

GROUP 1 AUTOMOTIVE INC

Form 10-Q

October 26, 2012

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

OR

· **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from                      to

Commission File Number: 1-13461

**Group 1 Automotive, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**76-0506313**  
(I.R.S. Employer  
Identification No.)

**800 Gessner, Suite 500**

**Houston, Texas 77024**

(Address of principal executive offices) (Zip Code)

**(713) 647-5700**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of October 22, 2012, the registrant had 22,719,937 shares of common stock, par value \$0.01, outstanding.

**Table of Contents**

**GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

**PART I. FINANCIAL INFORMATION**

Item 1.	<u>Financial Statements</u>	1
	<u>Cautionary Statement about Forward-Looking Statements</u>	22
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	44
Item 4.	<u>Controls and Procedures</u>	45

**PART II. OTHER INFORMATION**

Item 1.	<u>Legal Proceedings</u>	46
Item 1A.	<u>Risk Factors</u>	46
Item 6.	<u>Exhibits</u>	46
	<u>SIGNATURE</u>	47

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	September 30, 2012 (Unaudited)	December 31, 2011
(In thousands, except per share amounts)		
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 38,822	\$ 14,895
Contracts-in-transit and vehicle receivables, net	150,170	167,507
Accounts and notes receivable, net	98,106	92,775
Inventories, net	1,107,193	867,470
Deferred income taxes	19,223	16,012
Prepaid expenses and other current assets	33,217	16,925
<b>Total current assets</b>	<b>1,446,731</b>	<b>1,175,584</b>
PROPERTY AND EQUIPMENT, net	649,811	585,633
GOODWILL	564,898	531,458
INTANGIBLE FRANCHISE RIGHTS	194,170	170,687
OTHER ASSETS	11,175	12,981
<b>Total assets</b>	<b>\$ 2,866,785</b>	<b>\$ 2,476,343</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Floorplan notes payable - credit facility	\$ 910,849	\$ 718,945
Offset account related to floorplan notes payable - credit facility	(128,264)	(109,207)
Floorplan notes payable - manufacturer affiliates	172,738	155,980
Current maturities of long-term debt and short-term financing	30,293	14,663
Current liabilities from interest rate risk management activities	361	7,273
Accounts payable	164,922	148,048
Accrued expenses	117,892	109,245
<b>Total current liabilities</b>	<b>1,268,791</b>	<b>1,044,947</b>
LONG-TERM DEBT, net of current maturities	546,094	482,601
DEFERRED INCOME TAXES	90,548	78,459
LIABILITIES FROM INTEREST RATE RISK MANAGEMENT ACTIVITIES	44,708	26,766
OTHER LIABILITIES	41,047	36,470
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
TEMPORARY EQUITY - Redeemable equity portion of the 3.00% Convertible Senior Notes	33,313	
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, \$0.01 par value, 1,000 shares authorized; none issued or outstanding		
Common stock, \$0.01 par value, 50,000 shares authorized; 26,012 and 25,967 issued, respectively	260	260

Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

Additional paid-in capital	334,942	363,375
Retained earnings	664,124	591,037
Accumulated other comprehensive loss	(34,288)	(29,236)
Treasury stock, at cost; 3,292 and 3,260 shares, respectively	(122,754)	(118,336)
Total stockholders' equity	842,284	807,100
Total liabilities and stockholders' equity	\$ 2,866,785	\$ 2,476,343

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
(Unaudited, in thousands, except per share amounts)				
<b>REVENUES:</b>				
New vehicle retail sales	\$ 1,141,286	\$ 862,660	\$ 3,134,591	\$ 2,457,255
Used vehicle retail sales	462,395	377,115	1,333,603	1,053,609
Used vehicle wholesale sales	78,424	69,051	218,415	191,609
Parts and service sales	224,990	210,067	658,404	609,108
Finance, insurance and other, net	69,477	51,496	192,130	142,255
<b>Total revenues</b>	<b>1,976,572</b>	<b>1,570,389</b>	<b>5,537,143</b>	<b>4,453,836</b>
<b>COST OF SALES:</b>				
New vehicle retail sales	1,074,736	806,498	2,951,379	2,304,057
Used vehicle retail sales	424,663	345,048	1,220,628	958,094
Used vehicle wholesale sales	79,067	69,254	216,031	187,651
Parts and service sales	106,875	100,836	312,106	289,295
<b>Total cost of sales</b>	<b>1,685,341</b>	<b>1,321,636</b>	<b>4,700,144</b>	<b>3,739,097</b>
<b>GROSS PROFIT</b>	<b>291,231</b>	<b>248,753</b>	<b>836,999</b>	<b>714,739</b>
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b>	<b>216,082</b>	<b>188,185</b>	<b>629,521</b>	<b>547,120</b>
<b>DEPRECIATION AND AMORTIZATION EXPENSE</b>	<b>8,096</b>	<b>6,845</b>	<b>23,074</b>	<b>19,881</b>
<b>ASSET IMPAIRMENTS</b>		<b>3,644</b>	<b>288</b>	<b>4,008</b>
<b>INCOME FROM OPERATIONS</b>	<b>67,053</b>	<b>50,079</b>	<b>184,116</b>	<b>143,730</b>
<b>OTHER EXPENSE:</b>				
Floorplan interest expense	(7,942)	(6,964)	(23,424)	(20,245)
Other interest expense, net	(9,619)	(8,644)	(27,849)	(24,811)
<b>INCOME BEFORE INCOME TAXES</b>	<b>49,492</b>	<b>34,471</b>	<b>132,843</b>	<b>98,674</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>(18,157)</b>	<b>(12,977)</b>	<b>(49,766)</b>	<b>(37,135)</b>
<b>NET INCOME</b>	<b>\$ 31,335</b>	<b>\$ 21,494</b>	<b>\$ 83,077</b>	<b>\$ 61,539</b>
<b>BASIC EARNINGS PER SHARE</b>	<b>\$ 1.38</b>	<b>\$ 0.92</b>	<b>\$ 3.64</b>	<b>\$ 2.59</b>
Weighted average common shares outstanding	21,521	22,020	21,600	22,377
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 1.32</b>	<b>\$ 0.91</b>	<b>\$ 3.50</b>	<b>\$ 2.57</b>
Weighted average common shares outstanding	22,458	22,219	22,501	22,533
<b>CASH DIVIDENDS PER COMMON SHARE</b>	<b>\$ 0.15</b>	<b>\$ 0.13</b>	<b>\$ 0.44</b>	<b>\$ 0.35</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Unaudited, in thousands)			
<b>NET INCOME</b>	\$ 31,335	\$ 21,494	\$ 83,077	\$ 61,539
Other comprehensive loss:				
Foreign currency translation adjustment	1,856	(978)	1,850	319
Unrealized loss on marketable securities, net of tax benefit of \$10, \$7, \$5 and \$13, respectively	(16)	(11)	(8)	(22)
Net unrealized loss on interest rate swaps:				
Unrealized loss arising during the period, net of tax benefit of \$2,786, \$7,186, \$7,352 and \$9,593, respectively	(4,644)	(11,976)	(12,254)	(15,988)
Reclassification adjustment for loss included in interest expense, net of tax provision of \$1,006, \$1,281, \$3,216 and \$3,876, respectively	1,676	2,134	5,360	6,460
Net unrealized loss on interest rate swaps, net of tax	(2,968)	(9,842)	(6,894)	(9,528)
<b>OTHER COMPREHENSIVE LOSS, NET OF TAXES</b>	(1,128)	(10,831)	(5,052)	(9,231)
<b>COMPREHENSIVE INCOME</b>	\$ 30,207	\$ 10,663	\$ 78,025	\$ 52,308

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

	Common Shares	Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
	(Unaudited, in thousands)						
BALANCE, December 31, 2011	25,967	\$ 260	\$ 363,375	\$ 591,037	\$ (29,236)	\$ (118,336)	\$ 807,100
Net income				83,077			83,077
Other comprehensive loss, net					(5,052)		(5,052)
Purchases of treasury stock						(11,317)	(11,317)
3.00% Convertible Notes reclassification to temporary equity			(33,313)				(33,313)
Issuance of common and treasury shares to employee stock purchase plans	(236)	(2)	(9,387)			6,899	(2,490)
Proceeds from sales of common stock under employee stock purchase plans	85	1	4,242				4,243
Issuance of restricted stock	296	2	(2)				
Forfeiture of restricted stock	(100)	(1)	1				
Stock-based compensation			8,904				8,904
Tax effect from stock-based compensation plans			1,122				1,122
Cash dividends				(9,990)			(9,990)
BALANCE, September 30, 2012	26,012	\$ 260	\$ 334,942	\$ 664,124	\$ (34,288)	\$ (122,754)	\$ 842,284

The accompanying notes are an integral part of these consolidated financial statements.



**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(Unaudited, in thousands)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 83,077	\$ 61,539
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	23,074	19,881
Deferred income taxes	10,755	16,280
Asset impairments	288	4,008
Stock-based compensation	8,943	8,333
Amortization of debt discount and issue costs	9,659	8,871
Gain on real estate transactions	(2,131)	
Gain on disposition of assets		(967)
Tax effect from stock-based compensation	(1,015)	(651)
Other	1,609	636
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts payable and accrued expenses	19,294	39,722
Accounts and notes receivable	6,680	3,908
Inventories	(193,145)	111,704
Contracts-in-transit and vehicle receivables	25,135	13,525
Prepaid expenses and other assets	6,575	(3,454)
Floorplan notes payable - manufacturer affiliates	(5,979)	19,028
Deferred revenues	(110)	(1,245)
<b>Net cash provided by (used in) operating activities</b>	<b>(7,291)</b>	<b>301,118</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Cash paid in acquisitions, net of cash received	(116,528)	(109,935)
Proceeds from disposition of franchises, property and equipment	257	5,768
Purchases of property and equipment, including real estate	(67,877)	(45,052)
Other	2,814	421
<b>Net cash used in investing activities</b>	<b>(181,334)</b>	<b>(148,798)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Borrowings on credit facility - Floorplan Line	4,186,871	3,635,810
Repayments on credit facility - Floorplan Line	(4,014,024)	(3,759,598)
Borrowings on mortgage facility	18,080	
Principal payments on mortgage facility	(1,648)	(1,065)
Borrowings of other long-term debt	36	202
Principal payments of long-term debt related to real estate loans	(7,297)	(5,684)
Borrowings of long-term debt related to real estate	54,320	21,823
Principal payments of other long-term debt	(3,938)	(2,851)
Repurchases of common stock, amounts based on settlement date	(11,317)	(44,912)
Proceeds from issuance of common stock to benefit plans	1,753	3,094
Tax effect from stock-based compensation	1,015	651
Dividends paid	(10,029)	(8,262)
<b>Net cash provided by (used in) financing activities</b>	<b>213,822</b>	<b>(160,792)</b>

Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

EFFECT OF EXCHANGE RATE CHANGES ON CASH	(1,270)	(71)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>23,927</b>	<b>(8,543)</b>
CASH AND CASH EQUIVALENTS, beginning of period	14,895	19,843
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$ 38,822</b>	<b>\$ 11,300</b>

SUPPLEMENTAL CASH FLOW INFORMATION:

Purchases of property and equipment, including real estate, accrued in accounts payable and accrued expenses	\$ 3,738	\$ 845
Repurchases of common stock, accrued in accounts payable and accrued expenses	\$	\$ 5,866

The accompanying notes are an integral part of these consolidated financial statements.

---

**Table of Contents**

**GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. INTERIM FINANCIAL INFORMATION**

***Business and Organization***

Group 1 Automotive, Inc., a Delaware corporation, through its subsidiaries, is a leading operator in the automotive retailing industry with operations in 15 states in the United States of America ( U.S. ) and 11 towns in the United Kingdom ( U.K. ). Group 1 Automotive, Inc. and its subsidiaries are herein collectively referred to as the Company. The Company, through its regions, sells new and used cars and light trucks; arranges related vehicle financing; service and insurance contracts; provides automotive maintenance and repair services; and sells vehicle parts.

As of September 30, 2012, the Company's U.S. retail network consisted of the following two regions (with the number of dealerships they comprised): (a) the East (47 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina), and (b) the West (64 dealerships in California, Kansas, Oklahoma, and Texas). Each region is managed by a regional vice president who reports directly to the Company's Chief Executive Officer and is responsible for the overall performance of their regions, as well as for overseeing the market directors and dealership general managers that report to them. Each region is also managed by a regional chief financial officer who reports directly to the Company's Chief Financial Officer. The Company's 11 dealerships in the U.K. are also managed locally with direct reporting responsibilities to the Company's corporate management team.

***Basis of Presentation***

The accompanying unaudited condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments of a normal and recurring nature considered necessary for a fair presentation have been included in the accompanying unaudited condensed Consolidated Financial Statements. Due to seasonality and other factors, the results of operations for the interim period are not necessarily indicative of the results that will be realized for the entire fiscal year. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 ( 2011 Form 10-K ).

All acquisitions of dealerships completed during the periods presented have been accounted for using the purchase method of accounting and their results of operations are included from the effective dates of the closings of the respective acquisitions. The allocations of purchase price to the assets acquired and liabilities assumed are assigned and recorded based on estimates of fair value. All intercompany balances and transactions have been eliminated in consolidation.

***Recent Accounting Pronouncements***

In May 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This update changes certain fair value measurement principles and enhances the disclosure requirements, particularly Level 3 fair value measurements. The Company adopted ASU 2011-04 as of March 31, 2012 and it did not have a material impact on the Company's consolidated financial position or results of operations.

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment*. This update permits an entity to first assess qualitative factors to determine whether it is more likely than not (likelihood more than 50%) that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Company adopted ASU 2011-08 as of March 31, 2012 and it did not have an impact on the Company's consolidated financial position or results of operations.

In December 2011, the FASB issued ASU 2011-10, *Disclosures about Offsetting Assets and Liabilities*. This update requires additional disclosures related to offsetting either in accordance with U.S. generally accepted accounting principles ( GAAP ) or master netting arrangements. This ASU is effective for reporting periods beginning after January 1, 2013. The Company does not expect this update to have a material effect on its consolidated financial statements.

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

In July 2012, the FASB issued ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*. This update gives an entity the option to first assess qualitative factors to determine whether it is more likely than not (likelihood more than 50%) that the fair value of the indefinite-lived intangible assets is impaired as a basis for determining whether it is necessary to revalue the fair value of the impaired assets. This ASU is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company does not expect this update to have a material effect on its consolidated financial statements.

---

**Table of Contents**

**GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. ACQUISITIONS AND DISPOSITIONS**

During the first nine months of 2012, the Company acquired seven dealerships in South Carolina, Texas, Kansas, and Florida, as well as six dealerships in the U.K. Consideration paid for these dealerships totaled \$116.5 million. During the three months ended September 30, 2012, the Company terminated a dealership franchise in Texas.

During the first nine months of 2011, the Company acquired five dealerships in Texas. Consideration paid for these dealerships totaled \$109.9 million. In addition, the Company sold for \$4.1 million a non-operating dealership facility that qualified as held-for-sale as of December 31, 2010, with no gain or loss recognized by the Company during the nine months ended September 30, 2011.

**3. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT ACTIVITIES**

The periodic interest rates of the Revolving Credit Facility (as defined in Note 8, "Credit Facilities"), the Mortgage Facility (as defined in Note 9, "Long-Term Debt") and certain variable-rate real estate related borrowings are indexed to the one-month London Inter Bank Offered Rate (LIBOR) plus an associated company credit risk rate. In order to minimize the earnings variability related to fluctuations in these rates, the Company employs an interest rate hedging strategy, whereby it enters into arrangements with various financial institutional counterparties with investment grade credit ratings, swapping its variable interest rate exposure for a fixed interest rate over terms not to exceed the related variable-rate debt.

The Company presents the fair value of all derivatives on its Consolidated Balance Sheets. The Company measures its interest rate derivative instruments utilizing an income approach valuation technique, converting future amounts of cash flows to a single present value in order to obtain a transfer exit price within the bid and ask spread that is most representative of the fair value of its derivative instruments. In measuring fair value, the Company utilizes the option-pricing Black-Scholes present value technique for all of its derivative instruments. This option-pricing technique utilizes a one-month LIBOR forward yield curve, obtained from an independent external service provider, matched to the identical maturity term of the instrument being measured. Observable inputs utilized in the income approach valuation technique incorporate identical contractual notional amounts, fixed coupon rates, periodic terms for interest payments and contract maturity. The fair value estimate of the interest rate derivative instruments also considers the credit risk of the Company for instruments in a liability position or the counterparty for instruments in an asset position. The credit risk is calculated by using the spread between the one-month LIBOR yield curve and the relevant average 10 and 20-year rate according to Standard and Poor's. The Company has determined the valuation measurement inputs of these derivative instruments to maximize the use of observable inputs that market participants would use in pricing similar or identical instruments and market data obtained from independent sources, which is readily observable or can be corroborated by observable market data for substantially the full term of the derivative instrument. Further, the valuation measurement inputs minimize the use of unobservable inputs. Accordingly, the Company has classified the derivatives within Level 2 of the hierarchy framework as described by the Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification.

The related gains or losses on these interest rate derivatives are deferred in stockholders' equity as a component of accumulated other comprehensive loss. These deferred gains and losses are recognized in income in the period in which the related items being hedged are recognized in expense. However, to the extent that the change in value of a derivative contract does not perfectly offset the change in the value of the items being hedged, that ineffective portion is immediately recognized in other income or expense. Monthly contractual settlements of these swap positions are recognized as floorplan or other interest expense in the Company's accompanying Consolidated Statements of Operations. All of the Company's interest rate hedges are designated as cash flow hedges.

As of September 30, 2012, the Company held interest rate swaps in effect of \$425.0 million in notional value that fixed its underlying one-month LIBOR at a weighted average rate of 2.8%. For the three and nine months ended September 30, 2012, the impact of the Company's interest rate hedges in effect increased floorplan interest expense by \$2.4 million and \$7.7 million, respectively; for the three and nine months ended September 30, 2011, the impact of these interest rate hedges increased floorplan interest by \$3.1 million and \$9.6 million, respectively. Total floorplan interest expense was \$7.9 million and \$7.0 million for the three months ended September 30, 2012 and 2011, respectively, and \$23.4 million and \$20.2 million for the nine months ended September 30, 2012 and 2011, respectively.

