Remarks By
2009 NADA Chairman John McEleney
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Today I would like to discuss with you what the future holds for the major stakeholders in the automotive market.

But before I do, I want to tell you about NADA's Trucks for Haiti campaign. Just a couple of weeks ago, a dealer here in the Orlando area saw a speech in which President Bill Clinton said that what was needed most in Haiti was 100 small trucks, "yesterday."

That dealer realized that dealers were in a perfect position to answer that call and called NADA to suggest they spearhead the initiative, which they did, sending out an appeal immediately. Within 72 hours, we had commitments for more than 100 trucks, and donations are still coming in.

That story illustrates that, even though the past 12 months have been the most turbulent in the auto industry since the Great Depression, America's dealers found the resources to help those in dire need.

So what does the future hold? Let me begin by making a few observations about auto sales in 2009. Don't worry, I won't elaborate on this ... I don't think anyone here wants to re-live it.

It has been more than 40 years since we have witnessed such low sales volumes in our industry. In 2000, the U.S. auto industry had its best year ever, selling 17.4 million units. Those numbers are hard to comprehend today in view of 2009 totals.

As we all know, it was a very different story last year, when the industry sold only 10.4 million units. Retail volume was most challenging—less than 8.5 million. In my mind this was alarming—the fact that sales to retail buyers had shrunk so much and so fast, beginning in the 4th quarter of 2008 and continuing throughout 2009. The fact that in recent years a normal month would be 1.2 to 1.5 million units and suddenly we were in the 700,000 to 850,000 range illustrates how difficult things had become. Incredibly, there were some brands that out-performed the market and actually had sales increases, despite the industry's performance—namely, Hyundai, Kia and Subaru.

While most economists say the recession ended over this past summer, I believe that we will continue to see a <u>soft</u> recovery in the auto sector over the next few months.

So how did we get here?

To answer that question, we have to go all the way back to early 2008 when the residential real estate market began to falter. That summer, spiking oil prices led to a sharp decline in the sale of trucks and sport utilities.

This was followed by the crisis that paralyzed the global economy in September. What was not clear at that time was the depth of the challenges that the financial crisis would have on the entire automotive chain in the United States.

By October of 2008, showroom traffic was at a standstill. Consumers had stopped spending on big-ticket items like cars. Those who *were* purchasing vehicles were often having difficulty securing financing because of the lack of credit—or tighter lending standards.

By November, many dealers were also having problems obtaining credit to finance their vehicle inventories. This had a very real impact on sales. After all, manufacturers can only sell what dealers can buy…and dealers can only buy what they can finance.

In December, General Motors, Chrysler and Ford signaled that without financial assistance from the government, the Detroit 3 would face dire consequences. At year-end, the Bush administration authorized bridge loans totaling $17.4 billion to GM and Chrysler.

Fast forward to the middle of 2009, when the Obama Administration authorized critical additional funding for GM and Chrysler along with demands for restructuring. Chrysler and GM entered and exited bankruptcy in record time and more than 2,000 dealers had closed their doors. The only positive that can be identified in 2009 was the unprecedented success of “Cash for Clunkers.” This program demonstrated that a significant demand did exist, if properly motivated.

So, how have dealers survived all this? Five overall factors have contributed to dealer viability.

First, dealerships that were well-capitalized were in the strongest position to survive. As revenues declined rapidly, it was critical to have sufficient cash on hand to weather the storm. No one knows better than dealers how important cash reserves are—crisis or no crisis.

Second, expense control was critical. As you know, it is never easy to reduce the number of employees at our dealerships. But in these challenging times, it became necessary to cut overhead costs, such as personnel and advertising. Just like GM and Chrysler did during the bankruptcy process, dealers had to establish a “new breakeven” for our dealerships. And by doing this, we saved ourselves much-needed capital.

Third, dealers, unlike manufacturers, have profit centers other than new vehicle sales. Over the last twenty years, dealers have adopted strategies to leverage service and parts operations effectively. As we grapple with profitability of new vehicles, NADA expects dealers to continue to rely on fixed operations as well as used vehicle sales, more heavily to generate profits.

Fourth, dealers have survived because many of them have a diverse group of franchises. More than 42% of NADA's members have multiple franchises. In difficult times, that is an insurance policy to help alleviate the difficulties of a downturn.

While no franchises have been immune to challenges, a dealer than owns more than one franchise is effectively spreading his risk in difficult times.

Finally, through NADA, we were able to communicate the dealer message to the public, the media and government—policy makers, politicians and regulators. Dealers were not the reason GM and Chrysler faced financial Armageddon.

So what did we learn during this crisis that will help us going forward?

We learned that the dealership model is not widely understood—by government officials, the media or the general public. I was amazed at how often we had to educated people on how our business works. For example, most people did not know that dealers own and finance their vehicle inventories. The common belief was that manufacturers provide the inventory and we just sell it. As credit for wholesale financing became less available last year, this was one misperception that was critical to combat.

