

FINAL TRANSCRIPT

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GPI - Q3 2011 Group 1 Automotive Inc Earnings Conference Call

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PRESENTATION

Operator

Good morning ladies and gentlemen, and welcome to Group 1 Automotive's third quarter 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 Manufacturer Relations and Public Affairs. Please go ahead Mr. DeLongchamps.

Peter DeLongchamps - *Group 1 Automotive - VP, Manufacturer Relations, Public Affairs*

Thank you Valerie. Good morning everyone, and welcome to today's call. Before we begin, I would like to make some brief remarks about forward-looking statements and the use of non-GAAP financial measures. Except for historical information mentioned during the conference call, statements made by management of Group 1 Automotive are forward-looking statements

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that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements both involve 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 a non-GAAP financial measures to the most directly comparable GAAP measures on its website. Participating today; Earl Hesterberg, our President and Chief Executive Officer, John Rickel, our Senior Vice President and Chief Financial Officer, and Lance Parker, our Vice President and Corporate Controller. I would now like to hand the call over to Earl.

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Thank you Pete, and good morning everyone. As we announced earlier this morning, Group 1 reported another record-setting quarter of operating and financial results. Following up on our record second quarter earnings, we reported adjusted earnings per diluted share of \$1.04 this quarter, which is the third best any quarter Group 1 has ever delivered. And, we did this in an environment of constrained availability for approximately 45% of our new vehicle sales volume, and in a quarter where the average industry selling rate was 12.5 million units. It is important to note our best ever quarter was back in 2006, when the selling rate was running in the mid-16 million unit range. Most of the leverage we are gaining today is from a leaner expense structure. We anticipate seeing further leverage as the selling rates continue to climb toward a longer-term trend level of 15 million to 16 million annual units.

Turning to our supply issues, as we discussed last quarter, the earthquake and tsunami in that devastated number northern Japan had a significant impact on the Japanese manufacturers supply chains. In particular, Toyota and Honda were affected most. We anticipated that our supply of new vehicles from those manufacturers would have generally recovered by the end of the third quarter, but unfortunately, that was not the case. While Toyota and Honda production has begun to ramp up, the recovery was not nearly as rapid as we anticipated. In fact, most of our Honda, Lexus and Toyota dealerships reached their lowest inventory levels yet in late September. As a result, we lost significant sales of the most popular models of these brands.

Although inventory receipts are now increasing, we do not anticipate returning to normal levels until the first quarter of 2012. Given these supply constraints, our new vehicle unit sales were 2.3% lower on a year-over-year basis in the third quarter. However, these shortages due to a gross profit increase of 19.3% on 4.9% higher revenues. Additionally, given these inventory constraints, and the acquisitions we made in the first half of the year, the import brand mix of our third quarter new vehicle unit sales was consistent with the second quarter at 52%. Luxury sales fell slightly to 27%, and the domestic brand mix increased about 3 percentage points to 21% of our unit sales. Gaining share were Nissan Infiniti, Ford, GM and Chrysler. We would anticipate our mix returning to more recent historical levels, once the Toyota and Honda supply normalizes.

New vehicle inventory fell to 13,896 units from June 30, primarily driven by Toyota and Honda inventories falling to 34 and 25 days supply, respectively. We ended the quarter with a 49 day supply of new vehicles, but we expect the inventory to rebuild to a more normalized 60 days supply by early next year, as deliveries improve. In addition to the strong new vehicle margins results, retail used vehicle profit was up 4.9% on 10.7% higher revenues, as we retailed a 6.6% more used vehicles. Gross profit declined on both retail and wholesale units sold, as used vehicle pricing is often of the last couple of months. We continue to maintain a lean 29 day supply of used vehicle inventory. Finance and Insurance revenues grew 16.3%, on a 1.3% increase in units retail. This represented our best ever quarter, generating gross profit of \$1,156 per retail unit, driven by strong performance in vehicle financing and vehicle service contract sales.

Parts and service revenue growth continued to be strong, rising 7%. Gross profit increased 2.5%, as our lower margin wholesale and collision businesses grew at a faster rate than our higher-margin customer pay and warranty businesses. In total, revenues

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grew 7.4% to \$1.6 billion, and gross profit increased 8.7%, driving a 3.4% adjusted operating margin. We anticipate seeing continued improvement in our operating margin, as industry selling rates build. Turning to acquisitions, we recently announced the addition of 6 franchises, including 2 new Volkswagen dealerships in California and Texas, and a Cadillac Buick GMC dealership in Houston. Including these franchises, year to date, we have added 13 franchises that are expected to generate an additional \$528 million in annual revenues. Our strong balance sheet has permitted the Company to continue growing through acquisitions, while also returning cash to shareholders via an increased dividend in August, and through significant share repurchases in the third quarter. By adding desirable brands and locations to our portfolio of stores, we can continue to leverage our cost base.

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

John Rickel - Group 1 Automotive Inc - SVP/CFO

Thank you Earl, and good morning everyone.

On an adjusted basis for the third quarter of 2011, our net income rose to \$23.8 million, which is at 23.6% improvement over the 2010 results. The net income per diluted share improved 23.8% from the prior year amount to \$1.04. Our adjusted results for the third quarter of 2011 exclude \$2.3 million of after tax non-cash asset impairment charges, while the comparable prior year results exclude \$1 million of after tax non-cash asset impairment charges, as well as a \$761,000 gain on the sale of real estate. Compared to the same period a year ago, our adjusted operating margins improved 20 basis points to 3.4% and our adjusted pretax margin improved 30 basis points to 2.4%. On a consolidated basis, revenues increased during the third quarter by \$108.6 million, or 7.4% to \$1.6 billion, compared to the same period a year ago, reflecting increases in each of our business segments.

