CHAPTER 2

USED CAR SALES OVERVIEW

New and used vehicle sales will take divergent paths in 2018. New vehicle sales are expected to dip further, while used vehicle sales will rise again. The mix of more trucks and utilities coming off-lease may challenge new vehicle sales this year.

BY CHARLIE CHESBROUGH

2018 OUTLOOK IS ROSY FOR USED CAR SALES

The demand for personal transportation was strong in 2017 with more than 56 million new and used vehicles sold, and 2018 is expected to be a very similar year.

Buying conditions in the economy remain robust, and not much change for automobile consumers is expected over the next 12 months. Strong labor markets, coupled with low interest rates and solid credit availability, are providing a sound foundation for vehicle demand by supporting both the need and ability to buy for potential car buyers.

However, headwinds are growing within the industry, slowing the sales pace, and the mild divergence in 2017 between the direction of new and used sales will continue over the next year.

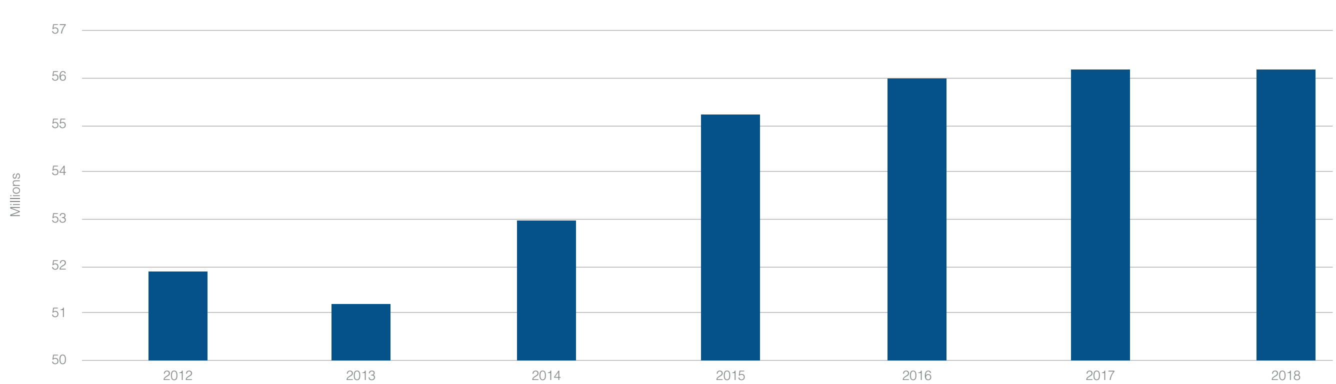
Used vehicle sales finished near 39.3 million units in 2017, up 1.8 percent from the previous year. However, new vehicle sales fell nearly 2 percent. Given that the new vehicle market is in the late stages of the recovery, the modest weakening in demand for new vehicles is not surprising after reaching record peaks in 2015 and 2016. Cox Automotive's expectation is that this divergence trend will continue into 2018, with the used market reaching 39.5 million sales while new sales decline further to 16.7 million. Although buying conditions are strong for all vehicle markets, growth in used supply from off-lease vehicles, coupled with record high prices for new products and a modest pull-back in fleet activity, is steering new and used products in different directions.

OFF-LEASE VEHICLES A HEADWIND FOR NEW CAR SALES

One of the growing headwinds for new vehicle sales comes directly from the used market in the form of off-lease vehicles. Leasing's share of total sales has grown rapidly since the Great Recession, rising from 17 percent of the total market in 2010 to nearly 25 percent in 2016 and 2017. A result of this sales strategy by OEMs is that a large number of off-lease vehicles have been coming back to dealers in recent years and providing a steady supply of high-quality, high-content products. Cox Automotive estimates that there will be nearly 3.9 million off-lease vehicles over the next year. They will provide growing competition for the new vehicle market.

