Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2017-02-02
Event Description: Q4 2016 Earnings Call

Market Cap: 1,683.83
Current PX: 78.79
YTD Change($): +.85
YTD Change(%): +1.091

Bloomberg Estimates - EPS
Current Quarter: 1.710
Current Year: 7.728
Bloomberg Estimates - Sales
Current Quarter: 2605.625
Current Year: 11005.583

Q4 2016 Earnings Call

Company Participants

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

Other Participants

- James J. Albertine
- Elizabeth Lane Suzuki
- Rick Nelson
- Michael Montani
- Brett D. Hoselton
- David Tamberrino
- William R. Armstrong
- Paresh B. Jain
- David Whiston
- David H. Lim

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to Group 1 Automotive's 2016 Fourth Quarter and Full Year Full Year Financial Results Conference Call. Please be advised that today's call is being recorded.

At this time, I would 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 the 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 are forward-looking statements that are 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 SEC over the last 12 months. Copies of these filings are available from both the SEC and the company.

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

Participating with me today on the call are 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 comparison in the prepared remarks are to the same prior year period, unless otherwise stated.

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

Earl J. Hesterberg

Thank you, Pete, and good morning, everyone. 2016 was a challenging year with economic and political disruptions in each of our regions. Our largest U.S. markets of Texas and Oklahoma were both pressured due to lower oil prices, and experienced same store new vehicle unit sales declines of 8% and 12%, respectively. Our UK region experienced disruption due to the Brexit vote, and the ensuing decline in the exchange rate negatively affected both revenues and net profits. And our Brazil region saw yet another double-digit decline in new vehicle industry sales.

Despite these significant challenges, we are proud to report that for the full year of 2016, Group 1 reported an 8% increase in adjusted earnings per diluted share to an all-time record of $7.42. Group 1 retailed over 170,000 new vehicles and approximately 130,000 used units, delivering record revenue of $10.9 billion, an increase of 5% on a constant currency basis.

For the full year, despite exchange rate headwinds, reported revenue increased across each of our business components, with new vehicles up 1%, used vehicles up 4%, parts and service up 6%, and finance and insurance up 3%. We are very proud of our team's performance and would like to sincerely thank all 13,000 associates working in our dealerships.

Turning to our fourth quarter results, I'm pleased to report that Group 1 earned $37.3 million of adjusted net income for the fourth quarter. This equates to record fourth quarter adjusted earnings per share of $1.74 per diluted share, an increase of 15% over last year driven by improved new vehicle margins and strong cost control. Total revenue increased slightly to a fourth quarter record of $2.7 billion. On a constant currency basis, revenue grew 3% for the quarter.

Turning to our business segments, during the quarter, we retailed over 42,000 new vehicles. Total consolidated new vehicle revenues increased 1% on a constant currency basis as the average new vehicle selling price increase of 4% was partially offset by 3% fewer unit sales. As has been the case throughout 2016, the volume weakness was seen throughout the oil dependent markets in the United States and in Brazil. Consolidated new vehicle gross profit was up 6% on a constant currency basis as gross profit per unit increased 10%.

U.S. new vehicle margins were up for the third consecutive quarter with an increase of 12%, as I will cover further in a moment. Our new unit sales geographic mix was 76% U.S., 19% UK, and 5% Brazil. Our new vehicle brand mix was led by Toyota Lexus sales, which accounted for 26% of our new vehicle unit sales. BMW MINI represented 14% of new vehicle unit sales, and Ford and VW Audi each represented 11% of our new vehicle unit sales.

We continued to make progress during the quarter on reducing our U.S. new vehicle inventory levels. Our U.S. new vehicle inventory stood at 27,100 units at year end. This equates to a days supply of 65, down from 74 days at the end of September and 83 days at the end of June.

