Volume 20 | Issue 11 | June 15th, 2006

OBSERVATIONS

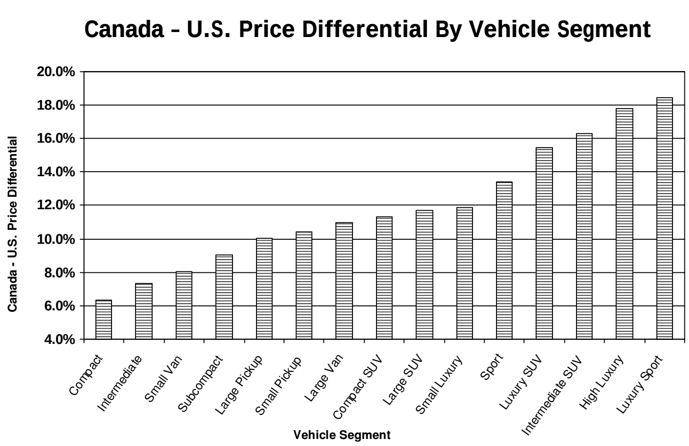
Dennis DesRosiers

The Canada - U.S. Vehicle Pricing Differential

Vehicle pricing is an issue fraught with difficulty for automakers selling into any world market. Success in every segment - even those featuring upscale vehicles - is strongly influenced by competitive pricing. In most years since 1999, we have performed an MSRP analysis comparing vehicle prices in Canada and the United States (adjusted for exchange rates), and this year's study has yielded some interesting results.

The subject of pricing is especially pertinent in Canada because of this country's proximity to the United States. Unlike in other international vehicle markets - where major differences in economic, social, and regulatory environments require automakers to tailor their lineups to a specific country's needs - Canada's showrooms are filled with vehicles similar and in some cases identical to those available in the United States. Having the same products available in both markets makes it fairly easy to draw conclusions about pricing trends between the two countries.

Many manufacturers obfuscate the equivalency issue by offering alternative trim levels or options packages in Canada and the U.S., but our study takes those potential differences into account by comparing base models and/or fully-loaded versions. The definition of "base model" (or even "loaded" model) in each country can be very different, and this analysis does not take all of these differences into account. However, we think that it gets you into the ballpark. It's certainly close enough to understand price differentials between countries.



Source: DesRosiers Automotive Consultants Inc.

We started doing this analysis in 1999, when vehicles were generally cheaper in Canada than in the U.S. Due to a

(continued on next page)

(continued from previous page)

number of factors (e.g., lower average incomes, frugal consumers, devalued currency, etc.), prices generally tilted in favour of Canadian buyers. In 1999, the average Canadian-market vehicle was $3,167 (Canadian dollars) less expensive than its U.S. counterpart (exchange rate adjusted). We believe automakers made a conscious effort to bring vehicles into the realm of affordability for a wider swath of the Canadian market (a practice that was less necessary for the U.S. market). True, this strategy limited per-unit profitability, but there is little doubt that the surging new vehicle market of the early 2000s was at least partially aided by this cut-rate pricing - pricing that could not logically continue.

This pricing analysis leads us to believe that the OEMs will be fairly aggressive with their incentives through the rest of the year.

In recent years, however, the situation has changed enormously. Using an average of U.S. dollar exchange rates from January to June 2006, we have determined that the typical vehicle is $5,842 (17 percent) more expensive in Canada than in the United States.

To take this down to a more comprehensible level, consider the case of the Subaru Impreza WRX. In Canada, this sporty sedan lists for $35,495, while in the U.S., it bases at $24,995. Converted using the above-mentioned exchange rate average, the U.S. price works out to $28,524 in Canadian currency. The Subaru WRX is 20 percent more expensive in Canada than in the U.S., the price differential effectively moving it from the upper end of the "Compact Sedan" category and into the meat of the "Small Luxury" market. A great number of other cars display similar social mobility when their Canadian and American prices are compared.

Contrary to our previous years' findings, only five 2006 models in the study (we did not price every vehicle) achieved the distinction of being more affordable in Canada than in the United States: the Pontiac Montana SV6, Toyota Corolla, Hyundai Elantra, Chrysler PT Cruiser Convertible, and Hyundai Accent. It appears that, to date, automakers have not adjusted their MSRPs to reflect our dollar's newfound strength, and Canadian vehicle buyers have not reaped the benefits resultant from a strong currency.

