

Pressure On Used Car Prices To Subside Later This Year

- Global sales gains moderate in March, though volumes remain on target to set a full-year record.
- New vehicle purchases declined across North America in April for the first time since 2009.
- Total US vehicle demand (new and used) continues to move higher, and strengthening economic fundamentals combined with slower growth in used vehicle supplies will reduce downside pricing pressure.

RECENT GLOBAL NEW VEHICLE SALES DEVELOPMENTS

The advance in global car sales moderated to 3.4% y/y in March, down from a 7% jump in February and an average gain of 5% during the previous two months. Slower sales in China dampened activity across Asia. Meanwhile, ongoing double-digit declines in US fleet purchases reduced overall US sales below a year earlier for the third consecutive month. In contrast, sales gains continue to accelerate in Western Europe, buoyed by strengthening economic conditions. Purchases also picked up in Eastern Europe, with sales in Russia climbing above a year earlier for the first time in four years. Volumes also advanced in South America at the fastest pace since mid-2013, as purchases in Brazil posted a double-digit year-over-year gain for the first time in more than three years.

More recent sales data for April point to some further softening. Purchases across North America, which account for nearly 30% of the global total, fell below a year earlier in April in all three countries for the first time since late 2009, when the global economic expansion was in its infancy. While the data were weaker than expected, we believe last month's slowdown likely reflects some distortions, such as a late Easter that was in April this year and reduced the number of selling days. Auto dealers in the US and Mexico had one less day to sell vehicles than April a year ago. Meanwhile, Canadian consumers had two fewer days to buy vehicles than in April 2016. As a result, sales in **Canada** fell 2% below a year earlier for the first time since late 2016. However, even with last month's slide, the annualized sales pace was a solid 1.98 million units, still above the full-year 2016 total of 1.95 million. Volumes outperformed on the Prairies, with Alberta posting its second consecutive monthly double-digit gain alongside an improving outlook for the oil patch.

US sales remained below an annualized 17 mn units for the second consecutive month, as retail activity receded below a year ago and fleet volumes continued their double-digit year-over-year slide. **We believe that the weakness in retail activity will prove to be temporary, as it likely reflects a shift among many consumers into used vehicles, due to improving affordability.** For example, the latest University of Michigan Consumer Sentiment Index indicates that the number of households planning to buy a pre-owned model has climbed to record highs.

USED VEHICLE PRICING PRESSURE LIKELY TO ABATE

Concern over declining US used car prices has climbed back into the headlines due to recent news that the largest auto rental car company

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Chart 1

Used Car Prices Likely to Stabilize

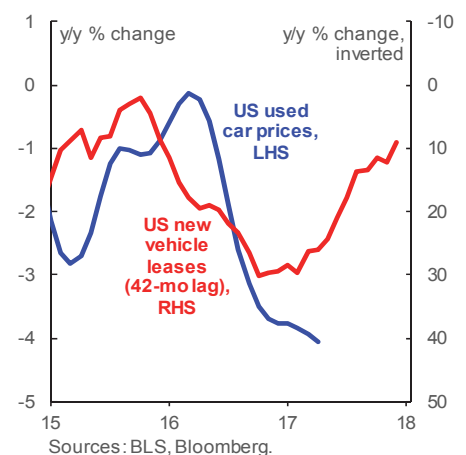
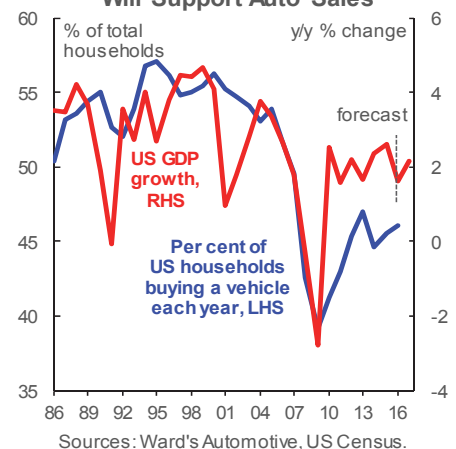


Chart 2

Stronger Economic Growth Will Support Auto Sales



reported a much sharper-than-expected loss in the latest quarter due to slumping residual values. This development combined with a rising number of vehicles coming off-lease has many worried that pricing pressure will continue to intensify, potentially leading to a cyclical downturn in the US auto industry. We do not share this view and believe that the industry is currently in the “eye of a used car price storm”, and that pricing will stabilize later this year once the growth in off-lease vehicles moderates.

