Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2016-04-27
Event Description: Q1 2016 Earnings Call

Market Cap: 1,524.35
Current PX: 66.37
YTD Change($): -9.33
YTD Change(%): -12.325

Bloomberg Estimates - EPS
Current Quarter: 2.060
Current Year: 7.288
Bloomberg Estimates - Sales
Current Quarter: 2893.000
Current Year: 11294.667

Q1 2016 Earnings Call

Company Participants

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

Other Participants

- Rick Nelson
- Patrick Archambault
- David H. Lim
- Brett D. Hoselton
- James J. Albertine, Jr.
- William R. Armstrong
- John J. Murphy
- Paresh B. Jain
- Michael Montani
- Steve J. McManus
- David Whiston

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Group 1 Automotive 2016 First Quarter Financial Results Conference Call. Please be advised that this call is being recorded.

I would now like to turn the conference 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, Jamie 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 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 Automotive are forward-looking statements that are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements involve both known and unknown risks and uncertainties, which may cause the company's actual results in future periods to differ materially from forecasted results. Those risks include, but are not limited to, risks associated with pricing, volume and the conditions of markets. Those and other risks are described in the company's filings with the Securities and Exchange Commission over the last 12 months. Copies of these filings are available from both the SEC and the company.

In addition, certain non-GAAP financial measures, as defined under SEC rules, may be discussed on this call. As required by applicable SEC rules, the company provides reconciliations of any such non-GAAP financial measures to the most directly comparable GAAP measures on its website.

Participating today with me on the call are 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 the same prior year period, unless otherwise stated.

I'll now hand the call over to Earl.

Earl J. Hesterberg

Thank you, Pete and good morning, everyone. I'm pleased to report Group 1 achieved record first quarter adjusted net income of $37.1 million. This equates to record first quarter adjusted earnings per share of $1.59 per diluted share, an increase of 8.2% over last year.

For the quarter total revenue increased approximately $176 million, or 7.2% to a first quarter record of over $2.6 billion. On a constant currency basis revenue grew nearly 10% for the quarter. Our growth was particularly strong in used vehicle retail sales and parts and service, which I'll cover in more detail in just a moment.

Turning to our business segment, during the quarter we retailed over 40,000 new vehicles. Total consolidated new vehicle revenues grew 5.8%, as we retailed 3.9% more units, and the average new vehicle selling price increased $607 to $34,571. Importantly, new vehicle margin stabilized this quarter.

New vehicle gross profit increased 2.9% as gross profit per unit decreased by $18 to $1,759 due to foreign exchange rate headwinds. In the U.S. new vehicle margins actually increased $50 per unit to $1,758.

Our unit sales geographic mix was 75.6% U.S., 18% U.K., and 6.4% Brazil. Our new vehicle brand mix was led by Toyota Lexus sales, which accounted for 24% of our new vehicle unit sales, BMW/MINI, Ford, Honda/Acura, and VW/Audi/Porsche each represented over 10% of our new vehicle unit sales. And Nissan and GM each accounted for roughly 8% of our unit sales.

U.S. new vehicle inventory stood at 31,400 units, which equates to an 85-day supply compared to a 69-day supply for the first quarter of 2015. Luxury brand inventories drove much of the year-over-year increase. We have adjusted orders and expect to bring inventory closer to our target level of 60 days by the end of the second quarter.

Total consolidated used vehicle retail revenues grew 10.4%, as we retailed 9.4% more units, and the average used vehicle selling price increased $202 to $20,987. Used vehicle retail gross profit increased 6.7% as gross profit per unit decreased $38 to $1,500. Roughly half of this decrease can be explained by changes in foreign exchange rates.

In the U.S., retail used margins increased $7 to $1,620 per unit. During the quarter, we retailed nearly 33,000 used retail units. U.S. used vehicle inventory stood at 13,100 units, which equates to a 30-day supply compared to a 32-day supply for the first quarter of 2015.

Total consolidated parts and service revenue increased 9.4%, while consolidated parts and service gross profit rose 10.5%. Despite exchange rate headwinds, same-store parts and service gross profit grew 6.5% on 5.4% higher revenues. U.S. same-store gross profit increased 8.6% on 7.3% higher revenues.

Finance and insurance gross profit increased 5.9% on a consolidated basis. This growth was driven by vehicle unit sales, as our consolidated F&I per retail unit was essentially flat at $1,361, reflecting the negative impact from foreign exchange rates. We delivered an all-time quarterly F&I per unit record in the U.S. of $1,564, an increase of $26 over the first quarter of 2015.

Regarding our geographic segment results, our U.S. operations grew total revenue by 4.2%. The revenue growth was driven by our parts and service, used vehicle and F&I performance. This growth was tempered by a 2% decrease in new vehicle unit sales.

Sales were impacted in the Texas, Gulf Coast, and Oklahoma markets due to the weakness in the oil industry. Same-store new vehicle unit sales decreased in these three markets by 3%, 5% and 2%, respectively. We were able to mitigate the volume decline, however, with the improved new vehicle gross profit per unit that I mentioned earlier. Used retail unit sales were a highlight with same-store sales up another 5.6% after increasing 6% in the first quarter of 2015.

Our U.K. operations had another strong quarter with total same-store revenue growth on a local-currency basis of 13.3%, driven by a 13.6% increase in new vehicle unit sales, a 6.9% increase in used retail unit sales, a 6.5% increase in parts and service revenues, and a 15.6% increase in F&I per unit to $742.

