

## INDUSTRY TRENDS

### TOYOTA RECALL IMPACTS RESALE

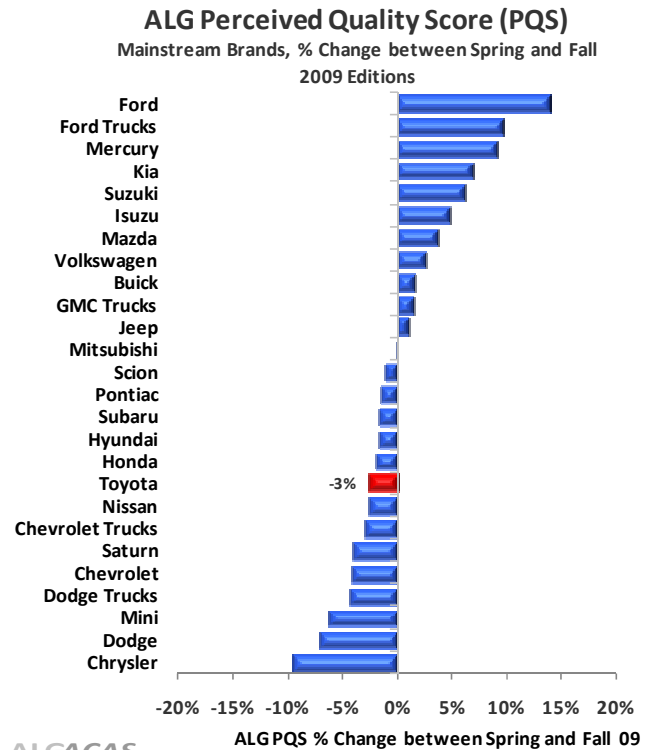
Reputation is the heart of any brand. Toyota has been renowned for its high quality and vehicle reliability, as a case in point it became one of the top 10 world's leading brands in 2008 based largely on its reputation for "reliability," according to the Global 500 report. This ranking made Toyota the world's most valuable automotive brand, remarkably earning 91% brand recognition.

Although their brand success didn't happen overnight, it appears their reputation for reliability is unraveling. Since September Toyota has recalled 8.5 million vehicles globally because of safety issues relating to gas pedals, floor mats and brakes and is considering further recalls.

Prior to the recalls, the Toyota brand image was already beginning to erode, however. Twice a year ALG measures perceived quality by asking consumers to tell us what they believe about the quality of the vehicles associated with each brand.

Based on findings from two of our most recent PQS studies (see chart at right), consumers were becoming less enchanted with the Toyota brand. Between the Spring and Fall of 2009, Toyota's perceived quality had already declined by 3%, months before the recall announcements.

How did this happen? Toyota may have pushed for sales at the expense of quality. Sales have increased by 59% since 1999, and Toyota currently holds 14.7% of the industry share, up from 7.6% in 1999. High incentives have plagued Toyota in the resale market. As noted in the sales and incentives chart below, incentives have increased on average from \$737 in 1999 to \$1,593 in 2009. In spite of such high incentives, the brand retained its value, largely due to its reputation for reliability and quality. Unfortunately, with the current erosion of Toyota's brand image, it is likely that high incentives will have more impact on resale values.



**ALGACAS**  
ALG PQS % Change between Spring and Fall 09

As of the March/April edition ALG has already included some negative adjustments to the residual outlook for the overall brand to the declining brand value, PQS and increases in incentives. ALG forecasts Toyota's PQS to decline by 5% over the next three years, resulting in a small 1% residual value decline over the next 36 months. Toyota's latest situation needs to be remedied quickly and without future recalls. If this is achieved, then it should have minimal impact to perceived quality. The impact of a damaged brand image would be lower sales and resale values. Within 3 to 4 years the reduced level of Toyota inventory will begin to appear in the used market and, to some extent, will help boost resale values of the brand, but due to declining demand, the net effect could be negative compared to today.

