

Hawaii Auto Outlook™

Comprehensive information on the Hawaii automotive market

Market Has Likely Reached Bottom; Improvement Expected by 2010

19.8% decline predicted for state market this year; Year-over-year increase is possible in the Fourth Quarter

The past six months have been, perhaps, the most difficult period ever for the modern automotive retailing industry. The abrupt stoppage in the flow of credit during the fall of 2008, combined with the recession and the abysmal state of household finances, have brought Hawaii new vehicle sales to a trickle. In addition, dealerships are caught in an intense squeeze play, as demand for new vehicles has come to a screeching halt, and the massive de-leveraging occurring in the banking industry has dried up sources of credit to fund floor planning.

The key question on everybody's mind is: when will the sales floor be reached? Obviously, in this environment, any sales prediction has a great deal of uncertainty, but we feel strongly that the market is at, or very close to, its low point. Simply put, new vehicle sales cannot fall much lower. The level of postponed purchases (i.e., pent up demand) is reaching record levels, and the majority of economists expect GDP growth to turn at least slightly positive before the end of the year as the bevy of fiscal and monetary stimulus programs kick in.

As summarized on the right, it appears as though the sales recovery will be gradual, but sustained. Consumer confidence, perhaps the best predictor of new vehicle sales, is at depressed levels and there is little reason to expect a quick rebound. Combined with excessive household debt, a sudden and sharp rebound in new vehicle sales is highly unlikely. Still, based on how far the market has fallen, improving conditions are nearly guaranteed, and there is a slim chance of an upside surprise.

Why Recovery Should Be Gradual, but Sustained

Pent up demand is reaching record levels New vehicle purchases are being postponed in record numbers and the median age of vehicles on the road is increasing. When the economy recovers and consumer confidence improves, financially sound consumers (see below) will enter the market.

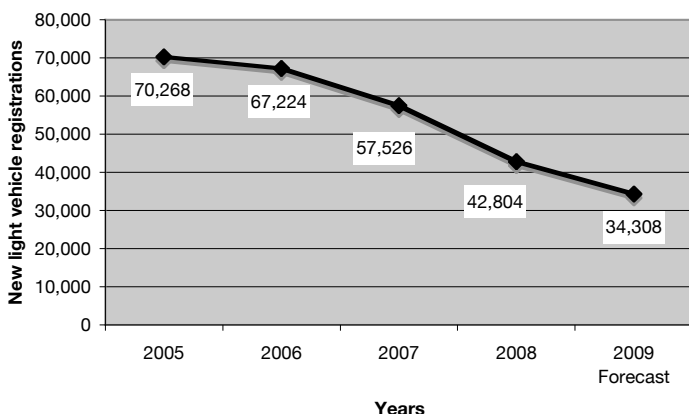
Household debt remains high, with no quick remedy Although the personal savings rate has moved significantly higher over the past several months, households are entering a period of financial belt-tightening as they restore health to ailing balance sheets. Reducing debt and building up savings will result in an extended period of subdued spending, an obvious negative for the new vehicle market.

Restoration of adequate credit availability will take time Eventually, the credit markets will thaw and auto loan issuance will move higher, but this is likely to be a slow process. Liquidity has already improved somewhat since last fall, but, clearly, there is a long way to go. In addition, lax credit standards during most of this decade are likely to be a thing of the past.

Possibility of manufacturer bankruptcies The potential of a bankruptcy filing by GM and/or Chrysler is likely keeping many potential buyers on the sidelines. The regaining of some relative stability in the industry will go a long way toward restoring consumer confidence.

Annual Trend in Hawaii New Vehicle Market

State New Retail Light Vehicle Registrations-2005 thru 2009



The graph above shows annual new retail light vehicle registrations in the state from 2005 thru 2008, and Auto Outlook's projection for this year.

