

Company Name: Group 1 Automotive  
Company Ticker: GPI US  
Date: 2018-10-25  
Event Description: Q3 2018 Earnings Call

Market Cap: 1,145.88  
Current PX: 57.55  
YTD Change(\$): -13.42  
YTD Change(%): -18.909

Bloomberg Estimates - EPS  
Current Quarter: 2.225  
Current Year: 8.789  
Bloomberg Estimates - Sales  
Current Quarter: 2925.000  
Current Year: 11708.333

## Q3 2018 Earnings Call

### Company Participants

- Peter C. DeLongchamps
- Earl Julius Hesterberg
- Daryl A. Kenningham
- John C. Rickel

### Other Participants

- Yarden Amsalem
- Rick Nelson
- James J. Albertine
- David Tamberrino
- David Whiston
- Arminas Sinkevicius

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen. Welcome to Group 1 Automotive 2018 Third Quarter Financial Results Conference Call. Please be advised that this call is being recorded. I would now like to turn the conference over to Mr. Pete DeLongchamps, Group 1's Senior Vice President of Manufacturer Relations, Financial Services and Public Affairs.

Please go ahead, Mr. DeLongchamps.

### Peter C. DeLongchamps

Thank you, Cole, and good morning, everyone, and welcome to today's call. The earnings release we issued this morning and the 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 call, statements made by management of Group 1 are forward-looking statements that are pursuant to the Safe Harbor provision 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 last 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.

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Participating today are, Earl Hesterberg, our President and Chief Executive Officer; John Rickel, our Senior Vice President and Chief Financial Officer; Daryl Kenningham, our President of U.S. Operations; and Lance Parker, our Vice President and Corporate Controller.

Please note that all comparisons in the prepared remarks are of the same prior-year period unless otherwise stated.

I'd now like to hand the call over to Earl.

## Earl Julius Hesterberg

Thank you, Pete, and good morning, everyone. I'm pleased to report that Group 1 earned \$49.2 million of adjusted net income for the quarter. This equates to record quarterly adjusted earnings per share of \$2.47 per diluted share, an increase of 11% over a very tough comparison from the prior year.

In September 2017, we witnessed unparalleled new vehicle sales in our Houston and Beaumont markets due to Hurricane Harvey replacement demand. Our 2018 third quarter Houston and Beaumont new vehicle unit sales were down 23% from 2017, which distorts our current U.S. same-store result. Our U.S. new vehicle same-store sales were down 10% for the quarter, while used vehicle sales increased 5.5%.

Also impacting the quarter was a superior decline in UK new vehicle unit sales due to a lack of 2019 model year new vehicle availability in key brands due to a new vehicle certification protocol. Our third quarter same-store UK new vehicle unit sales declined 22% from the prior year as the number of models were unavailable to sell, particularly in our Audi, Volkswagen, BMW and Mercedes brands. We expect these sales to be recovered over the course of the next two quarters.

We were able to mitigate the financial pressure from significantly lower UK new vehicle sales volume with a solid used car performance across the company and significant cost-control actions. Further offsetting these headwinds, there is a significant reduction in our outstanding share count. Year-to-date through today, we have repurchased over 1.9 million shares, which represents 9.5% of our beginning-of-the-year common share count.

And as announced in this morning's press release, our board has increased our share repurchase authorization to \$100 million. We will continue to assess our capital allocation priorities by comparing the returns on investment for corporate growth actions to our common stock valuation.

Before I make further comments about our quarterly results, I would like to address the impact of Hurricane Michael has had on our employees and operations. We have two stores located in Panama City, Florida, which was directly hit by the hurricane. The vast majority of our 53 local employees suffered property losses and some lost everything. We've taken steps to assist these employees during this difficult time.

Our dealership property and vehicle inventory suffered relatively minor damage and our operations were shut down for roughly one week. We expect no material impact on our fourth quarter financial statements. Our thoughts are with all of those who have been impacted by this storm.

Turning to our business segments, during the quarter, we retailed over 43,000 new vehicles. Total consolidated new vehicle revenues decreased 9% on constant currency basis, driven by a 10% decrease in unit sales related to Hurricane Harvey comps and UK emissions legislation as mentioned earlier.

