



Weekly Car Dealers Newsletter

October 22, 2007

This information that follows is taken from sources including *The Carconnection*, *Autoweek*, and other industry sources.

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IS TOYOTA IN TROUBLE?
2007 L.A. SHOW DESIGN CHALLENGE
CHRYSLER-UAW DEAL IN TROUBLE
TOKYO TALK: THE YEN'S TOO LOW
CHINA INVADES DETROIT
THE WAITING GAME OF U.S./CANADA PRICING
MYSTERY SOLVED: WHY THE CAR COMPANIES ARE GOUGING US

IS TOYOTA IN TROUBLE? Like millions of Americans, Suzanne Oshry is a loyal Toyota owner. Or at least she has been. Earlier this year, Oshry purchased the latest in a string of Camry sedans from Miller Toyota of Culver City, Calif., but she didn't even make it home before she noticed something seriously wrong with the way the car rode and handled. Her subsequent struggle to get the problem resolved has left Oshry with more than a sour taste in her mouth.

While her problem is more the exception than the norm, Oshry's experience is being repeated with unexpected frequency around the U.S. And so, ironically, even as the Japanese maker surges to the number-two spot in the American market, it is suffering what one influential publication has dubbed "cracks in its armor." Quality problems, recalls, and rising incentives could reverse what, until recently, seemed Toyota's irreversible momentum.

For Suzanne Oshry, the problem with her Camry - a set of improperly installed tires - was eventually resolved, but only by going to another dealer. Indeed, repeated efforts to get Miller Toyota, or the factory, to assist were rebuffed until TheCarConnection.com became involved. By then, said the Southern California housewife, it was too late.

"There (is) no way I would ever do business with Miller again and would also dissuade anyone I knew interested in acquiring a Toyota from using that particular dealership. "More disconcerting, at least for Toyota, Oshry adds that, "my loyalty to their brand has been lessened."

Even the best brands will occasionally make a mistake, and anger a customer. But over the years, Toyota's reputation and market share has grown based on a reputation for bulletproof products that give owners little reason to get upset. Suddenly, more consumers find themselves experiencing problems, often with Toyota's best-known and normally most reliable models.

Nagging issues with the latest version of the mid-size Camry, the new full-size Tundra pickup, and the all-wheel-drive version of the maker's highline Lexus GS sedan, led the highly influential *Consumer Reports* magazine to issue a stern rebuke. Declaring "Toyota is showing cracks in its armor," the magazine has pulled those three models from its "Recommended" list, a sought-after rating that Toyota and Lexus products have normally won automatically.

It needs be noted that Toyota still produced 17 of the 39 most reliable vehicles in the *Consumer Reports* survey, but, it finished overall in fifth place. "To see one of the premium manufacturers have three vehicles fall below average in reliability is a big concern," said David Champion, director of auto testing for the magazine. "They've always been average or better with all their products up to this point."

2007 L.A. SHOW DESIGN CHALLENGE For the fourth year, the Los Angeles Auto Show is hosting Design Los Angeles, a world conference for designers, along with the Design Challenge, a design contest that garners entries from some of the brightest rising stars at top North American design studios. We've come to expect the Design Challenge to be an auto show of its own, with "theoretical" concepts, in the form of sketches and models. They aren't quite the same as seeing rolling, life-size concept cars, but they sure are fodder to get us thinking about what we may be driving, or riding in, in the more distant future.

Last year's theme was meeting the environmental changes of living in L.A. This year's theme - "Robocar 2057" - looks particularly far into the future and has proven even more exciting (and open-ended).

Read on for a quick rundown of the eight entries for this year. The winner will be announced on November 15.

CHRYSLER-UAW DEAL IN TROUBLE The United Auto Workers' new contract with Chrysler LLC is facing serious challenges as opposition to the contract among union members mounts. The vote is now officially considered "too close to call," union officials have said.

