Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2015-10-27
Event Description: Q3 2015 Earnings Call

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Company Participants

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

Other Participants

- Elizabeth Lane Suzuki
- N. Richard Nelson
- William R. Armstrong
- Jamie Albertine
- Steve J. McManus
- Patrick K. Archambault
- Michael Montani
- 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 Third Quarter Financial Results Conference Call. Please be advised that this call is being recorded.

I would now like to turn the conference over to Mr. Pete DeLongchamps, Group 1's Vice President of Manufacturer Relations, Financial Services and Public Affairs. Please go ahead, Mr. DeLongchamps.

Peter C. DeLongchamps

Thank you, Dan, 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 conference 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 the website.

Participating with me today on the call; 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 would now like to hand the call over to Earl.

Earl J. Hesterberg

Thank you, Pete, and good morning, everyone. I am pleased to report Group 1 achieved record adjusted third quarter net income of $46 million. This equates the record third quarter EPS of $1.91 per diluted share, an increase of 21.7% over the prior year.

For the quarter, total revenue increased approximately $174 million or 6.6% to an all-time quarterly record of $2.8 billion. On a constant currency basis revenue grew 10.2% for the quarter.

Turning to our business segments, total consolidated new vehicle revenues grew 5.3% or 9.4% on a constant currency basis. As we retail 5.9% more units at an average new vehicle selling price of $33,977. New vehicle gross margins decreased 30 basis points as conditions remain competitive in all three of our markets. During the quarter, we retailed over 47,000 new vehicles.

On a same-store basis by market, new vehicle unit sales increased 4.4% in the U.S. The U.K. had an outstanding quarter with new unit sales up 19.1%. And almost as impressive was Brazil with 1.3% increase in unit sold in a market where the industry was down more than 25%. Our new vehicle unit sales geographic mix was 81.3% U.S., 11.1% U.K. and 7.6% Brazil. Our new vehicle brand mix was led by Toyota/Lexus sales which accounted for 27% of our new vehicle unit sales. Ford/Lincoln, BMW/MINI and Honda/Acura each represented over 11% of our new vehicle unit sales and Nissan was at 8%. U.S. new vehicle inventory stood at 28,518 units at the end of the quarter, which equates to a 72-day supply compared to a 75 day supply for the third quarter of 2014.

Total consolidated used vehicle retail revenues grew 11.6% or 14.6% on a constant currency basis as we retail 12.9% more units with an average used vehicle selling price of $21,164. Used vehicle retail gross profit increased 5.1% as lower gross margins down 40 basis points to 6.8% were a partial offset to the strong volume growth. During the quarter, we retailed over the 32,000 used retail units.

On a same-store basis, used vehicle retail unit growth was double digits across the board with a 10.3% increase in the U.S. and impressive 19% increase in the U.K. and a 15.3% increase in Brazil. U.S. used vehicle inventory stood at 13,239 units at the end of the quarter, which equates to a 32-day supply compared to a 30-day supply for the third quarter of 2014.

Total consolidated parts and service revenue increased 4%, while consolidated parts and service gross profit rose 7.8%. On a constant currency basis, same-store parts and service gross profit grew 8.9% on 6.3% higher revenues. Within finance and insurance, a combination of increased profitability per retail unit and higher volumes drove a total gross profit increase of 10.9% on a consolidated basis. Total consolidated F&I per retail unit increased $27 to $1,352. U.S. F&I increased $65 to a third quarter record of $1,515 per unit.

Regarding our geographic segment results, our U.S. operations delivered solid growth with total revenue increasing 7.7%. Our used retail growth was a highlight with revenue increasing 11.9%. Higher retail volumes and a further expansion in our income per unit drove a 12% increase in F&I revenue. And finally, parts and service continued to grow with revenue up 6.1%.

Our U.K. operations had an outstanding quarter with total revenue growth on a constant currency basis of 39.6%, driven by double-digit growth across all segments of new vehicle, used vehicle, parts and service and finance and insurance.

For Brazil, while the overall industry sales for the quarter were down more than 25%, reflecting the difficult macro environment, our new vehicle unit sales were up 1.3% on a same-store basis. Our strategy of aligning with growing brands is working and in conjunction with aggressive cost cuts allowed us to once again deliver a small operating profit this quarter.

We remain confident that the improved actions our team has implemented over the last year will allow us to be profitable on a full year basis. Relative to our cost performance, on an overall consolidated basis, adjusted selling, general and administrative expenses as a percent of gross profit improved 140 basis points to 72.5%.

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 C. Rickel

Thank you, Earl, and good morning, everyone. Our adjusted net income for the third quarter of 2015 rose $6.3 million or 15.7% over our comparable 2014 results to $46 million. On a fully diluted per share basis, adjusted earnings increased 21.7% to $1.91.

These results for 2015 exclude approximately $800,000 of net after tax adjustments related to non-cash asset impairments. The comparable results for the third quarter of 2014 excluded $13.6 million of net after tax adjustments including $17.9 million of charges related to the repurchase of all of our 2.25% as well as the remainder of our 3% convertible notes and $6.6 million of asset impairments primarily associated with the pending disposition of vacated U.S. dealership real estate and three Renault franchises in Brazil.

These charges were partially offset by a net after tax gain of $8.6 million resulting from the sale of several U.S. dealerships and the associated real estate combined with a $3.4 million favorable foreign income tax change.