Market Summary

New Retail Light Vehicle Registrations
2008 History and 2009 Forecast

	Forecast		% ch. '08 to '09	Mkt. Share 2009
	2008	2009		
TOTAL	42,804	34,308	-19.8%	
Car	20,180	15,782	-21.8%	46.0%
Light Truck	22,624	18,526	-18.1%	54.0%
Big Three	9,320	6,810	-26.9%	19.8%
Japanese	27,742	22,526	-18.8%	65.7%
European	4,260	3,661	-14.1%	10.7%
Korean	1,482	1,311	-11.5%	3.8%

Traditional Domestic consists of vehicles sold by General Motors, Ford and Chrysler, and excludes import nameplates.

Source for historical data: AutoCount, an Experian Company.

Long Term Trends

Are Annual U.S. Sales of 16 Million Units a Thing of the Past? Don't Bet On It!

With U.S. sales plummeting below the 10 million seasonally adjusted annual rate level during the first three months of this year, there is rampant speculation that the market has permanently downshifted to a new lower level. Consistent with this theory is that annual U.S. new vehicle sales will average about 12 million units for an extended period of time (perhaps as long as 10 years), with normal cyclical fluctuations above and below this long term trend.

Typical justification cited for this downward shift is that elevated new vehicle sales during much of this decade were juiced by unsustainably high incentives, easy credit, and leasing giveaways. As a result, according to this thinking, sales exceeding 16 million units from 1999 to 2007 were an artificial aberration that will never be repeated.

In short, we strongly disagree with these theories. We think the market will return to annual sales of 16 million to 17 million units, and perhaps even higher! It will take a while (perhaps as long as five years), but we think the current downturn

is a pronounced cyclical trough, not a permanent shift. Here's why:

1. **Pent up demand is accumulating.** As dramatically illustrated by the graph below, the new vehicle market will drop precipitously below its long term trend in 2008, and this is expected to continue until at least 2010. Some industry observers believe that the upward inclination of the long term trend will flatten considerably during the next 10 years, as inflated sales levels during most of this decade cannot be sustained.

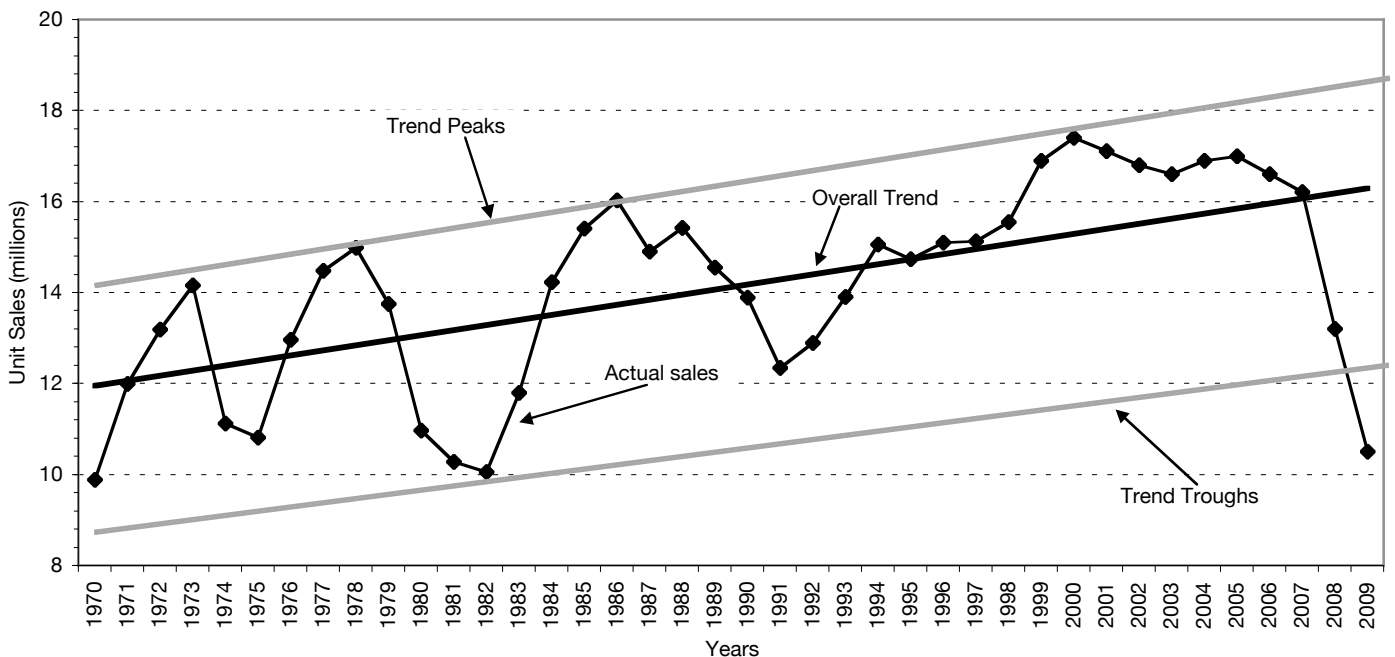
There are, however, several pieces of evidence that support continued, steady, growth in the upward long term trend of new vehicle sales: First, the median age of vehicles on the road has steadily increased over the past 10 years. And although the number of vehicles in operation per licensed driver has increased over the past several years, this figure will move back to historical norms as scrappage rates are likely to far exceed new vehicle sales from 2008 thru 2010.

