

Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2018-02-08
Event Description: Q4 2017 Earnings Call

Market Cap: 1,565.26
Current PX: 75.04
YTD Change(\$): +4.07
YTD Change(%): +5.735

Bloomberg Estimates - EPS
Current Quarter: 1.863
Current Year: 8.452
Bloomberg Estimates - Sales
Current Quarter: 2672.200
Current Year: 11246.900

Q4 2017 Earnings Call

Company Participants

- John C. Rickel
- Peter C. DeLongchamps
- Earl J. Hesterberg
- Daryl A. Kenningham

Other Participants

- John Murphy
- David H. Lim
- James J. Albertine
- Irina Hodakovsky
- Nicholas Todd Zangler
- David Whiston
- David Tamberrino

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Group 1 Automotive's 2017 Fourth Quarter and Full Year Financial Results Conference Call. Please be advised that today's conference call is being recorded.

At this time, I'd like to turn the conference call over to Mr. John Rickel, Group 1's Senior Vice President and Chief Financial Officer. Please go ahead, Mr. Rickel.

John C. Rickel

Thank you Jamie. Before we start the call, want to advise that in the press release tables that we published this morning as part of our earnings announcement, there is one correction that I want to highlight on page 37 of 42. The percentage changes for adjusted net income and adjusted diluted earnings per share were incorrect.

We'll be issuing an adjusted 8-K with the correct numbers. What was published was 23.4% for adjusted net income, the corrected percentages is 18.8%. The absolute numbers are correct. We did see the percentage change in our adjusted diluted income per share, what was published previously was 25.9%. The correct number is 21.3%. All other data as presented is correct.

With that, let me turn it over to Mr. Pete DeLongchamps, our Senior Vice President of Manufacturer Relations, Financial Services and Public Affairs.

Peter C. DeLongchamps

Thank you, John, 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 that we will refer to

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on this call for comparison purposes have been posted to the Group 1's website.

Before we begin, I'd like to make some brief remarks about forward-looking statements and the use of non-GAAP financial measures. Except for historical information mentioned during the conference call, statements made by management of Group 1 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 risk 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, maybe 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; Daryl Kenningham, our President of U.S. Operations; and Lance Parker, our Vice President and Corporate Controller. Please note that all comparisons in the prepared remarks are to the same prior-year period, unless otherwise stated.

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

Earl J. Hesterberg

Thank you, Pete and good morning everyone. 2017 was a year which again reminded us of how dynamic the auto retail market can be and how it can be impacted significantly by political, economic, and even weather-related events. Throughout most of the year, the most important factor in our U.S. business was a continuing drag in our heavy energy market footprint from lower oil and gas prices, which had reduced employment levels in many of our key markets.

This resulted in a high single-digit decreases in our new and used vehicle sales performance in most of our Texas and Oklahoma markets throughout the first eight months of the year. The situation in our Southern Texas markets changed drastically in late August due to the dramatic impact of Hurricane Harvey. This devastating storm resulted in a negative \$15 million impact to our Houston and South Texas business and more importantly, seriously changed the lives of almost 400 of our employees. Of course, in the months following this storm, especially September, October and early November, some of our key Texas markets experienced significant sales increases as vehicle replacement demand benefited our business to the upside.

Our UK business escaped major weather-related events but not political events. Since the onset of Brexit in the second half of 2016, the political uncertainty of leaving the EU has grown a consistently weight on consumer confidence. Additionally, the VW diesel issue exerted a substantial impact on the market with a sudden and massive shift away from diesel vehicles for all brands. This has created the possibility of future changes to the UK vehicle tax structure, which is also causing deferral of vehicle purchases for many consumers.

The net effect on the market was a decrease of 6% on industry sales for the full year, with even greater weakness in Q4. Our strong brand mix and operating improvements allowed us to outperform the market throughout the year but the market is softer at present. And of course, the Brazilian market has experienced an ongoing political drama and a few positive fiscal and economic improvements, which seem to bode well for the local auto industry. We saw the first signs of a sales recovery late in the year and things are better than they have for quite some time.

