not only have had a negative impact on residual values, but on perceived quality and brand image as well. In the past, many rental fleet companies purchased the most basic trims available for a particular model with little or no residual value adding equipment. Some manufacturers also offered fleet-only variants that had little equipment and occasionally had less potent powertrains. These strategies served to create a negative image for the fleet model, while increasing used supply on less desirable trims, which diluted the strength of a given model nameplate.

With many manufacturers becoming increasingly aware of this negative impact, the rental fleet strategies have shifted. The trim mix offered to rental fleet companies has begun to include better-equipped vehicles, while many manufacturers have also staggered rental fleet sales in order to mitigate the negative impact from large quantities of used supply returning to the market within a short period of time. While ALG has always recommended a conservative rental fleet strategy, there is some flexibility in rental fleet penetration levels for certain segments.

Optimal Rental Fleet Penetration for Select Segments

Segment	Optimal RFP	Actual Last 12m RFP*
Entry Compact	<20%	28.3%
Mid Compact	<15%	17.1%
Midsize	<10%	16.7%
Fullsize	5-10%	37.8%
Near Luxury	<5%	3.9%
Minivan	Segment Average	22.4%
Compact SUV	Segment Average	10.2%
Midsize SUV	Segment Average	16.9%
Fullsize SUV	Segment Average	18.0%

Results from ALG Proprietary Custom Modeling and External source: R.L Polk & Co. *May'10-April '11

The chart above shows the results of ALG's proprietary custom modeling. Generally and historically speaking, ALG has found that the negative impact to residual values increase when rental fleet penetration levels exceed 10% for mainstream brands, and 5% for luxury brands. The updated custom modeling has shown the following results for selected segments:

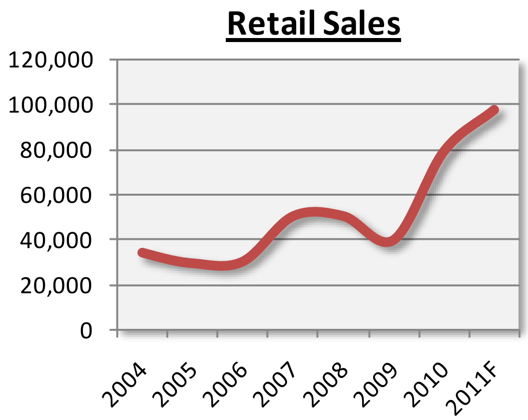
- The Entry Compact and Mid Compact segments see little negative impact on resale/residual values for rental fleet levels up to 15-20%.
- The Midsize and Fullsize segments are consistent with ALG's recommended threshold of 10% rental fleet penetration, while the Minivan, Compact SUV, Midsize SUV and Fullsize SUV segments show that maintaining rental fleet levels consistent with the segment average yields optimal resale values.
- Near Luxury modeling yields results consistent with ALG's established threshold.

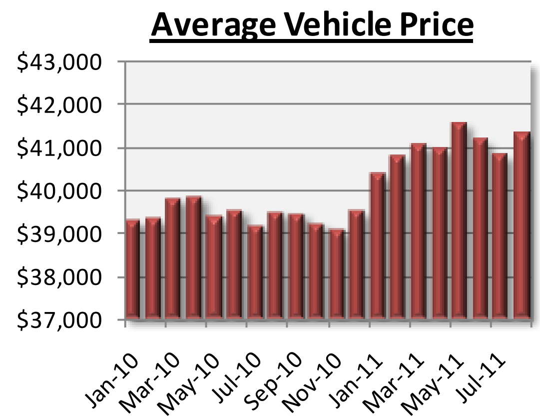
Conclusions

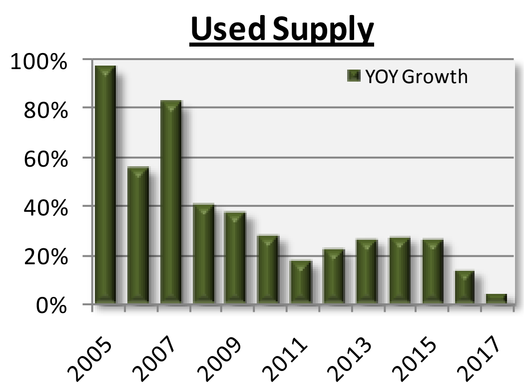
ALG maintains that the generalized rule of 10% and 5% rental fleet penetration for the mainstream and luxury brands remains the key gauge to avoid adverse impact on residual values but is also incorporating these new updated findings. Furthermore, ALG closely monitors rental fleet penetration levels that diverge significantly from optimal levels, as well as trends well above segment averages.