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

In addition to the \$425.0 million of swaps in effect as of September 30, 2012, the Company has entered into 12 additional interest rate swaps with forward start dates between December 2012 and December 2016 and expiration dates between December 2017 and December 2019, one of which was executed subsequent to September 30, 2012. The aggregate notional value of these forward-starting swaps is \$600.0 million, and the weighted average interest rate is 2.7%. The combination of these swaps is structured such that the notional value in effect at any given time through December 2019 does not exceed \$600.0 million.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of September 30, 2012 and December 31, 2011, the Company reflected liabilities from interest rate risk management activities of \$45.1 million and \$34.0 million, respectively, in its Consolidated Balance Sheets. Several of the Company's interest rate swaps expire in 2012, and as such, the fair value of these instruments are classified as current liabilities in the accompanying Consolidated Balance Sheets. Included in accumulated other comprehensive loss at September 30, 2012 and 2011 are unrealized losses, net of income taxes, totaling \$28.2 million and \$20.5 million, respectively, related to these hedges.

At September 30, 2012, all of the Company's derivative contracts were determined to be effective. The Company had no gains or losses related to ineffectiveness or amounts excluded from effectiveness testing recognized in the Consolidated Statements of Operations for either the three months ended September 30, 2012 or 2011, respectively.

<b>Derivatives in Cash Flow Hedging</b>	<b>Amount of Unrealized Gain (Loss), Net of Tax, Recognized in OCI</b>	
	<b>Nine Months Ended September 30,</b>	
<b>Relationship</b>	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
Interest rate swap contracts	\$ (6,894)	\$ (9,528)

<b>Location of Loss Reclassified from OCI into Statements of Operations</b>	<b>Amount of Loss Reclassified from OCI into Statements of Operations</b>	
	<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
Floorplan interest expense	\$ (7,720)	\$ (9,587)
Other interest expense	\$ (856)	\$ (749)

The amount expected to be reclassified out of other comprehensive income into earnings (through floorplan interest expense or other interest expense) in the next twelve months is \$10.4 million.

**4. STOCK-BASED COMPENSATION PLANS**

The Company provides stock-based compensation benefits to employees and non-employee directors pursuant to its 2007 Long Term Incentive Plan, as amended, as well as to employees pursuant to its Employee Stock Purchase Plan, as amended.

**2007 Long Term Incentive Plan**

The Group 1 Automotive, Inc. 2007 Long Term Incentive Plan ( Incentive Plan ) was amended and restated in May 2010 to increase the number of shares available for issuance under the plan to 7.5 million, for grants to non-employee directors, officers and other employees of the Company and its subsidiaries of: (a) options (including options qualified as incentive stock options under the Internal Revenue Code of 1986 and options that are non-qualified), the exercise price of which may not be less than the fair market value of the common stock on the date of the grant; and (b) stock appreciation rights, restricted stock, performance awards, and bonus stock, each granted at the market price of the Company's common stock at the date of grant. The Incentive Plan expires on March 8, 2017. The terms of the awards (including vesting schedules) are established by the Compensation Committee of the Company's Board of Directors. All outstanding option awards are exercisable over a period not to exceed ten years and vest over a period not to exceed five years. Certain of the Company's option awards are subject to graded vesting over a service period for the entire award. As of September 30, 2012, there were 1,075,940 shares available for issuance under the Incentive Plan.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Restricted Stock Awards***

In 2005, the Company began granting to non-employee directors and certain employees, at no cost to the recipient, restricted stock awards or, at their election, restricted stock units pursuant to the Incentive Plan. In 2006, the Company began granting to certain employees, at no cost to the recipient, performance awards pursuant to the Incentive Plan. Restricted stock awards and performance awards qualify as participating securities as each contain non-forfeitable rights to dividends. As such, the two-class method is required for the computation of earnings per share. See Note 5, *Earnings Per Share* for further details. Restricted stock awards are considered outstanding at the date of grant but are subject to forfeiture provisions for periods ranging from six months to five years. Vested restricted stock units, which are not considered outstanding at the grant date, will settle in shares of common stock upon the termination of the grantees' employment or directorship. Performance awards are considered outstanding at the date of grant and have forfeiture provisions that lapse based on the passage of time and the achievement of certain performance criteria established by the Compensation Committee of the Company's Board of Directors. During the first nine months of September 30, 2012, there were no granted or outstanding performance awards. In the event an employee or non-employee director terminates his or her employment or directorship with the Company prior to the lapse of the restrictions, the shares, in most cases, will be forfeited to the Company. Compensation expense for these awards is calculated based on the price of the Company's common stock at the date of grant and recognized over the requisite service period. Forfeitures are estimated at the time of valuation and reduce expense ratably over the vesting period. This estimate is adjusted periodically based on the extent to which actual or expected forfeitures differ from the previous estimate.

A summary of these awards as of September 30, 2012, along with the changes during the nine months then ended, is as follows:

	Awards	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2011	1,154,004	\$ 28.30
Granted	296,624	53.91
Vested	(150,956)	29.28
Forfeited	(100,422)	31.97
Nonvested at September 30, 2012	1,199,250	\$ 34.20

***Employee Stock Purchase Plan***

In 1997, the Company adopted the Group 1 Automotive, Inc. Employee Stock Purchase Plan as amended (the *Purchase Plan*). The *Purchase Plan* authorizes the issuance of up to 3.5 million shares of common stock and provides that no options to purchase shares may be granted under the *Purchase Plan* after March 6, 2016. The *Purchase Plan* is available to all employees of the Company and its participating subsidiaries and is a qualified plan as defined by Section 423 of the Internal Revenue Code. At the end of each fiscal quarter (the *Option Period*) during the term of the *Purchase Plan*, the employee acquires shares of common stock from the Company at 85% of the fair market value of the common stock on the first or the last day of the *Option Period*, whichever is lower. As of September 30, 2012, there were 745,960 shares available for future issuance under the *Purchase Plan*. During the nine months ended September 30, 2012 and 2011, the Company issued 85,081 and 80,667 shares, respectively, of common stock to employees participating in the *Purchase Plan*.

The weighted average fair value of employee stock purchase rights issued pursuant to the *Purchase Plan* was \$11.23 and \$9.04 during the nine months ended September 30, 2012 and 2011, respectively. The fair value of stock purchase rights is calculated using the grant date stock price, the value of the embedded call option and the value of the embedded put option.

***Stock-Based Compensation***



## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

Total stock-based compensation cost was \$3.0 million and \$2.8 million for the three months ended September 30, 2012 and 2011, respectively, and \$8.9 million and \$8.3 million for the nine months ended September 30, 2012 and 2011, respectively. Cash received from option exercises and Purchase Plan purchases was \$4.2 million and \$3.1 million for the nine months ended September 30, 2012 and 2011, respectively. Additional paid-in capital increased by \$1.1 million and \$0.8 million for the nine months ended September 30, 2012 and 2011, respectively, due to the effect of tax deductions for options exercised and vesting of restricted shares that were more than the associated book expense previously recognized. Total income tax benefit recognized for stock-based compensation arrangements was \$2.4 million and \$2.3 million for the nine months ended September 30, 2012 and 2011, respectively.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company issues new shares or treasury shares, if available, when options are exercised or restricted stock vests. With respect to shares issued under the Purchase Plan, the Company's Board of Directors has authorized specific share repurchases to fund the shares issuable under the Purchase Plan.

**5. EARNINGS PER SHARE**

The two-class method is utilized for the computation of Earnings Per Share (EPS). The two-class method requires a portion of net income to be allocated to participating securities, which are unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents. The Company's restricted stock awards qualify as participating securities as each contain non-forfeitable rights to dividends. Income allocated to these participating securities is excluded from net earnings available to common shares, as shown in the table below. Basic EPS is computed by dividing net income available to basic common shares by the weighted average number of basic common shares outstanding during the period. Diluted EPS is computed by dividing net income available to diluted common shares by the weighted average number of dilutive common shares outstanding during the period.

The following table sets forth the calculation of EPS for the three and nine months ended September 30, 2012 and 2011:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>(In thousands, except per share amounts)</b>			
Weighted average basic common shares outstanding	21,521	22,020	21,600	22,377
Dilutive effect of contingently Convertible 3.00% Notes	926	185	890	144
Dilutive effect of stock options, net of assumed repurchase of treasury stock	3	6	4	8
Dilutive effect of employee stock purchases, net of assumed repurchase of treasury stock	8	8	7	4
<b>Weighted average dilutive common shares outstanding</b>	<b>22,458</b>	<b>22,219</b>	<b>22,501</b>	<b>22,533</b>
<b>Basic:</b>				
Net Income	\$ 31,335	\$ 21,494	\$ 83,077	\$ 61,539
Less: Earnings allocated to participating securities	1,702	1,265	4,525	3,570
<b>Earnings available to basic common shares</b>	<b>\$ 29,633</b>	<b>\$ 20,229</b>	<b>\$ 78,552</b>	<b>\$ 57,969</b>
Basic earnings per common share	\$ 1.38	\$ 0.92	\$ 3.64	\$ 2.59
<b>Diluted:</b>				
Net Income	\$ 31,335	\$ 21,494	\$ 83,077	\$ 61,539
Less: Earnings allocated to participating securities	1,641	1,256	4,373	3,550
<b>Earnings available to diluted common shares</b>	<b>\$ 29,694</b>	<b>\$ 20,238</b>	<b>\$ 78,704</b>	<b>\$ 57,989</b>
<b>Diluted earnings per common share</b>	<b>\$ 1.32</b>	<b>\$ 0.91</b>	<b>\$ 3.50</b>	<b>\$ 2.57</b>

Any options with exercise prices in excess of the average market price of the Company's common stock during each of the quarterly periods in the years presented are not considered when calculating the dilutive effect of stock options for the diluted EPS calculations. The weighted average number of stock-based awards not included in the calculation of the dilutive effect of stock-based awards was immaterial for both the three and nine months ended September 30, 2012 and 2011.

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

As discussed in Note 9, Long-Term Debt below, the Company is required to include the dilutive effect, if applicable, of the net shares issuable under the 2.25% Notes (as defined in Note 9) and the 2.25% Warrants sold in connection with the 2.25% Notes ( 2.25% Warrants ) in its diluted common shares outstanding for the diluted earnings calculation. Although the ten-year call options the Company purchased on its common stock in connection with the issuance of the 2.25% Notes ( 2.25% Purchased Options ) have the economic benefit of decreasing the dilutive effect of the 2.25% Notes, the Company cannot factor this benefit into the diluted common shares outstanding for the diluted earnings calculation since the impact would be anti-dilutive. Since the average price of the Company's common stock for the three months ended September 30, 2012 was less than the conversion price in effect at the end of the respective periods, no net shares were included in the computation of diluted EPS for such period, as the impact would have been anti-dilutive. Refer to Note 9 for a description of the change to the conversion price, which occurred during the three months ended September 30, 2012 as a result of the Company's decision to pay a cash dividend in excess of \$0.14.

In addition, the Company is required to include the dilutive effect, if applicable, of the net shares issuable under the 3.00% Notes (as defined in Note 9) and the 3.00% Warrants sold in connection with the 3.00% Notes ( 3.00% Warrants ). Although the ten-year call options the Company purchased on its common stock in connection with the issuance of the 3.00% Notes ( 3.00% Purchased Options ) have the economic benefit of decreasing the dilutive effect of the 3.00% Notes, the Company cannot factor this benefit into the diluted common shares outstanding for the diluted earnings calculation since the impact would be anti-dilutive. Since the average

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

price of the Company's common stock for the three months ended September 30, 2012 was more than the conversion price in effect at the end of the respective periods, the dilutive effect of the 3.00% Notes and 3.00% Warrants was included in the computation of diluted earnings per share. Refer to Note 9 for a description of the change to the conversion price, which occurred during the three months ended September 30, 2012 as a result of the Company's decision to pay a cash dividend, as well as the change in the convertibility of the 3.00% Notes as of September 30, 2012.

**6. INCOME TAXES**

The Company is subject to U.S. federal income taxes and income taxes in numerous states. In addition, the Company is subject to income tax in the U.K. relative to its foreign subsidiaries. The effective income tax rate of 36.7% of pretax income for the three months ended September 30, 2012 differed from the federal statutory rate of 35.0% due primarily to taxes provided for the taxable state and foreign jurisdictions in which the Company operates.

For the nine months ended September 30, 2012, the Company's effective tax rate decreased to 37.5% from 37.6% for the same period in 2011. The change was primarily due to the mix of pretax income from the taxable state and foreign jurisdictions in which the Company operates.

As of September 30, 2012 and December 31, 2011, the Company had no unrecognized tax benefits with respect to uncertain tax positions and did not incur any interest and penalties nor did it accrue any interest for the nine months ended September 30, 2012. When applicable, consistent with prior practice, the Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

Taxable years 2007 and subsequent remain open for examination by the Company's major taxing jurisdictions.

**7. DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS**

Accounts and notes receivable consisted of the following:

	September 30, 2012 (unaudited)	December 31, 2011
	(In thousands)	
Amounts due from manufacturers	\$ 54,634	\$ 48,912
Parts and service receivables	18,360	16,956
Finance and insurance receivables	13,947	16,755
Other	12,540	11,395
<b>Total accounts and notes receivable</b>	<b>99,481</b>	<b>94,018</b>
Less allowance for doubtful accounts	1,375	1,243
<b>Accounts and notes receivable, net</b>	<b>\$ 98,106</b>	<b>\$ 92,775</b>

Inventories consisted of the following:

	September 30, 2012 (unaudited)	December 31, 2011
	(In thousands)	

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

New vehicles	\$ 814,715	\$ 610,694
Used vehicles	175,260	153,648
Rental vehicles	67,563	57,790
Parts, accessories and other	49,655	45,338
<b>Inventories, net</b>	<b>\$ 1,107,193</b>	<b>\$ 867,470</b>

New and used vehicles are valued at the lower of specific cost or market and are removed from inventory using the specific identification method. Parts and accessories are valued at lower of cost or market determined on a first-in, first-out basis.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Property and equipment consisted of the following:

	Estimated Useful Lives in Years	September 30, 2012 (unaudited)	December 31, 2011
(Dollars in thousands)			
Land		\$ 235,996	\$ 211,754
Buildings	30 to 40	318,855	284,638
Leasehold improvements	up to 30	93,445	86,084
Machinery and equipment	7 to 20	68,193	59,316
Furniture and fixtures	3 to 10	62,532	54,406
Company vehicles	3 to 5	10,739	9,877
Construction in progress		20,764	16,719
Total		810,524	722,794
Less accumulated depreciation		160,713	137,161
Property and equipment, net		\$ 649,811	\$ 585,633

During the nine months ended September 30, 2012, the Company incurred \$39.7 million of capital expenditures for the construction of new or expanded facilities and the purchase of equipment and other fixed assets in the maintenance of the Company's dealerships and facilities. In addition, the Company purchased real estate during the nine months ended September 30, 2012 associated with existing dealership operations totaling \$23.7 million. And, in conjunction with the Company's acquisition of 13 separate dealerships during the nine months ended September 30, 2012, the Company acquired \$34.4 million of real estate and other property and equipment.

**8. CREDIT FACILITIES**

The Company has a \$1.35 billion revolving syndicated credit arrangement with 21 financial institutions including four manufacturer-affiliated finance companies ( Revolving Credit Facility ). The Company also has a \$150.0 million floorplan financing arrangement with Ford Motor Credit Company ( FMCC Facility ), as well as arrangements with BMW Financial Services for financing of its new and used vehicles in the U.K. and with several other automobile manufacturers for financing of a portion of its rental vehicle inventory. Within the Company's Consolidated Balance Sheets, Floorplan Notes Payable Credit Facility reflects amounts payable for the purchase of specific new, used and rental vehicle inventory (with the exception of new and rental vehicle purchases financed through lenders affiliated with the respective manufacturer) whereby financing is provided by the Revolving Credit Facility. Floorplan Notes Payable Manufacturer Affiliates reflects amounts payable for the purchase of specific new vehicles whereby financing is provided by the FMCC Facility, the financing of new and used vehicles in the U.K. with BMW Financial Services and the financing of rental vehicle inventory with several other manufacturers. Payments on the floorplan notes payable are generally due as the vehicles are sold. As a result, these obligations are reflected in the accompanying Consolidated Balance Sheets as current liabilities.

**Revolving Credit Facility**

The Revolving Credit Facility expires on June 1, 2016 and consists of two tranches: \$1.1 billion for vehicle inventory floorplan financing ( Floorplan Line ) and \$250.0 million for working capital, including acquisitions ( Acquisition Line ). Up to half of the Acquisition Line can be borrowed in either Euros or Pound Sterling. The capacity under these two tranches can be re-designated within the overall \$1.35 billion commitment, subject to the original limits of a minimum of \$1.1 billion for the Floorplan Line and maximum of \$250.0 million for the Acquisition Line. The Revolving Credit Facility can be expanded to its maximum commitment of \$1.6 billion, subject to participating lender approval. The Floorplan Line bears interest at rates equal to the one-month LIBOR plus 150 basis points for new vehicle inventory and the

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

one-month LIBOR plus 175 basis points for used vehicle inventory. The Acquisition Line bears interest at the one-month LIBOR plus a margin that ranges from 150 to 250 basis points, depending on the Company's leverage ratio. The Floorplan Line also requires a commitment fee of 0.20% per annum on the unused portion. The Acquisition Line requires a commitment fee ranging from 0.25% to 0.45% per annum, depending on the Company's leverage ratio, based on a minimum commitment of \$100.0 million less outstanding borrowings. In conjunction with the Revolving Credit Facility, the Company had \$5.5 million of related unamortized costs as of September 30, 2012 that are being amortized over the term of the facility.

---

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

After considering outstanding balances of \$782.6 million at September 30, 2012, the Company had \$317.4 million of available floorplan borrowing capacity under the Floorplan Line. Included in the \$317.4 million available borrowings under the Floorplan Line was \$128.3 million of immediately available funds. The weighted average interest rate on the Floorplan Line was 1.7% and 1.8% as of September 30, 2012 and December 31, 2011, respectively, excluding the impact of the Company's interest rate swaps. Amounts borrowed by the Company under the Floorplan Line of the Revolving Credit Facility for specific vehicle inventory are to be repaid upon the sale of the vehicle financed, and in no case is a borrowing for a vehicle to remain outstanding for greater than one year. With regards to the Acquisition Line, no borrowings were outstanding as of September 30, 2012 or December 31, 2011. The amount of available borrowing capacity under the Acquisition Line is limited from time to time based upon certain debt covenants. After considering \$24.3 million of outstanding letters of credit and other factors included in the Company's available borrowing base calculation, there was \$225.7 million of available borrowing capacity under the Acquisition Line as of September 30, 2012.