Starting with a summary of our quarterly consolidated results. For the quarter, we generated $2.8 billion in total revenues. This is an improvement of $174.1 million or 6.6% 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 in the U.K. and Brazil were partial offsets.

Our gross profit increased $23.7 million or 6.3% from the third quarter a year ago to $398.4 million. For the quarter, adjusted SG&A as a percent of gross profit improved 140 basis points to 72.5% and adjusted operating margin was 3.5%, an increase of 20 basis points from the same period a year ago.

Floorplan interest expense decreased by over $700,000 or 7.3% from the prior year to $9.7 million, explained by lower floorplan borrowings in Brazil due to improved inventory management. Other interest expense increased by roughly $700,000 or 5.1% to $13.9 million. This increase is primarily attributable to an increase in weighted average debt outstanding related to our issuance of $550 million of 5% bonds used to retire our 2.25% and 3% convertible notes during the second and third quarters of 2014. Our consolidated adjusted effective tax rate for the quarter was 37.8%.

Now, turning to third quarter consolidated same-store results. For the quarter, we reported revenues of over $2.6 billion, which was a $114.3 million or a 4.5% increase from the comparable 2014 period. On a local currency basis, which ignores the change in foreign exchange rates, total same-store revenues increased 8%. Within this 8% total, new vehicle revenue was up 7.5% and used vehicle retail revenues improved 12.1%. Both finance and insurance and parts and service delivered another strong quarter growing revenues 10.5% and 6.3% respectively.

Please note that earlier this year we modified our press release and posted investor presentation to include year-over-year percentage change metrics on both the 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 7.5% on a 5.4% increase in unit sales, and 2% on our average new vehicle sales price. By country, same-store new unit sales increased 4.4% in the U.S., 19.1% in the U.K., and 1.3% in Brazil. Our used retail revenues improved 12.1% on an 11.3% increase in unit sales. By country, same-store used retail unit sales increased 10.3% in the U.S., 19% in the U.K. and 15.3% in Brazil.

F&I income for retail unit rose 2.5%, driven by increases in both income for contract and penetration rate for most of our major product offerings. Parts and service revenue grew 6.3% explained by increases of 12.1% in collision, 10.4% in warranty, 6% in wholesale parts and 3% in customer pay. We continue to make progress hiring additional service technicians. On a year-to-date same-store basis, we've increased our U.S. technician head count by 143, an increase of over 7% from December 2014.

In aggregate, our same-store gross profit grew 7.1% on a local currency basis. Our same-store new vehicle gross profit dollars increased 1%, reflecting the 5.4% increase in unit sales mentioned previously, which was partially offset by a 4.2% decrease in gross profit per unit.

New vehicle margin pressure was most notably seen in our volume import brands. Our used vehicle retail gross profit increased 4.8% as 11.3% increase in unit sales was partially offset by a gross profit per unit decrease of 5.8%.

Our F&I gross profit grew 10.5%, reflecting a 2.5% increase in PRU and a 7.8% increase in total retail unit sales. Finally, same-store parts and service gross profit grew 8.9%, reflecting a strong revenue growth mentioned previously as well as a 160 basis point increase in margins to 54.7%. By country, same-store parts and service gross profit improved 9.4% in the U.S., and 9.1% in the U.K., while Brazil was basically flat.

Turning now to our geographic segment, starting with the U.S. market on an actual basis. For the quarter, total U.S. revenues grew 7.7% to over $2.3 billion, driven by increases of 12% in F&I, 10.2% in used vehicles, 6.6% in new vehicles and 6.1% in parts and service. The increase in our parts and service revenues reflects growth in all areas of the business and our F&I revenue growth reflects a 7.2% increase in retail vehicle sales volume, coupled with improved profitability for retail unit, which grew $65 to $1,515.

Total gross profit improved 8.2%, driven by increases of 9.6% in parts and service and 6.5% in used vehicles as well as the 12% F&I increase that I just mentioned. For the third quarter, we grew gross profit by $26.4 million while adjusted SG&A expenses increased just $13.9 million.

As a result, our adjusted SG&A as a percent of gross profit improved 150 basis points to 71.4%. Adjusted operating margin for the U.S. business segment increased 20 basis points to 3.8%.

Related to our U.K. segment on a local currency actual basis, for the quarter, total revenues increased 39.6%. Roughly two-thirds of this increase is due to the December 2014 acquisition of three BMW and MINI dealerships.

Gross profit for the U.K. segment was up 30.5% from prior year. New vehicle gross profit grew 27% as an increase of 38.2% in unit sales was partially offset by a decrease in gross profit per unit of 8.1%. Used retail vehicle gross profit increased 19.5% as a 35.2% increase in unit sales was partially offset by a decrease of 11.6% in gross profit per unit. Parts and service gross profit improved 33.5% and F&I income increased 36.6%.

During the third quarter, our adjusted SG&A as a percent of gross profit increased 290 basis points to 77.6%, primarily reflecting the acquired stores and operating margin was 2.2%.

Related to our Brazil segment on a local currency same-store basis, as Earl mentioned, the total industry new unit volume decreased roughly 25% from the third quarter of 2014. Despite this, our total gross profit decreased only slightly by 1.3%. New vehicle gross profit increased 6.2%, reflecting an increase of 1.3% in unit sales combined with the 4.8% increase in gross profit per unit. Parts and service gross profit also increased by 0.002%.

