



Weekly Car Dealers Newsletter

January 21, 2008

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**CARMAKERS TRYING TO AVOID INCENTIVES
TOYOTA READY FOR ALL FUEL OPTIONS, ADDRESSING QUALITY PROBLEMS
GM'S LUTZ: CONSUMERS WILL PAY TO GO GREEN**

CARMAKERS TRYING TO AVOID INCENTIVES Faced with talk of recession and the fallout from a meltdown in the housing market, automakers are still hoping to avoid major incentives despite some sluggish sales.

Mark LaNeve, General Motors' vice president in charge of vehicle sales, said last week there was no doubt sales will be slow through the first quarter of 2008. Toyota also scaled back its forecast for higher sales in 2008 in the face of the deteriorating economic conditions in the U.S. At best, Toyota now expects its sales to improve only between one and two percent, Toyota officials said.

George Pipas, Ford's sales analyst, said Ford economists don't expect the economic environment to improve much in the next several months. Conditions will remain challenging in 2008, with light-vehicle sales running at the relatively anemic annual rate of 15.2 to 15.7 million units, Pipas said.

Chrysler vice chairman Jim Press also was careful to note that 2008 is still expected to be a difficult year. The company hopes to gain some retail market share but still plans to reduce the number of vehicles it builds for rental fleets. The housing crunch is continuing to pinch the economy, he said.

Bob Carter, Toyota Motor Sales vice president, however, emphasized Toyota was going to stick to its marketing plans and wasn't planning to add incentives - a sentiment echoed by other Asian automakers.

LaNeve also said GM also would not raise incentives to counter the gloomy economic news. Domestic carmakers have slimmed down inventories of unsold new vehicles as they enter the new year. The cuts were ordered last November just as subprime crisis gained new life. GM's inventories, for example, are in relatively good shape, following the decision to trim production in the first quarter of 2008 by 11 percent, LaNeve said. "We won't have to deal with any inventory

clearance," he said during a conference call with reporters and analysts. "With this kind of sales numbers, we'd actually be looking to build some inventory for the spring market."

Both Chrysler and Ford also reported entering 2008 with substantially reduced inventories and report that they are holding back on incentives after reducing production in the third and fourth quarter. Chrysler Vice President Steven Landry said the company's inventories are down 19 percent from year-ago levels and added that vehicles being delivered to dealers now are based on specific orders. "Our inventories are at the lowest levels since 1994," Landry said. The drop in inventories also represents a turnabout from last year, when dealers were asked to order more vehicles than they could handle, Landry said. Pipas said Ford's inventories were down ten percent at the end of December and have dropped by nearly 250,000 units since the end of 2005. Jim Farley, Ford group vice president of marketing and communications, said the sharp decline in inventories also has helped make Ford's dealers more profitable and will help in keeping incentives in check even if competitors decide they are needed.

Press also said the lower inventories would be augmented at Chrysler by new models in the next couple of months. "We have a ton of new products coming in '08," Press said, adding that the new Dodge Challenger is already sold out. "We're not just pipe dreaming. We've got a great product parade coming. "By the end of February, we're going to be launching several new models. We're substantially improving the level of appeal and quality," Press said.

Going forward, Michael DiGiovanni, GM's new director of global market analysis and former head of the HUMMER division, said the decline in house prices is a necessary precursor for recovery. The sharp declines are setting the stage for a broader economic recovery later this year and in early 2009, DiGiovanni said.

TOYOTA READY FOR ALL FUEL OPTIONS, ADDRESSING QUALITY PROBLEMS It's an uncertain world, acknowledged Toyota President Katsuaki Watanabe, and any company hoping to be a success will have to address all of its options. With the increasing emphasis on green, fuel-efficient automobiles, that means preparing a wide array of alternatives, from gasoline-electric hybrids to hydrogen-powered fuel cell vehicles. The CEO of what many expect to end 2008 as the world's largest automaker, Watanabe presented his vision of Toyota's – and the auto industry's – future – during an early morning conversation covering a wide range of topics. Among the many issues Watanabe addressed: reports of mounting quality problems that has tarnished the reputation of the once seemingly invincible automaker. Only a few months ago, the influential *Consumer Reports* magazine downgraded three key Toyota products, including both the V-6 Camry and 4x4 Tundra pickup, citing serious quality issues. Even the vaunted Lexus suffered a serious and unlikely challenge from none other than Buick, which matched its reliability numbers. "Quality is key to our very existence," declared Watanabe, responding to a question from TheCarConnection.com at the 2008 Detroit auto show. And it's something the CEO isn't inclined to let fix itself. He has launched a number of initiatives to resolve nagging problems and suggested that, if necessary, Toyota's rapid growth could be scaled back if it threatens to impact quality control.

Some of the problems have come from outside, suggested Watanabe, pointing a finger at suppliers who've delivered defective parts to Toyota plants. But in the long run, he added, it's still Toyota's problem to fix. A fix is what's needed for the environment, most industry leaders have come to grudgingly agree. Even those who still question the concept of global warming – and there are a few – acknowledge that consumers won't accept a laissez faire attitude. If you

aren't part of the solution, it seems, you're part of the problem. If anything, Toyota has moved the needle with its heavy promotion of the Prius hybrid – never mind the reality of its sliding corporate average fuel economy, the result of a steady push into the pickup and SUV market. Here, perceptions are defining realities.

