



# MARKET REPORT

July 2017

Market Insights for Our Insurance Partners





**Valued Partners,**

Together, our industries continue to move forward with advancements in technology and the competitive need for insured retention and growth. Although the individual factors driving our industry’s growth have not changed since our last market report, the magnitude of impact by each factor has varied. These movements have created changes in our market, that we not only projected but anticipated, and with your support, we were able to best respond with a new reinvestment strategy.

The increase in salvage volume, we reported on last year, continued throughout 2016 and into 2017. In turn, addressing the elevated salvage volume levels remains our primary focus in 2017 and in the future. Examined in this report, are several emerging factors that are contributing to the growth in auction supply and having a substantial impact on our industry. Although market conditions have led to much analysis on volume, this report also highlights market movements such as the changing U.S. dollar, scrap levels, and other factors.

**Current State of the Industry**

We have seen considerable growth in the volume of salvaged vehicles, which has been driven primarily by three factors; an increase in the number of cars on the road, an increase in the likelihood a car will be involved in an accident, and an increase in the likelihood a claim will result in a total economic loss rather than a repair. In turn, I would like to highlight these factors and their impact on the current state of our industry.

The automotive industry recorded its seventh consecutive year of growth in new car sales, as it reached 17.5 million in 2016, up from its trough of 10.4 million in 2009. Along with the growth in new car sales, the number of vehicles on the road increased to 264 million in 2016, representing a 4 percent increase over 2015.

Although its rate of growth has recently moderated, claim frequency continues to rise. In 2016, the total number of claims paid was nearly 4 percent higher than the 2015 total. Growth in claims and claims frequency has resulted primarily from the growth in the number of miles driven, the average rate of speed at which those miles are driven and, most importantly, the increase of driver distraction. Low fuel prices and high employment rates support the greater than 3 percent year over year increase in miles driven in the last two years. Additionally, the average rate of speed traveled continues to increase as more of the new incremental miles driven are on highways and rural roads, and as more states increase their maximum speed limits. In 2015, five states passed legislation allowing for higher speed limits and similar legislation is pending in six other states. However, as covered in this report, studies indicate the greatest contributor to the increase in claims and claim frequency is driver distraction. This emerging factor is primarily associated with cell phone usage and internet connectivity, as drivers are not only talking on cell phones but also reading and even composing texts and emails.

Most impactful on salvage volume growth has been the increase in total loss frequency, which has grown an average of 6.2 percent each year over the last two years. The increase in total loss frequency has resulted from the simple industry dynamics; used car values have remained relatively flat while repair costs continue to rise. Cars are becoming far more complex as they incorporate exotic and lightweight materials, intricate construction processes, sensors, cameras and other electronics. This, in turn, leads to a demand that shops employ new equipment, tools and training, as well as requiring more replacement parts per repair. Many of these replacement parts have no non-OEM alternative.

Finally, during the last year we have experienced 15 weather events, which not only became more frequent, but also more severe, contributing to the year over year growth in salvage volume.

**Future State of the Industry**

In the near future, we see the trends in the growth in car parc and in accident frequency continuing, although at a lower level. However, we believe there is a reasonable expectation that the growth in total loss frequency will accelerate. This expectation is derived from the fact that the current growth in total loss frequency has occurred in an environment of stable used car pricing. Since 2010, the Manheim used car index has fluctuated less than 2 percent. Going forward, while drivers of the current growth such as new car complexity, exotic metals usage and sophisticated electronics proliferation will continue, a new element is expected, that being the reduction in used car prices. Off lease volume is expected to exceed 4.5 million units by 2019, dramatically increasing used car supply and, consequently, reducing used car values. This will create an environment of increasing repair costs and decreasing value, leading to a significant increase in total loss frequency.

