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GPI - Q4 2013 Group 1 Automotive Earnings Conference Call

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OVERVIEW:

GPI reported 4Q13 consolidated total revenues of $2.28b and adjusted net income of $28.9m or $1.08 per diluted common share.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Group 1 Automotive's 2013 fourth-quarter and full-year financial results conference call. Please be advised that this call is being recorded.

I would now like to turn the call over to Mr. Pete DeLongchamps, Group 1's Vice President of Financial Services and Manufacturer Relations. Please go ahead, Mr, DeLongchamps.

Pete DeLongchamps - *Group 1 Automotive Inc - VP, Financial Services and Manufacturer Relations*

Thank you, Denise, and good morning, everyone, and welcome to today's call. The earnings release we issued this morning and a related slide presentation that include reconciliations related to the adjusted results we will refer to on this call for comparison purposes, have been posted to Group 1's website.

Before we begin, I'd like to make some brief remarks about forward-looking statements, and the use of non- GAAP financial measures. Except for historical information mentioned during the conference call, statements made by management of Group 1 are forward-looking statements that are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements involve both known and unknown risks and uncertainties, which may cause the Company's actual results in future periods to differ materially from forecasted results. Those risks include, but are not limited to, risks associated with pricing, volume, and the conditions of markets. Those and other risks are described in the Company's filings with the Securities and Exchange Commission over the past 12 months. Copies of these filings are available from both the SEC and the Company.

In addition, certain non-GAAP financial measures, as defined under SEC rules, may be discussed on this call. As required by applicable SEC rules, the Company provides reconciliations of any such non-GAAP financial measures to the most directly comparable GAAP measures on its website.

Participating with me today: Earl Hesterberg, our President and Chief Executive Officer; John Rickel, our Senior Vice President and Chief Financial Officer; and Lance Parker, our Vice President and Corporate Controller.

Please note that all comparisons in prepared remarks are to the same period, unless otherwise stated.

I will now hand the call over to Earl.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Think you, Pete, and good morning, everyone. For the full year of 2013, Group 1 retailed 155,900 new vehicles and 98,800 used retail units, driving a 19.3% increase in revenue to a record $8.9 billion. Strong same-store growth of 7.4% in parts and service, and 14% in finance and insurance, were important contributors as well. Adjusted earnings per diluted share were a record $4.96 on a 20.8% increase in adjusted net income to $130.7 million.

Turning now to our fourth-quarter results, Group 1 reported a 20.4% increase in adjusted net income to $28.9 million, or $1.08 per diluted share, on a 17.6% revenue increase to $2.3 billion. Group 1's new vehicle unit sales mix was 79. 2% US, 13.2% Brazil, and 7.6% UK. New vehicle revenues grew 16.9%, as we retailed 17.4% more units. New vehicle gross profit increased 14.6%, as gross profit per unit decreased $47 to $1,890.

On a consolidated basis in the fourth quarter, Group 1's import brands contributed 52%, domestic brands accounted for 19%, and luxury brands contributed 28% of new vehicle unit sales. Toyota/Lexus sales accounted for 25.4% of our new vehicle unit sales, with Honda/Acura, Ford, Hyundai and Kia increasing their share of Group 1's new vehicle unit sales during the quarter. New vehicle inventory expanded slightly to 72-day supply, or 35,300 units.

Total consolidated used vehicle retail unit sales increased 18.3% in the fourth quarter. This generated a retail gross profit increase of 7.8% on 18.9% higher revenues. The average used vehicle selling price increased $102 to $21,079. Used vehicle inventory stood at 14,300 units, or a 35-day supply.

Total consolidated parts and service revenue increased 15.9%, while consolidated parts and service gross profit rose 17.1%. Same-store parts and service gross profit grew 9.9% on a 7.5% higher revenues.

Total consolidated finance and insurance gross profit increased 16.4%. Same-store F&I increased $96 to $1,388 per retail unit, as our focus on process and value-add products for our customers continued to deliver improved penetration rates across our product line-up.

Relative to cost performance, on a consolidated basis, adjusted selling, general and administrative expenses as a percent of gross profit improved 40 basis points to 76.3%. While we are pleased with the improved cost leverage, we will continue to monitor and adjust our cost structure, as we have in recent quarters, to address the ongoing pressure on new vehicle margins.

I will now turn the call over to our CFO, John Rickel, to go over our fourth-quarter financial results in more detail. John?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Thank you, Earl, and good morning, everyone. Our adjusted net income for the fourth quarter of 2013 rose $4.9 million over our comparable 2012 results to $28.9 million, and our adjusted earnings per diluted common share increased $0.09 from the comparable prior-year results to $1.08.

These 2013 results exclude a $3.6-million valuation allowance for certain deferred tax assets, $3.3 million of net after-tax non-cash asset impairment charges, and a $237,000 of net after-tax severance costs associated with restructuring activities. The differential between the 20.4% increase in adjusted net income, and the 9.1% improvement in adjusted earnings per diluted common share, reflects a 2.4-million share increase in weighted-average diluted common shares outstanding to $25.8 million.

This increase in share count is primarily the result of the dilution from our 3% and 2.25% convertible notes, which changes in correlation with Group 1's average stock price, as well as the issuance of shares as part of the acquisition of UAB Motors earlier in 2013. It should be noted that the accounting dilution calculation does not include the beneficial impact of the call spreads the Company has in place.