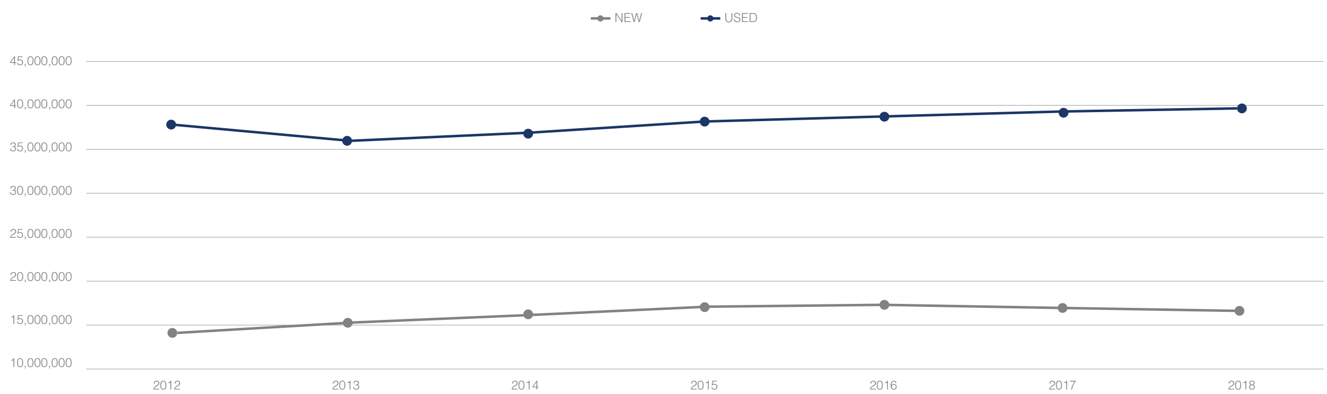
The threat to new sales comes not only from the sheer volume of off-lease vehicles coming back to dealers, but

