THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GPI - Q1 2012 Group 1 Automotive Earnings Conference Call

EVENT DATE/TIME: APRIL 26, 2012 / 2:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Pete DeLongchamps *Group 1 Automotive, Inc. - VP Manufacturer Relations, Public Affairs*

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

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

Lance Parker *Group 1 Automotive, Inc. - VP and Corporate Controller*

CONFERENCE CALL PARTICIPANTS

Elizabeth Lane *Bank of America/Merrill Lynch - Analyst*

Simeon Gutman *Credit Suisse - Analyst*

Ottie Oberoy *Goldman Sachs & Co. - Analyst*

Rick Nelson *Stephens Inc. - Analyst*

James Albertine *Stifel Nicolas & Co. - Analyst*

Ejay *Morgan Stanley - Analyst*

Matt Nemer *Wells Fargo Securities - Analyst*

Craig Bernstein *McCallum Capital - Analyst*

Brett Hoselton *KeyBanc Capital Markets Inc. - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Group 1 Automotive's first quarter 2012 earnings conference call. Please be advised that this call is being recorded.

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

Pete DeLongchamps - *Group 1 Automotive, Inc. - VP Manufacturer Relations, Public Affairs*

Thank you, Annie. And good morning, everyone, and welcome to today's call. Before we begin, I'd like to make some brief remarks about forward-looking statements and the use of non-GAAP financial measures.

Except for historical information mentioned during the conference call, statements made by the 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 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.

Participating with me today on the call are Mr. Earl Hesterberg, our President and CEO; John Rickel, our Senior Vice President and Chief Financial Officer; and Lance Parker, our Vice President and Corporate Controller. I will now hand the call over to Earl.

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

Thank you, Pete. And good morning, everyone.

At the risk of sounding repetitive I'm pleased to announce that earlier today Group 1 reported another record setting quarter. Diluted earnings per common share were $0.97 for the first quarter of 2012, breaking the prior first quarter record set in 2006 when the industry selling rate was 2.4 million units higher. Our earnings represented a 52% increase on a comparable basis to the first quarter of 2011. In addition, we also reported record first quarter revenues and all-time high gross profit.

Given the first quarter 2012 selling rate was still at a relatively low 14.5 million units and there were still some key model and brand inventory issues within the quarter, we're quite pleased with these results. We sold 27,930 new vehicles in the first quarter, and our average sales price increased 3% to $32,674, driving a 16% increase in new vehicle revenues and a 24% increase in new vehicle gross profit from the prior year period. New unit sales increased 13% for the quarter.

We were somewhat surprised by the strength of the used vehicle market and we're pleased with our performance in that segment. We retailed 24% more used vehicles than the first quarter of 2011, driving a 26% gross profit increase on 28% higher revenue. Gross profit expanded 2% to $1,754 per retail unit.

Our F&I business also remains strong. Finance and insurance revenues were 29% higher, with gross profit increasing $107 per unit retailed to $1,175. This was the best first quarter result the Company has ever reported, primarily attributed to better penetration rates of our product offerings.

Parts and service gross profit grew 8% on a 9% year-over-year revenue increase, reflecting growth in our customer pay, wholesale parts, and collision businesses. We continue to be very pleased with the work we have done in this business to improve processes, efficiencies, and customer satisfaction, driving revenue and gross profit growth.

The combination of these results led to an 18% increase in consolidated revenue to a first quarter record of $1.66 billion, an all-time record gross profit of $260.4 million, which was a 17% increase from the first quarter of 2011.

These sales results also enabled us to further leverage our cost structure with selling, general and administrative expenses as a percent of gross profit improving 280 basis points to 76.5%, since our gross profit generation continues to outpace expense growth. As a result, operating margin expanded 40 basis points to 3.2%.

Regarding our first quarter new vehicle unit sales mix, our inventory supply, Toyota and Honda were returning to more normalized levels late in the first quarter. We saw our import brand mix increase from the fourth quarter to 56% of our new vehicle unit sales. Luxury brands accounted for 24%, and domestic brands made-up the remaining 20% of our new vehicle unit sales. Toyota, the Lexus share expanded to 31% of our unit sales, the Nissan Infiniti and Honda Acura at 13% and 11%, respectively. BMW mini unit sales also accounted for 11%, followed by Ford with 10%, GM 6%, and Daimler and Chrysler at 5% each.

New vehicle inventory remained at 54-day supply, growing 9% to 20,537 units from December 31st. At quarter end our inventory is about where we want it to be, with import and luxury at a 48-day supply, and domestic brands at a 77-day supply. We had a 28-day supply of used vehicles at March 1st. Certified pre-owned sales remained flat at 33% of our used retail vehicle sales.

Turning to acquisitions, previously we announced that we acquired three franchises in the first quarter -- Volkswagen of Alamo Heights in San Antonio, Texas, Fulton Head BMW in South Carolina, and most recently Shawnee Mission Hyundai in Kansas City. These franchises are estimated to generate about $144 million in additional annual revenues. As of today we operate 144 franchises out of 112 dealerships in the United States and the United Kingdom.

