

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

GPI - Q2 2014 Group 1 Automotive Earnings Conference Call

EVENT DATE/TIME: JULY 24, 2014 / 2:00PM GMT



## CORPORATE PARTICIPANTS

**Peter DeLongchamps** *Group 1 Automotive, Inc. - VP Financial Services & Manufacturer Relations*

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

**John Rickel** *Group 1 Automotive, Inc. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Liz Suzuki** *Bank of America Merrill Lynch - Analyst*

**David Lim** *Wells Fargo Securities, LLC - Analyst*

**Rick Nelson** *Stephens, Inc. - Analyst*

**James Albertine** *Stifel Nicolaus & Co. - Analyst*

**Ravi Shanker** *Morgan Stanley - Analyst*

**Scott Stember** *Sidoti & Co. - Analyst*

**Brett Hoselton** *KeyBanc - Analyst*

**Bill Armstrong** *C.L. King & Associates - Analyst*

## PRESENTATION

### Operator

Good morning, ladies and gentlemen, and welcome to Group 1 Automotive's 2014 second quarter conference call. Please be advised that this call is being recorded. If you require Operator assistance, you may press star then zero to signal for an operator. 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.

---

### **Peter DeLongchamps** - *Group 1 Automotive, Inc. - VP Financial Services & Manufacturer Relations*

Thank you, Andrew, and good morning everyone, and welcome to today's call. The earnings release we issued this morning and a related slide presentation that includes reconciliations related to the adjusted results we will refer to on this call for comparison purposes have been updated to Group 1's web site. Before I begin I would like to make 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 Automotive 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 SEC 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 in this call as required by applicable SEC rules, the Company provides reconciliation of any such non-GAAP financial measures to the most directly comparable GAAP measures on its web site. Participating 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 and prepared remarks are to the same prior-year period unless otherwise stated. I would like to now hand the call over to Earl.

---

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

Thank you, Pete. Good morning, everyone. On an adjusted basis, Group 1 earned \$40 million in the second quarter, which equates to \$1.47 per diluted share. On a GAAP basis net income and EPS were \$16.9 million, and \$0.62 respectively. John will cover the adjustments in more detail, but



the largest was a one time loss we booked as a result of the purchase and retirement of 80% of our 3% convertible senior notes. This action, in conjunction with a mandatory redemption of all of our remaining 2.25% convertible senior notes, which will take place in early September, will significantly simplify our capital structure, and reduce both the variability and the absolute amount of our diluted share count.

As an example, the increase in our average share price during the second quarter drove an increase in our diluted share count of 1.3 million shares compared with the same period a year ago. This negatively impacted adjusted EPS by \$0.07. Based on the second quarter stock price, the reductions in our convertible senior notes will eliminate approximately 2.2 million shares of delusion by the start of the fourth quarter of the year. For the quarter, total revenue increased \$176.5 million, or 7.6% to a record \$2.5 billion, despite extreme weakness in the Brazilian market.

The increase was driven by improvements in all areas of the business, with new vehicle revenue up 6.5%, used retail revenue up 7.9%, parts and service revenue up 8.5%, and finance and insurance revenue up 12.9%. The results varied across our geographic exposures. The UK had another very strong quarter with total revenue growth of 21.2%, reflecting strong growth across each segment of the business. The US operations also had solid growth with total revenue increasing 9.5%, driven by the improving US sales environment and recent acquisitions. While the US market remains very competitive new vehicle margins have stabilized at about first quarter levels.

Brazil was our most challenging market this quarter with the effect of political and economic uncertainty further magnified by significant consumer disruptions associated with World Cup activities that spanned approximately half the quarter. Revenue for our Brazilian operations was down 18.8% in total, primarily explained by a 23.6% decline in new vehicle sales.

The team partially offset the new vehicle selling environment with improvements in used retail sales which were up 7.6%, and improvements in F&I which was up 10.9%. Given the rapid fall off in revenue, we were not able to fully adjust costs quickly enough compared with the same period a year ago. Our small loss in Q2 this year, versus a solid profit last year, explained approximately \$0.15 of adjusted EPS deterioration in the quarter. On a consolidated basis for the quarter we retailed 42,456 new vehicles, and 26,721 used retail units, with new unit sales up 2.2%, and used retail unit sales increasing 4.2%. Group 1's new vehicle unit sales mix was 81.7% US, 9.8% Brazil, and 8.5% UK.

Toyota/Lexus sales accounted for 27.2% of our new vehicle unit sales, while BMW mini, Honda Acura and Ford all represented over 10% of our new vehicle unit sales, while Nissan was at 9.3%. New vehicle inventory rose slightly to 72 day supply, or 33,540 units, at the end of the second quarter compared to 67 day supply for the second quarter of 2013. Used vehicle inventory stood at 15,106 units, or 35 day supply, compared to a 33 day supply for the second quarter of 2013. Thanks to our consolidated, revenue grew 4.2% driven by increases of 5.6% in parts and service, and 9.9% in finance and insurance. Our same store consolidated finance and insurance income per retail unit increased \$124 to \$1,319, with strong improvements in each of the three country groups.