During the quarter, we retailed over 30,000 used retail units. Total consolidated used vehicle retail revenues grew 4% on a constant currency basis as we retailed 1% more units, and the average used vehicle selling price increased 3%. Used vehicle retail gross profit decreased 2% on a constant currency basis as the retail unit increase was more than offset by gross profit per unit decline. This per unit decline has been partially caused by an increased supply of industry used vehicle inventory, specifically car inventory, which has been particularly difficult on our more car centric brands such as Toyota. U.S. used vehicle inventory stood at 13,000 units, which equates to a 32 day supply.

Total consolidated parts and service revenue and gross profit both increased 7% on a constant currency basis, driven by increases in collision of 10%, customer pay of 8% and warranty of 7%. U.S. same-store parts and service revenues increased 5%, and we maintain our guidance of mid single digit same-store revenue growth through 2017. Finance and insurance gross profit increased 5% on a consolidated constant currency basis. This growth was driven by an increase in F&I for retail unit of 7% as retail unit sales were down 2%. U.S. F&I per retail unit delivered yet another quarterly year-over-year increase, up $129 per unit, to an all time quarterly record of $1,644.

Regarding our geographic segment results, our U.S. same-store operations saw a total revenue decline of 1%, driven by a 7% decline in new vehicle unit sales. Sales were once again negatively impacted in the Texas and Oklahoma markets due to weakness in the oil industry, with decreases of 8% in Texas and 17% in Oklahoma. As mentioned previously, we were able to more than offset the volume decline with improved new vehicle gross profit per unit, resulting in a new vehicle gross profit increase of 2%. So despite a 7% decline in new vehicle unit sales, we were able to grow total same-store gross profit by 2% due to a focus on improving new vehicle margins, with further expansion of our parts and service operations and strong F&I per unit result.

Our UK operations had a very strong quarter with total same-store revenue growth on a constant currency basis of 15%, driven by a 21% increase in new vehicle revenue, a 7% increase in used retail revenue, an 8% increase in parts and service revenues, and an 18% increase in F&I revenue.

In Brazil, quarter four industry sales were down an additional 11% and were down 20% for the full year. Partially offsetting the weak new vehicle environment are process improvements the team has implemented in our used car operations, where we saw same-store used retail margins improve 370 basis points to 7.2% and total used gross profit dollars increase nearly 100% on a constant currency basis.

Underlying business improvements such as these have allowed the team to offset the deep downturn in new vehicle sales and generated a small profit for the quarter, as well as having us well positioned to take full advantage of the future recovery in the local market.

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

John C. Rickel

Thank you, Earl, and good morning, everyone. For the fourth quarter of 2016, our adjusted net income increased $1.6 million or 4.4% over our comparable 2015 results to $37.3 million.

On a fully diluted per share basis, adjusted earnings increased 15% to $1.74, a record fourth quarter result. These quarterly results for 2016 exclude $6.4 million of net after tax adjustments primarily explained by $12.8 million of net non cash franchise rates impairments primarily associated with our dealerships in Brazil, partially offset by $7.3 million of net income recognized from an OEM settlement.

Starting with the summary of our quarterly consolidated results. For the quarter, we generated $2.7 billion in total revenues, which was a slight increase over the prior year. On a constant currency basis, which ignores the change in foreign exchange rates, total revenues increased 2.6% for the quarter.

Our gross profit increased $9 million or 2.4% from the fourth quarter a year ago to $389.2 million. As a percent of gross profit, adjusted SG&A decreased 90 basis points to 74.4%, primarily due to the recent U.S. cost cutting initiatives that were discussed on our last earnings call.

Floorplan interest expense increased by $1 million or 9.5% from the prior year to $11.2 million. This increase is primarily attributed to a higher LIBOR interest rate versus the fourth quarter last year. Other interest expense increased $2.4 million or 15.9% to $17.2 million, primarily 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%, down from 37.5% a year ago, as a mix of our income generated in the UK has increased following our recent acquisitions.

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 decreased 1.1% to $2.2 billion, driven by a decrease of 3.7% in new vehicles. This decrease was partially offset by a 5.1% increase in parts and service, a 2.3% increase in F&I, and a 1.1% increase in used retail. The 5.1% increase in same-store parts and service revenue consisted of increases of 6.6% in customer pay, 6.4% in warranty, 6.1% in collision, and half a percent in wholesale parts. We reiterate our guidance for mid-single digit same-store revenue growth through 2017.