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

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

Thank you, Earl, and good morning, everyone.

Our net income for the first quarter of 2012 rose $7.6 million or 49.1% on a comparable basis over our 2011 results to $23.1 million, which is the best first quarter in our Company's history. Earnings per diluted common share improved 52% on a comparable basis over the prior year results, to $0.97, which is also the best first quarter result in our Company's history. In comparison, the previous best first quarter results were achieved in a SAR environment of 16.9 million units. This result continues to highlight significant improvements we have made to our processes and cost structure, and demonstrates the leverage those improvements are delivering as new vehicle sales volumes continue to increase.

Compared to the same period a year ago our operating margin improved 40 basis points over the comparable prior year results to 3.2%, and our pretax margin also improved 40 basis points to 2.2%.

On a consolidated basis we delivered record revenues in the first quarter of $1.66 billion, increasing $255.4 million or 18.1% compared to the same period a year ago. This record reflect increases in each of our business segments.

New vehicle revenues increased 16.3% to $912.6 million on 13.1% more units. Our used vehicle retail revenues improved 28.3% to $415 million on 24% more units and a 3.4% increase in our average used vehicle retail sales price per unit. Used vehicle wholesale revenues grew 7.9% to $66.9 million, while our F&I revenues rose 29.3% to $57.2 million or $1,175 per retail unit sold, which is the Company's best ever first quarter F&I performance.

And for the ninth straight quarter we've reported year-over-year revenue growth from the core of our business, the parts and service segment. Revenues from our parts and service business improved $18.2 million or 9.3% to $213.1 million. Our gross profit increased $38.6 million or 17.4% from the first quarter a year ago to $260.4 million, which represents the best all-time any quarter in the Company's history. The gross profit results included increases of 23.5% in new vehicles, 24.5% in total used vehicles, and 7.7% in parts and service, as well as the F&I improvement that I just mentioned.

We continue to leverage our cost base, and as a result SG&A expenses as a percent of gross profit improved 280 basis points to 76.5%. Interest expense increased $900,000 or 12.7% from prior year, to $7.6 million. This increase is primarily explained by an $85.3 million increase in weighted average borrowings as Japanese brand inventories started to normalize and overall inventory increases were required to support rising sales, as well as recent dealership acquisitions.

At March 31st, 2012 our new vehicle inventory stood at 20,537 units with a value of $694.5 million, compared to 18,766 units with a value of $619.2 million as of December 31st, 2011.

Manufacturers interest assistance, which we record as a reduction of new vehicle cost of sales at the time vehicles are sold, covered 97.3% of total F&I interest expense in the first quarter, which is up from 91.9% in the first quarter a year ago.

Other interest expense increased $1.1 million or 13.8%, $9 million, explained by increased mortgage borrowings associated with recent dealership acquisitions. Our consolidated interest expense includes noncash discount amortization of $2.4 million related to our convertible notes.

Now turning to first quarter same store results. In the first quarter we reported revenues of $1.54 billion, which was $132.3 million or 9.4% increase from the comparable 2011 period. Within this total new vehicle revenue was up 7.3% to $840.7 million, reflecting higher unit sales of 4.6% and an increase in our average new vehicle sales price of $818 per unit for $32,597.

In total our used vehicle revenues rose 16% to $446.7 million, within that our used retail revenues improved 19.3% to $385.5 million on 15.4% more units and a $657 increase in our average retail used vehicle sales price to $19,995 per unit. Our wholesale used vehicle revenues declined 1.2% to $61.2 million.

F&I income per retail unit rose 10.6% to $1,181 per unit, driven primarily by increases in our penetration rate and income per contract for our major product offerings. In total F&I revenues were up $9 million or 20.4% compared to the same period a year ago.

We posted another solid quarter in our parts and service business. Parts and service revenues grew 2.3% despite a 12.4% decline in our warranty parts and service revenues resulting from the drop-off of several large recall campaigns that bolstered prior year results. The increase is more than explained by increases of 7.1% in our customer paid parts and service revenues, 2.6% in our wholesale parts business, and 10.8% in our collision business.

Our customer pay revenues improved in most of the major brands that we represent as initiatives focused on customers, products, and processes continue to build momentum. In addition, improved business processes and initiatives in our collision segment are also driving positive results. Within the decline of warranty parts and service revenues our Lexus brand stores decreased nearly 50%, BMW decreased 20%, and Toyota decreased 14% from prior year.

As a reminder, all parts and service revenues are not bolstered by increases in internal business. The revenue associated with internal work is eliminated in consolidation. This varies across the sector, as some of our competitors account for internal work differently.

Overall, our gross profit improved $20.9 million or 9.4%, while our total gross margin remained flat compared to prior year at 15.7%. Compared to results a year ago, our same store new vehicle gross profit dollars improved 14.3%, which is primarily the result of higher volumes and $160 increase in gross profit per retail unit to $1,891, and our total used vehicle gross profit dollars increased 14.5%, reflecting a $43 increase in gross profit per unit sold, as well as the 15.4% increase in retail unit sales I previously mentioned.