Several months of lower-than-expected new vehicle sales combined with the largest fall-off in used car prices since the global economic downturn have led to fear that the US auto cycle may have peaked. However, we point out that used car prices have weakened temporarily in past cycles, with only a limited impact on the overall US auto market (see bottom chart on page 7). Furthermore, we believe the industry is currently at the “high tide” of off-lease vehicle growth, and the pace will moderate going forward. This reflects the fact that leasing enjoyed its largest growth spurt in 2013–14, and the pace of growth has moderated significantly since then. For example, leasing’s share of the US auto market jumped from 22% in 2012 to 27% at the end of 2014. This represents an average increase of nearly 2.5 percentage points annually in 2013–2014, double the average of the past fifteen years. During those two years, the number of vehicles leased in the United States surged by nearly 1.5 million units, roughly 60% above the advance of the previous two years. Those vehicles are now coming back to be remarketed, leading to a 30% y/y surge in the number of vehicles coming off-lease and creating the “price scare” that we are currently experiencing (see chart 1).

While leasing has continued to increase since the high-water growth mark of 2013, the pace subsided to less than 400,000 vehicles last year, nearly half the advance of several years ago. This moderation will lead to significantly slower growth in off-lease vehicles and less downward pressure on used car prices.

It is also important to highlight that **past automotive cycles only ended when demand was undermined by weakening economic fundamentals, especially a deteriorating labour market and softer income trends**. None of those pre-conditions are currently in place. For example, the US labour market remains strong, with wage gains accelerating, and real income growth above the cycle average. Other leading indicators such as interest rates and credit conditions also remain favourable and are inconsistent with a peaking auto market. Meanwhile, vehicle-replacement rates still remain historically low. More than half of all US households bought a new or used vehicle annually between 1986 and 2006. However, vehicle-buying rates have slumped to an average of only 44% since then, leading to a significant ageing of the US fleet to a record high 11.6 years. Stronger economic growth and an ageing fleet suggest that significant vehicle replacement still lies ahead and that a near-term auto cycle peak is unlikely (see chart 2).

INTERNATIONAL CAR SALES OUTLOOK

(millions of units)

	<u>1990–99</u>	<u>2000–13</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017f</u>
TOTAL SALES	39.20	53.74	71.18	72.61	77.29	78.36
North America*	16.36	17.74	19.42	20.64	21.05	21.37
Canada	1.27	1.61	1.85	1.90	1.95	1.94
United States	14.55	15.15	16.44	17.39	17.50	17.80
Mexico	0.54	0.98	1.13	1.35	1.60	1.63
Western Europe	13.11	13.79	12.11	13.20	13.97	14.25
Germany	3.57	3.25	3.04	3.21	3.35	3.42
Eastern Europe	1.18	3.03	3.81	3.15	3.14	3.30
Russia	0.78	1.83	2.49	1.60	1.43	1.50
Asia	6.91	16.08	31.69	32.29	36.06	36.24
China**	0.43	6.52	18.37	20.01	23.57	23.34
India	0.31	1.18	1.87	2.06	2.09	2.19
South America	1.64	3.10	4.15	3.33	3.07	3.20
Brazil	0.94	1.90	2.50	1.82	1.39	1.39

*Includes light trucks. **Includes crossover utility vehicles from 2005. Sources: Ward's Automotive Reports, Bloomberg.