Our new unit sales geographic mix was 74% U.S., 21% UK and 5% Brazil. Our new vehicle brand mix was led by Toyota/Lexus, which accounted for 27% of our new unit sales, VW/Audi represented 12%, BMW/MINI represented 12% and Ford represented 11% of our new vehicle sales.

During the quarter, we retailed over 37,000 used retail units, driven by strong performances in both the U.S. and UK. Total consolidated used vehicle revenues grew 5% on a constant currency basis as we sold 3% more units and average used vehicle selling price increased 2%. Used vehicle gross profit increased 7% on a constant currency basis as the unit increase combined with total used vehicle gross profit per unit increased up 5%. The used volume and per unit margin

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increase were the result of our corporate-wide focus in this area of our business and especially our new Val-U-Line initiative in the U.S.

Total consolidated parts and service revenue increased 4% on a constant currency basis, driven by increases in customer pay of 8%, wholesale parts of 3% and collision of 1%, partially offset by a 1% decline in warranty. Finance and insurance gross profit decreased 1% on a consolidated constant currency basis. This decline was driven by a decrease in retail units of 2%, partially offset by F&I per retail unit increase of 1%.

Regarding our geographic segment results, I'd like to turn the call over to Daryl Kenningham, President of U.S. Operations, to discuss our U.S. quarterly results before I cover the UK and Brazil.

## Daryl A. Kenningham

Thank you, Earl. We were generally pleased with our performance in the U.S. in the third quarter, despite very difficult comps versus a year ago. As Earl mentioned, Hurricane Harvey significantly distorted our year-over-year operating metrics. On a sequential basis, we increased total revenues by 1.5% and gross profit by 1%. On a year-over-year same-store basis, I'm particularly proud of the fact that we continue to generate strong growth in used retail unit sales as we saw 5.5% improvement.

Val-U-Line retail unit sales increased to 11% of our units during the quarter and was the primary driver in our same-store used vehicle gross profit growth. In addition, we lowered our reliance on the used vehicle wholesale markets, as our wholesale unit sales volume declined 28%. Our new internal auction process, more aggressive internal inventory transfer policies, improved reconditioning practices and more disciplined inventory management drove this trend.

In addition to the 5.5% same-store sales increase, we increased our total used vehicle gross profit per unit by \$31. Our quarterly after sales results were slightly lower than anticipated at a 2.4% increase in same-store gross profit. The results were negatively impacted by a 6% decline in warranty gross profit, which is primarily explained by the lapping of Takata airbag recalls. Both collision and wholesale parts gross profit increased 2%, while customer pay increased over 6% on a same-store basis. That's our best customer pay quarter in over two years.

We continue to roll out our 4-Day Work Week initiative and are very pleased with the outperformance and after sales growth at the 39 stores where it's been fully implemented. I'd also like to recognize the efforts of our team in controlling costs. Although SG&A slightly delevered versus a very tough year-over-year comp, the team has continued to place a strong focus on expense control. SG&A as a percent of gross profit at 70.6% is near historical lows for the U.S.

Lastly, our digital efforts are showing great progress. Consistent with our strategy to do business when and how our customers want to, we now have pilots in 24 stores that enable a customer to purchase a vehicle online. Results are early, but we're encouraged to this point.

Closing rates are significantly higher when customers start their purchase process online and our customers tell us the process is outstanding and they love the time savings. In addition, we are making it easier for our service customers to do business with us. Our online service appointments increased 26% versus the third quarter of 2017 and now represent nearly one quarter of all of our service appointments.

Lastly, due to changes we've made in our website content and our search engine optimization, the traffic coming to us organically is up 31% year-over-year. Organic traffic is much more productive and profitable than traffic we receive from third-party sources. All of these initiatives will lead to lower costs for Group 1 and more convenience for our customers. We will have more updates on these initiatives in the future.

I will now turn the call back over to Earl.

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## Earl Julius Hesterberg

Thanks, Daryl. As mentioned earlier, our UK operations were significantly disrupted in the quarter due to WLTP legislation that came into effect on September 1. The total industry was down 10% for the quarter, but our brands, particularly the VW family of brands, were disproportionately affected.