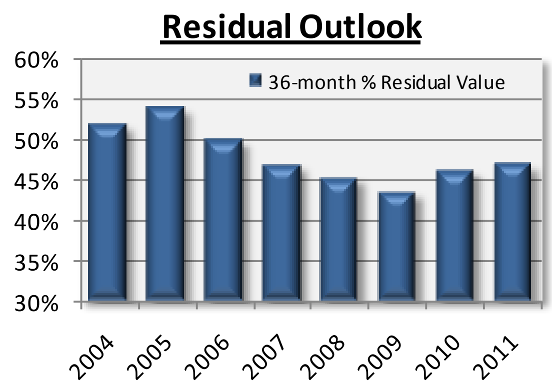
ENTRY PREMIUM CUV SEGMENT

The relatively young Entry Premium CUV segment has experienced significant growth over the last few years, with retail sales increasing three-fold. With the segment only 10 years old, growth has been mostly generated by new entries; individual nameplate sales growth has been limited by the competitive nature of this market segment. While the Land Rover Freelander was around since the 2002MY, BMW's X3 kick started the segment for 2004MY. Visible success in the Premium CUV segment, with the initial entries of Mercedes-Benz M-Class, Acura MDX, Lexus RX and BMW X5, convinced these same manufacturers to invest in a smaller segment, which ALG classifies as Entry Premium CUV. ALG currently includes the Infiniti EX, Mercedes-Benz GLK, Land Rover LR2 (which replaced the Freelander), Audi Q5, Acura RDX, BMW X3 and Volvo XC60 in the segment.









Source: R.L. Polk (Retail Sales), ALG AMP (Vehicle Price), ALG (Used Supply and Residual Outlook)

The charts above provide an overview of the Entry Premium CUV segment in terms of retail sales, vehicle price, used supply growth and residual outlook:

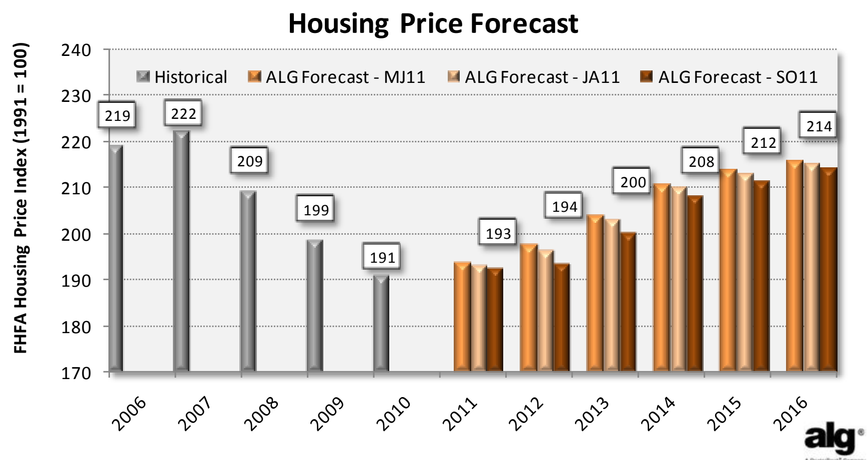
- ***Sales:*** Entry Premium CUV has grown its retail sales from under 40,000 units in 2004CY to an estimated 100,000 units in 2011CY. The manufacturers are expecting to grow this segment to 200,000 in the next few years. According to CSM Worldwide, total sales expectations are to exceed 180,000 units in 2012CY based on new entries such as the BMW X1 and Range Rover Evoque, as well as growth in the existing nameplates.
- ***Vehicle Price:*** Average new vehicle price hovered around the $39,000 mark in 2010CY. According to ALG's AutoMarketPulse data, prices for the segment are trending at the $41,000 level in 2011CY. This is mainly driven by the new-generation BMW X3 and its new 2-trim strategy—with a more expensive xDrive 35i trim—as opposed to the single trim in previous model years.
- ***Used Supply:*** 1- to 5-year-old used market supply experienced high year-over-year growth rates in the segment early on, largely due to the low starting point. The growth rate has consistently declined as the segment has aged. In absolute levels, used market supply is expected to clip the 180,000 unit mark in 2014CY compared to an estimated 94,000 units in 2011CY, mainly due to new entries and sales growth in existing entries.
- ***Residual Outlook:*** The residual outlook has initially been quite strong for the 36-month term, at 52% in 2004. Yet the segment's competitive nature and the addition of new entries have clearly put pressure on used market prices and thus ALG has a more conservative residual outlook. A combination of reduced demand due to the recession, more competition in the segment and increasing used supply is affecting new and used market prices. ALG's current 2011MY outlook is on average 47% for the segment, ~3 ppts higher than its lows for 2009MY.

