Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2015-07-23
Event Description: Q2 2015 Earnings Call

Market Cap: 2,214.72
Current PX: 94.90
YTD Change($): +5.28
YTD Change(%): +5.892

Bloomberg Estimates - EPS
Current Quarter: 1.828
Current Year: 6.925
Bloomberg Estimates - Sales
Current Quarter: 2813.875
Current Year: 10663.500

Q2 2015 Earnings Call

Company Participants

- Peter C. DeLongchamps
- Earl J. Hesterberg
- John C. Rickel

Other Participants

- Jamie J. Albertine
- N. Richard Nelson
- David J. Tamberrino
- William R. Armstrong
- Elizabeth Lane Suzuki
- Irina Hodakovsky
- Paresh B. Jain
- David H. Lim

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to Group 1 Automotive's 2015 Second Quarter Financial Results Conference Call. Please be advised that this call is being recorded. I would now like to turn the call over to Mr. Pete DeLongchamps, Group 1's Vice President of Manufacturer Relations, Financial Services and Public Affairs.

Please go ahead, Mr. DeLongchamps.

Peter C. DeLongchamps

Thank you, Amy, and good morning, everyone, and welcome to today's call. The earnings release we issued this morning and a related slide presentation that include reconciliations related to the adjusted results we will refer to on this call for comparison purposes have been posted to the Group 1's website. Before we begin, I'd like to make some brief remarks about forward-looking statements and the use of non-GAAP financial measures.

Except for historical information mentioned during the call, statements made by management of Group 1 are forward-looking statements that are 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, Earl Hesterberg, our President and Chief Executive Officer; John Rickel, our Senior Vice President and Chief Financial Officer; and Lance Parker, our Vice President and Corporate Controller.

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

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

Earl J. Hesterberg

Thank you, Pete, and good morning, everyone. Today, Group 1 reported record quarterly results, including best ever results for adjusted net income, which is $47.9 million, was up 19.9% over the prior year period; adjusted diluted earnings per share of $1.98, which was up 34.7% over the same period; and total revenue, which increased approximately $215 million or 8.6% for another all-time quarterly record of over $2.7 billion.

On a local currency basis, revenue was up even more at 11.7% for the quarter, as both the British pound and the Brazilian real have weakened significantly against the dollar over the past year.

Turning to our business segments, total consolidated new vehicle revenues grew 4.7%, as we retailed 5.4% more units. The average new vehicle selling price decreased $257 to $34,274 with currency exchange rates more than explaining the decrease.

New vehicle gross profit decreased 5.8%, as gross profit per unit decreased by $203 to $1,701. The decrease in new vehicle gross profit is more than explained by lower margins in the U.S. and exchange rate headwinds. In the U.S., competitive conditions amongst volume import brands explained most of the deterioration.

During the quarter, we retailed nearly 45,000 new vehicles with a unit sales geographic mix of 82.4% U.S., 10.5% U.K., and 7.1% Brazil. Our new vehicle brand mix was led by Toyota/Lexus sales, which accounted for roughly 27% of our new vehicle unit sales. BMW/MINI, Honda/Acura and Ford each represented roughly 11% of new vehicle unit sales.

Nissan was at 8.2%, Volkswagen/Audi, GM, Chrysler, and Hyundai/Kia each increased their share of Group 1's new vehicle unit sales during the quarter. U.S. new vehicle inventory stood at roughly 29,200 units, which equates to a 69-day supply compared to a 77-day supply for the second quarter of 2014.

The second quarter was one of the strongest used vehicle sales quarters in our history, with U.S. same-store sales increasing 14.2% and UK sales up 14.1%. Some of this strong sales performance was accomplished at the expense of lower per-unit margins that capitalized on our ongoing F&I performance strength. Our important U.S. certified pre-owned business was also a highlight with 23.2% growth during the quarter.

Total consolidated used vehicle retail revenues were 18.2% as we retailed 17.7% more units and the average used vehicle selling price increased $99 to $21,702. Used vehicle retail gross profit increased roughly 1% as the unit growth was largely offset by a gross profit per unit decrease of $244 to $1,465. During the quarter we resold over 31,000 used retail units.

U.S. used vehicle inventory stood at roughly 13,800 units which equates to a 32-day supply compared to a 36-day supply for the second quarter of 2014. Total consolidated parts and service revenue increased 7.1% while consolidated parts and service gross profit rose 9.2%.

On a local currency basis, same-store parts and service gross profit grew 9.4% on 8.2% higher revenues. U.S. same-store gross profit increased 9.3% on 8% higher revenues. The U.S. growth has been supported by the progress we're making in adding service technicians. Since June of 2014 we've added 115 net technicians with plans to add more over the coming year.