These increases were offset by used vehicle and F&I gross profit decreases. Used vehicle gross profit decreased 22.4%, with a 7.2% increase in total used unit sales was more than offset by a decrease of 27.6% in gross profit per unit. F&I income decreased by 12.4% as a 4.6% increase in total retail unit sales was more than offset by 16.2% decrease in gross profit PRU. Despite the local economic challenges, our Brazil segment generated small pre-tax profit for the third quarter. And as Earl indicated, we continue to expect we will achieve a pre-tax operating profit for the full year.

Turning to our consolidated liquidity and capital structure, as of September 30, 2015, we had $22 million of cash on hand and another $48 million that was invested in our floorplan offset accounts, bringing immediately-available funds to a total of $70 million. In addition, we had $122 million available on our acquisition line that can also be used for general corporate purposes. As such, our total liquidity at quarter-end was $192 million.

With regards to our real estate investment portfolio as of September 30, we owned roughly $775 million of land and buildings, which represents 46% of our 153 dealership locations. To finance these holdings, we've utilized our mortgage facility and executed borrowings under other real estate-specific debt agreements. As of September 30, we had $55.5 million outstanding under our mortgage facility and $343.7 million of other real estate debt, excluding capital leases.

During the third quarter, we repurchased approximately 443,000 shares of our outstanding stock at an average price of $85.69 for a total of $38 million. This brings our year-to-date repurchases to 850,000 shares at an average price of $83.67 for a total of $71.1 million. As of September 30, we had $28.3 million of share repurchase authorization remaining. In the third quarter, we used $5 million to pay dividends of $0.21 per share, an increase of $0.04 per share or 23.5% over the prior year.

Finally, I want to mention a key point relative to the normal seasonality of our business. Historically, our business has always been stronger in terms of sales and profit in Q3 than Q4. We expect this year to be no different.

I would highlight that last year was an exception due to the extinguishment of our convertible debt which created an unusual pattern of our Q4 earnings per share exceeding our Q3 levels due to the dramatic reduction in our share count.

I just want to remind everyone of this anomaly to the calendarization of our EPS trend in 2014 to avoid any confusion. 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, as previously announced, during the quarter, the company acquired Mercedes-Benz, Sprinter, and Smart franchises in Central Texas near Austin which are expected to generate approximately $100 million in annual revenues.

Year-to-date, the company has acquired five franchises that are expected to generate approximately $340 million in annual revenues and disposed of four franchises that have generated approximately $30 million in trailing 12-month revenues. We continue to adjust our dealership portfolio to ensure we are generating appropriate returns for our shareholders.

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

Q&A

Operator

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

<Q - Elizabeth Lane Suzuki>: Good morning. This is Liz Suzuki on for John. It looks like on a same-store basis for the consolidated company, parts and service grew about 6.3% excluding foreign exchange. Were there any headwinds year-over-year in the parts and service channel that we should make a note of, because we've been seeing some stronger results with some other dealer groups and even your U.S. operations were only up about 6.6%. So just wondering if there is potentially some stronger growth ahead in that segment?

<A - Earl J. Hesterberg>: No, I'm not aware of any headwinds at all. In fact, I would say, overall, our repair shops are quite full in both the U.S. and the U.K. in particular. No, I don't – I think that's probably just a normal variation depending on to a large degree the recall and warranty work and the nature that work by month and by quarter. But I would say the parts and service business remains very, very strong.

<Q - Elizabeth Lane Suzuki>: Great, thanks. I know it's like – in the slides you had the – Texas is up with 7.2% year-over-year same-store, which is up more than 4.4% growth for the overall U.S. So it seems like the numbers kind of speak for themselves and you dedicated a section of the slide for this, but could you just mention if you are seeing any negative impact at all in any of your Texas stores due to the weak energy market?

<A - Earl J. Hesterberg>: There is very slight negative impact in a certain Texas market. For example, we have a BMW dealership in downtown Houston that services the energy company headquarters in downtown Houston that dealership has been impacted, but 8 miles away our Toyota store is red hot selling everything we can get. Our Chevrolet dealership is up way year-over-year. Our overall Houston business was up 6% plus for the quarter. So there are a few spots where you can see it. The main issue for us relative to energy impacting our sales would be our new vehicle sales in the state of Oklahoma, that's about 8% of the company sales and our new vehicle sales were down 5% for the quarter there. That's probably the drag that you were looking for. But our used vehicle sales in the state of Oklahoma are up well into double digits. So, it's possible, there is some shift from new to used there. It would seem that the Oklahoma economy isn't as diverse as the Texas economy. It's much more impacted by this latest drop from $60 a barrel of oil to $45 or whatever it dropped to. But, Texas for us still, I would say, is probably at least up the national industry average or better in new vehicle sales.

<Q - Elizabeth Lane Suzuki>: Okay. Thanks very much.

Operator

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

<Q - N. Richard Nelson>: Thanks, good morning. To ask about the acquisition environment, you have acquired $340 million revs year-to-date, $100 million in the quarter, if you could discuss the multiples that you're seeing out there?

<A - Earl J. Hesterberg>: Well, I can't really speak to multiples, Rick, because we look at it on a return on investment basis, but I think the gist of your question is that there is a lot of activity in terms of sellers in the market. I also think the prices are probably at near record levels because of the trailing couple of years of earnings, as you know, have been pretty strong. So I would say there is a lot of activity in the buy/sell market, but I would say that it's probably more toward expensive than reasonable in terms of pricing.