Relative to our cost performance, on a consolidated basis selling general and administrative expenses as a percent of gross profit increased an adjusted 30 basis points to 73.1%. The increase more than explained by the deterioration in our Brazilian operations. Total adjusted SG&A as a percent of gross profit improved 30 basis points in the US, and SG&A improved 260 basis points in the UK. We continue to monitor and adjust our cost structure as we have in recent quarters to address the ongoing pressure on new and used vehicle margins. We are also accelerating efforts in Brazil to reduce the expense structure to better reflect the recent significant slow down in the economy. I'll now turn the call over to our CFO, John Rickel, to go over our second quarter financial results in more detail. John?

---

**John Rickel** - Group 1 Automotive, Inc. - CFO

Thank you, Earl. Good morning, everyone. Our adjusted net income for the second quarter of 2014 rose \$248,000, or 0.006 of a percent over our comparable 2013 results, to \$40 million. On a per share diluted basis adjusted earnings declined 3.3% to \$1.47 as a result of a 5.1% increase in weighted average diluted shares outstanding.

As Earl mentioned, our second quarter 2014 convertible note delusion of 2.9 million shares, increased by 1.3 million shares from the second quarter of last year. Of the 2.9 million convertible share delusion, 2.3 million related to the 3% convertible notes, of which over 80% were repurchased in late June, 2014. The other 600,000 diluted shares relate to our 2 1/4 convertible notes, of which we have filed a mandatory redemption notice and will repurchase all of these notes in early September 2014.

These results for 2014 exclude \$23.1 million of net after tax adjustments, including \$20.8 million of charges related to the partial redemption of our 3% convertible notes, \$1.1 million of asset impairments mainly attributable to the relocation of a dealership onto owned real estate, and \$1 million related to hailstorms in Shawnee Mission, KS, and Rock Hill, SC. The comparable results for the second quarter of 2013 exclude \$2.3 million of net after tax and adjustments, including \$6.8 million of charges related to catastrophic events, and \$400,000 of charges related to non-cash asset impairments. These adjustments were partially offset by \$4.8 million net after tax gain on dealership and real estate transactions. Starting with the summary of our consolidated results. For the quarter we generated \$2.51 billion in total revenues.

This was an improvement of \$176.5 million, or 7.6% over the same period a year ago, and reflects increases in each of our business units. Our gross profit increased \$27.9 million or 8.2% from the second quarter a year ago to \$369.1 million. For the quarter adjusted SG&A as a percent of gross profit increased 30 basis points to 73.1%, and adjusted operating margin was 3.5%. The increase in SG&A as a percent of gross profit relates specifically to the weakening of the Brazilian economy relative to the second quarter of the prior year. Floor plan interest expense decreased \$500,000, or 5% from prior year to \$10.3 million. This decrease is primarily explained by the credit facility amendment that took place in mid-2013, which lowered our US new and used floor plan borrowing rate by 25 basis points.

Other interest expense increased \$3 million, or 31.3%, to \$12.6 million, which includes approximately \$1.1 million of interest incurred on our \$350 million of 5% senior unsecured notes prior to the redemption of our 3% convertible notes. The remaining \$1.9 million increase is attributable to an increase in weighted average debt outstanding of \$219 million, primarily explained by additional real estate related financing included mortgage borrowing associated with recent dealership acquisitions, as well as an increase in weighted average borrowings on our acquisition line during the second quarter of 2014. Our adjusted consolidated effective tax rate for the quarter was 39%.

We expect our tax rate to be approximately 38% over the remainder of 2014. Now, turning to the second quarter same store results, which now include a full three months of Brazil results from each period. In the second quarter we reported revenues of \$2.37 billion, which was a \$94.5 million, or 4.2% increase, from the comparable 2013 period. Within this total new vehicle revenues were up 3% and used vehicle retail revenues improved 4.2%. Both finance and insurance, and parts and service delivered another strong quarter, growing revenues 9.9%, and 5.6% respectively. New vehicle revenue increased to \$1.4 billion, as a 0.7% decrease in unit sales was more than offset by an increase in our average new vehicle sales price of \$1,263, or \$34,542 per unit. By country, same store new vehicle unit sales increased 3% in the US, 0.6% in the UK, and decreased 23.4% in Brazil.

Our used retail revenues improved \$22.5 million to \$543.5 million, on an increase in our average used vehicle retail sales price of \$867, to \$21,787 per unit. F&I revenue per retail unit rose 10.4% to \$1,319, driven by increases in both income per contract and penetration rates for most of our major product offerings. The 5.6% revenue growth in parts and services is explained by increases of 16.6% in wholesale parts, 7.6% in warranty, 5.2% in collision, and .5% in customer pay. Within these totals US parts and service revenue was up 5.4%, with wholesale up 11.3%, warranty up 7.8%, collision up 3.8%, and customer pay up 2.1%. In the US as manufacturer paid maintenance continues to expand there is an ongoing shift of business from customer pay to warranty.