Our 2.3% F&I revenue increase was driven by a PRU increase of $102 or 6.7% to $1,636 per unit, partially offset by a 4.1% decrease in total retail units. Total same-store gross profit increased 1.5%, driven by increases of 4.1% in parts and service and 1.9% in new vehicles, partially offset by a 6% decrease in used retail.

As Earl previously mentioned, we continue to display improved pricing discipline as our new vehicle gross profit per unit increased $179 per unit to $2,043, which more than offset the 7.1% decline in new vehicle retail unit volume.

Our adjusted SG&A as a percent of gross profit decreased 110 basis points to 72% as a result of the aforementioned cost cutting initiatives, and adjusted operating margin increased 30 basis points to 3.8%.

Related to our UK segment on a same-store basis, with percentage change metrics on a constant currency basis. For the quarter, total revenue decreased $16.6 million to $268.5 million, but increased 15.1% on a constant currency basis. Gross profit for the UK segment was up 13.7% from prior year.

New vehicle gross profit grew 12.5%, driven by a unit sales increase of 18.9%. Total retail used vehicle gross profit increased 8.9% as a 7.4% increase in unit sales combined with a 1.4% increase in gross profit per unit. Parts and service gross profit improved 12.1%, and our F&I income increased 18%, which is attributable to both a 14% increase in total retail units and a 3.6% increase in gross profit per retail unit. For the quarter, our adjusted SG&A as a percent of gross profit increased 70 basis points to 82.4%, and adjusted operating margin decreased 10 basis points to 1.6%.

Related to our Brazil segment on a same-store basis. As Earl mentioned, the total industry new unit volume decreased 11% from the fourth quarter of 2015. Our local team did a great job increasing both parts and service gross profit, and F&I PRUs, as well as the improvements in the used business, which Earl covered previously, which offset the steep new vehicle sales decline and allowed to us make a small profit for the quarter. We expect to generate a small profit in 2017 as we continue to improve processes and benefit from a stronger brand portfolio.

Turning to our consolidated liquidity and capital structure. As of December 31, we had $21 million of cash on hand and another $85.1 million that was invested in our floorplan offset accounts, bringing immediately available funds to a total of $106.1 million. We did not repurchase any common stock during the quarter. For the full year 2016, we repurchased approximately 2.3 million shares at an average price of roughly $55.90 per share for a total of $127.6 million.

Those repurchases equated to an approximate 10% reduction from our 2015 year-end diluted common share count of 22.6 million shares. As of today, we have approximately 20.6 million diluted common shares outstanding and $22.4 million remaining on our board authorized share repurchase program. During the fourth quarter, we used $4.9 million to pay dividends at $0.23 per share, an increase of 4.5% per share over the fourth quarter a year ago and an annualized yield of over 1%.

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 will now turn it back over to Earl.

Earl J. Hesterberg

Thanks, John. Related to our corporate development efforts, the company is pleased to announce the January addition of a BMW motorcycle franchise in the state of Paraná, Brazil. This franchise will be moved into one of our existing BMW locations and provide additional scale for the dealership. The franchise is expected to generate approximately $5 million in annual revenues. The company also divested of its only Skoda franchise in the UK during the fourth quarter, and of its two remaining Nissan dealerships in Brazil as of February 1.

In total, these dealerships generated approximately $35 million in trailing 12-month revenues. The disposals are consistent with Group 1's portfolio management strategy, and the case of the Brazilian dispositions now completes our significant portfolio enhancement process that's been ongoing since 2014.

Before I turn the call over to the operator for your questions, let me update you on our market outlook for 2017. For the U.S., we expect to see a slight pullback in the overall new vehicle industry. Total new vehicle sales in 2016 came in at a record 17.5 million units. We are anticipating a 17.2 million unit industry for the U.S. in 2017. For the UK, we expect the market to decline roughly 10% to 2.4 million units from the record 2016 of 2.7 million units.