<Q - N. Richard Nelson>: And premium luxury stores you bought this quarter Mercedes, we're hearing about some big tickets there in that segment and...

<A - Earl J. Hesterberg>: I would say that would be true, Rick. The luxury brands in the U.S. are certainly bringing the highest prices. It's probably the highest prices ever. That would be a valid observation.

<Q - N. Richard Nelson>: Any comments on October sales and what you are seeing thus far. I know there's been a lot of rain in Texas. Do you view that as a headwind or is that an opportunity, the potential flood damage, et cetera.

<A - Earl J. Hesterberg>: Well, the overall pattern of sales in October beginning the quarter was probably quite consistent with the previous quarter. But we were wiped out in terms of weekend business, last weekend. Obviously, you could see that rain coming so there was a lot of media attention to it on Friday and Thursday. And so it was a pretty dreadful sales weekend across Texas, Oklahoma and then I guess spreading around the Gulf Coast here the last day or two. But we have a lot of the quarter to go and sometimes when you miss a weekend of sales you catch that up with people stay in for a few days and come back later. So, we'll have to see how that goes. People were better prepared. There was some flooding certainly in parts of Texas. So, you do get a little parts and service kick from that. So, maybe we will see that. So there was quite a bit of flooding in Texas.

<Q - N. Richard Nelson>: Okay, thanks. And finally a question for Pete on the F&I side. This is a regular phenomena, because you hit records every quarter, $1,515 in the U.S.

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

<Q - N. Richard Nelson>: How much more opportunity do you see and are there risks out there that we should be thinking about F&I as we move forward?

<A - Peter C. DeLongchamps>: Yeah, I can't speak to specific risks and I'll stick with my consistent message, Rick, that we are very pleased with where we are and we work every day to improve the underperforming stores and increase our product penetrations. So, that's been a lot of hard work by the team and we're delighted with the results.

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

<A - Peter C. DeLongchamps>: Thanks.

Operator

And our next question comes from Bill Armstrong of C.L. King Associates. Please go ahead.

<Q - William R. Armstrong>: Good morning, gentlemen. A couple questions, so starting with Brazil, you outperformed the overall market by a mile both in new and used. So I was wondering – you mentioned brand mix, so I was wondering if maybe you could drill down a little bit in talking about your outperformance and what the outlook for Brazil is for the rest of the year and into the new year.

<A - Earl J. Hesterberg>: Well, I think the overall outlook for the market is certainly still negative. I guess when your President is under threat of impeachment, there is not much hope that you're going to have a stable political environment in the near-term. And in September three of the four big brands, I believe it was Fiat, Volkswagen and General Motors were down between 40% and 45%. So overall, the current automotive sales environment is about as bad as you would ever see. Those are the levels that put two auto manufacturers into bankruptcy in the U.S. in 2008.

But our strength is that our brands; Toyota, Honda, BMW, Land Rover have moved toward local production and have some new products that are quite popular. And so they have much smaller market share, but they're gaining market share in this environment that is really hammering the big brands. So that's helped us stay around flat in sales in a market that's down probably 25%. So we're pretty proud of our Brazilian operating team and we do have a couple of brands that struggle, Peugeot and Nissan, at least to make profit. But we keep making that business stronger. We keep strengthening our management team, which I think is a brilliant management team. And so, we're just going to continue to deliberately build a strong business so that we'll have some leverage when the market does eventually recover and that's the same way we approach the U.K. business which we built from an original acquisition of three dealerships. We slowly and deliberately built that business and it was very powerful for us in this past quarter.

<Q - William R. Armstrong>: And in Brazil your used unit comps were up 15% too which was much better performance than we've seen over the last few quarters. So I was wondering if you could give us some color there, what happened there?

<A - Earl J. Hesterberg>: Yeah, I'll give you some color, but I will admit to you that we don't believe that we are particularly proficient used car operators in Brazil yet. I would tell you we're coming off a low base, that's probably the majority of it. The other part is that with floorplan rates near 18%, we liquidated quite a few cars just to keep the inventory in line. Actually, we're in pretty solid position with our brands relative to sales in Brazil compared to others as I just mentioned. But the floorplan rates were the biggest challenge in Brazil right now, which probably are somewhere in the order of magnitude of 18%. So we're trying to keep the inventories lean.

<Q - William R. Armstrong>: So, should we take that as maybe had some unusual liquidation activity and maybe we get back to maybe a more normalized trend going forward?

<A - Earl J. Hesterberg>: Yes, I think that's true. And I think we can continue to grow that business simply because we're starting from a low level. The used car business in Brazil through franchise dealer is still somewhat undeveloped. So we believe that to be a big long-term opportunity for our company. But I think the growth was a bit overstated last quarter.

<A - John C. Rickel>: Yeah, Bill, this is John. I would add. You see that really show up in – we discounted the gross profits pretty heavily, that's why you saw the extreme pressure on gross profits per unit was a tradeoff that the operating team made to clear that inventory out.

<Q - William R. Armstrong>: Right. Yeah, I saw that. Okay. And then last question back in the U.S. parts and service margins were up very nicely. What were the drivers there?

<A - Earl J. Hesterberg>: Well, I think it's mostly our mix among our business. One of our strongest businesses in Group 1 for quite some time is our collision business and it's been up double digits quarter-after-quarter this year. And so I believe that helps our margin mix to a certain degree.