ECONOMIC OUTLOOK & SEPTEMBER/OCTOBER EDITION SUMMARY

The U.S. Bureau of Economic Analysis (BEA) sharply revised its Q1 2011 GDP growth (quarter-over-quarter) estimate to 0.4% from 1.8%, which is virtually a standstill. The initial growth estimate for Q2 of 2011 came in at 1.3%; a partial factor impacting growth has been weaker automotive industry output. The consensus forecast has been downgraded for 2011 to below 2% annual growth. The outlook for 2012 has also been scaled back to 2-2.5% annual economic growth from earlier estimates this year. In general, a weaker economy also impacts the housing sector significantly. In Q2 of 2011, existing home sales, home prices and housing starts have retracted from more resilient results in Q1 of 2011. For this edition, ALG has adjusted its housing price outlook to marginally impact residual values.

Energy Prices: ALG has not made any changes to the energy prices outlook for the current edition. The Western Texas Intermediate (WTI) oil spot price averaged $97 per barrel in July 2011, which is down from the peaks of over $110 in April 2011. ALG believes the upward trend in oil and gasoline prices since the lows in December 2008 at ~$30 per barrel will continue yet at a slower rate due to the fact that economic growth is not as resilient as anticipated earlier. Rising global energy demand mainly driven by emerging countries is expected to be the chief driver of rising energy prices. Regular gasoline has been averaging ~$3.50 per gallon so far in 2011. The 3-year outlook is pegged at $3.89 while clipping the $4 mark in 2015.

Housing Market: ALG has lowered its housing market outlook for the third time in a row based on a weakening situation in the real estate market. Concurrent with the overall weakness in the economy, going from soft patches to more recessionary tendencies again, the housing market is adversely impacted due to higher unemployment and less income growth. The Federal Housing Finance Agency (FHFA) housing price index (HPI) was reported at 181.8 index points in its latest reading in May 2011, which is down ~6% YOY. The index averaged 191 points last year, whereas the current year-to-date average is roughly 182 points. ALG's adjustment to the housing index outlook is ~0.5% lower than the forecast in the previous edition, resulting in ~0.5-ppt industry decline in 36-month residuals on average. The shorter terms (2012 through 2014) are more heavily affected than values in 2015 and 2016.



Labor Market: The labor market is faring better than in 2010, yet ALG is aware of the weaker momentum currently observed in the unemployment figures, as the general economic trends are adversely impacting various sectors of the economy. In Q2 of 2011 the unemployment rate was on the rise, though about 117,000 non-farm jobs were added in July, lowering the rate to 9.1% from June's 9.2%. Based on the marginal changes in between the editions, no change to the wage outlook has been made for September/October.

Used Supply: ALG has not made any adjustments to the current used supply outlook. A more significant adjustment was made for the July/August 2011 edition to account for the sales trend. The seasonally-adjusted annualized rate (SAAR) of total light vehicle sales has averaged 12.5 million units so far (July YTD) which is roughly 10% higher than last years' rate of 11.4 million units. Consensus forecasts show that the expected sales for 2011 are hovering in between 12.5 and 13 million units.

Overall Impact for September/October 2011 edition: In total, the forecast changes in the economic factors (housing market only) have a residual value impact in 36 months of -0.5 ppts versus the previous edition, depending on a vehicle's sensitivity to housing prices. Vehicles with higher than normal depreciation will show larger declines for this category. Overall, total declines (including housing price changes and expected declines) for the edition were on average 1.8 ppts.

Expected Outlook for the November/December 2011 edition: The November/December 2011 edition is expected to have negative seasonality. Expected declines (depreciation and seasonal pattern) will be roughly -1.2 ppts on average, with varying degrees for particular segments due to differing depreciation rates. Based on the latest economic data, including housing and labor market figures as well as overall economic growth rates, ALG may make further adjustments in the November/December edition to reflect the current and anticipated economic situation. As some experts have pointed out a few months ago that the economy is experiencing soft patches, it has become more evident that the recovery might be troubled with some more systemic issues. ALG is paying close attention to the labor market and therefore disposable income to impact current and future big ticket item purchases such as automobiles. With consumer confidence hitting lows in the 2nd and 3rd quarter of 2011, renewed concerns arise about the resilience of the economic recovery. Overall, ALG is expecting the economic recovery to be slower than anticipated earlier this year.