With all of this complex background and many challenges, we're proud to announce it for the full year of 2017, Group 1 reported a 4% increase in adjusted earnings per diluted share to an all-time record of \$7.73. Group 1 retailed over 170,000 new and approximately 130,000 used vehicles delivering record revenue of \$11.1 billion, an increase of 3% on a constant currency basis.

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For the full year, despite exchange rate headwinds, reported revenue increase across each of our business components with new vehicles up 2%, used vehicles up 2%, parts and service up 6% and finance and insurance up 2%. Given the headwinds previously mentioned in our energy markets, the U.K. and Brazil, this across the board growth represents good work by our team of over 14,000 associates.

Turning to our fourth quarter results, I'm pleased to report that Group 1 earned \$44.3 million of adjusted net income for the fourth quarter. This equates to record fourth quarter adjusted EPS of \$2.11 per diluted share, an increase of 21% over last year driven by strong revenue growth and cost control. That 21% number was mistakenly recorded as 26% in our original release, which was just corrected as John mentioned. So the fourth quarter EPS number increased by 21%, not 26%. So revenue increased 9% to a fourth quarter record of \$2.9 billion.

Turning to our business segments. During the quarter, we retailed over 44,000 new vehicles. Total consolidated new vehicle revenues increased 9% on a constant currency basis, as the average new vehicle selling price increase of 2%, combined with 6% more unit sales. Consolidated new vehicle gross profit was up 7% on a constant currency basis, as gross profit per unit increased slightly. Our new unit sales geographic mix was 75% U.S., 20% UK and 5% Brazil.

Our new vehicle brand mix was led by Toyota and Lexus sales which accounted for 25% of our new vehicle unit sales. Volkswagen/Audi represented 13% of our new vehicle unit sales, BMW/MINI represented 12%, Ford represented 11% of our new vehicle unit sales. During the quarter, we refilled over 32,000 used retail units. Total consolidated used vehicle retail revenues grew 7% on a constant currency basis as we retailed 5% more units and average used vehicle selling price increased 2%. Used vehicle retail gross profit increased 3% on a constant currency basis as the retail unit increase was partially offset by a gross profit per unit decline of 3%.

Total consolidated parts and service revenue increased 10% on a constant currency basis driven by increases in wholesale parts of 12%, warranty of 12%, customer pay of 8% and collision of 6%. Finance and insurance gross profit increased 9% on a consolidated constant currency basis. This growth was driven by an increase in retail units of 6% and F&I for retail unit of 3%.

Regarding our geographic segment results, I would like to turn the call over to Daryl Kenningham, President of U.S. Operations to discuss our U.S. fourth quarter results before I cover the UK and Brazil.

Daryl A. Kenningham

Thank you, Earl. Our U.S. same-store revenues grew 4% for the quarter while same-store gross profit increased 5%, driven by new vehicle unit sales that were up 4.4% and parts and service revenue growth of 6.6%. Relative to new vehicle margins, we again registered a slight increase, marking the seventh time in the past eight quarters that our U.S. dealerships have grown gross profit per unit.

Relative to the Q4 impact of Hurricane Harvey on our business, new vehicle replacement demand carried at the beginning of the quarter in our Houston and Beaumont markets. But we believe that was fulfilled as we entered December.

We continue to hold U.S. new vehicle inventory at a reasonable level. Our inventory sit at 26,400 units at year end, this equates to a supply of 64 days, down from 88 days at the end of the second quarter when we placed intense focus on our inventory procurement processes.

Total U.S. F&I per retail unit delivered yet another quarterly year-over-year increase, up \$56 per unit to an all-time quarterly record of \$1,700. This increase was largely driven by increased product penetration, mainly extended warranties and maintenance contracts, which benefit our business by bringing customers back into our service departments.

U.S. same store parts and service revenues increased 6.6% driven by increases in wholesale parts at 11%, warranty of 8%, collision of 6% and customer pay of 4%. Same store gross profit increased 5% as a 7% revenue increase was partially offset by a 70 basis point decline in gross margin to 53.1%. This decline was due entirely to the mix effect of

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more wholesale parts revenues and less internal reconditioning work. We maintain our guidance of mid-single digit same store parts and service growth through for 2018.