<A - John C. Rickel>: Yeah, that was a piece of it, but the other thing, Bill, is that it looked like we had a little bit of improvement in our customer pay margins as well and some of that's probably just mixed among within the actual customer pay business. And then the final piece is with the strength in new and used obviously the internal work contributed as well.

<Q - William R. Armstrong>: Got it. Okay. Thank you very much.

Operator

And our next question comes from James Albertine of Stifel. Please go ahead.

<Q - Jamie Albertine>: Great. Thanks for taking the question and good morning, everyone.

<A - Earl J. Hesterberg>: Morning, Jamie.

<A - John C. Rickel>: Good morning.

<Q - Jamie Albertine>: If I may ask on the used retail side, another peer's very strong quarter in the U.S., units up double digits. Could you help us understand some of the ancillary opportunities though as you are sort of driving more customers through your used business? We talked about internal work, I think, John has referenced it in the margin question a minute ago, but I am thinking more along the lines of attachment rates for extended service plans or the need for financing and sort of thinking about it more holistically how does the used – incremental used unit hit every vertical within the business?

<A - John C. Rickel>: Well, Jamie, obviously, being a good used car operator is key to being a good new car operator as well. So it supports the new car business by being able to take the trade and turn it into retail. So supports that – clearly it helps parts and service, the attachment rates on parts and service are not the same as new but especially as we continue to grow the CPO business. CPO business does have a pretty good attachment rate and we're running about 30% CPO mix. And then the final piece is in Pete's world, you really can't tell the F&I unless you sell that used retail unit. So, we continue to drive a lot of volume through F&I which the industry leading levels that we're running generate a lot of gross profit through F&I for us.

<Q - Jamie Albertine>: Is it about the same level of penetration for financing that the consumers are looking for on a used vehicle relative to new?

<A - Earl J. Hesterberg>: Yes, it is, Jamie. And we also – as John mentioned, CPO and then it also gives us a nice attachment rate on vehicle service contract at level above 40%. So as John mentioned, the best used car dealers have the ability to retail the new cars because they have the ability to put more into the trade. So it's a critical piece of the business. So we have really been spending a lot of time on.

<Q - Jamie Albertine>: Well, that's extremely – thank you for that data point, over 40% service contract penetration. And then the last – I just want to, not to beat a dead horse here, but it seems to me just looking at the estimate, not about the estimates but the results on the used retail side, there's an acceleration going on and otherwise. The concerns that people are sharing under the new vehicle sales cycle don't seem to be manifesting themselves on the used side of the business. You even said, I think, Earl, double-digit growth in used sales, if I heard you correctly, in Oklahoma. So there's in fact offsets from maybe some other pressures you're seeing on the new vehicle side. Would you agree in general what sort of that accelerate – we're on a maybe earlier curve of the used retail unit acceleration call?

<A - Earl J. Hesterberg>: Yeah, I believe the big part of that acceleration is increase supply. There has been – we have been starved for used cars and quite frankly we still are in many segments of the market such as a little bit older cars that are still high quality maybe in a three-year to four-year old range. So – but there has been a lot better supply of used cars this year, and I think that's one of the factors. And I also think that we are a lot more proficient than we once were at – in the used car business and systems and things like that and discipline and I think made us better used car retailer.

<Q - Jamie Albertine>: Well, that's it for me. For the moment, I appreciate. John will follow up offline. Have a great third – sorry, fourth quarter and we will talk soon.

<A - Earl J. Hesterberg>: All right. Thanks.

Operator

And our next question comes from Steve McManus of Sidoti & Company. Please go ahead.

<Q - Steve J. McManus>: Good morning, everyone. Thanks for taking my questions.

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

<Q - Steve J. McManus>: So my first question, you guys have really been ramping up the technician hiring so far this year. Where within the P&S segment are you focusing on adding capacity? And do guys have kind of a ballpark internal target for head count additions for the year and maybe into next year?

<A - Earl J. Hesterberg>: Yeah, we have been actually for a couple of years trying to ramp up our productive capacity, our manpower capacity and service and we still are. We still basically have needs for technicians and service advisors across the board in every geography and every brand. I would say we have made some progress this year. Maybe we've gotten some technical people back from the oil field in some of our markets, but we still have great needs and it's still a company-wide effort. So I don't think anything has changed there. As I mentioned earlier, our shops are still quite full.

<Q - Steve J. McManus>: Okay. Then the next one just with respect to the ongoing shift towards real estate ownership versus leasing, can you just talk about some of the benefits and savings you guys have been realizing as a result of the transition, is anything starting to materialize yet, any commentary there would be great.

<A - John C. Rickel>: Yeah, Steve. This is John Rickel. This has been kind of an ongoing strategy really Earl and I came onboard. The company in 2005 really was a 100% sale/leaseback. So at this point, we're about to half. We see certainly benefit in lower cost of sale/leaseback, tends to run 200 basis points to 300 basis points higher costs versus what we are able to do with a mortgage to support it. Plus it's also, I think, strategic for us. You're controlling an important part of the business, your location. A lot of these places, like Highway 59 here in Houston, you couldn't replace one of these if you ever lost them. So being able to own that underlying asset we think it's important to a lower cost for us and also I think gives us a control over our future.

<Q - Steve J. McManus>: Okay, great. Thanks a lot, guys. I appreciate it.