And we believe that our brand exposure, combined with the improved performance of our recent acquisitions, will allow us to outperform the industry. And for Brazil, we expect the market to be flat at around 2 million units.

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

[Operator Instructions] Our first question today comes from Jamie Albertine from Consumer Edge. Please go ahead with your question.

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

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

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

<Q - James J. Albertine>: Look, I don't know how to ask this without Pete getting a big head here, but the F&I PVR was exceptional, 16.36% in the U.S. Three years ago, I think if we had thought about that, we were asking you guys about where is the ceiling, and you keep breaking through it. Pete, where can it go from here and what's driving it?

It seems like it is a pretty difficult time in Texas and Oklahoma to get some sales done, and yet, you guys, in aggregate, in the U.S., you are doing really well in F&I PVR. So any help there would be great.

<A - Peter C. DeLongchamps>: So, Jamie, I appreciate the first question on F&I. Usually, it comes towards the end of the call, but this has been a process that we have been working on for over the years and we are selling more product. We have had increases in most of our product offerings. Our reserve is staying pretty constant. So I think that we have reached a high level. I would suggest you don't model anything higher than this. We have got rising interest rates coming towards us. So we are pleased with the performance. I'm thankful for the job the team has done, but we are still working hard at it, but I wouldn't model anything higher than where we currently are.

<Q - James J. Albertine>: Very good. I appreciate that. And then, if I may, on the used vehicle side, in a down 7% new vehicle environment, to do flat for used retail units is, I think, a pretty good result. Clearly, those are some margin pressures out there, and you talked about cars versus trucks. Can you just help us sort of delineate which is the bigger threat to gross profit per unit looking to 2017? Is it supply of cars versus trucks, or is it some sort of competitive dynamic that you see out in the markets?

<A - Earl J. Hesterberg>: This is Earl. I think there are two key factors. One is the supply, off-lease vehicles in particular. They continue to increase in numbers year-over-year, which is not a surprise because everyone watched the growth of leasing in recent years. So supply is the primary factor.

And secondarily, when you have aggressive new vehicle incentives, new vehicle transaction prices can start to sit down a little bit on used car prices. I believe those are the two big factors.

<Q - James J. Albertine>: Okay, great. And just a housekeeping item real quick. Can you remind us what the Texas and Oklahoma top-line trends looked like throughout 2016? As we look forward to 2017, it feels like you should have some, if you will, easier compares. And just wanted to understand kind of how they trended throughout the year as we think about building our models. Thanks.

<A - John C. Rickel>: Yeah, Jamie. This is John. For the full year, new vehicle same-store new unit sales were down 8% percent in Texas and 12% in Oklahoma. And then through the quarter, they were still kind of that same level, you were down 8% in Texas and 17% in Oklahoma. So while we do think, at some point, higher oil prices will be beneficial, it hasn't quite manifested itself yet. But I would remind you that it took really three quarters at least when oil prices came down pretty sharply to see the impact on the market. So I think there is definitely a lag effect. But, so far, we have not seen a change in the trend that we saw over the year.

<Q - James J. Albertine>: Okay, great. Thanks so much, and good luck.

Operator

Our next question comes from John Murphy from Bank of America. Please go ahead with your question.

<Q - Elizabeth Lane Suzuki>: Hi, good morning. It's Liz Suzuki on for John. Looking at your acquisition and divestiture strategy, it sounds like we are at a point where we shouldn't expect to see more material divestitures coming in 2017. Do you think you will be growing your base this year with some more acquisitions and where are you seeing the best opportunities?

<A - Earl J. Hesterberg>: I believe it's a valid assumption to say you should not see any significant dispositions in the near term here. I believe we have the portfolio where we want it. But, yes, we are very interested in growing in all three of our markets, including the U.S. So, yes, we would prefer to deploy our capital to grow the business externally if we can find investments that meet our return hurdle.

<Q - Elizabeth Lane Suzuki>: Great. Thanks. And just looking at the potential policies that could be put in place in the next couple of years and the net impact of a lower corporate tax rate but potentially higher new vehicle prices if automakers have to pass through the cost of a border tax, do you expect to benefit on a net basis in your U.S. operations?