Our used vehicle business was the loan area of gross profit decline, down 3% on the same-store basis. Hurricane Harvey replacement demand did lift our used vehicle selling rate versus earlier in the year, but not enough to exceed prior year levels. Also, our inventory procurement strategy post-hurricane resulted in a bit too much stock, which ultimately resulted in lower margins as we cleared those units.

We ended the quarter with a 35-day supply of used vehicles, which is a reasonable level of inventory. For 2018, we believe there is ample opportunity to grow our used business and look forward to the results of several strategic initiatives we have underway.

Lastly, I'd like to thank our 9,700 U.S. employees for all the great work they do every day, and now I'll turn the call back over to Earl.

Earl J. Hesterberg

Thanks, Daryl. Our UK operations performed well in Q4 in a very new vehicle sales market. Our same-store new vehicle unit sales decreased 7% in an overall market which declined 13% and overall, we grew same-store gross profit by 5% with strong used car, F&I and parts and service performance. Specifically, we've realized a 39% increase in total used vehicle gross profit, a 14% increase in F&I gross profit and a 5% increase in parts and service gross profit.

For the full year of 2017, our same-store new vehicle unit sales increased to 1% despite an industry decline of 6%. This is a testament to both our local management team and our favorable brand portfolio.

In Brazil, we once again generated a significant increase in quarterly profit with substantial growth in all of our business segments. Total same-store gross profit increased 15% on a constant currency basis driven by a 31% increase in F&I, a 24% increase in total used and 11% increase in new and a 10% increase in parts and service. We're also able to leverage the growth in gross profit via controlled cost – continued cost control as SG&A as a percent of gross profit improved 180 basis points to 88.7%.

We continue to be very proud of the work that our local team has done and are well-positioned to take full advantage of recovering market.

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

John C. Rickel

Thank you, Earl. Good morning, everyone. For the fourth quarter of 2017, our adjusted net income increased \$7 million or 18.8% over our comparable 2016 results to \$44.3 million. On a fully diluted per share basis, adjusted earnings increased 21.3% to \$2.11, yet another record fourth quarter result. These quarterly results for 2017 exclude \$66.2 million of net after tax adjustments primarily related to reduction in the corporate income tax rate enacted in the U.S. Tax Reform Bill which benefited the company by approximately \$73 million. This benefit was partially offset by net non-cash asset impairment charges for approximately \$6.5 million.

Starting with a summary of our quarterly consolidated results, for the quarter, we generated \$2.9 billion in total revenues which was a 9.2% increase over the prior year. Our gross profit increased \$36.5 million or 9.4% from the fourth quarter a year ago to \$425.7 million. As percent of gross profit, adjusted SG&A decreased 180 basis points to 72.6% as gross profit flow through equaled 47% in the quarter. SG&A leverage was particularly impressive in the U.S. and in Brazil where the operating teams remain focused on cost discipline while increasing gross profit. U.S. SG&A improved 290 basis points to 69%, an all-time quarterly record for the company.

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Floorplan interest expense increased by \$2.5 million or 22.6% from prior year to \$13.7 million. This increase is primarily attributed to higher LIBOR interest rates versus the fourth quarter last year. Other interest expense increased \$1.1 million or 6.4% to \$18.3 million, also due to higher interest rates. Our adjusted consolidated effective tax rate for the quarter was 36.2% and for the full year was 35.7%.

We expect a very favorable benefit in 2018 and beyond from the U.S. Tax Reform Bill. If in place for the full year of 2017, our total company effective tax rate would have been between 23% and 24% which would have resulted in over \$20 million of additional operating cash flow and over \$1.25 in additional earnings per share. We are excited about the benefits this additional capital will provide for our shareholders.

Turning to our consolidated liquidity in capital structure. As of December 31, we had \$28.8 million of cash on hand and another \$109 million that was invested in our floorplan offset accounts, bringing immediately available funds to a total of \$137.8 million. We did not repurchase any common stock during the quarter.