TOTAL LIGHT VEHICLE MARKET



Source: Cox Automotive analysis of IHS Registrations

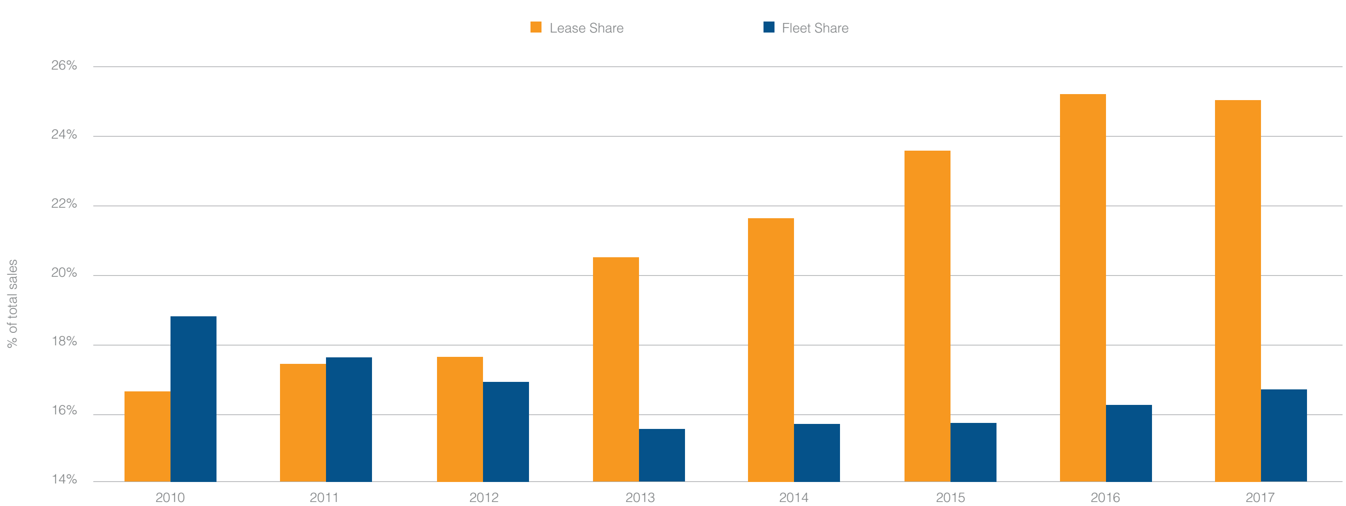
NEW AND USED LIGHT VEHICLE MARKET



Source: Cox Automotive analysis of IHS Registrations

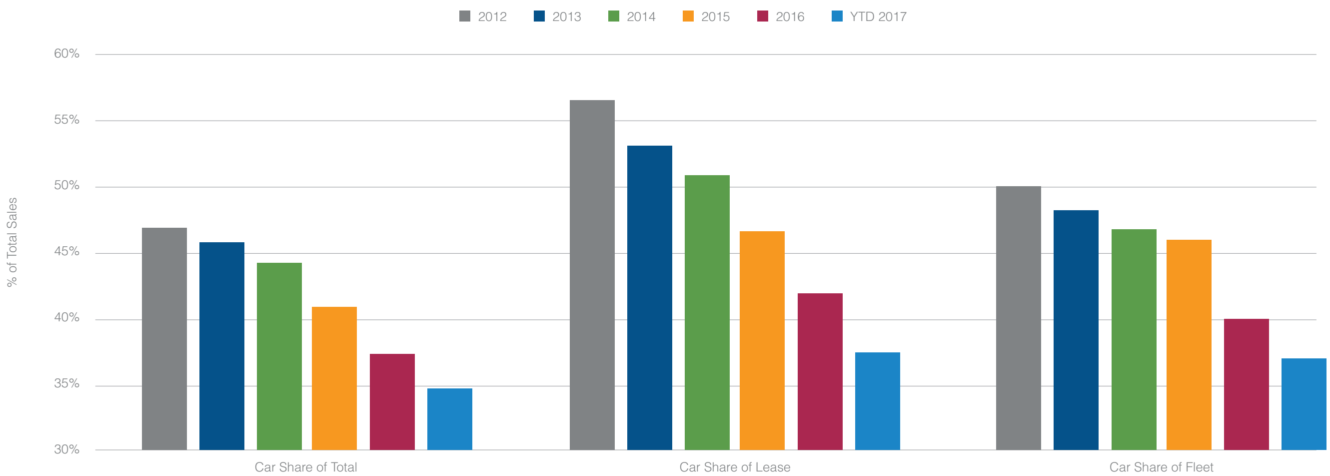
3.9 million vehicles return to the market off-lease in 2018

LEASE AND FLEET SHARE OF NEW VEHICLE MARKET



Source: Cox Automotive analysis of IHS Registrations

PASSENGER CAR SHARE OF NEW LIGHT VEHICLE SALES



Source: Cox Automotive analysis of IHS Registrations

also the types of products that will be available. During the early years of the market recovery, the car segment share of the entire market was 47 percent. However, within leasing, the car share was much higher at 56 percent. In fact, car share of both leasing and fleet has been much higher than the overall market during the recovery period as OEM leasing and fleet strategies were slow to respond to changing consumer preferences. Thus, the off-lease vehicles coming back to dealers in recent years consisted of many car products that consumers today are less interested in.

The product mix returning to dealers over the next couple of years will be different. The off-lease product mix coming back to dealers in 2018 and 2019 will have many more SUVs, CUVs and pickups – the products consumers are most interested in. And, the content of these vehicles will be strong. These are not stripped-down, baseline versions of higher-end nameplates as most, if not all, will have touch screens, Bluetooth connectivity and other key features consumers crave.

This will be a significant threat to some new vehicle segments as used products will provide a viable alternative for some car shoppers. Many consumers will buy only new, but a portion will opt for used vehicles. Some buyers can afford only lower-end new segments; but still, they want a CUV. The flood of off-lease vehicles may change the ownership calculation for some buyers: Priced similarly, do consumers buy a new small car or a "gently used" 3-year-old CUV?

Cox Automotive expects that a couple hundred thousand new vehicle buyers, primarily from the small to mid-sized car segments, will be "lost" to the used market. This shift from new to used for some buyers may drive car share of new vehicle sales even lower as these segments will likely suffer most.