Overall, given the strong comparative data we were up against this quarter of 8.8% growth in the same period a year ago, which was driven by significant collision work following a large hailstorm in Oklahoma, we're pleased with our parts and service revenue growth. As a reminder, our parts and service revenues are not impacted by increases in internal business. The revenue associated with internal work is eliminated upon consolidation. This varies across the sector as some of our competitors account for internal work differently. In aggregate, our same store growth profit grew \$14.5 million, or 4.3%, to \$347.2 million. Our same store new vehicle gross profit dollars declined 4% to slightly lower volumes combined with a \$64 decline in gross profit per unit to \$1,902. By country, US new vehicle gross profit increased approximately 1% as a \$36 decrease in gross profit per retail unit partially offset to 3% increase in unit sales.

In the UK, a \$510 increase in gross profit per retail unit explained by a mixed shift towards luxury brands and dropping some low margin fleet business, combined with the slight increase in unit sales resulting in a new vehicle gross profit increase of 26.5%. In Brazil, a \$509 decrease in gross profit per retail unit, coupled with a 23.4% decrease in unit sales, resulted in a 37.4% decrease in new vehicle gross profit. Our used vehicle retail gross profit was up 0.1% as unit sales grew slightly and gross profit per unit remained at \$1,704. Our F&I gross profit grew \$7.7 million, or 9.9%, reflecting the improved per retail unit previously mentioned. Finally, parts and service gross profit grew \$9.3 million, or 7%, primarily reflecting the strong revenue growth mentioned previously, as well as an 80 basis point improvement in margins to 53.3%. For the second quarter we grew our

total gross profit by \$14.5 million while adjusted SG&A expenses rose \$13.5 million. As a result, our adjusted SG&A as a percent of gross profit increased 90 basis points to 72.7%, primarily attributed to the weakening of the Brazilian economy as previously mentioned.

Turning now to our geographic segment starting with the US market on an actual basis. While the US revenues grew 9.5% to \$2.06 billion dollars, driven by increases of 12.3% in F&I revenue, 10.4% in new vehicle revenue, 8.8% in parts and service revenue, and 7.4% in total used vehicle revenue. The increase in our parts and service revenues reflects growth in all areas of the business and our F&I revenue growth reflects a 5.3% increase in retail vehicle sales volume, coupled with improved profitability per retail unit which grew \$91, or 6.7% to \$1,442. Total gross profit improved 9.1%, driven by a 10% increase in parts and service, as well as the F&I increase that I just mentioned. Second quarter, we grew gross profit by \$26.3 million, while adjusted SG&A expense rose \$17.9 million. As a result, our adjusted SG&A as a percent of gross profit improved 30 basis points, to 71.3%.

Adjusted operating margin for the US business segment held at 4%. Related to our UK segment, our UK operating team delivered another outstanding quarter with total revenues for the UK segment up 21.2% from the prior year, to \$251.3 million. There has been no acquisition or disposition activity in the past 12 months, this metric is on a same store basis, as well. New vehicle revenues grew 19.3% on slightly more retail unit sales, an increase of \$5,705 in the average sales price per unit, to \$36,349. This increase in average sales price was attributed to a mixed shift towards our BMW and Audi luxury brands. Used vehicle retail revenues improved 25.4% on 7.8% more retail units, and an increase of \$3,785 in the average sales price per unit to \$26,934.

Parts and service revenues improved 18.7%, representing double digit increases in each segment. Our F&I income growth of 26.7% reflects the 3.5% increase in total retail unit sales, and a 22.5% increase in gross profit per retail unit to \$709. During the second quarter total gross profit grew 24.4% reflecting healthy increases across each business segment. We also leveraged our costs and adjusted SG&A as a percent of gross profit improved 260 basis points to 75.6%. Operating margins in UK business segment increased 30 basis points to 2.5%. Related to our Brazil segment, on a macro basis the economy has slowed significantly from the second quarter of last year and the World Cup further served to pressure new vehicle sales. As such, we retailed 4,145 new units, compared to 5,337 units in the second quarter of 2013, a decrease of 22.3%.

We did, however, show positive growth in each of the other business segments as we increased total used gross profit by 10.3%, parts and service gross profit by 6.2%, and F&I gross profit by 10.9%. The increase in F&I was despite a decrease in total retail unit of 16.6%, as we increased F&I gross profit for retail unit by \$131, or 32.8%, to \$531. Our adjusted SG&A as percent of gross profit was 95.1% compared to 80.5% a year ago, while our operating margin decreased 170 basis points 0.3%. For the quarter, the Brazil segment was not profitable and we expect continued economic pressure in the short term that will limit our operations to break even over the remainder of 2014. Turning to our consolidated liquidity and capital structure. As of June 30, 2014, we had \$21.3 million of cash on hand, and another \$64.6 million that was invested in our floor plan offset account bringing immediately available funds to a total of \$85.9 million. In addition, we had \$220.8 million available on our acquisition line, that can also be used for general corporate purposes.

As such, our total liquidity at June 30, 2014, was \$306.7 million. Year-to-date for 2014 we have generated \$104.1 million of operating cash flow on an adjusted basis. As previously announced we successfully tendered for roughly 80% of the then \$115 million face value of outstanding 3% convertible notes, and paid cash of \$210.4 million excluding accrued interest. After the quarter ended we also received cash proceeds of \$26.4 million related to the unwind of the associated calls and warrants resulting in a net transaction cost of \$184 million. To fund this transaction we issued \$350 million of 5% senior unsecured notes due 2022. The excess cash from this bond offering we used to pay down our acquisition line and for general corporate purposes. As of June 30th, \$22.5 million of face value of the 3% convertible notes remain outstanding.