In Brazil, while the overall first quarter industry sales were down 28%, our same-store total revenues remained roughly flat on a local-currency basis versus prior year. An amazing performance by our local team. Our strategy of aligning with growing brands is working, and in conjunction with the significant portfolio adjustments that I will detail later, we remain confident that we have positioned ourselves to be profitable for the remainder of 2016.

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

John C. Rickel

Thank you, Earl, and good morning, everyone. For the first quarter of 2016, our adjusted net income increased $1.2 million or 3.5% over our comparable 2015 results to an all-time first quarter record of $37.1 million. On a fully diluted per share basis, adjusted earnings increased 8.2% to an all-time first quarter record of $1.59. These quarterly results for 2016 excludes $2.8 million of net after-tax adjustments, consisting primarily of $1.7 million of losses due to hail damage in the U.S. and $800,000 of charges related to the decision to divest the four dealerships in Brazil.

There are no adjustments made to the prior year's first quarter GAAP earnings. I would also point out we have incurred additional losses thus far in the second quarter from the recent flooding in Houston, and a large hailstorm in San Antonio that have combined to cause approximately $3 million in inventory damage. These additional pre-tax losses will be reflected in our second quarter GAAP results.

Starting with a summary of our quarterly consolidated results; for the quarter, we generated an all-time first quarter record of $2.6 billion in total revenues. This was an improvement of $176 million or 7.2% over the same period a year ago, and reflects increases in each of our business units. On a local-currency basis, which ignores the change in foreign exchange rates, total revenues increased 9.7% for the quarter. Our gross profit increased $25.2 million or 6.9% from the first quarter a year ago to $389.1 million.

For the quarter, adjusted SG&A, as a percent of gross profit increased 20 basis points to 74.8% and operating margin remained flat at 3.3%. Floorplan interest expense increased by $1.7 million or 17.8% from prior year to $11 million. This increase is primarily attributed to higher U.S. inventory levels. Other interest expense increased $3 million or 21.7% to $16.9 million, reflecting the issuance of $300 million of 5.25% bonds in December 2015.

Our adjusted consolidated effective tax rate for the quarter was 35.8%, which is lower than our historical tax rate, primarily due to the increased profitability from our U.K. region. With the Spire acquisition, the U.K. will comprise a larger part of our results going forward, and therefore we forecast our full year tax rate to be approximately 37%.

Turning now to our geographic segments, starting with the U.S. market on a same-store basis. For the quarter, total U.S. same-store revenues grew 2.3% to $2 billion driven by increases of 7.3% in used retail, 7.3% in parts and service, and 1.7% in finance and insurance. These increases were partially offset by seven tenths of a percent decrease in new vehicle revenues. The 7.3% increase in same-store parts and service revenue consisted of increases of 11.5% in collision, 8.5% in warranty, 7% in wholesale parts, and 5.3% in customer pay. To support continued growth in part and service, we've grown our same-store net technician head count by 8.4% from March 2015.

Total same-store gross profit improved 4.1% driven by increases of 8.6% in parts and service, and 4.5% in used retail, as well as the F&I increase that I just mentioned. These increases were partially offset by a decrease in new vehicle gross profit of 1.5%, and a profit per vehicle increase of $28 to $1,730, partially offset a 3.1% unit sales decrease primarily attributable to our oil affected markets of Texas, Oklahoma and the Gulf Coast.

Our adjusted SG&A, as a percent of gross profit, increased 50 basis points to 73.1%. The cost increase is primarily explained by significantly higher loaner vehicle costs as we continue to service a large amount of customers affected by recalled vehicles, who are awaiting repairs, and by higher insurance costs associated with the increased new vehicle inventory levels in larger loan fleet. For the quarter, our adjusted operating margin remained flat at 3.8%. Related to our UK segment, on a same-store basis, the percentage change metrics on a local-currency basis, for the quarter, total revenue increased $21.8 million to $321.3 million, an increase of 13.3%. Gross profit for the U.K. segment was up 11.4% from prior year. New vehicle gross profit grew 8.9% as a unit sales increase of 13.6% was partially offset by a 4.1% decrease in gross profit per unit. Total used vehicle gross profit increased 7.3% as a 5.4% increase in unit sales combined with a 1.8% increase in gross profit per unit.

Parts and service gross profit improved 8.2%, and our F&I income increased 27.8%, which is attributable to both a 15.6% increase in gross profit PRU to $742 and a 10.6% increase in total retail units.

For the quarter our adjusted SG&A as a percent of gross profit improved 370 basis points to 74.6% and operating margin increased 40 basis points to 2.5%. Both improvements represent the impact of leverage from our growing scale in the UK as we continue to fully integrate acquisitions from prior years and capitalize on efficiencies in our processes.

Related to our Brazil segment on a same-store basis. As Earl mentioned, the total industry new unit volume decreased roughly 28% from the first quarter of 2015. Despite this, our total revenues remain roughly flat on a local-currency basis, and we only recognized a small adjusted loss for the quarter, which is seasonally the weakest for the year in Brazil. Despite the continued local economic challenges, we expect will persist throughout 2016, we still project our Brazil segment to generate a small pre-tax profit for the year.

Turning to our consolidated liquidity and capital structure. As of March 31, we had $22.4 million of cash on hand, and another $134.1 million that was invested in our floorplan offset accounts, bringing immediately available funds to a total of $156.5 million.

With regards to our real estate investment portfolio, as of March 31, we own roughly $810 million of land and buildings, which represents 46% of our dealership locations. To finance these holdings, we have a total of $389 million of real estate debt outstanding excluding capital leases.