Finally, and perhaps most important, as shown on the following page, the growth rate in the number of U.S. households has out-paced the growth in new vehicle sales over the past 28 years. From 2000 to 2009, new vehicle sales averaged 15.8 million units, versus 12.7 million units in the 1970's, an increase of 24.3%. Over the same period, the number of U.S. households increased 59.4%, a strong signal that the market was NOT overheated during the 2000's. In fact, the rate of growth in new vehicle sales has not come close to keeping pace with the growth in the number of households.

To be sure, many consumers will postpone new vehicle purchases over the next several years and keep their current vehicles longer, but we view this as a common cyclical occurrence, not a permanent change in buying habits. So, will the long term trend line flatten somewhat during the next 10 years? Perhaps. But it is our opinion that an increasing population, an aging vehicle fleet, and enhanced fuel efficiency

(Continued on following page)

U.S. New Light Vehicle Sales - 1970 thru 2008 Actual, 2009 Projection



The graph shows four data series from 1970 to 2008, and a projection for 2009. 1. **Actual** new vehicle sales. 2. The **overall** sales trend. 3. **Trend peaks**, which is the trend line for the four cyclical sales peaks. 4. **Trend troughs**, which is the trend line for the cyclical sales troughs. Source: CNW Research.

Long Term Trends (continued)

Are Annual U.S. Sales of 16 Million Units a Thing of the Past? Don't Bet On It!

technology (see number 5) will continue to push the long term trend of new vehicle sales higher.

2. **Credit-induced bubble for autos is slim compared to housing.** Some have theorized that like housing, the auto market feasted on cheap, easy credit to fuel sales. But the credit-induced sales bubble for autos pales in comparison to housing. First, there was less emphasis on sub-prime lending, and although automotive credit may have flowed a little too easily, lending standards were held to stricter standards than some of the haphazard practices in mortgage lending.

And perhaps most important, auto loans carry fixed interest rates. So the time bomb that hit housing (i.e., adjustable rate mortgages that moved higher and were tied to depreciating home values) is a non-issue for autos. Granted, debt issuance for auto purchases will be tighter for an extended period of time. Higher average down payment requirements will hamper trade-ins from consumers who are upside down on their current contract, and leasing penetration will likely settle in at closer to 10% of sales, rather than 20% or higher. But when a sense of normalcy returns to the credit markets (and there already has been improvement), there will be ample credit for automotive lending.