We continue to be proud of the leverage we are delivering in our SG&A costs. Our SG&A as a percent of gross profit improved 280 basis points to 76.5%. As new vehicle sales increase and gross profit continues to grow we would anticipate further leveraging in SG&A. For example, in the first quarter of 2012 we grew gross profit by $20.9 million and held SG&A expense growth to $9.8 million. This equates to a 53% flow-through of gross profit to EBITDA.

A rough rule of thumb is that we expect each incremental gross profit dollar will only add about $0.50 of variable SG&A expenses on a same store basis, which we believe is the appropriate way to analyze this metric as acquired stores will clearly bring their own fixed cost load and distort the analysis for the year immediately following acquisition. This cost leverage enabled our same store operating margin to improve 40 basis points over the comparable prior year results to 3.2%.

Now, turning to liquidity and capital structure, during the first quarter of 2012 we generated adjusted cash flow from operations of $62.9 million, an increase of 34.6% from the first quarter a year ago. As of March 31st, 2012 we had $21.3 million of cash on hand and another $111 million that was invested in our [four point] offset account, bringing immediately available funds to a total of $132.3 million. In addition, we had $225.7 million available on our acquisition line that can also be used for general Corporate purposes. As such, our total liquidity at March 31st, 2012 was $358 million.

With regards to our real estate investment portfolio, we own $513 million of land and buildings at March 31st, which represents more than one-third of our total real estate. To finance these holdings we've utilized our mortgage facility and executed borrowings under other real estate specific debt agreements. As of March 31st we had $44.5 million outstanding under our mortgage facility and $196 million of other real estate debt, excluding capital leases. During the first quarter we used $3.2 million to pay dividends of $0.14 per share, an increase of $0.03 per share over the first quarter of 2011.

Finally, I want to mention that we were pleased with Standard & Poor's announcement earlier this week that they were upgrading our corporate credit rating from BB- to BB, consistent with our improved operating performance and the strength of our balance sheet, which is exemplified by our Best in Sector debt to equity ratio of 38%.

For additional details regarding our financial condition please refer to the schedules and additional information attached to the news release, as well as the Investor presentation posted on our website.

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

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

Thanks, John.

We're excited about the future of Group 1 in the automotive retailing industry. As we noted, at recent auto shows our manufacturer partners are rolling out a significant number of exciting new products over the next two years that will help bring customers into our dealerships. Customers have been holding on to their aging vehicles, which average 10.8 years old, during the recession and are looking for new fuel efficient and technology loaded vehicles being offered. Our brand mix positions us well to gain share in the markets we serve.

As I mentioned, industry selling rate came in at 14.5 million units for the first quarter. Given the strength of the quarter we're raising our full year 2012 SAR estimate from 14.0 million to 14.5 million new vehicle units.

To wrap-up our prepared statements, we're pleased that we're delivering another record setting quarter. We're optimistic about the opportunities to leverage our improved cost structure as Group 1 and the industry grows in the coming years. That concludes our prepared remarks. I'll now turn the call over to the Operator to begin the question and answer session.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question and answer session. (Operator Instructions)

Our first question is from John Murphy with Bank of America/Merrill Lynch. Please go ahead.

Elizabeth Lane - *Bank of America/Merrill Lynch - Analyst*

Good morning. This is [Elizabeth Lane] on for John. When you look at your regional performance did the northeast have stronger year-over-year gains than the other regions due to the more favorable weather? And I mean in other words did the regions that typically have more dramatic seasonal patterns have stronger year-over-year gains?

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

Well, actually, there were big regional variations, and counter to what we might have thought with the weather and so forth our weakest area was northeast and, in particular, New England. And our strong area remained Texas and Oklahoma. And so I was somewhat surprised by that, and sales results on new vehicles were the most uneven by brand and geography than I'd seen in a long time, so some of that was quite surprising. Now, overall, it was good nonetheless, but surprisingly weak in the northeast for us.

Elizabeth Lane - *Bank of America/Merrill Lynch - Analyst*

And just -- okay, and you mentioned the rollout of new products. When you look at the schedule for product launches coming up for the brands you represent, which vehicles do you think are going to be the most impactful and which seem like they might be kind of missing the mark?

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

Well, I think the two that we look at quite carefully here are Toyota and Honda because they represent so much of our business, and Toyota has a large number of new vehicle launches over the next year or two. The Camry, obviously, recently launched. But I think most people in the industry are anxious to see the new Honda Accord and how the sell-down from the existing Accord goes because that will be critical for Honda to regain some of the market share they lost. And then I believe very late in the year, early next year, they have another redesign of the Civic. So we focus quite a bit on Toyota and Honda.

Elizabeth Lane - *Bank of America/Merrill Lynch - Analyst*

Okay, great. And, finally, are you seeing any pickup in incentive activity, either on the manufacturer end or the dealer end at the end of 1Q or in April?