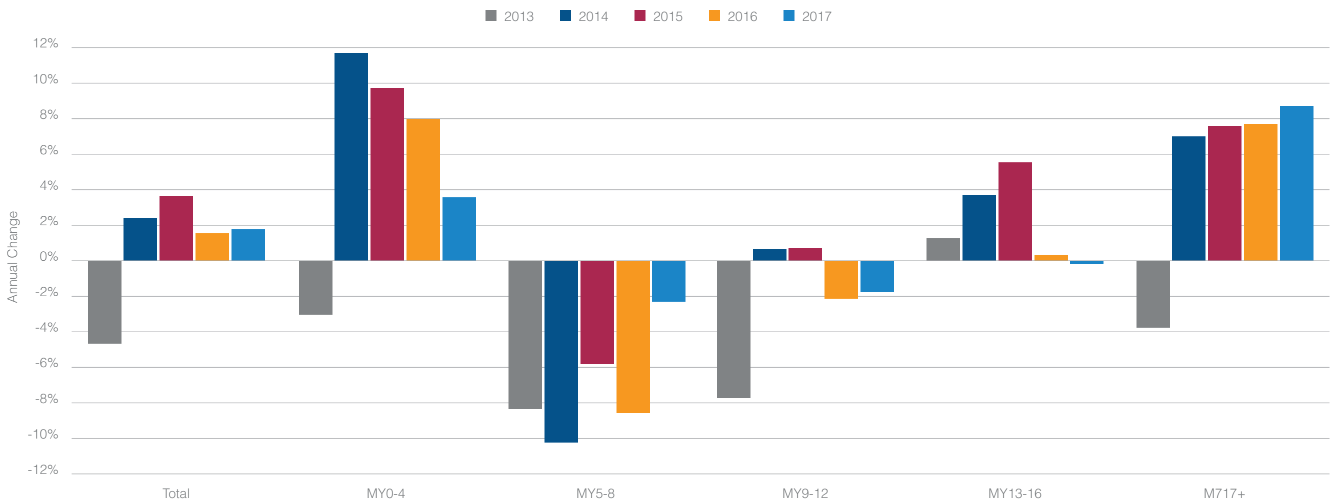
VEHICLES OF A CERTAIN AGE IN SHORT SUPPLY

Besides the emphasis on leasing during the recovery period, the Great Recession is having other lasting effects on the used vehicle market. New vehicle sales fell well below trend from 2008 through 2012, creating a significant supply constraint for some used sales today. Vehicles ages 6 to 10 years old are in limited supply, having implications for both used car buyers and sellers.

Sales in the used market vary greatly by the age of the vehicle. Cox Automotive tracks the market in model year age groups: 0-4 years old, 5-8, 9-12, 13-16 and 17+. Franchised dealers dominate the sales of "gently used" vehicles (0-4 model years old), while older, less expensive vehicles are sold primarily by independent dealers.

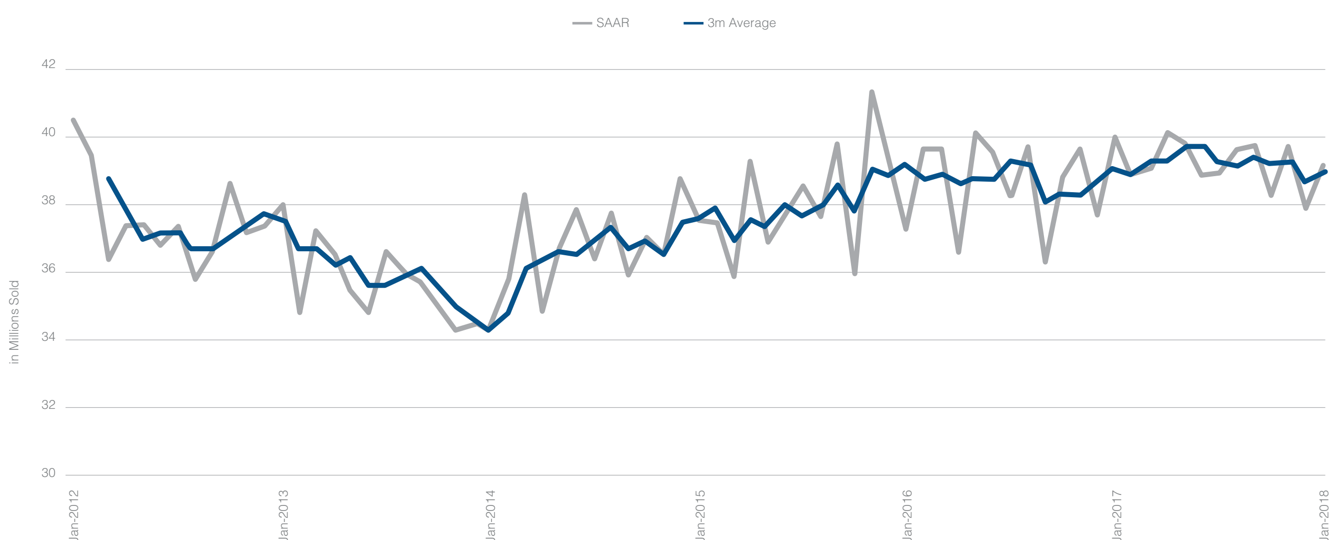
However, because of supply constraints, many independent dealers are being forced to buy newer, more expensive