Within finance and insurance, a combination of increased profitability for retail units and higher volumes drove a total gross profit increase of 16.7% on a consolidated basis. Total consolidated F&I for retail unit increased $78 to $1,381.

U.S. F&I increased $93 to $1,535 per unit. Relative to our cost performance, on an overall consolidated basis, adjusted selling general and administrative expenses as a percent of gross profit improved 170 basis points to 71.4%, driven by strong cost control in the U.S. and significant restructuring actions in Brazil.

Regarding our geographic segment results, our U.S. operations performed very well with total revenue increasing 11$ where oil prices continue to be a topic of concern in several of our key markets we're pleased to report that there have not been any significant negative impacts on our overall sales. We have seen the most notable impact in our Oklahoma markets where vehicle sales were down 2.3% for the quarter. Our total Texas same-store new unit sales improved over 7% for the quarter.

And while total Houston market industry sales were up 7.1% in the second quarter, Group 1 Houston sales were up double digits. So we see no effects from lower oil prices in our largest market. Our U.S. team did an excellent job of leveraging the growth in gross profit with adjusted SG&A as a percent of gross profit, improving 150 basis points to an all-time quarterly record of 69.8%.

Our U.K. operations delivered another solid quarter with total revenue growth on a local currency basis of 34.7% supported by double-digit growth across all business segments. In Brazil, despite overall second quarter industry sales being down 23.2%, our team produced positive gross profit growth on a same-store local currency basis. This was due to double-digit gross profit growth and fixed operations and positive new vehicle gross profit growth on a local currency basis, despite a 15.7% decrease in new unit sales.

Our continued outperformance of the industry of selling rate is a testament to our strong brand mix and operating team. In a very weak macro environment our team was able to increase gross profit, cut expenses and generate an adjusted pre-tax operating profit. We continue to believe that we will deliver a pre-tax operating profit in Brazil for the full year of 2015.

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

John C. Rickel

Thank you, Earl, and good morning, everyone. Our adjusted net income for the second quarter of 2015 rose $7.9 million or 19.9% over our comparable 2014 results to $47.9 million.

On a fully diluted per share basis, adjusted earnings increased 34.7% to $1.98, an all-time quarterly record. These results for 2015 exclude $1.6 million of net after-tax adjustments, including the $850,000 of charges related to non-cash asset impairments, a $600,000 charge for resolution of a prior period legal matter and $600,000 of losses related to flood damage. These adjustments were partially offset by a $600,000 net after-tax gain on a dealership disposition.

The comparable results for the second quarter of 2014 excluded $23.1 million of net after-tax adjustments including $20.8 million charge related to the partial redemption of our 3% convertible notes, $1.1 million of asset impairments, mainly attributed to the relocation of the dealership onto owned real estate, and $1 million related to hailstorms in Kansas and South Carolina.

Starting with the summary of our quarterly consolidated results. For the quarter, we generated over $2.7 billion in total revenues. This is an improvement of $214.8 million or 8.6% over the same period a year ago and reflects healthy increases in each of our business units in the U.S. and the U.K. Weaker exchange rates and the impact of a slowing economy in Brazil were partial offsets.

Our gross profit increased $22.4 million or 6.1% from the second quarter a year ago to $391.6 million. For the quarter, adjusted SG&A as a percent of gross profit improved 170 basis points to 71.4% and adjusted operating margin was 3.7%, an increase of 20 basis points from the same period a year ago.

Floorplan interest expense decreased roughly $300,000 or 3% from the prior year to $10 million, explained by lower floorplan borrowings in Brazil due to both inventory management and the procurement of lower cost alternative financing options that are now reported under other interest expense.

Other interest expense increased $1.7 million or 13.2% to $14.2 million. This increase is primarily attributable to an increase in weighted average debt outstanding related to our issuance of $550 million for 5% bonds used to retire our 2.25% and 3% convertible notes during the second and third quarters of 2014, as well as the shift in Brazil inventory financing that I just mentioned.

Our consolidated adjusted effective tax rate for the quarter was 36.9%. We expect our effective tax rate for the remainder of the year to be in the low 37% range as we continue to benefit from an increased mix from lower tax jurisdictions.

Now turning to the second quarter consolidated same-store results. For the quarter, we reported revenues of over $2.5 billion, which was $104.2 million or a 4.3% increase from the comparable 2014 period. On a local currency basis, which ignores the change in foreign exchange rates, total revenues increased 7.4%. Within this 7.4% total, new vehicle revenue was up 4.6% and used vehicle retail revenues improved 14.3%. Both finance and insurance and parts and service delivered another strong quarter, growing revenues 12.6% and 8.2% respectively.