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

Yes, slightly. I don't think it's a major movement yet, but I believe it's been pretty well covered that Honda got more aggressive in a sell down program on the current model Accord to pave the way for their new model Accord. And I think we will probably see more activity as we move into the summer, particularly as Toyota and Honda make further efforts to regain share and as their inventory situation has only recently normalized.

Elizabeth Lane - *Bank of America/Merrill Lynch - Analyst*

Okay, great. Thanks, and congrats on the great quarter.

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

Thank you very much.

Operator

Our next question is from Simeon Gutman with Credit Suisse. Go ahead.

Simeon Gutman - *Credit Suisse - Analyst*

Thanks. Good morning. Do you have -- do you know what kind of share, how share played out in the quarter? Did you take share in your markets with brands? And then related to that, I think that the fleet sales certainly helped some of the J3 in the first part of the year, how confident are you that the market share on the retail side, just from an overall brand side, will start to accelerate?

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

Yes, Simeon, that's a good point. I think there was maybe a little bit of exuberance on the first quarter selling rate increases, being in mid or low double digits, but there was of lot [bleed] in that. I think someone already mentioned that this morning. The real retail growth rate so far this year seems to be more around 8%, and that's great. I mean that type of pace is fantastic for us, 7% or 8%.

Yes, I think generally we gained share, even in the northeast where I just mentioned a moment ago we were a little disappointed with our new vehicle sales. We're very powerful with Toyota there. We outperformed our region in terms of sales growth there. It just wasn't the kind of increases we got in Texas, Oklahoma, and in some cases California. So I think that the industry sales increase on the retail side is still very significant and steady, but it seems to be high single digits and that's -- I think that bodes well for all of us in this industry.

Simeon Gutman - *Credit Suisse - Analyst*

Okay, and then a question on operating leverage, maybe for John. I appreciate the color and the commitment to that, the flow through. Granted you'll continue to do acquisitions, which will obscure the number to some degree, but if you're going through a period in which sales start to accelerate here, especially some of the brands that there was an inventory, could the core business be north of that for a temporary period? Does that make sense?

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

Yes, you mean -- this is John -- I guess, I mean but what we're committed to is kind of the numbers I gave on the call, and that's really looking at it over kind of the rest of the year. We're very comfortable with that view on a same store basis that $0.50 on the incremental gross profit dollar will flow through.

Simeon Gutman - *Credit Suisse - Analyst*

Okay, and then one more on the F&I side, it looks like the performance was good again. I think we're up 10% year-over-year, it's about close to where we were on a year-over-year basis. Once we start to cycle the pickup that began last year, how does that play out? Are there drivers to continue to push that higher or do we start to level off? Thanks.

Pete DeLongchamps - *Group 1 Automotive, Inc. - VP Manufacturer Relations, Public Affairs*

Hi, Simeon. It's Pete DeLongchamps. I think that we begin to level off. We've got some -- we still have some opportunity to improve underperforming dealerships, but I think from a modeling perspective we're at a pretty good level right now.

Simeon Gutman - *Credit Suisse - Analyst*

And when you said underperforming dealerships is that in either the financing side or is it in selling some of the additional?

Pete DeLongchamps - *Group 1 Automotive, Inc. - VP Manufacturer Relations, Public Affairs*

It's a combination of both. It's just focusing on specific brands and making sure that the dealerships that have opportunity, we're paying particular focus to those to bring those up to the average, and we use our high performers as the examples.

Simeon Gutman - *Credit Suisse - Analyst*

Okay, thanks. Good quarter.

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

Thank you.

Operator

Our next question is from [Ottie Oberoy] with Goldman Sachs. Go ahead please.

Ottie Oberoy - *Goldman Sachs & Co. - Analyst*

Great, thanks a lot. My first question is on your used to new ratio, it has been tracking pretty high. Can you talk a little bit about how you're thinking about that going forward and were there any specific reasons why this quarter had a great performance?

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

This is Earl. We do not really pay much attention to the used to new ratio because it fluctuates based on geography. We're very heavy in the northeast compared to maybe other companies, and we lack land there, also in the State of Massachusetts they have some regulations that relate to you can't promote a used car for sale until you physically have possession of the title and things like that. So there, in places like New Jersey and New York, Boston, California, we just don't have the space for big retail used car lots in some cases. So as our geography changes, both with the acquisitions and in terms of economic strength in various regions in the country that ratio can change a lot.

What we do try to do is sell every used car we can possibly get, and we had one of our better quarters, but I have to say the market was much stronger than we would have expected. And as we came out of December, December was a very big retail, new vehicle retail month, and what that means is we get an increased number of trade-ins, and so we were able to start out the year in January with probably a better used car availability than we normally have.

So we set out to make sure that we retailed as many of those as possible, and by the time we got to the end of the quarter we were down to a 28-day supply, so we did a very good job of retailing every vehicle we had available to us. And for nine months or so we also tried to trade more aggressively because of the shortage of used cars in the market. So the market was stronger than we thought and we did a good job of retailing what we had available to us.