The contract was approved by workers in Kenosha, Wisconsin, by a comfortable margin but workers at Chrysler plants in St. Louis; Twinsburg, Ohio; and at an axle plant in Detroit have all voted the contract, prompting predictions of a narrow vote. Workers at Chrysler's big assembly plant in Belvidere, Illinois also are expected to vote to reject the contract.

The fate of the contract could ultimately be decided at Chrysler plants in Kokomo and in and around Detroit. Temporary plant shutdowns have pushed back the final tally until late in the week.

The 45,000 Chrysler employees voting on the contract are distressed by the lack of job security guarantees, the two-tier wage system embedded in the contract and the distinction between core and non-core employees written into the contract.

Meanwhile, Chrysler officials are anxiously watching the vote on the pact, which was fashioned after a brief six-hour strike on October 10. Mike Aberlich, a Chrysler spokesman, noted that Chrysler and its new owners have already committed \$3 billion to new products that will keep union members employed in the future.

Union dissidents, however, have gotten a lot of mileage out of comments by Chrysler's new president Jim Press that Chrysler was preparing to ax some overlapping models.

"We have two to three vehicles that serve the same market segment or same customer and compete with each other," Press said recently.

However, Press also said during the same roundtable with reporters in Las Vegas that the company also had segments where it didn't compete effectively and needed to add new models. That part of the messages has been lost during the debate in the union as the proposed agreement contains no commitments to keep any Chrysler plant open beyond the term of the contract, which expires in 2011. The union's new contract with GM, however, did include commitments that extended beyond the term of the contract.

Meanwhile, UAW president Ron Gettelfinger is actively campaigning for the contract. Nevertheless, union members and local union leaders remain divided over the contract.

"A lot of people are scared. They don't like the contract but they didn't like being out on strike," said one union official who asked not to be identified.

Still, the lack of any kind of language offering a modest bit of job protection is daunting. Shawn Fain, a committeeman from UAW Local 1166 in Kokomo, Ind., who attend the council meeting, said in a message circulated on the Internet, "I want each of you to understand is that the vote among the Chrysler Council was not unanimous or even close to overwhelming in favor of this agreement.

"When you look at the agreement in its entirety there remain a lot of unanswered questions," said Fain, who is calling for a no-vote on the agreement. Fain added the union's own bargaining committee rejected the tentative pact at least twice before Gettelfinger lined up enough votes.

"Cutting hourly wages in half is repulsive and completely unacceptable," he said. "This union was founded on the principle of equality among the workers. Wages are a small percentage of the cost of building vehicles," he added. "My contention is that Chrysler needs to fix the real problems. Mismanagement has and is costing this company billions of dollars," he said.

However, Diane Swonk, the chief economist Mesirow Financial in Chicago, said in her monthly newsletter the U.S. economy is undergoing structural change that makes it more difficult for workers without higher education to command top wages.

"The days of middle-class incomes without a college degree are long gone," she said in a recent newsletter.

TOKYO TALK: THE YEN'S TOO LOW On the eve of the Tokyo Motor Show, American automakers are again leaning on the U.S. government to get the Japanese to boost the value of the yen.

The yen has been appreciating gradually since the first signs last spring of trouble in the U.S. mortgage industry. With the U.S. economy continuing to slip - car sales appear to have dropped again in October - General Motors, Ford, and Chrysler have continued to push for policies that would increase the value of the yen.

The North American carmakers came up with new figures recently, arguing that Japanese policies that artificially weaken the yen provide Japanese automakers with a \$4000 per vehicle subsidy on the cars exported to the United States .

The undervalued yen has also become a major issue in Europe where the European Union's finance experts are complaining that the yen should have appreciated against the dollar right along with the euro, which is now at record levels.

The issue could become more volatile if the U.S economy continues to weaken.

"There is a growing consensus around the world that Japan's misaligned yen is also damaging the economies whose currencies have been allowed to trade freely in the markets such as the European Union, Canada, Korea, and Australia," said Stephen Collins, president of the Automotive Trade Policy Council.