All of the Company's domestic dealership-owning subsidiaries are co-borrowers under the Revolving Credit Facility. The Company's obligations under the Revolving Credit Facility are secured by essentially all of the Company's domestic personal property (other than equity interests in dealership-owning subsidiaries) including all motor vehicle inventory and proceeds from the disposition of dealership-owning subsidiaries. The Revolving Credit Facility contains a number of significant covenants that, among other things, restrict the Company's ability to make disbursements outside of the ordinary course of business, dispose of assets, incur additional indebtedness, create liens on assets, make investments and engage in mergers or consolidations. The Company is also required to comply with specified financial tests and ratios defined in the Revolving Credit Facility, such as fixed charge coverage, total adjusted leverage, and senior secured adjusted leverage. Further, the Revolving Credit Facility restricts the Company's ability to make certain payments, such as dividends or other distributions of assets, properties, cash, rights, obligations or securities (Restricted Payments). The Restricted Payments shall not exceed the sum of \$100.0 million plus (or minus if negative) (a) one-half of the aggregate consolidated net income of the Company for the period beginning on January 1, 2011 and ending on the date of determination and (b) the amount of net cash proceeds received from the sale of capital stock on or after January 1, 2011 and ending on the date of determination (Restricted Payment Basket). For purposes of the calculation of the Restricted Payment Basket, net income represents such amounts per the consolidated financial statements adjusted to exclude the Company's foreign operations, non-cash interest expense, non-cash asset impairment charges, and non-cash stock-based compensation. As of September 30, 2012, the Restricted Payment Basket totaled \$109.7 million. As of September 30, 2012, the Company was in compliance with all applicable covenants and ratios under the Revolving Credit Facility.

***Ford Motor Credit Company Facility***

The FMCC Facility provides for the financing of, and is collateralized by, the Company's Ford new vehicle inventory, including affiliated brands. This arrangement provides for \$150.0 million of floorplan financing and is an evergreen arrangement that may be canceled with 30 days notice by either party. As of September 30, 2012, the Company had an outstanding balance of \$98.9 million under the FMCC Facility with an available floorplan borrowing capacity of \$51.1 million. This facility bears interest at a rate of Prime plus 150 basis points minus certain incentives; however, the prime rate is defined to be a minimum of 3.75%. As of September 30, 2012, the interest rate on the FMCC Facility was 5.25% before considering the applicable incentives.

***Other Credit Facilities***

The Company has a credit facility with BMW Financial Services and Volkswagen Finance for the financing of new, used and rental vehicle inventories related to its U.K. operations. These facilities are evergreen arrangements that may be canceled with notice by either party and bears interest of a base rate, plus a surcharge that varies based upon the type of vehicle being financed. Dependent upon the type of inventory financed, the interest rates charged on borrowings outstanding under these facilities ranged from 1.1% to 4.5% as of September 30, 2012.

Excluding rental vehicles financed through the Revolving Credit Facility, financing for rental vehicles is typically obtained directly from the automobile manufacturers. These financing arrangements generally require small monthly payments and mature in varying amounts over the next two years. As of September 30, 2012, the interest rate charged on borrowings related to the Company's rental vehicle fleet varied up to 5.3%. Rental vehicles are typically transferred to used vehicle inventory when they are removed from rental service and repayment of the borrowing is required at that time.





**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. LONG-TERM DEBT**

The Company carries its long-term debt at face value, net of applicable discounts. Long-term debt consisted of the following:

	September 30, 2012	December 31, 2011
	(Dollars in thousands)	
2.25% Convertible Senior Notes	\$ 150,465	\$ 144,985
3.00% Convertible Senior Notes	79,854	77,401
Mortgage Facility	57,435	41,003
Other Real Estate Related and Long-Term Debt	241,205	194,580
Capital lease obligations related to real estate, maturing in varying amounts through November 2032 with a weighted average interest rate of 11.1%	38,762	39,295
	567,721	497,264
Less current maturities of mortgage facility and other long-term debt	21,627	14,663
	\$ 546,094	\$ 482,601

***Fair Value of Long-Term Debt***

The Company's outstanding 2.25% Convertible Senior Notes ( 2.25% Notes ) had a fair value of \$212.3 million and \$192.3 million as of September 30, 2012 and December 31, 2011, respectively. The Company's outstanding 3.00% Convertible Senior Notes ( 3.00% Notes ) had a fair value of \$199.4 million and \$170.6 million as of September 30, 2012 and December 31, 2011, respectively. The carrying value of the Company's variable rate debt approximates fair value due to the short-term nature of the interest rates.

The fair value estimates are based on Level 2 inputs of the fair value hierarchy available as of September 30, 2012 and December 31, 2012. The Company determined the estimated fair value of its long-term debt using available market information and commonly accepted valuation methodologies. Considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, these estimates are not necessarily indicative of the amounts that the Company, or holders of the instruments, could realize in a current market exchange. The use of different assumptions and/or estimation methodologies could have a material effect on estimated fair values. These amounts have not been revalued since those dates, and current estimates of fair value could differ significantly from the amounts presented.

***2.25% Convertible Senior Notes***

As of September 30, 2012 and December 31, 2011, the carrying value of the 2.25% Notes, related discount and equity component consisted of the following:

	September 30, 2012	December 31, 2011
	(In thousands)	
Carrying amount of equity component	\$ 65,270	\$ 65,270
Allocated underwriter fees, net of taxes	(1,475)	(1,475)
Allocated debt issuance cost, net of taxes	(58)	(58)

Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

Total net equity component	\$ 63,737	\$ 63,737
Deferred income tax component	\$ 11,518	\$ 13,452
Principal amount of 2.25% Notes	\$ 182,753	\$ 182,753
Unamortized discount	(31,071)	(36,344)
Unamortized underwriter fees	(1,217)	(1,424)
Net carrying amount of liability component	\$ 150,465	\$ 144,985
Unamortized debt issuance cost	\$ 48	\$ 56

The Company determined the discount using the estimated effective interest rate for similar debt with no convertible features. The original effective interest rate of 7.5% was estimated by comparing debt issuances from companies with similar credit ratings during the same annual period as the Company. The effective interest rate differs due to the impact of underwriter fees associated with this

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

issuance that were capitalized as an additional discount and are being amortized to interest expense through 2016. The effective interest rate may change in the future as a result of future repurchases of the 2.25% Notes. The Company utilized a ten-year term for the assessment of the fair value of its 2.25% Notes.

For the nine months ended September 30, 2012 and 2011, the contractual interest expense and the discount amortization, which is recorded as interest expense in the accompanying Consolidated Statements of Operations, were as follows:

	<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(Dollars in thousands)</b>	
Year-to-date contractual interest expense	\$ 3,084	\$ 3,091
Year-to-date discount amortization <sup>(1)</sup>	\$ 5,158	\$ 4,758
Effective interest rate of liability component	7.7%	7.7%

(1) Represents the incremental impact of the accounting for convertible debt as primarily codified in ASC 470, Debt.

The 2.25% Notes are convertible into cash and, if applicable, common stock based on the conversion rate, subject to adjustment, including a quarterly cash dividend in excess of \$0.14 per share, under the following circumstances: (a) during any calendar quarter (and only during such calendar quarter) beginning after September 30, 2006, if the closing price of the Company's common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the applicable conversion price per share (or \$77.23 as of September 30, 2012); (b) during the five business day period after any ten consecutive trading day period in which the trading price per \$1,000 principal amount for each day of the ten day trading period was less than 98% of the product of the last reported sale/bid price of the Company's common stock and the conversion rate on that day; and (c) upon the occurrence of specified corporate transactions set forth in the 2.25% Notes Indenture. Upon conversion, a holder will receive an amount in cash and common shares of the Company's common stock, determined in the manner set forth in the 2.25% Notes Indenture. The if-converted value of the 2.25% Notes exceeded the principal amount of the 2.25% Notes by \$1.9 million at September 30, 2012.

As of September 30, 2012, the conversion rate was 16.8329 shares of common stock per \$1,000 principal amount of 2.25% Notes, with a conversion price of \$59.41 per share, which was reduced during the second quarter of 2012 as the result of the Company's decision to pay a cash dividend in excess of \$0.14 per share. If any cash dividend or distribution is made to all, or substantially all, holders of the Company's common stock in excess of \$0.14 per share in the future, the conversion rate will be adjusted based on the formula defined in the 2.25% Notes Indenture.

As of September 30, 2012, the exercise price of the 2.25% Warrants, which are related to the issuance of the 2.25% Notes, was \$80.28 due to the Company's decision to pay a cash dividend in excess of \$0.14 per share. If any cash dividend or distribution is made to all, or substantially all, holders of the Company's common stock in excess of \$0.14 per share in the future, the conversion rate will be adjusted based on the formula defined in the 2.25% Notes Indenture.

Under the terms of the 2.25% Purchased Options, which become exercisable upon conversion of the 2.25% Notes, the Company has the right to receive a total of 3.1 million shares of its common stock at the conversion price then in effect. The exercise price is subject to certain adjustments that mirror the adjustments to the conversion price of the 2.25% Notes (including payments of cash dividends in excess of \$0.14 per share).

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3.00% Convertible Senior Notes**

As of September 30, 2012 and December 31, 2011, the carrying value of the 3.00% Notes, related discount and equity component consisted of the following:

	September 30, 2012	December 31, 2011
	(In thousands)	
Carrying amount of equity component (including temporary equity)	\$ 25,359	\$ 25,359
Allocated underwriter fees, net of taxes	(760)	(760)
Allocated debt issuance cost, net of taxes	(112)	(112)
Total net equity component	\$ 24,487	\$ 24,487
Deferred income tax component	\$ 12,132	\$ 12,956
Principal amount of 3.00% Notes	\$ 115,000	\$ 115,000
Unamortized discount	(33,313)	(35,638)
Unamortized underwriter fees	(1,833)	(1,961)
Net carrying amount of liability component	\$ 79,854	\$ 77,401
Unamortized debt issuance cost	\$ 270	\$ 289

The Company determined the discount using the estimated effective interest rate for similar debt with no convertible features. The original effective interest rate of 8.25% was estimated by receiving a range of quotes from the underwriters for the estimated rate that the Company could reasonably expect to issue non-convertible debt for the same tenure. The effective interest rate differs from the 8.25%, due to the impact of underwriter fees associated with this issuance that were capitalized as an additional discount and are being amortized to interest expense through 2020. The effective interest rate may change in the future as a result of future repurchases of the 3.00% Notes. The Company utilized a ten-year term for the assessment of the fair value of its 3.00% Notes.

For the nine months ended September 30, 2012 and 2011, the contractual interest expense and the discount amortization, which is recorded as interest expense in the accompanying Consolidated Statements of Operations, were as follows:

	Nine Months Ended September 30,	
	2012	2011
	(Dollars in thousands)	
Year-to-date contractual interest expense	\$ 2,588	\$ 2,588
Year-to-date discount amortization <sup>(1)</sup>	\$ 2,199	\$ 2,006
Effective interest rate of liability component	8.6%	8.6%

(1) Represents the incremental impact of the accounting for convertible debt as primarily codified in ASC 470, Debt.

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

The 3.00% Notes are convertible into cash and, if applicable, common stock based on the conversion rate, subject to adjustment, on the business day preceding September 15, 2019, under the following circumstances: (a) during any fiscal quarter (and only during such fiscal quarter) beginning after September 30, 2010, if the last reported sale price of the Company's common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the applicable conversion price per share (or \$49.09 as of September 30, 2012) ( "Stock Price Trigger" ); (b) during the five business day period after any ten consecutive trading day period in which the trading price per \$1,000 principal amount for each day of the ten day trading period was less than 98% of the product of the last reported sale/bid price of the Company's common stock and the conversion rate on that day; and (c) upon the occurrence of specified corporate transactions set forth in the 3.00% Notes Indenture. Upon conversion, a holder will receive an amount in cash and common shares of the Company's common stock, determined in the manner set forth in the 3.00% Notes Indenture.

As a result of the Stock Price Trigger on September 30, 2012, the 3.00% Notes are convertible at the option of the holders during the three months ending December 31, 2012. As such, the Company reclassified the redeemable equity portion of the 3.00% Notes to temporary equity from the additional paid-in capital component of permanent equity on the Consolidated Balance Sheet as of September 30, 2012. The debt portion of the 3.00% Notes continued to be classified as a long-term liability as of September 30, 2012, since the Company has the intent and ability to refinance any conversion of the 3.00% Notes with another long-term debt instrument. The combination of the debt portion and temporary equity portion represents the aggregate principal obligation of the 3.00% Notes redeemable at the option of the holders as of September 30, 2012. The if-converted value of the 3.00% Notes exceeded the principal amount of the 3.00% Notes by \$67.8 million at September 30, 2012.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of September 30, 2012, the conversion rate was 26.4811 shares of common stock per \$1,000 principal amount of 3.00% Notes, with a conversion price of \$37.76 per share, which was reduced during the second quarter of 2012 as the result of the Company's decision to pay a cash dividend. If any cash dividend or distribution is made to all, or substantially all, holders of the Company's common stock in the future, the conversion rate is adjusted based on the formula defined in the 3.00% Notes Indenture.

As of September 30, 2012, the exercise price of the 3.00% Warrants, which are related to the issuance of the 3.00% Notes, was \$55.49 due to the Company's decision to pay a cash dividend. If any cash dividend or distribution is made to all, or substantially all, holders of the Company's common stock in the future, the conversion rate is adjusted based on the formula defined in the 3.00% Notes Indenture.

Under the terms of the 3.00% Purchased Options, which become exercisable upon conversion of the 3.00% Notes, the Company has the right to receive a total of 3.0 million shares of its common stock at the conversion price then in effect. The exercise price is subject to certain adjustments that mirror the adjustments to the conversion price of the 3.00% Notes (including payments of cash dividends).

***Real Estate Credit Facility***

As amended and restated, the Company's real estate credit facility with Bank of America, N.A. and Comerica Bank (Mortgage Facility) provides the right to expand up to \$83.4 million of term loans, of which \$60.7 million has been used as of September 30, 2012. The term loans can be expanded provided that (a) no default or event of default exists under the Mortgage Facility; (b) the Company obtains commitments from the lenders who would qualify as assignees for such increased amounts; and (c) certain other agreed upon terms and conditions have been satisfied. This facility is guaranteed by the Company and substantially all of the domestic subsidiaries of the Company and is secured by the relevant real property owned by the Company that is mortgaged under the Mortgage Facility. The Company capitalized \$0.9 million of debt issuance costs related to the Mortgage Facility that are being amortized over the term of the facility, \$0.6 million of which were still unamortized as of September 30, 2012.

The interest rate is equal to (a) the per annum rate equal to one-month LIBOR plus 2.50% per annum, determined on the first day of each month, or (b) 1.45% per annum in excess of the higher of (i) the Bank of America prime rate (adjusted daily on the day specified in the public announcement of such price rate), (ii) the Federal Funds Rate adjusted daily, plus 0.5%, or (iii) the per annum rate equal to the one-month LIBOR plus 1.05% per annum. The Federal Funds Rate is the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published by the Federal Reserve Bank of New York on the business day succeeding such day.

The Company is required to make quarterly principal payments equal to 1.25% of the principal amount outstanding, which began in April 2011, and is required to repay the aggregate amount outstanding on the maturity dates, from December 29, 2015 through February 27, 2017. During the nine months ended September 30, 2012, the Company borrowed an additional \$18.1 million to finance the acquisition and/or improvement of dealership facilities and made principal payments of \$1.6 million on outstanding borrowings from the Mortgage Facility. As of September 30, 2012, borrowings outstanding under the amended and restated Mortgage Facility totaled \$57.4 million, with \$3.0 million recorded as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

The Mortgage Facility also contains usual and customary provisions limiting the Company's ability to engage in certain transactions, including limitations on the Company's ability to incur additional debt, additional liens, make investments, and pay distributions to its stockholders. In addition, effective December 31, 2011, the Mortgage Facility was amended to require certain financial covenants that are identical to those contained in the Company's Revolving Credit Facility. As of September 30, 2012, the Company was in compliance with all applicable covenants and ratios under the Revolving Credit Facility.

***Real Estate Related Debt***

The Company has entered into separate term mortgage loans in the U.S. with three of its manufacturer-affiliated finance partners—Toyota Motor Credit Corporation (TMCC), Mercedes-Benz Financial Services USA, LLC (MBFS), BMW Financial Services NA, LLC (BMWFS) and several third-party financial institutions (collectively, Real Estate Notes). The Real Estate Notes are on specific buildings and/or properties and are guaranteed by the Company. Each loan was made in connection with, and is secured by mortgage liens on, the relevant real property owned the

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

Company that is mortgaged under the Real Estate Notes. The Real Estate Notes bear interest at fixed rates between 4.56% and 5.47%, and at variable indexed rates plus a spread between 2.25% and 3.35% per annum. The Company capitalized \$1.3 million of related debt issuance costs related to the Real Estate Notes that are being amortized over the terms of the notes, \$1.0 million of which were still unamortized as of September 30, 2012.



**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The loan agreements with TMCC consist of seven term loans, two of which were added during the nine months ended September 30, 2012 for \$11.6 million. As of September 30, 2012, \$48.4 million was outstanding under the TMCC term loans with \$5.4 million classified as current. The maturity dates vary from two to seven years and provide for monthly payments based on a 20-year amortization schedule. These seven loans are cross-collateralized and cross-defaulted with each other and are cross-defaulted with the Revolving Credit Facility.

The loan agreements with MBFS consist of three term loans. As of September 30, 2012, \$47.5 million was outstanding under the MBFS term loans with \$1.6 million classified as current. The agreements provide for monthly payments based on a 20-year amortization schedule and have a maturity date of five years. These three loans are cross-collateralized and cross-defaulted with each other. They are also cross-defaulted with the Revolving Credit Facility.

The loan agreements with BMWFS consist of 15 term loans, two of which were added during the nine months ended September 30, 2012 for \$14.4 million to finance the acquisition of a dealership facility. As of September 30, 2012, \$82.2 million was outstanding under the BMWFS term loans with \$4.0 million classified as current. The agreements provide for monthly payments based on a 15-year amortization schedule and have a maturity date of seven years. In the case of three properties owned by subsidiaries, the applicable loan is also guaranteed by the subsidiary real property owner. These 15 loans are cross-collateralized with each other. In addition, they are cross-defaulted with each other, the Revolving Credit Facility, and certain dealership franchising agreements with BMW of North America, LLC.