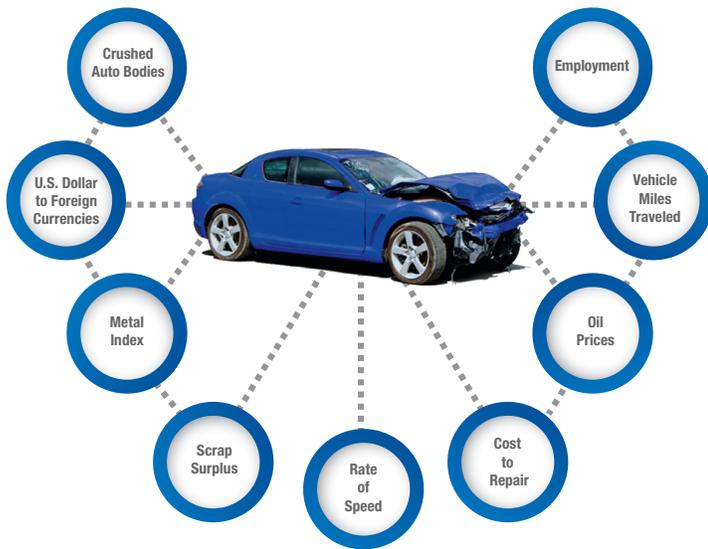
Although not as frequent as accidents, but still contributing to the rise total loss volumes, is weather-related events. With 15 CAT events in 2016, and a yearly increase of CAT events over the past decade, weather has become an increasingly relevant factor. Although it is difficult to predict the impending forces of Mother Nature, this report includes the developing trends of weather-related events and their impact on total loss results.

Our team is working diligently to be prepared for the expected increase in volume, and constantly strives to further reinvest in improving our infrastructure, enhancing our auction technology, and purchasing more land. We are committed to combating the increasing auction supply as we create greater demand for your assets. We will continue to watch the markets going forward and are eager to supply you with this report and will continue to do so as markets change.

Yours respectfully,



## Factors and Industry Influencers of 2017



are still 30 percent lower than the March monthly average over the last 6 years (Lasky, 2017).

Scrap prices will be worth monitoring in the coming months, however, they are expected to level off. Scrap prices could be further hindered, as the dollar continues to strengthen. In addition, the strong U.S. dollar will cause ferrous export demand to suffer (Metro Group, 2017).



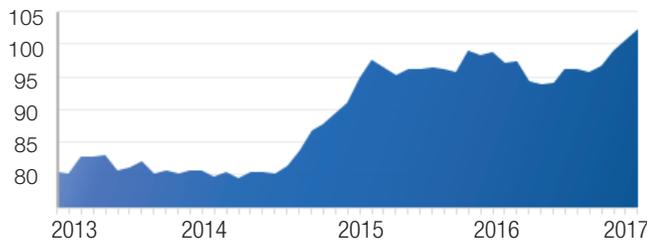
Figure 2: U.S. Crushed Auto Bodies Price Index (February 2012 - February 2017)



## U.S. Dollar Index

Shortly after the U.S. presidential election, the U.S. dollar surpassed its highest level in 13 years. Continuing, from its strong start in 2016, the value of the U.S. dollar was further stimulated in December of 2016, when the Federal Reserve raised interest rates for the second time, before raising them again this summer (Long, 2017).

Figure 1: U.S. Dollar Index (January 2013 - January 2017)



The U.S. Dollar Index, over the last 12 months, increased 6.4% (Bloomberg, 2017). It is reported, the Federal Reserve intends to raise interest rates again in the next 12 to 18 months, which may continue to strengthen the value of the dollar (Torry, 2016). The U.S. dollar is expected to remain relatively strong and will be a top factor to monitor over the next 12 months.



The U.S. dollar strengthened nearly 6 percent against the Yen and nearly 3 percent against the Euro over the last twelve months, as the Euro fell to a 14-year low against the dollar. However, Mexico, one of the largest international buyers of salvage vehicles, saw the value of the Peso remain relatively flat versus the dollar over the last 12 months. The exception to this being December 2016 and January 2017, when the Peso's value dropped considerably versus the dollar, shortly after the U.S. presidential election (Trading View, 2017).