For the full-year 2017, we repurchased approximately 650,000 shares with at an average price of \$61.75 for a total of \$40.1 million. These repurchases represent 3% of the total common shares outstanding at the beginning of 2017. As of today, we have approximately 20.3 million diluted common shares outstanding and \$49.6 million remaining on our board authorized share repurchase program. Also during the fourth quarter, we used \$5.2 million to pay dividends of \$0.25 per share, an increase of 8% per share over the fourth quarter a year ago and annualized yield of over 1%.

Lastly, in December and January, we purchased the previously leased underlying real estate of nine U.S. dealerships, increasing our U.S. real estate ownership to 65% and we have purchase options in place that would allow us to increase our U.S. ownership to 70% by the end of 2019. We will continue strategically pursue control over these assets as lease terms near expiration. For additional detail regarding our financial condition, please refer to the schedules of additional information attached to news release as well as the investor presentation posted on our website.

I will now turn the call back over to Earl.

Earl J. Hesterberg

Thanks John. Related to our corporate development efforts, the company was pleased to have previously announced the January addition of the Land Rover franchise in the UK and the purchase of Audi and Subaru franchises in El Paso Texas. These three franchises are expected to generate approximately \$100 million in annual revenues. We expect to continue our strategy of discipline growth through acquisitions in all three of our markets over the course of 2018.

As John mentioned, the U.S. Tax Reform bill will provide a material benefit to our company and our shareholders. We were pleased to have previously announced that we will be sharing this benefit with tenured non-managerial U.S. dealership employees and support staff. Approximately 6,600 employees will receive a \$500 bonus on March 1 at a total cost of approximately \$3.3 million. This one-time payment will be reflected in our first quarter results.

Finally, before I turn the call over to the operator for your questions, let me update our market outlook for 2018. For the U.S. we expect to see another slight pullback in the overall new vehicle industry. Total new vehicle sales in 2017 came in at 17.2 million units, a 2% decline from 2016. We are anticipating another 2% decline in 2018, so around 16.8 million units. For the UK, the new vehicle industry declined 6% in 2017 from a record 2.7 million unit sales in 2016 down to 2.5 million units. We expect the market to continue on the same path in 2018 with another 5% to 10% decline which would equate to industry sales of between 2.3 million units and 2.4 million units.

We believe that our brand exposure combined with the improved performance of our recent acquisitions will allow us to once again outperform the industry as we did in 2017. And for Brazil, the market improved substantially more than we had anticipated at the beginning of the year. Industry unit sales increased from 2.0 million to 2.2 million units, a gain of over 9%. Given the positive signals we're seeing in the economy, we expect this trend to continue with an increase of another 5% to 10% which would equate to industry sales of between 2.3 million units and 2.4 million units.

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

<Q - **John Murphy**>: Good morning guys. Just wanted to ask you, sort of the tax question from three different angles. You know first, are you seeing any benefit from retail or small business sales that are kind of picky – that are picking up? Second, how much of the tax savings do you think will be retained, it could be – could it be competed away? And then third, is there any change in your strategy as far as making acquisitions because after tax returns now should be a little bit better than they were in the past because your tax rate is going down, so you might be a little bit more aggressive on those acquisitions because they make more sense?

<A - **Earl J. Hesterberg**>: Hi John, it's Earl. First of all, I think it's too early for us to see any impact from businesses and such – in the new vehicle sales market. Unfortunately, this time of year, January and February, most years, it's very difficult to tell where the market is. It's generally late February and actually March in both the U.S. and the UK and Brazil as well before we really know what kind of market we have and if there's incrementality from the recent tax actions. I do expect there will be some. Certainly, I would say a positive factor in the overall market development. So that's kind of the first part.

And we continue to prefer the capital available to us be deployed to grow our business, so that would generally lead with acquisitions. So that should put us in a stronger position to look at acquisitions. Clearly, the way the math works that tax benefit is a positive when you're looking at individual acquisitions, but we also need to bear in mind, when we're looking at acquisitions in the U.S. and the U.K. the trend line on total market demand is not a positive one. So that probably mitigates it a bit, but – so overall, I wouldn't say that factor by itself is going to make us buy more dealerships. But we continue to prefer to grow our business in all three of these markets and we'll look to do that.