In addition, agreements with third-party financial institutions consist of six term loans for an aggregate principal amount of \$37.0 million, to finance real estate associated with six of the Company's dealerships. The loans are being repaid in monthly installments that began in September 2011 and will mature by August 2019. As of September 30, 2012, borrowings under these notes totaled \$35.9 million, with \$1.5 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets. These six loans are cross-defaulted with the Revolving Credit Facility.

The Company has also entered into separate term mortgage loans in the U.K. with another third-party financial institution which are secured by the Company's foreign subsidiary properties. During the nine months ended September 30, 2012, the Company borrowed £4.9 million to partially finance the April 2012 acquisition of six U.K. dealerships. These mortgage loans (collectively, Foreign Notes) are being repaid in monthly installments that began in March 2010 and mature by August 2027. As of September 30, 2012, borrowings under the Foreign Notes totaled \$19.1 million, with \$2.4 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

**10. FAIR VALUE MEASUREMENTS**

Accounting Standards Codification (ASC) 820 defines fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; requires disclosure of the extent to which fair value is used to measure financial and non-financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date; establishes a three-level valuation hierarchy based upon the transparency of inputs utilized in the measurement and valuation of financial assets or liabilities as of the measurement date:

*Level 1* unadjusted, quoted prices for identical assets or liabilities in active markets;

*Level 2* quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable or that can be corroborated by observable market data by correlation; and

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

*Level 3* unobservable inputs based upon the reporting entity's internally developed assumptions that market participants would use in pricing the asset or liability.

The Company's financial instruments consist primarily of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, investments in debt and equity securities, accounts payable, credit facilities, long-term debt and interest rate swaps. The fair values of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, accounts payable, and credit facilities approximate their carrying values due to the short-term nature of these instruments or the existence of variable interest rates.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company designates its investments in marketable securities and debt instruments as available-for-sale, measures them at fair value, and classifies them as either cash and cash equivalents or other assets in the accompanying Consolidated Balance Sheets based upon maturity terms and certain contractual restrictions. The Company maintained multiple trust accounts comprised of money market funds with short-term investments in marketable securities, such as U.S. government securities, commercial paper and bankers' acceptances, that have maturities of less than three months. The Company determined that the valuation measurement inputs of these marketable securities represented unadjusted quoted prices in active markets and, accordingly, classified such investments within Level 1 of the hierarchy framework.

The Company, also held investments in debt instruments, such as government obligations and other fixed income securities. The debt securities were measured based upon quoted market prices utilizing public information, independent external valuations from pricing services or third-party advisors. Accordingly, the Company concluded the valuation measurement inputs of these debt securities to represent, at their lowest level, quoted market prices for identical or similar assets in markets where there are few transactions for the assets and has categorized such investments within Level 2 of the hierarchy framework.

The Company periodically invests in unsecured, corporate demand obligations with manufacturer-affiliated finance companies, which bear interest at a variable rate and are redeemable on demand by the Company. Therefore, the Company has classified these demand obligations as cash and cash equivalents in the accompanying Consolidated Balance Sheets. The Company determined that the valuation measurement inputs of these instruments include inputs other than quoted market prices, that are observable or that can be corroborated by observable data by correlation. Accordingly, the Company has classified these instruments within Level 2 of the hierarchy framework.

The Company's derivative financial instruments are recorded at fair market value. See Note 3, Derivative Instruments and Risk Management Activities for further details regarding the Company's derivative financial instruments.

The Company evaluated its assets and liabilities for those that met the criteria of the disclosure requirements and fair value framework of ASC 820 and identified investments in marketable securities, debt instruments, and interest rate derivative financial instruments as having met such criteria. The respective fair values measured on a recurring basis as of September 30, 2012 and December 31, 2011, respectively, were as follows:

	<b>As of September 30, 2012</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>
	<b>(In thousands)</b>		
<b>Assets:</b>			
<b>Debt securities:</b>			
Demand obligations	\$	\$ 30,123	\$ 30,123
Total	\$	\$ 30,123	\$ 30,123
<b>Liabilities:</b>			
Interest rate derivative financial instruments	\$	\$ 45,069	\$ 45,069
Total	\$	\$ 45,069	\$ 45,069

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	As of December 31, 2011		
	Level 1	Level 2	Total
	(In thousands)		
<b>Assets:</b>			
Marketable securities - money market	\$ 1,571	\$	\$ 1,571
<b>Debt securities:</b>			
Demand obligations		271	271
Collateralized mortgage obligations		19	19
Corporate bonds		338	338
Municipal obligations		683	683
Mortgage backed		632	632
<b>Total debt securities</b>		<b>1,943</b>	<b>1,943</b>
<b>Total</b>	<b>\$ 1,571</b>	<b>\$ 1,943</b>	<b>\$ 3,514</b>
<b>Liabilities:</b>			
Interest rate derivative financial instruments	\$	\$ 34,040	\$ 34,040
<b>Total</b>	<b>\$</b>	<b>\$ 34,040</b>	<b>\$ 34,040</b>

**11. COMMITMENTS AND CONTINGENCIES**

From time to time, the Company's dealerships are named in various types of litigation involving customer claims, employment matters, class action claims, purported class action claims, as well as claims involving the manufacturer of automobiles, contractual disputes and other matters arising in the ordinary course of business. Due to the nature of the automotive retailing business, the Company may be involved in legal proceedings or suffer losses that could have a material adverse effect on the Company's business. In the normal course of business, the Company is required to respond to customer, employee and other third-party complaints. Amounts that have been accrued or paid related to the settlement of litigation are included in SG&A expenses in the Company's Consolidated Statements of Operations. In addition, the manufacturers of the vehicles that the Company sells and services have audit rights allowing them to review the validity of amounts claimed for incentive, rebate or warranty-related items and charge the Company back for amounts determined to be invalid rewards under the manufacturers' programs, subject to the Company's right to appeal any such decision. Amounts that have been accrued or paid related to the settlement of manufacturer chargebacks of recognized incentives and rebates are included in cost of sales in the Company's Consolidated Statements of Operations, while such amounts for manufacturer chargebacks of recognized warranty-related items are included as a reduction of revenues in the Company's Consolidated Statements of Operations.

**Legal Proceedings**

Currently, the Company is not party to any legal proceedings that, individually or in the aggregate, are reasonably expected to have a material adverse effect on the Company's results of operations, financial condition, or cash flows, including class action lawsuits. However, the results of current, or future, matters cannot be predicted with certainty, and an unfavorable resolution of one or more of such matters could have a material adverse effect on the Company's results of operations, financial condition, or cash flows.

**Other Matters**

The Company, acting through its subsidiaries, is the lessee under many real estate leases that provide for the use by the Company's subsidiaries of their respective dealership premises. Pursuant to these leases, the Company's subsidiaries generally agree to indemnify the lessor and other parties from certain liabilities arising as a result of the use of the leased premises, including environmental liabilities, or a breach of the lease by the lessee. Additionally, from time to time, the Company enters into agreements in connection with the sale of assets or businesses in which it

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

agrees to indemnify the purchaser, or other parties, from certain liabilities or costs arising in connection with the assets or business. Also, in the ordinary course of business in connection with purchases or sales of goods and services, the Company enters into agreements that may contain indemnification provisions. In the event that an indemnification claim is asserted, liability would be limited by the terms of the applicable agreement.

**Table of Contents****GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

From time to time, primarily in connection with dealership dispositions, the Company's subsidiaries assign or sublet to the dealership purchaser the subsidiaries' interests in any real property leases associated with such dealerships. In general, the Company's subsidiaries retain responsibility for the performance of certain obligations under such leases to the extent that the assignee or sublessee does not perform, whether such performance is required prior to or following the assignment or subletting of the lease. Additionally, the Company and its subsidiaries generally remain subject to the terms of any guarantees made by the Company and its subsidiaries in connection with such leases. Although the Company generally has indemnification rights against the assignee or sublessee in the event of non-performance under these leases, as well as certain defenses, and the Company presently has no reason to believe that it or its subsidiaries will be called on to perform under any such assigned leases or subleases, the Company estimates that lessee rental payment obligations during the remaining terms of these leases were \$8.2 million as of September 30, 2012. The Company's exposure under these leases is difficult to estimate and there can be no assurance that any performance of the Company or its subsidiaries required under these leases would not have a material adverse effect on the Company's business, financial condition, or cash flows. The Company and its subsidiaries also may be called on to perform other obligations under these leases, such as environmental remediation of the leased premises or repair of the leased premises upon termination of the lease. However, the Company does not have any known material environmental commitments or contingencies and presently has no reason to believe that it or its subsidiaries will be called on to so perform.

In the ordinary course of business, the Company is subject to numerous laws and regulations, including automotive, environmental, health and safety, and other laws and regulations. The Company does not anticipate that the costs of such compliance will have a material adverse effect on its business, consolidated results of operations, financial condition, or cash flows, although such outcome is possible given the nature of its operations and the extensive legal and regulatory framework applicable to its business. The Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law on July 21, 2010, established a new consumer financial protection agency with broad regulatory powers. Although automotive dealers are generally excluded, the Dodd-Frank Act could lead to additional, indirect regulation of automotive dealers through its regulation of automotive finance companies and other financial institutions. In addition, the Patient Protection and Affordable Care Act, which was signed into law on March 23, 2010, has the potential to increase the Company's future annual employee health care costs. Further, new laws and regulations, particularly at the federal level, may be enacted, which could also have a materially adverse impact on its business.

**12. ACCUMULATED OTHER COMPREHENSIVE LOSS**

Changes in the balances of each component of accumulated other comprehensive loss for the nine months ended September 30, 2012 and 2011 were as follows:

	Unrealized Loss on Foreign Currency	Unrealized Gain on Marketable Securities	Unrealized Loss on Interest Rate Swaps	Accumulated Other Comprehensive Loss
	(In thousands)			
Balance, December 31, 2010	\$ (7,852)	\$ 50	\$ (10,953)	\$ (18,755)
Other comprehensive income (loss), net of tax	319	(22)	(9,528)	(9,231)
Balance, September 30, 2011	\$ (7,533)	\$ 28	\$ (20,481)	\$ (27,986)
Balance, December 31, 2011	\$ (7,969)	\$ 8	\$ (21,275)	\$ (29,236)
Other comprehensive income (loss), net of tax	1,850	(8)	(6,894)	(5,052)
Balance, September 30, 2012	\$ (6,119)	\$	\$ (28,169)	\$ (34,288)



**Table of Contents**

**CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q ( Form 10-Q ) includes certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended ( Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended ( Exchange Act ). This information includes statements regarding our plans, goals or current expectations with respect to, among other things:

our future operating performance;

our ability to maintain or improve our margins;

operating cash flows and availability of capital;

the completion of future acquisitions;

the future revenues of acquired dealerships;

future stock repurchases and dividends;

future capital expenditures;

changes in sales volumes and availability of credit for customer financing in new and used vehicles and sales volumes in the parts and service markets;

business trends in the retail automotive industry, including the level of manufacturer incentives, new and used vehicle retail sales volume, customer demand, interest rates and changes in industry-wide inventory levels; and

availability of financing for inventory, working capital, real estate and capital expenditures.

Although we believe that the expectations reflected in these forward-looking statements are reasonable when and as made, we cannot assure that these expectations will prove to be correct. When used in this Form 10-Q, the words anticipate, believe, estimate, expect, may and similar expressions, as they relate to our company and management, are intended to identify forward-looking statements. Forward-looking statements are not assurances of future performance and involve risks and uncertainties. Actual results may differ materially from anticipated results in the forward-looking statements for a number of reasons, including:

depressed consumer confidence, raised unemployment and limited availability of consumer credit, may cause a marked decline in demand for new and used vehicles; future deterioration in the economic environment, including consumer confidence, interest rates, the price of gasoline, the level of manufacturer incentives and the availability of consumer credit may similarly affect the demand for new and used vehicles, replacement parts, maintenance and repair services and finance and insurance products;



## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

adverse domestic and international developments such as war, terrorism, political conflicts or other hostilities may adversely affect the demand for our products and services;

the future regulatory environment, including legislation related to the Dodd-Frank Wall Street Reform and Consumer Protection Act, climate control changes legislation, and unexpected litigation or adverse legislation, including changes in state franchise laws, may impose additional costs on us or otherwise adversely affect us;

our principal automobile manufacturers, especially Toyota, Nissan, Honda, BMW, Ford, Daimler, General Motors, Chrysler, and Volkswagen, because of financial distress, bankruptcy, natural disasters that disrupt production or other reasons, may not continue to produce or make available to us vehicles that are in high demand by our customers or provide financing, insurance, advertising or other assistance to us;

**Table of Contents**

restructuring by one or more of our principal manufacturers, up to and including bankruptcy may cause us to suffer financial loss in the form of uncollectible receivables, devalued inventory or loss of franchises;

requirements imposed on us by our manufacturers may require dispositions, limit our acquisitions or increases in the level of capital expenditures related to our dealership facilities;

our existing and/or new dealership operations may not perform at expected levels or achieve expected improvements;

our failure to achieve expected future cost savings or future costs may be higher than we expect;

manufacturer quality issues may negatively impact vehicle sales and brand reputation;

available capital resources, increases in cost of financing and various debt agreements may limit our ability to complete acquisitions, complete construction of new or expanded facilities, repurchase shares or pay dividends;

our ability to refinance or obtain financing in the future may be limited and the cost of financing could increase significantly;

foreign exchange controls and currency fluctuations;

new accounting standards could materially impact our reported earnings per share;

the inability to complete additional acquisitions or changes in the pace of acquisitions;

the inability to adjust our cost structure to offset any reduction in the demand for our products and services;

our loss of key personnel;

competition in our industry may impact our operations or our ability to complete additional acquisitions;

the failure to achieve expected sales volumes from our new franchises;

insurance costs could increase significantly and all of our losses may not be covered by insurance; and

our inability to obtain inventory of new and used vehicles and parts, including imported inventory, at the cost, or in the volume, we expect.

For additional information regarding known material factors that could cause our actual results to differ from our projected results, please see (a) Part II, Item 1A. Risk Factors and elsewhere in this Form 10-Q and (b) Part I, Item 1A. Risk Factors in our 2011 Form 10-K.

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We undertake no responsibility to publicly release the result of any revision of our forward-looking statements after the date they are made.

---

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements because of various factors. See Cautionary Statement about Forward-Looking Statements.*

#### **Overview**

We are a leading operator in the automotive retail industry. As of September 30, 2012, we owned and operated 143 franchises, representing 32 brands of automobiles, at 111 dealership locations and 26 collision service centers in the U.S. and 16 franchises at 11 dealerships and three collision centers in the U.K. Through our regions, we sell new and used cars and light trucks; arrange related vehicle financing; sell service and insurance contracts; provide automotive maintenance and repair services; and sell vehicle parts. Our operations are primarily located in major metropolitan areas in Alabama, California, Florida, Georgia, Kansas, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, Oklahoma, South Carolina and Texas in the U.S. and in the towns of Brighton, Chelmsford, Colchester, Farnborough, Hailsham, Harold Wood, Hindhead, London, Southend, Stanstead, and Worthing in the U.K.

As of September 30, 2012, our U.S. retail network consisted of the following two regions (with the number of dealerships they comprised): (a) the East (47 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina) and (b) the West (64 dealerships in California, Kansas, Oklahoma and Texas). Each region is managed by a regional vice president who reports directly to our Chief Executive Officer and is responsible for the overall performance of their regions, as well as for overseeing the market directors and dealership general managers that report to them. Each region is also managed by a regional chief financial officer who reports directly to our Chief Financial Officer. Our dealerships in the U.K. are also managed locally with direct reporting responsibilities to our corporate management team.

#### **Outlook**

In 2011 and through the first nine months of 2012, consumer demand for new and used vehicles has shown improvement. According to industry experts, the September 2012 seasonally adjusted annual rate of sales (or SAAR) was 14.9 million units, compared to 13.1 million units a year ago. We believe that the stabilizing economic trends provide opportunities for us to improve our operating results as we: (a) expand our new and used vehicle sales results and improve our sales efficiency; (b) continue to focus on our higher margin parts and service business by enhancing the cost effectiveness of our marketing efforts, implementing strategic selling methods, and improving operational efficiencies; (c) invest capital where necessary to support our anticipated growth, particularly in our parts and service business; and (d) further leverage our revenue and gross profit growth through continued cost containment. But given the depth of the economic downturn experienced from September 2008 through most of 2009, we believe the recovery to historically normalized industry selling levels will probably be extended.

Our operations have, and we believe that our operations will continue to generate positive cash flow. As such, we are focused on maximizing the return on the capital that we generate from our operations and positioning our balance sheet to take advantage of investment opportunities as they arise. We continue to closely scrutinize all planned future capital spending and work closely with our original equipment manufacturer (OEM) partners in this area to make prudent investment decisions that are expected to generate an adequate return and/or improve the customer experience. We anticipate that our 2012 capital spending will be less than \$63.0 million, which includes \$15.0 million for specific growth initiatives in our parts and service business.

We remain committed to our growth-by-acquisition strategy, and with the prolonged nature of the anticipated economic recovery, we believe that significant opportunities exist to enhance our portfolio with dealerships that meet our stringent investment criteria. During the first nine months of 2012, we completed the acquisition of 13 dealerships. We will continue to pursue dealership investment opportunities that we believe will add value for our stockholders.

#### **Financial and Operational Highlights**

Our operating results reflect the combined performance of each of our interrelated business activities, which include the sale of new vehicles, used vehicles, finance and insurance products, and parts, as well as maintenance and collision repair services. Historically, each of these activities has been directly or indirectly impacted by a variety of supply/demand factors, including vehicle inventories, consumer confidence, discretionary spending, availability and affordability of consumer credit, manufacturer incentives, weather patterns, fuel prices and interest rates. For example, during periods of sustained economic downturn or significant supply/demand imbalances, new vehicle sales may be negatively impacted as consumers tend to shift their purchases to used vehicles. Some consumers may even delay their purchasing decisions altogether, electing instead to repair their existing vehicles. In such cases, however, we believe the new vehicle sales impact on our overall business is

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

mitigated by our ability to offer other products and services, such as used vehicles and parts, as well as maintenance and collision repair services. In addition, our ability to reduce our costs in response to lower sales also tempers the impact of lower new vehicle sales volume.