USED VEHICLE GROWTH RATES BY MODEL YEAR AGE GROUPS



Source: Cox Automotive analysis of IHS registrations

USED VEHICLE MONTHLY SALES SAAR



Source: Cox Automotive analysis of IHS Registrations

vehicles if they want to have inventory. And, many consumers who are budget-constrained are forced to buy above or below their desired vehicle age due to supply limitations.

The market growth rates of these vehicle age groups reveal the supply issue facing the used market. Gently used vehicles are now past their growth peaks, but are still growing as record new sales and aggressive leasing continue to provide supply to this segment. However, middle-aged vehicles reveal the supply constraint in the market as 5- to 8-year-old, 9- to 12-year-old and even 13- to 16-year-old vehicles sales all declined in 2017. The oldest vehicles, those ages 17 years and above, are seeing strong sales growth as better quality, more affordable products continually support this segment. In 2018, these trends are expected to continue.

USED VEHICLE SALES SAAR

Cox Automotive's Used Vehicle SAAR estimates the seasonally adjusted monthly sales pace and has found the total market to be quite volatile. Measuring activity in the used market is challenging, particularly since more than 50 percent are private-party transactions. The Used SAAR three-month moving average removes some of the volatility and reveals the history and momentum over the last four years.

The sales pace began falling in early 2013 due to recession-created supply constraints but has been rising steadily since. With the new market reaching sales peaks in 2015 and 2016, and leasing's large share, there is strong support for the used market to continuing growing over the near term from this supply.

Cox Automotive expects the used vehicle market to grow above 39.5 million in 2018. Buying conditions for the used light vehicle market are expected to remain robust throughout the year, and implementation of tax reform policies will contribute.

METRICS THAT MATTER

FOR BEST DEALERSHIP PERFORMANCE

Cox Automotive studied vast amounts of data from thousands of dealers, including the highest performers, to come up with a list of Key Performance Indicators (KPIs) and best-in-class benchmarks against which dealers can measure their own performance.

USED-TO-NEW RATIO

Good 1:1 Great 1.25:1

Used retail unit volume equaling or surpassing new retail volume is a foundational correlation of highly successful used-vehicle departments, assuming the dealership is meeting new vehicle volume goals. Success in used-to-new ratio requires a combination of acquisition, reconditioning and retailing skills. In today's market, a key driving force is the resulting increase in profitability, which releases some pressure on the new-vehicle department for overall dealership profitability.

PRICE TO MARKET / MARKET DAYS SUPPLY

Top performers embrace the balance between a vehicle's desirability and its price. They use data to dictate when it is appropriate to "go for the gross" and when the window for profit is short, so they need to price aggressively from the start. The data is also a foundational element in inventory acquisition and appraisal processes.

INVENTORY TURN RATE

Good 12 Great 16

The inventory turn rate is the amount of in-stock inventory compared to monthly sales. The highest performers turn inventory every 20 days. Fast turn rates require a commitment by all dealership departments and a focus on efficiencies, including age intolerance. The reward is worth it. Fast inventory turns maximize high-gross opportunities associated with fresh inventory and drives profits in other dealership departments.

MECHANICAL AND COSMETIC RECONDITIONING TIME

3 days

Top performers solve reconditioning delays. It may require dedicated techs, staying open late and sublet. Speed is paramount.

PACKS

Good: Max 1% of vehicle value Great: $0

High performers understand the drag that packs place on their used operations. They slow down acquisition, including reducing new car appraisals. Packs made sense prior to the internet age, but those days are long gone.