New vehicle revenues increased 4.9% to \$862.7 million, despite ongoing supply shortages for a number of our Japanese brands. These shortages continue to constrain sales at our Toyota, Lexus, Honda and Acura stores, which make up more than 45% of our normal new vehicle sales. As a result of the shortages, we saw new unit sales decline by 2.3%, but this decline was more than offset by a \$2,321 per unit increase in average selling prices. In addition, used vehicle retail revenues increased 10.7% to \$377.1 million on 6.6% more units. Used vehicle wholesale revenues grew \$10.6 million, or 18.1% to \$69.1 million, and our F&I revenues improved to 16.3% to \$51.5 million. Revenues from the core of our business, the parts and service segment, grew \$13.8 million, or 7% to \$210.1 million. This is the seventh straight quarter that we have reported revenue growth from our parts and service business.

Our gross profit increased \$19.9 million, or a 8.7% from the third quarter a year ago to \$248.8 million, which included increases of 19.3% in new vehicles, 4.9% in retail used vehicles, 2.5% in parts and service, and 16.3% in F&I. Overall, our gross margin improved 10 basis points in the third quarter to 15.8% on the strength of our F&I results and new vehicle retail gross margins, which improved 80 basis points over the prior year to 6.5%. Our retail used vehicle gross margin declined 50 basis points to 8.5%, reflecting pressure from declining used vehicle market values in the third quarter. The Manheim Index increased steadily through the first half of 2011, reaching an all-time high in June, but declined during the third quarter to reach its low point for the year in September.

SG&A expenses, as a percent of gross profit, improved 90 basis on an adjusted basis to 75.7%, as gross margin improvements continued to leverage our cost base. Included in our SG&A costs this quarter is approximately \$800,000 related to the clean up the facility repairs for Northeast stores following Hurricane Irene, as well as facility maintenance costs specific to recent dealership acquisitions. Floor plan interest expense declined by \$2.1 million, or 22.8% from prior year, to \$7 million. This decrease reflects declines in both the weighted average floor plan borrowings during the quarter, as well as the weighted average interest rate. The weighted average interest rate was positively impacted this quarter by the expiration of interest rate swaps in December of 2010 and in August 2011.



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At September 30, 2011, our new vehicle inventory stood at 13,900 units, with a value of \$479.6 million, compared to 17,400 units with a value of \$537.6 million a year ago. Inventory levels at the end of the third quarter remained below normal, primarily because of the Toyota and Honda production constraints we have discussed previously. We expect new vehicle supply to improve going into 2012.

Manufacturers interest assistance, which we report as a reduction of new vehicle cost of sales at the time the vehicles are sold, covered 96.8% of total floor plan interest expense in the third quarter, a 650 basis point improvement from the second quarter. Other interest expense increased \$1.8 million, or 25.4% to \$8.6 million, primarily explained by increased mortgage borrowings associated with recent acquisitions, and higher mortgage interest rates. Our consolidated interest expense includes non-cash discount amortization of \$2.3 million related to our convertible notes.

Now, turning to third quarter same-store results. In the third quarter, we reported revenues of \$1.5 billion, which was a 2.7% increase from the 2010 period. Within this total, new vehicle revenue was about flat, while the 7.1% decrease in new vehicle retail unit sales, primarily explained by constrained sales at our Japanese brand stores was offset by \$2,369 increase in average new vehicle selling prices to \$33,499. The improvement in our average new vehicle selling price reflects the continued impact of the inventory supply shortage, as well as a shift in car-truck mix back towards trucks.

Our used retail revenues improved 6.6% to \$361.5 million on 2.6% more units. On a per-unit basis, retail used vehicle revenues, were up more than \$700 to \$20,152. We also experienced an increase in our wholesale used vehicle revenues of 13.6%, or \$7.9 million, to \$66 million on about the same number of units.

Our F&I revenues were up \$4.8 million, or 10.9% compared to the same period a year ago. Overall, our F&I income per retail unit increased 14.7% for \$148 for the same period a year ago to \$1,155, driven primarily by improvements in our income per contract and penetration rates for all of our major product offerings. As Earl mentioned, this is a record results for us, so congratulations to the Team. These results reflect the focus we have had on improving our business processes in this segment.

We posted another strong quarter in our parts and service business. Parts and service revenue grew 2.2%, reflecting a 2.6% increase in our customer pay parts and revenues, 6.8% growth in our wholesale parts and service business, and a 7.4% increase in our collision business. As a partial offset, our warranty parts and service revenues declined 6.3% in the quarter, which is predominantly explained by the non-recurrence of the 2010 Toyota recalls. Our customer pay revenues improved in most of the major brands that we represent. Initiatives focused on customers, products, and processes continue to build momentum. Our wholesale part sales continue to benefit from the closure of competing dealerships, as well as the impact of stabilizing economy that has helped to strengthen the credit worthiness of our wholesale parts customers. And, our collision segment continues to benefit from improved business processes.