Year-to-date, we have repurchased approximately 1.5 million shares of our common stock at an average price of roughly $55 per share for a total of $81.9 million. These repurchases equate to a 6.6% reduction from our year end diluted share count of 22.6 million shares. As of April 27, we have approximately 21.3 million diluted shares outstanding and $68.1 million remaining on our Board authorized share repurchase program.

While we will continue to look for acquisitions, we still believe that our current share price offers a very attractive alternative for capital allocation. Therefore any potential acquisitions would need to offer a very attractive return on investment opportunity for us.

Also during the first quarter, we used $5.1 million to pay dividends of $0.22 per share, an increase of 10% per share over the first quarter a year ago. 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, the company acquired the Spire Group in the U.K. at the beginning of February. This group consists of 15 franchises and is expected to generate $575 million in annual revenues. The company has also added four franchises in Brazil during the month of April.

First, BMW of Joinville in the state of Santa Catarina represents our fifth BMW franchise in Brazil and the first in the state of Santa Catarina, which is just south of our existing dealership base. The dealership is located adjacent to the recently opened BMW factory. Second, we opened Land Rover and Jaguar franchises that were granted to us last year by the manufacturer. These franchises are located in the city of Maringá in the state of Paraná.

Lastly, we opened a new Toyota location in the city of Taubaté in the state of São Paulo. These three dealerships are expected to generate approximately $20 million in annual revenues bringing total acquired revenues in 2016 to $595 million.

During the quarter, the company also disposed of two Nissan franchises, and one Peugeot franchise in the state of São Paulo, and started the termination process on our one remaining Peugeot franchise in Brazil. These four franchises combined and generate roughly $35 million in trailing 12-month revenues. This disposition activity combined with the previously announced disposal of a VW dealership in New Jersey and a Toyota dealership in Massachusetts brings our total 2016 disposed revenues to $110 million. We will continue to adjust our dealership portfolio to ensure we're 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

Ladies and gentlemen, at this time we'll begin the question-and-answer session. [Operator Instructions] And our first question today comes from Rick Nelson from Stephens. Please go ahead with your question.

<Q - Rick Nelson>: Thanks. Good morning.

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

<Q - Rick Nelson>: I wanted to follow up on the commentary on the new car margins, which stable, actually improved a bit in the U.S. If you could provide some color around what's happening in premium luxury midline and domestic as it relates to the margin?

<A - John C. Rickel>: Yeah Rick, this is John Rickel. Yeah, we were happy to see actually a bit of an increase in our margins for the quarter. The improvement basically came out of imports and we saw some continued pressure in luxury and in domestic.

<Q - Rick Nelson>: And the inventory, 85 days goal to get back to 60 days, if you could provide some color to where you are heavy, where you might be light, and how the stop sale has affected those numbers?

<A - Earl J. Hesterberg>: Yeah Rick, this is Earl. The inventory excess correlates exactly with the margin information that John just gave you. We basically have too much inventory on everything except Toyota and Honda. So because we don't have as much inventory pressure, on the Japanese imports, we've been able to arrest the margin decline. I think that's the biggest factor.

And there may be another factor that says it couldn't go any lower. But we've been trying to arrest that margin decline for probably a year, so we finally had a little bit of success. But we have far too much inventory in virtually every brand other than Toyota and Honda. The stop sale and recall things are not really material to the inventory situation. I think Pete may have some numbers on that.

<A - Peter C. DeLongchamps>: Sure so Rick, we did the analysis on stop sale and 1% of our new vehicle inventory is on stop sale which equates to about 360 total units, and as far as the used business it's about 6% sales, so 743 total units in stop sale. So these numbers don't equate to the days supply issue.

<Q - Rick Nelson>: Thanks. The industry seems to be heavy sort of across the board and especially in the premium luxury segment. Any signs at all that the OEMs are going to scale back on production?

<A - Earl J. Hesterberg>: Well, just anecdotally, Rick, I actually talked with top four executives yesterday they are very aware of it and they told me they are taking action to adjust it which made me feel good. The other conversation I've had is with Audi, and I know they are very concerned about it. But those are the only two direct conversations I've had. But I think the numbers are fairly clear and somewhat overwhelming.

I think it's a little more difficult perhaps on our company because we are so concentrated in these oil impacted areas, oil price impacted areas, and so at the same time some of our retail markets have softened up a bit, while the production has kept coming. So I have to believe that there will be some adjustments made on a fairly broad basis.

<Q - Rick Nelson>: And finally, speaking of the oil markets, Houston has had quite a bit of flooding there. To you, it's got be a near-term negative. But do you view that as actually a positive as it relates to the service business and insurance reimbursements driving new and used car sales?

<A - Earl J. Hesterberg>: Well, no doubt you get and we're already seeing a big wave of flood cars come into our service repair shops, and we probably lost a couple of days of service business last week because people just weren't out and about even though we were open actually by the end of the day Monday, which was the day of the floods. But I also remember vividly we had similar floods last year in the second quarter because I got stuck in my car for eight hours overnight on Memorial Day. So we actually had a big wave of flood business late May, early June last year. So, I expect that is likely to kind of cancel out in the second quarter, but yes, we – our shops are filling up quickly with some of these flood vehicles at the moment.

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

<A - Earl J. Hesterberg>: Sure.

Operator

Our next question comes from Pat Archambault from Goldman Sachs. Please go ahead with your question.