Government can be our partner and assist us, but it requires interaction and education for that assistance to be effective. I—along with other dealers from the NADA Board and NADA staff—sat in multiple meetings with members of President Obama's administration and had lengthy, frank discussions with the Auto Task Force. This interaction was important in allowing dealers and NADA to articulate our concerns and outline the important role dealers play in the value chain. There was no one other than NADA to represent dealer/stakeholders as the future of GM and Chrysler hung in the balance.

Dealers everywhere had to ensure that our lawmakers fully understand the vital economic role we play in our communities. As the global economic crisis unfolded, dealers and NADA repeatedly made the argument that we are an important economic engine. Amazingly, dealerships collected more than $21 billion in sales tax revenue last year, representing as much as 20% of many states' and municipalities' revenue.

We also learned the importance of NADA's healthy relationships with manufacturers, and this proved invaluable in 2009. We meet with all major manufacturers twice a year to review the results of the NADA Dealer Attitude Survey, in addition to numerous other OEM meetings as circumstances warrant. This ongoing dialogue proved critical in 2009 as the fate of GM, Chrysler and its dealers was being determined in Washington. Generally speaking, the dealers' voice in Washington was instrumental in successfully navigating these manufacturers through bankruptcy, often amidst the protest of some Washington lawmakers.

Finally, much has been said about the state of franchise laws and their importance. While franchise laws did not protect dealers from termination in the bankruptcies, it is important that the integrity of these laws be protected for the future. Bankruptcy is essentially the only way State franchise laws protecting dealers can be pre-empted. Without these protections dealership values would be negatively impacted and capital investment in dealerships would become less attractive and more difficult to obtain.

All the turmoil in our industry and overall economy has made it difficult to accurately predict where we are going. But, we do have some idea.

For one thing, it is clear that the dealership size is generally increasing.

Since 1989, the number of dealers selling more than 750 units has increased by more than 13 percent. It is apparent that over time we will see the average dealership continue to grow unit volume. This is partially a result of manufacturers' actions, but also a desire among dealers to generate operating synergies and economies of scale. In 2009, the average U.S. dealer sold 541 new units, and I expect that figure will continue to increase going forward.

So what does the future hold for the American market? Clearly the bankruptcies of GM and Chrysler and their consequent restructuring will change the landscape permanently.
The real tragedy of the industry's crisis is the closure of approximately 2,000 dealers. For the most part, GM and Chrysler's termination plans were too fast and too deep. Chrysler dealers were given only 24 days to wind down their operations. Dealership enterprises that were held by families for decades—many of which were profitable—were shuttered with no compensation, no blue sky and often with real estate mortgages or leases they couldn't satisfy. Fortunately, the arbitration process currently under way will at least provide cancelled dealers some rationale regarding their situation and an opportunity to appeal their case.

The trends in the U.S. market over the next five years will likely continue what we have seen in the past decade. With the elimination of only two brands in the marketplace—Pontiac and Saturn—and the entrance of the Indian and Chinese automakers on the horizon, competition will no doubt increase.

While a multitude of choices is good for consumers, it could mean diminished profits for dealers as the pie is divided into smaller pieces.

It is likely the U.S. market will start to resemble the European market over the next five years, with four manufacturers each having similar market share. It is likely that GM, Ford, Toyota and Honda will see their respected shares approach comparable levels. Hyundai, Kia and VW should gain share based upon recent trends.

Let me take just a moment to talk about the Toyota recall. Of course, it remains to be seen how that will affect their sales and market share. Dealers are working diligently to install the remedy on vehicles as quickly as possible, which will prove to be an important component in bolstering Toyota's reputation.

Toyota has a long history of working closely with its dealers, and this underscores the importance of having a strong dealer network in place to handle just such situations. As a Toyota dealer, I am confident they will bounce back.

Finally, the biggest change that I expect moving forward is a divergence in consumers' buying habits. The question we all want answered is: "Has this crisis permanently changed consumer buying preferences?"

No one really can answer that question: However, we do know that for more than two decades, U.S. consumers have been *negative* net savers—they spend more than they save. Since the economic crisis began, Americans have become *positive* net savers, on average saving more and spending less. This could significantly impact the automotive market.

Will consumers be unwilling to spend more for vehicles? Will they move to lower-priced models? While more influence on fuel efficiency mean consumers will gravitate away from bigger vehicles with bigger engines?

Demographic changes could also deeply impact our industry.

Credit Suisse reported that by 2020, 40% of car buyers in the developed world will be over age 60, compared to less than 30% today. Credit Suisse noted that older people drive less, have less disposable income, and often opt for smaller, more fuel-efficient vehicles. As a result, their cars last longer and they are less willing to spend money for cars and trucks.

On these questions, we can learn from the South American and European models. Both continents are dominated by smaller vehicles with smaller engine displacement. Of course fuel prices are higher, which drives consumer choice. If U.S. automakers continue to offer smaller, more fuel-efficient products, the shift could be permanent—and this could have an impact on dealer revenues.

Dealers and manufacturers will have to reach profitability targets because of selling smaller vehicles—*not* in spite of that fact. Ultimately, I suspect America's shift away from larger vehicles won't be as dramatic as in Europe. The United States will not become the land of A- or B-segment cars.