It is also worth mentioning that many of our dealership operations in the Northeast portion of the United States, which represents approximately 25% of our revenue, were negatively impacted by Hurricane Irene. In particular, our parts and service businesses in the affected areas lost opportunities for the better part of the week during August.

Overall, our gross profit improved \$11 million, or 4.8%, and our total gross margin improved over prior year by 30 basis points to 16%, primarily reflecting the strength of our new vehicle, and F&I performance. Compared to results a year ago, our same-store new vehicle gross margin improved 90 basis points to 6.6%. Retail used vehicle margin declined 50 basis points to 8.5%, as compared to the third quarter of 2010, as a result of the declining used vehicle market prices that I mentioned earlier.

Our same-store parts and service margin declined 150 basis points to 52.8%, reflecting the mix effect of our growing collision and wholesale parts businesses, which on a relative basis generate lower margins than our customer pay and warranty parts and services businesses. The margin decline is further explained by a return to more normalized margins in our warranty parts and service business, as our 2010 warranty margins were bolstered by the higher labor content of the Toyota recalls.

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SG&A as a percent of gross profit improved 60 basis points to 75.5%, as gross margin growth continued to leverage our cost base. On an adjusted basis our same-store operating margin improved 20 basis points to 3.5%.

Now, turning to liquidity and capital structure. During the third quarter of 2011, we generated cash flow from operations of \$17.4 million on an adjusted basis. As of September 30, 2011, we had \$11.3 million of cash on hand, and another \$116.8 million that was invested in our floor plan offset account, bringing immediately available funds to a total of \$128.1 million. In addition, we had \$232.8 million available on our acquisition line that can also be used for general corporate purposes. As such, our total liquidity at September 30, 2011 was \$360.9 million.

During the quarter, we repurchased 977,000 shares of our common stock at an average price of \$37.63 per share, which brought weighted average diluted shares outstanding to \$22.8 million for the third quarter. And, as of September 30, diluted shares outstanding totaled \$21.9 million. At the end of the third quarter, we had \$16.7 million of authorization remaining under the \$50 million share repurchase program approved by the Board in August. We used \$9.9 million for capital expenditures during the quarter to construct new facilities, purchase equipment, and improve existing facilities. We will continue to critically evaluate all plan capital spending, and work with our manufacturer partners to maximize the return on our investments. We anticipate that our full-year capital spending will be less than \$50 million in 2011, which includes about \$10 million for specific growth initiatives in our parts and service business.

With regards to our real estate investment portfolio, we own \$432.7 million of land and buildings at quarter end, which represents approximately 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 September 30, had \$41.5 million outstanding under our mortgage facility, and \$179.7 million of other real estate debt, excluding capital leases.

In conjunction with executed amendment to our revolving credit facility that was effective on July 1 of this year, the associated covenant calculations and required ratios were modified, and in the case of current ratio, eliminated. The amended credit facility covenants require a senior secured leverage ratio of less than 3.75, a total leverage ratio of less than 5.5, and a fixed charge coverage ratio of more than 1.35. The debt portions of both the senior secured leverage and total leverage ratio calculations are now rent adjusted, using a rent expense factor of 8. Likewise, the earnings portion of these ratios now exclude rent expense. You can find the modified covenant calculation definition posted to our website. As of September 30, we were in compliance with all such covenants, and based upon our industry outlook and projected earnings for the remainder of 2011 and 2012, we expect to remain compliant for the foreseeable future. For additional detail regarding our financial condition, please refer to the schedules of additional information attached to the news release, as well as the investor presentation posted on our website.

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

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Thanks John. We are very pleased that we were able to deliver another record-setting performance this quarter. Our operating team worked hard to deliver revenue and gross profit growth across every segment of the business, while at the same time remaining focused on holding expenses down. As I stated earlier, we anticipate new vehicle sales continue to build momentum, with fourth quarter 2011 sales likely to run close to a \$13 million SAR pace for the remainder of the year, similar to the sales rate of the early months of 2011. And used vehicle sales should remain stable, but as the new vehicle selling rates improve, we could see used vehicle pricing continue to soften. Our finance and insurance and parts and service businesses should remain strong, as we remain focused on improving processes and leveraging unit volume increases.

We're optimistic about our future, and we have made it through the depths of the recession, we are seeing increased advertising spend by our manufacturing partners, customer financing has improved, and import vehicle production is beginning to come back on stream. As sales rates climb, we should have the opportunity to continue to leverage our cost structure, and continue to grow earnings.



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

QUESTIONS AND ANSWERS

Operator

Thank you. We'll now begin a question-and-answer session.

(Operator Instructions)

Our first question comes from Himanshu Patel of JPMorgan.

Himanshu Patel - *JPMorgan - Analyst*

Good morning, guys.

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

Good morning.

Himanshu Patel - *JPMorgan - Analyst*

I wanted to talk a little bit more about the Used Business. Can you shed a little light on two issues? 1, the cadence of retail volume over the course of the quarter. Were there any differences there? And number 2, on the Used pricing softness, can you give a little bit more color on what you think the drivers of that are? Is it simply that the gap with New pricing got a little bit too tight, or is it really just some of the availability issues that you guys have talked about are starting to ease up?

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

Yes, those are good questions. The Used business is the one that we probably struggled with the most in the quarter. There is still very good used car market out there. I don't it was quite as strong as it was in the previous quarter. The real issue is, even in a time -- and at normal times, the seasonality of the used car prices starts to turn against you in the Fall. But I think this year, used car prices have gone up for so long, whether it was 18 months or 2 years, they peaked in June. And they just got so close to new car prices, particularly when you quote a monthly payment, with some type of [subvented] or low new car interest rate, that they just really couldn't go any higher.