3. **Longer term outlook for vehicle affordability expected to remain strong.** As a result of the severe recession and big losses in 401K and other retirement savings accounts, many consumers will likely be less willing to assume the added debt that usually accompanies a new vehicle purchase. And this inclination toward less debt could very well be a longer term trend. However, aggressive vehicle pricing and the likelihood of continued low interest rates should keep vehicle affordability at historically strong levels.

4. **Automobiles are not appliances.** Will increasing numbers of consumers now view an automotive purchase more as a necessity, and less as a discretionary luxury? With the depletion in real es-

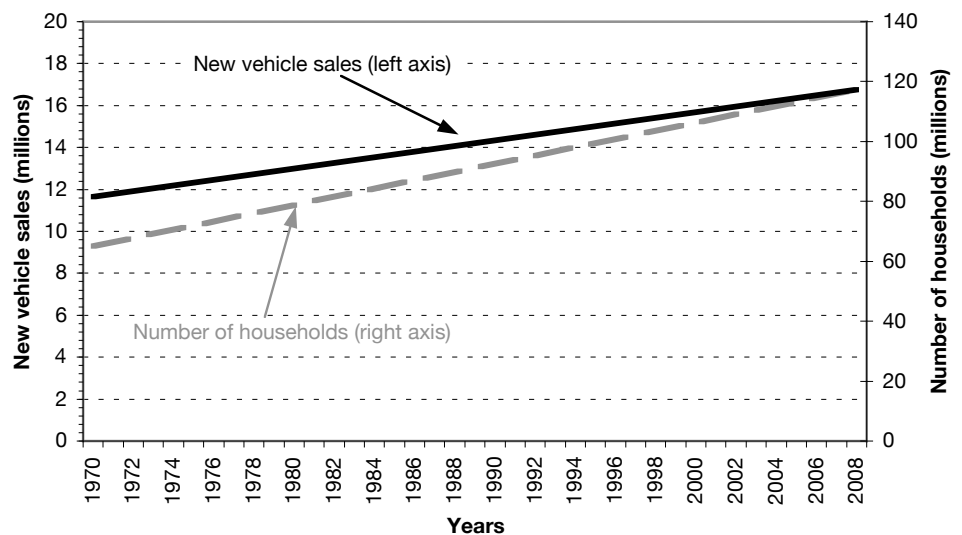
tate and financial assets and the need to reduce debt, many undoubtedly will. In addition, the fact that vehicles have better long term quality and reliability will allow owners to keep them longer. However, many Americans derive extreme satisfaction from driving a new car. Simply put, a lot of consumers who would LIKE to buy a new vehicle will find a way to do so, even if the financial method of acquisition is different, harder to achieve, and more difficult. In short, don't underestimate Americans' love for the automobile.

5. **A product renaissance is on the horizon in the form of alternative powertrain vehicles.** Lately, as fuel prices have come down, some have questioned the salability of higher mileage, cleaner running vehicles. From a long term perspective, however, these types of vehicles will dominate the industry. Gas prices will increase, and perhaps most important, governmental policies will in one way or another mandate that increasing numbers of more fuel efficient, eco-friendly vehicles will be produced and sold. In addition, enhanced environmental consciousness by consumers is likely to boost demand for these vehicles,

independent of fuel prices. In short, there will be a dramatic transformation in the U.S. new vehicle fleet over the next 5 to 10 years. And this transformation can only take place with big numbers of new vehicles being sold, much more than the 12 million unit average that some are predicting.

Conclusion: There is little doubt that new vehicle sales will remain sluggish (i.e., below trend line levels) for an extended period. Consumers are necessarily entering an extended period of emphasizing thrift over extravagance, and as a result, the average rate of new vehicle purchases is likely to be lower. However, Auto Outlook strongly believes that the downturn is precipitated by the severe recession and the wide ranging process of de-leveraging, and not by a structural change in the long term trend of new vehicle sales. And the fact that the long term trend for sales is still increasing, portends that eventually (and perhaps sooner than many think) the market will return to the 16 million unit level attained for most of this decade.