<A - John C. Rickel>: Thanks.

Operator

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

<Q - Patrick K. Archambault>: Hi, yeah. It's actually Pat Archambault here from Goldman. Good morning. Just a couple of questions or follow-ups, I should say. Just on the parts and service side, on your slide 13 in the deck that you provided, you kind of went back into sort of negative territory with customer pay same-store comps. And just wanted to understand why that was. Clearly, other areas are doing very well like collision and warranty. But is this kind of going back to the issue of capacity squeezing out customer pay growth or what's going on there.

<A - John C. Rickel>: Yeah, Pat, this is John Rickel. That's on a U.S. dollar basis. If you look at it on a constant currency, we actually grew customer pay. So what you are really seeing there is the impact of FX.

<A - Earl J. Hesterberg>: Yeah. And I do think that we just have a natural flow of customers into the shops and with some of the recall activity and it varies by brand, sometimes I would say, it is possible that we are displacing some customer pay business. For example, a couple of the brands that have the highest recall activity at this moment are Honda and Chrysler. We are not very big with Chrysler and Honda is maybe 11% of our business, but those are the airbag recalls and we tend to prioritize those. And it is possible on some of these recalls that some customer pay business gets displaced. We try not to do that, but by brand it is somewhat situational.

<A - John C. Rickel>: Yeah, Pat, let me just say out the number. On a constant currency basis, we grew customer pay 3.7% and total parts and service on a constant currency basis consolidated same-store was up 6.6%. So it is really just the currency that's getting to it.

<Q - Patrick K. Archambault>: Got it. That's helpful. And just to follow up on that, I mean, what – in terms of the Takata recall, how much of the way through are we on that one?

<A - Earl J. Hesterberg>: Well, I don't have hard data to give you a definitive answer, but I don't think we're anywhere near halfway, that's for sure.

<Q - Patrick K. Archambault>: Got it. And then one another one from me. VW, can you just give us an overview of what the impact has been there on your U.S. business just given the headlines that have been announced since dieselgate, is there something that's impacting the brand in a general way or is it only some of these diesel cars that are being affected, what are you seeing on the ground?

<A - Earl J. Hesterberg>: Well, we spent a material amount of time on it, but it's not a material amount of business. We have seven dealerships, I would say, three of them are quite small. And I would say it's clearly the top public relations item in the industry these days. I think we have about 120 new cars in our inventory on stop sale and maybe 60 used cars across the company on stop sale. But the Volkswagen factory, people have been really magnificent in supporting these types of costs, they have been much more aggressive at retailing their – the remaining 80% of their inventory that's not on stop sale which I guess is primarily petrol engines. So it hasn't been a big deal. I think in September, our Volkswagen sales were still up 6%. I think we're projecting this month they will probably be down about 10%, maybe a little more. So it's not pleasant, but the number of cars impacting Group 1 just isn't material.

<Q - Patrick K. Archambault>: Okay. Well, appreciate the color. Thanks a lot.

<A - John C. Rickel>: Hey, Pat, let me correct one number that I gave you. The customer pay on a consolidated local currency basis was 3%, not 3.7%. But still up.

<Q - Patrick K. Archambault>: Okay, great. Okay. Thanks, John.

<A - John C. Rickel>: Yeah.

Operator

And our next question comes from Michael Montani of Evercore ISI. Please go ahead.

<Q - Michael Montani>: Hey, guys. Good morning. Wanted to ask first on the retail used unit side, 10% comp in the U.S. quite strong. Can you give any incremental color there on how CPO has grown year-over-year and then obviously how the non-CPO business is tracking?

<A - Earl J. Hesterberg>: It's strange how consistent our CPO mix has been for many years kind of from 27% to 33%. So it's growing in concert with our overall double-digit increase. We normally figure it's about a third of our business and it stays pretty close to that. Actually, one of the bigger issues on those cars these days is, it takes a while to get them through the shop and again we worry about displacing warranty and customer pay business. But it's very much a stable part of that business and seems to grow about the same rate. And many of these off-lease cars that are coming from the OEMs are two years or three years old which makes them perfect CPO cars. So that part of the business is still quite strong.

<Q - Michael Montani>: Okay, great. Thanks. And then just to follow up on gross profit. One of your competitors cited some incremental pressure on the luxury side and that that could continue into the fourth quarter. I guess what I wanted to understand and to be clear with your outlook for the fourth quarter, are you thinking of more normal seasonality trends where GPU could increase quarter-over-quarter? And could you give any incremental color in terms of domestic versus import versus luxury GPU trend?

<A - Earl J. Hesterberg>: No, I can't remember when there wasn't this margin pressure. And it seems to be quite across the board now in brands. My recollection is that sometimes in the fourth quarter, you get a little overall margin lift because December is a big luxury brand sales month and the end of the year tends to be very strong with a lot of leases expiring for Mercedes and Lexus and BMW and such. So December in particular, generally has a strong luxury mix. And so depending, I guess, on what the luxury margins are, I am still going to believe that even under pressure they are higher than the volume brands. So there may be a little statistical lift in the fourth quarter, but I don't think there is anything that's changing in terms of the competitive nature of the market for luxury brands, Japanese brands or domestic brands.

<Q - Michael Montani>: Okay, great. Thank you.

Operator

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

<Q - Irina Hodakovsky>: Good morning, everyone. This is Irina Hodakovsky on for Brett Hoselton. How are you?