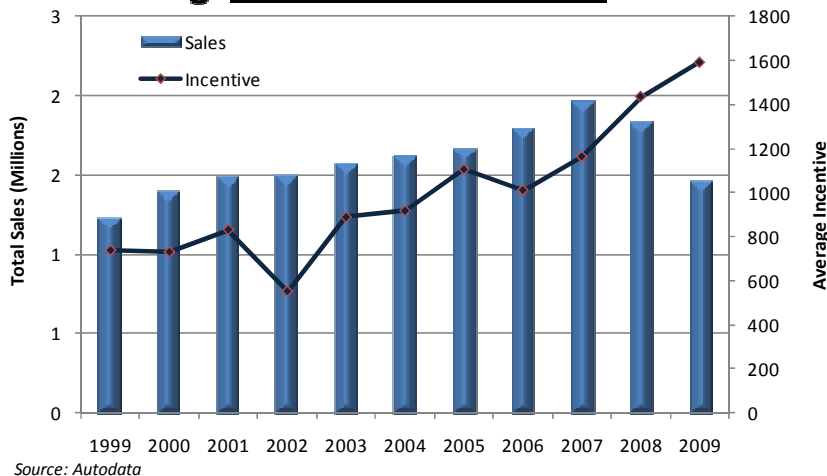
### Impact on Resale

As of the March/April edition ALG has already included some negative adjustments to the residual outlook for the overall brand to the declining brand value, PQS and increases in incentives. ALG forecasts Toyota's PQS to decline by 5% over the next three years, resulting in a small 1% residual value decline over the next 36 months. Toyota's latest situation needs to be remedied quickly and without future recalls. If this is achieved, then it should have minimal impact to perceived quality. The impact of a damaged brand image would be lower sales and resale values. Within 3 to 4 years the reduced level of Toyota inventory will begin to appear in the used market and, to some extent, will help boost resale values of the brand, but due to declining demand, the net effect could be negative compared to today.

ALG is currently reviewing critical data regarding the impact of these recalls, which will be available

in the next few days. ALG will be providing the industry a comprehensive report in Mid March which will provide a solid insight on the impact to Toyota demand in the short term, the value of the Toyota brand over the next several years, and on how this situation compares to other recalls in the past.

### alg Sales and Incentives: Toyota

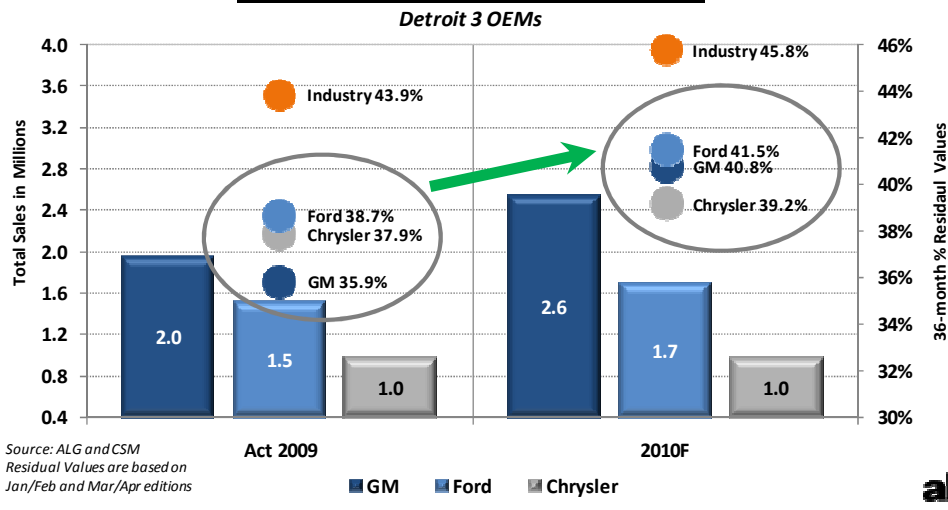


in the next few days. ALG will be providing the industry a comprehensive report in Mid March which will provide a solid insight on the impact to Toyota demand in the short term, the value of the Toyota brand over the next several years, and on how this situation compares to other recalls in the past.

## DETROIT 3 OUTLOOK

GM and Chrysler required a hefty infusion of tax-dollars to stay alive in 2009. As part of its federal financing deal, Chrysler was required to form a strategic alliance with Italian automaker Fiat. Ford, the sole bailout exception, avoided bankruptcy, and of the three Detroit automakers performed well in 2009. Yet overall U.S. auto sales in 2009 dropped to 10.4 million units, down from 13.1 million in 2008. Even though the Cash for Clunkers program was popular with an incremental ~700,000 cars sold, foreign automakers benefited more than U.S. automakers in 2009. In 2010, sales performance is showing new signs of life for the Detroit 3. GM was up 14% YOY and Ford performed with sales growth of 25% YOY in January 2010. On the other hand, Chrysler was down 8% YOY - Toyota and Honda experienced a sales decline of 16% and 5% YOY, respectively. However, the overall industry posted a sales gain of ~6% YOY.