CANADA/US MOTOR VEHICLE SALES OUTLOOK

	<u>1991-05</u>	<u>2006-14</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	
	Average				Jan-Mar**	Annual f
(thousands of units, annualized)						
CANADA	1,398	1,643	1,898	1,949	2,067	1,940
Cars	797	783	714	662	677	650
Domestic	583	491	476	438	481	435
Imports	214	292	238	224	196	215
Light Trucks	601	860	1,184	1,287	1,390	1,290
(millions of units, annualized)						
UNITED STATES	15.5	14.1	17.4	17.5	17.1	17.8
Cars	8.3	6.9	7.5	6.9	6.2	6.4
Light Trucks	7.2	7.2	9.9	10.6	10.9	11.4
(millions of units, annualized)						
NORTH AMERICAN PRODUCTION*	15.58	14.25	17.95	18.17	17.52	18.50
CANADA	2.50	2.24	2.28	2.37	2.48	2.35
UNITED STATES	11.67	9.53	12.10	12.20	11.37	12.40
MEXICO	1.41	2.48	3.57	3.60	3.67	3.75

*Includes light, medium and heavy trucks. **Canadian sales are Scotiabank estimates. Sources: Ward's Automotive Reports, Statistics Canada.

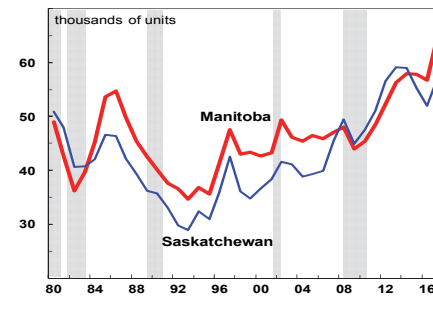
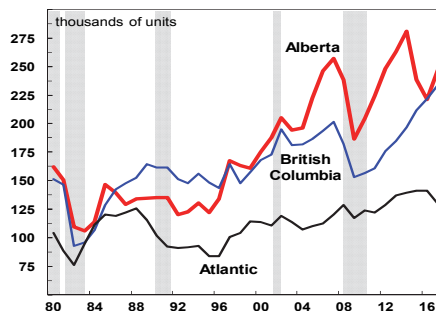
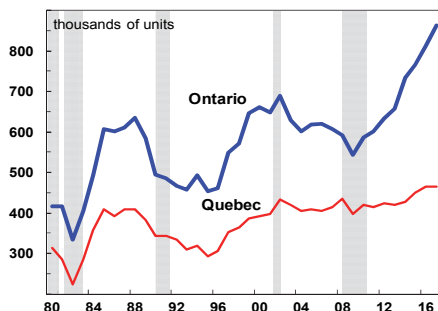
VEHICLE SALES OUTLOOK BY PROVINCE*

(thousands of units, annual rates)

	<u>1994-05</u>	<u>2006-14</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	
	Average				Jan-Mar**	Annual f
CANADA	1,446	1,643	1,898	1,949	2,067	1,940
ATLANTIC	102	123	140	140	137	135
CENTRAL	936	1,017	1,205	1,265	1,323	1,256
Quebec	366	411	444	458	454	456
Ontario	570	606	761	807	869	800
WEST	408	503	553	544	607	549
Manitoba	42	48	56	55	61	56
Saskatchewan	36	49	54	51	60	52
Alberta	166	231	236	220	251	223
British Columbia	164	175	207	218	235	218

*Includes cars and light trucks. **Scotiabank estimates. Sources: Statistics Canada, Canadian Vehicle Manufacturers' Association.

VEHICLE SALES BY PROVINCE



Includes cars and trucks (light, medium and heavy). Shaded bars indicate U.S. recession periods. Source: Statistics Canada.