<Q - **John C. Rickel**>: Yeah, John, this is John Rickel. On your other question about, do we think this gets competed away? I think Mike Jackson actually did a pretty good job of answering this last week on his call. If you look at the data, the vast majority of the dealerships in the U.S. are still owned by private cap and most of those, the vast majority of those are organized as kind of pass through entities. So they're not going to get the same level of tax benefit that we got, that's kind of the first point. Their implied rate will go from basically 39.6% to 29.6% if you are on a pass through whereas we're dropping from 35% to 21%. So on a relative basis, we're going to get more benefit than somebody organized that way.

The second more important point is dealerships really kind of operate at the PTI level. Most of these, the owners are not the day-to-day operators. And if their plans are on PTI, so they're not going to have an incentive really to compete that away, the owner's tax bill really doesn't get into the decision of the day-to-day decision making at the dealership level.

<Q - **John Murphy**>: That's very helpful. Then just a second question. And Daryl, you kind of alluded to some strategic initiatives around used. I might be putting the cart before the horse here, but it does sound like there might be some change or shift in your thought process around the used business. Is there anything you can share with us at this point or am I reading too much into the comments?

<A - **Daryl A. Kenningham**>: Well, we have opportunity in used. We acknowledge that and we've started some work on some used car initiatives that will help us grow that business inside our network, and – but it's too early for us to talk in detail about them, but we're working hard on it.

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<Q - **John Murphy**>: Okay. And then just lastly, I mean, F&I, particularly in the U.S. was very strong. I know, Pete keeps mentioning we're kind of reaching asymptotic limits or ceilings here, but at \$1,700 that's a big number and up year-over-year, I think you said \$56. Is there room to push that further? Are we there on this?

<A - **Peter C. DeLongchamps**>: Well, John, I think the financial services team in all three countries continue to do a great job of executing on our strategy and clearly, this quarter's performance was record setting. We are moving forward. It's clearly that our intent is to outperform, but with interest rate hikes inevitable, and our plan to increase the used car business, as Daryl alluded to, I think still a probably mid-\$1,600s,= PVR, your number is probably a good number for modeling.

<Q - **John Murphy**>: And is there a difference between the used F&I PVR and the new or are they generally more or less the same on the ...

<A - **Peter C. DeLongchamps**>: You make more money on the new business.

<A - **John C. Rickel**>: John, this is John Rickel. It's is about \$200 a unit delta between new and used with new being a little more lucrative. We have more opportunities really with extended service contracts in particular on the new units.

<Q - **John Murphy**>: Great. Thank you very much, guys.

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 good morning Sheila. So the first question, I have is, can you give us some color on the SG&A cost control, it came down a lot a year-over-year? What are you guys doing? What's the secret sauce there for the achievement in the quarter?

<A - **Earl J. Hesterberg**>: Well, David, the secret sauce was we started out last year really struggling with our energy markets and we – I should say mostly Daryl and his team, they started aggressive cost reduction actions at the very beginning of the year. So in the first seven or eight months of the year, we were stripping out cost from the business. And then clearly, we had some improvement in the last four or five months of the year, some of it was hurricane replacement demand but also we had better business in places like Boston and the Southeast and some of our other markets. And so as we had a gross profit, it really helped leverage the cost reduction efforts that the U.S. team had been working on for the first six or eight months of the year.

<A - **John C. Rickel**>: David, this is John Rickel. The other piece I would add to that is Daryl and team did a great job overall on the cost control and as part of that though they also did a great job on getting our inventory levels down. And one of the things that goes along with too much inventory is not just the margin pressure, but it's also the cost of moving units around it, the extra parking lot, it's the damage. There's a whole bunch of ancillary costs. So there is definitely some extra benefit that came of getting that inventory back to normalized level. So I think that's another plus that looks to be sustainable for us.

<Q - **David H. Lim**>: So can we conceivably think that there's more leverage to come in the future quarters. Just trying to get a gauge of how sustainable this progress is throughout 2018?