And so I think it was a combination of those factors. And we continue to have to buy more cars than we would like outside, in the free market, at auction and so forth. And we were trying to offset some of the lost Japanese brand buying we had. So we had to struggle through the quarter a little bit, on both the wholesale side and the used vehicle retail margin side, to liquidate some cars at lower than ideal margins to keep from getting burned. So we didn't have the best used car quarter, but I do believe there's still a very strong used car business out there.



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Himanshu Patel - *JPMorgan - Analyst*

And then, Earl, can you comment a little bit on what you are seeing on incentive activity at the Japanese? It seems like the availability is improving, but maybe versus expectations a couple of quarters ago, the pace of incentive increases from the Japanese does not seem to be happening maybe at the same rate. I don't know if you guys agree with that view or not?

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

I do agree with that view. I haven't seen significant Japanese brand incentive increases. I'm speaking of Honda and Toyota. Nissan has had their foot on the accelerator through the Summer. They have had good availability, and they are aggressively in the marketplace, and they are gaining share. So I would put Nissan in a different category. But we have not seen any meaningful incentive actions by Honda and Toyota, primarily, because they have not had any -- you know they have not had their core vehicles in place to sell. And they are still not in place. So I have been surprised by the lack of availability lasting this long. And, of course, we would've expected a little more marketing activity. But that would have had to be coupled with better vehicle availability, which still isn't there.

Himanshu Patel - *JPMorgan - Analyst*

Okay. And then, lastly, just you guys have been active on acquisitions. Can you talk a little bit about where is the M&A market for dealerships? Or is there more of a convergence on multiples now between seller and buyer? My understanding was, about a year ago, or even six month ago, that there was still a big gap to close most of the desirable assets.

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

I think there is still a big gap. But I believe there are more deals in the marketplace. I think there is quite a few deals in play in the market, but there is still a big gap. I think it is just up to companies like us to find acquisitions that fit our strategic needs, relative to brand and geography, and then ones that meet our return hurdles, and that is still the biggest challenge, finding ones that meet our return hurdles.

Himanshu Patel - *JPMorgan - Analyst*

Thank you.

Operator

Our next question comes from John Murphy of Bank of America.

John Murphy - *BofA Merrill Lynch - Analyst*

Good morning, guys.

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

Good morning John.

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John Murphy - BofA Merrill Lynch - Analyst

First question, Earl. You had mentioned something on used cars, that the pricing in June had sort of peaked and it had come down. I'm just curious if you think that you were at a point in June, or maybe July, where used car prices were so high that, that used car buyer was then tripping into buying a low-priced new car, and that might be what we are seeing support new vehicle sales here? Is it that pricing convergence drove people to buy new cars?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Well, I think that the dynamic was in effect. In June, June was the peak month on used car prices, according to the Manheim data, and the guidebooks, and such, and I'm just quoting that as the basis for that comment. But at that time, in June, July, and even August, when many of those customers saw that a new car was a relatively better deal, there was no supply. Not just of the Japanese brands, but Ford didn't have Fiestas and Fusions, and Chevrolet didn't have Cruzes, and Hyundai didn't have Elantras, or whatever their small models are, Accent and Elantra So there has also been a supply issue that didn't let the market function like it normally would through this Summer. And now the supply on many of those smaller vehicles either has or will soon be much better.

John Murphy - BofA Merrill Lynch - Analyst

Okay. So, second question. Is there anything that Toyota or Honda are doing in the interim, as they are short of inventory, to help dealers out -- like inventory term programs, or extending leases, or any dealer payments that they're making to really offset this short-term pain for you with this constrained inventory?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Nothing that is meaningful at this time. I think back in the Summer or early Summer, Honda and Toyota had some lease extension actions, and extended existing incentives to customers who special-ordered vehicles that would wait. So I think there were some actions taken, but there is not anything that is meaningfully been helping us through this right now. And the real issue is, even when you look at a days' supply, whether it shows 24 or 30 days, the mix of that inventory is not what it needs to be. I mean, there are no Camrys. If you are in the Toyota business and you can't sell Camry's, you've got a problem. There are no RAV4s, there are limited Civics, there are no CRVs. When you really drill down into the model mix of the inventory, it is still not there.

John Murphy - BofA Merrill Lynch - Analyst

And then lastly, John. You had mentioned in some of your comments that consolidation within the industry, or closures of some of your competition, had helped your Parts and Service Business. I'm curious, as we think forward, as sales recover, if you think there will be even more leverage to your Business, given that consolidation in the industry has occurred, but we have not even really seen sales rise yet. Trying to understand what you think the benefits might be throughout your 4 Business segments, being New, Used, F&I, and Parts and Service; because it sounds it is helping Parts and Service right now, but at some point it is going to help the other segments. Just curious what your thoughts are there?

John Rickel - Group 1 Automotive Inc - SVP/CFO

Yes, John, this is John Rickel.

We have kind of made the point along that fewer dealers out there should benefit from the overall model for those of us that are left. The first place it does show up is Parts and Service. The warranty work can only be done at a franchise dealer. If you are

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buying OEM parts, they pretty well have to come through a franchise dealer as well. So that is the first place that you see it show up. You know the customer pay, then, hopefully follows along with that.