AUTO MARKET SHARE BY MANUFACTURER — CANADA*

(thousands of units, not seasonally adjusted)

	<u>2016</u>		<u>2017</u>		<u>2016</u>		<u>2017</u>	
	Jan to Apr		Jan to Apr		Apr		Apr	
	Units	% of Total	Units	% of Total	Units	% of Total	Units	% of Total
TOTAL	207.1	100.0	197.5	100.0	72.5	100.0	66.0	100.0
Big Three	42.8	20.7	41.1	20.8	15.6	21.5	15.0	22.8
General Motors	22.1	10.7	21.6	10.9	7.6	10.6	8.1	12.3
Ford	13.5	6.5	10.8	5.5	5.2	7.1	3.7	5.7
Chrysler	7.2	3.5	8.7	4.4	2.8	3.8	3.2	4.8
Japanese	91.0	43.9	90.7	45.9	31.2	43.1	28.6	43.3
Honda	27.8	13.4	29.0	14.7	9.3	12.8	9.0	13.6
Toyota	29.0	14.0	26.8	13.6	11.0	15.2	9.6	14.5
Nissan	15.8	7.6	16.9	8.6	4.1	5.7	3.9	6.0
Mazda	10.0	4.8	10.7	5.4	3.9	5.3	2.9	4.5
Mitsubishi	3.5	1.7	2.7	1.3	1.1	1.6	1.0	1.4
Subaru	4.8	2.3	5.9	3.0	1.8	2.5	2.2	3.4
Hyundai	24.8	12.0	20.7	10.5	8.3	11.4	7.6	11.4
Volkswagen	16.1	7.7	12.9	6.5	6.4	8.8	4.6	7.0
Kia	12.6	6.1	11.2	5.7	4.5	6.2	3.9	5.9
BMW	7.2	3.5	6.4	3.2	2.5	3.5	2.1	3.2
Mercedes-Benz	7.1	3.4	8.0	4.1	1.9	2.6	2.2	3.4
Other	5.5	2.7	6.5	3.3	2.1	2.9	2.0	3.0

*Source: Dealer sales from the Global Automakers of Canada.

TRUCK MARKET SHARE BY MANUFACTURER — CANADA*

(thousands of units, not seasonally adjusted)

	<u>2016</u>		<u>2017</u>		<u>2016</u>		<u>2017</u>	
	Jan to Apr		Jan to Apr		Apr		Apr	
	Units	% of Total	Units	% of Total	Units	% of Total	Units	% of Total
TOTAL	405.8	100.0	429.7	100.0	130.5	100.0	133.6	100.0
Big Three	223.6	55.1	235.7	54.9	71.4	54.7	73.7	55.1
General Motors	59.0	14.5	70.6	16.4	18.9	14.5	22.8	17.1
Ford	78.3	19.3	82.4	19.2	25.2	19.3	26.7	19.9
Chrysler	86.3	21.3	82.7	19.3	27.3	20.9	24.2	18.1
Other Domestic	12.5	3.1	13.5	3.1	3.4	2.6	3.9	2.9
Japanese	113.2	27.9	121.4	28.2	36.3	27.8	36.3	27.2
Honda	26.1	6.4	30.3	7.0	8.6	6.6	9.3	7.0
Toyota	40.2	9.9	40.2	9.3	12.8	9.8	12.4	9.3
Nissan	26.4	6.5	29.3	6.8	8.0	6.1	7.4	5.5
Mazda	10.8	2.7	11.6	2.7	3.6	2.8	3.8	2.9
Mitsubishi	4.0	1.0	4.3	1.0	1.4	1.1	1.6	1.2
Subaru	9.7	2.4	10.1	2.3	3.2	2.5	3.3	2.5
Hyundai	17.6	4.3	18.0	4.2	6.3	4.8	7.0	5.3
Kia	9.1	2.2	9.8	2.3	3.2	2.5	3.3	2.5
Other Imports	29.8	7.4	31.3	7.3	9.9	7.6	9.4	7.0
LIGHT TRUCKS	396.1	97.6	426.4	99.2	127.8	97.9	131.0	98.0

*Source: Dealer sales from the Global Automakers of Canada.