Please note that starting with the previous quarter, we've modified our press release and posted investor presentation to include year-over-year percentage change metrics on both a U.S. dollar and local currency basis. My remaining same-store comments will be on a local currency basis unless otherwise noted.

New vehicle revenues increased 4.6% on a 3.3% increase in unit sales and a 1.3% increase in our average new vehicle sales price.

By country, same-store new unit sales increased 4.5% in the U.S., increased 11% in the UK, and decreased 15.7% in Brazil. In each case, we outperformed the local market. Our used retail revenues improved 14.3% on a 12.6% increase in unit sales as U.S. CPO unit growth of 23.2% helped drive revenues.

By country, same-store used retail unit sales increased 14.2% in the U.S., increased 14.1% in the UK and decreased 19.9% in Brazil. F&I per retail unit rose 5.4% driven by increases in both income per contract and penetration rates for most of our major product offerings. Parts and service revenue grew 8.2% explained by increases of 17% in collision, 13.3% in warranty, 6.2% in wholesale parts, and 4.7% in customer pay.

In aggregate our same-store gross profit grew 4.8% on a local currency basis. Our same-store new vehicle gross profit dollars decreased 6.4% reflecting a 9.4% decrease in gross profit per unit, which was partially offset by the 3.3% increase in unit sales mentioned previously. New vehicle margin pressure was most notably seen in our volume import brands. Our used vehicle retail gross profit decreased 3% as the 12.6% increase in unit sales was more than offset by a gross profit per unit decrease of 13.9%.

Our F&I gross profit grew 12.6% reflecting a 5.4% increase in PRU and a 6.9% in total retail unit sales. Finally, same-store parts and service gross profit grew 9.4% reflecting a strong revenue growth mentioned previously as well is an 80 basis point increase in margins to 54.3%. By country, same-store parts and service gross profit improved 9.3% in the U.S., 10.1% in the UK, and 10.7% in Brazil.

Turning now to our geographic segment, starting with the US market on an actual basis. For the quarter, total US revenues grew 11% to $2.3 billion, driven by increases of 19% in total used vehicles, 18.2% in F&I, 8.3% in parts and service and 7.4% in new vehicles. The increase in our parts and service revenues reflects growth in all areas of the business and our F&I revenue growth reflects 11% increase in retail vehicle sales volume, coupled with improved profitability for retail units, which grew $93 or 6.4% to $1,535.

Total gross profit improved 8% driven by increases of 10% in parts and service and 3.5% in used retail vehicles as well as the F&I increase that I just mentioned. In the second quarter, we grew gross profit by $25.4 million while adjusted SG&A expenses increased just $13.1 million. As a result, our adjusted SG&A as a percent of gross profit improved 150 basis points to a record 69.8%.

Our same-store gross profit flowthrough in the US was 47% which is near the top end of our targeted range of 40% to 50%. Adjusted operating margin for the US business segment increased 10 basis points to 4.1%.

Related to our UK segment on a local currency actual basis, for the quarter total revenue increased 34.7% roughly two thirds of this increase is due to the December 2014 acquisition of three BMW/MINI dealerships. Gross profit for the UK segment was up 26.1% from the prior year. New vehicle gross profit grew 18.7%, as an increase of 29.2% in unit sales was partially offset by a decrease in gross profit per unit of 8.2%.

Used retail vehicle gross profit increased 9.2%, as a 33.8% increase in unit sales was partially offset by a decrease of 18.4% in gross profit per unit. Parts and service gross profit improved 36.4% and F&I income increased 41.3% which is attributable to a 7.7% increase in gross profit for retail unit and a 31.2% increase in total retail units.

During the second quarter, our adjusted SG&A as a percentage of gross profit increased 230 basis points to 77.9% and operating margin was 2.1%. Related to our Brazil segment on a local currency same-store basis, as Earl mentioned the total industry new unit volume decreased roughly 23% from the third quarter of 2014. Despite this our total gross profit increased slightly by 0.3%. New vehicle gross profit increased 3.1% as the decline of 15.7% in unit sales was more than offset by an increase in gross profit per unit of 22.2%.

Parts and service gross profit also increased by 10.7%. These increases were partially offset by used vehicle and F&I gross profit decreases. Used vehicle gross profit decreased 30.6% as a 17.8% decrease in total used unit sales combined with a decrease of 15.6% in gross profit per unit. F&I income decreased by 14.3%. The 2.9% increase in gross profit per retail unit was more than offset by a 16.7% decrease in total unit sales. Adjusted SG&A as a percentage of gross profit improved 230 basis points to 90.4% and adjusted operating margins increased 20 basis points to 0.7%.

