

Structured Finance Newsletter

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THE USED VEHICLE AUCTION MARKET

The auction market for vehicles is a specialized sector within the automotive industry and an important part of the overall economy. It represents anywhere from 10% to 25% of total retail sales and can assist in gauging overall recoveries if the used vehicle indices are moving in one direction or another. The auction market is a largely regionalized business with large and small auctions located throughout the U.S. and in Canada. There are two very large auction companies: Adesa Inc. and Manheim Inc. (the Majors) and a host of smaller or regional auctions like ABC Auctions and Insurance Auto Auctions Inc. Vehicle auctions have matured from a fragmented to a highly sophisticated marketplace. The auction sites are all secured facilities and set sale dates, and if vehicles do not sell, at the seller's option, they are stored at the auction site. Bidders need to wear badges so auctioneers can see the bidder is qualified. The auction normally has vehicles labeled and running through lanes in a pre-identified order so that upon inspection of that day's run list the dealer can focus on specific vehicles. Subsequent to the sale of a vehicle, it cannot be taken from the auction lots without proper documentation. More than a third of dealers self-finance inventories even though there are specialty finance companies that participate in financing vehicles for dealers. The largest finance companies that specialize in this sector are Manheim Automotive Financial Services, Inc., Automotive Finance Corporation and Dealer Services Corp.

The auctions are a network of constituents that come together to buy and sell vehicles with consignors supplying vehicles to each auction. The majority of consignors include: dealers selling vehicles that are trade-ins or aged vehicles, rental companies that are selling vehicles coming off individual programs, commercial fleets or vehicle manufacturers that are coming off lease, or banks and financial institutions or captive finance companies who are seeking to liquidate repossessed vehicles. The buyers are franchised or independent dealers that are seeking to refresh their used vehicles they are offering for sale.

Vehicles at auction are generally used vehicles but they are not necessarily vehicles of a certain aged status and can be brand new or extremely old vehicles. Rental car programs dispose of vehicles either through the manufacturer or through the rental car company directly to the auction. Although rental car companies have retained these vehicles longer than they have historically, these vehicles are generally twelve to eighteen months old before they are liquidated at the auctions.

The biggest strength of auctions is that they provide a current assessment on the market value of a vehicle or portfolio of vehicles running through the auction lanes. If a ten year old vehicle runs through the auction lanes and is improperly valued, it will not be sold. This is extremely valuable since these markets provide a directional measure on used vehicle prices. These values are also wholesale prices.

Used Vehicle Value Index



Generally the profit margins tend to be higher for used vehicles than for new vehicles. There are a few fundamental reasons for this including the following: new vehicle values tend to be easily available and are well known throughout the industry. Used vehicle values are also relatively easy to obtain through quoting services such as Kelly Blue Book and Edmunds but these values are given in ranges that speak to the quality of the vehicle. These ranges are highly interpretive and dealers easily capitalize on that. The other reason used profit margins are higher is the values of the vehicles is much lower than the sales price for new vehicles, thus the denominator affect works to benefit the seller.

DBRS recognizes that auctions have become very sophisticated over the years offering a unique set of services designed to aid in the sale of vehicles. These include preparing conditioning reports and reconditioning vehicles prior to sale in addition to simultaneously broadcasting auctions on the internet to allow for a broader audience. DBRS believes that the auction market for vehicles is an important part of the overall economy because it represents approximately ten to 25% of total retail sales. As a result, the auction sales can help to gauge the overall recovery of the market based on the direction of the used vehicle indexes and is used as a proxy by the government and industry participants.

For questions or comments, please contact Chris O'Connell at coconnell@dbrs.com.

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