In a Reuters interview a few months ago, AutoNation's Mike Jackson signaled that his company was bullish on the U.S. auto sector and they were interested in acquiring more stores. Of particular note is that AutoNation is considering buying Ford and Chevrolet franchises. Mike ended his interview by saying: "Chevy, Ford, Toyota, Honda, Nissan, BMW and Mercedes. That's my holy grail."

I think Mike's comments are right on target. As a result of the global crisis, dealers over time are going to acquire more dealerships. This is happening for two reasons. First, dealers exiting the business will create opportunities for well-capitalized dealers to grow. And second, some manufacturers will realize that they are under-represented in certain markets, and add dealers in those areas.

To be successful going forward, franchised dealers must more aggressively exploit the used vehicle market. When you consider that franchised new car dealers had retail sales of about 10 million used vehicles out of 37 million sold in 2008, it is evident there is a terrific opportunity to grow our business in this segment. New car dealers need a bigger slice of the used car pie.

Service and parts operations will continue to represent a growing portion of dealer profitability. In 2009, we generated $82 billion in service and parts sales, or an average of $4 million per dealership. Dealers have had to re-adjust in these departments as vehicle quality improved and warranty work has declined. Last year, warranty service and parts sales totaled almost $13 billion for the industry, while customer pay sales totaled $44 billion. This continued trend away from warranty sales has caused dealers to be more conscious of the value of getting consumers into our shops for routine maintenance. This is a paradigm shift that will be even more critical going forward.

Amidst all the other issues of 2009, one that drifted off the radar screen is CAFE — Federal fuel economy requirements. U.S. automakers must find a way to produce smaller vehicles that are innovative, exciting and that American consumers will want to buy. Ford is hoping that their European models can be successful in the U.S. GM is leveraging their partnership with Daewoo to allow them to sell a range of smaller vehicles here. And Chrysler's alliance with Fiat is hedged on the success of its small cars sold in Europe and South America.

Another historical problem is overcapacity. PricewaterhouseCoopers estimates that North America will have excess capacity of over 4 million units this year. Their forecast for Europe is even worse, with excess capacity at 6.5 million units. Unutilized capacity has always been our industry's Achilles heel, and it remains to be seen whether manufacturers have learned the lessons of the past—don't overproduce. Overproduction leads to discounting and discounting leads to lower profits for both the manufacturer and the dealer.

Although vehicle sales, or SAAR, have stabilized we will not likely see the industry sales rebound significantly until the middle of this year; however, the future *is* brighter. Worldwide consulting form IHS Global Insight expects that by 2015, the U.S. market will sell close to 17 million units again. When you consider the pain that dealers faced last year, increasing volume by almost 60% in just five years will dramatically benefit dealers, as well as the overall industry.

In the past several months as I have traveled the country speaking to different audiences, I have drawn a few conclusions about auto retailing. First, the franchise system for new vehicle dealerships continues to be a viable model. Dealers have proven they can withstand many difficult challenges. In my lifetime as a dealer and currently as NADA chairman, I continue to be amazed at the resiliency and tenacity of auto dealers facing unprecedented conditions.

In many ways, the dealer model has not substantially changed. As independent business owners, we continue to grapple with the challenges we have always faced: competitive pressure; keeping expenses under control; finding new revenue sources; and satisfying our customers. When so much of our business model is controlled by manufacturers, I find comfort in knowing that these business basics have not changed. These are things we can control. Ultimately, it is key that each of us focus on what we *can* control and not worry so much about the things we *cannot* control.

Finally, I want to assure each of the dealers here today that one of the smartest investments you've made recently is to attend this year's NADA convention. I know for some of you, it was a tough call in the current business environment. But I am confident you will find it will live up to your expectations. Happily, attendance this year will increase 20% from last year's convention in New Orleans.

Thousands of the nation's new-car and –truck dealers—and dealers from more than 30 other countries—are here to find ways to improve their overall business operations and prepare for an economic rebound.

With 19 franchise meetings scheduled, 108 workshop sessions to choose from and more than 450 companies exhibiting on the expo floor, this is once again the "Industry event of the year."

Here in Orlando, NADA will launch NADA University, which will offer new online educational programs through an interactive-based training system, in addition to instructor-led training and consulting programs. Training demos will be provided on site at the NADA University booth and studio at the convention center.

For the first time, we have also given dealers and managers $200 vouchers to spend on goods and service on the expo floor. For the next three days, dealers and managers will walk the exhibit floor with that money burning a hole in their pocket, and that has to be a good thing for them and our exhibitors.

Our general session speakers include 2010 NADA Chairman Ed Tonkin; Stefan Jacoby, President and CEO of Volkswagen Group of America; Mike Jackson of AutoNation; and oil-tycoon-turned-energy-activist T. Boone Pickens.

Once, again, thank you for inviting me to be here today and thank you for attending our convention. Best of luck in 2010. I'd be happy to answer any questions you may have.

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