AUTO SALES BY PROVINCE

(thousands of units, not seasonally adjusted)

	<u>2016</u> Jan to Mar	<u>2017</u> Jan to Mar	<u>2016</u> Mar	<u>2017</u> Mar
CANADA	134.3	131.3	61.7	61.2
ATLANTIC	9.4	7.9	4.6	3.8
Newfoundland	1.7	1.6	0.8	0.8
Nova Scotia	4.2	3.3	2.1	1.6
New Brunswick	3.0	2.5	1.4	1.1
Prince Edward Island	0.5	0.5	0.3	0.3
CENTRAL	93.0	92.6	43.8	44.2
Quebec	39.8	36.9	19.9	18.5
Ontario	53.2	55.7	23.9	25.7
WEST	31.9	30.8	13.3	13.2
Manitoba	2.9	2.8	1.2	1.3
Saskatchewan	1.9	1.9	0.8	0.9
Alberta	10.7	10.4	4.5	4.4
British Columbia	16.4	15.7	6.8	6.6

Source: Statistics Canada.

TRUCK SALES BY PROVINCE*

(thousands of units, not seasonally adjusted)

	<u>2016</u> Jan to Mar	<u>2017</u> Jan to Mar	<u>2016</u> Mar	<u>2017</u> Mar
CANADA	276.5	294.8	116.5	128.2
ATLANTIC	18.7	19.1	7.8	9.0
Newfoundland	4.6	4.7	2.0	2.2
Nova Scotia	6.8	7.4	2.8	3.4
New Brunswick	6.3	6.0	2.6	2.9
Prince Edward Island	1.0	1.0	0.4	0.5
CENTRAL	168.0	175.6	73.6	77.5
Quebec	55.5	55.2	25.1	25.6
Ontario	112.5	120.4	48.5	51.9
WEST	89.8	100.1	35.1	41.7
Manitoba	9.2	10.2	3.7	4.2
Saskatchewan	9.1	11.0	3.5	4.8
Alberta	39.1	43.7	15.1	18.1
British Columbia	32.4	35.2	12.8	14.6

*Light, medium and heavy trucks. Source: Statistics Canada.

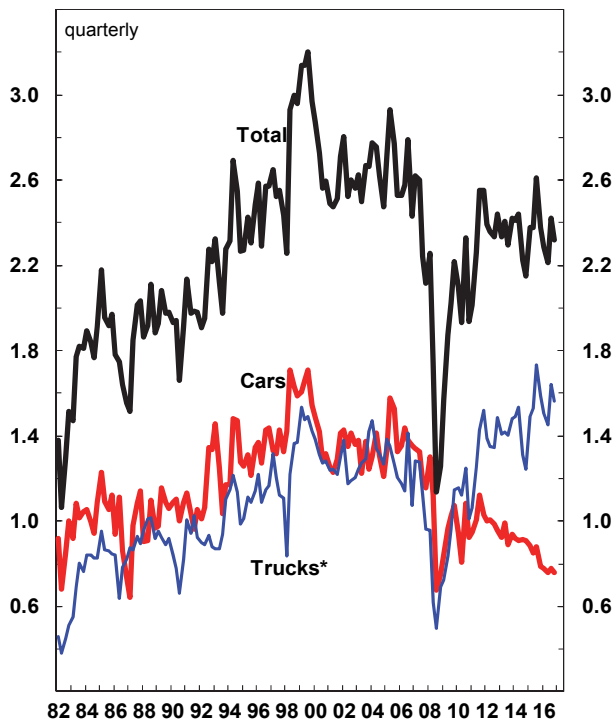
CANADIAN MOTOR VEHICLE PRODUCTION

(thousands of units, not seasonally adjusted)