And then, over time, as you build a relationship with those people, hopefully it shows up in better through-put and higher new vehicle sales per remaining location. And people that are looking for a used car that are going to deal with a franchise dealer are not all of a sudden going to go across to a buy-here pay-here lot, just because there are a fewer dealers. It should also help on the late model used cars going through the channel is well. So we do think that over time, as volumes come back, that should be beneficial to the remaining dealers. That was why GM and Chrysler tried to thin the dealer ranks during the bankruptcy process, was a recognition that to really strengthen their distribution channel, they had to take out some of that excess capacity.

John Murphy - *BofA Merrill Lynch - Analyst*

That's great. I promise this is actually the last question. On F&I PVR at \$1,155 in the quarter. Obviously that is a really strong number. Are the banks getting more aggressive in what they are paying for you to originate loans? Is that part of that the equation, why we are really busting through the -- what we had thought of as this \$1,000 ceiling on F&I PVR? I know you did a good job of selling, and there was good penetration there, but the F&I PVR was particularly high the quarter.

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

Yes, John. It's Pete DeLongchamps. To answer your question, the bank fees have not fundamentally changed. I think we've taken a different tact, and have worked on providing a little more market share to our key lenders, which has helped leverage some of the size and scale. But you know, at the end of the day, what we really focused on was taking a look at our operators that were below average, and really working with them on process and training, and bringing the bottom half up to middle, if you will.

And that really made a significant difference, especially in markets where, traditionally, it's heavy lease, and we had some economic challenges after the hurricane in the Gulf Coast, and those markets have been having a nice rebound. So it's been a combination of hard work, work in the service drive for vehicle service contracts, and improving that penetration. So it's been a combination of a lot of different things, but a lot of hard work by the field staff.

John Murphy - *BofA Merrill Lynch - Analyst*

Great, thank you very much. Keep it up, guys.

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

Thanks.

Operator

Our next question comes from Rick Nelson of Stephens.

Rick Nelson - *Stephens Inc. - Analyst*

Thank you. Good morning. Congratulations as well. Your same-store sales lagged on others in the sector that have reported. Is that the brand mix, do you think, the heavy Honda and Toyota? And if you could comment on how you think you are doing from a market share standpoint within your local markets.

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

Yes, I believe it was totally brand mix. On both Toyota and Honda we were far below even the national declines. You know, we just ran out of cars. To give you little color, we have 2 of the top 10 Toyota dealerships in America. 1 of them normally would have 800 to 1,000 vehicles on the ground, and at the end of September we had 222. That dealership sells well over 100 Camrys a month; at the end of September we had 1 old model, 2 new model Camrys, 3 on the ground.

So we got hammered in Toyota and Honda. We just didn't have cars to sell, which put some of the pressure, then, to try to push the used car business during a time of declining prices. So when we consider the 45% of our sales mix is in those brands, where we didn't have the popular models to sell -- 1, we had a great quarter, when you consider that. 2, we've got a lot of good upside when we do have some cars to sell.

Rick Nelson - *Stephens Inc. - Analyst*

It sounds like you are thinking supplies are going to remain tight -- improving, albeit still tight -- and maybe a back off of incentives from the J3 versus what we may have thought a while back. Do you think you are going to be able to retain some of this gross profit per unit improvement that we have seen in the last couple of quarters?

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

Yes. I'm probably more optimistic now than I was at this time last quarter. I thought the supply was going to come back much more quickly than it has. And in the last few days, we checked with our Toyota and Honda general managers, and they have got some visibility of the shipments, October, November, and December. And we are really not going to be back to normal until the first quarter. So it appears to me that the supply is going to be tighter than I would have guessed in the fourth quarter. And so, while I expect there's going to be some pressure on new vehicle margins, I don't think the bottom is going to fall out. So I do think that we're going to be able to hold onto some of this in the near term.

Rick Nelson - *Stephens Inc. - Analyst*

You are forecasting \$13 million unit industry SAAR for the fourth quarter. And with supplies normalizing in 2012, any early thoughts on where the SAAR might shake out for next year?

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

Well, I'd like to see the fourth quarter, but I am extremely confident that there is going to be significant growth in the market next year. I saw somebody prognosticate flat sales. It may have been a General Motors executive. I don't believe that for a minute. Now that I have witnessed the strength in the market through some of these stock market gyrations and debt gyrations in late September, and that we are still running at \$13 million, I really believe that we will be well over \$13 million next year, and there's going to be growth in the market again. So I'm quite optimistic.

Rick Nelson - *Stephens Inc. - Analyst*

I'd like to ask about the SG&A to gross. That ticked up a bit in 2Q post-sequentially and last versus a year ago. What were the drivers there, and where do you think that goes as we look forward?

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John Rickel - Group 1 Automotive Inc - SVP/CFO

Yes, Rick. This is John Rickel.

We would anticipate that as the growth continues to build, that we should be able to continue to leverage the cost base, that we should be able to continue to bring that ratio down. And we have been able to demonstrate that over the last couple of quarters, so we feel pretty good about that.

Rick Nelson - Stephens Inc. - Analyst

Okay, thanks a lot. And good luck.

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Thank you Rick.

Operator

Our next question comes from Ravi Shanker of Morgan Stanley.