Ottie Oberoy - *Goldman Sachs & Co. - Analyst*

Great, then that's helpful. My second question is on the P&S segment, can you remind us when you guys kind of were lapping those tough comps which benefited your segment from a warranty standpoint?

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

Well, the best of my recollection, there were actually several waves of recalls. I think the Toyota recalls were well chronicled, oh, I guess two years ago, early in the calendar year two years ago. But then through last summer or fall there were other non-Toyota brand recalls, including some big Lexus recalls that were large dollar. And I think it will be third or fourth quarter this year before we cycle through that big warranty hit that we're getting now, which was almost 12.5% down in the first quarter. So we definitely have one more big quarter to fight that, if not two or three. John, do you remember?

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

Yes, this is John. Based on what we've looked at I think the second quarter should be the majority of it. By that point, especially the Lexus item that Earl mentioned is pretty well behind us, as well as some of the BMWs. So I think by second half we should be in more favorable territory on a comp basis.

Ottie Oberoy - *Goldman Sachs & Co. - Analyst*

And, great, and finally on the F Series we had heard some comments that the F Series was running tight in some of the regions. Can you talk a little bit about what you're seeing currently or how are things on that front?

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

Yes, this is John. The F Series, in particular the EcoBoost option on the F Series has been a big seller, and I know a lot of our Ford stores continue to be looking for that inventory.

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

Yes, and despite that, the Ford business is one of our strongest businesses in our portfolio right now. Our Ford sales were up 22% in the quarter, so that's one where we probably gained quite a bit of share. I don't believe Ford sales were up 22% in the quarter nationally.

Ottie Oberoy - *Goldman Sachs & Co. - Analyst*

Great. Thanks a lot, guys, and congratulations on a good quarter.

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

Thank you.

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

Thank you.

Operator

Our next question is from Rick Nelson with Stephens. Go ahead please.

Rick Nelson - *Stephens Inc. - Analyst*

Thank you. Good morning. my congrats, as well.

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

Thank you, Rick.

Rick Nelson - *Stephens Inc. - Analyst*

Hearing about more stair step programs out there, including the Accord, which I think you mentioned earlier, do you think the targets on these stair steps are reasonable and where do you see that gross profit per unit, you were around $1,900 [inaudible]?

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

When the word stair step comes up Pete has to calm me down, so I'm taking a deep breath. There are too many stair step programs out there. We didn't need any more. They tend to have a negative affect on gross margins and a negative impact on customer satisfaction. And my opinion is that sooner or later those objectives do become unfair somewhere and the bigger the dealership and we tend to have big dealerships, the more the problem that can be created.

Now I could not tell you that we had any major negative impact in Q1 that I would attribute to stair steps, but it's just a cancer in the industry that isn't good for dealers or customers. And, in particular, you get in a situation where fringe metro dealers get objectives of 20 or 25 cars and then the next dealership in toward the population center has an objective of 160. So, and then you get basically two-tiered pricing between two dealers that may be a 10 or 15-minute drive apart. Those are the things that really bother us. But in terms of financial impact on our business at the moment or that I would predict in the second quarter I couldn't really attribute anything material to what I've seen.

Rick Nelson - *Stephens Inc. - Analyst*

Okay, got you. And, Earl, if you look at the three segments of your business, domestic, the mid-line import, and luxury, where do you see the biggest growth rates occurring as inventories normalize would it come into Japan?

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

Yes, I think, Rick, definitely in the future it would be with the Japanese brands. At this moment, as we sit here, in the first quarter, I just mentioned our Ford business was up 22%. And that's about 10% of our total business, so we're not one of the bigger domestic brand retailers. And our Chrysler business, which is only 5%, was up 42%. So right now it's still the domestics are on, at least those two companies are by far the most powerful in our portfolio, but I believe it's going to shift to -- more toward Toyota and Honda, and Nissan has carried momentum for a year-and-a-half or so. So I think that the growth rate for the rest of this year I would expect to be better for the Japanese brand.

Rick Nelson - *Stephens Inc. - Analyst*

Got you. And then, finally, if I could ask you about this [resin] issue, what you're hearing from the OEMs in terms of supply?

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

Yes, I've had some conversations with it, and obviously everyone is very concerned, but my impression from everyone I talked to on the manufacturer side is that it's manageable, that they have identified alternative sources. There are some questions about the price they have to pay from the alternative sources and the exact timing of the availability, but no one, no manufacturer has advised us of any significant negative impact on production yet.

Rick Nelson - *Stephens Inc. - Analyst*

Got you. Thanks a lot and good luck.

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

Thank you, Rick.

Operator

Our next question is from James Albertine with Stifel Nicolas. Go ahead, please.

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

Great. Good morning and thank you for taking my question, and may I add my congratulations on a great quarter. First and foremost, wanted to focus on the parts and service business just to get an idea, and I apologize if you mentioned it in the prepared remarks of your call and I missed it, but the traffic versus ticket breakdown as customer pay work has gone up here as of late?