2012 NISSAN VERSA SEDAN

Until recently, the Versa had been locked in a fairly tight race with the Honda Fit and Toyota Yaris for the Entry Compact sales crown. For the past two years, Nissan has won the fight with a combination of low price (it carried the lowest starting MSRP of any vehicle) and size (its dimensions fall closer to those of a Mid Compact than its entry-level peers). For 2012 Nissan introduces a new sedan—the hatch is expected next year—which retains the same formula, its price going up by $1,000 to $10,990, but still coming in over $1,000 less than the cheapest 2011 Kia Rio. Sporting the same wheelbase, the redesign remedies the old sedan's worst styling offenses, particularly its rear roofline. However, the new styling remains uninspired.

ALG OUTLOOK – Nissan insists that buyers in this segment see value as paramount, but competitive offerings have become more stylish and compelling in recent years, and Nissan has already lost the sales lead this year to Honda and Ford.

September/October 2011	24 Month	36 Month	48 Month	60 Month
Nissan Versa	70%	55%	44%	35%
Nissan Avg.	56%	48%	41%	33%
Entry Compact Car Avg.	61%	49%	41%	32%

2012 CADILLAC SRX

While the SRX may look the same on the outside, under the hood it gets a substantial upgrade. Gone is the 3.0L V6 (the 2.8 turbo was dropped earlier), replaced by GM's 3.6L engine with 308 hp, a bump of 43 horses. Torque rises by 42 lb-ft to 265. This new engine puts the Cadillac in the thick of the competitive set, competing more effectively with the 300-hp Acura MDX and 305-hp Lincoln MKX, while trumping the 275-hp Lexus RX350. In exchange, though, the SRX loses 1 mpg, putting it at the low end of the segment fuel-efficiency spectrum.

ALG OUTLOOK – The SRX has jumped to number two in the segment, challenging the pack on the value front. With gas prices expected to continue their rise, however, buyers may wish for the return of the 3.0L.

September/October 2011	24 Month	36 Month	48 Month	60 Month
Cadillac SRX	67%	55%	45%	37%
Cadillac Avg.	57%	49%	42%	35%
Premium CUV	60%	50%	42%	35%

2012 LAND ROVER RANGE ROVER EVOQUE

Land Rover is extending the Range Rover line further downward, with the Evoque. The smallest Range Rover does a convincing impression of the LRX concept that inspired it, and even offers a 2-door version along with the 4-door that is expected to be more popular. The Evoque shares its underpinnings with the LR2, but justifies its looks and Range Rover badging with more sure-footed on-road handling. It also sports a more refined cabin, but the step up between the two models is a dear $7,500 or more, depending on trim. Unlike the 6-cylinder LR2, the Evoque sources a turbo four from Ford, which, at 240 hp, has only a 10-hp advantage over that six. The more efficient turbo engine, combined with a 350-lb weight advantage, yields an enormous mpg difference, with the Evoque returning 19 city and 28 highway, compared with the LR2's 15/22.

ALG OUTLOOK – Although the Evoque is priced towards the top of the segment, its combination of style and Range Rover cachet should help it to meet Land Rover's modest sales goal.

September/October 2011	24 Month	36 Month	48 Month	60 Month
Range Rover Evoque	67%	53%	43%	34%
Land Rover Avg.	64%	54%	46%	38%
Entry Premium CUV Avg.	61%	49%	40%	31%

2012 AUDI A6

As Mercedes and BMW have continued to consolidate their hold on the Luxury segment (sharing roughly 60% of sales), Audi looks to regain the glory of its 2nd generation A6, which made a big sales splash with its curvy aesthetic. The brand again sets the segment design standard, and takes elements from its upscale A7 and A8 brethren, such as available full-LED headlights, textured wood trim and Audi's touch-pad MMI interface. It even offers an in-car Wi-Fi hotspot. Audi has managed to make the car lighter with aluminum despite more size and features. Powertrains carry over, but a hybrid debuts later in the year.

ALG OUTLOOK – The new A6 should help Audi once again challenge the segment leaders.

September/October 2011	24 Month	36 Month	48 Month	60 Month
Audi A6	64%	54%	45%	37%
Audi Avg.	63%	53%	44%	36%
Luxury Car Avg.	59%	49%	40%	33%