<A - Earl J. Hesterberg>: Well, it's a bit difficult to predict that, but I would say we're encouraged, like most business people, of the general – of a focus of the administration on improving a lot of business aspects. The specific ones still are a bit fuzzy. Obviously, we pay the maximum U.S. corporate income tax, it seems, year after year. So that would be critical to provide us with more investment capital. So, that's one we're particularly interested in.

Relative to these other discussions about border adjustment taxes and things, it's impossible for us to really grasp what could happen there. But experience tells me the market adjusts to these things, and our business is quite broad and diverse because it includes used vehicles, parts and service, and other things. So, I expect the market will adjust to whatever settles out.

<Q - Elizabeth Lane Suzuki>: Great. And just one more follow-up on that, which is how sensitive do you think new vehicle buyers are to price hikes if we do see a scenario where automakers and particularly the import brands have to pass through some of their cost increases to customers?

<A - Earl J. Hesterberg>: My experience is that new vehicle customers are extremely price sensitive, as are used vehicle customers. But the key there is the transaction price, not the published price. So as you can see now, there's a lot of incentive activity in the market. But it's fair to assume that new vehicle customers are very price sensitive.

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

Operator

Our next question comes from Rick Nelson from Stephens. Please go ahead with your question.

<Q - Rick Nelson>: Thanks. Good morning. Earl, if we look at the acquisition opportunity, the pipeline potential, U.S., UK, Brazil, how you see that unfolding. And is there any give yet in terms of the multiples? Those auto sales seem to be plateauing.

<A - Earl J. Hesterberg>: Rick, this is Earl. I wouldn't say we have any significant pipeline at the moment, but I have seen an increase in the number of available deals in both the U.S. and the UK over the last six to 12 months. And I believe it is because there is a perception that these markets have peaked. I wouldn't say that people necessarily think the markets are going to contract very much, but there are many opportunities available.

<Q - Rick Nelson>: Yeah. The last couple of years, we really haven't seen that much in the sector. Would you think 2017 is going to be a better year from an acquisition standpoint?

<A - Earl J. Hesterberg>: I would think there will be significant activity, Rick. But again, this policy uncertainty, I think there are a lot of business people waiting to see where things settle out before making substantial investments at the moment.

<Q - Rick Nelson>: Got you. And the inventory looks like it is in good shape, 65 days of supply in the U.S. Any comments about where you're light, where you're heavy and how you see inventory in the channel? Is that still problematic?

<A - Earl J. Hesterberg>: Yeah. Certainly, Rick. Overall, I would say we are in reasonably good shape, the best shape we have been in, in more than a year, probably a year and a half or more. So that is good. We still have more than we like to see in the three domestic brands. They are not very close to our 75-day guide or target. But overall, we can live with where we are now. We actually have some brands like Lexus in the 20-day supply range, where we no doubt lost Lexus sales in their most popular models. But overall, this is probably the best inventory picture we have had in quite a while.

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

<A - Peter C. DeLongchamps>: 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.

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

<Q - Michael Montani>: Just wanted to ask first on the UK side. Have to say, almost 20% increase there, same-store new units quite strong. Do you attribute that to some sort of a pre-buy given the risk of rising prices, or what would you attribute that to? It's just stronger than the market overall.

<A - Earl J. Hesterberg>: Although I am reluctant to do this, I will have to give credit to our operating team. Hopefully, they are not listening. But the market has been very stable and strong in the UK, but that type of increase is obviously way beyond what the market has done. In particular, our Ford dealerships in the UK had a spectacular year, one that was really eye-popping in my opinion.

And we did make some improvements on stores that we bought in recent years there that were underperforming and they had some nice room to improve. We still have quite a ways to go and a significant number of broken stores from recent acquisitions that we need to do work on this year. But I would say it was primarily improving recent acquisitions and some pretty strong operating performance by our team.