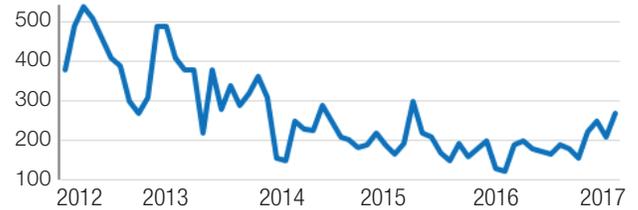
## Metals and Crushed Auto Bodies

Coming as a surprise to the steel industry, crushed auto bodies rose nearly 6 percent in the first quarter of 2017. However, scrap prices

## Scrap Surplus

As a result of the slowing in economic growth and the over estimates in consumption rates in countries such as China, scrap steel continued to experience additional reductions in demand.

Figure 3: Chinese Scrap Imports (February 2012 - February 2017)



While scrap demand continued to decline throughout 2016, conditions in China had a considerable impact on North America and other parts of the world. The overcapacity of steel in China, reduced the output by steel producers in North America, and reduced the global demand for scrap (Toh, 2017). Although the market experienced a slight increase at the end of 2016, it continues to experience fluctuation, making it very unpredictable. At this point, we see scrap demand rising primarily on the eastern seaboard of the U.S., especially in the southeast.



Turkey, once again, was the primary importer of U.S. ferrous scrap metals, along with Mexico accounted for nearly 24 percent and 15 percent, respectively, of U.S. scrap exports in 2016 (Lasky, 2017). According to the World Steel Association, demand for steel and scrap is likely to remain weak, however, it is reported that the steel demand in India and other developing countries may be on the rise over the next 3 to 5 years (World Steel, 2016).

As we projected last year, aluminum experienced higher prices, as it closed out 2016 with a 16 percent increase over the previous year (Lasky, 2017). Aluminum prices are becoming increasingly relevant to the remarketing industry, particularly as aluminum becomes more frequently used by vehicle manufacturers, and is reported, at times, to be more costly to repair.



## Employment

As of February 2017, the Bureau of Labor Statistics reported 2.2 million jobs were added in 2016, and the **unemployment rate hit a 9-year low, as it fell to 4.7 percent**. Optimistic scenarios put the unemployment rate as low as 4.3 percent for 2017 (Bureau of Labor Statistics, 2017).



Reductions in unemployment and underemployment continue to have a direct impact on both new and used vehicle sales, as they relate to miles driven.

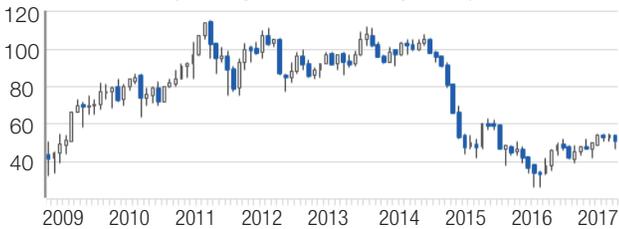
Figure 4: U.S. Unemployment Rate (January 2009 - January 2017)



## Oil Prices

After a three-month low, in late 2016, oil prices saw a boost after the presidential election. By December, OPEC and other major oil producing nations agreed to reduce production by 1.2 million barrels per day, to balance the oversupplied market and attempt to lift crude oil prices out of their two-year slump. As a result, crude oil prices ended the year flat, although well under the last five years average historically (Krauss, 2017).

Figure 5: Crude Oil Price History (January 2009 - January 2017)



The U.S. energy administration reports that volatility will not be as great in 2017, due to the offset of petroleum prices, the increasing strength of the U.S. dollar, as well as the increase of U.S. shale oil and alternative fuels production. Although prices for fuel have increased in the last 6 months, they remain well below yearly averages experienced from 2009 to 2015. As a result, miles driven continues to increase.

## Vehicle Miles Traveled

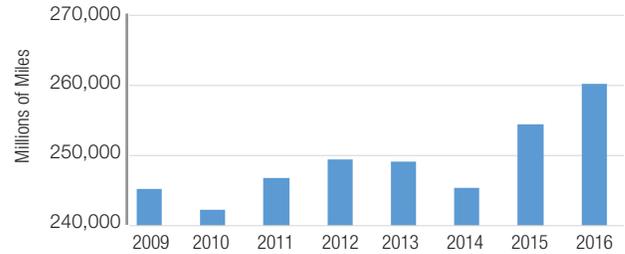
Reflecting the strengthening economy, the U.S. continued to see an increase in total vehicle miles traveled for the fifth consecutive year.