REDUCED RECONDITIONING MARKUP FOR OLDER VEHICLES

Retail reconditioning hinders vehicle acquisition, especially on older vehicles that tend to be some of the most desirable but also have the highest reconditioning costs. Top performers recognize the strain and reduce the rates for older vehicles, typically five years or older.

IMMEDIATE WHOLESALE VOLUME

Under 33%

Top used-car departments separate the measurements of immediate wholesale, that is, a vehicle never offered for retail from aged wholesale. They look for ways to keep trades. They typically have discounted recon rates for older vehicles and few to no packs.

IMMEDIATE WHOLESALE PROFIT/LOSS PER VEHICLE

+/-$150

The goal is a small profit/loss per vehicle, an indication that appraisers are accurately assessing valuations and assumes no inventory adjustments or pack adjustments. It is closely tied to appraisal-to-trade ratio.

AGED WHOLESALE LOSS PER VEHICLE

Up to 5% of vehicle cost

Aged wholesale losses are from vehicles that were wholesaled after an attempted retail. Top performers recognize vehicles that were reconditioned and offered for retail but did not sell are likely to lose money. They separate these vehicles from the ones that were immediately wholesaled and set a KPI for the average wholesale loss on these specific units. A benchmark of 5 percent wholesale loss allowance is common. High-performing dealers do not consider a pack adjustment to offset these losses. They want the ability to identify the losers and look for any process adjustments that might prevent future losses.

APPRAISAL-TO-TRADE RATIO

50%+

The appraisal-to-trade ratio is the ratio of all vehicles appraised to how many were traded. Ideally, the metric is tracked by individual appraiser and salesperson. It is a key indicator of the support the used-car department provides to the new-car department. Packs, excessive recon charges and aged used inventory contribute to lower ratios. Another key factor is the point at which the appraisal occurs in the sales process. Dealerships that appraise vehicles early on tend to have lower ratios as they are appraising many more trades.

GROI

Good 120%+ ***Great 160%+***

GROI, or Gross Return on Investment, is the product of the gross as percentage of the sale multiplied by turn rate. For example, a $10,000 vehicle generates a $1,000 profit for a 10 percent gross as a percent of sale. Is that a good job? It depends how long it took to sell. If it took a year, the turn rate would be one for a GROI of 10. If it sold in one month (a 12-turn equivalent), the GROI would be 120. For a vehicle to make financial sense, the goal is a minimum GROI of 120. This concept can also be applied to an entire inventory.

COST TO MARKET

The highest achievers monitor Cost to Market, which compares the retail value of a vehicle to the total investment in a vehicle, including acquisition cost, reconditioning, transportation, pack, etc. Efficient dealers minimize costs to enable aggressive acquisition of inventory and deliver maximum ROI.

BY LES ABRAMS

Cox Automotive Director, Training and Dealer Services

The opportunities at Fox Motors are in the pre-owned departments and service. We invested in a lot of new technology in 2017 and expect this to help us gain share in these areas. Our customers are interested in working deals online and using the digital retailing tools to make their negotiation process smoother. They want a more efficient process that results in less time in the store. We see the future customer being even more focused on the ability to buy a car online. At Fox Motors, we value the customers' time and will adjust to their needs and car buying preferences. If this means investing in more technology to do so, we are on board with that. We now offer a mobile delivery service for customers who would rather have their vehicle delivered to home or work. This has been popular, but we believe it will become even more popular as time goes on. Time is valuable, and we need to respect it.

– DIANE MAHER

President and COO, Fox Motors, Grand Rapids, Mich.

ABOUT COX AUTOMOTIVE

Cox Automotive Inc. makes buying, selling and owning cars easier for everyone. The global company's 34,000-plus team members and family of brands, including Autotrader®, Dealer.com®, Dealertrack®, Kelley Blue Book®, Manheim®, NextGear Capital®, VinSolutions®, vAuto® and Xtime®, are passionate about helping millions of car shoppers, 40,000 auto dealer clients across 100+ countries and many others throughout the automotive industry thrive for generations to come. Cox Automotive is a subsidiary of Cox Enterprises Inc., a privately-owned, Atlanta-based company with revenues exceeding $20 billion.

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