For the fourth quarter of 2013, the call spreads would offset 1.8 million shares of the calculated dilution. For your reference, we include tables in both our investor presentation, and our quarterly SEC filings, that provide both the accounting and economic share dilution fees notes at various stock prices.

Starting with a summary of our consolidated results, for the quarter we generated $2.28 billion in total revenues. This was an improvement of $340.5 million, or 17.6%, over the same period a year ago, and reflects increases in each of our business units. Our gross profit increased $41.1 million, or 14.7% from the fourth quarter a year ago, to $321.3 million.

On an adjusted basis for the quarter, SG&A as a percent of gross profit improved 40 basis points to 76.3%, and operating margin was 2.9%. Floor plan interest expense increased $2.4 million, or 28.3%, from the prior year to $10.7 million. This increase is primarily explained by our Brazil acquisition earlier this year, which added $1.5 million of floor plan interest expense over the comparable prior-year period, as well as higher inventory levels to support rising sales and dealership acquisitions in the US.

At December 31, 2013, our new vehicle inventory stood at 35,300 units, with a value of $1.2 billion, compared to 26,600 units with a value of $906 million as of December 31, 2012. Additionally, our new vehicle inventory days supply increased to 72 days as of December 31, 2013, compared to 63 days as of December 31, 2012.

Other interest expense increased $572,000, or 5.9%, to $10.2 million. This increase is attributable to an increase in weighted average debt outstanding of $61.8 million, primarily explained by additional real estate-related financing, including mortgage borrowings associated with recent dealership acquisitions. Our consolidated interest expense for the fourth quarter of 2013 includes incremental, non-cash, discount amortization of $2.8 million related to our convertible notes.

Now, turning to the fourth-quarter same-store results, which include stores from the US and UK owned during the same period. In the fourth quarter, we reported revenues of $1.93 billion, which was a $79.7-million, or 4.3%, increase from the comparable 2012 period. Within this total, new vehicle revenue was up 1.5%, and used vehicle retail revenues improved 8%.

Both finance and insurance, and parts and service, delivered another strong quarter, growing revenues 10% and 7.5%, respectively. New vehicle revenue increased to $1.12 billion on slightly higher unit sales, an increase in our average new vehicle sales price of $370 to $35,605 per unit. Our used retail revenues improved to $440.3 million on 5.6% more units, and an increase in our average used vehicle retail sales price of $474 to $21,625.

F&I revenue for retail unit rose 7.4% to $1,388, driven by increases in both penetration rates and income per contract for most of our major product offerings. The 7.5% revenue growth in parts and service is explained by increases of 5.7% in customer pay, 13.7% in warranty, 10.8% in collision, and 4.1% in wholesale parts. As a reminder, all parts and service revenues are not impacted by increases in internal business. The revenue associated with internal work is eliminated in our consolidation. This varies across the sector, as some of our competitors account for internal work differently.

In aggregate, our same-store gross profit grew $12.6 million, or 4.7%, to $280.7 million. Our same-store new vehicle gross profit dollars declined 3.8%, as slightly higher volumes were more than offset by an $84 decline in gross profit per unit to $1,897. Our used vehicle retail gross profit dollars declined slightly, as increased volume was more than offset by a $102 decline in gross profit per unit to $1,544. Our F&I gross profit grew 10%, reflecting unit volume growth and the improved PRU that I mentioned previously. Finally, parts and service gross profit grew $10.7 million, or 9.9%, primarily reflecting the strong revenue growth and a 110-basis-point improvement in margins to 53%.

For the fourth quarter, we grew our total gross profit by $12.6 million, while adjusted SG&A expenses rose by $7.6 million. As a result, our adjusted SG&A as a percent of gross profit decreased 70 basis points to 74.9%. This equates to a 40% flow-through of gross profit. Our same-store adjusted operating margin improved by 10 basis points to 3.2%.

Turning now to geographic segments, starting with the US market on an actual basis. As a reminder, we re-balanced our US dealership portfolio over the last 12 months, and as a result, we [pared a net] of five franchises representing additional annualized revenues of approximately $171 million. As a result, our consolidated results are not fully reflective of underlying same-store performance in the US.

Total US revenues grew 3.6% to $1.86 billion, primarily driven by increases of 7.8% in used retail revenue, and 5.9% in parts and service revenue. The increase in used vehicle retail revenues reflects 6% growth in retail units sold, coupled with a $339 increase in our average retail sales price per unit. The increase in our parts and service revenues reflects growth in all areas of the Business. Our F&I revenue growth of 11% reflects the increase in retail vehicle sales volume, coupled with improved profitability per retail unit, which grew $117, or 9%, to $1,418. New vehicle revenues grew $9.7 million, or 9/10% over the prior year, as a slight decline in retail volumes was more than offset by a 1.5% improvement in average retail sales prices.

It should be noted that our year-over-year comparisons include the period from last year following Hurricane Sandy, when our concentration of dealerships in the Northeast benefited from strong new and used vehicle replacement demand, making for tough comps this quarter for both our new and used vehicle sales.

Total gross profit improved 4%, driven by a 6.8% increase in parts and service, as will as the F&I increase that I just mentioned. For the fourth quarter, we grew gross profit by $10.5 million, while adjusted SG&A expenses rose $3.4 million. As a result, our adjusted SG&A as a percent of gross profit decreased 170 basis points to 74.4%. Adjusted operating margin for the US business segment improved 20 basis points to 3.3%.