Closing out 2016, vehicle miles traveled reached a **10-year high**, as drivers put a record 3.22 trillion miles on the nation's roads, a 3 percent increase year over year, and a 6 percent increase over 2014 (ALFRED, 2017).



Positive employment statistics and near record low fuel prices have given rise to a greater portion of the population driving to work. Low unemployment also led to an increase in discretionary income, which led to a rise in recreational driving, such as driving to entertainment venues and vacation destinations.

Figure 6: U.S. Vehicle Miles Traveled (January 2009 - December 2016)

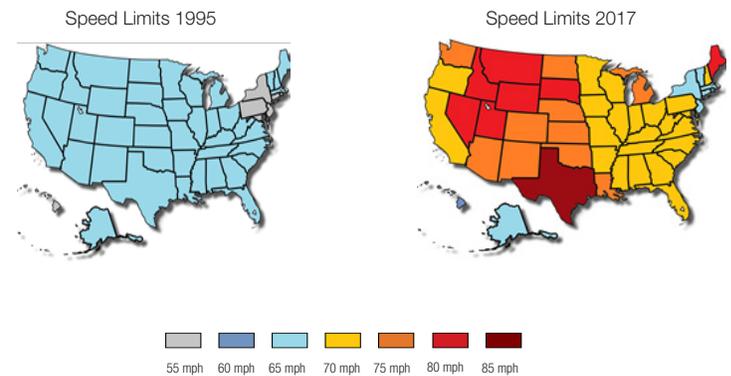


Going forward, OPEC projects an average of \$55 per barrel of oil throughout 2017, unemployment is expected to remain low, and expectations are that vehicle miles traveled will remain high (U.S. DOT, 2017). At the time of this report, oil is priced at \$47 per barrel.

## Rate of Speed

Following the repeal of federal speed limits in 1995, 43 states have raised their maximum speed limit, some as high as 85 mph. A comprehensive study, by the Highway Loss Data Institute, found that every 5 mph increase on interstates and freeways correlated to an 8 percent increase in traffic fatalities (Radar, 2016).

### U.S. Speed Limit Increases



## Driver Distractions

Activities that take drivers' attention away from the road, such as texting and use of touch screen technologies in vehicles, contribute to not only the frequency of accidents, but also their severity. The National Highway Traffic Safety Administration reported, 94 percent of crashes are caused by human error.

The National Safety Council found that and nearly 660,000 people are using their phone at any given time while driving. Despite texting and driving being banned in 46 states, a large portion of the population admits to the use of mobile technologies while driving (National Highway Traffic Safety Administration).



## Cost to Repair

Consumer preference for increased safety, advanced technology and increased environmental awareness, continues to drive vehicle complexity. In turn, this has not only led to the rising cost of new vehicles, but also to the increasing the cost of repairs. Constant advancements in materials and technology, such as headlamps, cameras, and sensors have resulted in higher vehicle repair costs across the industry.

Some of these technological advancements will become mandatory for manufacturers by 2018. By the final months of 2017, it is expected that 80 percent of all manufactured vehicles in the U.S. will have back up cameras.



Newer vehicles are fueling the growing cost of repairs, as newer vehicles tend to have more parts replaced with fewer alternative parts available. In 2016, the total cost of repair averaged \$2,861, nearly a 4 percent increase over 2015. Total

losses increased by nearly 9 percent in 2016, with volume added from numerous severe storms throughout the year driving up overall repair costs.

Historically, parts have accounted for about 40 percent of a vehicle's overall repair cost. Due to greater part complexity, the average price-per-part tends to be more expensive, and contributes to the rising cost of repair. Over the last 12 months, parts repair costs have increased by 1.4 percent, and as expected, should continue to rise over the next several years (McGavin, 2017).

## Consolidation in the Collision Repair Industry

The collision repair industry continues to see acquisition activity by many multi-store operators (MSOs), and now the top four independent consolidators account for more 11 percent of the U.S. collision repair market (Huetter, 2016).