**Table of Contents**

We generally experience higher volumes of vehicle sales and service in the second and third calendar quarters of each year. This seasonality is generally attributable to consumer buying trends and the timing of manufacturer new vehicle model introductions. In addition, in some regions of the U.S., vehicle purchases decline during the winter months due to inclement weather. As a result, our revenues and operating income are typically lower in the first and fourth quarters and higher in the second and third quarters. Other factors unrelated to seasonality, such as changes in economic condition and manufacturer incentive programs, may exaggerate seasonal or cause counter-seasonal fluctuations in our revenues and operating income.

For the three months ended September 30, 2012, total revenues increased 25.9% from 2011 levels to \$2.0 billion and gross profit improved 17.1% to \$291.2 million. For the nine months ended September 30, 2012, total revenues increased 24.3% from 2011 levels to \$5.5 billion and gross profit improved 17.1% to \$837.0 million. Operating income increased for the three and nine months ended September 30, 2012 by 33.9% and 28.1%, respectively, from 2011 to \$67.1 million and \$184.1 million, respectively. Income before income taxes increased to \$49.5 million for the third quarter of 2012, which was a 43.6% improvement over the same period from the prior year. For the first nine months of 2012, income before income taxes increased 34.6% to \$132.8 million. For the three months ended September 30, 2012 and 2011, we realized net income of \$31.3 million and \$21.5 million, respectively, and diluted income per share of \$1.32 and \$0.91, respectively. For the nine months ended September 30, 2012 and 2011, we realized net income of \$83.1 million and \$61.5 million, respectively, and diluted income per share of \$3.50 and \$2.57, respectively. For the nine months ended September 30, 2012, our net cash provided was \$23.9 million and in the same period of 2011, our net cash used was \$8.5 million.

**Table of Contents****Key Performance Indicators**

The following table highlights certain of the key performance indicators we use to manage our business:

**Consolidated Statistical Data**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Unit Sales				
Retail Sales				
New Vehicle	34,532	25,777	95,386	74,578
Used Vehicle	22,433	18,770	65,186	52,700
Total Retail Sales	56,965	44,547	160,572	127,278
Wholesale Sales	12,049	9,697	33,287	27,246
Total Vehicle Sales	69,014	54,244	193,859	154,524
Gross Margin				
New Vehicle Retail Sales	5.8%	6.5%	5.8%	6.2%
Total Used Vehicle Sales	6.9%	7.1%	7.4%	8.0%
Parts and Service Sales	52.5%	52.0%	52.6%	52.5%
Total Gross Margin	14.7%	15.8%	15.1%	16.0%
SG&A <sup>(1)</sup> as a % of Gross Profit	74.2%	75.7%	75.2%	76.5%
Operating Margin	3.4%	3.2%	3.3%	3.2%
Pretax Margin	2.5%	2.2%	2.4%	2.2%
Finance and Insurance Revenues per Retail Unit Sold	\$ 1,220	\$ 1,156	\$ 1,197	\$ 1,118

(1) Selling, general and administrative expenses.

The following discussion briefly highlights certain of the results and trends occurring within our business. Throughout the following discussion, references are made to Same Store results and variances that are discussed in more detail in the Results of Operations section that follows.

During the first nine months of 2012, our industry experienced an increase in SAAR of new vehicle unit sales. While the average SAAR is still low relative to the years before 2008, it has risen from an average of 12.5 million through the first nine months of 2011 to 14.4 million in 2012. Our new vehicle retail sales revenues increased 32.3% and 27.6% for the three and nine months ended September 30, 2012, respectively. This growth primarily reflects an increase in new vehicle unit sales of 34.0% and 27.9% for the three and nine months ended September 30, 2012, respectively, reflecting healthier consumer confidence, improved inventory levels in our import brands that experienced shortages as a result of the March 2011 natural disaster in Japan and strong execution by our operating team. New vehicle retail gross margin declined during the three and nine months ended September 30, 2012 primarily as a result of an industry wide increase in the supply of new vehicles units.

Our used vehicle results are directly affected by economic conditions, the level of manufacturer incentives on new vehicles and new vehicle financing, the number and quality of trade-ins and lease turn-ins, the availability of consumer credit, as well as our ability to effectively manage the level and quality of our overall used vehicle inventory. The stabilizing economic environment that has benefited new vehicle sales also supported improved used vehicle demand that positively impacted our used vehicle retail sales. Used vehicle gross margins declined for the three and nine months ended September 30, 2012.

Our parts and service sales increased by 7.1% and 8.1%, respectively, for the three and nine months ended September 30, 2012, as compared to the same periods in 2011, primarily driven by increases in our customer pay parts and service business and in our collision business, as well as an increase in our wholesale parts business. Our parts and service margins increased for the third quarter of 2012 and for the nine months ended September 30, 2012, as compared to the same periods in 2011, primarily as a result of an increase in internal work generated by increased new

and used retail vehicle sales volumes.

Our consolidated finance and insurance income per retail unit sold increased for the three and nine months of 2012, as compared to the same periods in 2011, primarily driven by increases in penetration rates for finance and vehicle service contracts. In addition, we experienced increases in income per contract in our insurance and other product offerings.



## **Table of Contents**

Our total gross margin declined for the three and nine months ended September 30, 2012, as compared to the same periods in 2011, as a result of the shift in business mix towards the lower margin new and used vehicle businesses.

Our consolidated SG&A expenses increased in absolute dollars for the three and nine months ended September 30, 2012, as compared to the same periods in 2011 primarily as a result of the correlation to vehicle sales volumes, as well as dealership acquisitions. However, SG&A as a percentage of gross profit declined 150 and 130 basis points respectively, for the three and nine months ended September 30, 2012 from the same periods in 2011, reflecting ongoing cost control and the leverage on our cost structure that the higher revenues and gross profits provide.

For the three and nine months ended September 30, 2012, floorplan interest expense increased 14.0% and 15.7%, respectively, as compared to the same periods in 2011, primarily due to higher weighted average borrowings as our import brand inventories returned to more normalized levels following the March 2011 natural disasters in Japan and reflecting recent acquisitions. Other interest expense increased 11.3% and 12.2%, respectively, for the three and nine months ended September 30, 2012, largely due to an increase in real estate related borrowings.

We address these items further, and other variances between the periods presented, in the Results of Operations section below.

## **Critical Accounting Policies and Accounting Estimates**

The preparation of our Consolidated Financial Statements in conformity with U.S. generally accepted accounting principles requires management to make certain estimates and assumptions.

We disclosed certain critical accounting policies and estimates in our 2011 Form 10-K, and no significant changes have occurred since that time.

## **Results of Operations**

The following tables present comparative financial and non-financial data for the three and nine months ended September 30, 2012 and 2011 of (a) our Same Store locations, (b) those locations acquired or disposed of during the periods ( Transactions ), and (c) the consolidated company. Same Store amounts include the results of dealerships for the identical months in each period presented in the comparison, commencing with the first full month in which the dealership was owned by us and, in the case of dispositions, ending with the last full month it was owned by us. Same Store results also include the activities of our corporate headquarters.

**Table of Contents**

The following table summarizes our combined Same Store results for the three and nine months ended September 30, 2012, as compared to 2011:

**Total Same Store Data**

(dollars in thousands, except per unit amounts)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
<b>Revenues</b>						
New vehicle retail	\$ 1,036,633	20.2%	\$ 862,661	\$ 2,856,681	16.5%	\$ 2,452,455
Used vehicle retail	425,287	12.8%	377,115	1,228,597	16.8%	1,051,812
Used vehicle wholesale	68,160	(1.3)%	69,051	192,587	0.6%	191,528
Parts and service	210,839	0.4%	210,066	615,547	1.3%	607,733
Finance, insurance and other	64,996	26.2%	51,508	178,771	25.9%	141,994
<b>Total revenues</b>	<b>\$ 1,805,915</b>	<b>15.0%</b>	<b>\$ 1,570,401</b>	<b>\$ 5,072,183</b>	<b>14.1%</b>	<b>\$ 4,445,522</b>
<b>Cost of Sales</b>						
New vehicle retail	\$ 977,462	21.2%	\$ 806,497	\$ 2,691,543	17.0%	\$ 2,299,593
Used vehicle retail	390,146	13.1%	345,049	1,124,507	17.6%	956,566
Used vehicle wholesale	68,613	(0.9)%	69,254	190,142	1.4%	187,588
Parts and service	100,656	(0.2)%	100,836	292,127	1.3%	288,406
<b>Total cost of sales</b>	<b>\$ 1,536,877</b>	<b>16.3%</b>	<b>\$ 1,321,636</b>	<b>\$ 4,298,319</b>	<b>15.2%</b>	<b>\$ 3,732,153</b>
<b>Gross profit</b>	<b>\$ 269,038</b>	<b>8.1%</b>	<b>\$ 248,765</b>	<b>\$ 773,864</b>	<b>8.5%</b>	<b>\$ 713,369</b>
<b>Selling, general and administrative expenses</b>						
Selling, general and administrative expenses	\$ 198,852	5.6%	\$ 188,230	\$ 581,773	6.5%	\$ 546,415
Depreciation and amortization expenses	\$ 7,631	11.5%	\$ 6,8465	\$ 21,882	10.2%	\$ 19,855
Floorplan interest expense	\$ 7,364	5.7%	\$ 6,964	\$ 21,543	6.8%	\$ 20,166
<b>Gross Margin</b>						
New vehicle retail	5.7%		6.5%	5.8%		6.2%
Used vehicle	7.0%		7.1%	7.5%		8.0%
Parts and service	52.3%		52.0%	52.5%		52.5%
<b>Total gross margin</b>	<b>14.9%</b>		<b>15.8%</b>	<b>15.3%</b>		<b>16.0%</b>
SG&A as a % of gross profit	73.9%		75.7%	75.2%		76.6%
<b>Operating margin</b>	<b>3.5%</b>		<b>3.2%</b>	<b>3.4%</b>		<b>3.2%</b>
<b>Finance and insurance revenues per retail unit sold</b>						
Finance and insurance revenues per retail unit sold	\$ 1,243	7.5%	\$ 1,156	\$ 1,212	8.4%	\$ 1,118

The discussion that follows provides explanation for the material variances noted above. In addition, each table presents, by primary statement of operations line item, comparative financial and non-financial data of our Same Store locations, Transactions and the consolidated company for the three and nine months ended September 30, 2012 and 2011.

**Table of Contents****New Vehicle Retail Data**

(dollars in thousands, except per unit amounts)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
<b>Retail Unit Sales</b>						
Same Stores	31,463	22.1%	25,777	87,154	17.1%	74,414
Transactions	3,069			8,232		164
Total	34,532	34.0%	25,777	95,386	27.9%	74,578
<b>Retail Sales Revenues</b>						
Same Stores	\$ 1,036,633	20.2%	\$ 862,661	\$ 2,856,681	16.5%	\$ 2,452,455
Transactions	104,653		(1)	277,910		4,800
Total	\$ 1,141,286	32.3%	\$ 862,660	\$ 3,134,591	27.6%	\$ 2,457,255
<b>Gross Profit</b>						
Same Stores	\$ 59,171	5.4%	\$ 56,164	\$ 165,138	8.0%	\$ 152,862
Transactions	7,379		(2)	18,074		336
Total	\$ 66,550	18.5%	\$ 56,162	\$ 183,212	19.6%	\$ 153,198
<b>Gross Profit per Retail Unit Sold</b>						
Same Stores	\$ 1,881	(13.7)%	\$ 2,179	\$ 1,895	(7.7)%	\$ 2,054
Transactions	\$ 2,404			\$ 2,196		\$ 2,049
Total	\$ 1,927	(11.6)%	\$ 2,179	\$ 1,921	(6.5)%	\$ 2,054
<b>Gross Margin</b>						
Same Stores	5.7%		6.5%	5.8%		6.2%
Transactions	7.1%		200.0%	6.5%		7.0%
Total	5.8%		6.5%	5.8%		6.2%

Coupled with the increase in SAAR, we believe the focus that we have placed on improving our dealership sales processes has contributed to increased Same Store new vehicle sales and profit. In addition, the recovery by our major import brand OEM partners from the natural disasters in Japan in 2011 led to the normalization of inventory levels and bolstered new vehicle sales. Our Same Store new vehicle retail sales revenues increased 20.2%, primarily as a result of increased new vehicle retail unit sales of 22.1% for the three months ended September 30, 2012, as compared to the same period in 2011. From a mix standpoint, we generated the majority of the volume increase through our import brands, which sold 31.1% more units in the third quarter of 2012, as compared to the same period in 2011. Same Store revenues for the three months ended September 30, 2012 improved 29.8% in our import brands, as compared to the same period in 2011, as well as 15.6% and 9.4% in our luxury and domestic categories, respectively. The mix shift effect on revenues from the normalization of import brand inventories contributed to a decline in our Same Store revenues per retail unit ( PRU ), which decreased 1.6% to \$32,948 in the third quarter of 2012, as compared to the same period in 2011. The level of retail sales, as well as our own ability to retain or grow market share during the future periods, is difficult to predict.

Our Same Store new vehicle gross profit increased 5.4% for the three months ended September 30, 2012 as a result of the 22.1% increase in new vehicle retail unit sales. The mix effect of our new vehicle business shifting to import from luxury brands, coupled with the improved level of industry-wide supply of import brand inventory contributed to a decline in our Same Store gross profit PRU by 13.7% to \$1,881 for the three months ended September 30, 2012, as compared to the same period in 2011. As a result, our Same Store new vehicle gross margin for the three months ended September 30, 2012 declined 80 basis points to 5.7% from the same period in 2011.

For the nine months ended September 30, 2012, as compared to the same period in 2011, Same Store new vehicle retail unit sales increased 17.1% and retail sales revenues increased 16.5%. Same Store retail unit sales increased 22.3%, 16.7%, and 7.3% in our import, domestic, and luxury categories, respectively. Our Same Store new vehicle retail sales revenues PRU were down 0.5% to \$32,777 for the nine months ended September 30, 2012, as compared to the same period in 2011. Gross profit PRU decreased 7.7% to \$1,895 in the first nine months of 2012 from the same period in 2011, and, as a result, our gross margin decreased 40 basis points from 6.2% to 5.8% for the nine months ended 2012, as

compared to the same period in 2011.

**Table of Contents**

The following table sets forth our Same Store new vehicle retail sales volume by manufacturer:

**Same Store New Vehicle Unit Sales**

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
Toyota	10,626	43.7%	7,393	29,458	29.3%	22,786
Nissan	4,132	5.5	3,916	11,325	8.2	10,464
Honda	3,647	51.8	2,402	10,342	24.9	8,283
BMW	3,392	0.4	3,378	9,789	(0.5)	9,839
Ford	2,990	15.2	2,595	7,498	19.3	6,284
Daimler	1,500	16.1	1,292	4,389	6.1	4,135
General Motors	1,545	(4.0)	1,610	4,149	5.3	3,942
Chrysler	1,488	14.5	1,300	4,196	26.4	3,319
Volkswagen	829	15.6	717	2,080	13.7	1,829
Other	1,314	11.9	1,174	3,928	11.2	3,533
<b>Total</b>	<b>31,463</b>	<b>22.1%</b>	<b>25,777</b>	<b>87,154</b>	<b>17.1%</b>	<b>74,414</b>

Most manufacturers offer interest assistance to offset floorplan interest charges incurred in connection with inventory purchases. This assistance varies by manufacturer, but generally provides for a defined amount, adjusted periodically for changes in market interest rates, regardless of our actual floorplan interest rate or the length of time for which the inventory is financed. We record these incentives as a reduction of new vehicle cost of sales as the vehicles are sold, impacting the gross profit and gross margin detailed above. The total assistance recognized in cost of goods sold during the three months ended September 30, 2012 and 2011 was \$9.2 million and \$6.7 million, respectively. And, during the first nine months of 2012 and 2011, we recognized total interest assistance of \$25.3 million and \$18.8 million, respectively. The amount of interest assistance we recognize in a given period is primarily a function of: (a) the mix of units being sold, as domestic brands tend to provide more assistance, (b) the specific terms of the respective manufacturers' interest assistance programs and market interest rates, (c) the average wholesale price of inventory sold, and (d) our rate of inventory turnover. The increase in floorplan interest assistance from 2011 to 2012 was primarily the result of increased inventory turnover.

In effect, as of September 30, 2012, we had interest rate swaps with an aggregate notional amount of \$425.0 million, at a weighted average one-month LIBOR of 2.8%. We record the majority of the impact of the periodic settlements of these swaps as a component of floorplan interest expense, effectively hedging a substantial portion of the variable component of our total floorplan interest expense and further mitigating the impact of interest rate fluctuations. Over the past three years, manufacturers' interest assistance as a percentage of our total consolidated floorplan interest expense has ranged from 62.6% in the fourth quarter of 2009 to 115.9% in the third quarter of 2012.

We continue to aggressively manage our new vehicle inventory in response to the rapidly changing market conditions. We increased our new vehicle inventory levels by \$206.8 million, or 33.4%, from \$619.2 million as of December 31, 2011 to \$826.0 million as of September 30, 2012, primarily as a result of the Japanese brand inventory levels that have normalized in 2012 and in response to an improved selling environment in 2012. Our consolidated days supply of new vehicle inventory increased to 63 days as of September 30, 2012 compared to 54 days at December 31, 2011, as import brand inventories recovered from the industry-wide shortages in 2011.