The Japanese carmakers, led by Toyota , have vigorously denied getting preferential treatment. However, they are also under pressure to export more because they are facing slow growth in their home market, where car sales have essentially stalled in the past couple of years because of the slow-growing economy.

The slow growth in Japan and the U.S. is expected to be a key topic this week in Tokyo.

CHINA INVADES DETROIT Chinese exhibitors announced for 2008 NAIAS - Five Chinese companies will have displays at the 2008 Detroit auto show, the show's organizers said. The list is:

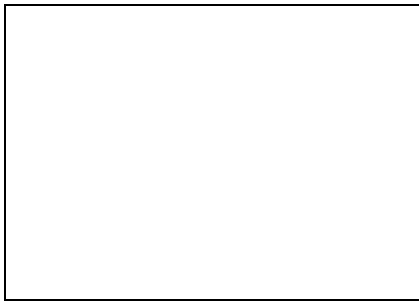
Changfeng Motor Group: Changfeng's main automaking unit is Hunan Changfeng Motor Co., which builds a previous-generation Mitsubishi Montero SUV (known as the Pajero outside the United States) under license for sale as the Liebao. It is making a return visit to the Detroit show.

BYD Auto Co.: BYD is a rarity among Chinese automakers: a privately owned company with no government parent. BYD began as a battery maker, expanded with the rapid spread of cell phones using its batteries, then bought a maker of SUVs to enter the auto industry. Its 2006 sales in China totaled 60,116 cars, led by its Flyer and F3 models, according to Automotive Resources Asia Ltd. This will be its first appearance at the Detroit show.

Geely International Corp.: A part of Zhejiang Geely Automobile Holdings Group, Geely has enjoyed explosive growth in China despite having no foreign partners. Its 2006 sales in China jumped 55 percent to 149,869, says Automotive Resources Asia. Models in its lineup include the Merrie, Beauty Leopard, Haoqing and Hysoon. It is making a return visit to Detroit.

China America Cooperative Automotive Inc./ZXNA (Chamco): Chamco is the Parsippany, N.J., distributor of cars built by Hebei Zhongxing Automobile Co. The latter is a small automaker, with 2006 sales of 31,342. This will be its first time at the Detroit show.

Li Shi Guang Ming Auto Design Co.: Founded in 2002, the Beijing company claims to be China's first independent automotive design studio in China. Its first product is the Tanghua electric car, which already is on sale. This will be its first time at the Detroit show. The Detroit show opens to the public Jan. 19-27,2008. Industry preview days are Jan.16 and 17.



The Tanghua electric car was designed by Li Shi Guang Ming Auto Design Co., which will have a display at the Detroit auto show in January.

THE WAITING GAME OF U.S./CANADA PRICING It didn't take long this week, in a meeting with the *Star's* editorial board, for Ford of Canada's president to start talking about U.S. auto prices.

Bill Osborne said he gets letters every week from people wanting to know why we pay more for vehicles in Canada than south of the border – as does Wheels.

You'd better believe Osborne knows all about the issue: the Canadian government apparently estimates that some 160,000 vehicles will be imported this year alone from the U.S.

"There is the potential for prices to come down in Canada," he said. "One manufacturer making a significant move will trigger all the other manufacturers... If that happens, Ford will react, and will react instantly."

And none of them want to be the first to do so, because all it will do over the long term is cut everybody's profits across the board.

The facts are that now that the greenback is worth less than the loonie, vehicles are thousands of dollars cheaper in the United States than here.

In many cases, those cars and trucks were actually built here – Ontario is now the largest auto-producing jurisdiction in North America.

In the U.S., vehicle prices have been fairly stable over the last several years. There's no issue down there.

But the problem is that if Canadian prices are slashed to match them, the bottom will drop out of the used-vehicle market up here. Cars coming off a four-year lease could have a guaranteed residual value of not much less than the new, next-generation vehicle.

Not everyone is worried about existing owners losing the resale value of their current vehicles.

Harley-Davidson, for example, dropped its Canadian prices this week for the third time this year, this time by 5 per cent, to bring them more into line with American MSRPs.