<A - Earl J. Hesterberg>: Good.

<A - John C. Rickel>: Good morning, Irina.

<Q - Irina Hodakovsky>: Good morning. I wanted to ask you guys a little bit in terms of industry dynamics on the used vehicle side, you've seen an increase in supply, are you seeing an impact on pricing in that vehicle segment, the two-year to three-year old car or is it impacting older vehicle pricing? Is there any impact on gross profit per unit as a result of that or is gross profit per unit simply a competitive factor?

<A - Earl J. Hesterberg>: My impression this year is that the pressure on used margins has been more a competitive matter, much as it is on the new car side. We have very powerful retailing entities, fighting for market share and to move units and my impression is that a factor of competition more so than this increased supply.

<Q - Irina Hodakovsky>: Got you. And is it affecting pricing on the used vehicle side?

<A - Earl J. Hesterberg>: I would say not significantly.

<A - John C. Rickel>: If you look at the Manheim index, it's continuing to hold in. So it doesn't appear to be an issue with pricing. It's more, Irina, as Earl indicated, just the competitive set that's out there.

<Q - Irina Hodakovsky>: As a follow-up on that and speaking with Tom Webb of Manheim, he's a little bit surprised of how well the pricing is holding. What do you think, is this just demand holding prices above where one would anticipate in this level of supply? Or is it just that the cars are better? These two-year, three-year old cars are coming back with better technology than before and they are just naturally more expensive?

<A - Earl J. Hesterberg>: Well, I think the continued ability of the manufacturers to increase new vehicle prices is kind of creating a vacuum to the upside that helps a bit. It is possible that over time with this expanded increased supply, that there will be some slight downward pressure on used vehicles. But at the moment it seems that the dynamics of everything considered are holding used car prices better than I would have expected with the increased supply.

<Q - Irina Hodakovsky>: Got you. And then a question for you guys on the parts and service gross profit margins, very strong trend here. We are actually back to pre-recession levels when you had some pretty high numbers then. Even as the franchise dealers are competing for the lower margin business, your margins are very strong and you mentioned some of the drivers behind it like recall activity and reconditioning work. But how do we think about this going forward? Is there additional upside? I think in the past your highest number you have ever hit was 56%. Do we ever get back to that? How should we think about this going into 2016 and beyond?

<A - Earl J. Hesterberg>: Well, I think the margin fluctuation you see in our business is just somewhat normal based more on mix more than anything. But our general margin position should be fairly consistent because there isn't a need to discount much when you are running at full capacity and our shops are full. So, in quarters where we have a different warranty mix or a different collision repair mix or wholesale parts mix, we'll have some fluctuation. But I think we're now operating in a range that's fairly consistent and predictable.

<Q - Irina Hodakovsky>: Thank you very much for that. Congratulations, solid quarter with Brazil and everything. Great job.

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

<A - John C. Rickel>: Thank you.

Operator

[Operator Instructions] And our next question comes from Paresh Jain of Morgan Stanley. Please go ahead.

<Q - Paresh B. Jain>: Good morning, everyone.

<A - John C. Rickel>: Good morning.

<Q - Paresh B. Jain>: Couple of questions. Starting with U.K., you mentioned about increased supply last quarter and perhaps some of that was originally destined for China and was redirected to U.K. which kind of hurt your GPUs in that market. How has that supply environment trended since 2Q, because GPU still look under pressure a little bit in that region?

<A - Earl J. Hesterberg>: And I that's correct and that's the proper observation. The U.K. market is still very strong on demand and retail side, but it's continued to be oversupplied this year for most manufacturers and that has put a bit of downward pressure on the new vehicle margins. The good news is the volume is there. The volume increases are there. But most brands are oversupplied in the U.K. at the moment.

<Q - Paresh B. Jain>: Got it. And, Earl, a question for you again and wanted to go beyond the next few quarters here. We are increasingly hearing about new entrants in the Silicon Valley potentially making cars one day. And while it's too early to say if these cars would be available for consumer purchase or be part of a shared fleet and even if they are available for consumer purchase, would it be sold at dealers or through independent stores, we don't know all that yet. But wanted to get your thoughts on how you see that space evolving and if the new entrants do end up as fleet managers, how do you see Group 1 and other dealers fit within that ecosystem?

<A - Earl J. Hesterberg>: Well, I don't think I am a real good prognosticator. There's probably a lot of people on this call, they are a lot better at that than I am. But what we have found over the decades is that the automotive retail distribution system is quite flexible. And basically retailing is a local business. And we see that time and time again. And these are big pieces of merchandize regardless of who buys them or how much in terms of electronics or inside of them. There is technical problems that occur and you can have the highest level of service when you are located in the marketplace. And I think that U.S. retail distribution system has stood the test of time. And I think that in the near-term, it's not likely to go anywhere or see any dramatic changes. Maybe a decade or two from now, we'll see if things change. But these are big pieces of merchandise. It weighs several thousand pounds and have quite a few moving parts and somebody has got to handle them, deliver them and fix them.

<A - John C. Rickel>: And in most cases, customer also has a used vehicle that they have to trade to do as part of the transaction which also has to be handled.

<Q - Paresh B. Jain>: Got it. And, John, one last, if I may. A question for you on the Honda solution for dealer reserve, has there been an update on the additional fee beyond the 100 bps, 125 bps spread.