We also announced the mandatory redemption of all \$182.8 million of face value of our 2.25 convertible notes. This transaction will be finalized in early September. When completed at the start of the fourth quarter this year, the redemptions of both the 3% and 2.25 convertible notes were estimated to improve EPS by proximately \$0.09 per quarter. Please refer to our investor presentation on the web site for the pro forma income statement effects from both of these transactions. With regards to our real estate investment portfolio, we own \$674 million of land and buildings at June 30th which represents 42% of our dealership locations. To finance these holdings we have utilized our mortgage facility and executed borrowings under other real estate specific debt agreements.

As of June 30th, we had \$66.3 million outstanding under our mortgage facility, and \$293.9 million of other real estate debt excluding capital leases. During the second quarter we used \$4.1 million to pay dividends of \$0.17 per share, an increase of \$0.01 per share over the second quarter of last



year. For additional detail regarding our financial condition please refer to the schedule for the additional information attached to the news release as well as the investor presentation posted on our web site. With that, I'll now turn it back over to Earl.

---

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

Thanks, John. Related to our 2014 corporate development efforts, in the second quarter we previously announced the acquisition of Mercedes Benz and Kia dealerships in Texas and in July announced the acquisition of Chevrolet and Mazda dealerships, also in Texas. Additionally, we were also granted a Springer franchise Beverly Hills, CA in June. Year-to-date we estimate the total annualized revenues from our 2014 acquisitions to be \$535 million. As also previously announced we disposed of a Hyundai franchise in April in New Orleans, LA with annualized revenue of \$20 million, and a Volvo franchise on Long Island, NY in June, with annualized revenue of \$30 million. We continue to adjust our dealership portfolio to ensure we are generating appropriate returns for our shareholders. I'll now turn the call over to the Operator for your questions.

---

## QUESTIONS AND ANSWERS

### Operator

We will now begin the question-and-answer session. (Operator Instructions). At this time, we will pause momentarily to assemble our roster. First question comes from John Murphy of Bank of America Merrill Lynch. Please go ahead.

---

**Liz Suzuki** - *Bank of America Merrill Lynch - Analyst*

Good morning. This is Liz Suzuki on for John. It looks like US same store revenue growth was a little lighter than we might have expected, especially on the used vehicle side. Is there anything you're seeing in the used environment that might be causing growth to slow a little bit in the US?

---

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

This is Earl. My impression was that the used car market overall was a little bit softer last quarter. I couldn't tell you exactly why, although in June I had the impression that there was a lot of new vehicle volume pressure from a variety of OEMs to hit targets and things, and perhaps new cars sat down on used cars a bit. In our case, we had a big variation, the biggest variation I had seen in a long time, among performance from various geographies, and much of our weakness was driven by an actual 20% decrease in used car sales in New Jersey and New York. We also had a couple markets that's were flat, but generally our used car performance was much better than our total corporate metric would indicate. So we were depressed a bit by a couple of poor performances in specific geographies and the same was true on new vehicles. We had a little bigger variation than I had seen before.

---

**Liz Suzuki** - *Bank of America Merrill Lynch - Analyst*

Okay. Interesting. Thanks. And with all of the recalls that have been announced, not just with GM but several other automakers as well, is your parts and service business seeing any benefit from that yet, and if not what do you think the likely timing of any real volume growth would be from recalls?

---

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

Quite frankly these recalls that have received the most publicity, notably the General Motors ones, and the ones that have been announced here in the last month by a couple of other manufactures, we've had virtually no impact yet. Parts aren't available in many cases, or not sufficient parts. But for the last year or so, I think it's fair to say that our overall business has had a positive effect from a variety of recalls but probably not the ones that you're thinking of that you've heard the most about recently.

**Liz Suzuki** - Bank of America Merrill Lynch - Analyst

Right. Okay. And is there enough capacity in the service base for material increase in volume if those parts do start to become available and you see any real short-term bump in parts and service from recalls?

---

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

There is capacity, but I have to tell you we always struggle with technicians. We could use more technicians and we have been trying to increase our human capacity for quite some time. We have the physical plant necessary but we're going to continue to try to increase the number of technicians we have.

---

**Liz Suzuki** - Bank of America Merrill Lynch - Analyst

Okay. Thank you very much.

---

**Operator**

The next question comes from David Lim of Wells Fargo Securities. Please go ahead.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

Thank you. Can you hear me?

---

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

Yes. We have window washers outside our window here on the sixth floor, and Pete is knocking on the window, and hopefully they won't jump off their scaffolding.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

The question I have is I was wondering if you could box this out for me, Brazil same store sales on an F&I portion of the business there, it looks like new vehicle declined about 24%, used vehicles did better. Is it just that the 35% increase per unit, is that mainly due to mix or can you explain that a little bit more? What kind of products are you guys selling that you guys could enjoy that kind of a lift when new vehicle sales were down?

---

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

Well, the improvement we've had has just been by putting focus on it for the first time probably in the Corporation's history. There's not a big extended service contract market there. There is legal limitations on finance income, but we actually sell auto insurance there. And that's one of the prime products. I don't know, Pete, if you have anything to add to that?