In the areas that we can control, used, after sales and F&I, our team once again delivered strong same-store growth. Our used retail unit sales increased 8% and total used gross profit increased a staggering 18% on a constant currency basis. F&I per retail unit increased 4% and after sales gross profit increased 3%, both on a constant currency basis.

Finally, I should note that while our new vehicle sales were depressed in September, our customer demand remained steady. We would expect to make up a good portion of the lost sales late in the fourth and throughout the first quarter.

Now turning to Brazil, which had a very strong quarter, as we continue to benefit from process improvements and strong cost control. Total same-store gross profit increased 15% on a constant currency basis, driven by a 36% increase in new vehicles, a 17% increase in F&I and a 5% increase in after sales. Our team did a tremendous job leveraging this additional gross profit as SG&A declined 460 basis points to 85.1% and operating margin increased 80 basis points to 1.7%.

We continue to be very proud of the work our local team has done and we're well-positioned to take full advantage of the recovering market.

I'll now turn the call over to our CFO, John Rickel, to go over some of our third quarter financial results in more detail. John?

## John C. Rickel

Thank you, Earl, and good morning, everyone. For the third quarter of 2018, our adjusted net income increased \$2.6 million or 5.5% over our comparable 2017 results to \$49.2 million. These 2018 adjusted quarterly results exclude \$14.4 million of net charges, consisting of \$17.7 million of non-cash franchise rights impairment in part explained by an OEM granting an adjacent open point to another dealer group, partially offset by \$4.4 million of net gains associated with dealership in real estate transactions.

On a fully diluted per share basis, adjusted earnings increased 10.8% to \$2.47, an all-time quarterly record. For the quarter, we generated \$2.9 billion in total revenues, which was a 4.3% decrease from the prior year due to both Hurricane Harvey comps and the impact of the WLTP legislation on new vehicle sales in the UK. Our gross profit only declined 0.7% however, as gross margin increased from 14.5% to 15.1%.

As a percent of gross profit, adjusted SG&A increased 80 basis points to 73.6% as Hurricane Harvey's boost to new vehicle sales and margins in September last year contributed to a very difficult SG&A comp. Floorplan interest expense increased by \$1.2 million or 8.9% from prior year to \$14.7 million, reflecting higher LIBOR interest rates versus the third quarter of last year. Other interest expense increased \$1.3 million or 7.1% to \$19.1 million due to increased mortgage and other borrowings.

Our consolidated adjusted effective tax rate for the third quarter was 23% and year-to-date, it is 23.6%. We forecast our full-year 2018 tax rate to be between 23.5% and 24%.

Turning to our consolidated liquidity and capital structure, as of September 30, we had \$32 million of cash on hand and another \$91.9 million that was invested in our floorplan offset account, bringing immediately available funds to a total of \$123.9 million. During the third quarter, we repurchased 790,000 shares at an average price of \$69.77 for a total of \$55.1 million. In October, we repurchased an additional 400,000 shares at an average price of \$62.52 for a total of \$25 million.

As Earl stated, year-to-date through today, we have repurchased over 1.9 million shares at an average price of \$67.86 for a total of \$131.4 million. These repurchases totaled 9.5% of our beginning-of-the-year share float. Our outstanding

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common share count as of today is 18.6 million.

Also during the third quarter, we used \$5.2 million to pay dividends of \$0.26 per share, an increase of 8% per share over the third quarter a year ago and an annualized yield of approximately 1.8%. 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.

I will now turn the call back over to Earl.

## Earl Julius Hesterberg

Thanks, John. Related to our corporate development efforts, the company was pleased to have previously announced the third quarter purchase of 200 stores in the U.S. that will generate approximately \$125 million in annual revenues. The stores are located in metro areas of San Antonio and New Orleans. These acquisitions brought our total 2018 year-to-date acquisition activity to 14 franchises, generating \$530 million of annual revenues.

During the quarter, we also disposed of a Ford franchise in California that generated \$60 million in trailing 12-month revenue. This disposition is consistent with our strategy of disposing of underperforming assets and redeploying capital in ways that are beneficial to our shareholders.