### 36-month Residual Value vs. Sales Outlook



**GM Outlook** - At the start of 2009, GM had eight brands. It has since dropped or sold off Hummer, Pontiac, Saab, and Saturn. In 2010 and forward, GM is focusing on its four core brands (GMC, Chevrolet, Buick, Cadillac). While shedding less performing brands as well as exiting bankruptcy swiftly, the impact on perception has been less visible.

- **Sales forecast** - GM displays the highest forecasted growth in total annual sales according to CSM Worldwide, up 30% from 2009 levels to ~2.6 million units
- **Residual outlook** – GM's current 36-month residual performance is at 40.8% on average which is 4.9 pts higher than in 2009 (only January / February and March / April editions are included)

**Ford Outlook** - Ford successfully reduced incentives and fleet sales, leading to an improved residual outlook. The automaker also has the best reputation and perceived quality among the Detroit 3. Additionally, Ford performed well without any government bailout which has impacted consumer perception – Ford posted the strongest gains in ALG's perceived quality score (PQS) in the Fall 2009 survey versus the Fall 2008 iteration.

- **Sales forecast** - Ford shows 11.6% YOY growth for 2010 from 2009 levels to ~1.7 million units
- **Residual outlook** – Ford's current 36-month outlook is at the top among the Detroit 3 OEMs with 41.5% - 2.8 pts higher than in 2009

**Chrysler Outlook** – Even though Chrysler has managed to come out of bankruptcy quickly in 2009 with minimized impact on resale values, uncertainty about the product plan under the alliance Fiat still remains. This has also impacted the perception of the Chrysler brands while clearly slipping in ALG's PQS by significant amounts relative to pre-bankruptcy perception

- **Sales forecast** - Chrysler is relatively flat at <1% expected YOY growth from 2009 levels
- **Residual outlook** – Chrysler's current 36-month outlook has slipped to the bottom of the Detroit 3 at 39.2% - a gain of 1.3 pts over 2009

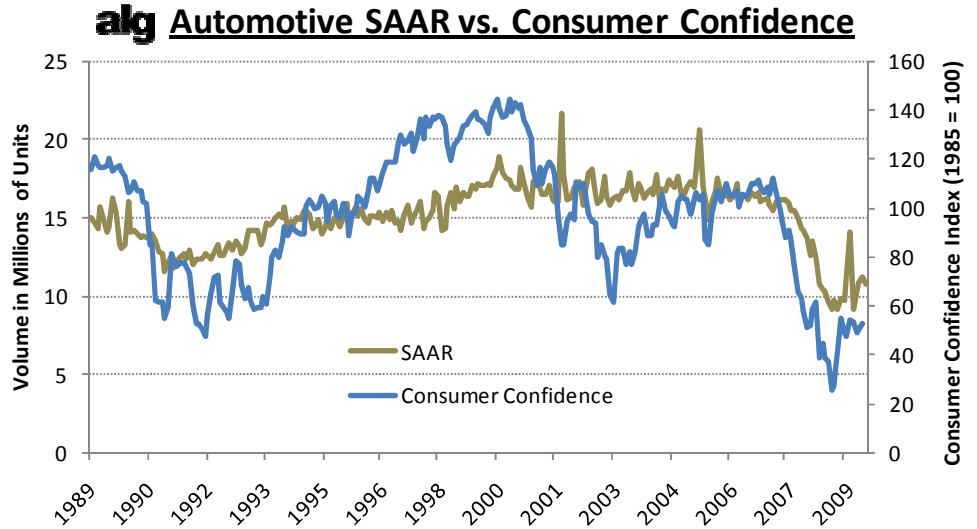
**Conclusion** - 2009 was one of the roughest roads the auto industry has traveled with significant difficulties for the Detroit 3. Yet the road ahead looks more promising for the Detroit 3 with on average a gain of ~3 pts in the 36-month residual outlook. GM is projected to be the big gainer, coming from a low point. Because of uncertainty Chrysler remains rather flat in the sales outlook and gains little in ALG's residual forecast falling back to third position. Ford is on track to further strengthen its leadership position among the three (followed closely by GM). ALG predicts an industry gain of ~2 pts in 36-month residuals over 2009.