Ravi Shanker - Morgan Stanley - Analyst

Thank you, and good morning. If I could follow up on the F&I. You said in your slides that you benefited from a renegotiated product pricing in F&I in the quarter. If you can expand on that a little bit. And also, some of these benefits that you are seeing from improved training and operating efficiency, how much more room do you have to go there? Is that something that you think continues to improve the F&I Business in the coming quarters?

John Rickel - Group 1 Automotive Inc - SVP/CFO

Ravi, this is John Rickel.

The slide that you are referring to, the renegotiated product pricing, really refers to the trend over the last couple of years. There was nothing specific on renegotiated product pricing in the quarter. That really relates to the increase that you have seen over the last couple of years. I will let Pete address the rest of your question.

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

And I guess as far as the upside, we are very comfortable where we are right now after setting a record. And so much of it has to do with what incentives are in place to the manufacturer OEMs. So we are satisfied with where we are today, and we are going to continue to work each individual store. But I don't think that we are prepared to talk about how high we can go.

Ravi Shanker - Morgan Stanley - Analyst

All right. And then also, can you give us a sense of what is going through the head of the average consumer right now? I mean, given the mixed signals that you are seeing from everything that is going on the markets and the macro; and also, the SAAR continues to pick up despite the lack of supply still. Are people who are coming in and buying cars now folks who absolutely need a new car? Or is there still a discretionary buyer out there? Or are they nervous? Or what is going on?

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

Yes. I think you are kind of alluding to the point. These people in the market basically, particularly the buy-in brands, they need to buy a car. It is time for them to buy 1. The average age of these cars is 10.7 years, or 10.6 years or something. And a lot of them, now, they are looking at used versus new. But most of these customers now have to buy. There still very cautious. You know, they are shopping hard and such.

The discretionary purchases still tend to be in the luxury brands, so I think there is still a lot of discretionary purchases. You can see, not just in luxury cars, but you see other types of luxury goods are still moving along pretty nicely. So that's where most of the discretionary purchases are. But in the volume brand world, these people need a car. And they also seem to be looking ahead a bit to, this car is going to last a while, so a lot more fuel conscious, fuel economy conscious. Some downsizing going on -- the small SUVs are still hot. And that is 1 of the problems with the Japanese brands -- you can't get RAV4s and CRVs. So it is still a very cautious customer, but there is a lot of pent-up demand in the market. And that is why we are optimistic about 2012 and the future.

Ravi Shanker - *Morgan Stanley - Analyst*

Great, thank you.

Operator

Our next question comes from Patrick Archambault of Goldman Sachs.

Patrick Archambault - *Goldman Sachs - Analyst*

Thank you. Good morning.

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

Good morning.

Patrick Archambault - *Goldman Sachs - Analyst*

So it looks like it was a good quarter to be selling cars in Texas. AutoNation also called it out. I did have just a general question on your geographic exposures. It does really look like, short of California, areas outside of the North cities did very well. How much of that is the impact of Irene? How much of that is a trend that may have some legs to it as we go forward?

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

Well it is actually, from our Company data, it's hard for me to give you a geographic economic trend. Our trend -- we were weak in Northeast and in Houston. We were strong in Texas, but not in Houston, because that's where we have our density of Japanese brand stores. In the Northeast I think we have 2 Lexus, 4 Toyota dealerships, several Honda dealerships. In Houston, we have lots of Japanese brand dealerships. So it wasn't anything to do with the economy, but we didn't do as well as those markets; whereas in the remainder of Texas, and the Southeast, where we have these other brands we did better. So our geographic performance was more brand driven than geography driven in the third quarter.

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Patrick Archambault - *Goldman Sachs - Analyst*

Okay. Got you. I other 1 that I had for you -- you might have said it earlier, but can you give us a sense of where your used car inventories are? I think you had said that you had -- and I might have gotten this wrong -- but that you had sort of taken those down and did more wholesalings? Was that just because you are changing the way you are acquiring them, or did you go a little high on inventory and have to correct; and sort of where are you now?

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

We bought more outside than we would like to, particularly in our Japanese brand dealerships. To try to -- so our salespeople have something to sell when they were low on new cars, and to try to mitigate the loss of new vehicle volume. And we were buying more than we wanted outside, which means you pay more; and we also were buying during a time of declining market prices, and actually we came through that with only a \$9 per unit wholesale loss, so we didn't do that bad. But we had to really work hard in the quarter, and it wasn't our best used car quarter. We also had to take smaller retail margins to move out of some of that inventory.

But we're in great shape; we're at 29 days, which is about where we would always be. We would be willing to actually be a little higher on that. So we are pretty clean right now. And we can get back to focusing on retailing more used cars at better margins. And as the new vehicle sales increase, particularly at the Japanese brand dealerships, we will get more trade-in volume, which will help fuel our used car business.

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

Patrick, this is John Rickel.

The other thing that I would add is that we also had to shift the mix little bit. We were probably a little heavy on smaller cars at the end of second quarter, primarily as we were trying to make sure we had something at the Japanese stores to sell. And as fuel prices came down across the quarter, not only did demand on index come down, but it came down more for smaller cars than it did for trucks. So some of it was also rebalancing mix to move a little more towards trucks and away from small cars, also played into it.

Patrick Archambault - *Goldman Sachs - Analyst*

Got you. And then, the implications for used margins as we look forward to the next couple of quarters, with the inventories kind of in better shape. I suppose on the one hand right there, there is going to be competition from new, but it sounds like your inventories are in better shape and your acquisition costs could go down a little bit. Could you see an improvement, or where do you think those ought to go?