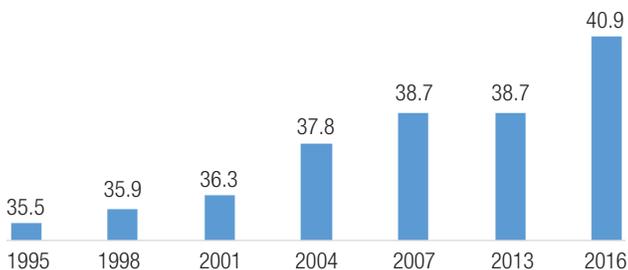
Consolidation could double in size by 2020, creating greater shop demand in certain parts of the country. In addition to rising demand, this occurrence is negatively impacting insured customer satisfaction, as reported by three of the

top five insurance carriers in the nation.

The rapidly growing use of different materials, such as aluminum and carbon fiber, as well as increasing electronic complexity requires repairers to constantly upgrade their tools, equipment and training. It has become more challenging for smaller repair shops to keep up with operating costs, employee training and new equipment.

Many of today's technicians are over age 50, with the industry average being nearly 41-years old, 13 percent higher than the average in 1995. In turn, the U.S. is facing a shortage of trained auto body technicians, as repair shops have an average of 0.9 unfilled entry level technician openings, and nearly 2 unfilled experienced technician openings (Collision Repair Education Foundation's study).

Figure 7: Average Age of Collision Repair Technicians

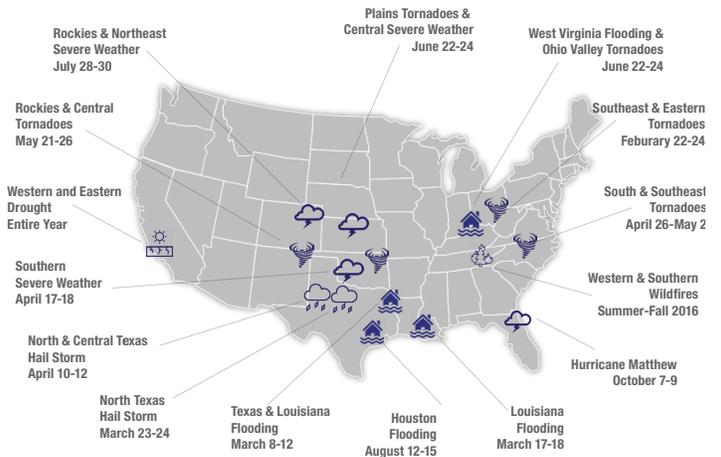


## Weather-Related Events

Over the last four decades, total losses derived from severe weather CAT events have continued to rise. With 15 weather related events, 2016 experienced the largest amount of weather-related catastrophic events since 2012.

Texas, Florida and New York accounted for nearly one-third of insured CAT losses over the last 20 years. By population these states are ranked second, third and fourth largest in the country. The 2016 top five catastrophic events in the U.S. totaled more than \$30 billion in insured losses, and accounted for the highest overall cost in five years.

The 2016 Atlantic Hurricane Season not only began nearly six months early, but was also the most active since 2012. Researchers at the National Center for Atmospheric Research warn, hurricanes in the U.S. could increase by five times by the end of the century.



Catastrophic weather will be a key element to monitor over the next decade, as the frequency of the events continues to rise. The rate of growth for weather-related events has grown exponentially, as the industry averaged one major event per year in 1980, but now averages four major events per year. We project this growth will continue, as scientific evidence warns climate change is causing average temperatures to rise. Warmer weather will not only contribute to the increasing number of heavy downpours and flooding, but also to the unusual weather patterns and intensity of these events.

It is not just hurricanes. The increase in severe storms has not only caused more weather-related total losses, but also had an impact on collision total losses. Snowstorms, sleet, heavy rain, high winds and fog can affect driver capabilities, vehicle performance, pavement friction and crash risk.

Data from NHTSA shows, nearly 22 percent of crashes are related to weather. Majority of accidents, 73 percent, happen on wet pavement, and nearly half, 46 percent, of accidents occur in rainfall, 17 percent happen in snow or sleet, and 3 percent in fog.

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