**Table of Contents****Used Vehicle Retail Data**

(dollars in thousands, except per unit amounts)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
<b>Retail Unit Sales</b>						
Same Stores	20,808	10.9%	18,770	60,398	14.8%	52,606
Transactions	1,625			4,788		94
Total	22,433	19.5%	18,770	65,186	23.7%	52,700
<b>Retail Sales Revenues</b>						
Same Stores	\$ 425,287	12.8%	\$ 377,115	\$ 1,228,597	16.8%	\$ 1,051,812
Transactions	37,108			105,006		1,797
Total	\$ 462,395	22.6%	\$ 377,115	\$ 1,333,603	26.6%	\$ 1,053,609
<b>Gross Profit</b>						
Same Stores	\$ 35,141	9.6%	\$ 32,066	\$ 104,090	9.3%	\$ 95,246
Transactions	2,591		1	8,885		269
Total	\$ 37,732	17.7%	\$ 32,067	\$ 112,975	18.3%	\$ 95,515
<b>Gross Profit per Retail Unit Sold</b>						
Same Stores	\$ 1,689	(1.1)%	\$ 1,708	\$ 1,723	(4.9)%	\$ 1,811
Transactions	\$ 1,594			\$ 1,856		\$ 2,862
Total	\$ 1,682	(1.5)%	\$ 1,708	\$ 1,733	(4.4)%	\$ 1,812
<b>Gross Margin</b>						
Same Stores	8.3%		8.5%	8.5%		9.1%
Transactions	7.0%			8.5%		15.0%
Total	8.2%		8.5%	8.5%		9.1%

**Table of Contents****Used Vehicle Wholesale Data**

(dollars in thousands, except per unit amounts)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
<b>Wholesale Unit Sales</b>						
Same Stores	10,763	11.0%	9,697	29,925	9.9%	27,232
Transactions	1,286			3,362		14
Total	12,049	24.3%	9,697	33,287	22.2%	27,246
<b>Wholesale Sales Revenues</b>						
Same Stores	\$ 68,160	(1.3)%	\$ 69,051	\$ 192,587	0.6%	\$ 191,528
Transactions	10,264			25,828		81
Total	\$ 78,424	13.6%	\$ 69,051	\$ 218,415	14.0%	\$ 191,609
<b>Gross Profit</b>						
Same Stores	\$ (453)	123.2%	\$ (203)	\$ 2,445	(37.9)%	\$ 3,940
Transactions	(190)			(61)		18
Total	\$ (643)	216.7%	\$ (203)	\$ 2,384	(39.8)%	\$ 3,958
<b>Gross Profit per Wholesale Unit Sold</b>						
Same Stores	\$ (42)	100.0%	\$ (21)	\$ 82	(43.4)%	\$ 145
Transactions	\$ (148)		\$ (18)	\$ (18)		\$ 1,286
Total	\$ (53)	152.4%	\$ (21)	\$ 72	(50.3)%	\$ 145
<b>Gross Margin</b>						
Same Stores	(0.7)%		(0.3)%	1.3%		2.1%
Transactions	(1.9)%			(0.2)%		22.2%
Total	(0.8)%		(0.3)%	1.1%		2.1%

**Table of Contents****Total Used Vehicle Data**

(dollars in thousands, except per unit amounts)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
<b>Used Vehicle Unit Sales</b>						
Same Stores	31,571	10.9%	28,467	90,323	13.1%	79,838
Transactions	2,911			8,150		108
Total	34,482	21.1%	28,467	98,473	23.2%	79,946
<b>Sales Revenues</b>						
Same Stores	\$ 493,447	10.6%	\$ 446,166	\$ 1,421,184	14.3%	\$ 1,243,340
Transactions	47,372			130,834		1,878
Total	\$ 540,819	21.2%	\$ 446,166	\$ 1,552,018	24.6%	\$ 1,245,218
<b>Gross Profit</b>						
Same Stores	\$ 34,688	8.9%	\$ 31,863	\$ 106,535	7.4%	\$ 99,186
Transactions	2,401		1	8,824		287
Total	\$ 37,089	16.4%	\$ 31,864	\$ 115,359	16.0%	\$ 99,473
<b>Gross Profit per Used Vehicle Unit Sold</b>						
Same Stores	\$ 1,099	(1.8)%	\$ 1,119	\$ 1,179	(5.1)%	\$ 1,242
Transactions	\$ 825			\$ 1,083		\$ 2,657
Total	\$ 1,076	(3.8)%	\$ 1,119	\$ 1,171	(5.9)%	\$ 1,244
<b>Gross Margin</b>						
Same Stores	7.0%		7.1%	7.5%		8.0%
Transactions	5.1%			6.7%		15.3%
Total	6.9%		7.1%	7.4%		8.0%

In addition to factors such as general economic conditions and consumer confidence, our used vehicle business is affected by the level of manufacturer incentives on new vehicles and new vehicle financing, the number and quality of trade-ins and lease turn-ins, the availability of consumer credit, and our ability to effectively manage the level and quality of our overall used vehicle inventory. The improved economic conditions, uptick in consumer confidence, and a healthier new vehicle selling environment have translated into an increase in used vehicle demand in 2012.

The improved selling environment, coupled with our emphasis on improving our dealership sales processes resulted in an increase in our Same Store used vehicle retail units sales of 10.9% for the three months ended September 30, 2012, as compared to the same period in 2011. In addition, our average used vehicle retail selling price increased by \$347 to \$20,439 during the three months ended September 30, 2012 from the same period in 2011. These factors drove a 12.8% increase in our Same Store used vehicle retail revenues. For the nine months ended September 30, 2012, our Same Store used vehicle retail revenues improved by 16.8% as a result of a 14.8% increase in Same Store used vehicle retail unit sales, as compared to the same period in 2011, as well as an increase in our average selling price PRU of 1.7% to \$20,342.

Our certified pre-owned ( CPO ) volume increased 25.1% to 7,515 units sold for the three months ended September 30, 2012, as compared to the same period in 2011, corresponding to the overall increase in used vehicle retail volume. As a percentage of total used vehicle retail sales, CPO units increased 150 basis points to 33.5% of total used vehicle retail units sold for the three months ended September 30, 2012, as compared to the same period in 2011. CPO units sold represented 32.9% of total used vehicle retail units sold for the nine months ended September 30, 2012, as compared to 33.2% for the same period in 2011.

During 2011, an industry shortage in supply of new vehicle inventory in many of the import brands drove up demand for used vehicles. With increased demand and shortening supply, auction prices of used vehicles experienced steady increases. During 2012, supply of new vehicle inventory improved to more normalized levels and price differences between new and used vehicles have negatively impacted used vehicle retail gross profits. As a result, gross profit per used vehicle retail unit declined by 1.1% to \$1,689 and our Same Store used vehicle retail margins



## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

declined 20 basis points to 8.3% in the third quarter of 2012, as compared to the same period in 2011. For the nine months ended September 30, 2012, gross profit per used vehicle retail unit declined 4.9%, while our average sales price PRU increased by 1.7%. As a result, our Same Store used vehicle retail vehicle margins over the first nine months of 2012 decreased 60 basis points to 8.5%, as compared to the same period in 2011.

**Table of Contents**

For the three months ended September 30, 2012, we sold 11.0% more used vehicle wholesale units, as compared to the same period in 2011, corresponding with the improvements in new and used vehicle retail sales volumes. Our wholesale gross profit PRU declined \$21 during the third quarter of 2012 to a loss of \$42 per used vehicle wholesale unit and our used vehicle wholesale gross margin experienced a 40 basis-point decrease, as compared to the same period in 2011. For the nine months ended September 30, 2012, as compared to the same period in 2011, we experienced a 43.4% decline in used vehicle wholesale gross profit PRU and an 80 basis-point decline in used vehicle wholesale gross margin on a 9.9% increase in used vehicle wholesale units. These declines in profitability correspond with our continued focus on maximizing our used vehicle retail sales, as well as with the decrease in used vehicle market prices reflective in a gradual decline of the Manheim index through 2012 following the significant jump in 2011 related to our vehicle shortage following the natural disasters in Japan.

Our days supply of used vehicle inventory was 30 days at September 30, 2012, which was down from December 31, 2011 levels of 33 days.

**Parts and Service Data**

(dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,			
	2012	% Change	2011	2012	% Change	2011
<b>Parts and Service Revenues</b>						
Same Stores	\$ 210,839	0.4%	\$ 210,066	\$ 615,547	1.3%	\$ 607,733
Transactions	14,151		1	42,857		1,375
Total	\$ 224,990	7.1%	\$ 210,067	\$ 658,404	8.1%	\$ 609,108
<b>Gross Profit</b>						
Same Stores	\$ 110,183	0.9%	\$ 109,230	\$ 323,420	1.3%	\$ 319,327
Transactions	7,932		1	22,878		486
Total	\$ 118,115	8.1%	\$ 109,231	\$ 346,298	8.3%	\$ 319,813
<b>Gross Margin</b>						
Same Stores	52.3%		52.0%	52.5%		52.5%
Transactions	56.1%		100.0%	53.4%		35.3%
Total	52.5%		52.0%	52.6%		52.5%

Our Same Store parts and service revenues increased 0.4% for the three months ended September 30, 2012 as compared to the same period in 2011, driven primarily by a 3.6% increase in collision revenues. Our Same Store customer pay, warranty, and wholesale parts and service revenues all remained relatively flat when compared to the same period in 2011. Third quarter 2012 results were negatively impacted by the loss of approximately one week's worth of business at 12 of our Gulf Coast dealerships as a result of Hurricane Isaac. For the nine months ended September 30, 2012, Same Store parts and service revenues increased 1.3% as compared to the same period in 2011. The overall increase consisted of improvements in our customer pay parts and service revenues of 3.3%, our collision revenues of 4.7%, and our wholesale parts business of 1.6%. Our warranty parts and service revenues decreased 5.9%, as compared to the same period in 2011.

Our Same Store collision business increased for the three and nine months ended September 30, 2012, as compared to the same periods in 2011, benefitting from recent improvements in our business processes, as well as the expansion of our collision center footprint. The increase in Same Store customer parts and service revenues for the three and nine months ended September 30, 2012, as compared to the same periods in 2011, was primarily driven by initiatives focused on customers, products and processes that continue to build momentum and generate results. Our Same Store wholesale parts business has benefitted through much of 2012 from an increase in business with second-tier collision centers and repair shops, stimulated by the stabilization in the economy. The decrease in our Same Store warranty parts and service revenue for the nine months ended September 30, 2012, as compared to the same periods in 2011, was primarily driven by the resolution of several large recall campaigns that bolstered our prior year's results. Specifically by brand, Same Store warranty parts and service revenues from Lexus, BMW, Toyota, and Ford declined 40.6%, 10.5%, 6.1% and 14.2%, respectively, for the nine months ended September 30, 2012, as compared to the same period in 2011, primarily due to a decline in manufacturer recall activity.

**Table of Contents**

Same Store parts and service gross profit for the three and nine months ended September 30, 2012 increased 0.9% and 1.3%, respectively, from the same periods in 2011. For the three months ended September 30, 2012, our Same Store parts and service margins increased 30 basis points from the same period in 2011 primarily due to an increase in internal work between the parts and service departments of our dealerships and the new and used vehicle departments generated by improved new and used retail vehicle sales volumes, as well as improvements in our collision and warranty parts and service businesses. For the nine months ended September 30, 2012, our Same Store parts and service margins remained constant, as the impact of the mix shift from our warranty parts and service business and to our relatively lower margin collision and wholesale parts businesses was offset by the impact of increased internal work.

**Finance and Insurance Data**

(dollars in thousands, except per unit amounts)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
<b>Retail New and Used Unit Sales</b>						
Same Stores	52,271	17.3%	44,547	147,552	16.2%	127,020
Transactions	4,694			13,020		258
Total	56,965	27.9%	44,547	160,572	26.2%	127,278
<b>Retail Finance Fees</b>						
Same Stores	\$ 21,658	17.0%	\$ 18,516	\$ 60,718	20.8%	\$ 50,265
Transactions	2,091			5,763		123
Total	\$ 23,749	28.3%	\$ 18,516	\$ 66,481	31.9%	\$ 50,388
<b>Vehicle Service Contract Fees</b>						
Same Stores	\$ 26,852	27.3%	\$ 21,099	\$ 74,039	25.3%	\$ 59,080
Transactions	996		(8)	3,897		81
Total	\$ 27,848	32.0%	\$ 21,091	\$ 77,936	31.7%	\$ 59,161
<b>Insurance and Other</b>						
Same Stores	\$ 16,486	38.6%	\$ 11,893	\$ 44,014	34.8%	\$ 32,649
Transactions	1,394		(4)	3,699		57
Total	\$ 17,880	50.4%	\$ 11,889	\$ 47,713	45.9%	\$ 32,706
<b>Total</b>						
Same Stores	\$ 64,996	26.2%	\$ 51,508	\$ 178,771	25.9%	\$ 141,994
Transactions	4,481		(12)	13,359		261
Total	\$ 69,477	34.9%	\$ 51,496	\$ 192,130	35.1%	\$ 142,255
<b>Finance and Insurance Revenues per Unit Sold</b>						
Same Stores	\$ 1,243	7.5%	\$ 1,156	\$ 1,212	8.4%	\$ 1,118
Transactions	\$ 955			\$ 1,026		\$ 1,012
Total	\$ 1,220	5.5%	\$ 1,156	\$ 1,197	7.1%	\$ 1,118

Our focus on improving our finance and insurance business processes, coupled with improved retail vehicle sales volumes, continues to generate growth in finance and insurance revenues. Our Same Store finance and insurance revenues increased by 26.2% to \$65.0 million for the three months ended September 30, 2012, as compared to the same period in 2011. This improvement was primarily driven by a 17.3% increase in new and used vehicle unit sales, along with an increase in penetration rates for finance and vehicle service contracts of 90 basis points and 190 basis points, respectively. In addition, income per contract in our vehicle service contract segment increased by 3.4% for the three months ended September 30, 2012, as compared to the same period in 2011, as well as in most of our other product offerings. These increases more than offset an increase in our chargeback expense. As a result, our Same Store revenues PRU for the three months ended September 30, 2012 improved

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

7.5%, or \$87, to \$1,243, as compared to the same period in 2011.

For the first nine months of 2012, our Same Store finance and insurance revenues improved 25.9% over the same period in 2011, primarily reflecting a 16.2% increase in our new and used retail volumes, coupled with a 3.7% increase in our finance income per contract and improvements in penetration of both our finance and vehicle service contracts. As such, our Same Store revenues PRU increased 8.4%, or \$94, to \$1,212 for the nine months ended September 30, 2012, as compared to the same period in 2011.

**Table of Contents****Selling, General and Administrative Data**

(dollars in thousands)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
<b>Personnel</b>						
Same Stores	\$ 122,278	5.9%	\$ 115,454	\$ 357,996	7.8%	\$ 332,159
Transactions	9,861			28,835		745
Total	\$ 132,139	14.5%	\$ 115,454	\$ 386,831	16.2%	\$ 332,904
<b>Advertising</b>						
Same Stores	\$ 13,151	14.4%	\$ 11,494	\$ 37,584	8.8%	\$ 34,546
Transactions	1,292		(8)	3,152		90
Total	\$ 14,443	25.7%	\$ 11,486	\$ 40,736	17.6%	\$ 34,636
<b>Rent and Facility Costs</b>						
Same Stores	\$ 22,230	(5.8)%	\$ 23,604	\$ 64,481	(4.3)%	\$ 67,357
Transactions	2,151		1	5,810		104
Total	\$ 24,381	3.3%	\$ 23,605	\$ 70,291	4.2%	\$ 67,461
<b>Other SG&amp;A</b>						
Same Stores	\$ 41,193	9.3%	\$ 37,678	\$ 121,712	8.3%	\$ 112,353
Transactions	3,926		(38)	9,951		(234)
Total	\$ 45,119	19.9%	\$ 37,640	\$ 131,663	17.4%	\$ 112,119
<b>Total SG&amp;A</b>						
Same Stores	\$ 198,852	5.6%	\$ 188,230	\$ 581,773	6.5%	\$ 546,415
Transactions	17,230		(45)	47,748		705
Total	\$ 216,082	14.8%	\$ 188,185	\$ 629,521	15.1%	\$ 547,120
<b>Total Gross Profit</b>						
Same Stores	\$ 269,038	8.1%	\$ 248,765	\$ 773,864	8.5%	\$ 713,369
Transactions	22,193		(12)	63,135		1,370
Total	\$ 291,231	17.1%	\$ 248,753	\$ 836,999	17.1%	\$ 714,739
<b>SG&amp;A as a % of Gross Profit</b>						
Same Stores	73.9%		75.7%	75.2%		76.6%
Transactions	77.6%		375.0%	75.6%		51.5%
Total	74.2%		75.7%	75.2%		76.5%
Employees	9,200		8,100	9,200		8,100

Our SG&A consists primarily of salaries, commissions and incentive-based compensation, as well as rent, advertising, insurance, benefits, utilities and other fixed expenses. We believe that the majority of our personnel and all of our advertising expenses are variable and can be adjusted in response to changing business conditions.

Our absolute dollars of Same Store total SG&A expenses increased by \$10.6 million, or 5.6%, and \$35.4 million, or 6.5%, for the three and nine months ended September 30, 2012, respectively, from the same periods in 2011. The increase was primarily attributable to personnel costs, which generally correlate with the vehicle sales, as well as a change in estimated reserves for workers' compensation claims.

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

Same Store advertising expenses increased by 14.4%, or \$1.7 million, in the third quarter of 2012, as compared to the same period in 2011, primarily corresponding with our efforts to stimulate parts and service activity. For the nine months ended September 30, 2012, advertising expense increased 8.8%, or \$3.0 million, from the same period in 2011, due largely to the same stimulus efforts.

Our Same Store rent and facility costs declined 5.8%, or \$1.4 million, for the three months ended September 30, 2012 as compared with the same period in 2011. For the nine months ended September 30, 2012, such costs declined 4.3%, or \$2.9 million, as compared to the same period in 2011. These decreases were primarily a result of our purchase of real estate associated with existing dealerships, which served to reduce our rent expense. We plan to continue to strategically add dealership-related real estate to our portfolio. The

**Table of Contents**

results for the three and nine months ended September 30, 2012 include a \$0.6 million charge for the portion of our insurance deductibles associated with the property damaged in Hurricane Isaac, while the results for the nine months ended September 30, 2012 also include a \$0.3 million charge for the portion of our insurance deductibles associated with the property damaged in the Oklahoma City hail storm in the second quarter of 2012.

Our Same Store other SG&A increased \$3.5 million and \$9.4 million for the three and nine months ended September 30, 2012, respectively, from the same periods in 2011. The 9.3% increase in the third quarter of 2012 was primarily the result of an increase in areas that traditionally trend with sales volume, as well as a change in estimated reserves for general liability claims that was partially offset by a gain resulting from the disposal of a dealership franchise in Texas. Additionally, a \$2.4 million charge for the portion of our insurance deductibles associated with damaged vehicle inventory in the Oklahoma City hail storm contributed to the 8.3% increase during the first nine months of 2012. We continue to aggressively pursue opportunities that take advantage of our size and negotiating leverage with our vendors and service providers.