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

Well, I don't have those figures in my head. The customer pay, we're focusing on traffic, so our repair order count is definitely up. So my feel is that our growth in customer pay, which has mitigated some of that warranty hit, is more on the side of pushing more traffic than it is any major increase in dollars per repair order. I do have a couple of my teammates here trying to flip through some pages to see if we can get you any more quantifiable data on that. Can't come up with any precise data at the moment, but we'll try to get back with you.

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

That's all right.

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

Our focus is on generating traffic increases because we know that over time our repair order values, you know, dollars per repair order are relatively consistent.

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

Sure. No, understood, and we can certainly follow-up on that point. I guess, secondly, the financing part of the business, get an idea -- can you help me get an idea of the penetration this quarter versus prior quarters and perhaps any indication of uptick in subprime?

Pete DeLongchamps - *Group 1 Automotive, Inc. - VP Manufacturer Relations, Public Affairs*

It's Pete DeLongchamps. The penetration was up slightly this past quarter, and subprime certainly is becoming a bigger part of the business. But also what's changed along with that, and a lot of it has to do with what happened with the recession and people's or our customer's scores becoming a little bit lower based on financial situations. But the banks have also become more active in that arena. We have one particular bank that we'll send them 500 [bekins] and above, so it's a different landscape than what we've seen even three years ago, but it's definitely becoming a bigger part of the business and it's definitely regional.

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

That's very helpful. And then, lastly, if I can just ask kind of a bigger picture question in terms of the M&A environment, are you seeing any sort of discernible trends in terms of the quality of the targets that are out there or is it pretty much sort of par for the course? And when you get to a point where you can negotiate a viable takeout valuation it's a similar sort of ramp rate in terms of getting up to the average EBIT of your existing stores?

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

Well, the number of potential sellers and the quality of the sellers has been pretty significant for the last 12 to 18 months, so I haven't seen any recent change in that. The issues still relate to finding acquisition targets that meet our strategic need in terms of brands and geography. Also, a price that represents a good return on investment for us, and more and more are real estate issues because the current value of commercial real estate is pretty far below where it was four or five years ago, and that's an impediment to some of the sellers and some of the transactions. But each acquisition is so incredibly different based on geography and brand that it's very hard to weave a common thread through them. And so it's hard for me to give you an intelligent answer on the question of integration.

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

No, understood. That's very helpful. Thank you, again, for taking my question.

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

James, this is John Rickel.

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

Hi, John.

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

Back to your question, customer pay repair orders were up 2% in the quarter and dollars per repair order were up 5%.

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

Perfect. Thanks, again.

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

Our next question is from Ravi Shanker with Morgan Stanley. Go ahead please.

Ejay - *Morgan Stanley - Analyst*

Hi, this is [Ejay] for Ravi. How are you guys doing?

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

Good. How are you Ejay?

Ejay - *Morgan Stanley - Analyst*

Doing well. If we could jump back to used sales for a second? You mentioned that strong retail sales in 4Q and a corresponding increase in trade-ins may have helped your performance in that segment this quarter. As new vehicle sales ramp-up through the rest of the year and ostensibly trade-ins continue to improve would you expect there to be some up side to used, you know, can we see this level of performance continue?

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

I don't know that we would expect something like 15% to 18% increases, the sorts of things that we saw in many of our dealerships in the first quarter. But, yes, I think there's still excellent growth room in the used vehicle retail business in the U.S. market. The more trade-ins we get that will, I think we can be more competitive and have more attractive merchandise, and it should also give us a chance to do a little better on the margins. And so, yes, I believe that we would expect a strong used car market this year, in addition to a strong new car market.

Ejay - *Morgan Stanley - Analyst*

Got it. And sort of along the same lines, used retail pricing remains for you guys at near record levels, but it looked like used wholesale pricing was down a couple of points. Could you comment a bit on that divergence, are we maybe seeing signs that used pricing will begin to normalize a bit going forward?

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

Well, most of the things that go to auction now, at least from our Company, are really junk. I mean and I think that's probably not just true of our Company. I mean we are trying to hold for retail every unit. We're selling probably lower dollar value retail units and older model year retail units, higher mileage retail units than we ever have in our history, and it's worked out pretty well for us so far, and we book margins on them and so forth. So I think you can assume that if we're sending it to auction it's not a very nice car.

Ejay - *Morgan Stanley - Analyst*

All right. And continuing around that same line, one final question, despite sending what you would call the junkiest cars to auction, it looks like your used vehicle wholesale gross margins were pretty good in the quarter, although it seems like in recent years it's been a trend that in the first quarter you guys were reducing around the 4% level. Could you -- can you just help me understand what's going on there?

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

This is John Rickel. I think it is a factor, there is some seasonality to it, and it has been a pretty robust auction environment, so even stuff that we're sending that's not all that desirable we're still making small profits. Though our main goal, as Earl indicated, is to try to retail as many of those as we can. So we made money at the auctions. We were obviously happy with that, but we're happier when we can keep them and retail them ourselves.

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

Well, and if we're short of used car inventory the entire used car industry and all types of used car retailers are short on inventory. So even those people attending auctions who are non-franchised, local independent used car retailers, they're very aggressively looking for vehicles, also.