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

## Q&A

### Operator

Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] And our first question comes with John Murphy with Bank of America. Please go ahead, sir.

<Q - Yarden Amsalem>: Hey, guys. Good morning. This is Yarden Amsalem here on for John. Congratulations on the quarter.

<A - Earl Julius Hesterberg>: Thank you.

<Q - Yarden Amsalem>: So, my first question is on your strategic initiatives and in particular your technician initiatives. I was wondering if you – maybe you guys can comment on how do you see that ramping.

<A - Daryl A. Kenningham>: With our 4-Day Work Week, I assume is the question, we're more interested in doing it well than we are in doing it quickly. And so, we've rolled out completely 39 of our stores. And this is Daryl Kenningham by the way. And we expect to continue that on a steady basis throughout the rest of this year and into the first quarter.

When we're all finished, about 80% of our stores will have that, because there are some stores that are too small to support that structure, but about 80% of stores will have that. So, should be between now and the end of the first quarter, should be – we expect it to be almost fully rolled out.

<Q - Yarden Amsalem>: Got it. So, can you quantify maybe the incremental benefit that you're seeing in those stores in which you have implemented these initiatives versus the one that you haven't?

<A - Earl Julius Hesterberg>: Yeah. This is Earl. I don't think that our customer pay growth in the quarter was accidental. We had our largest customer pay growth quarter in the last two years I believe, which was about 8%.

<A - Daryl A. Kenningham>: It was well under 7% in the U.S.

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<A - **Earl Julius Hesterberg**>: Yeah.

<A - **Daryl A. Kenningham**>: Yeah.

<Q - **Yarden Amsalem**>: Okay. Makes sense. And then, on F&I, it was very strong particularly in the U.S. So, can you maybe talk about the drivers there and how should we think about going forward? I mean do you guys think that there's more room to push that even further.

<A - **Peter C. DeLongchamps**>: Well, thank you for asking. This is Pete DeLongchamps. I think that the financial services team in all three countries continue to do a very good job of executing on our strategy. In this quarter's performance, we continue to really keep our financing levels steady, but we've done a much better job with product. And I think for modeling purposes, where we are today, the \$1,600 range, we've got rising interest rates in our used car business as Val-U-Line continues to grow. So, we're pleased with the performance and I think that if we model kind of where we are today, it will be a fair direction.

<Q - **Yarden Amsalem**>: So, I have a quick follow-up on that. Can you maybe comment about the difference in FI PVR that you're seeing on a new vehicle versus a traditional zero to five years old vehicle and then what you're seeing in Val-U-Line?

<A - **Peter C. DeLongchamps**>: So, yes, we make a little bit more money on new and used continues to be relatively steady. And then, the Val-U-Line is about a third of what we would make on the overall.

<Q - **Yarden Amsalem**>: Okay. Thank you. And then, last question is just on SG&A. Can you maybe break down the performance for us by region and then talk about some of the initiatives that you've taken to drive improvement there?

<A - **Earl Julius Hesterberg**>: This is Earl. Yeah. We've had – since the first quarter this year, it's simply dealership by dealership in both the U.S. and the UK quarter-after-quarter and it's in every single expense area. So, that's ongoing.

I will say in the UK, there is some limit in a few of the brands as we've lost new vehicle sales volume quickly, but it's going to come back. So, in some stores, we can't resize them to the current level of volume, because it's going to come back somewhat quickly. But, yeah, it's down and dirty store-by-store in every country and every expense category.

<Q - **Yarden Amsalem**>: Okay. Thank you, guys. That's it for me.

## Operator

And our next question comes with Rick Nelson from Stephens. Please go ahead with your question.

<Q - **Rick Nelson**>: Thanks. Good morning. I'd like to follow-up on the UK and whether there is a way to really size up the challenge, how many units you may be lost in the third quarter because of WLTP and how you think that inventory – and does it all get made up in the fourth quarter? Are we looking at – into the first quarter of next year, I don't know, for that to be made up?