While our absolute dollars of Same Store SG&A increased for the three and nine months ended September 30, 2012, from the same periods in 2011, we have continued our focus on leveraging our gross profit growth. Our Same Store gross profit improved 8.1% and, as a result, Same Store SG&A as percentage of gross profit decreased 180 basis points to 73.9% for the three months ended September 30, 2012, as compared to the same period in 2011. For the nine months ended September 30, 2012, SG&A as a percentage of gross profit declined 140 basis points to 75.2%, as compared to the same period in 2011.

**Depreciation and Amortization Data**

(dollars in thousands)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
Same Stores	\$ 7,631	11.5%	\$ 6,845	\$ 21,882	10.2%	\$ 19,855
Transactions	465			1,192		26
<b>Total</b>	<b>\$ 8,096</b>	<b>18.3%</b>	<b>\$ 6,845</b>	<b>\$ 23,074</b>	<b>16.1%</b>	<b>\$ 19,881</b>

Our Same Store depreciation and amortization expense increased 11.5% and 10.2%, respectively, for the three and nine months ended September 30, 2012, as compared to the same period in 2011. Depreciation and amortization expense has increased as we continue to strategically add dealership related real estate to our portfolio and to make improvements to our existing facilities that are designed to enhance the profitability of our dealerships and the overall customer experience. We critically evaluate all planned future capital spending, working closely with our OEM partners to maximize the return on our investments.

**Floorplan Interest Expense**

(dollars in thousands)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	% Change	2011	2012	% Change	2011
Same Stores	\$ 7,364	5.7%	\$ 6,964	\$ 21,543	6.8%	\$ 20,166
Transactions	578			1,881		79
<b>Total</b>	<b>\$ 7,942</b>	<b>14.0%</b>	<b>\$ 6,964</b>	<b>\$ 23,424</b>	<b>15.7%</b>	<b>\$ 20,245</b>

Memo:

Manufacturer's assistance	\$ 9,204	36.6%	\$ 6,740	\$ 25,276	34.2%	\$ 18,836
---------------------------	----------	-------	----------	-----------	-------	-----------

Our floorplan interest expense fluctuates with changes in borrowings outstanding and interest rates, which are based on the one-month LIBOR (or Prime rate in some cases) plus a spread. Mitigating the impact of interest rate fluctuations, we employ an interest rate hedging strategy, whereby we swap variable interest rate exposure for a fixed interest rate over the term of the variable interest rate debt. As of September 30,

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

2012, we had effective interest rate swaps with an aggregate notional amount of \$425.0 million that fixed our underlying one-month LIBOR at a weighted average interest rate of 2.8%. The majority of the monthly settlements of these interest rate swap liabilities are recognized as floorplan interest expense. From time to time, we utilize excess cash on hand to pay down our floorplan borrowings, and the resulting interest earned is recognized as an offset to our gross floorplan interest expense.

Our Same Store floorplan interest expense increased 5.7%, or \$0.4 million, for the three months ended September 30, 2012, and 6.8%, or \$1.4 million, during the nine months ended September 30, 2012, as compared to the same periods in 2011. These increases primarily reflect growth in our weighted average floorplan borrowings outstanding between the respective periods, primarily associated with the normalization of our import brand inventories.



---

**Table of Contents*****Other Interest Expense, net***

Other net interest expense consists of interest charges primarily on our real estate related debt and our other long-term debt, partially offset by interest income. For the three months ended September 30, 2012, other interest expense increased \$1.0 million, or 11.3%, to \$9.6 million, as compared to the same period in 2011. For the nine months ended September 30, 2012, other net interest expense increased \$3.0 million, or 12.2%, to \$27.8 million as compared to the same period in 2011. The increases are primarily attributable to additional borrowings during the periods used to finance real estate purchases. Since the second half of 2011, we entered into 17 additional loan agreements with third-party financial institutions to finance real estate purchases primarily associated with our recently acquired dealerships. We will continue to strategically add dealership-related real estate to our portfolio.

Included in other interest expense for the three months ended September 30, 2012 and 2011 is non-cash, discount amortization expense of \$2.5 million and \$2.3 million, respectively, representing the impact of the accounting for convertible debt as required by ASC 470. Based on the level of 2.25% Convertible Senior Notes due 2036 (our 2.25% Notes ) and 3.00% Convertible Senior Notes due 2020 (our 3.00% Notes ) outstanding, we anticipate that the ongoing annual non-cash discount amortization expense related to the convertible debt instruments will be \$12.9 million, which will be included in other interest expense, net.

***Provision for Income Taxes***

Our provision for income taxes increased \$5.2 million to \$18.2 million for the three months ended September 30, 2012, as compared to the same period in 2011, primarily due to the increase of pretax book income. For the three months ended September 30, 2012, our effective tax rate decreased to 36.7% from 37.7% from the same period in 2011. This decrease was primarily due to the mix of our pretax income from the taxable state and foreign jurisdictions in which we operate.

Our provision for income taxes increased \$12.7 million to \$49.8 million for the nine months ended September 30, 2012, as compared to the same period in 2011, primarily due to the increase of pretax book income. For the nine months ended September 30, 2012, our effective tax rate decreased to 37.5% from 37.6% from the same period in 2011. This decrease was primarily due to the mix of our pretax income from the taxable state and foreign jurisdictions in which we operate.

We believe that it is more likely than not that our deferred tax assets, net of valuation allowances provided, will be realized, based primarily on the assumption of future taxable income and taxes available in carry back periods. We expect our effective tax rate for the remainder of 2012 will be approximately 38.0%.

***Liquidity and Capital Resources***

Our liquidity and capital resources are primarily derived from cash on hand, cash temporarily invested as a pay down of Floorplan Line levels, cash from operations, borrowings under our credit facilities, which provide vehicle floorplan financing, working capital, dealership and real estate acquisition financing, and proceeds from debt and equity offerings. Based on current facts and circumstances, we believe we have adequate cash flow, coupled with available borrowing capacity, to fund our current operations, capital expenditures and acquisitions for the remainder of 2012. If economic and business conditions deteriorate or if our capital expenditures or acquisition plans for 2012 change, we may need to access the private or public capital markets to obtain additional funding.

*Cash on Hand.* As of September 30, 2012, our total cash on hand was \$38.8 million. Included in cash on hand are balances from various investments in debt securities, such as variable-rate demand obligations with manufacturer-affiliated finance companies, which have maturities of less than three months or are redeemable on demand by us. The balance of cash on hand excludes \$128.3 million of immediately available funds that were used to pay down our Floorplan Line as of September 30, 2012. We use the pay down of our Floorplan Line as a channel for the short-term investment of excess cash.

**Table of Contents**

*Cash Flows.* The following table sets forth selected historical information regarding cash flows from our Consolidated Statements of Cash Flows:

	<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
Net cash provided by (used in) operating activities	\$ (7,291)	\$ 301,118
Net cash used in investing activities	(181,334)	(148,798)
Net cash provided by (used in) financing activities	213,822	(160,792)
Effect of exchange rate changes on cash	(1,270)	(71)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>\$ 23,927</b>	<b>\$ (8,543)</b>

With respect to all new vehicle floorplan borrowings, the manufacturers of the vehicles draft our credit facilities directly with no cash flow to or from us. With respect to borrowings for used vehicle financing, we finance up to 80% of the value of our used vehicle inventory, except in the U.K., and the funds flow directly to us from the lender. All borrowings from, and repayments to, lenders affiliated with our vehicle manufacturers (excluding the cash flows from or to manufacturer-affiliated lenders participating in our syndicated lending group) are presented within Cash Flows from Operating Activities on the Consolidated Statements of Cash Flows. All borrowings from, and repayments to, the Revolving Credit Facility (including the cash flows from or to manufacturer-affiliated lenders participating in the facility) are presented within Cash Flows from Financing Activities.

***Sources and Uses of Liquidity from Operating Activities***

For the nine months ended September 30, 2012, we used \$7.3 million in net cash flow from operating activities, primarily driven by \$141.6 million in net changes of operating assets and liabilities. This net use of cash was substantially offset by \$83.1 million in net income, as well as significant non-cash adjustments related to depreciation and amortization of \$23.1 million, amortization of debt discounts and debt issue costs of \$9.7 million, deferred income taxes of \$10.8 million and stock-based compensation of \$8.9 million. Included in the net changes of operating assets and liabilities are cash inflows of \$25.1 million from decreases of vehicle receivables and contracts-in-transit, \$19.3 million from increases in accounts payable and accrued expenses, \$6.7 million from decreases in accounts and notes receivable and \$6.6 million from decreases in prepaid expenses and other assets. These cash inflows were more than offset by cash outflows of \$193.1 million from increases of inventory levels and \$6.0 million from the net decrease in floorplan borrowings from manufacturer-affiliates.

For the nine months ended September 30, 2011, we generated \$301.1 million in net cash flow from operating activities, primarily driven by \$61.5 million in net income and \$183.2 million in net increase in operating assets and liabilities, as well as significant non-cash adjustments related to deferred income taxes of \$16.3 million, depreciation and amortization of \$19.9 million, amortization of debt discounts and debt issue costs of \$8.9 million, stock-based compensation of \$8.3 million, and asset impairment charges of \$4.0 million. Included in the net increase in operating assets and liabilities are cash inflows of \$111.7 million from decreases in inventory levels, \$19.0 million from the net increase in floorplan borrowings from manufacturer-affiliates, \$39.7 million from increases in accounts payable and accrued expenses, \$13.5 million from decreases of contracts-in-transit and vehicles receivables, and \$3.9 million from decreases in accounts and notes receivables.

*Working Capital.* At September 30, 2012, we had \$177.9 million of working capital. Changes in our working capital are driven primarily by changes in floorplan notes payable outstanding. Borrowings on our new vehicle floorplan notes payable, subject to agreed upon pay-off terms, are equal to 100% of the factory invoice of the vehicles. Borrowings on our used vehicle floorplan notes payable, subject to agreed upon pay-off terms, are limited to 80% of the aggregate book value of our used vehicle inventory. At times, we have made payments on our floorplan notes payable using excess cash flow from operations and the proceeds of debt and equity offerings. As needed, we re-borrow the amounts later, up to the limits on the floorplan notes payable discussed below, for working capital, acquisitions, capital expenditures or general corporate purposes.

***Sources and Uses of Liquidity from Investing Activities***

During the first nine months of 2012, we used \$181.3 million for investing activities, primarily related to the acquisition of thirteen dealerships located in South Carolina, Texas, Kansas, Florida and the U.K., for a total of \$116.5 million, including the amounts paid for vehicle inventory, parts inventory, equipment and furniture fixtures, as well as the purchase of some of the associated real estate. The acquired vehicle inventory related to the U.S. stores was subsequently financed through borrowing under our Floorplan Line. We also used \$67.9 million during the first nine months of 2012 for purchases of property and equipment to construct new and improve existing facilities, \$8.0 million of which was

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

accrued as of December 31, 2011. The \$67.9 million consisted of \$39.7 million for capital expenditures and \$23.7 million for the purchase of real estate associated with existing dealership operations,

---

## **Table of Contents**

During the first nine months of 2011, we used \$148.7 million for investing activities, primarily related to the acquisition of a Ford dealership in Houston, Texas, a Volkswagen dealership in Irving, Texas, and a BMW/MINI dealership, Ford dealership, and Buick/GMC dealership, all in El Paso, Texas for a total of \$109.9 million, including the amounts paid for vehicle inventory, parts inventory, equipment and furniture fixtures, as well as the purchase of some of the associated real estate. The vehicle inventory for the Ford dealerships and other dealerships were subsequently financed through borrowing under the FMCC Facility and our Floorplan Line, respectively. We also used \$45.1 million during the first nine months of 2011 primarily for purchases of property and equipment to construct new and improve existing facilities, consisting of \$22.4 million for real estate to be used for existing dealership operations and \$22.2 million for capital expenditures. These cash outflows were partially offset by \$5.8 million in proceeds from the sale of property and equipment, during the first nine months of 2011.

*Capital Expenditures.* Our capital expenditures include uses of cash to extend the useful lives of current facilities and expenditures to start or expand operations and exclude real estate purchases. In general, capital expenditures relating to the construction or expansion of dealership facilities are driven by new franchises being granted to us by a manufacturer, significant growth in sales at an existing facility, dealership acquisition activity or manufacturer imaging programs. We forecast our capital expenditures for 2012 to be less than \$63.0 million, generally funded from excess cash. This amount includes approximately \$15.0 million for specific growth initiatives in our parts and service business.

*Acquisitions.* We purchase businesses based on expected return on investment. In general, the purchase price, excluding real estate and floorplan liabilities, is approximately 15% to 20% of the annual revenues acquired. Cash needed to complete our acquisitions comes from excess working capital, operating cash flows of our dealerships and borrowings under our floorplan facilities, Mortgage Facility, Real Estate Notes and our Acquisition Line.

### ***Sources and Uses of Liquidity from Financing Activities***

We generated \$213.8 million in net cash inflows from financing activities during the nine months ended September 30, 2012, primarily related to \$172.8 million in net borrowings under the Floorplan Line of our Revolving Credit Facility, which included a net cash outflow of \$19.1 million due to an increase in our floorplan offset account. In addition, financing cash inflows included \$72.4 million in borrowings of long-term debt related to real estate loans. These cash inflows were partially offset by outflows of \$10.0 million for dividend payments and \$8.9 million for principal payments of long-term debt related to real estate loans. In addition, we used \$11.3 million to repurchase shares of our common stock.

We used \$160.8 million in net cash outflows from financing activities during the nine months ended September 30, 2011, primarily related to \$153.8 million in net repayments under the Floorplan Line of our Revolving Credit Facility, which included a net cash inflow of \$12.4 million due to a decrease in our floorplan offset account. In addition, we used \$44.9 million to repurchase treasury shares of our common stock during the second and third quarter of 2011, \$8.3 million for dividend payments, and \$5.7 million for principal payments of long-term debt related to real estate loans. These cash outflows were offset by \$21.8 million in borrowings of long-term debt related to real estate.

*Credit Facilities.* Our various credit facilities are used to finance the purchase of inventory and real estate, provide acquisition funding and provide working capital for general corporate purposes. Our most significant domestic revolving facilities currently provide us with a total of \$1.25 billion of borrowing capacity for inventory floorplan financing and an additional \$250.0 million for acquisitions, capital expenditures and/or other general corporate purposes.

*Revolving Credit Facility.* Effective July 1, 2011, we entered into an amended and restated revolving credit facility, which we refer to herein as our Revolving Credit Facility. Our Revolving Credit Facility, which is comprised of 21 financial institutions, including four manufacturer-affiliated finance companies, expires on June 1, 2016 and consists of two tranches: \$1.1 billion for the Floorplan Line and \$250.0 million for the Acquisition Line. Up to half of the Acquisition Line can be borrowed in either Euros or Pound Sterling. The capacity under these two tranches can be re-designated within the overall \$1.35 billion commitment, subject to the original limits of a minimum of \$1.1 billion for the Floorplan Line and maximum of \$250.0 million for the Acquisition Line. The Revolving Credit Facility can be expanded to its maximum commitment of \$1.6 billion, subject to participating lender approval. The Floorplan Line bears interest at rates equal to the one-month LIBOR plus 150 basis points for new vehicle inventory and the one-month LIBOR plus 175 basis points for used vehicle inventory. The Acquisition Line bears interest at the one-month LIBOR plus a margin that ranges from 150 to 250 basis points, depending on our leverage ratio. The Floorplan Line requires a commitment fee of 0.20% per annum on the unused portion. The Acquisition Line also requires a commitment fee ranging from 0.25% to 0.45% per annum, depending on our leverage ratio, based on a minimum commitment of \$100.0 million less outstanding borrowings.

As of September 30, 2012, after considering outstanding balances, we had \$317.4 million of available floorplan borrowing capacity under the Floorplan Line. Included in the \$317.4 million available borrowings under the Floorplan Line was \$128.3 million of immediately available funds. The weighted average interest rate on the Floorplan Line was 1.7% as of September 30, 2012, excluding the impact of our interest rate swaps. After considering \$24.3 million of outstanding letters of credit at September 30, 2012, and other



**Table of Contents**

factors included in our available borrowing base calculation, there was \$225.7 million of available borrowing capacity under the Acquisition Line as of September 30, 2012. The amount of available borrowing capacity under the Acquisition Line may be limited from time to time based upon certain debt covenants.

All of our domestic dealership-owning subsidiaries are co-borrowers under the Revolving Credit Facility. Our obligations under the Revolving Credit Facility are secured by essentially all of our domestic personal property (other than equity interests in dealership-owning subsidiaries) including all motor vehicle inventory and proceeds from the disposition of dealership-owning subsidiaries. The Revolving Credit Facility contains a number of significant covenants that, among other things, restrict our ability to make disbursements outside of the ordinary course of business, dispose of assets, incur additional indebtedness, create liens on assets, make investments and engage in mergers or consolidations. We are also required to comply with specified financial tests and ratios defined in the Revolving Credit Facility, such as fixed charge coverage, total adjusted leverage, and senior secured adjusted leverage. Further, the Revolving Credit Facility restricts our ability to make certain payments, such as dividends or other distributions of assets, properties, cash, rights, obligations or securities ( Restricted Payments ). The Restricted Payments may not exceed the sum of \$100.0 million plus (or minus if negative) (a) one-half of our aggregate consolidated net income for the period beginning on January 1, 2011 and ending on the date of determination and (b) the amount of net cash proceeds received from the sale of capital stock on or after January 1, 2011 and ending on the date of determination ( Restricted Payment Basket ). For purposes of the Restricted Payment Basket calculation, net income represents such amounts per our consolidated financial statements, adjusted to exclude our foreign operations, non-cash interest expense, non-cash asset impairment charges, non-cash stock-based compensation, and gains and losses on the redemption of debt. As of September 30, 2012, the Restricted Payment Basket totaled \$109.7 million.

As of September 30, 2012, we were in compliance with all our Revolving Credit Facility s financial covenants, including:

	As of September 30, 2012	
	Required	Actual
Senior Secured Adjusted Leverage Ratio	< 3.75	2.38
Total Adjusted Leverage Ratio	< 5.50	3.43
Fixed Charge Coverage Ratio	> 1.35	2.04

Based upon our current operating and financial projections, we believe that we will remain compliant with such covenants for the next twelve months.