Why? First, prices this year are comparable to last year. Only the exchange has changed not fundamental pricing. Second, stable pricing regimes are valued and have a lot of merit. Drop prices too quickly and consumers will just wait for the next price decrease. Third, the economy and the vehicle markets are strong and the OEM's can get away with these prices. Fourth, some OEMs purchase in their home market currencies and and do not see any exchange rate advantage. Fifth, profits in the markets have been very lean for a long time and some of the exchange rate advantage is simply restoring profitability.

One issue that became apparent this year was that import nameplate automakers have adopted a radically different pricing structure compared to their GM/Ford/DaimlerChrysler-branded competitors. In past years, the vehicle pricing strategies employed by all manufacturers resulted in nearly-equal price differentials relative to each

(continued on next page)

(continued from previous page)

company's U.S. pricing matrix, but there has been a major swing towards import-nameplate profitability in 2006. The numbers speak volumes:

- GM/Ford/DaimlerChrysler **passenger cars** average \$4,332 over American MSRPs, whereas import-nameplate cars average \$7,939 over U.S. pricing.

- GM/Ford/DaimlerChrysler **light trucks** average \$3,639 over American pricing, while import-nameplate trucks average an extra \$6,432.

Clearly, this is an exchange rate issue. With the Canadian dollar commanding nearly \$1.10 in the U.S. conversion, there has been a restoration of profitability at all levels of the Canadian vehicle distribution and retail sectors. Manufacturers, distributors, and dealers no longer need to operate at the low margins that were their hallmark of Canadian vehicle companies during the lean 1990s. The flip side of this equation is that a greater amount of negotiating headroom exists on any given vehicle, so hardnosed consumers may be able to extract an extra bit of value from their vehicle purchases. This study would yield a different set of results if transaction prices (rather than unnegotiated MSRPs) were compared, since some companies have been very aggressive with incentives this year. We now know why: the exchange rate has given them the ability to be aggressive with incentives.

Going through the vehicle segments, some trends are brought to light. High volume vehicles have the most competitive cost structures, while lower volume models are the most likely to receive premium pricing - *even if they are, in fact, medium-to-high volume products in the United States*. Similarly, those vehicles purchased on a "needs basis" (e.g. Entry Level or Midsize/ Family vehicles) generally have Canada-U.S. price differentials under 10 percent, whereas "aspirational" vehicles - even the relatively high-volume Small Luxury models - regularly carry Canadian price premiums between 15 and 25 percent.

Perhaps as a result of its recently (and publicly) adjusted pricing strategy, General Motors has the distinction of offering the greatest parity between Canadian and American vehicle prices. Outside the luxury segments, it was uncommon for any GM vehicle to carry a price premium greater than 5 percent. Even within the luxury segments, GM vehicles often populated the bottom of the price differential matrix.

Interestingly, GM is also the company that has lost the most market share in the past 12 months. One could interpret this as Canadians not recognizing GM's pricing advantage. We believe this is because consumers have come to expect a heavy discount from GM. When they didn't get it (even though GM's prices were competitive), they didn't purchase. This is a good example of the downside of incentives. How does any OEM get off this drug?

Subcompact, Compact, & Intermediate Cars

While all vehicle segments in the Canadian market showed marked affordability downswings, Subcompact (+\$1,420), Compact (+\$1,245), and Intermediate Passenger Cars (+\$1,991) remained the least affected areas of the market. Vehicles in these segments are aimed at price-sensitive consumers, so

(continued on next page)

(continued from previous page)

manufacturers have not exploited the pricing differential to the same degree as in other sub-markets. Of all passenger car segments, these three showed the least change in the past two years; between 2004 and 2006, the price differential increased by $2,448 for Subcompact, Compact, and Intermediate cars, while the average passenger car price differential (including Luxury and Sport segments) rose by $4,464 during the same period.

Large/Luxury/Sport Vehicles

Not surprisingly, the various segments that comprise our "Large/Luxury/Sport" category (Small Luxury, High luxury, Large SUV, Luxury SUV, Sport, and Luxury Sport) were home to the largest average price differentials on the Canadian market. In terms of both absolute value and percentage differences, the High Luxury and Luxury Sport segments commanded top dollar with average Canadian pricing of $12,204 (+ 17.8 percent) and $14,408 (+ 18.4 percent) above equivalent American MSRPs. To cite specific examples, both the Chevrolet Corvette and Lexus LS430 carry an astonishing 25 percent Canadian market differential. Converted to Canadian dollars, these vehicles carry respective American market price tags of $50,771 and $64,506, but the identical cars purchased from Canadian dealerships retail for $67,805 and $85,700. Granted, these are low volume vehicles, but the level of price inflation currently on display represents an obstacle in the path of one of Canada's fastest-growing vehicle segments (i.e., the broader Large/Luxury/Sport grouping).