<A - **Earl Julius Hesterberg**>: Yeah. Sure, Rick. I'm not sure I can do the math quickly enough to give you a unit count, but you could see we were down a bit more than 20% in the quarter. And in September, I believe we were down about 23%. That's critical because that's a big volume month, one of the two plate changes. But probably, more importantly, is where are we at this moment. And through the 24th of October, I was looking at registration data in the UK, the market's still down 11% in total. But it seems that most of our key brands are coming back and are now down in single digits and there's cars coming in. The problem we still have is the Volkswagen Group and it appears they have solved the problem and those vehicles will start to be released, but as of the 24th, Audi, for example, was still down 59% in the month of October in the UK.

We have 10 Audi stores, 5 Volkswagen stores in the UK. I checked yesterday, we are starting to get some of the high-end Audi models, A6, A7, Q7 and Q8, which is a start. And obviously, there is gross profit potential on those, but our volume is down in models like A1, A3, A4, Q2, Q3, and we don't expect to get numbers back until very late this

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year and early next year on those volume models. So, it seems that it's going to be narrowed down to more of a Volkswagen Group brand issued for us as we move later into the fourth quarter.

<Q - **Rick Nelson**>: And can you remind us what those brands account for your UK sales?

<A - **Earl Julius Hesterberg**>: What the...

<A - **Daryl A. Kenningham**>: Yeah. The Audi, Volkswagen brand is probably a third of our UK business, Rick. And kind of to your earlier question, I mean, in total, we were down 2,200 units on a year-over-year basis. The industry maybe have been a little bit weaker coming in. So, I'd say, rough estimate, it probably cost us 2,000 units in the quarter.

<Q - **Rick Nelson**>: And maybe two-thirds of those come back then in the fourth quarter or...?

<A - **Earl Julius Hesterberg**>: I would certainly hope that we get at least half back this quarter. And then, by the first quarter, we should be getting back to normal, in particular, since the big volume in the first quarter next year will be March. So, by March, I'm sure, all the OEMs are going to want to be full speed ahead.

<Q - **Rick Nelson**>: Got you. And Hurricane Harvey, you started to lap that replacement demand late in the third quarter and that's probably going to have a bigger impact in the fourth quarter. Any color around how we should think about that impact in Houston?

<A - **John C. Rickel**>: Yeah. Rick, this is John Rickel. I mean, clearly, there was a lot of sales in September of last year. That continued into October and November. If you take a look, we were up almost 5% in the fourth quarter last year on new vehicle sales. So, that's kind of the bogey we'll be chasing against. In addition, the margins were pretty strong during that time. So, the gross profit dollars were even up kind of more than that. So, we've got a couple more months of pretty strong comps we're going to be up against.

<Q - **Rick Nelson**>: All right. Thanks a lot and good luck.

<A - **John C. Rickel**>: Thanks.

## Operator

And our next question comes with James Albertine from Consumer Edge. Please go ahead.

<Q - **James J. Albertine**>: Great. Thank you and good morning, everyone.

<A - **Earl Julius Hesterberg**>: Good morning, Jamie.

<Q - **James J. Albertine**>: Wanted to focus on the used segment, if I could, in the United States, you've got a lot going on there with Val-U-Line working its way into the gross profit per unit trajectory there. Could we just maybe try and unpack to late model vehicles? And if you can maybe help us isolate what's going on competitively in that segment that may be impacting margins there either positively or negatively. Just kind of give us some direction as to what's going on in that part of the used vehicle segment. Thanks.

<A - **Daryl A. Kenningham**>: Jamie, Daryl Kenningham. Just to clarify, are you asking what's happening with older used cars or with Val-U-Line specifically?

<Q - **James J. Albertine**>: No. The opposite, younger. So, the CPO, the off-lease, the zero to four segment, so would be the higher price points.

<A - **Daryl A. Kenningham**>: The CPO was up marginally for us and while volume percentage of our mix, that was down a bit. In the quarter, we're seeing competition in luxury mix, as we manage through our motor fleets, which has significant sources of – vehicle sources that are late model, new, nearly new. So, there's quite a bit of competition there, I guess I would tell you.