Despite the local economic challenges, our Brazil segment generated a pre-tax profit for the second quarter. And as Earl indicated, we continue to expect that we will achieve an operating profit for the full year.

Turning to our consolidated liquidity and capital structure. As of June 30, 2015, we had $24.2 million of cash on hand and another $45.8 million that was invested in our floorplan offset accounts, bringing immediately-available funds to a total of $70 million. In addition, we had $183.6 million available on our acquisition line that can also be used for general corporate purposes. As such, our total liquidity at quarter-end was $253.6 million.

With regards to our real estate investment portfolio as of June 30, we owned roughly $760 million of land and buildings, which represents 47% of our dealership locations. To finance these holdings, we've utilized our mortgage facility and executed borrowings under other real estate-specific debt agreements. As of June 30, we had $56.3 million outstanding under our mortgage facility and $352 million of other real estate debt, excluding capital leases.

During the second quarter, we repurchased approximately 208,000 shares of our outstanding stock at an average price of $81.30 for a total of $16.9 million. This brings our year-to-date repurchases to 407,000 shares at an average price of $81.46 or a total of $33.1 million. As of June 30, we had $66.3 million of share repurchase authorization remaining.

In the second quarter, we used $4.8 million to pay dividends of $0.20 per share, an increase of $0.03 per share or 17.6% over the prior year. 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 J. Hesterberg

Thanks, John. Related to our corporate development efforts, during the quarter, the company disposed of three small dealerships – one Audi dealership in South Carolina and two Peugeot franchises in Brazil.

Year-to-date, the company has acquired two dealerships, which are expected to generate approximately $240 million in annual revenues and disposed of four dealerships, which generated approximately $30 million in trailing 12-month revenues. We continue to adjust our dealership portfolio to ensure we are generating appropriate returns for shareholders.

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

Q&A

Operator

[Operator Instructions] Our first question comes from Jamie Albertine at Stifel.

<Q - Jamie J. Albertine>: Thanks and good morning, everyone. I wanted to focus – and maybe apologies in advance because I know it's been a point that's sort of belabored all week on the margin side, specifically for used. And understanding that your gross profit throughput for the U.S. business was actually quite good again in the second quarter, it was a little but more degradation on a per unit basis than we were modeling.

So maybe could you help us understand kind of the pushes and pull on the used business? As supply is ramping, you're doing a better job of F&I attachment rates and penetration on your product side, how should we really think about modeling for the used gross margin business going forward?

<A - Earl J. Hesterberg>: Jamie, this is Earl. I'm not exactly sure how you should model it, but I do think it was one of our weaker areas of performance in the quarter. I don't think we did a good job. We've had 23 days to work on this. So we've spent a lot of time on it. And my impression is that with the improved availability of used vehicles, and that we bought a little heavy and also that in some of our oil challenged markets that there may have been a little bit of shift from new to used, and I think we had too many cars for the quarter. You'll note from our inventory level, 32 day supply, we don't hold onto these things. We have a discipline that – encourages our people to liquidate these things one way or another and keep our inventory in line.

So we retailed far too many cars at a low margin during the quarter. Compared to what we would normally do. But it leverages our F&I business, it gives money to the bottom line and you can see that we have some pretty powerful throughputs. So that's something we are going to work to move up a bit. I have learned not to try to forecast margins because I'm not very good at that. The market dictates a lot of that, but I think we can do a better job there. I wasn't particularly impressed with our margin result. I was impressed with our volume result.

<Q - Jamie J. Albertine>: Okay, great. It does sound like you withstood maybe a temporary sort of underperformance and you still had a great result, so we should see some – perhaps some better margins in the back half. And then if I could sneak one in the F&I side, just give us maybe your take on what we are hearing from the settlements discussions that are out there, Honda and elsewhere, and how you see this playing out from your portfolio's perspective over time. Thanks.

<A - Earl J. Hesterberg>: Let's let Pete comment on that. He's deeply involved in that every day.

<A - Peter C. DeLongchamps>: Jamie, I appreciate the question. And I will tell you, Jamie, based on our understanding of the program and input from a variety of different sources, we still believe that the revised program will either be neutral or quite frankly positive to our business overall. So it's something we continue to monitor, but we think from a business standpoint we will be fine.

<Q - Jamie J. Albertine>: Okay, thanks. And congratulations on a great result, Pete, and the U.S. F&I PVR. Take care.

<A - Peter C. DeLongchamps>: Thank you.

Operator

The next question is from Rick Nelson at Stephens.

<Q - N. Richard Nelson>: Thanks. [indiscernible] (26:26) starting to see impact from lower oil prices, Houston [ph] had it not (26:33). Why you could think that might be and do you think there is a lag potentially here?