But also this week, Bombardier copied the example of most auto manufacturers by stepping in to prohibit its U.S. dealers from selling to Canadians, who were saving more than \$3,000 on every snowmobile and ATV.

Dealers are often penalized for making a cross-border sale, and Canadian consumers are penalized by many manufacturers refusing to honour warranties on cross-border cars.

So much for free trade.

The bigger the price tag, the bigger the price difference. Luxury makers are feeling the pressure a lot more than Ford.

Osborne said this week that his company's research shows that the average Canadian stands to save only \$500 to \$1,200 on the purchase of an American Ford, and that's after all the various duties are paid, modifications made to bumpers and speedometers, and the considerable paperwork hassles.

As well, Canadians do not qualify in the U.S. for low-interest financing; the best they can hope for is a bank loan at the regular rate.

This is the key, for as Osborne explained, "If you do not need financing and are able to take the cash out of your pocket (to pay for the vehicle), there is a much greater disparity. Most Canadians finance their cars. If they didn't, we'd probably be seeing 1.6 million (vehicles) imported."

Americans, of course, can benefit from American financing plans.

And so the manufacturers are sticking it out, nobody wanting to be the first to move in this most competitive of markets.

If, when and how far prices drop is anyone's guess – it all depends on who blinks first.

MYSTERY SOLVED: WHY THE CAR COMPANIES ARE GOUGING US Why does a Lexus cost \$20,000 more in Canada than it does in the U.S., even now that the Canadian dollar has reached parity with the U.S. dollar? Why do products made in Canada often cost less outside Canada than they do domestically?

A free trade agreement should ensure that, adjusted for transportation costs, goods sell at much the same price in member states. But at present we are witnessing border differentials of 20 per cent in car prices.

Callers to phone-in shows think Canadians are being gouged, and they're probably right: Segmented markets leave themselves open to price discrimination.

Different demand conditions mean that a supplier will maximize profit by choosing a different price in each market. In other words, nice unquestioning Canadian buyers are not likely to shop around for better prices. Suppliers who recognize this can price-discriminate.

At the same time, competition is supposed to eliminate such price disparities. Monopolists can price-discriminate because they have no close competing products, and warranty conditions may limit resale opportunities. But a Toyota is not so different from a Mazda; a Mercedes is not so different from an Audi. Yet Canadian car dealers are not aggressively cutting their prices to U.S. levels in an effort to increase their sales.

Canadian buyers are beginning to look at purchasing in the U.S., but are frequently prevented: Dealers refuse to sell to buyers who do not have an American address. Some manufacturers are telling their American distributors not to sell to Canadians at all. What's going on here?

The answer has to do with leasing: Lower prices might boost new-car sales in Canada, but that is not, right now, in the interest of the manufacturers which own big chunks of the leasing corporations.

Each year in Canada more than half of all new vehicles going through dealers are leased, rather than sold. If, on average, cars lose half their value over a three-year leasing period, then the value of a \$40,000 car, after a three-year lease, will be \$20,000. This \$20,000 is an asset on the books of the leasing company.

Now, if the \$40,000 new-car price were reduced in Canada to the U.S. level of \$33,300, then the buy-back value after three years would be only \$16,650.

Between 2004 and 2006, Statistics Canada data say 1.5 million light vehicles were sold in Canada each year: 800,000 cars, 200,000 SUVs and 500,000 light trucks. If half of these are on lease, there might be 2.25 million outstanding leases. If each of these leases/assets were to take a \$2,000 hit (assuming the average retail overpricing is only \$4,000) then parity in pricing would be almost a \$5 billion loss on the balance sheets of leasing companies. Obviously, lease owners have an interest in continued high prices.

How will this market evolve in the coming months? First, some cracks are showing in price maintenance. Suppliers with a small market share in Canada (Subaru for instance) and a growing market (i.e. contented dealerships) seem to place no barriers to Canadians buying in the U.S.