Watanabe, an early Toyota hybrid proponent, has been pushing to add a hybrid version of every one of the automaker's products, and that plan hasn't changed, though it may take until 2020 to accomplish, the executive explained. Hybrid sales are definitely on the rise, however, and will grow from less than 500,000 vehicles in 2007 to more than 600,000 this year, forecast Watanabe. By sometime in the next decade, he expects that to jump, again, to 1 million. The automaker now owns a 60-percent stake in its battery manufacturing partnership with the electronics giant, Panasonic. Together, they're racing to come up with an effective formulation for new, lithium ion batteries that can endure in the demanding automotive environment. While considered the leader in hybrid technology, Toyota is facing an increasing assault, particularly from its U.S. arch-rival, General Motors. Last year, GM captured the Detroit show with its Chevrolet Volt plug-in hybrid-electric vehicle. The concept introduces a larger battery pack capable of being plugged into the electric grid, using the added power to handle up to 40 miles solely on battery power. GM promises to put Volt into production by 2009. After initially poo-pooing the concept, citing problem with lithium technology, Toyota is now racing its own plug-in to market, hopefully by 2010, said Watanabe, using the Prius as a base.

Looking forward, said Watanabe, plug-ins, conventional hybrids, diesels and other forms of power will add need to become part of a manufacturer's powertrain line-up. "As of today," he asserted, "there is no single solution that solve all the (energy) problems" the world faces."

Price is another challenge for manufacturers like Toyota. The Indian maker, Tata, announced, earlier this month, plans to produce a \$2500 car for first-time buyers looking to trade up from carts and mopeds. Matching such an offering is "very difficult for us to come up with," admitted Watanabe, though he insisted Toyota will keep trying. "We should never allow ourselves to lose our advantage in terms of quality and cost."

GM'S LUTZ: CONSUMERS WILL PAY TO GO GREEN "Everybody's going to have to get with it," says General Motors' "car czar, Bob Lutz. "Business as usual is not acceptable." The septuagenarian executive, long known as a proponent of power, is talking a very different game, these days, promoting GM's new green technology. But while the GM Vice Chairman insists the automaker will meet market demands – as well as tough new U.S. fuel economy regulations, he warns that consumers better be ready to pay – or sacrifice. The alternatives are simple, Lutz suggested, during a discussion at the Detroit Auto Show. To maintain the sort of cars, trucks and crossovers they have today, American motorists will have to pay as much as \$10,000 a vehicle more to cover the cost of advanced powertrains, lighter weight materials and other advanced technology. The alternative, he stressed, is "a shift in what is offered by the auto industry to the American public." To underscore that point, Lutz noted that GM has already cancelled plans for the next-generation Northstar V-8 now used in its Cadillac products. And it will likely switch from a rear-wheel-drive version of its big Chevrolet Impala sedan, powered by V-6s and V-8s, to a more fuel-efficient, front-drive design with smaller engines.

What could change that equation, however, is ethanol, Lutz insisted, especially if that alcohol fuel is produced using a new method called "cellulosic." That technology can make use of wood pulp and other agricultural scraps, rather than corn and other food stocks. Earlier this week, at

the Detroit show, GM CEO Rick Wagoner announced that GM would invest in the new cellulosic ethanol producer, Coskata.

The automaker has promised to make 50 percent of its vehicles capable of running on ethanol-based E85 fuel by 2012, though it remains to be seen if supplies will grow to meet potential demand. While skeptics question whether ethanol can really supplant gasoline to any great degree, Lutz said it has a singular advantage over other advanced fuels, such as hydrogen, since it would require “a minimal tear-up in terms of price and what Americans like to drive.” The reality seems to point towards some degree of “tear-up,” however. With Congress now mandating a goal of 35 mpg fuel economy, the V-8, said Lutz, “will remain, but I don’t see many (companies) investing lots of money” into developing future versions.

Diesel engines will likely replace V-8s in heavy-duty truck applications, he added, such as the full-size Chevrolet Silverado pickup, while V-6s and alternative powertrains, such as GM’s new two-mode hybrids, seem likely to become dominant in SUVs. “You can make a small V-6 behave like a large V-8,” he said. “All it takes is money.” GM’s cross-town rival aims to prove that point with its new line of EcoBoost powertrains. The 3.5-liter V-6 version produces as much power and torque as a typical V-8, but the premium will be somewhere north of \$1000. Meanwhile, Lutz put in a good word for GM’s planned “extended-range electric vehicle,” otherwise known as a plug-in hybrid. The Chevrolet Volt, which the automaker intends to launch in 2009, should deliver more than 30 miles on battery power alone. For longer drives, its gasoline engine would kick in.

Despite all the attention being paid to fuel economy and global warming, these days, Lutz questions whether U.S. consumers really are that serious about higher-mileage technology. Even at \$3 a gallon, the past year’s run-up in fuel prices doesn’t impact the average consumer all that much, he contended. “For many Americans, the difference between 20 and 30 mpg is, like, who cares?” argued Lutz. At most, it’s costing the typical commuter, he added, \$20 to \$30 a week. But then again, the normally conservative executive suggested that if the country is really serious about slashing fuel consumption, it should bite the bullet and sharply rise fuel taxes. The best way, he said, “is to use market mechanisms to transition the American (motor vehicle fleet) to something more like what Europeans drive.”