<A - Earl J. Hesterberg>: Rick, this is Earl. We were very much braced and took quite a few actions assuming that we were going to get hit pretty hard. I am now starting to think that the Houston economy is diverse enough that we probably won't see anything substantial in Houston. But to be fair, Houston is very diverse. Oklahoma, we felt it; they're really – the Oklahoma economy – and we are the biggest retailer in Oklahoma of autos, it's not that diverse. It is very energy dependent. And we weren't able to get Oklahoma State data, but looking at the major OEM reports, it seems that the Oklahoma market may have been down even double digits in the quarter. We were only down 2% or 3%. So we have a pretty strong position there. But there was a little headwind for us in Oklahoma.

There were a couple of other small oil related markets. Beaumont, it's quite small but we have most of the franchises there. I think we were likely down 5% or 6% there. There's big oil refineries in Beaumont. Lubbock isn't necessarily directly an oil town, I don't think they consider it to be in the Permian Basin, but it appears a lot of trucks are sold in Lubbock that make their way into the Permian Basin. So we had a little headwind in Lubbock.

So, we saw a little bit of that, but Houston seems to have some power beyond just the energy business. So we believe we've gained quite a bit of share in the first two quarters of the year in Houston, which is our strongest market.

<Q - N. Richard Nelson>: [indiscernible] (28:17) double-digit growth. Do think the flooding in Houston was a net positive or negative for your business in the quarter?

<A - Earl J. Hesterberg>: I think it was a net positive, Rick. Actually, the data I had on the Houston market through May, the market was down and in June was really strong. So I think in June there were some flood car replacements in the Houston industry. We were up double digits before June, so – but I think that – I think there were some incremental flood replacement sales and I think there was also some decent service business that came from the flood. So I think it was positive.

<Q - N. Richard Nelson>: Thanks a lot and good luck.

<A - Earl J. Hesterberg>: Thanks.

Operator

The next question is from David Tamberrino at Goldman Sachs.

<Q - David J. Tamberrino>: Hey, great. Thanks for taking our questions this morning. I just want to center around your SG&A leverage for a couple questions here in the three different regions. Now, obviously, in the U.S. it sounds like you braced yourself in the Houston market and really set up. Maybe by shedding some employees, I'm not really sure what you've done, but you've outperformed what we've been thinking for your leverage. Just wanted to walk us through kind of what you've done and if you see that continuing through the back half of the year or if you have to rehire anyone, at least in the Texas market.

<A - John C. Rickel>: Yes. This is John Rickel. It actually really was not employment comp driven. Employment comp was actually up a little bit and we were able to more than offset that with cost reductions in other areas. We continue to be very focused on advertising cost control and then just the other cost elements and we think that that is sustainable in the U.S.

<Q - David J. Tamberrino>: Okay. And then further, in Brazil you've been positive, at least in the SG&A flowthrough, for the first two quarters of year. You again reiterated that you should be profit positive for the year. Is there anything in the back half of the year that would make it more difficult than what we've seen, kind of the low 90s more recently for the first half of this year versus last half of – 2H 2014, if you will, when you were in the high 80s?

<A - John C. Rickel>: No, there's really nothing in the comps. And the team down there has done a great job on cost control and they continue to be very focused on it. So we would anticipate that we'll continue to be able to keep costs in hand down there. They have done a good job of adjusting to the lower market conditions and they work on it every day.

<Q - David J. Tamberrino>: That's fair. And then just lastly, on the M&A environment, have you seen multiples contract at all more recently? Have they been inflating a bit little higher or how is the environment been for you?

<A - Earl J. Hesterberg>: I haven't seen any meaningful change in the M&A environment. I think you probably heard that there are quite a few dealerships for sale on the market in the U.S., but I think all of the asking prices are pretty stout and so I haven't really seen any change. There's a lot of potential deals out there if the buyer and seller can get together I guess.

<Q - David J. Tamberrino>: Do you expect any change in the asking price in a rising interest rate environment?

<A - Earl J. Hesterberg>: Well, that's hard for me to judge on asking price but these deals have to make sense for the buyer, and I think in a 17 million unit industry, it's a different proposition than buying in a 13 million or 14 million unit industry. And higher interest rates are certainly going to temper any projected returns for the future, so they have to be factored into that to be a good return for the buyer. So yes, I think that there are some issues that people have to be concerned with for acquisitions looking forward.

<Q - David J. Tamberrino>: Okay. That's fair. The only reason I ask is the thought process, if you had a rising interest-rate environment you might be seeing a potential slowdown in auto sales and sellers might get a little easier to reign in their expectations.

<A - Earl J. Hesterberg>: I guess that will remain to be seen.