<Q - Patrick Archambault>: Thanks a lot. Good morning guys. A couple of questions just to build-off that, I guess let's start with the Texas impacts. I think if I am remembering well you said down 3% collectively. That may have been the oil patch number. Can we separate what was the kind of the weather impacts, right, from hail and stuff like that which is also an issue versus just the overall weakness that you saw excluding that event?

And then, just curious to understand what your view is of how long that overhang could last. I mean, the oil prices have come back somewhat, but I think they are still down quite a bit year-on-year, so since you guys are so close to it, curious to get your perspective there?

<A - Earl J. Hesterberg>: This is Earl. I'll just talk about kind of the energy price impact in markets, which we live in. The issue that's hitting the sales in Texas and Oklahoma is simply the restructuring of all these oil and gas companies. And as they lay people off, which continues every day, and people don't get raises, they don't get bonuses, the person next to them loses their job, it's just a massive economic and consumer confidence issue.

That said, our new vehicle sales in Houston we held to a 1% decrease for the quarter. So we're fighting it pretty well. But I attend a lot of meetings and I am on various boards with these oil company executives and they still have quite a way to go in restructuring their balance sheets and that's what's happening now.

So I think the general consensus at the moment is that we might start to see some light late this year. Now that assumes that the oil price doesn't crater back to $30 or something, but the real issue is they are restructuring their companies and there is job losses and consumer confidence issues during this process. So we're not at the end of that yet. That's still unfolding every day. It's in the newspapers everyday throughout Texas and Oklahoma. That said, it does appear that at least in some markets people still need cars because the average age of the car park is quite old. Some of this business is shifting into the used car market. And actually some of these energy markets our used car business is up significantly.

<A - John C. Rickel>: Yeah, Pat, this is John Rickel. On your other question, the really – I mean the weather was kind of a point in time I wouldn't point any of our sales issues being weather related really at this point in time.

<Q - Patrick Archambault>: Okay understood. That's helpful to know. Just building on that, yeah I mean, I was a bit surprised to hear you when you said, when you were describing the inventory issues by brand that there were issues pretty much everywhere except for Toyota and Honda as you said. If you look at some of the data, I mean it seems like at least until recently, right, trucks have also been in pretty good shape inventory wise. So this seems to be a little bit of a change, right? We're all used to thinking that pickup trucks and SUVs, full-size SUVs are kind of healthy and tight and those plants are over utilized, but it seems that that has changed. Is that maybe kind of related to the oil patch or is there something broader there and maybe a little bit more troubling about that segment as well?

<A - Earl J. Hesterberg>: I think this has been progressive. But our truck day supply is still probably a full 20 days below our car day supply. So, relatively speaking, the truck business on sales, from a sales aspect is still stronger and our inventories are still significantly lower on trucks. So the low fuel prices are continuing to strengthen the truck part of the business.

<Q - Patrick Archambault>: Got it. Okay. I'll leave it there and just get back in the queue at this time.

<A - Earl J. Hesterberg>: Sure.

Operator

Our next question comes from David Lim from Wells Fargo Securities. Please go ahead with your question.

<Q - David H. Lim>: Hi. Good morning gentlemen and Sheila. Just wanted to dive a little bit more on the Honda and Toyota, is there some sort of strategy that maybe Honda and Toyota is partaking in, in order to make sure that their inventory levels are whittled down? Is there something that you guys could dimensionalize if it had to do with maybe some incentive actions or production cuts, just a little bit more detail there would be helpful?

<A - Earl J. Hesterberg>: David, it's Earl. I can't really speak exactly to what their strategy is, but over history both of those brands have always been sensitive to making a supreme effort to balancing supply and demand. So I think that's in their DNA. And so I think that that's just what I would expect from those brands.

<Q - David H. Lim>: Outside of the energy states, and I am just going to ask bluntly, are you seeing any kind of weakness on the fringes with the consumer perhaps retail sales in Q1 was really, really weak, it seems like most of the SAAR gain year-over-year in the quarter was due to fleet deliveries but I wanted to get an idea outside of Texas because it has some crosscurrents there because of energy if you are seeing anything?

<A - Earl J. Hesterberg>: No. I don't really see weakness outside of the energy build, David, I think people are reacting to the fact that it's just not growing significantly as it has been in recent years. So when it's flattened out it only grows 1%, 2% or 3% I think it feels to a lot of people like it's very slow. But I wouldn't say I've seen any big consumer confidence crisis anywhere outside of the energy impacted market.

<Q - David H. Lim>: Got you. And then my final question, if you would, is assuming a flattish SAAR environment, can you sort of bucket on areas of where you could achieve EPS growth on a year-over-year basis, and whether it'd be new, used, parts and service, F&I, SG&A to growth, if you could sort of bucket that probably you in an order of like what would have the greatest impact versus a decent impact, if you would?

<A - Earl J. Hesterberg>: Certainly David and I would think that the best example is our performance this quarter. We've known for about a year that we were going to at some point have some pretty severe oil price headwinds in our key markets. And so we've been trying to pull on those used car and service levers for quite a while and we are starting to get some traction on that.

So servicing used cars is the best way for us to do that. And I still believe there's a bit of upside for us in F&I, but clearly not at the same degree that we can continue to exploit the parts and service and used car part of our business. And now I think there's another obvious area that's financially damaging us and that's this high levels of inventory. So we've got to do a lot of work on that immediately, because that's costing us millions of dollars.

<Q - David H. Lim>: Thank you so much.

Operator

Our next question comes from Brett Hoselton from KeyBanc. Please go ahead with your question.