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<Q - **James J. Albertine**>: Yeah. And how about from a sourcing perspective? I don't think there's been as much focus among the questions on the franchise dealer side as to how much you bring from auction versus how much you depend on trade-ins and so forth. I'd imagine you're in a pretty advantageous spot just from an off-lease perspective? If you could help us sort of quantify your primary sourcing channels would be great.

<A - **Daryl A. Kenningham**>: The best place that we can get a pre-owned car is by trading for it. And we put a lot of focus on that. Our wholesale volumes were down 28% last quarter and that's on purpose. We tried to rely less on the wholesale markets, meaning buying and selling through auctions. And we want to try to trade for more of our customers' cars and keep more of those cars and we have purposely put some initiatives in place to try to do exactly that. We just feel like those are our better units. We know the service history and we feel like we can control more of that transaction.

<Q - **James J. Albertine**>: Are you able to put a percentage around it? I mean, over 50% would you say source from trade-ins or off-lease vehicles? Would that be fair?

<A - **Daryl A. Kenningham**>: I'd say about 60% from trade-ins, Jamie.

<Q - **James J. Albertine**>: Okay. Perfect. Thank you so much.

<A - **Daryl A. Kenningham**>: I'm not quite sure it's one-third. We like it to be two-thirds one-third. I think the other point to make, which is part of your question is that acquiring all police vehicles from the OEM is very much like an auction. Most of those cars we wouldn't consider a trade-in. If you're buying off-lease from the OEMs, it may be an online auction or it's not really the most price-efficient way to acquire some of the vehicles. So, there is some margin pressure in dealing with quantities of off-lease vehicles, which you get from the OEM. We don't influence that pricing a lot.

<Q - **James J. Albertine**>: Understood. But you do have a right of first refusal, right? So you could pass on vehicles that might have a more difficult or more pressured margin condition.

<A - **Daryl A. Kenningham**>: For those which are returned to your dealerships.

<Q - **James J. Albertine**>: Understood. Understood. Okay. Great. That's very helpful. Thanks so much and best of luck in the next quarter.

<A - **Daryl A. Kenningham**>: Thanks.

## Operator

And our next question comes with David Tamberrino from Goldman Sachs. Please go ahead.

<Q - **David Tamberrino**>: Yeah. Hey. Just wanted to dig in a couple of the regional stuff, in Brazil and then U.S. First on Brazil, I think adjusted SG&A was pretty good down to mid-80s this quarter and more often not, it's been a little bit higher and somewhat money losing. I mean are you at a position where that trend should continue? And if so, is there any incremental leverage that you can get as the environment potentially rebounds?

<A - **Earl Julius Hesterberg**>: The most important thing for Brazil at the moment is the Presidential election on Sunday. If there is a business-friendly administration, which everyone is hoping for, then we would expect the overall market to continue to recover from kind of a low 2 million units and move up kind of from the 2.3 million pace or whatever it's currently at. So, that is the biggest factor for us.

In the quarter, we had a big increase in our new vehicle margins. Some of that was because we're blowing out volume vehicles a year ago and we have a much better supply demand relationship with Honda and Toyota at the moment. And then also, we have some recovery in some of our luxury brand business there, which is BMW and JLR. So, I think our Brazilian business can continue to grow if the overall political and economic environment continues to improve.



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**<Q - David Tamberrino>**: Got it. And can you contrast that against – I understand you're expecting a rebound next year in the U.K. as vehicles become more available, but how do you think about the headwinds from the overall market if we do end up having a no-deal Brexit and it starts to weigh on consumers' minds?

**<A - Earl Julius Hesterberg>**: Yeah. And that's kind of like the overall political environment in Brazil, that is probably the critical factor in determining the size of the market next year. The supply matter, the correction to it is well underway and it's going to happen. So, the inventory will be there. It's very hard to imagine that Brexit won't be sorted out in some reasonable manner that will enable life to go on economically. Both the UK and the EU need each other, on vehicles, there's twice as many vehicles coming into the UK, as they are being exported out. It's a big issue for Germany. The number three, four and five brands in the UK auto market are German, the Audi, BMW and Mercedes, not necessarily in that order and, of course, the Japanese manufacturers and JLR export lot of vehicles, they have factories there.