<A - John C. Rickel>: This is John Rickel. Normally rising interest rates would imply that the economy is getting stronger, so in the ranges that are being talked about we'd only anticipate that that's going to materially curb of sales, we continue to look for 17 million this year and there are still plenty of room to run if you look at replacement demand. So I think the bigger issue is on things – does it impact the dealers floor plan spend, does it impact their ability to do F&I, I don't think there is a big risk that will materially slow auto sales.

<Q - David J. Tamberrino>: All right. Thanks for your thoughts.

Operator

Our next question comes from Bill Armstrong at C.L. King & Associates.

<Q - William R. Armstrong>: Good morning, gentlemen. Similar to many of your peers, your parts and service margins were up pretty nicely year-over-year. Can you talk about what the drivers were there? And maybe what you see going forward in terms of parts and service margin?

<A - John C. Rickel>: Yes. Bill, this is John Rickel. Most of that growth is really driven by how we account for the internal reconditioning work. If you strip out the benefit of the 100% growth from the internal work, margins have been pretty stable. As we continue to grow our used vehicle business, we continue to expect that those parts and service margins will continue to rise a bit. But the underlying margins for customer pay, collision, wholesale parts are all really steady.

<Q - William R. Armstrong>: And it looks like warranty was – kind of, led the way in terms of comps. Maybe not as much as some of other public companies there. What are we seeing in terms of warranty work and particularly recalls?

<A - Earl J. Hesterberg>: There is just a steady flow of recalls and I think you have visibility of that as well. And it's not predictable. It also – there is a time lag because frequently when these recalls are announced the parts aren't available in such. There's a steady flow of recall work in the shops which is generally a good thing although, I would say that it does have the ability to displace some customer paid business. Actually the strongest part of our business in the quarter was our collision repair business. I had to look at that number about three times to make sure that it was accurate, but we have a huge growth trend in our collision repair business based on quite a few new insurance companies doing business with us.

<Q - William R. Armstrong>: I saw that, that was a very big number and then finally...

<A - Earl J. Hesterberg>: That's a margin friendly business also.

<Q - William R. Armstrong>: Yes. And then finally on gross profit per new unit, you guys have a lot of midline import brands, we hear that obviously there is a lot of margin pressure there. Maybe can you talk about what you guys are seeing in the market? Is that sort of driving margin pressure and maybe also perhaps a shift in customer demand towards the larger vehicles that may favor the domestic brands more than the imports and the demand away from sedan?

<A - Earl J. Hesterberg>: Yes, that's exactly what we are seeing as well. We are very heavy with Toyota, Honda, and Nissan. There are more car brands than truck brands and there is a little but more supply than demand on cars these days. So OEMs are pushing, they are pushing us, we are pushing metal, summertime, everybody is trying to take share from each other and so that's a big part of the dynamic, it's hammered those margins quite a bit. I don't think anybody likes it but you either sell the car or you don't.

<Q - William R. Armstrong>: Right, okay, thank you.

Operator

Next question comes from John Murphy, Bank of America Merrill Lynch.

<Q - Elizabeth Lane Suzuki>: Hi. This is actually Liz Suzuki on for John. I just wanted to follow-up quickly on the question about the Honda settlement with CFPB and you mentioned that you didn't think it would have a negative impact, and it might actually be a positive. Can you disclose what your average market bids that you're getting now? Because it just seems like most of the public companies are already pretty close to that 100 to 125 range that the Honda settlement laid out, so I wanted to get confirmation of that.

<A - John C. Rickel>: Yes, Liz. This is John Rickel. I don't want to get into the specific number. I will just reiterate what Pete said that we are comfortable that with what we have been told from Honda. We have had rate caps in place for quite some time, and this fits within the bandwidth of how we have been operating.

<Q - Elizabeth Lane Suzuki>: Okay great, thanks.

Operator

The next question comes from Irina Hodakovsky at KeyBanc.

<Q - Irina Hodakovsky>: Good morning, everyone.

<A - Earl J. Hesterberg>: Hi, Irina

<Q - Irina Hodakovsky>: Just a follow-up a little bit on the new vehicle gross profit per unit pressures, it sounds like you are going out industry headwinds and not so much company specific headwinds?

<A - Earl J. Hesterberg>: I would think it's both actually. I mentioned a moment ago that we are very heavy in the Japanese brand mix and they tend to be more car driven brands than truck brands and there is an imbalance of supply and demand on cars in the market right now. So much of brands – the trucks. So there is a lot of pressure to move those cars and both the OEMs and the dealers are pushing hard and taking lower margins to do that.

<Q - Irina Hodakovsky>: Would you expect that to change as we go forward, would you expect the OEMs to adjust the mix in their production to meet the market demand?