---

**Peter DeLongchamps** - Group 1 Automotive, Inc. - VP Financial Services & Manufacturer Relations

I do not.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

Gotcha. And we have noticed that the US new vehicle same stores sales underperformed relative to overall US industry, and obviously there could be some functions related to mix and fleet, but also we noticed the gross margin declined year-over-year. Could you speak to the dynamics of what happened in the quarter and, to tag along with that, did you have enough used vehicle inventory going into Q2?

---

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

Yeah, couple questions there. There continues to be pressure on new vehicle margins but they weren't dramatically different in the second quarter than they were in the first. That was, you know, 20 basis points or so lower than a year ago, so there continues to be pressure but I think we flattened out a bit there. On the new vehicle sales performance, I just alluded to it a moment ago when we chatted about used vehicles. We were getting very uneven by geography. Most of our core markets actually were quite strong. South Texas, California, and the Gulf coast were all up almost 9% in new vehicle sales, but we were down almost 6% in New York and New Jersey. We were flat for the first time in the Atlantic coast and we were very weak in New Orleans. So we had a huge spread. But overall, I would say new vehicle sales were probably a little bit better than what our average metric indicated. Relative to used vehicle inventory, we don't have any different problem now than we've had over the last year or two. There are some shortages of good late model used cars, but nothing different than what we've experienced in the past.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

Gotcha. Just two more questions. On UK seem same store sales, parts and service was really strong at plus 19%. I was wondering if you could share with us what are the underlying differences, if any, between the US and the UK? What I'm trying to get here is if the US can come close to the UK performance, or are there massive fundamental differences in parts and service that evade that?

---

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

Well, strangely enough, there isn't nearly the recall influence in the UK, which is counter intuitive to the point you're trying to make. But I think the main benefit there is simply the units in operation, and kind of the economic attitude there, the consumer confidence. Most of our growth is coming from BMW and Audi brands, and the expanding units in operation, and those customers are loyal and they're bringing their cars back.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

Gotcha. My final question is staying on the US parts and services, can you provide like a rough revenue mix or split between vehicles in the 0-5 year range versus 6-11 year range? What I'm trying to get at is in your parts and service business, how is that weighted between those two verticals or categories?

---

**John Rickel** - Group 1 Automotive, Inc. - CFO

Yeah, this is John Rickel, we don't have detail specifics but I will tell you the vast majority of our profitability would be in that kind of 0-6 category. Once you get beyond that they start to fall off really rapidly.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

They tend to go to like the outside mechanics for one reason or another.





**John Rickel** - Group 1 Automotive, Inc. - CFO

Yes. Well, partially, if you think about it, most of these are customers that we've met through either selling them a new vehicle or used, and by the time a car gets 6-years-old it's probably changed ownership, so you lose the relationship a lot of times.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

Is it also the fact that most new vehicle Powertrain warranties expire after five years, too?

---

**John Rickel** - Group 1 Automotive, Inc. - CFO

Certainly that's a piece of it. The bumper to bumper stuff tends to be after three years. And the Power-trains five or six, yes.

---

**David Lim** - Wells Fargo Securities, LLC - Analyst

Gotcha. Thank you very much.

---

**John Rickel** - Group 1 Automotive, Inc. - CFO

Thanks.

---

**Operator**

The next question comes from Rick Nelson of Stephens, Inc. Please go ahead.

---

**Rick Nelson** - Stephens, Inc. - Analyst

Thanks a lot. Good morning.

---

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

Good morning, Rick.

---

**Rick Nelson** - Stephens, Inc. - Analyst

You asked about on the markets in Brazil, which has been a challenge, the UK, you know, really strong. The World Cup had to have been disruptive. You called out \$0.10 or \$0.15 year-over-year pressures there. Earl, if you could discuss the outlook for that market, what you're doing I guess from an expense standpoint to adjust?

---

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

Sure, Rick, thank you. The market, we have no near-term positive hope for the market, at least through the election. The election is in early October. Even if you watched the World Cup I think you could see some of the elections spilled into that, and so that's creating a lot of the uncertainty. So that means we have to be more aggressive in our cost cutting. I just got back from Brazil two or three days ago, so we did launch, on Monday, a much more drastic resizing effort. Since Monday we've eliminated 100 positions. I expect within a couple week that number will be 150. That's somewhere around 10% of our head count. We will do as much of that as possible through attrition. But we've got to resize the business.

The big issues for us are the French brands, Peugeot is down 20% in the first six months, and Renault shows being up but as much as 40% of Renaults sales are fleet so the throughput in the dealerships is way down. Nissan is our other challenge. Their sales are down 16%, although they've opened a new factory in Brazil recently and by August that's supposed to turn up. But we have no choice but to resize our business particularly in those three brands to lower levels. Our Land Rover business is still very good and profitable but it's down 15% this year as they transition to local production. And we do 9% or 10% of all the Land Rovers in Brazil and 9% or 10% of all the BMWs. So we are resizing there very aggressively. I also think it's safe to say we'll make a few adjustments to our portfolio if possible over the next six to nine months, as well there.