*Ford Motor Credit Company Facility.* Our FMCC Facility provides for the financing of, and is collateralized by, our Ford new vehicle inventory, including affiliated brands. This arrangement provides for \$150.0 million of floorplan financing and is an evergreen arrangement that may be canceled with 30 days notice by either party. As of September 30, 2012, we had an outstanding balance of \$98.9 million under the FMCC Facility, with an available floorplan capacity of \$51.1 million. This facility bears interest at a rate of Prime plus 150 basis points minus certain incentives; however, the prime rate is defined to be a minimum of 3.75%. As of September 30, 2012, the interest rate on the FMCC Facility was 5.25% before considering the applicable incentives.

*Other Credit Facilities.* We finance the new, used and rental vehicle inventories related to our U.K. operations using a credit facility with BMW Financial Services and Volkswagen Finance. These facilities are evergreen arrangements that may be canceled with notice by either party and bears interest at a base rate, plus a surcharge that varies based upon the type of vehicle being financed. Dependent upon the type of inventory financed, the interest rates charged on borrowings outstanding under these facilities ranged from 1.1% to 4.5%, as of September 30, 2012.

Financing for rental vehicles is typically obtained directly from the automobile manufacturers, excluding rental vehicles financed through the Revolving Credit Facility. These financing arrangements generally require small monthly payments and mature in varying amounts over the next two years. As of September 30, 2012, the interest rate charged on borrowings related to our rental vehicle fleet varied up to 5.3%. Rental vehicles are typically moved to used vehicle inventory when they are removed from rental service and repayment of the borrowing is required at that time.

**Table of Contents**

The following table summarizes the position of our credit facilities as of September 30, 2012:

<b>Credit Facility</b>	<b>As of September 30, 2012</b>		
	<b>Total Commitment</b>	<b>Outstanding (In thousands)</b>	<b>Available</b>
Floorplan Line <sup>(1)</sup>	\$ 1,100,000	\$ 782,585	\$ 317,415
Acquisition Line <sup>(2)</sup>	250,000	24,288	225,712
<b>Total Revolving Credit Facility</b>	<b>1,350,000</b>	<b>806,873</b>	<b>543,127</b>
FMCC Facility	150,000	98,921	51,079
<b>Total Credit Facilities <sup>(3)</sup></b>	<b>\$ 1,500,000</b>	<b>\$ 905,794</b>	<b>\$ 594,206</b>

(1) The available balance at September 30, 2012 includes \$128.3 million of immediately available funds.

(2) The outstanding balance of \$24.3 million at September 30, 2012 is related to outstanding letters of credit.

(3) The outstanding balance excludes \$73.8 million of borrowings with manufacturer-affiliates for foreign and rental vehicle financing not associated with any of the Company's credit facilities.

*Real Estate Credit Facility.* As amended and restated, the Mortgage Facility provides the right to expand to \$83.4 million of term loans, of which \$60.7 million has been used as of September 30, 2012. The term loans can be expanded provided that (a) no default or event of default exists under the Mortgage Facility, (b) we obtain commitments from the lenders who would qualify as assignees for such increased amounts, and (c) certain other agreed upon terms and conditions have been satisfied. The Mortgage Facility is guaranteed by us and essentially all of our existing and future direct and indirect domestic subsidiaries. Each loan is secured by the relevant real property (and improvements related thereto) that is mortgaged under the Mortgage Facility.

The interest rate is now equal to (a) the per annum rate equal to the one-month LIBOR plus 2.50% per annum, determined on the first day of each month, or (b) 1.45% per annum in excess of the higher of (i) the Bank of America prime rate (adjusted daily on the day specified in the public announcement of such price rate), (ii) the Federal Funds Rate adjusted daily, plus 0.5%, or (iii) the per annum rate equal to one-month LIBOR plus 1.05% per annum. The Federal Funds Rate is the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published by the Federal Reserve Bank of New York on the business day succeeding such day.

We are required to make quarterly principal payments equal to 1.25% of the principal amount outstanding beginning in April 2011 and are required to repay the aggregate principal amount outstanding on the maturity dates, which vary from December 29, 2015 to February 27, 2017. During the nine months ended September 30, 2012, we borrowed an additional \$18.1 million to finance the acquisition and/or improvement of dealership facilities and made principal payments of \$1.6 million on outstanding borrowings from the Mortgage Facility. As of September 30, 2012, borrowings outstanding under the amended and restated Mortgage Facility totaled \$57.4 million, with \$3.0 million recorded as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

The Mortgage Facility also contains usual and customary provisions limiting our ability to engage in certain transactions, including limitations on our ability to incur additional debt, additional liens, make investments, and pay distributions to our stockholders. In addition, effective December 31, 2011, the Mortgage Facility was amended to require certain financial covenants that are identical to those contained in our Revolving Credit Facility.

*Real Estate Related Debt.* We have entered into separate term mortgage loans in the U.S. with three of our manufacturer-affiliated finance partners, TMCC, MBFS, BMWFS and third party financial institutions (collectively, Real Estate Notes). The Real Estate Notes are on specific buildings and/or properties and are guaranteed by us. Each loan was made in connection with, and is secured by mortgage liens on the relevant real property owned by us that is mortgaged under the Real Estate Notes. The Real Estate Notes bear interest at fixed rates between 3.67% and 5.47%, and at variable indexed rates plus between 2.25% and 3.35% per annum. During the first nine months of 2012, we entered into seven term mortgage loans for a total of \$46.5 million. At September 30, 2012, the aggregate outstanding balance under these Real Estate Notes was \$214.0 million, with \$12.3 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

We also entered into separate term mortgage loans in the U.K. with another third-party financial institution which are secured by our foreign subsidiary properties. During the nine months ended September 30, 2012, we borrowed £4.9 million to partially finance the April 2012 acquisition of six U.K. dealerships. These mortgage loans (collectively, Foreign Notes ) are being repaid in monthly installments that began in March 2010 and mature by August 2027. As of September 30, 2012, borrowings under the Foreign Notes totaled \$19.1 million, with \$2.4 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.



**Table of Contents**

*Dividends.* The payment of dividends is subject to the discretion of our Board of Directors after considering the results of operations, financial condition, cash flows, capital requirements, outlook for our business, general business conditions, the political and legislative environments and other factors.

Further, we are limited under the terms of the Credit Facility and Mortgage Facility in our ability to make cash dividend payments to our stockholders and to repurchase shares of our outstanding common stock, based primarily on our quarterly net income or loss. As of September 30, 2012, the Restricted Payment Basket under both facilities was \$109.7 million and will increase in the future periods by 50.0% of our cumulative net income, as well as the net proceeds from stock option exercises, and decrease by subsequent payments for cash dividends and share repurchases.

*Stock Issuances.* No shares of our common stock have been issued or received under the 3.00% Purchased Options or the 3.00% Warrants. For diluted earnings-per-share calculations, we are required to include the dilutive effect, if applicable, of the net shares issuable under the 3.00% Notes and the 3.00% Warrants as depicted in the table below under the heading Potential Dilutive Shares. Although the 3.00% Purchased Options have the economic benefit of decreasing the dilutive effect of the 3.00% Notes, for EPS purposes, we cannot factor this benefit into our dilutive shares outstanding as their impact would be anti-dilutive.

As of September 30, 2012, changes in the average price of our common stock impacted the share settlement of the 3.00% Notes, the 3.00% Purchased Options and the 3.00% Warrants as illustrated below:

<b>Company</b>	<b>Net Shares Issuable Under the 3.00% Notes</b>	<b>Share Entitlement Under the Purchased Options (Shares in thousands)</b>	<b>Shares Issuable Under the Warrants</b>	<b>Net Shares Issuable</b>	<b>Potential Dilutive Shares</b>
<b>Stock Price</b>					
\$ 37.50					
\$ 40.00	170	(170)			170
\$ 42.50	339	(339)			339
\$ 45.00	490	(490)			490
\$ 47.50	624	(624)			624
\$ 50.00	745	(745)			745
\$ 52.50	855	(855)			855
\$ 55.00	954	(954)			954
\$ 57.50	1,045	(1,045)	107	107	1,152
\$ 60.00	1,129	(1,129)	229	229	1,358
\$ 62.50	1,205	(1,205)	342	342	1,547
\$ 65.00	1,276	(1,276)	446	446	1,722
\$ 67.50	1,342	(1,342)	542	542	1,884
\$ 70.00	1,402	(1,402)	631	631	2,033
\$ 72.50	1,459	(1,459)	715	715	2,174
\$ 75.00	1,512	(1,512)	792	792	2,304
\$ 77.50	1,561	(1,561)	865	865	2,426
\$ 80.00	1,608	(1,608)	933	933	2,541
\$ 82.50	1,651	(1,651)	997	997	2,648
\$ 85.00	1,692	(1,692)	1,057	1,057	2,749
\$ 87.50	1,731	(1,731)	1,114	1,114	2,845
\$ 90.00	1,768	(1,768)	1,168	1,168	2,936
\$ 92.50	1,802	(1,802)	1,219	1,219	3,021
\$ 95.00	1,835	(1,835)	1,267	1,267	3,102
\$ 97.50	1,866	(1,866)	1,312	1,312	3,178
\$100.00	1,895	(1,895)	1,356	1,356	3,251

*Stock Repurchases.* From time to time, our Board of Directors authorizes us to repurchase shares of our common stock, subject to the restrictions of various debt agreements and our judgment. Under our Board of Directors' authorization from August 2011, we repurchased 241,991 shares during the first six months of 2012 at an average price of \$46.75 for a cost of \$11.3 million.



---

**Table of Contents**

In July 2012, our Board of Directors authorized a new repurchase program of up to \$50.0 million of our common shares, replacing any amount remaining from the August 2011 authorization. No repurchases have been executed under the July 2012 authorization. Future repurchases are subject to the discretion of our Board of Directors after considering our results of operations, financial condition, cash flows, capital requirements, existing debt covenants, outlook for our business, general business conditions and other factors.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

We are exposed to a variety of market risks, including interest rate risk, and foreign currency exchange rate risk. We address these risks through a program of risk management, which includes the use of derivative instruments. The following quantitative and qualitative information is provided about financial instruments to which we are a party at September 30, 2012, and from which we may incur future gains or losses from changes in market interest rates and foreign currency exchange rates. We do not enter into derivative or other financial instruments for speculative or trading purposes.

Hypothetical changes in interest rates and foreign currency exchange rates chosen for the following estimated sensitivity analysis are considered to be reasonable near-term changes generally based on consideration of past fluctuations for each risk category. However, since it is not possible to accurately predict future changes in interest rate and foreign currency exchange rates, these hypothetical changes may not necessarily be an indicator of probable future fluctuations.

The following information about our market-sensitive financial instruments constitutes a forward-looking statement.

As of September 30, 2012, the outstanding principal amounts of our 2.25% Notes and 3.00% Notes totaled \$182.8 million and \$115.0 million, respectively, and had fair values of \$212.3 million and \$199.4 million, respectively. The carrying amounts of our 2.25% Notes and 3.00% Notes were \$150.5 million and \$79.9 million, respectively, at September 30, 2012.

*Interest Rates.* We have interest rate risk in our variable-rate debt obligations. Our policy is to monitor the effects of market changes in interest rates and manage our interest rate exposure through the use of a combination of fixed and floating-rate debt and interest rate swaps.

As of September 30, 2012, we had \$908.4 million of variable-rate floorplan borrowings outstanding, \$57.4 million of variable-rate Mortgage Facility borrowings outstanding, and \$78.4 million of other variable-rate real estate related borrowings outstanding. Based on the aggregate amount of variable-rate borrowing outstanding as of September 30, 2012, and before the impact of our interest rate swaps described below, a 100 basis-point change in interest rates would have resulted in an approximate \$10.5 million change to our annual interest expense. After consideration of the interest rate swaps described below, a 100 basis-point change would have yielded a net annual change of \$6.2 million in annual interest expense based on the variable borrowings outstanding as of September 30, 2012. This interest rate sensitivity increased from 2011 primarily as a result of the increase in variable rate borrowings.

Our exposure to changes in interest rates with respect to our variable-rate floorplan borrowings is partially mitigated by manufacturers' interest assistance, which in some cases is influenced by changes in market based variable interest rates. We reflect interest assistance as a reduction of new vehicle inventory cost until the associated vehicle is sold. During the nine months ended September 30, 2012, we recognized \$25.3 million of interest assistance as a reduction of new vehicle cost of sales. For the past three years, the reduction to our new vehicle cost of sales has ranged from 62.6% of our floorplan interest expense for the fourth quarter of 2009 to 115.9% for the third quarter of 2012. Although we can provide no assurance as to the amount of future interest assistance, it is our expectation, based on historical data that an increase in prevailing interest rates would result in increased assistance from certain manufacturers.

We use interest rate swaps to adjust our exposure to interest rate movements when appropriate, based upon market conditions. As of September 30, 2012, we held interest rate swaps with aggregate notional amounts of \$425.0 million that fixed our underlying one-month LIBOR at a weighted average rate of 2.8%. These hedge instruments are designed to convert floating rate vehicle floorplan payables under our Revolving Credit Facility and variable rate Mortgage Facility borrowings to fixed rate debt. We entered into these swaps with several financial institutions that have investment grade credit ratings, thereby minimizing the risk of credit loss. We reflect the current fair value of all derivatives on our Consolidated Balance Sheets. The fair value of interest rate swaps is impacted by the forward one-month LIBOR curve and the length of time to maturity of the swap contracts. The related gains or losses on these transactions are deferred in stockholders' equity as a component of accumulated other comprehensive loss. As of September 30, 2012, net unrealized losses, net of income taxes, totaled \$28.2 million. These deferred gains and losses are recognized in income in the period in which the related items being hedged are recognized in expense. However, to the extent that the change in value of a derivative contract does not perfectly offset the change in the value of the items being hedged, that ineffective portion is immediately recognized in the results of operations. All of our interest rate hedges are designated as cash flow hedges. As of September 30, 2012, all of our derivative contracts were determined to be effective. As of September 30, 2012, a 100 basis-point change in the interest rates of our swaps would have resulted in a \$4.3 million change to our annual interest expense. In addition to

## Edgar Filing: GROUP 1 AUTOMOTIVE INC - Form 10-Q

the \$425.0 million of swaps in effect as of September 30, 2012, we also held interest rate swaps with forward starting dates between December 2012 and December

**Table of Contents**

2016. These 12 additional swaps, one of which was executed subsequent to September 30, 2012, expire between December 2017 and December 2019. As of September 30, 2012, the aggregate notional value of these forward-starting swaps was \$600.0 million and the weighted average interest rate was 2.7%. The combination of these swaps is structured such that the notional value in effect at any given time through December 2019 does not exceed \$600.0 million.

A summary of our interest rate swaps, including those in effect, as well as forward-starting, follows (dollars in millions):

	2012										
	1Q12	2Q12	3Q12	4Q12	2013	2014	2015	2016	2017	2018	2019
Notional amount in effect at the end of period	\$ 300	\$ 275	\$ 425	\$ 450	\$ 450	\$ 550	\$ 550	\$ 600	\$ 350	\$ 200	\$
Weighted average interest rate during the period	4.26%	4.37%	3.58%	2.73%	2.63%	2.63%	2.56%	2.76%	2.69%	2.77%	2.52%

*Foreign Currency Exchange Rates.* As of September 30, 2012, we had dealership operations in the U.K. The functional currency of our U.K. subsidiaries is the Pound Sterling. We intend to remain permanently invested in these foreign operations and, as such, do not hedge against foreign currency fluctuations that may impact our investment in our U.K. subsidiaries. If we change our intent with respect to such international investment, we would expect to implement strategies designed to manage those risks in an effort to mitigate the effect of foreign currency fluctuations on our earnings and cash flows. A 10% change in average exchange rates for the Pound Sterling versus the U.S. dollar would have resulted in a \$34.5 million change to our revenues for the nine months ended September 30, 2012.

For additional information about our market sensitive financial instruments please see Part II, Item 7. Management's Discussion & Analysis of Financial Condition and Results of Operations, Item 7A. Quantitative and Qualitative Disclosures About Market Risk and Note 4 to Item 8. Financial Statements and Supplementary Data in our 2011 Form 10-K.

**Item 4. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the Exchange Act), we have evaluated, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2012 at the reasonable assurance level.

**Changes in Internal Control over Financial Reporting**

During the nine months ended September 30, 2012, there was no change in our system of internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. *Legal Proceedings***

We are not party to any legal proceedings, including class action lawsuits that, individually or in the aggregate, are reasonably expected to have a material adverse effect on our results of operations, financial condition or cash flows. For a discussion of our legal proceedings, see Part I, Item 1. Financial Information, Notes to Consolidated Financial Statements, Note 11, Commitments and Contingencies and Part II, Item 1. Legal Proceedings of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012.

**Item 1A. *Risk Factors***

There has been no material changes in our risk factors as previously disclosed in Item 1A. Risk Factors of our 2011 Form 10-K. Readers should carefully consider the factors discussed in Part 1, Item 1A. Risk Factors in our 2011 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in our 2011 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

**Item 6. *Exhibits***

Those exhibits to be filed by Item 601 of Regulation S-K are listed in the Exhibit Index immediately preceding the exhibits filed herewith and such listing is incorporated herein by reference.

**Table of Contents**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Group 1 Automotive, Inc.

By: /s/ John C. Rickel

John C. Rickel  
Senior Vice President and Chief Financial Officer  
*(Duly Authorized Officer and Principal Financial  
and Accounting Officer)*

Date: October 26, 2012

**Table of Contents****EXHIBIT INDEX****Exhibit**

<b>Number</b>	<b>Description</b>
3.1	Restated Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 of Group 1 Automotive, Inc.'s Registration Statement on Form S-1 (Registration No. 333-29893) filed June 24, 1997)
3.2	Amended and Restated Bylaws of Group 1 Automotive, Inc. (Incorporated by reference to Exhibit 3.1 of Group 1 Automotive, Inc.'s Current Report on Form 8-K (File No. 001-13461) filed November 13, 2007)
10.1**	First Amendment to Eighth Amended and Restated Revolving Credit Agreement dated effective October 25, 2012, among Group 1 Automotive, Inc., the Subsidiary Borrowers listed therein, the Lenders listed therein, J.P. Morgan Chase Bank, N.A., as Administrative Agent, Comerica Bank, as Floorplan Agent, Bank of America, N.A., as Syndication Agent, and U.S. Bank, N.A. and Wells Fargo Bank, N.A., as Co-Documentation Agents
31.1**	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2**	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

\*\* Filed or furnished herewith  
Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under those sections.