<A - Earl J. Hesterberg>: I think they well over time to the degree possible. I don't know how quickly they can do that. I know that brands that don't have SUVs like Volkswagen and the Koreans maybe that aren't as [ph] truck heavy (39:00) they have new products planned that are in the truck or at least the crossover and SUV end of the business. And so over time, I think there will be some balance there, because they're trying to manage their profitability as well. Pushing cars with heavy marketing emphasis isn't good for their profit either. So I'm sure they will try to adjust that to a degree possible probably not in the near-term, though.

<Q - Irina Hodakovsky>: Not in the near-term. Thank you. And then on F&I you did mention that part of the increase was due to income per contract. What do you mean by that, is that your finance reserve?

<A - Earl J. Hesterberg>: Yes.

<Q - Irina Hodakovsky>: So your finance reserve is increasing. What are the drivers of that increase, is it higher selling prices or higher loan amounts or are you actually maybe increasing your spread a little bit?

<A - John C. Rickel>: Irina, this is John. It is primarily the dollars per contract is the pricing on new vehicles that needs to go up. The average amount financed to creep up along with that.

<Q - Irina Hodakovsky>: All right, thank you very much, guys. Congratulations on the good quarter.

<A - Earl J. Hesterberg>: Thank you.

Operator

Your next question is from Paresh Jain at Morgan Stanley.

<Q - Paresh B. Jain>: Good morning, everyone. And thank you for the slides, they are really helpful. I wanted to go back to slide 15 and look beyond 2Q. It seems like the new and used [ph] GP or ex-F&I (40:32) have consistently declined since 2011 but more than offset by a 50% or so jump in new F&I and a 25% jump in used F&I.

And again this is not specific to Group 1, it's pretty much industry-wide. So what in your opinion explains these continuous declines in GPU despite SAAR being really strong over the years, and do you see them recover from these levels at all or just have F&I offset it going forward?

<A - Earl J. Hesterberg>: Well, I think the factor in addition to the SAAR recovering is that that makes the auto manufacturers stronger, it makes the dealer network stronger and there is a big fight for market share. So I think it's a competitive dynamic. I also think as you get into some oversupply situations where supply gets out of balance with demand, which is more in these car areas at the moment, that that's another factor that helps drive these margins down.

But I think this is one of the most competitive industries in the world, and I think you are seeing a lot of healthy, powerful companies, both at the manufacturer level and at the retail level, fighting. It's competition.

<A - John C. Rickel>: And some of this is – this is John Rickel. Some of this is the fact that with F&I as lucrative as it is, you really don't want to miss that opportunity for the sale because if you don't sell the new or the used unit, you don't get the shot at that F&I. So that certainly plays into it. As Earl indicated, we think that there are probably some opportunities on used vehicle margins, there's some things that we are working on internally. But on new vehicle, it's competitive and for the time being, we anticipate it's going to stay competitive.

<Q - Paresh B. Jain>: Understood, thanks. And on U.K., a really strong performance there ex-currency, but GPU there saw a sharp decline as well which perhaps hurt your SG&A [ph] growth (42:25). Does the cost structure there need any adjustment, is there any room for that or was this just a one-off issue in 2Q?

<A - Earl J. Hesterberg>: No, there actually is a more simplistic explanation for the U.K. And again, it relates to the balance of supply and demand. As the euro has weakened against the dollar, it's also weakened against the British pound. So auto manufacturers who manufacture in euro and sell in pounds had a nice windfall. And so most of your major auto manufacturers do manufacture vehicles on the continent of Europe, they can't ship as many to China as they once did, so there is some oversupply and there's some increased shipments of vehicles into the U.K. these days which is making things just a little bit stickier on the margin side.

But that said, the demand has stayed very strong and steady in the U.K. and there is also increasing units in operation. So, again, we have to adjust our business model in the U.K. like we have in the U.S. by working the cost structure, working our parts and service growth, working the used car business and the finance business. So, yes, it's a dynamic market and we adjust these things as we see them happening. And that's kind of the same thing we've had to do in the U.S. as we've had this margin pressure on new vehicles.

<A - John C. Rickel>: The other side of – this is John Rickel. The other item that's impacting, at least on a consolidated basis, is obviously we bought the three Elms BMW stores in the fourth quarter last year and we're still integrating those in. It takes a little longer to take cost out in the U.K. when you do an acquisition because of the labor laws, so we would anticipate that there's additional costs that will come out as we fully integrate those stores.

<Q - Paresh B. Jain>: That's good color. Thank you.

Operator

[Operator Instructions] Our next question comes from David Lim at Wells Fargo.

<Q - David H. Lim>: Hi, good morning.