<Q - Brett D. Hoselton>: Good morning Earl, John, Pete, Sheila.

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

<Q - Brett D. Hoselton>: First of all, just wanted to look at – I mean your used car improvement obviously outpaced your new car improvement on a same store basis, and so just unit sales, kind of wondering what's driving that. Is there something taking place within the company that you are changing something to allow you to perform better on the used car side?

<A - Earl J. Hesterberg>: There is probably three factors in that. And we've had – we've been outpacing the market on used vehicle sales growth for probably more than a year. So I would say there is an operational improvement component within that which is primarily I think some management changes we made in recent years. But the other issues I would say are supply. There's a lot more used cars available to us in the market. As I think all of you know off lease sources and so forth.

And the third component I think is that there is some price elasticity, and I think when there is some economic pressure on consumers and they need a car due to the age of their car or whatever that used vehicle tends to be a good alternative for them just based on a lower cost and a better cost value equation for some people. So I think those are the three components.

<Q - Brett D. Hoselton>: And then April sales wise, can you kind of – and I think you might have answered this in a previous question. I apologize if you did, but how are sales trending in April just kind of broadly across your business? Have you seen any material uptick or decrease in the kind of the pace of light vehicle sales and specifically the U.S.?

<A - Earl J. Hesterberg>: Yeah, in terms of the U.S. I really haven't seen any material change in the market. I think there was a lot of consternation in March because of the Easter shift when you look at it year-over-year and now there's more days in April, so maybe the numbers will be a little more favorable when we look at them in April, but I haven't seen any movement in terms of strength or weakness.

<Q - Brett D. Hoselton>: Okay. And then kind of wanted to ask you kind of a longer-term broad strategic question, you're obviously growing your presence in Brazil, I've been in this industry for 20 years and Brazil kind of always seems to be the emerging market that never quite emerges. Certainly, from a parts supplier standpoint, many of them are kind of retracting a bit from their operations in South America. The dealership model I think lend itself to maybe more flexibility and more opportunity than does the parts supply model, so my question is, how are you thinking about Brazil? Obviously, you're growing there, I mean, why is it that you think it may be a very good opportunity for you?

<A - Earl J. Hesterberg>: Well, about three years ago Brazil auto market was bigger than Germany. It was almost 4 million units a year. Now at the moment it is more or like 2.2 million units, so it's kind of cut almost in half. But there is no doubt that the market will get back to 4 million units and then probably hit north. It's just the function of math with the population of over 200 million people, no public transportation and a very low density of car ownership.

We're just handling that business quite deliberately like we built the U.K. business over the years. We are not injecting any significant amount of money down there. We're rebalancing what we do have.

And we believe that -- and part of our strategy was to be known as the most attractive auto retailer in Brazil, and we think we're on the way to doing that. BMW requested us to be the dealer adjacent to their factory. Mercedes has made the same request of us. So we're just going to strengthen the core business we have.

This business is about brands and people. So as we make these adjustments to the brands moving from Peugeot and expanding with BMW and Toyota, and Jaguar, Land Rover. We're building a stronger core business, so we'll be able to take advantage of when the market does recover. It is an incredibly horrendous political situation which has to be solved before the economic situation can be addressed. But history tells us these markets go up just as fast as they go down.

<Q - Brett D. Hoselton>: Fair enough. Thank you very much Earl. I appreciate that.

<A - Earl J. Hesterberg>: My pleasure.

Operator

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

<Q - James J. Albertine, Jr.>: Thanks and good morning everyone.

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

<A - Peter C. DeLongchamps>: Good morning, Jamie.

<Q - James J. Albertine, Jr.>: Wanted to ask on the used side. I know the questions come up a few times you provided some good detail we appreciate that. Just what percentage of your used business right now would you say is running in terms of the certified pre-owned percentage, and if you could give us sort of is there a sequential or a year-over-year trend there that would be helpful? Thanks.

<A - John C. Rickel>: It's actually dropped a bit. It's about 28% now. It had been running 30% to 33%. And I think that's a function of just increased supply in the market, cars available.

<Q - James J. Albertine, Jr.>: As it relates to that off-lease supply you alluded to earlier, just looking at Manheim, using a blunt instrument arguably, it does seem like truck prices are still quite high and probably doing well with respect to residual cars the opposite. Could you share with us of the off-lease vehicles that come back to your dealers, how many, on a percentage basis, you end-up retaining for sale versus those that you would just elect to push back to the OEM or ultimately to auction?

<A - Earl J. Hesterberg>: Well, most of the OEMs at least in the luxury brand world have targets for us and incentives for us to take a certain percent of our off-lease vehicles and we generally achieve those. So, I would say we accept the vast majority of them for now. But our footprint is not one that's in big leasing areas. We lease about 16% of our total sales and Texas and Oklahoma are not traditionally big lease markets.

So I would expect that if you were in the Northeast you might have trouble taking all the off lease vehicles back because leasing is so prevalent there. It's big in California, it's big in Florida. So it's not a big issue for us. We tend to take a very high percentage of these vehicles because they are good for us in terms of being able to retail.

<Q - James J. Albertine, Jr.>: So if I could paraphrase, your response, it sounds like you are going to source more than sort of the average dealer outside of Texas from either trades or auctions or some combination thereof. Is that fair?

<A - Earl J. Hesterberg>: Yeah, that too, we get about two-thirds of our used vehicle supply from trade-ins and it's a little bit below that right now. But that's pretty consistent for us. And there probably will be more lease vehicles available so that may go up a little bit, but it's not anything that we would anticipate materially impacting our business.