	<u>2016</u> Jan to Apr	<u>2017</u> Jan to Apr	<u>2016</u> Apr	<u>2017</u> Apr
TOTAL	829.6	787.2	200.0	186.0
CAR	285.9	259.6	67.8	60.7
Chrysler	83.5	73.3	20.6	17.6
GM	49.5	32.1	10.2	8.5
Honda	70.3	72.0	16.7	16.2
Toyota	82.6	82.2	20.3	18.4
TRUCKS*	543.7	527.6	132.2	125.3
Chrysler	108.1	102.9	18.8	26.1
Ford	94.3	86.7	24.8	20.3
GM	138.0	130.7	37.0	31.9
Honda	74.2	78.1	18.8	17.7
Toyota	124.2	124.4	31.4	28.2
Others	4.9	4.8	1.4	1.1

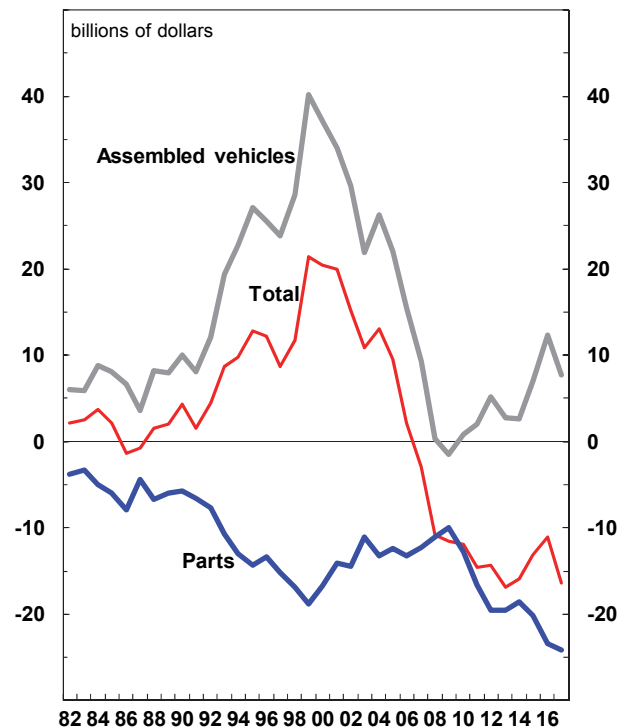
*Light, medium and heavy trucks. Source: Ward's Automotive Reports.

Canada — Motor Vehicle Production



Millions of units, seasonally adjusted annual rates.
*Light, medium and heavy trucks.
Source: Ward's Automotive Reports.

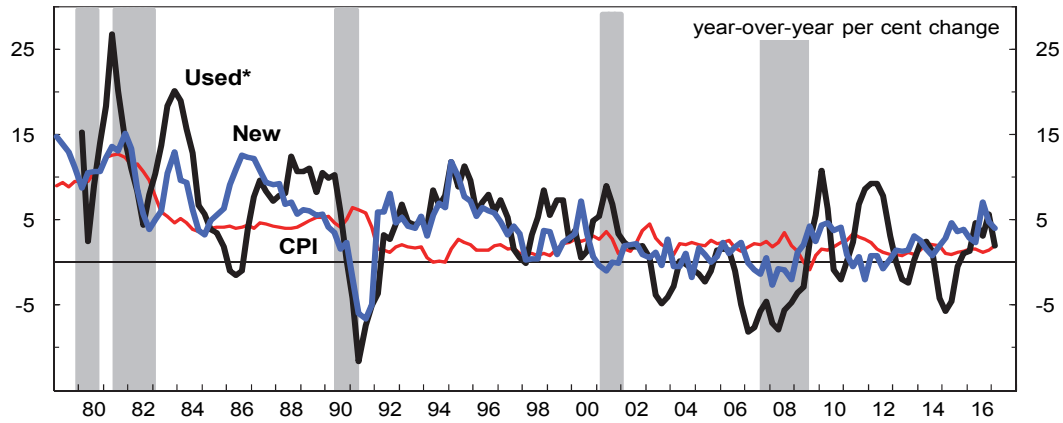
Canada — World Auto Trade Balances



2017 data are January-March annualized.
Source: Statistics Canada.