<A - Peter C. DeLongchamps>: This is Pete DeLongchamps. There has not been and our business has remained static with Honda through this.

<Q - Paresh B. Jain>: Is there a timeline by when we can see a more structured solution?

<A - Peter C. DeLongchamps>: I think that the solution is in place.

<Q - Paresh B. Jain>: Okay. Got it. Thanks.

Operator

And our next question comes from David Lim of Wells Fargo. Please go ahead.

<Q - David H. Lim>: Hi. Good morning, everyone. Sorry, I missed the first part of the call here. But the question that I wanted to ask this morning was speaking with industry personnel, it appears that maybe a majority of the OEMs are anticipating either 2016 or 2017 TIV to start a flattish trajectory. Now, if this is true on that assumption, what can GPI do to sustain both top line and bottom line growth?

<A - Earl J. Hesterberg>: Well, I think we're still in a pretty strong growth mode in our used car and parts and service business, David. And I think that's the key. And I would probably agree even an optimistic scenario for new vehicle sales growth next year is only going to be 1%, 2%, or 3% or something like that. We are starting to get to pretty high levels. But there is also a lot of work we can do on truck mix. We are very short of trucks as we speak and I think you know the low fuel prices have really pushed the market that way towards trucks and SUVs. Our Ford truck sales were up 20% last quarter. Our General Motors truck sales, I think, were up 16%. We have absolutely no Toyota trucks.

So, I still think there is some mix to work. I think our used car momentum is strong. I think our parts and service momentum is strong. Our shops are full. So, I think we still have a lot to work with. I think we still are in a very strong point in the business model.

<Q - David H. Lim>: So, Earl, to follow up on that, I know that maybe capacity over at the OEMs when it comes to trucks are being sort of maxed out running on multiple shifts. Does that mean that maybe on the OEM side in order to fulfill consumer demand that additional capacity would need to be added?

<**A - Earl J. Hesterberg**>: Well, I will leave that to them.

<**Q - David H. Lim**>: Okay.

<**A - Earl J. Hesterberg**>: I know that Ford really has not had a very long period of time up and running both their F-Series plants at maximum capacity.

<**Q - David H. Lim**>: True.

<**A - Earl J. Hesterberg**>: So, I think that's still fairly new occurrence. I'm not quite as up to speed on where GM is on their production. I know Toyota is launching this new Tacoma which seems to be taking away some Tundra production and we could sell a lot more both of those and we're a big Toyota company as you know.

<**Q - David H. Lim**>: Got you.

<**A - Earl J. Hesterberg**>: It's somewhat surprising in such a competitive market that we still at this moment don't really have enough trucks in most of our key brands.

<**Q - David H. Lim**>: Now, on the – can you also couch for us how flexible are these framework agreements, I mean, valuations can vary due to like dealer location and other factors, but which franchises would you "pay up for" given what you know about future product introductions and among the Detroit Three, I mean, which brands will Group 1 sort of add to your portfolio?

<**A - Earl J. Hesterberg**>: Yeah, David, I'm not going to let him answer one of those questions.

<**A - John C. Rickel**>: He just gagged me, David.

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

<**Q - David H. Lim**>: I got you. I know it can be a little sensitive in nature. But...

<**A - John C. Rickel**>: I just wonder if you're starting to think about becoming a broker.

<**A - Earl J. Hesterberg**>: I would say though in this environment, there is still a wide range of brands that can be attractive to us domestic, Japanese, import and luxury. And I just think that we're probably as wide open on brand as we've ever been and it just kind of depends on the return in – on investment and where's located, if it makes sense for us.

<**Q - David H. Lim**>: Got you, got you. And then I do have a question on margins and maybe somebody have already asked this, new vehicle gross margins continue to be on the this glide path even though the industry seems pretty healthy and OEMs obviously doing well. I mean, can you sort of explain the disconnect on how the dealer groups are feeling in general about this where you're seeing gross margin compression, but again, industry is healthy, OEM is making money. What are some of the levers that you could pull where new vehicle grosses could become better?

<**A - Earl J. Hesterberg**>: Well, this primarily is a function of supply and demand as it always is. And as OEMs push for more share, they get a little aggressive. But we're finally starting to really hear from some OEMs that they are starting to be concerned about it too, because the first step is the dealer margins get put under pressure. The second step is the OEM start to cut their pricing with incentive.

<**Q - David H. Lim**>: Sure.

<**A - Earl J. Hesterberg**>: And I think they are probably more sensitive to that now than they might have been one cycle ago. And so we are starting to have that discussion with some of these top executives at a couple of the brand. So let's hopefully – we get a healthier balance of supply and demand on some of these model lines as we move forward.

<**Q - David H. Lim**>: Great, excellent. And just comment for Pete, I know that his Baylor team went through a little bit of a hiccup with the QB, but I think Jarrett Stidham is a four star quarterback, so he should do fine.

<A - Peter C. DeLongchamps>: Well, I suppose, Mr. Trojan, it's better to have a hiccup with your quarterback than your coach.

<Q - David H. Lim>: Absolutely. Maybe we'll go after Art Briles post the season.

<A - Peter C. DeLongchamps>: Please don't.

<Q - David H. Lim>: Thank you, gentlemen.

<A - Earl J. Hesterberg>: Thanks.

Operator

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

Earl J. Hesterberg

Well, thank you for joining us today. We look forward to updating you on our fourth quarter earnings call in February. Have a good day.

Operator

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