<Q - James J. Albertine, Jr.>: Okay. Great, thanks. And if I may sneak one more on the credit side, if Pete could give us maybe a view on, if you think about the non-prime and below segments of the auto lending universe, any shifting that's going on there, more or less aggressive on trying to attract customers, or as it relates to conversion. So sort of any incremental update there on the fourth quarter would be, and if you can share on sort of year-to-date trends in 2016 that would be helpful? Thanks.

<A - Peter C. DeLongchamps>: So Jamie, as you know, we've had a strategy to consolidate our lender base, which I think we've done a great job was in the name of the leverage, the opportunities with our lenders. And we haven't seen any changes sequentially or year-over-year. It continues to be a favorable credit market for us and our consumers. Our banks are performing very well. John and I have met with the majority of them at NADA over the last at the end of February. So as far as we can tell, the lending situation continues to remain very favorable.

<Q - James J. Albertine, Jr.>: Good to hear. Thanks again everyone, and best of luck in the second quarter.

<A - Earl J. Hesterberg>: Thanks.

Operator

And our next question comes from Bill Armstrong from CLK & Associates. Please go ahead with your question.

<Q - William R. Armstrong>: Good morning everyone. On the U.S. gross profit per unit improvement, it sounds like most of it came from the imports. Could you maybe quantify what the improvement was in imports versus the presumed decrease in luxury and domestic? And could you also maybe discuss the stair-step programs that you saw in the domestics during the quarter?

<A - Earl J. Hesterberg>: I'll talk to the stair-step while John is trying to see if he can find some data on your gross profit question. The stair-step programs are everywhere, across the board now and they've even grown in the last year, so which is not helpful to anyone when you are trying to fight this margin compression. And of course, the high inventory doesn't contribute to arresting the margin compression either, but I would say the prevalence of the stair-step programs is greater than ever and not something that most retailers are going to tell you is beneficial.

<A - John C. Rickel>: Bill this is John. On your question on the gross profit, as we said, the biggest change we saw was on import. It actually improved about $136 a unit, and the offset was basically in domestic was down about $100 and luxury was down about $80, and since we're obviously heavier on import, the mix among ends up favorable in total.

<Q - William R. Armstrong>: Got it. Okay. And back to the CPO question, you're presumably, I know a lot of your business Texas and other markets you don't do – you don't have a heavy lease component, but in the markets where you do, do a lot of leases I guess on the coast, presumably you're going to get a lot more lease returns coming in, if you haven't already and those units normally tend to be good candidates to certify and turnaround as CPO, do you see that CPO business growing maybe as we move through this year and next?

<A - Earl J. Hesterberg>: I think it is possible that it will grow again for that exact reason. And – yeah, that's a very valid point. I think it's true.

<Q - William R. Armstrong>: So you're not seeing that yet though.

<A - Earl J. Hesterberg>: No, we haven't seen it in this quarter. And of course, it's also skewed toward luxury brands because you lease more of luxury brands and a higher percent of your used vehicle sales in the luxury brand business are CPO. So some of it's brand mix as well.

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

Operator

And our next question comes from John Murphy from Bank of America Merrill Lynch. Please go ahead with your question.

<Q - John J. Murphy>: Good morning guys.

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

<Q - John J. Murphy>: Just first question on the strength of parts and service in the U.S. and what you think is driving that, and if that will continue for some time to come, and it looks like, in your commentary you said you hired 8.4% more techs, will you have to go out and hire a lot more techs, or will you have to build more service base? I'm trying to understand the capacity utilization there and what you might need to do to respond to the strength in parts and service.

<A - Earl J. Hesterberg>: Well, as we remodel and build new facilities, it generally includes capacity expansion, but it's not really a capacity issue in terms of growing our service business. And we measure our service productivity and we have some that are full up and some that are 80% or 85%, but it's quite easy to do a shift and a half or two shifts, if you have more business and you can run through on a normal day.

So, very seldom is the physical capacity in terms of number of service bays going to put a lid on our business. It's much more a human element. And nowadays it's also parts availability element in many of these recalls. We have work waiting to be done if we can get parts as well.

<Q - John J. Murphy>: Okay. And then just a second question on SG&A in UK came down a lot in the quarter. I was just curious as you build further scale over there, what you think the SG&A to gross could get to in the UK because it's obviously a little bit higher than the U.S.

<A - Earl J. Hesterberg>: Well, I am not sure I can give you a good target on SG&A, but our goal has always been, John, to get to an operating margin of 3% in the UK and we are 2.5% now, this is the best we've ever done. So maybe if we did some math we could kind of tell you what the SG&A would be if we got to 3% operating margin. But clearly, it's a couple of hundred basis points lower than what we achieved, it's 74.5% or thereabouts this quarter. So the scale will certainly benefit us. But that's kind of how we've been looking at is trying to get to a 3% operating margin.

<Q - John J. Murphy>: Okay.

<A - John C. Rickel>: Yeah, it's John Rickel. I'd just add that there are some, a few structural impediments to get all the way to the U.S. levels. It tends to be less of the F&I income, which is obviously, we've had 100% margin stuff, which is really helpful. There is less of that over there for a variety of reasons. Your rent tends to be a bit more expensive and we tend to be just a little less overall kind of gross margin, but I think Earl is right that something in the low 70%s is probably not a bad overall target over time.