With more pricing latitude in Canada, we expect this will provide an opportunity for the market to perform better than we forecast last fall.

Small Luxury vehicles fared slightly better in the comparison, with an average price differential of 11.9 percent. Out of 12 cars included in the study, only a single model (Cadillac's CTS, + 4 percent) carried a Canada-U.S. price differential under 10 percent.

Canadian Sports Cars also carry a stiff premium, with the segment averaging 13.4 percent over U.S. pricing. Notable vehicles included the Mazda MX-5 Miata (+ 18 percent), MINI Cooper S (+ 18 percent), Acura RSX (+ 19 percent), and the aforementioned Subaru Impreza WRX (+ 20 percent). The Chrysler PT Cruiser GT Convertible carried a refreshing 4 percent price advantage.

On average, Large SUVs are priced 12 percent higher in Canada than in the U.S. The GM/Ford/DCX vs. import nameplate issue is on full display in this segment, with vehicles like the GMC Yukon (+ 2 percent) competing against the Nissan Armada (+ 18 percent) and Toyota Sequoia (+ 22 percent).

Like the Luxury passenger cars with which they compete, Luxury SUVs were another bastion of high Canada-U.S. pricing differentials. Of 20 vehicles compared, only two possessed price differentials under 10 percent (Dodge Magnum, 5 percent; Hummer H2, 9 percent). Nearly two thirds of Luxury SUVs carry a Canadian price disadvantage of 15 percent or greater, with the highest sampled differential of

(continued on next page)

(continued from previous page)

22 percent belonging to the $68,400 Lexus GX470 ($53,219 CDN at US dealers).

Compact and Intermediate SUVs

We normally do not group these vehicle segments together, but it seemed apropos for the purposes of this comparison. Compact SUVs, unlike the majority of "Entry Level" vehicles with which they are usually grouped, have an average Canada-U.S. price differential of 11 percent. The figure increases to 16 percent in the Intermediate SUV market. The Ford Escape Limited, a mainstay in the Compact SUV segment, carries a 21 percent Canadian market price differential.

Compact and Intermediate SUVs carried average price premiums of $2,976 and $6,261 in Canada. Both dollar values are greater than those attached to any other "needs-driven" vehicle segment.

Small Vans

Minivan pricing appears to follow the Intermediate Passenger Car segment very closely. Minivans were, on average, 8 percent more expensive in Canada, with the average differential rounding to $2,564. Given that this is one of the most heavily incentivized segments in the Canadian vehicle market, we believe that the actual transaction prices of vehicles in this segment (especially those sold by GM, Ford, and DaimlerChrysler) would align more closely with U.S. values. As in many other segments, General Motors offers the most competitive pricing, with the Canadian market Pontiac Montana SV6 basing 6 percent below the American MSRP.

Small Pickup, Large Pickup, and Large Van

Both pickup truck segments had an average Canadian price premium of 10 percent, but a good portion of the differentials comprising that figure come from import nameplate vehicles. In the Small Pickup sector, the GMC Canyon and Ford Ranger both carried a 6 percent premium in Canada, while the Nissan Frontier was over by 23 percent. Similarly, in the Large Pickup segment, the Chevrolet Silverado and GMC Sierra were priced identically in Canada and the United States - complete parity was achieved between the trucks' MSRPs in both countries. The Dodge and Ford pickups were also competitive, with small differentials of 3 and 5 percent, respectively. Contrast this pricing philosophy with that employed by Nissan and Toyota, sellers of the Titan (+ 18 percent or $5,894) and Tundra (+ 25 percent or $6,616) full size pickups.

Manufacturers, distributors, and dealers no longer need to operate at the low margins that were their hallmark of Canadian vehicle companies during the lean 1990s.

Large Vans, the single segment in which no import nameplate automakers currently compete, has clearly retained some of the domestic-nameplate profitability forsaken in the Large Pickup category. General Motors' two vans each carry an identical Canadian price premium of 5 percent ($1,466), while Ford's Econoline commands an extra 10 percent and DaimlerChrysler's Sprinter earns 15 percent over U.S. MSRPs. Segment-wide, there is an average Canadian market

(continued on next page)

(continued from previous page)

price disadvantage of $3,927. Compare this with our 2004 analysis, where we determined that Large Vans carried an average $10,947 price *advantage* in Canada.