---

**Rick Nelson** - *Stephens, Inc. - Analyst*

Have the sales trends changed of late? Especially since the World Cup, ended?

---

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

No, of course it was a disaster during the three or four weeks of the competition. It did appear last weekend that some customers started to come out again but I don't have any data yet to see what kind of bounce back we're going to get, but the country did pretty much come to a stand still during the World Cup. We had days with no customers in the shop. I must say that there is still an underlying base in Brazil. Unemployment is not an issue, the people have jobs. There is cranes all over Sao Paulo and Rio. So, with some policy changes or pro business government, Brazil could turn around fairly quickly but until the election in October I don't expect a lot of change in consumer confidence.

---

**Rick Nelson** - *Stephens, Inc. - Analyst*

Thank you for that color. And then the strength in the UK, really across all segments, the used business was really strong there, 25% same store growth and units up 7.8%, is that OEM punching cars over there? What was the driver to the strong used results?

---

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

Well, our management team says it's through their brilliant abilities, but there is always in the UK a big low mileage used business. It kind of goes with aggressive OEM activities, but I haven't really seen any increase in that. It just seems that the vehicle sales market new and used remains very, very strong and we expect a very strong September, based on kind of the early order bank build up.

---

**Rick Nelson** - *Stephens, Inc. - Analyst*

That's encouraging. Thanks a lot, and good luck.

---

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

Thank you.

---

**Operator**

Next question comes from James Albertine, of Stifel. Please go ahead.



**James Albertine** - *Stifel Nicolaus & Co. - Analyst*

Thanks for taking the question, and good morning everyone. And thanks for that indication on the UK by the way. September was a question I had, as well. On the parts and service business I wanted to get a sense for, you know, it looks like you've now transitioned out of the investment phase as it relates to your inbound call center. I wanted to get an indication of the benefits that you're seeing from that investment, and maybe some advantages you think that gives you looking forward into the back half of this year.

---

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

Well, we have been very pleased with those investments but I have to tell you we continue to struggle to stay up with the volume and keep the service levels up. The parts and service business remains very strong, and I'm still very optimistic about it. I think there were some questions. Our comp number may look a little lower than it has in previous quarters but the second quarter last year I think we were up over 8%. 8.8% last year, and we had a bit of a tail wind in some of that number a year ago. Overall I would tell you the parts and service business is still strong, and as someone noted on the call, a lot of recall work to support us in the third and fourth quarter, I think.

---

**James Albertine** - *Stifel Nicolaus & Co. - Analyst*

That's great detail. I appreciate the insight. As it relates to recalls, any sense that for some of the older units that are being recalled that consumers are recognizing the advantages now in miles per gallon and sort of "info-tainment" and so forth for newer vehicles and rather than have those vehicles fixed as you would expect, they are, in fact, replacing them with newer used vehicles? Are you seeing any of that flow through the system?

---

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

I have no evidence of that yet, but I have to tell you I don't think we have as much traffic in the dealerships yet on these old model recalls as you might expect us to. And I'm not sure yet how many of these customers are going to come in. So we'll have to wait and see about that. Some of these cars are very, very old, and my experience is you get a very low return rate on some of these very old cars.

---

**James Albertine** - *Stifel Nicolaus & Co. - Analyst*

If I could sneak one more in on M&A, and you guys had a great cadence relative to your peer group, congratulations there. As it relates to the OEMs, I think we've heard on the luxury side Lexus in particular, do you see the OEMs relaxing their standards as it relates to aggregate ownership?

---

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

I do believe Lexus might have made a small policy change in that direction, but I haven't seen any major movement in that direction overall.

---

**James Albertine** - *Stifel Nicolaus & Co. - Analyst*

Great. Thank you guys so much and good luck in the next quarter.

---

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

Thank you.



**Operator**

The next question comes from Ravi Shanker of Morgan Stanley. Please go ahead.

---

**Ravi Shanker** - *Morgan Stanley - Analyst*

Thanks. Good morning everyone.

---

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

Good morning.

---

**Ravi Shanker** - *Morgan Stanley - Analyst*

For F&I you guys went a little bit counter to the industry in that you had a very strong year-on-year improvement over the industry, which seemed to slow down the quarter. Any reason to explain that? Is this just your own execution which was good, or are you still seeing the industry kind of pick up or see tail winds on F&I?

---

**Peter DeLongchamps** - *Group 1 Automotive, Inc. - VP Financial Services & Manufacturer Relations*

Ravi, this is Pete DeLongchamps. Thank you for the question. I think we put a business plan in place five years ago, we've been executing on it. I've got a field team that is working directly with the dealerships on a daily basis. We also now have an F&I representative in the UK, which is driving improvements. So this is just a follow up to the things that we put in place. We continue to work very hard on the underperforming stores. And we got great partners, both on a product side but with our lenders, as well. It's a plan coming together and we're very pleased with the results, and thankful for the job our dealers have done for us.

---

**Ravi Shanker** - *Morgan Stanley - Analyst*

Got it. And on new pricing specifically the other dealers, and I think you yourself mentioned this call that there has been pretty meaningful uptick in competitive pressures on the new pricing side. And you've mentioned in the past about it must import kind of being the source of that. We certainly expect the Japanese (inaudible) to come up with some really cool new products over the next couple years. Do you think that eases that, or do you think as we push on towards new cyclical highs we might see more of this price competition in the new side?