So, it's unlikely that economically the two parties are going to damage themselves at the end of the day. So, I think it will get sorted out. And I believe when clarity does occur, whatever it is, because this has never been done before, we don't know exactly what will happen, but there should be an uptick in consumer confidence, which should help the auto market.

**<Q - David Tamberrino>**: Understood. And then lastly, I think towards the end of the quarter, maybe even afterwards, you announced some partnerships and working in vehicle subscription programs. How do you see that really adding to the dealer product offerings that you have so far? And what type of margins – how does that improve your business model?

**<A - Daryl A. Kenningham>**: Well, realistically I don't think it's material financially to anybody. I think we're all trying to learn from these experiences. We were asked by Audi to participate. We were eager to do so, because we want to learn, they want to learn, but we don't see this as any significant profit opportunity in the near term. We're just trying to get experience and adapt to change as it occurs in the market.

**<Q - David Tamberrino>**: Yeah. And I understand that, but maybe it's too early to tell, but if it was to become a serious business model and you were to see a significant percentage of the U.S. buyer move towards that type of contract or financing for a vehicle, I mean does that take away from what your profit generation could be from the triple play or the quadruple play, if you will, where you're getting a new sale or trade-in, the P&S and the F&I?

**<A - Daryl A. Kenningham>**: I don't know enough to really comment on that, but I think the underlying assumption is that as long as we continue to serve our customers with their transportation needs, that'll be a business model that needs to work for everyone, the OEM and the retailer. And so, we're trying to maintain our value to the OEM by being good distribution partners. We're trying to maintain our value to the customer. And that's the best odds we have for continuing to have a good business model.

**<Q - David Tamberrino>**: Okay. Thanks for taking the questions.

## Operator

[Operator Instructions] And our next question comes with David Whiston from Morningstar. Please go ahead.

**<Q - David Whiston>**: Thanks. Good morning. Can you talk about what you're seeing in the U.S. in terms of are you seeing any actual aggressive price war, like discounting tactics from your competitors in Japan, three franchise stores?

**<A - Daryl A. Kenningham>**: Daryl Kenningham here. Generally, we're seeing an aggressive market. Inventories are fairly balanced, car to truck, for the – that's the second quarter in a row and we've seen that a year ago, and we're significantly heavier in car than we were truck/SUV. I would say incentives are more aggressive in trucks now than they've been. The structure of the incentives are changing. Because of interest rate increases, you're seeing less APR support and more cash support. And then it appears to me, appears to us that the OEMs are managing cars through production and managing truck sales through incentives. That's just a general statement.

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YTD Change(%): -18.909

Bloomberg Estimates - EPS  
Current Quarter: 2.225  
Current Year: 8.789  
Bloomberg Estimates - Sales  
Current Quarter: 2925.000  
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<Q - David Whiston>: Okay. And interest rate is going up, most dealers are saying it really hasn't hurt their customers' ability to buy a car yet, do you agree?

<A - Daryl A. Kenningham>: I think we haven't seen enough evidence yet. We're watching it, obviously, and we haven't seen enough evidence of that yet.

<Q - David Whiston>: Okay. And...

<A - Daryl A. Kenningham>: John, you want to add to that?

<A - John C. Rickel>: Yeah. The sensitive – John Rickel. The sensitivity, 100 basis points for our average customers worth about \$25 a month in payment. And I agree with Daryl, I think, it's a little premature to be able to say, obviously, if rates continue to go up at some point, it'll start to waive, but I think it's a little early yet.

<Q - David Whiston>: Okay. And I guess my last question, John, is just – I apologize for missing this, but I think you gave some tax rate guidance that I missed, so do you mind repeating it?

<A - John C. Rickel>: Yeah. Basically, we were 23% for the quarter. We're 23.6% adjusted for year-to-date and we're comfortable with you modeling kind of 23.5% to 24% for the full year.

<Q - David Whiston>: All right. Thank you.

## Operator

And our next question comes from Armintas Sinkevicius from Morgan Stanley. Please go ahead.

<Q - Armintas Sinkevicius>: Great. Good morning. Thank you for taking the question. A little bit more commentary in the prepared remarks today from the digital initiatives. Maybe you could talk about the amount of investment you're putting into that and what spurred increased focus on this?