Related to our UK segment, our UK operations delivered another strong quarter of growth, with total revenues up 38%, driven by the acquisition of four Ford dealerships in the first quarter of the year, as well as impressive same-store growth of 14.1%, reflecting positive contributions from each of our retail business segments. New vehicle revenues grew 28% on 37.5% more retail unit sales, which more than offset a mix-driven decline of 6.9% in the new vehicle average retail sales price. Used vehicle retail revenues improved 63% on 94.3% more retail units, which more than offset a 16.1% decrease in the average used vehicle retail sales price, also explained by an increase mix of volume brand unit sales linked with the Ford dealership acquisitions.

Parts and service revenues improved 28.7%, primarily attributable to a 41.2% increase in our customer-paid parts and service business. Our F&I income growth of 29% reflects the 57.9% increase in total retail unit sales, partially offset by a $147 decline in income per retail unit sold to $657, which also primarily reflects the effect of a change in brand mix.

Total gross profit grew 37.5%, primary attributable to the 52.4% increase in parts and service gross profit, coupled with a 95% increase in used vehicle gross profit. During the fourth quarter, we leveraged our costs, and SG&A as a percent of gross profit improved 250 basis points to 82.7% over the fourth quarter of last year on an adjusted basis. Adjusted operating margin for the UK business segment improved 40 basis points to 1.8%.

Related to our Brazil segment, for the fourth quarter we retailed 5,131 new units, compared to 5,139 in the third quarter. We also retailed 1,420 used units in the fourth quarter, versus 1,343 in the third quarter. In aggregate for the fourth quarter, we generated $220.6 million in total revenues, and $23.8 million in gross profit, compared to $215.9 million and $23.7 million, respectively, in the previous quarter.

Our SG&A as a percent of gross profit was 90.6% in the fourth quarter compared to 85.6% last quarter, while our operating margin for the fourth quarter was 8/10% versus 1.4% in the third quarter on a comparable basis. Overall, we remained profitable during the quarter, but we did not generate enough income this quarter to cover dilution.

Turning to our consolidated liquidity and capital structure. As of December 31, 2013, we had $20.2 million of cash on hand, and another $56.2 million that was invested in our floor plan offset account, bringing immediately available funds to a total of $76.4 million. In addition, we had $228 million available on our acquisition line that could also be used for general corporate purposes. As such, our total liquidity at December 31, 2013, was $300.4 million. Year to date for 2013, we generated $205 million of operating cash flow on an adjusted basis.

With regards to our real estate investment portfolio, we own $618.4 million of land and buildings at December 31, which represents more than one-third of our total real estate. To finance these holdings, we have utilized our mortgage facility, and executed borrowings under other real estate-specific debt agreements. As of December 31, we had $67.7 million outstanding under our mortgage facility, and $268.2 million of other real estate debt, excluding capital leases.

During the fourth quarter, we used $4.1 million to pay dividends of $0.17 per share, an increase of $0.02 per share over the fourth quarter of last year. We also repurchased 55,655 shares of our outstanding stock at an average price of $63.82, for a total of $3.6 million. As of December 31, we had $71.4 million of share repurchase authorization remaining. For additional detail regarding our financial condition, please refer to the schedules of additional information attached to the news release, as well as the investor presentation posted on our website.

With that, I'll now turn it back over to Earl.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thanks, John. I want to update you on our corporate development efforts. For the full year, we acquired a total of 38 franchises that are expected to generated $1.3 billion in annual revenues, and disposed of 7 franchises that generated $318.9 million in annual revenues. We began 2014 with the acquisition of two franchises in southern California in January, with annualized revenues of $135 million.

We completed several multi-year projects in the US that have allowed us to consolidate our transactional accounting and commonize key operational computer systems across our US dealerships. These projects provide a strong foundation to support further expansion of our Business.

Before I turn the call over to the operator for your questions, let me update you on our market outlook for 2014. As we stated last quarter, the US market continues to be highly competitive. The overall condition for car buyers remains positive, with low interest rates, improving employment levels, and attractive products. Coupling that with an aging carpark that is supporting demand, we anticipate new vehicle industry sales will increase approximately 5% from 2013 levels, to about 16.3 million units.

With robust inventory levels and a competitive selling environment, we do not anticipate any significant improvement in our new vehicle margins. Used vehicle conditions are likely to become more favorable as increasing numbers of vehicles coming off lease improve our supply of late-model, lower-mileage used cars. The continued improvement in new vehicle industry sales over the past four years is expanding the size of the zero- to six-year-old carpark, which, when coupled with our initiatives in this area, should continue to support mid-single-digit growth in our parts and service business.

We also remain optimistic about the finance and insurance business. We have endorsed the process improvements recommended by NADA in response to concerns raised by the CFPB, and intend to begin implementing these changes across our US operations in the next several months. As such, we are comfortable assuming our 2013 results in F&I are sustainable going forward.

The UK outperformed the rest of Europe in 2013, with the overall UK market rising 10.8%. Conditions look favorable for continued expansion in 2014, and we believe with our brand mix and geographical locations, we are well positioned to take advantage of this growth.

For 2013, industry sales totaled 3.6 million units in Brazil, making it the fourth-largest vehicle market in the world. The Brazilian economy continues to face many challenges. Slowing growth and rising interest rates are having a negative impact on new vehicle sales, and as a result, we expect industry sales to be flat at best for 2014. We reiterate a bullish perspective on the long-term outlook for the country in auto sales, but we'll focus our near-term efforts on reducing costs and improving operational efficiency.