<Q - Michael Montani>: Great. Thank you. And then another one here for Pete, which was just if you could talk a little bit about the way you guys are seeing leasing this year kind of continue to grow and penetration, and also just overall credit availability in the marketplace up and down the spectrum, Pete.

<A - Peter C. DeLongchamps>: Sure. Credit availability clearly remains strong and not an issue for us. In regard to leasing, it's clearly been the incentive du jour. And I think that as Earl pointed out, transaction price is everything. And with strong used car prices, leasing has certainly benefited from that. But as more and more cars begin to come off lease, I think it's something that we'll be watching closely as I'm sure the captive OEM finance companies will be as well.

<Q - Michael Montani>: Okay. And just the last one I had was, as you all think about the gross profit per unit on the new side, obviously, it's been phenomenal performance there. Wondering if you can share a little bit of if that's just across the board or if there is particular makes or models that are driving it.

And then, secondly, it sounded like you were looking for SAR to be down a bit. How are you thinking about the ability to sustain gross profit dollars if we continue to see these incentive levels where they're at?

<A - Earl J. Hesterberg>: Well, I think most of our margin improvement has been across the board. In particular, though, it's probably been geographic in Texas and Oklahoma because when your sales are dropping as much as 17%, as they did in Oklahoma last quarter, you literally can't adjust if you don't adjust your margins. You can't adjust your costs that much.

So it's probably more concentrated in Texas and Oklahoma just from a survival standpoint. But I would not say it was particularly brand-specific. Even with a 300,000-unit industry decline in the U.S., I wouldn't say that is too material. I wouldn't expect us to be able to improve our new vehicle margins too much more, but I think we would be well served if we can keep them approximately where we have them now. The greater work to do is to stabilize the used vehicle margins, and that's where we are going to try to put some more work in this year to generate more gross profit with both increased used vehicle volume and trying to stabilize these margins. There is still a very good used vehicle market out there.

<Q - Michael Montani>: Great. Thank you, guys.

Operator

And our next question from Brett Hoselton from KeyBanc. Please go ahead with your question.

<Q - Brett D. Hoselton>: Good morning.

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

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

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

<Q - Brett D. Hoselton>: I was wondering if you could speak to what was driving or what drove the $179 improvement in U.S. new vehicle gross profit per unit.

<A - Earl J. Hesterberg>: Well, I think one of the factors is our improved inventory position, where we weren't sitting with 100 plus days on key brands, in particular, brands like BMW, where we had very high inventories through much of last year. And, overall, I would say our luxury brands did contribute quite a bit, led by BMW, because we have those inventories in line now.

<Q - Brett D. Hoselton>: And then a number of your peers are actively pursuing a used vehicle standalone strategy. I'm kind of wondering, what is your level of interest in terms of that?

<A - Earl J. Hesterberg>: At this time, we don't have any interest in that, although we certainly will watch it closely. I understand the concepts that are being pursued. But for now, we believe we have quite a bit of upside within our own used vehicle structure.

<Q - Brett D. Hoselton>: Excellent. Thank you, Earl.

<A - Earl J. Hesterberg>: You're welcome.

Operator

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

<Q - David Tamberrino>: Yeah. Hi. Thank you. Just wanted to dig in a little bit on your 17.2 million units forecast versus, I think consensus is more in the mid 17 million units range. I know we are talking shades of grey, but wanted to get a feeling for what you were thinking would probably drive us down year-over-year, particularly as we've seen OEMs continue to be willing to drive incentives higher to kind of maintain this mid 17 million units level. So wanted to get a feel for, one, what's driving you a little below this mid 17 million units level and, two, how the OEM discipline is looking in the market today.

<A - Earl J. Hesterberg>: Well, our assumptions, which, of course, are subject to debate, are that there is a little pressure on used vehicle prices that make trade-ins a little bit more difficult. And that the current incentive levels may not be, indefinitely, sustainable.

Now, I may be wrong on that. Also, I have seen some inclination by the OEMs to back off on the fleet business a bit. So it doesn't take too much of any of those factors to add up to 300,000 units in a 17.5 million units industry. And we have some assumptions for a couple more interest rate hikes this year also in our operating assumption.