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

Well, they ought to go up. I mean, we are not happy with what our retail Used margins were in Q3. So we are going to spend every day between now and the next time we talk on trying to get them up.

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

Patrick, the only caveat to that, as Earl indicated, if you would see further pressure on the Manheim index and overall market prices coming down, that is obviously a headwind you have to battle against. But Earl is right, there's a lot of focus on trying to move those numbers up.

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Patrick Archambault - Goldman Sachs - Analyst

Okay, perfect. Thanks a lot, guys. Congratulations on a good quarter.

Operator

Our next question comes from James Albertine of Stifel Nicolaus.

James Albertine - Stifel Nicolaus - Analyst

Good morning, and thanks for taking my question. Congratulations on a strong quarter. Wanted to ask the SG&A as a percentage of gross profit dollars in sort of a different way. Very clearly you have made some substantial improvements across the board. I wanted to get a sense for how much more is it a fixed cost improvements versus variable cost improvements, and so where do you see that sort of fixed-to-variable ratio over time trending? And I had a quick follow-up after that as well.

John Rickel - Group 1 Automotive Inc - SVP/CFO

Yes James this is John Rickel.

We tend to run about 60% of our SG&A costs right now are kind of in the variable sort of buckets, things like personnel. And 40% is basically fixed, things like rent expense. Obviously, as the leverage comes into the model, the math is going to continue to move that ratio slightly. So the fixed piece will come down mathematically as a piece of that. And we do think that as gross margins continue to rebuild, as the industry comes back, that we should be able to use that leverage to continue to drive SG&A as a percent of gross down as we go forward.

James Albertine - Stifel Nicolaus - Analyst

Great. I appreciate that color. And then the follow-up -- again, some of our channel checks, some of our survey work, and what we have been hearing in the industry, suggested that the driveability of existing cars, so your car breaks down, you go and replace it. But also, the incentives that were offered on 2011 models in September really driving a lot of the increase in SAAR that we saw. Can you give us any sort of indication on the 2012 models? Are they arriving -- and certainly the Japanese models sound like they are arriving later -- but broadly, is there going to be bigger gap this year relative to other years between the '11 and the '12s?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

I don't think so. I'm not aware of any significant sell-down problems in the market between 2011 and 2012, much less than usual. The only place for there is any significant activity is in full-size pickups, which is the only part of the market that seems to have quite a bit of inventory out there, and there is some incentive activity. So, outside of full-size pickups, I don't see anything that is going to move or distort the market.

James Albertine - Stifel Nicolaus - Analyst

Thank you very much, and congratulations again.

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

Thank you.

Operator

Our next question comes from Matt Nemer of Wells Fargo Securities.

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

Good morning everyone.

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

Good morning, Matt.

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

It just wanted to follow up on a previous question on the used car business. How are you feeling about that, given that used car prices have come down a little bit, how are you feeling about the price separation in the market right now between a nearly new and a new car, given the financing offers that are out there, and the prices?

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

It is still a little bit tight. I think that dynamic still has some room to change, Matt. And until there's a little more new car supply, and a little more marketing activity, I think that gap is still pretty close, even though used car prices have fallen. So I think there is still some more room to go there, before it really fuels the fence-sitters into choosing new versus used.

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

Okay. And then, secondly, what kind of impact does mix have on F&I PVRs; and as Toyota and Honda become a larger percentage of your sales going forward, does that create some kind of an adverse mix affect on that number? And as a follow-up to that, can you just give us a sense for where the top third or top half of your stores are on F&I PVRs, in terms of where the best performers are?

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

Your second question first -- no. We don't disclose at that level, in terms of store by store. But to your first question, it's not the Toyota and Honda brand mix that would drive our per units on F&I, as much as it is the types of programs those manufacturers offer, Matt. So if they decided to go on a big lease offensive, well, then that does impact us. Or if they capped our -- if they did some kind of APR buy down and capped our margin, or our commission, that could hurt us. And then also, if they go heavy on lease, it then becomes a bigger geographic issue with the Northeast and California, which are heavy lease markets.

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Matt Nemer - Wells Fargo Securities, LLC - Analyst

Got it. And then, lastly, on the new vehicle segments. As Toyota and Honda inventory starts to come back to the US, will it be -- are there any differences in terms of whether you're getting that inventory direct from Toyota USA, or 1 of the 2 distributors? Are there any imbalances in the market related to the type of distribution?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

No, not that we can tell.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Okay, that's all I've got. Thanks very much.

Operator

Our next question comes from Scott Stember of Sidoti and Company.

Scott Stember - Sidoti & Company - Analyst

Good morning.

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Good morning, Scott.

Scott Stember - Sidoti & Company - Analyst

Could you guys maybe dig into the Parts and Service a little bit on the collision side? What is driving these increases? Is there share gains, increased accident activity in the area? And maybe also talk about the margin profile of the collision business versus, let's say, the traditional customer pay business?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Yes. On the collision business, we have made quite a bit of investment in that Business. I think John mentioned, it's up somewhere around 7% for the quarter. But that is really just a function of the focus we have put on it in investment. You know, we have added shops in recent years, and we have invested in more equipment and technicians in the shops that we have owned. So that is the sole reason there. Not anything in the market itself.