<A - Daryl A. Kenningham>: Daryl Kenningham here. We're not prepared to share investment number, but it is getting a lot of focus for us. Our customers want to do business that way. And as I mentioned, we're going to do business when our customers want to do business and how they want to do business and they demonstrate that over and over. So, it's really the customer driving this. And where we can see some cost savings, we will certainly take advantage of that, but service and sales, we're seeing a great deal of it.

<Q - Armintas Sinkevicius>: Okay. And are you delivering the vehicle to the customers' homes?

<A - Daryl A. Kenningham>: We offer that. Candidly, a lot of customers aren't taking advantage of that, but we offer that.

<Q - Armintas Sinkevicius>: Okay.

<A - Daryl A. Kenningham>: And it's early in this initiative for us. So, some...

<Q - Armintas Sinkevicius>: Sure.

<A - Daryl A. Kenningham>: ...of the things we will learn more as we go.

<Q - Armintas Sinkevicius>: Yeah. I guess one question with that, to the extent that you have delivered some vehicles to the home, any sense on how many vehicles people like to test drive? Is it just one vehicle that you deliver or the people want to try two, just curious on your thoughts there, experiences?

<A - Daryl A. Kenningham>: Well, I think there's a lot of confusion and misrepresentation in this whole area. We've been delivering vehicles to customers' homes, particularly used vehicles for a decade and new cars, too, if they wanted, but they usually don't. They usually don't. You don't have to go that far to deliver a new vehicle, because they're not going so far away from home to buy it.

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So, yeah, I think buyers are much more educated now and they're very much zeroed in on the model they want by the time they get into serious engagement with us. That's one of the advantages of the online world. So, I suppose they may test drive two or three, but I think today's shopper is pretty well zeroed in on the model they want in the new car.

And relative to this investment conversation, there's a lot of confusion there too. Most of this investment from an IT viewpoint on this online purchasing, this is done by vendors. We don't pay for most of that. There is a variety of vendors that do it. OEMs are supporting it in many ways. There's different OEM programs. Now, we can call investment the people we have in our Internet lead handling centers, which I think perhaps is what some people do. But this is not something where we're investing many millions of dollars to develop proprietary software. It's not necessary. It's all being developed in the industry.

<Q - **Armintas Sinkevicius**>: Yeah. Okay. And then, curious on the oil markets, I know there's some tough comps coming up with – or we're in the middle of them as far as Houston and Hurricane Harvey, but what are you seeing maybe on a sequential basis regarding the oil markets there?

Hello? Hello?

<A - **Daryl A. Kenningham**>: Were we muted?

<A - **Earl Julius Hesterberg**>: Yeah, for a second.

<Q - **Armintas Sinkevicius**>: Hello?

<A - **Daryl A. Kenningham**>: Yeah. We're back. Sorry.

<A - **Earl Julius Hesterberg**>: I'm sorry.

<Q - **Armintas Sinkevicius**>: No worries.

<A - **Daryl A. Kenningham**>: Did you hear any of the response?

<Q - **Armintas Sinkevicius**>: I missed the entire response.

<A - **Daryl A. Kenningham**>: Okay. My apologies.

<Q - **Armintas Sinkevicius**>: No worries.

<A - **Daryl A. Kenningham**>: I do think the oil impact at the time, we were just continuing to recover. We finally see in Oklahoma, lap there, weak comps and they're starting to come into the plus side a little bit on unit comps. In markets like Houston, the economy continues to slowly gather strength as the world adjusts to these higher oil prices and lower cost of production and so forth. So, I think we're continuing to see a recovery in those energy-related economies.

<Q - **Armintas Sinkevicius**>: Okay. And then, on the flip side, with rising gas prices, are you seeing anything at the store level with regards to that affecting purchases, whether it's units or mix or anything like that?

<A - **Daryl A. Kenningham**>: Not yet. No.

<Q - **Armintas Sinkevicius**>: Okay. Thank you.

## Operator

And this concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

## Earl Julius Hesterberg

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Okay. Thanks to everyone for joining us today. We look forward to updating you on our fourth quarter earnings call in February. Thank you.

## Operator

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

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