<Q - John J. Murphy>: Okay. And then just lastly, I mean as we look at the repurchases, year-to-date, you've been more aggressive than you have been sort of traditionally, obviously the stock is a huge opportunity where it sits right now. How much more aggressive you think you can get on buybacks and how much more room do you have on the balance sheet? I realize you might need to get incremental authorization, but given where the stock is that sounds like almost a [indiscernible] (48:00) just curious on the balance sheet side that where you think capacity is to potentially do a lot more chunky buybacks here?

<A - John C. Rickel>: Yeah, John. This is John Rickel. The target we set out there is that we want to try to live with our total rent adjusted leverage that kind of 4 times or less. We were under that at the end of the quarter. We were at 3.86 times. So there is still room on the balance sheet. As you say, the stock we thought was an incredible value in the first quarter, and we stepped up the repurchase. We've got $68 million left on the repurchase authorization. And certainly have balance sheet capacity to do all of that and then some. So let us work on that piece and then when we get through that we'll give you an update.

<Q - John J. Murphy>: Great. Thank you very much.

Operator

And our next question comes from Paresh Jain from Morgan Stanley. Please go ahead with your question.

<Q - Paresh B. Jain>: Good morning everyone. First question on UK, really good volumes trend there, any color on what's driving share gain despite tougher comps and how much room do you have with store throughput?

<A - John C. Rickel>: Yeah. Store throughput – this is John Rickel. I think it gets back to kind of the question that John Murphy was asking. We think that there is a bit more if we're going to get to that 3% longer term goal on operating margin, some of that's going to come out of SG&A. As for basically the volume gains, I think it just continues to be great execution by our management team there.

<Q - Paresh B. Jain>: Got it. And just a little more color on Texas and going beyond new vehicle sales. First, any color on gross profit and net profit performance in that region? And when you think about used vehicle demand, is that being driven by consumers trading down or more driven by share gains?

<A - John C. Rickel>: Relative to the color on the profit impact of the energy markets, it's actually all across the board. Although our sales are only down about 1% in Houston, our profits are down almost 10%. But we have markets like Oklahoma where we are continuing to slightly grow our profit due to a strong used vehicle performance. So, the profits are kind of all over the board, but probably the most pressure is on the Houston market, which is near a double-digit profit drop. And I'm sorry what was the other part of the question?

<Q - Paresh B. Jain>: Used vehicle demand is that being driven by consumers trading down, or are you just seeing more share gains?

<A - John C. Rickel>: Well, when you say trading down, I think these – I'm not sure if exactly what that means, but my interpretation would be that there are some customers who maybe a year or two ago had they entered the market would have been shopping and buying new, and in this situation they are buying used. That's the way I kind of see it.

<Q - Paresh B. Jain>: Right. Thanks for the additional color. And finally, one last, if I may, and I'm sorry I probably hopped on the call a little bit late. In light of the peer performance and exposure to Texas, SG&A performance in the U.S. was clearly very impressive, any big buckets to highlight?

<A - Earl J. Hesterberg>: No, I think things are actually very consistent in the energy markets with being sticky, and outside it's still a good U.S. auto market. So we're doing quite well in the Northeastern U.S. and California and outside the Gulf Coast in the Southeast. So I think the market is still generally strong on an absolute basis, but there's a lot of reaction to the fact that it's not growing like it has been the last four years. But I think there's still a lot of strength outside the energy markets.

<A - John C. Rickel>: Let me add to that kind of specific on the SG&A, I think we made good progress on the advertising costs, done a good job controlling there. The areas of opportunity for us, as Earl alluded to, is there is a lot of ancillary costs that come with having too much inventory. And kind of the big thing we've got to are flow through. Normally we would have expected kind of 40%ish flow through, and we clearly didn't deliver that this quarter is there's a lot of higher insurance costs that go with having that much inventory, and there's a lot of additional costs right now around loaner vehicles. Because of everybody [indiscernible] (52:28) loaners as we are awaiting some of these parts coming in on the safety recalls. So we think there actually continues to be more opportunity for leverage SG&A as we go forward in the year, but those were kind of the two headwinds, if you will, for this quarter.

<Q - Paresh B. Jain>: Thank you.

Operator

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

<**Q - Michael Montani**>: Hey guys good morning. I was just wondering if you could give some additional color about what happened with days inventory during the quarter. How did January and February progress, if you could? And then also in the comments that you could get to 60 days by the end of next quarter, what kind of sales, sell through rate does that kind of assume and also what kind of GPU trends would you anticipate in order to do that?

<**A - John C. Rickel**>: Yes Michael this is John Rickel. Basically, we saw a similar pattern on the inventory this year as you would last year. Traditionally you are going to build a bit of inventory in January and February as you come into the spring selling season. So day supply at the end of February 2016 was at 94-day, kind of 94-day supply. Same as we were in February 2015. We just didn't sell down quite as much in March as we did in March of last year.

So some of it was I think maybe the Easter weekend shift was maybe a piece of it, and some of it is just there's been some extra supply as Earl has explained. So I think that's really kind of the story on day supply. Our assumption on margins is I think we've done a good job of finding stability, and we're thinking kind of that $1,750 level is the assumption that I would use for the rest of the year on new margins.

<**Q - Michael Montani**>: Okay great. That's certainly helpful context there. I guess if I could just follow up John on cash flow. In the deck you provided $135 million or less I think of CapEx for the year.

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

<**Q - Michael Montani**>: Can you give any corresponding cash flow? I had been more or like $80 million or $90 million, but that was a little bit less on CapEx than I was looking for too?