This concludes our prepared remarks. I'll now turn the call over to the operator to begin the question-and-answer session. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you, Sir. Ladies and gentlemen, we will now begin the question and answer session.

(Operator instructions)

At this time, we will pause momentarily to assemble our roster.

Our first question will come from John Murphy, Bank of America, Merrill Lynch.

John Murphy - *BofA Merrill Lynch - Analyst*

Good morning, guys.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Good morning, John.

John Murphy - *BofA Merrill Lynch - Analyst*

A first question on the growth in parts and service, It looks like you guys were about 7.5% in the fourth quarter, that's what you were talking about. It seems like there's a bit of an acceleration your kind are talking about mid-single digit numbers for 2014. But as you also alluded to, you've seen this growth in the zero-to-six year old car population.

Is there something that happened in the fourth quarter that boost that number up to that 7.5%, as far as recalls, that might result in sort of a more normalization to that mid single-digit number you were talking about for 2014?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Yes, John, this is Earl.

There has been some pretty strong recall activity across a variety of brands, and you can see that warranty growth is pretty robust. I think it's fairly robust across the industry. And we can't count on that to be there every quarter. I think that's the point you're making. Our collision business remained very strong. And customer pay is strong, but I think the real tailwind we've had recently has a lot to do with recalls and warranty work.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay, that's helpful. And then a second question as we think about the flow-through of gross profit to the operating line in the US part of the business, is 40% a reasonable number to think about for 2014? Or are there any investments or initiatives that might offset that for now and create an acceleration in 2015?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

John, this is John Rickel.

I think that 40% range, 40% to 50%, assuming that margins stabilize, I think we're continued to be comfortable with that. There's not any new initiatives that I can think of in 2014 that would change that much.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay. And then just on acquisitions, obviously you guys have been reasonably active overseas, but have now executed a few more recently here in the US. Where do you see the best opportunities regionally? Do you need to build more scale in Brazil, and would that lead you to sort of focus a little bit more on that market than the US market? Or do you see the opportunities in the US market heating up?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

I think the opportunities are more in the US at the moment, John. We are looking --we will look to expand in the UK because more scale would benefit us there. We don't have anything planned, and we've been very deliberate how we've built that business over five years or so.

And we will also be very careful about expanding in Brazil until we get the core platform where we want it and efficient. But yes, we're going to look at opportunities in Brazil. I think some of them will be open points. But more scale will benefit all of these operations. But will be very careful in both Brazil and the UK.

John Murphy - *BofA Merrill Lynch - Analyst*

But the more obvious opportunities, or better opportunities, right now, in the short-term, seem like they are popping up in the US. Is that a fair characterization?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

That's accurate, yes.

John Murphy - *BofA Merrill Lynch - Analyst*

Then just lastly, you guys have a relatively unique exposure in Northeast for some of the public groups. I'm just wondering if you could talk about the impact of weather, and it's not just the Northeast, it's a big part of the country. Being a Northeasterner I'm focused on that myself today.

But what kind of impact do you think the weather really had on your January sales? And are there any markets where you didn't see a significant weather impact that you think might represent what, sort of the more normal underlying run-rate of increases might have been in January?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Well, California was pretty good. Outside of California, it was very odd, that we even lost a couple days in Houston, which there wasn't ever any real bad weather, but a little ice one day and the entire city shut down. So I think the entire industry probably felt it from Texas, Oklahoma, Kansas, where we do business, all the way to Boston and New Hampshire, and across --you saw what happened in Atlanta and so forth. It was a very odd weather pattern this year.

But in the first quarter every year, we lose days to weather. So until the quarter is over, I don't know what to say. I think we actually were closed down again in Boston yesterday. So there's just no way to do business, when, as you can see on these weather reports. It's been compressed because I think we've had maybe three widespread closing episodes over the last three weeks in many of our key markets.

So it's certainly been concentrated in January, and the first few days of February this year. But we have some lost days in the first quarter every year. So it's kind of hard for me to keep track of those, but certainly I think January, everybody agrees that business days were lost.

John Murphy - *BofA Merrill Lynch - Analyst*

Earl, the comments are some of the companies were that the California sales were up about 10% or low teens, is that something that you would generally agree with for January?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well, I haven't looked at our January data. I know the fourth quarter in California was very strong for us. We only have, --we now have nine dealerships there, we had seven in the fourth quarter. California market is good right now, whether it's the fourth quarter, and I expect early this year too. The California market is one market is one of the stronger markets in the US right now from my viewpoint.

John Murphy - *BofA Merrill Lynch - Analyst*

Great, thank you very much.

Operator

Ravi Shanker, Morgan Stanley.

Unidentified Participant - - *Analyst*

Good morning, this is EJ in for Ravi.

I wanted to talk about the new segment first. It looks like your US new vehicle volumes were down slightly versus an overall industry that was up about 6%. Was that mostly because of divestitures, or was there anything else that we should think about?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Divestitures was one factor, but another big factor was a year ago, we had the tailwind from Hurricane Sandy. We have a substantial operation in New Jersey, Long Island, New York, and some areas to the north and south of that, that got a big lift in the fourth quarter last year on new and used vehicles.

So in our Western region, we -- our growth, new vehicle growth approximated the industry growth, and it was our East region where we fell down on a year-over-year basis.