U.S. New Vehicle Sales and Number of Households - Long Term Trends



The graph shows the trend lines for U.S. new vehicle sales (plotted from the left axis) and number of households (plotted from the right axis) in millions, from 1970 thru 2008. As shown, the rate of growth in the number of households has been higher than the rate of growth in new vehicle sales, a strong signal that the level of new vehicle sales has not been "over-stimulated" by aggressive incentives or easy credit. In addition, this supports our contention that that the long term upward trend in sales can be sustained.

County Close-Up

All Four Markets Decline by More than 25% in First Quarter

The table below provides a summary of each of Hawaii's four retail light vehicle markets. The table is divided into four sections. Market Summary shows total new retail light vehicle registrations during the First Quarters of 2008 and 2009 and the percent change. The second and third sections show Light Truck and Big Three market share. The fourth section shows market share figures for the top 10 selling light vehicle brands in the state. The top rated county in each category is shaded.

Source: AutoCount data from Experian Automotive.

New Vehicle Markets Summary					
	Local Markets				Statewide
	Hawaii	Kauai	Maui	Oahu	Total
Market Summary					
YTD '08 thru March	1,496	583	1,482	8,360	11,921
YTD '09 thru March	962	368	789	6,189	8,308
Percent change	-35.7%	-36.9%	-46.8%	-26.0%	-30.3%
Light Truck Market Share					
YTD '08 thru March	62.3%	68.8%	68.4%	52.1%	56.2%
YTD '09 thru March	64.4%	67.9%	66.0%	50.3%	54.2%
Change (share points)	2.1	-0.9	-2.4	-1.8	-2.0
Detroit Three Market Share					
YTD '08 thru March	23.9%	29.0%	29.2%	21.5%	23.1%
YTD '09 thru March	24.8%	32.1%	27.0%	22.0%	23.3%
Change (share points)	0.9	3.1	-2.2	0.5	0.2
Market Share for Top 10 Selling Brands in State - YTD '09 thru March					
Toyota/Scion	34.2%	28.5%	30.9%	28.3%	29.2%
Honda	17.6%	16.0%	16.0%	12.9%	13.9%
Nissan	7.6%	12.0%	7.4%	10.4%	9.8%
Ford	7.8%	7.1%	12.4%	6.6%	7.3%
Chevrolet	3.3%	7.6%	5.1%	4.6%	4.6%
Dodge	8.0%	9.8%	4.9%	4.2%	5.0%
Lexus	0.7%	0.8%	2.9%	3.7%	3.2%
Mazda	6.1%	2.2%	1.6%	2.9%	3.2%
BMW	1.4%	0.5%	1.9%	3.3%	2.8%
Mercedes	0.6%	0.5%	1.0%	2.3%	1.9%

Hawaii Automobile Dealers Association
1100 Alakea Street
Suite 2601
Honolulu, HI 96813

Hawaii Auto Outlook

Published by:
Auto Outlook, Inc.
5 Great Valley Parkway, Suite 234
Malvern, PA 19355
Phone: 800-206-0102
Email: jfoltz@autooutlook.com

Reproduction, including photocopying of this publication in whole or in part, is prohibited without the express permission of Auto Outlook, Inc. Any material quoted must be attributed to *Hawaii Auto Outlook*, published by Auto Outlook, Inc. on behalf of HADA. Unforeseen events may affect the forecast projections presented in *Hawaii Auto Outlook*. Consequently, Auto Outlook, Inc. is not responsible for management decisions based on the content of *Hawaii Auto Outlook*.

Copyright Auto Outlook, Inc.
April, 2009

Hawaii Auto Outlook is distributed free of charge to all members of the Hawaii Automobile Dealers Association. The publication is sponsored and supported by the Association.

Hawaii Auto Outlook is published and edited by Auto Outlook, Inc., an independent automotive market research firm. Opinions expressed in *Hawaii Auto Outlook* are solely those of Auto Outlook, Inc., and are not necessarily shared by the Hawaii Automobile Dealers Association.