---

**John Rickel** - *Group 1 Automotive, Inc. - CFO*

Ravi, this is John Rickel. I think the positive within the quarter was that we actually saw some stability, certainly sequentially. We actually saw new vehicle margins tick up just a little bit. Clearly, if there's new product that comes, you've got redesigned Camry, you got F series, traditionally that's good for margins. At this point it continues to be competitive and I think what we've said is we would guide to continuing to model at about these levels for the foreseeable future.

---

**Ravi Shanker** - *Morgan Stanley - Analyst*

Understood. And just finally on Brazil, I think it's understandable that you saw disruption in the quarter because of the World Cup, and coming up to the elections. Just wondering what kind of visibility you guys have in the Brazilian market even beyond that. And I have to ask you this, I'm wondering if you would consider at all exiting Brazil if this doesn't turn around sometime very soon?



---

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

Yeah, Ravi this is Earl. I have absolutely no intention of recommending that we exit Brazil. In fact, the more I work with the country the more excited I am about its future. Days like today aren't a great day to be in Brazil, I can assure you of that. But over 40 years I've been through these things many, many times. So no, I think it's one of the most exciting markets in the world. Probably after China. And we have great people, and we have great brands. We have some adjustments I think we need the make. First of all cost in the near-term, long-term we have to adjust our brands a bit in the footprint, but, no I think it's going to be a great long term investment for our shareholders. That said, you know, we've got some real heavy lifting to do in the near-term, because it is highly unpredictable but there is 200 million people there, a growing middle class, they all need cars, they have no public transportation, they love cars. Somebody is going to be the best car dealer group in Brazil and I'm pretty sure it's going to be Group 1.

---

**Ravi Shanker** - *Morgan Stanley - Analyst*

Great. I'm sure you'll get there. Thanks all.

---

**Operator**

(Operator Instructions). The next question comes from Scott Stember, of Sidoti & Company. Please go ahead.

---

**Scott Stember** - *Sidoti & Co. - Analyst*

Good morning, guys.

---

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

Good morning, Scott.

---

**Scott Stember** - *Sidoti & Co. - Analyst*

In the US on new car side, could you talk about brand mix and how some of your brands performed, compared to what the industry did?

---

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

Yeah, again, Scott, I think, you know, our performance was spotty by geography. Big variations we don't normally see. And our Ford business is very good but I don't think we were as strong in Ford in this quarter as we were probably for the last year or so. Toyota business remains very solid. There's pressure on those margins but the volume is pretty good. And I would say BMW business is still very, very strong. So those are our major brands, and I think Ford is probably one where we didn't do as well as we had in probably the previous four or five quarters. That's what comes to mind, based on the data I remember looking at. Any other comments?

---

**John Rickel** - *Group 1 Automotive, Inc. - CFO*

Yeah, I think Earl hit the key ones. This is John. The other ones we performed at about what the market did on Honda. Honda was about flat. We were about flat. We had some strength with Nissan. We were up double-digits there. The other one that we were really, really strong with was Hyundai. We were up double-digits with Hyundai, kind of out-performed what they did in the market.



**Scott Stember** - *Sidoti & Co. - Analyst*

Okay. And by region, I know you mentioned a couple of areas that were weak. How did you guys do in Texas and Oklahoma?

---

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

Actually Oklahoma was weak. I should have mentioned that before. It was down about 2%, which is again the first weakness we had seen there in a long, long time. But south Texas was up 9%, California was up almost 9%. North Texas wasn't quite as strong as south Texas. And the Gulf Coast. Our major markets were very strong but we were weak primarily from New York/New Jersey, down the Atlantic coast.

---

**John Rickel** - *Group 1 Automotive, Inc. - CFO*

The one thing Scott on Oklahoma that I would mention is that perversely enough we had the hailstorm there a year ago, and when that happens you get hail sales that actually move a lot of inventory. We were up against a pretty difficult comp in Oklahoma because of the hail related sales last year.

---

**Scott Stember** - *Sidoti & Co. - Analyst*

Okay. Gotcha. And John, just one last question a follow up on your comments about Brazil being break even at best in the back half of the year, is that assuming any pick up in sales or is that strictly related to the cost cuts that you implemented on Monday?

---

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

We assume some pick up, Scott. This is Earl. We basically couldn't have a lower sales level than what we had during that World Cup time period. So there will be some increase in gross profit as we move through the end of the year. Now, historically November, December aren't particularly strong, but there will be a little bit higher gross profit generation levels than what we saw in the second half of the second quarter.

---

**Scott Stember** - *Sidoti & Co. - Analyst*

Okay. That's all I have. Thank you, guys.

---

**Operator**

The next question comes from Brett Hoselton of KeyBanc. Please go ahead.

---

**Brett Hoselton** - *KeyBanc - Analyst*

Good morning, gentlemen.

---

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

Good morning, Brett.

---



**Brett Hoselton** - KeyBanc - Analyst

I was hoping you could speak to gross profit throughput. If I calculated things correctly it looks like in the US you had a 32% gross profit throughput. On a fully consolidated basis it looks like it's around 22%. John can you just talk about maybe some of the unusual things that impacted that and where you expect that to go going forward?