Unidentified Participant - - *Analyst*

Alright, that makes sense. Some of your peers have been talking about some of the challenges that they're seeing, particularly within the mid-sized segment, and so the resulting challenges to the Japanese brands. Could you talk a bit about your view on that and how that's impacted your business?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well, the biggest issue we've had has been margin pressure on new vehicles, and I think a lot of that is in the compact car, mid-sized car segments, and for us in particular with a large import brand mix. And our margin pressure in the quarter remained in the Japanese import and domestic brands, and in particular in the car segment.

So, we see that also.

Unidentified Participant - - *Analyst*

Okay, and then maybe as kind of a follow-on onto that, there's been quite a bit of talk as well on inventory levels within the industry being relatively high. Could you comment on how you're thinking about that, and if that's impacting pricing at all, the incentive environment?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well, we have experienced what you've read in the press. In particular, I think the reports I've seen related to the traditional, I don't know if they call them Detroit three anymore, but Ford, General Motors, and Chrysler/Fiat. We have over a 100-day supply in those three brands. And there is no way you can have dealerships with that much inventory without it impacting margins. So we are experiencing the same thing.

Unidentified Participant - - *Analyst*

Got it. One final one if I can sneak in, if we could talk about the retail used business for a second. Margins were a little bit softer than what we would have thought, just given where you guys were last year and in the previous quarter. I just wanted to get a sense of how we should think about margins in that business going forward.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

I believe our margins were below average on used cars in the fourth quarter. Again, some of that was driven by our East Coast, we had too many used cars. We also had a wholesale loss for the quarter, which is unusual for us.

Again, one factor was, we sold a lot of used cars in the fourth quarter of last year, replacing demand from Hurricane Sandy. And I think we thought we were going to sell that many this year, and our inventories were too high going into the quarter, and we had to liquidate them through cutting margin at retail and through wholesaling some units at a loss.

Again, we had a big difference between our East region business and our West region. So I would expect for us to have higher margins than what we demonstrated in Q4 on used cars.

Unidentified Participant - - *Analyst*

Okay, that's helpful. Thank you very much.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Thank you.

Operator

Patrick Archambault, Goldman Sachs.

Patrick Archambault - *Goldman Sachs - Analyst*

Thank you very much. Can you hear me okay?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Yes.

Patrick Archambault - *Goldman Sachs - Analyst*

Maybe just building off that last question, because I think if I'm correct, your used-to-new ratio, ticked up a decent amount year-on-year, is that, was that partially because you are trying to sort of run an inventory clearance, trading a little bit of volume for growth? Or was there something sort of underlying that, that was more fundamental?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well I don't think I can answer that question well, Patrick. We don't look at that metric. It could have also been some of the dispositions we've made in California, where we generally don't have enough land to operate big used car operations because we've sold some dealerships in California.

There is nothing intentional, we look at the business as trying to grow our used car business every quarter faster than the industry. And then the new-to-used ratio is a fall-out on that. So I don't know if anybody else here at the table has a comment on that.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

No, I think you hit it, Earl. I think there was a piece of it clearly, the stores we sold would have been lower used car operations. We continue to focus on it. As you say, we don't really look at the new-to-used metric. But the operating team's been very focused on continuing to do more with used cars, and I think we're getting some traction there.

Patrick Archambault - *Goldman Sachs - Analyst*

Okay, thank you. And then switching to the new side, your new margins came in certainly better than--a little bit better than what we had expected. Can you just give us a little bit of the environment? I mean, I understand that there's some potential pressure from the big three as per your answer one of the previous questions, but are you able to--have margins on some of the mid-line import stuff started to stabilize? Have you able to push back a bit on stair-steps, and where do you expect, the trajectory of new margins from here, if you will?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

I think generally we expect margins to be similar to where they've been in recent quarters. In the fourth quarter, you generally get a little bit of help from the luxury brand business. December's always a big luxury car sales month. Our luxury margins were up significantly for the quarter.

BMW and Mercedes in particular had programs where there were certain types of bonus money that goes into margin. And so if you have a good mix of BMW, Mercedes, and some other luxury brands, that's a help of 28%. So we had a tailwind on 28% of our business, but the rest of the business is still highly competitive. And that's whether it's trucks or cars.

Patrick Archambault - *Goldman Sachs - Analyst*

Got it, okay that's helpful. And my last one is, UK kind of defied gravity last year. This is more of a macro question, but how sustainable is that performance? One just looks at it, and you know, it's just far outperformed any other region within Europe. Is there any signs that may be slowing, or is that an area where you continue to expand based on comps?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Like you, I have been somewhat amazed in recent years at how the UK, economy has defied some of the economic factors, and they have been working hard to address some of their budget issues. And they cut government spending and their economy is still, at least on the auto side, really has thrived. And all the indications we get from economists in the UK and our team on the ground, is they expect the momentum to carry through this year. So I can't explain it economically, but the trend still seems to be valid.

Patrick Archambault - *Goldman Sachs - Analyst*

Okay, great, terrific, thanks a lot, guys.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thank you.

Operator

Rick Nelson, Stephens.

Rick Nelson - *Stephens Inc. - Analyst*

Thanks, good morning.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Good morning, Rick.

Rick Nelson - *Stephens Inc. - Analyst*

The 14% add back for the valuation allowance, if you could provide some color on that, and where it shows up in the income statement?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Basically, that valuation allowance, Rick, is around some deferred tax assets, so basically showing up in the tax line.