This pricing analysis leads us to believe that the OEMs will be fairly aggressive with their incentives through the rest of the year. To date, most OEMs are using the exchange rate situation to their advantage by doing some or all of the following:

- offering higher incentives
- increasing equipment options
- restoring their profitability
- restoring dealer profitability

With more pricing latitude in Canada, we expect this will provide an opportunity for the market to perform better than we forecast last fall when exchange rates were in the 85 to 87 cent range. Add in the GST cut and the market could actually be up this year a point or two instead of down 3 to 5 percent as originally forecast.

One of the biggest issues raised in this study is that of arbitrage. Namely, will Canadian consumers start crossing the border to buy vehicles? Yes and no - it is entirely possible that an arbitrage situation will take place (or is currently taking place) in the **used** vehicle market, but it is unlikely that individual Canadians will purchase **new** vehicles in the U.S. to avoid the high price differentials. It is too complex for them. Dealers might but this is also limited.

But there are major differences between the new and used vehicle markets. The only hurdles involved in importing a used vehicle are regulatory. New vehicle dealers are often bound by franchise agreements that prohibit cross-border selling. In Canada, car dealers selling into the U.S. risk the possibility of losing OEM franchise agreements, and

(continued on page 8)

Price Differentials in Canada vs. U.S. (Not Sales Weighted)

	2000 Unweighted	2002 Unweighted	2004 Unweighted	2006 Unweighted
Passenger Cars				
Subcompact	-$1,401	-$3,505	-$44	$1,420
Compact	-$2,848	-$3,684	-$1,403	$1,245
Sport	-$2,976	-$2,032	$453	$4,130
Luxury	-$4,325	-$7,183	$885	$4,576
Intermediate	-$3,540	-$5,879	-$1,242	$1,991
Luxury High	-$4,150	-$6,213	$3,143	$12,204
Luxury Sport	$851	-$8,194	$6,934	$14,408
Total	**-$3,595**	**-$5,684**	**$817**	**$6,720**
Big Three Nameplate	**-$3,339**	**-$5,587**	**$136**	**$4,322**
Import Nameplate	**-$3,199**	**-$5,254**	**$984**	**$7,939**
Light Truck				
Compact Sport Utility	-$2,563	-$5,611	$285	$2,976
Intermediate Sport Utility	-$3,475	-$5,461	$2,834	$6,261
Large Sport Utility	-$5,546	-$8,222	$7,559	$5,973
Luxury Sport Utility	-$2,071	-$7,658	$4,533	$8,345
Small Pickup	-$857	-$1,706	-$437	$2,565
Large Pickup	-$1,334	-$3,388	-$263	$2,446
Small Van	-$5,849	-$7,829	$560	$2,564
Large Van	-$3,434	-$9,841	-$10,947	$3,927
Total	**-$3,072**	**-$6,787**	**$729**	**$4,970**
Big Three Nameplate	**-$3,158**	**-$5,946**	**-$710**	**$3,639**
Import Nameplate	**-$2,965**	**-$8,109**	**$2,682**	**$6,432**
Total All Vehicles	**-$3,167**	**-$6,236**	**$773**	**$5,860**
High Volume Vehicles Only	**-$3,076**	**-$5,220**	**-$341**	**$3,664**

Source: DesRosiers Automotive Consultants Inc.