<Q - David Tamberrino>: Got it. That's really helpful. If I were to extrapolate that going forward, are you still thinking we are in that 17 million units range as vehicle affordability continues to go down and trade-in values come down, with residual values under pressure, moving into 2018 and 2019, or you still think we can be in a 17 million units range based on some of the benefits that you've pointed out clearly with pent-up demand, and I guess, some continued economic growth perhaps coming out of some fiscal stimulus?

<A - Earl J. Hesterberg>: It's hard to say, but I think the summary is that we are still in a very strong automotive market in the U.S. And it could vacillate up or down 0.5 million units, but I still think there is an awful lot of capability for a 17 million-unit to 18 million-unit industry, and it could go either way. So I think the takeaway is that we're still going to have another good year.

<Q - David Tamberrino>: Got it. And then just lastly, coming back to the OEM discipline portion. We are a little bit off-sides as a industry after January. January is typically a slow month, but vehicles in absolute are still up 9% year-over-year out on dealer lots. Are you seeing any increased behavior from a stair-step incentive perspective? I know that was more of a 2015 thing, and some of the OEMs backed off during 2016, but are you seeing any of the foreign OEMs be a little bit less disciplined there and continue to push the metal? And what are you seeing at the D3 partners, where there is some excess inventory in the channel, is for a few of them?

<A - Earl J. Hesterberg>: I can't really see any material change yet, but January isn't a month where you would see that, and quite frankly, neither is February. March is the month that tells us how the year is going to progress.

I do see that there is a lot of activity aggressiveness in the truck area, particularly full-size pickup truck. I think that will continue. But I can't really give you a read after January, and probably couldn't after February either. I think March is what tells us what's happening.

<**Q - David Tamberrino**>: Understood. Thank you for the time.

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

Operator

And our next question comes from Bill Armstrong from C.L. King. Please go ahead with your question.

<**Q - William R. Armstrong**>: Good morning, everyone. So, with a sort of flat or slightly down SAAR with lower used car prices, and with those used cars, therefore, presenting a more attractive value proposition, is it fair to assume that we might see some acceleration in the pace of used car sales as we move through 2017 from your point of view?

<**A - Earl J. Hesterberg**>: Yes, I think that is a good assumption. And the used car market adjusts very quickly and we need to adjust to it, and one of the advantages of having a 32-day supply of inventory is we should be able to roll with the punches on the pricing, and the volume should remain strong in the used market this year.

<**Q - William R. Armstrong**>: Right. So in that environment, you should be able to more or less hold your spread between what you are paying to acquire that inventory and what you can sell it for.

<**A - Earl J. Hesterberg**>: Yes, I think [indiscernible] (38:23).

<**Q - William R. Armstrong**>: Yeah. Okay. And you're at 32 days used inventory at the end of the year?

<**A - Earl J. Hesterberg**>: That's correct.

<**Q - William R. Armstrong**>: Great. Okay. All right. Thank you.

<**A - Earl J. Hesterberg**>: You're welcome.

Operator

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

<**Q - Paresh B. Jain**>: Good morning, everyone. Just to follow up on the U.S. margins, you had talked about improving them or stabilizing them going forward. I was hoping you could remind us again as to the drivers of the GPU gap you have and, quite frankly, most franchise dealers have, versus the leading independent U.S. car dealer out there, and how that gap can be closed, assuming some of that $800 gap can be closed.

<**A - Earl J. Hesterberg**>: Well, I don't know that I can articulate in great detail versus some of the independents, but the factor that we have in our company is that 26% of our business comes from Toyota or Lexus brand franchises. And these are car driven franchises, and to keep that machine running, we take a lot of car trade-ins. And cars have been hit the hardest on used vehicle values, and we have to keep taking those to make the new car sales. So that's one of the challenges that we need to overcome. But that said, I would think there is still opportunity for us to have a bit more discipline and do a better job than we have in the past.

<**Q - Paresh B. Jain**>: Got it. That's all I had.