Rick Nelson - *Stephens Inc. - Analyst*

Got it, okay. Also, looks like you did a great job narrowing SG&A in both the US and the UK markets. Brazil went the other direction. Curious, how long you think it's going to take to right-size the expense structure there? I realize politically, culturally, it's more difficult to effect change over there.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Rick, this is Earl. One of the biggest challenges we have to get our business sorted out in Brazil is actually IT. There's no one DMS provider in Brazil. In fact, we have multiple DMS providers and one OEM just mandated their own. And so, it took us two or three years in the US to get a common chart of accounts and one DMS. And so forth, so our big task right now is to get realtime operating data to our individual operators. That's going to be our primary task this year.

But we think we can do a lot this year to get it sorted out and get the business leaned out so that when the market recovers, we will be able to take advantage of it. But a lot of that is really things we take for granted in the US, which relates to technology and information flow.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Rick, this is John Rickel. I would add to that, that if you actually look at the underlying costs, the team in Brazil is making progress. The quarter-to-quarter deterioration in the fourth quarter was actually because of some decisions we've made around the items that Earl is talking about: Investing in budgeting system.

One of the fun things is the US Corporation, is we get to make we have SoCs, capable financial statements down there. So a lot of spending on internal control. So a lot of what is going on right now is one-time investment stuff. The actual --if you look at personnel costs, are actually trending down nicely down there.

Rick Nelson - *Stephens Inc. - Analyst*

Okay, thank you for that. Also, F&I per unit, we saw growth in both the US and Brazil, the UK market, we saw that backtrack. I'm curious about that.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Rick, this is John Rickel again. The issue with the UK is basically mix driven. We bought four Ford dealerships over their early in 2013, and you just don't make as much per unit on a Ford as what you do on a BMW or an Audi. So it's basically mix driven.

Rick Nelson - *Stephens Inc. - Analyst*

Got you, and that's what caused the lower gross per unit over there?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Exactly.

Rick Nelson - *Stephens Inc. - Analyst*

Thanks very much and good luck.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thanks.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Thank you.

Operator

Scott Stember, Sidoti & Company.

Scott Stember - *Sidoti & Company - Analyst*

Good morning.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Good morning.

Scott Stember - *Sidoti & Company - Analyst*

Could we maybe touch base a little bit more on the pricing on midline imports? Obviously, it's been an issue for gross margin over the last few quarters. It seems at least, for you guys that it's stabilized, could you maybe confirm that?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Scott, it's Earl. Yes, I think it stabilized because it can't get much lower. Because we have to pay our salespeople, we advertise a certain amount and so forth. So there is still a lot of pressure to move metal in a lot of these volume brands, and we are still moving it. Of course the strong F&I performance plays into that.

Scott Stember - *Sidoti & Company - Analyst*

Got you. And just going over to the flow-through that you mentioned, about 40% in the US in the quarter, that was will ahead of what you did in the third quarter, I think it was 25%. Can you talk about some of the moves that took place and how you got to that in such a short period of time?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Yes, Scott, it's John Rickel, we'd indicated on the call that we were focused on cost, and it's just basic blocking and tackling. The fact that margin stabilized helped, because it is a function also of the margins you generate, so the combination of the margins holding up, and the attention to detail on the various cost items gives us a better flow-through result this quarter.

Scott Stember - *Sidoti & Company - Analyst*

Okay, and just talking about the impairment, what was the impairment related to?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

The impairment was basically, we do the annual test in the fourth quarter on franchise guides, and those you have to test store by store. And basically, when you do that, there's usually one or two stores that pop-up, so basically related to impairment of franchise, four stores franchise values.

Scott Stember - *Sidoti & Company - Analyst*

Okay, and just the last person on the parts and service, as far as same store sales growth in the US, would those numbers be similar to what the consolidated number was?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Yes, very close.

Scott Stember - *Sidoti & Company - Analyst*

Okay, that's all I had, thank you so much.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Thank you.

Operator

James Albertine, Stifel Nicolaus.

James Albertine - *Stifel Nicolaus - Analyst*

Great, thanks for taking the question and good morning, everyone.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Good morning, James.

James Albertine - *Stifel Nicolaus - Analyst*

First, on used, if I may, it sounded like if we go back to your view on the US new vehicle market for 5% growth to $16.3 million in 2014, at least what I heard, you sort of intimate that used is likely or could potentially outperform that growth. Could you maybe help to frame that? Is it 200 basis point or 300 basis point improvement, or could we even see double-digit growth in the used market given what you've seen in off-lease supply?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

I'm not sure about double-digit growth, but it's still a solid business. And I think there will be better supply of vehicles as we move through the year, because we are starting to get into an off-lease cycle, where more new vehicles for lease two and three years ago as OEMs got back into leasing after the downturn, economic downturn.

I think it will certainly be at least as strong as the new vehicle business this year. And I think there will be more lower mileage cars available in inventory across the market, which will give customers maybe a better selection of used cars this year than they've had in recent years.

James Albertine - *Stifel Nicolaus - Analyst*

Thanks, and maybe as it relates to that, could you just remind us if the Sandy impact bled into the first quarter, as well, last year? Or is that predominantly a fourth-quarter impact for your Eastern stores?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

I can't really remember.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Yes, it was primarily fourth quarter. We made maybe a little bit into January, but it was primarily fourth quarter.

James Albertine - *Stifel Nicolaus - Analyst*

Okay, that's helpful.

And my last question here just getting back to Brazil for the moment, I think it's probably fair to say that the last nine months have been a little bit underwhelming versus perhaps what you had anticipated prior to the acquisition. It sounds like there's a lot of reinvestment going on down there.