---

**John Rickel** - Group 1 Automotive, Inc. - CFO

Sure. And your calculations I think are certainly in the ballpark. Clearly you know Brazil contributed to the consolidated piece, and, as Earl indicated, we've launched some pretty significant cost reduction efforts down there. We'll need to see the traction we get, how quickly that comes, to be able to really comment on the consolidated piece. The US certainly was a little bit of a disappointment, too. Normally we would anticipate \$0.40 to \$0.50 of flow through and it was below that. There is additional work that we're doing on cost in the US, as well.

---

**Brett Hoselton** - KeyBanc - Analyst

So, there is nothing that you would necessarily call out as particularly unusual or one time, or something along those lines? It's just a matter of we need to make some adjustments and that will hopefully benefit it over the next few quarters?

---

**John Rickel** - Group 1 Automotive, Inc. - CFO

I think that's fair, Brett.

---

**Brett Hoselton** - KeyBanc - Analyst

And from a M&A standpoint, as you compare M&A activity today versus where we were maybe six months or a year ago, can you speak to the deal flow? How many deals are you seeing and/or multiples? And then, where are you at today in terms of the pace of acquisitions? Is there any reason to believe you might slow down or speed up the pace of acquisitions?

---

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

Bret, this is Earl. My impression is that the overall activity level and the deal flow has slowed down recently, because it's been quite strong in the last, 6-12 months. But there is certainly still activity out there. We plan to continue to try to grow in the US and the UK in particular. As I mentioned we may re-balance our portfolio a little bit in both Brazil and the US. I think you can expect some dispositions from us also in the US. We don't have any strategic reason to stop our growth, but we have to again be disciplined at our return on investment hurdles. And pricing has been pretty high in the market. So that may be another reason for some of the activity to slow down a bit.

---

**Brett Hoselton** - KeyBanc - Analyst

And kind of specifically along those lines, Lithia made a pretty large acquisition, you might consider it transformational. Your thoughts on the potential of doing something similar at Group 1? Or would you consider your pace of acquisition to be more consistent to where you have been historically?

---

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

I think the large magnitude acquisition we made was in Brazil, but I don't see the potential for large scale acquisitions in the US or the UK for our Company.

---

**Brett Hoselton** - *KeyBanc - Analyst*

Okay. Excellent. Thank you very much.

---

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

Thanks, Brett.

---

**Operator**

The next question comes from Bill Armstrong, of C.L. King & Associates. Please go ahead.

---

**Bill Armstrong** - *C.L. King & Associates - Analyst*

Good morning. I was wondering if you could discuss incentive activity during the quarter? We've heard some incentive activity may have impacted used car sales a little bit in the industry. I was wondering if you've seen any of that?

---

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

Well, it was a bit more aggressive. I think it's always a bit more aggressive as you come into the big spring and summer selling months. Generally speaking for OEMs and dealers if you don't sell cars in those months you're not going to have much of a year. There was reasonably brisk incentive activity in the second quarter, and I would expect it in the third. I wouldn't say necessarily that the cost per units are getting out of control by the OEMs, but there is plenty of competition out there per market share.

---

**Bill Armstrong** - *C.L. King & Associates - Analyst*

Do you think that might have impacted used car sales on the margin?

---

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

I had that feeling in June, at least based on our experience, there was an awful lot of pressure to hit volume targets and things, so I did have the impression that there was a lot of focus on the new vehicle side of the business by a lot of dealerships, not just ours in June, at the quarter end.

---

**Bill Armstrong** - *C.L. King & Associates - Analyst*

Okay. And within used, what were your same-store sales for certified preowned in the US?

---

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

I don't have it on the same store basis, but I think it's still somewhere around 30% of our total.

---

**John Rickel** - *Group 1 Automotive, Inc. - CFO*

About 30% of our mixed, Bill, but I don't have the actual increase in same store basis split that fine.



**Bill Armstrong** - *C.L. King & Associates - Analyst*

30% of your total used you mean?

---

**John Rickel** - *Group 1 Automotive, Inc. - CFO*

Correct.

---

**Bill Armstrong** - *C.L. King & Associates - Analyst*

What would that have been a year ago? Any idea about that?

---

**John Rickel** - *Group 1 Automotive, Inc. - CFO*

About the same.

---

**Bill Armstrong** - *C.L. King & Associates - Analyst*

About the same, so about flat then. Okay. And fine. Next question, what do you think were the drivers that caused New York and New Jersey to be weaker than the rest of the country?

---

**John Rickel** - *Group 1 Automotive, Inc. - CFO*

Well, we always assume it to be management. It's hard to get used vehicle market information on a timely basis. We made some management changes, I will tell you that, and we also may make some portfolio adjustments.

---

**Bill Armstrong** - *C.L. King & Associates - Analyst*

Okay. Thank you.

---

**Operator**

This concludes our question-and-answer session. I would like to turn the conference back over to Earl Hesterberg, President and CEO, for any closing remarks.

---

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

Thanks to everyone for joining us today we look forward to updating you on our third quarter earnings in October.

---

**Operator**

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

---



**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2014, Thomson Reuters. All Rights Reserved.