<A - Earl J. Hesterberg>: Good morning, David.

<Q - David H. Lim>: Good morning. SG&A to gross profit, I just wanted to get a little bit more color if you guys could give some sort of description on maybe the glide path for the U.K. and Brazil as it relates to the U.S. I think in the past you mentioned that it probably can't get to the U.S. level, but wondering if you guys could provide some detail on how close can it come to the U.S. SG&A to GP levels.

<A - John C. Rickel>: Yes. That's not really the – David, and I'll take a little bit of a shot at it. U.K., we don't own as much of the real estate there. And you also don't have some of the higher margin things, like the F&I is not quite as lucrative, so it's a little harder to leverage.

I think if we can run that in that mid 75% range, I think they are doing a pretty good job. So, there's probably a couple more points, but it's not going to get sub-70% like what we are able to run in the U.S.

Brazil, it's still too early to tell. We're obviously continuing to take out more costs, but ultimately we need to get back to generating more [ph] growth (45:50) down there to be able to lever it. So, I'll take a save on giving you any sort of shot right now at Brazil until we see a little more normalization in the market.

<Q - David H. Lim>: Understood.

<A - Earl J. Hesterberg>: I think we also would benefit, David, in both of those markets from more scale. Obviously, we're going to be careful about adding too much scale too quickly in Brazil until things settle down. But we're continuing to look to grow our businesses in both those markets because we have a pretty nicely established platform and infrastructure, and being able to leverage some of that fixed cost will help our company in the years ahead.

<Q - David H. Lim>: And a question for Pete. AutoNation is sort of dabbling with – or they've actually announced that they're going to do a private label maintenance program, and obviously that's going to probably likely boost the F&I per unit. Has Group 1 considered something similar to that strategy on the private-label front?

<A - Earl J. Hesterberg>: Yes, we've looked at that several times. Pete, do you want to make some comments?

<A - Peter C. DeLongchamps>: Sure. And we have looked at it and we took the position that from a penetration standpoint, it's better for our consumer and our shareholder for us to utilize the factory endorsed – OEM endorsed maintenance program. So we have aligned ourselves with each of the manufacturers whether it's Toyota with the Toyota Care Wrap or Honda, to utilize the maintenance program offered by the OEM.

<A - Earl J. Hesterberg>: Yes, David, just to add something to that, I think you will appreciate this. When we look at doing it and selling free maintenance and there are some smaller companies that sell free oil changes, if you will. A lot of our customers, particularly in the Japanese brands, and the luxury brands, when you say you are going to provide free maintenance it's not just an oil change.

And trying to keep up with the detailed maintenance schedules of the auto manufacturers and what they include at various intervals, 15,000 miles, 30,000 miles, it becomes a cottage industry to keep up with those things and you want to make sure that you can afford to do all of those different maintenance items at each interval and it's different from brand to brand and it's awful hard to keep up with.

<Q - David H. Lim>: Sure. Thanks for that. The other question I had was truck mix has been really favorable over the last several months, and I personally thought it would be a tailwind to gross profit per unit. I was wondering if you guys could dive on that a little but more and also how is the F-Series launch going as well as the availability on the new truck?

<A - Earl J. Hesterberg>: Well, we actually didn't get as much truck mix benefit as we should have in the quarter. We were up pretty strongly in Ram and General Motors, but we are down in Toyota and we are a pretty big Toyota Company. We just couldn't get enough Toyota trucks. There are in very short supply, at least in our markets.

And Ford, we went backwards a little, but, again I think most of that is supply, but I think that you've also seen Ford has become more aggressive on their marketing support here in the last three weeks for the F-Series. So I think we will get some truck mix benefit in the second half of the year and we will do our best to translate some of that into a little better margin also. And selling new products should give us a little chance of that I would think, so that should be a positive.

<Q - David H. Lim>: And my final question is obviously Ferrari filed their IPO papers today, would you guys be interested in a Ferrari franchise going forward? Thanks.

<A - Earl J. Hesterberg>: John wanted to demo Ferrari. I actually have trouble fitting into some of those cars. But – no, that's generally – you never say never, because if it's a good business opportunity, we are in that business, but we have stayed away from those super luxury or exotic brands or whatever you call them.

<A - John C. Rickel>: In general there are too many people that do you like those as demos, so they take too much for the dealership.

<Q - David H. Lim>: Thank you, guys. Good luck.

<A - Earl J. Hesterberg>: Thanks.

Operator

This concludes our question-and-answer session. Would you like to make any closing remarks?

Earl J. Hesterberg

Thanks, everyone, for joining us today. We look for to updating you on our third quarter earnings call in October. Have a good day.

Operator

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