# INDUSTRY TRENDS

## SALES EXPECTATIONS

Automotive sales have declined dramatically over the last two years. Between September 2008 and March 2009, the U.S. economy diminished at about a 6% annualized rate, and suffered through the sharpest rise in the unemployment rate since the 1930s. Automotive sales were particularly hard hit, seeing a decline from 16.2m (Seasonally Adjusted Annualized Rate) on average in November 2007 to 9.2m in April 2009.

Nonetheless, there are signs that the worst is behind us. According to the GDP definition of recession, the recession ended in Q3 2009 as we saw 0.6% growth in Real GDP; this was followed by even stronger growth of 1.4% in Q4 2009. Positive signs are slowly beginning to appear. Consumer Confidence has recovered 37% YOY, with automotive sales following behind with a recovery of 8% (see chart to the right). Boosting consumer confidence is the fact that job losses are down and unemployment has recovered from its high in October 09 at 10.1%, recording a rate of 9.7% in January. The President's Economic Report predicts for 2010, the average monthly gain in jobs will be about 95,000. These job gains contrast favorably to job losses from January 2009 through December 2009, a period that averaged 350,000 job losses per month. As a caveat, Federal Reserve Chairman Ben S. Bernanke while claiming an end to the recession warned that growth may not be strong enough to quickly reduce the unemployment rate. In other words, we could be facing a jobless recovery. And a recovery with high unemployment would not bode well for automotive sales.

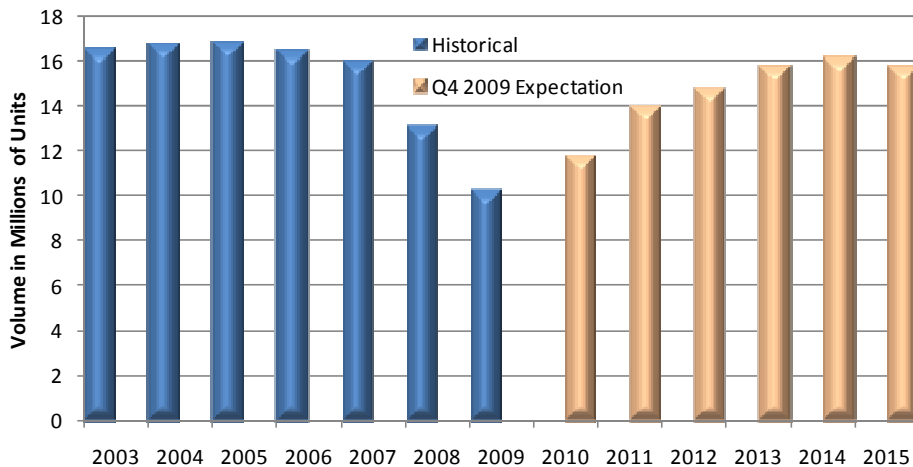


Source: SAAR - St Louis Fed, CC - Conference Board

### Outlook

ALG believes that despite the short term difficulties that may arise, the unemployment rate should decline over the next two years, bringing it down to around 5-6% historical levels. ALG also believes that wage recovery is not too far away. Wage growth hit a low in September 09 at 4.5% down YOY; it has since recovered, but remains in negative territory. ALG expects that wages will begin to see growth over the next two to three months. Based on estimates from CSM Worldwide (see chart at left), auto manufacturers may expect industry sales to reach 11.85 million for 2010. CSM expects a rebound in sales numbers over the

### alg Industry Sales: History & Expectations



Source: Wards/CSM Q4 2009

next 4 to 5 years to reach 2007 levels. Slow and steady is the course. The impact on the used market will be stronger demand going forward, in combination with declining supply through 2014 due to the low new market sales in 2008 and 2009, boosting residuals. From 2015 supply will begin to pickup reflecting the forecasted growth in new market sales, and this will lessen the positive impact on residuals.

## NEW PRODUCTS

### 2010 TOYOTA 4RUNNER

With fuel economy coming to the forefront of many buyers' consideration lists, Toyota has an interesting response. With other companies (like Ford and GM) dropping their truck-based SUVs in favor of crossovers, the 4Runner will stick around, though its engine lineup now tilts heavily toward economy. The V8 option is no more, while the 4Runner gains a 157-hp 4-cylinder engine. Oddly enough the I-4's highway mileage is the same as that of the upgraded 270-hp V6, which beats the old six by 2 mpg hwy. The new off-road-focused Trail trim gives some insight into the 4Runner's *raison d'être*.