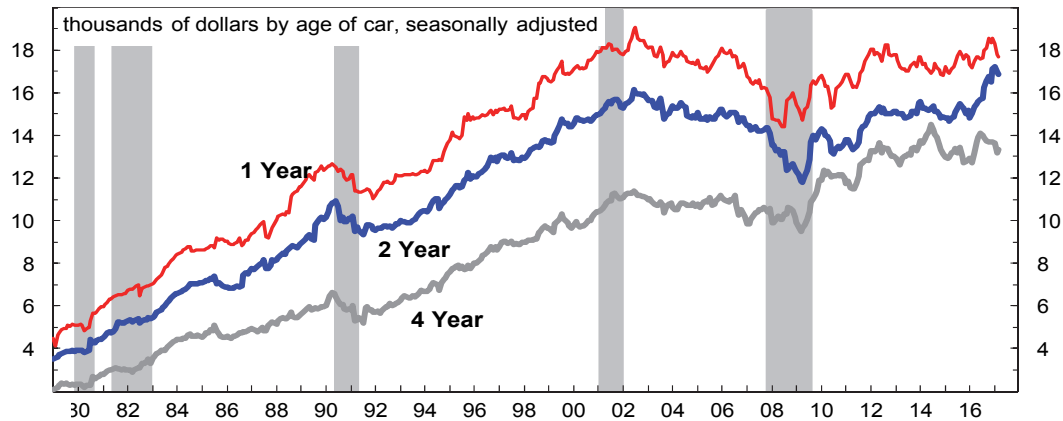
New & Used Car Prices

Scotiabank Car Price Indicators — Canada



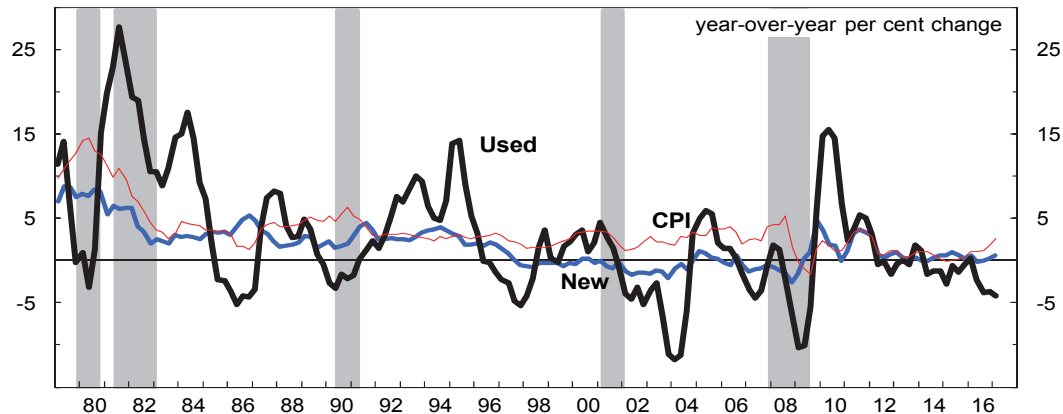
*Scotiabank estimate from Canadian Black Book data.
Sources: Canadian Black Book, Statistics Canada.

Scotiabank Car Price Indicators — Canada



Scotiabank estimate from Canadian Black Book data.

Scotiabank Car Price Indicators — United States



Consumer price indices for new and used cars.
Shaded areas indicate recession periods. Source: U.S Bureau of Labor Statistics.