<**A - John C. Rickel**>: Yeah. I can't give you a full year cash flow because that would imply a profit forecast, which we're not going to do. Happy to work with you on the CapEx piece, but overall cash flow could have a profitability assumption and we're not going to get into that game.

<**Q - Michael Montani**>: We can try. Thanks, John.

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

Operator

Our next question comes from Steve McManus from Sidoti & Company. Please go ahead with your question.

<**Q - Steve J. McManus**>: Hey, guys. How's it going? And thanks for taking my questions.

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

<**Q - Steve J. McManus**>: So, first one, very strong growth in the UK. I just wanted to see where are you seeing a lot of that growth and maybe how much was acquisition related during the quarter?

<**A - Earl J. Hesterberg**>: Well, the key growth metrics we gave you were same-store, which was kind of 13%. And it seems that it takes us quite a bit longer to integrate and improve the performance of our acquisitions in the UK. So we are continuing to get leverage from the Audi dealerships we bought several years ago. And then about 15 months or 16 months ago we bought three BMW dealerships up around the Cambridge area. And those are starting to produce much better now. So it's really harvesting some of the previous investments we made.

This new acquisition is only 60 days old, and it has a lot of potential, and probably half the stores already perform very well, and I imagine it will take us a year or two to get the other ones up to the level that we will be able to achieve. But we are basically continuing to improve the existing businesses we've had and some of them we've had for one or two years and they are still starting to pay dividends.

<Q - Steve J. McManus>: Okay. And then, looking at the parts and service margins in the UK, a bit lower than the U.S., should we expect room for improvement there, is there anything worth noting kind of causing the difference between the UK and the U.S.?

<A - John C. Rickel>: No. This is John Rickel. I think those levels are kind of what I would continue to model. We'll continue to focus on growing same-store revenue, but there are some structural differences, reimbursement rates and warranty things like that that just make it a bit of a different business in the UK than the U.S.

<A - Earl J. Hesterberg>: And one thing I guess I seldom mention is we actually have four Ford businesses in the UK, and they have continually performed better and better, and even though most of our businesses are luxury brand in the UK, I believe we had a record first quarter with those Ford businesses. They continue to improve also. And that by nature is a lower margin business, but it's actually ends up being a very, very valuable business for our company.

<Q - Steve J. McManus>: Okay. And then a last one, just looking at the F&I penetration chart in the presentation, it seems like a few of the programs offered in the U.S. not currently offered in the U.K. even more so in Brazil. Any plans for a push to roll out some of those new projects in either region?

<A - Peter C. DeLongchamps>: So, this is Pete DeLongchamps. In the UK, Mark Bridgland has done a marvelous job of trying to integrate some of our programs. Not every product is applicable in the UK. And as far as Brazil, it certainly an area of opportunity for us, and it's something that we know we can improve on, and there's measures in place to get that done with the operating team there.

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

Operator

And our final question today comes from David Whiston from Morningstar. Please go ahead with your question.

<Q - David Whiston>: Thanks good morning. Couple of things on each area of the company, first earlier in the Q&A you were talking about how there were customers in the oil markets, two years, three years ago would have bought new and are now buying used. Do you think that's also specifically true for the full-size pickup truck customer?

<A - Earl J. Hesterberg>: Well, sure. Yeah. In fact, one of the best businesses in our markets is used pick-up trucks. In fact, the biggest issue there is they are always in short supply. You don't see a lot of leases on pick-up trucks. Pick-up trucks don't get pumped into rental car companies. People who buy trucks keep them a long time. So the used truck business is always good and very price sensitive in Texas and Oklahoma.

<Q - David Whiston>: Okay. And in Brazil you talked about the parts and service business are offsetting a lot of the severe headwind in new. How difficult is it to get a Brazilian consumer to go to the dealer for service versus an American?

<A - Earl J. Hesterberg>: Well, I'd say very difficult in the volume brands. But we're somewhat fortunate. Our brands tend to be luxury brands and so that loyalty is good. And there's not a lot of aftermarket expertise in repairing BMWs and Land Rovers and such. And then our volume brands are more and more tending to be Toyota and Honda. And just like the U.S., those customers are quite loyal in terms of service retention and brand loyalty to the dealership. So, if we were selling the big four volume brands, which we are not, Fiat, Volkswagen, Ford and General Motors, I believe service retention would be a much more challenging proposition in Brazil.

<Q - David Whiston>: That's helpful. Thanks. And last question is on the UK, with the acquisition volume was up a lot, GPU was down double digit percentages. Is that profitability something you think you can improve as you integrate the acquired acquisition, or [ph] are you all about just getting volume to increase UIO (1:00:33)

<A - John C. Rickel>: No, some of that is the exchange rate impact, and then some of that is the mix piece that Earl alluded to that the growth in the Ford stores. There is some margin pressure on the luxury brands. You've got a similar issue going on in the UK that you have in the U.S. There's oversupply to one of the areas where BMW and Audi have kind of diverted some of their production that was headed for either China or Russia. So there is a piece of that, but I don't think it's as severe as what the U.S. dollar impact would look like because of the FX impact.

<Q - David Whiston>: Okay. Thank you.

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

Operator

And ladies and gentlemen, this concludes our question-and-answer session. At this time, I'd like to turn the conference call back over to Mr. Hesterberg for any closing remarks.

Earl J. Hesterberg

Okay, thanks everyone for joining us today. We look forward to updating you on our second quarter earnings call in July. Have a good day.

Operator

And ladies and gentlemen, the conference has now concluded. We do thank you for attending today's presentation. You may now disconnect your telephone lines.