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

If you look at it on a dollars per unit sold we're basically flat with same period a year ago. We did 275 in 2011 first quarter, and we did 270 this quarter, so it's pretty consistent from first quarter to first quarter.

Ejay - *Morgan Stanley - Analyst*

Okay, that's very helpful. Thanks, guys, and congrats on a good quarter.

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

Thank you.

Operator

Our next question is from Matt Nemer with Wells Fargo. Go ahead, please.

Matt Nemer - *Wells Fargo Securities - Analyst*

Good morning, everyone.

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

Good morning, Matt.

Matt Nemer - *Wells Fargo Securities - Analyst*

So great quarter. My first question is on the new vehicle gross profit per unit. Had a little bit of an abnormal move down from the fourth quarter. It seems like the two quarters tend to be a little closer to each other. How do you think the trend plays out for the rest of the year? Does it hold at 1900ish or do you think we could go a little lower as the mix shifts back to mid-line imports?

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

Matt, I think that the margin should stay within a reasonably tight band. I think it's fair to say that volume brand, volume increases that we might expect Toyota, Honda, which we've talked about, might put a little pressure down on the margin, but also I don't think any retailers in the U.S. had very many luxury vehicles to sell in the first quarter. BMW, Mercedes, Lexus, so I would hope that there'll be a better availability as we move through the remainder of the year on those things, you know, BMW 3 Series, X3, X5, there are several Mercedes models that have been short. So I would hope that will be a tailwind that'll help any headwind in the margins that we get from volume brands.

Matt Nemer - *Wells Fargo Securities - Analyst*

Do you -- is that something that you can see in your upcoming allocations or deliveries?

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

In terms of better availability?

Matt Nemer - *Wells Fargo Securities - Analyst*

Correct.

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

Yes, but I don't think we have enough visibility up front to say that we know when we're going to be able to meet demand on a lot of those luxury models. And, quite frankly, we don't get too upset about being a little bit short on luxury models because that supply and demand relationship on these luxury brands has been pretty good. But after December there was a huge push by the luxury brands in December, and of course Lexus still hasn't caught up, so we still aren't -- and I think dealers across the country still aren't anywhere near where they want to be on luxury brand inventory.

Matt Nemer - *Wells Fargo Securities - Analyst*

Okay, that's very helpful. And then turning to the F&I performance, it looks like a lot of the strength or the change in penetration was on the service contract side, if I'm reading your chart correctly? What's driving that, the growth in extended service contracts?

Pete DeLongchamps - *Group 1 Automotive, Inc. - VP Manufacturer Relations, Public Affairs*

Hey, Matt. It's Pete. I think it comes down to training process, it's a menu driven approach. We've really worked on making sure that the presentations are consistent across the Company. I think the approach that the regional finance directors have worked with our general managers is paying dividends for us. So it's just been some good hard work and training in process.

Matt Nemer - *Wells Fargo Securities - Analyst*

Okay, and then, lastly, on the SG&A expense side there was some good leverage. One of the lines that didn't leverage was personnel, and I was just wondering if you could talk to that and if there have been any changes in comp plans or anything else that may have been a temporary headwind?

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

Matt, this is John. The one thing that gets into it, especially in first quarter, is the payroll taxes. By fourth quarter you've, basically, the higher compensated people you've kicked out of most of your FICA obligations, that always resumes in first quarter, so that's one of the things that distorts first quarter numbers.

Matt Nemer - *Wells Fargo Securities - Analyst*

Got it. Okay, that's helpful. Again, congrats, guys. Great quarter.

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

Thanks.

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

Thank you very much.

Operator

Our next question is from [Craig Bernstein] with [McCallum Capital]. Go ahead.

Craig Bernstein - *McCallum Capital - Analyst*

Hi, and thank you for taking my call. Obviously, there's a lot of reasons to feel good about the overall car market, and Q2 remains to be seen. But thinking about Q1 and your unit comp, your new unit comp, maybe you can help us tie that back a little bit to inventory, particularly at Toyota, Honda, and BMW, and these are obviously something around the order of 40% of your business, and maybe you can help directionally help us understand how much was inventory down in those brands in the first quarter and how quickly would you expect that to ramp in Q2? Thanks.

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

Well, Toyota in particular, if we look at our absolute inventory numbers for Toyota through the quarter you wouldn't see anything that looked particularly low, but within that, particularly in January and February there were some key model shortages. Preuss got particularly popular with some new model introduction and higher fuel prices, and SUVs and some trucks and things like that. So, but by the end of the quarter we were starting to be probably in the best shape on Toyota that we'd been since before the Tsunami and so forth.

Honda, obviously, the new CRV is hot. There's been no shortage on Accords. But even some of the key Civic trim series were short as late as early March. And, again, I think with the exception of the CRV, which will probably remain sold out or near sold out for the foreseeable future, Honda inventories are likely to be pretty good in the second quarter. They caught up the latest.