John Rickel - Group 1 Automotive Inc - SVP/CFO

Right, the margins, Scott, are kind of in the mid to upper 40s in collision. So a little bit less than the average, but given the growth profile, we are quite pleased with that Business, and quite pleased with the performance the Team has turned in there.

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Scott Stember - Sidoti & Company - Analyst

Got you. And could you maybe talk about the UK? I know it's a small piece of your business, but maybe just talk about the trends that you saw in the quarter?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Yes, well it's 5% of our sales, and we had a surprisingly good quarter in the UK. Now, bear in mind that all we have is BMW and Mini there at the moment, so we are competing more in the luxury segment. My impression is that the volume segments there are pretty rough right now. But we had a good quarter.

Scott Stember - Sidoti & Company - Analyst

The sales in September in the big registration month?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Yes that's what drove it, of course. So that came through, probably, better than you would've expected in a -- their tight macroeconomic issues, their government policies, and such.

Scott Stember - Sidoti & Company - Analyst

Okay, and how did the Used to do over there?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

I would just say average. There was, in the Summer, some falling used car values in the UK, particularly in luxury. But it was nothing atypical in our quarter.

Scott Stember - Sidoti & Company - Analyst

Okay. And just lastly, you alluded to outperformance Group 1 versus the industry for Honda and Toyota brands. Could you maybe elaborate on that, and give us specific numbers?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Well, 1 of the 2 brands, for example, was down 15% for the quarter, and our branded stores were down 23. I don't remember if that was Honda or Toyota, but that is the order of magnitude, they were both somewhat similar.

Scott Stember - Sidoti & Company - Analyst

All right, that's all I have. Thank you.

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Thanks.

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Operator

Our next question comes from Mark Mandel of ThinkEquity.

Mark Mandel - *ThinkEquity - Analyst*

Thanks. Good morning everyone.

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

Good morning, Mark.

Mark Mandel - *ThinkEquity - Analyst*

Just a couple of follow-ups at this point. On the supply side, have you seen any impact, or are you anticipating any impact, from the flooding in Thailand? I was reading something about that the other day.

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

No, we are not aware of anything, and the manufacturers have not made us aware of anything. So thus far, no, I don't think any of our significant models are sourced from there.

Mark Mandel - *ThinkEquity - Analyst*

In terms of your projection for a recovery in the first quarter on the supply side, can you drill down a little further in terms of when during the quarter that might happen? Beginning, end, middle?

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

Well, January and February are not great sales months. So the key is that you have those cars in February for the beginning of the March selling season. And, I guess, in some parts of the country, late February with Presidents' Day, kind of kicks off a selling season. And we have been led to believe that by then, based on our analysis, that inventories will be normal.

Mark Mandel - *ThinkEquity - Analyst*

Okay, great. And in terms of your traffic to your showrooms and traffic to your websites, I mean can you provide any color as to what you're seeing there?

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

Only that it has been fairly steady across the last 3 or 4 months. Not a big lift up, and not a big decrease down.

Mark Mandel - *ThinkEquity - Analyst*

Great. Okay, thanks a lot, and good luck, and congratulations.



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

Thank you.

Operator

Our next question comes from Jordan Hymowitz of Philadelphia Financial.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Thanks for taking my call.

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

You're welcome, Jordan.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

A couple things. You commented that the used car business was weakening, to some extent benefiting the new cars, because of the prices that are coming closer. Do you see, specifically, you are taking more shares from CarMax? I know you have a couple of stores close to them, and they were kind of weak on their sales.

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

Well, no. I don't have any data that would say that. They are always a pretty good competitor, but they seem to appeal to customers on a different basis than we do, with their big selection and 1 price policy. It seems to -- people that are interested in that and driven by that. We don't have any trouble competing with them when it comes to what we can pay for a car in trade, or what we can sell a car for, so they seem to be a little bit different in the type of buyer. But I will say that we have found the used car business to be good, to be a pretty good market out there throughout this year, and more so than maybe their results seem to have demonstrated.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Do think in general the franchise dealers are starting to take more used car sales from them, as you guys get send less to auctions?

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

It is hard for me to say that. They are a very formidable competitor. But I will say that I believe franchise dealers -- and I'll just speak for ourselves in particular -- we have become much more professional and sophisticated in the used car business in recent years, in terms of what we stock, how we acquire, and what we pay and sell cars at, including on the web. So, I think we have become better competitors, because I think CarMax certainly was a sophisticated -- more sophisticated than we were, if you look back a few years ago. And I think that we, using technology, franchise dealers have raised their level of play.



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Jordan Hymowitz - Philadelphia Financial - Analyst

And the second question is -- your Chrysler sales were up noticeably, again, also a small number in the quarter. Are you interested again in buying Chrysler dealerships? Is there any new Chrysler product that is out that is driving that?

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Yes, our Chrysler dealerships are doing incredibly well. I think our sales are up 50%-plus. I'm not quite ready to buy any more Chrysler dealerships yet, but I have to tell you the Chrysler business is good, and Jeep is driving that. Jeep sales, in particular, have been strong all year, and the product is very, very well received.

Jordan Hymowitz - Philadelphia Financial - Analyst

Okay, thank you.

Earl Hesterberg - Group 1 Automotive Inc - President, CEO

Thank you.

Operator

This concludes our question-and-answer session, and I would like to turn the conference back over to Earl 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 fourth-quarter earnings results in February.

Operator

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

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