**ALG OUTLOOK** – Sales in this segment will likely continue to drop off, though buyers now have the option of a body-on-frame SUV that matches or beats the fuel-economy of the Honda Pilot. This means that compromising capability is less of a necessity for the sake of efficiency. It may be tough for Toyota to communicate this fact in the face of the segment's stigma, though.



March/April 2010	24 Month	36 Month	48 Month	60 Month
<b>Toyota 4Runner</b>	55%	50%	42%	35%
<b>Toyota Avg.</b>	57%	50%	41%	34%
<b>Midsized SUV Avg.</b>	45%	39%	31%	26%

### 2010 BMW 5 SERIES GT

BMW's recent strategy has been to diversify into several new niches in order to capture additional marginal volume gains. The 5 Series GT fills the tiny gap between the 5 wagon and the X6, with a raised ride height and increased utility from its trick dual-function tailgate. Engine choices include the 400-hp 4.4L turbo V8 first seen on the new 7 Series, with which it also shares much of its platform. The 300-hp 3.0L turbo used across BMW's line-up will also be available a couple months after launch. The 5 GT is roomy and comfortable, and even manages to be an engaging drive, despite its increased height and weight.

**ALG OUTLOOK** – The 5 GT is certainly a unique proposition, and that could be either to its advantage or disadvantage. Many buyers will no doubt be unsure of exactly what the vehicle is, but those who are convinced to check it out in the showroom will be impressed by its comfort, flexibility and ride. The Mercedes R Class suffered for its out-of-the-box shape and questionable styling, but BMW has had success with the X6, and buyers are demanding more utility from their cars.



March/April 2010	24 Month	36 Month	48 Month	60 Month
<b>BMW 5 Series Gran Turismo</b>	48%	42%	33%	27%
<b>BMW Avg.</b>	52%	46%	37%	30%
<b>Luxury Car Avg.</b>	50%	44%	35%	27%

### 2010 HYUNDAI TUCSON

The new Tucson finally escapes Hyundai's dowdy old styling idiom, with a sleek shape and completely modern details. It also presents a big story on the powertrain side, with solid fuel economy of 23 city/31 highway. Hyundai's new 6-speed auto and the Tucson's relatively light weight help to achieve these impressive numbers, as well as some fairly sporty driving dynamics. The turbo I-4 that arrives next year should be an even bigger story in terms of both power and fuel economy.

**ALG OUTLOOK** – Hyundai is on a roll right now, and the Tucson is no exception. The compact crossover will be well positioned in a segment that is poised for strong growth as the economy rebounds, especially with its focus on fuel economy.



March/April 2010	24 Month	36 Month	48 Month	60 Month
<b>Hyundai Tucson</b>	59%	51%	44%	39%
<b>Hyundai Avg.</b>	55%	47%	37%	29%
<b>Compact SUV Avg.</b>	53%	46%	38%	31%

### 2010 SUZUKI KIZASHI

After a four-year absence from the Midsized segment, the Kizashi fills this important gap for Suzuki. Unlike the poor-selling Verona, the Kizashi is a completely in-house effort by Suzuki, and the automotive press has been pleasantly surprised. Praise for its handling has been high, and its 2.4L I-4 is strong and smooth. The Kizashi's styling is based off of the previous concept car, though its proportions have lost some of their sex appeal since then. Still, Suzuki is confident enough in its new sedan that it will pay \$100 to anyone who test drives the Kizashi and then goes on to buy an Acura TSX 2.4 or Audi A4 2.0T.

**ALG OUTLOOK** – The Kizashi is an impressive Midsized entry, but the Suzuki brand will be the limiting factor in its success. Any buyer who drives it will be impressed, but Suzuki will need to spend a good deal of marketing money to bring awareness up. If too much of that money comes in the form of incentives, the Kizashi could suffer in the long term.



March/April 2010	24 Month	36 Month	48 Month	60 Month
<b>Suzuki Kizashi</b>	54%	47%	42%	36%
<b>Suzuki Avg.</b>	53%	45%	36%	28%
<b>Midsized Avg.</b>	53%	45%	36%	29%