I just wanted to get your view, longer-term, if things don't stabilize, if they don't turn in this year or even next year, how long can you continue to generate enough cash flow to reinvest it in the entity within Brazil before you have to think about injecting capital from abroad?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well, I guess it depends on whether or not we want to expand there. But I don't really have any significant concern about Brazil long term. In fact, I find it somewhat remarkable that with all of the turmoil in the past year, first it was the demonstrations, and then the interest rates rising again, the currency devaluation, the market really hasn't declined significantly.

And the underlying factor in Brazil is, they have a middle-class that is growing even during these times. And 30 million people came into that middle class in the last decade. And another 10 million are going to come in and be able to buy their first car here in the next three or four years. And so I think that market is going to be there regardless of these choppy economic factors, which you know, are true of emerging markets.

I think last week, you could see that when currency started to devalue, the emerging market currencies, Brazil devalued very quickly, but then immediately separated itself from Ukraine, and South Africa, and Turkey and some of these other economies. So, I think Brazil -- that the growth factors for automotive there a pretty undeniable and there are going to power through whatever we get from growth market pains, and elections, and so forth.

And our intention is to be the best automotive retailer, somebody's going to sell cars in Brazil, somebody's going to do that, to this growing middle-class. And generally, history tell us that the dominant retailers in significant sized markets make money. And so, I'm not particularly worried about it. I have a lot of challenges to deal with it.

But this business is about brands and people. And we got good brands and we got great people down there. So I think we will find our way through it and we will find a way to make this a good business. So I still feel very strongly. We didn't do this for a short-term hit, and it may end up taking a while to work through it because of the market and so forth, but we will do it.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

James, the other thing I would add is that even though it may not be quite as strong as what we have hoped, it's still profitable, right? Your question seems to imply that we are losing money. We are making money down there. So at this point, it's not a cash drain on the business. They are generating profits down there.

James Albertine - *Stifel Nicolaus - Analyst*

Understood, and I appreciate the clarification. Just to make sure I'm understanding, though, it's generating profit. Perhaps it's not as bad as I implied in my question, but you are certainly not thinking about it, and sound like you're thinking about taking advantage of that dislocation to acquire further stores, or to grow the portfolio at this point. Is that fair?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Well, I think we're going to have some opportunities to grow. We have some very good relationships with OEMs down there, and so I think it is quite possible we are going to grow down there this year. But it will be very, you know, very pragmatic, deliberate growth, because until we do have a strong business, we are not going to inject large amounts of money.

But we're there to stay, and we haven't even been there a year yet. So we will have to manage it carefully, but we will plan to grow in all three of the markets that we are in. But we are not going to be shipping many tens of millions of dollars down there real quickly.

James Albertine - *Stifel Nicolaus - Analyst*

Okay, well I appreciate the clarification again, and things for taking the question. Good luck in the first quarter.

Operator

Matt Nemer, Wells Fargo.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Good morning, everyone.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Good morning, Matt

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

I just wanted to drill down into the new vehicle grosses a little bit more. Do you think that the luxury, the kind of upward pressure we've seen in luxury grosses is sustainable over the next few quarters? Or is that primarily just kind of a Q4, one timer? And if it is sustainable, is it enough to offset the pressure that we have seen on the imports and, potentially, the domestics?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Matt, it's Earl. I think there was a little one-time either annual benefit or quarterly benefit that occurred for some of the major luxury brands in December. And that's pretty natural every year. So I think December may have been a little better than average on luxury brand grosses.

But the luxury brand business is still, you know, far superior in margins to the volume business per unit. No doubt about it. But I think there was a little plus on the upside in the fourth quarter.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Okay, secondly, can you just spend a minute and talk about the sub-prime business? I'm just curious what percentage of your new unit sales, or used unit sales are related to some kind of sub-prime financing, where that has been historically and whether you see any changes in financing availability in your markets.

Pete DeLongchamps - *Group 1 Automotive Inc - VP, Financial Services and Manufacturer Relations*

Matt, it's Pete DeLongchamps. The sub-prime business is approximately 20% of what we do, I think what's interesting, that's changed over time, is the lenders that have, if you look at Chase, they've gone to a Chase Custom. We have several more opportunities within the lending arena to get the sub-prime business. And it's readily available, and as you can see from our penetration numbers that we've maximized all those opportunities with the lenders.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Okay, and then lastly, I'm just curious if there were any significant process or IT related investments that your planning along the lines of a shared service center, consolidated back office in 2014, any major changes that we should be thinking about or investments?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Matt, this is John Rickel. We've got most of that done now. We were, --completed the -- our transactional accounting in 2013, so for the US that's complete. We've rolled out all of our common computer systems, that's one of the things we're proudest of for 2013, as we've got a really strong foundation. So, there's not anything specific that I can think of, other than we continue to look at, are there better ways, perhaps, of handling some of the lead generation and lead management. We will continue to look at that.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Great, that's all I've got. Good luck this year, guys.

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

Thank all -- thanks, Matt.

Operator

(Operator instructions)

Bill Armstrong, CL King and Associates.

Bill Armstrong - *CL King & Associates - Analyst*

Good morning. Most of mine have been answered, but just a follow-up on a previous one. So your gross profit per new vehicle in Q4 obviously was much better than in Q3 in the US, and you touched on that a little bit with the luxury brands being a little bit better than usual in December. Were there any other drivers that contributed that you can point out to -- that contributed to the strong performance?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

No, actually none that I can think of.