Canada - U.S. Average MSRP Price Differentials - 2006

	Average Cdn MSRP Unweighted	Average U.S. MSRP US $'s Unweighted	Average U.S. MSRP Cdn $'s Unweighted	2006 Differentials Unweighted	Price Differential Percent Unweighted	Average Cdn MSRP Weighted	Average U.S. MSRP Cdn $'s Weighted	2006 Differentials Weighted	Price Differential Percent Weighted
Passenger Cars									
Subcompact	$15,721	$12,532	$14,301	$1,420	9.0%	$14,065	$13,274	$791	6.0%
Compact	$19,638	$16,117	$18,392	$1,245	6.3%	$19,134	$21,108	-$1,973	-9.3%
Intermediate	$27,164	$22,019	$24,974	$1,991	7.3%	$25,832	$24,632	$1,200	4.9%
High Luxury	$68,662	$49,473	$56,458	$12,204	17.8%	$56,830	$51,657	$5,173	10.0%
Small Luxury	$38,597	$29,812	$34,021	$4,576	11.9%	$39,765	$34,639	$5,126	14.8%
Luxury Sport	$78,098	$55,810	$63,690	$14,408	18.4%	$65,361	$58,352	$7,010	12.0%
Sport	$30,812	$23,381	$26,682	$4,130	13.4%	$32,367	$27,889	$4,477	16.1%
Total	**$44,817**	**$33,384**	**$38,097**	**$6,720**	**18%**	**$24,625**	**$28,434**	**$226**	**-13.4%**
Big Three Nameplate	**$38,460**	**$29,914**	**$34,138**	**$4,322**	**12.7%**	**$24,738**	**$25,958**	**$166**	**-4.7%**
Import Nameplate	**$48,049**	**$35,148**	**$40,110**	**$7,939**	**19.8%**	**$24,568**	**$29,960**	**$263**	**-18.0%**
High Volume	**$26,538**	**$21,153**	**$24,140**	**$2,399**	**9.9%**	**$22,883**	**$24,934**	**$199**	**-8.2%**
Light Truck									
Compact Sport Utility	$26,369	$20,499	$23,393	$2,976	11.3%	$28,448	$24,708	$3,740	15.1%
Intermediate Sport Utility	$38,442	$28,200	$32,182	$6,261	16.3%	$39,834	$32,898	$6,937	21.1%
Large Sport Utility	$51,031	$39,483	$45,058	$5,973	11.7%	$47,232	$43,298	$3,934	9.1%
Luxury Sport Utility	$54,009	$40,015	$45,664	$8,345	15.5%	$49,924	$45,268	$4,656	10.3%
Small Pickup	$24,631	$19,336	$22,066	$2,565	10.4%	$22,787	$20,761	$2,027	9.8%
Large Pickup	$24,336	$19,181	$21,890	$2,446	10.1%	$22,155	$21,244	$910	4.3%
Small Van	$31,811	$25,629	$29,247	$2,564	8.1%	$29,437	$30,040	-$604	-2.0%
Large Van	$35,694	$27,837	$31,767	$3,927	11.0%	$31,171	$28,549	$2,622	9.2%
Total	**$38,008**	**$28,950**	**$33,037**	**$4,970**	**15.0%**	**$29,411**	**$28,891**	**$2,922**	**1.8%**
Big Three Nameplate	**$36,374**	**$28,685**	**$32,735**	**$3,639**	**11.1%**	**$27,745**	**$27,941**	**$2,229**	**-0.7%**
Import Nameplate	**$39,801**	**$29,241**	**$33,369**	**$6,432**	**19.3%**	**$34,216**	**$31,087**	**$4,921**	**10.1%**
High Volume	**$31,003**	**$24,053**	**$27,449**	**$3,553**	**12.9%**	**$27,697**	**$26,236**	**$2,562**	**5.6%**
Total All Vehicles	**$41,471**	**$31,205**	**$35,611**	**$5,860**	**16.5%**	**$26,974**	**$28,703**	**$2,436**	**-6.0%**
Total High Volume	**$29,938**	**$23,023**	**$26,274**	**$3,664**	**13.9%**	**$25,216**	**$25,683**	**$2,035**	**-1.8%**

Source: DesRosiers Automotive Consultants Inc.

(continued from previous page)

vehicles they sell into a foreign market often lack the warranty coverage that domestically-purchased enjoy. We suspect similar rules bind U.S. dealers from selling vehicles to Canadians. These policies exist to promote pricing sanity within both markets.

Although used vehicle prices are affected by a number of other factors (e.g. sales region, vehicle condition), one of the major determinants of prices in the used market is new vehicle pricing. Therefore, it is very possible that the current new vehicle market price differentials will be reflected in the used values in the coming years. This will make the used vehicle market susceptible to arbitrage, though it is unlikely that many individual consumers will deal with the trials of vehicle importation. It is far more probable that dealers and wholesalers have begun shopping at U.S. auction houses and undertaking the necessary paperwork to bring late-model vehicles into the Canadian market at cut-rate prices.

An identical situation cropped up in the early 1990s, when free trade made it possible to import used Large/Luxury/Sport vehicles from the U.S. (where the prices of such vehicles had historically been lower in both the new and used markets). It took a year or two for OEMs to adjust their pricing, but once changes were made, both the price differential and the arbitrage situation evaporated.

We believe that vehicle companies will do whatever it takes to make sure Canadians do not go south of the border for their vehicle purchases. Professional players taking advantage of the used market price differential have a limited window of opportunity to play the arbitrage game, since the OEMs will likely adjust prices accordingly within a couple of years (as GM already has). **DAR**