Operator

Our next question comes from David Whiston from Morningstar. Please go ahead with your question.

<**Q - David Whiston**>: Thanks. First, on M&A in the U.S., are you interested in increasing all of your existing brand portfolio, or would you prefer to focus more on Japanese or Detroit 3?

<A - Earl J. Hesterberg>: I would say we're quite open on brands as we look to grow externally. And everybody would like luxury brands and so forth, but we have had success with virtually all brands. And so it's just a function of geography and return on investment. So I would say we're as open as we've ever been on brand.

<Q - David Whiston>: Okay. And, John, with rates going up, does that tempt you guys to do a bond offering while the market is still attractively priced?

<A - John C. Rickel>: No. At this point – we did our offering in December 2015. We are very actively capitalized. We have plenty of dry powder, so there is really no need for that at this point.

<Q - David Whiston>: Okay. And just the last question on U.S. new vehicle PRU up 12%. Is it fair to say you guys are just being really disciplined on pricing and not buying market share?

<A - John C. Rickel>: Yeah, I think that's a good explanation. The team has done a good job of making those trades.

<Q - David Whiston>: Okay. Thanks, guys.

Operator

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

<Q - David H. Lim>: Hi, good morning, Earl, John, Pete and Sheila. Just – before I start off on my question, John, congratulations for a stellar recruiting class for Ohio State yesterday. But in all seriousness, the question that I wanted to ask was on residual values. As it's falling, would that – and that would obviously impact leases. Would that mean that the OEMs would have to put on more, let's say, cash on the hood or dealer incentives as the variance or the walk between used vehicle transaction prices and new vehicles could be even greater?

<A - Earl J. Hesterberg>: Well, I do think it dictates that they will be tweaking up their incentive tactics or strategy a bit. But we have to remember, leasing is very regionalized within the U.S. Northeast, and California and Florida come to mind. So, in many cases, they can deal with that on a regional basis, I think. But I do believe that most of these companies that have done a lot of leasing, most these brands, are going to be making some adjustments. And there will be funds flowing into non-lease tactics.

<Q - David H. Lim>: And then on the used vehicle side, has Group 1 considered maybe a direct sales model where you could sell used vehicles directly to customers? I think CarMax is working on some sort of similar program. Any thoughts there on direct sales, like Internet direct?

<A - John C. Rickel>: David, this is John Rickel. I mean, we have an Internet presence today, and we do, do some direct sales. We use multiple channels, whether it's our Internet, whether it's eBay Motors. So, we are doing some of that today. We have the capability of doing basically online sales.

<Q - David H. Lim>: And finally, on that 17.2 million units outlook, what's the assumption for retail growth versus fleet?

<A - Earl J. Hesterberg>: Well, I would say there is an assumption of a slight decline in retail.

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

Operator

[Operator Instructions] Our next question comes from Michael Montani from Evercore ISI as a follow-up. Please go ahead with your question.

<Q - Michael Montani>: Thanks. Just wanted to ask if you could share also the day supply of inventory globally, sorry if I missed that number, for the new side.

<A - John C. Rickel>: Yeah, it is obviously less impactful on a global basis because you have less, but on a new vehicle, we are basically 62 days on a global basis.

<Q - Michael Montani>: Okay. Great. And then, I didn't hear you guys mention, which I'm assuming is because it wasn't that material, but Takata, what percentage of your inventory is on stop sale currently, and just overall, how would you characterize availability of replacement airbags?

<A - Earl J. Hesterberg>: Yeah, you're correct, that is not material. But it is, I think, 400 new units and 450 used units. So in the overall scheme of things, irritating but not material.

<Q - Michael Montani>: Thank you.

Operator

And at this time, we have reached the end of the allotted time for today's question-and-answer session. I would like to turn the conference call back over to management for any closing remarks.

Earl J. Hesterberg

Okay. Thanks, everyone, for joining us today. We look forward to updating you on our first quarter earnings call in April. Thank you.

Operator

Ladies and gentlemen, with that, we will conclude today's conference call. We do thank you for joining. You may now disconnect your lines.