Bill Armstrong - *CL King & Associates - Analyst*

So it was just luxury brands then?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Yes, that's the only factor that I can tell from the data.

Bill Armstrong - *CL King & Associates - Analyst*

Okay, All right, Thank you.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thank you.

Operator

David Whiston, Morningstar.

David Whiston - *Morningstar - Analyst*

Good morning. I wanted to go back to a follow-up on that strategy question. You said that with the computer rollouts, centralization, all done, really, what's going to be your focus in 2014? Is it going to be much more Brazil or just what initiatives are you looking at?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well, the focus in the US for our management team really doesn't relate to Brazil. Obviously, I've spent a lot of time with Brazil and so has John. But in the US, now we have to use the technology we have given our people. We have found it takes more than a year to really get the most out of the technology, just installing it doesn't mean the people leverage it and use it.

We now have a one CRM system and one, what we call desk-in tool, which is how you figure payments and work deals at the dealership. So we have a lot more training to do and our people really have to embrace how they use these tools we gave them. So that will be the focus in the US this year.

David Whiston - *Morningstar - Analyst*

And in Brazil, you mentioned that there's not one DMS system. Does that mean it's just not possible to go to one vendor there?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Not at the moment. Obviously we are talking with companies from the US and other parts of the world to see if we can find someone who can do it. But at the moment, it doesn't appear to be possible. I think it will be someday, we're trying to accelerate that.

David Whiston - *Morningstar - Analyst*

Okay. And I agree with all of your long-term optimism on Brazil, but I'm just curious, as you've had to have discussions with your auditors on any impairment related to the opposition?

John Rickel - *Group 1 Automotive Inc - SVP/CFO*

No, this is John Rickel. No.

David Whiston - *Morningstar - Analyst*

Okay, last question, Ford has talked a lot about how the weak end, as it puts them and the Detroit three at a major disadvantage. And given your large Toyota exposure, I'm just curious what you're seeing on the pricing front from Toyota and also Honda.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well, I haven't seen anything different because of the end. It's highly competitive, I think for every band in the market whether you're Korean, Japanese, German, US-based, or whatever. It appears to be, particularly in the car segments, very competitive.

But I haven't seen any elevation in marketing spend, or decrease in vehicle pricing by Toyota and Honda that you would think it was attributable to the end. It does appear their profits have been supported quite a bit, it looks like a lot of that money is going to the bottom line based on what Toyota reported yesterday.

David Whiston - *Morningstar - Analyst*

Yes, absolutely. It's all currency. That's all I have, thank you.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thank you.

Operator

Jordan Hymowitz, Philadelphia Financial.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Hey, guys, two quick questions. One is can you break out the service and parts year-over-year without the benefit of the recalls?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

No, we can't because it's all in warranty. And quite frankly, some maintenance work is now in warranty also for these companies that offer two-year free maintenance, like Toyota or BMW, four-year free maintenance. Those claims get paid by the factory. And so recalls, free maintenance, and traditional warranty all go into that category and we don't have a breakdown beyond just the general warranty dollars.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay, and also, what was warranty up again year-over-year?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

On a year-over-year basis Jordan, warranty -- well I've got same store, which is primarily US, was up about 11%.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

And my second question is on the wholesale, you had a slight loss on the gross profit line. When you look going forward, are you still targeting being about breakeven for that line?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

That's correct. That's our budget, that's our goal, our target. We should be able to do that.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay, thank you.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thank you.

Operator

Brett Hoselton, KeyBanc.

Irina Hodakovsky - *KeyBanc Capital Markets - Analyst*

Good morning, guys, this is Irina Hodakovsky for Brett Hoselton, how are you?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Good Morning, Irina.

Irina Hodakovsky - *KeyBanc Capital Markets - Analyst*

Most of my questions have been answered, but I wanted to ask you on the acquisitions, you have been pretty aggressive on that front. What are your expectations going forward? Do you intend to slow down or remain at the same pace?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Well, I think our results last year were distorted by the large acquisition in Brazil. And as we mentioned, we've made one acquisition this year. So I clearly wouldn't expect to do a billion dollars plus like we did last year.

So we're going to continue to try to be disciplined about it. But we are looking to expand, certainly in the US, and if we can find opportunities that make sense, in the UK or Brazil. So I would expect our activity to be significantly less than last year, but I do expect that we'll grow the company further throughout this year with acquisitions.

Irina Hodakovsky - *KeyBanc Capital Markets - Analyst*

And can you comment a little bit on the environment that you are seeing the M&A market? Is it improving? What is the inventory like for the stores for sale? Good inventory, motivated sellers, multiples?

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

It's been the same for the last year to 18 months. There have been a significant number of sellers in the market. It's hard to tell how motivated they are until you actually talk to them about the final price. But, I think there is still a significant number of opportunities in the market for everyone.

Irina Hodakovsky - *KeyBanc Capital Markets - Analyst*

Thank you very much.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thank you.

Operator

Ladies and gentlemen, at this time this will conclude the question-and-answer session. I would like to turn the conference back over to Earl Hesterberg for his closing remarks.

Earl Hesterberg - *Group 1 Automotive Inc - President, CEO*

Thank you for joining us today. We look forward to updating you on our first-quarter earnings call in April. Thanks.

Operator

Ladies and gentlemen, the conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines.