And BMW had such a strong close to last year in December that I really don't know when the X3 was sold out almost since the new model launched, whenever that was. X5 has never really caught up. And now with the launch of the new 3 Series those are going out about as quickly as they come in. So I don't have a very good view as to the future when that will catch up, but I think BMW is likely to run short much longer than Honda and Toyota, which appear to be in pretty good shape at the moment.

Craig Bernstein - *McCallum Capital - Analyst*

Right, so shorter than maybe what demand might be, but you would still expect your inventories in those kind of key shortage -- where you're seeing shortages, you would expect your inventory to be up year-over-year, well, up sequentially relative to the first quarter. In other words, you have more inventory year-over-year in Q2 than you do in Q1?

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

Yes.

Craig Bernstein - *McCallum Capital - Analyst*

Or you did in Q1?

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

Yes, that is absolutely correct.

Craig Bernstein - *McCallum Capital - Analyst*

Okay, that's great news. Well, thanks for that, and congrats on a great quarter.

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

Thank you.

Operator

Our next question is from Brett Hoselton with KeyBanc. Go ahead please.

Brett Hoselton - *KeyBanc Capital Markets Inc. - Analyst*

Good morning.

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

Hello, Brett.

Brett Hoselton - *KeyBanc Capital Markets Inc. - Analyst*

Oh, let's see here, wanted to start off with just acquisitions and your thoughts on kind of the remainder of the year? I know that you don't necessarily want to forecast or predict acquisitions and so forth, but you added about $150 million in revenue in the first quarter, and I guess what I'm wondering is is there any reason to believe that that trend is going to materially increase or decrease going forward in your mind? Or is that just kind of what the environment will bear at this point in time in your mind?

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

Yes, it's just impossible to predict when you can get together with the seller, but clearly our top priority for our cash and investment is in acquisitions. So we would hope that number would be higher by the end of the year, and we've been in this mode for 18 months or longer since the recovery started. So I would -- our goal will be to add more than $150 million in annualized revenue this year, which is pretty much what we've already secured, so that's really about all I could say. We're trying.

Brett Hoselton - *KeyBanc Capital Markets Inc. - Analyst*

Yes, and so I'm really impressed with the used vehicle unit sales increase, I mean just really nice job there. What is it -- I know that you're selling more value vehicles and various other things along those lines, but it just the number is quite impressive. And I'm wondering is it simply digging deeper into the value lines that is really driving that, trying to sell everything you're getting over the curve? It also sounded, and I kind of came into the call a little later on, that you felt like your availability was a little better given the amount of trade-in that you got into the first quarter and so forth. I mean are these all the factors that are driving that or is there something else that's incrementally driving the very strong performance in terms of used unit sales?

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

Well, I think there's a factor on the market side that we can't take credit for, and then there's a factor that our team does pretty well, and we've over the last four years we've learned to use our technology a lot better and be much more data driven and objective about how we move used cars around, how we acquire them, and how we market them and so forth.

But I also think in this type of market, which still has a lot of unemployment and kind of recessionary pressure, even though it's not a recession, people are coming into the market from pent-up demand and because they need a car, and some of them buy new cars, but there's still an awful lot of people who are looking at relative value propositions and are just a little conservative and say, well, maybe I'll just take a two or three-year-old used car because they have -- the certified cars have a nice warranty or I can buy a service contract. So I just think the used part of the market is capturing a lot of pent-up demand, and I think over the years we've gotten to be better and more efficient used vehicle retailers, so I think there's an our team side and a market side to that.

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

Yes, Brett, this is John. I would add to that, you know, if it was really all about value vehicles we wouldn't be able to continue to increase our average selling prices. We were up $657 on a year-over-year basis, which tells me it's not all about value, I think it's more along the lines of what Earl has described. And I think he probably underplays a little bit the great job the guys have done on processes and really using the technology to do a good job driving our used retail sales.

Brett Hoselton - *KeyBanc Capital Markets Inc. - Analyst*

Good point. Thank you very much. And then retail financing availability, generally over the past couple of years seen some steady improvement there, even kind of down into the lower FICO scores and so forth, but my question is going forward do you anticipate that retail financing, excuse me, availability is going to continue kind of the steady increase we've seen over the past year or two, or is there some reason to believe that we may see some sort of an inflection point over the next month, two months, six months that might cause maybe subprime to improve significantly?

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

Well, I just have to admit that I haven't seen financing as a hindrance to retailing newer used vehicles in many, many months now. So I think there's a lot of aggressive parties supporting auto finance in the market now, not just the captives who generally do a super job, but the large commercial banks and all the way down through a credit union. So I don't think there should be any significant change up or down. I think financing is a real big part of the resurgence of the market, but I think it's been in place to a very competitive degree for quite awhile now, back into last year. So I wouldn't see any big movements in the future. We don't accept financing as an excuse from our people anymore, that they didn't sell a vehicle.

Brett Hoselton - *KeyBanc Capital Markets Inc. - Analyst*

Okay. Thank you very much.

Operator

this concludes our question and answer session. I would like to turn the conference back over to Mr. Hesterberg 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 second quarter earnings results in July. Have a good day.

Operator

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