CANADIAN CORPORATE FINANCIAL PERFORMANCE
MOTOR VEHICLE DEALERS AND REPAIR SHOPS

		Net Income After Tax (\$ mil)	Pre-Tax Profit Margin (%)	Inventory Turnover Ratio	Interest Coverage Ratio	Debt/ Equity Ratio	Return on Shareholders Equity (%)
Annual	2004	571	0.69	4.98	2.25	3.17	10.49
	2005	799	0.93	5.35	2.55	2.74	12.90
	2006	942	1.20	5.16	2.64	2.75	14.37
	2007	1089	1.41	5.05	3.36	2.56	15.13
	2008	1142	1.43	5.04	3.51	2.44	14.66
	2009	1392	1.84	5.34	4.85	2.07	16.99
	2010	1649	2.06	4.91	5.34	2.11	18.09
	2011	1664	1.99	5.17	5.19	2.02	17.44
	2012	1748	1.97	4.86	5.32	2.03	16.71
	2013	2215	2.32	5.08	6.64	2.02	20.08
	2014	2740	2.65	5.10	7.56	1.86	20.90
	2015	2854	2.57	5.07	7.81	1.87	20.50
	2016	2687	2.20	4.97	7.46	1.91	17.91
Quarterly at annual rates							
	2015Q4	2988	2.65	4.98	7.57	1.84	20.63
	2016Q1	2008	1.93	4.56	6.54	1.94	13.95
	Q2	3228	2.43	5.40	8.74	1.92	21.79
	Q3	2756	2.43	5.07	7.67	1.89	18.12
	Q4	2756	2.65	4.82	6.88	1.88	17.68
Average (89–16)		929	1.28	6.03	3.30	2.33	12.05
Low (89–16)		-68	0.10	4.38	1.10	3.57	-1.20

Definition of Ratios:

Pre-tax Profit Margin: pre-tax income/sales

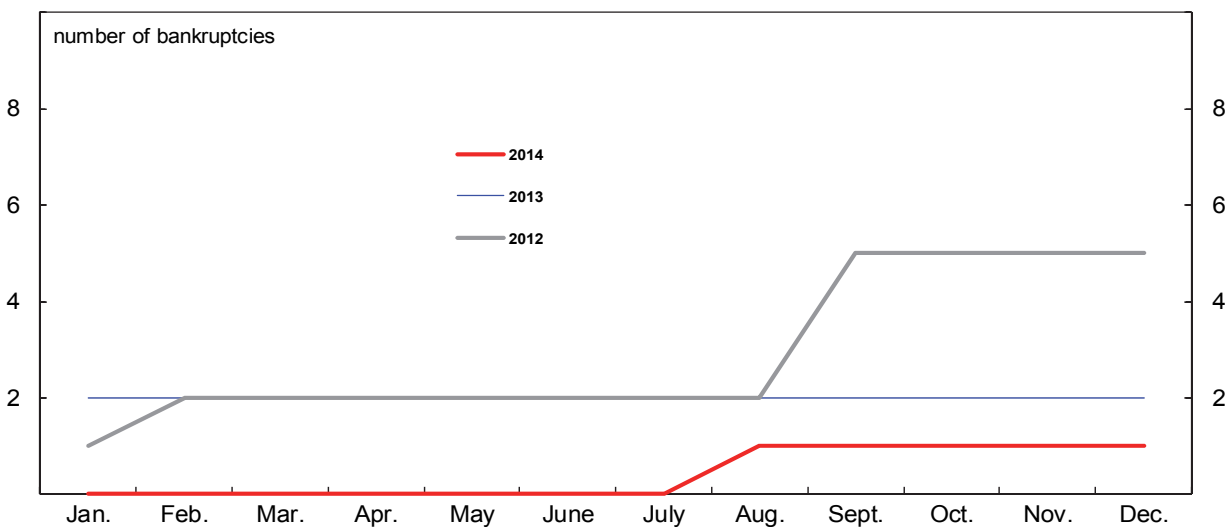
Inventory Turnover Ratio: sales/inventory

Source: Statistics Canada.

Interest Coverage Ratio: (pre-tax income and interest payments)/(interest payments)

Debt/Equity Ratio: (short-term and long-term debt)/total equity

Return of Shareholders' Equity: after-tax income/total equity

Retail Auto Dealer Bankruptcies


New car dealers only; cumulative total during the year.

Source: Office of the Superintendent of Bankruptcy.

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