<A - **John C. Rickel**>: Yeah. David, this is John again. To some degree, it is a function of kind of your gross profit generation as Earl indicated because it's the ratio. I think the team will continue to stay focused on cost. It's really a battle of can you continue to grow gross profit? If you can grow gross profit, we continue to think you can leverage that. We're still comfortable with kind of the \$0.40 on the dollar flowing through. So it really comes down to the view on how much gross profit generation we can do for the year.

<Q - **David H. Lim**>: Understood. And then...

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<A - **Earl J. Hesterberg**>: David, this is Earl and relative to cost and SG&A, we do have a lot of work to do in the UK. I don't think we're happy with our current cost level there. We've grown significantly larger in the last 18 to 24 months and we have a lot of work to do to streamline some of our more recent acquisition. So I think we have a lot of cost work to do in the UK.

<Q - **David H. Lim**>: So piggybacking on UK and I know that you gentlemen talked about this in your prepared remarks. The outperformance is really impressive relative to the industry. Is it a lot of low-hanging fruit there that you're picking on or how should we think about the continuation of that performance going into 2018?

<A - **Earl J. Hesterberg**>: Well I think our brand mix has a lot to do with it David, our Audi businesses and Ford businesses in the UK remained extremely strong even when many other brands were falling and falling dramatically. So that, that is a part of it and some of our more mature businesses also are pretty resilient in the UK and we have some that we've had for up to 10 years now. So I think that's been the primary factor in allowing us to outperform the market in 2017.

<Q - **David H. Lim**>: Understood. And my final question is, when it comes to acquisition, so is it safe to assume that you're targeting more acquisitions in Brazil given maybe some of the industry backdrop in the U.S. and then in the UK? Thank you.

<A - **John C. Rickel**>: David, this is John. I would say that we're pretty open in all three markets. We're opportunistic. We've got the financial resources in all three and we're looking at opportunities in all three markets.

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

Operator

Our next question comes from Jamie Albertine from Consumer Edge. Please go ahead with your question.

<Q - **James J. Albertine**>: Great. Thank you and good morning everybody and congratulations on a great quarter.

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

<Q - **James J. Albertine**>: Could we maybe spend some time on parts and service, just want to unpack a little bit some of the trends you're seeing develop in the fourth quarter and into the early part of the first quarter of this year, if you can? And maybe elaborate a little bit upon or update us on if you can some of the centralization efforts you undertook over the past several years and how you're seeing that play out in terms of customer retention, conversion things of that nature? Thanks.

<A - **Daryl A. Kenningham**>: The trends in the fourth quarter, we saw really good growth in our wholesale parts business. Very pleased with that. Our warranty grew and safety grew as well although not as much but our collision business is also quite healthy. So we saw sort of across the board growth. It wasn't one area that led it.

In terms of some of the centralization area, we continue to try to leverage that with our call center and Business Development Center in Houston. We continue to leverage that, find new ways to leverage that cost across more gross profit opportunities and we don't want to talk specifically yet. Some of them are fairly new but we found that that is – we still have – we feel like we've leveraged at a great deal and it's helped our customer service, customer retention and we see that the retention numbers that we publish. But we also see that there is still more opportunity to grow our business incrementally from that.

<Q - **James J. Albertine**>: Okay. Very good and if I may quickly as a follow-up to a prior question on used. Can you talk a little bit about the fourth quarter trends that you saw and my question would be, would you characterize them as an anomaly, we did see some spike in used car prices and at the same time, incentives to move higher than average new vehicle inventory through post-storm, had a lot of OEMs, I think focused on the new vehicle side at the same time. So just wondering if you would characterize fourth quarter used trends as an anomaly. And if you can maybe give us some color on January or do you see that normalizing in any way shape or form as we kind of forecast into 2018? Thanks.

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<A - Earl J. Hesterberg>: Okay. This is Earl. Yeah, there was a little bit of market distortion in used certainly in the hurricane impact in markets, residuals got strong. We actually brought too many cars into the hurricane impacted market and our observation at the end of the day was the replacement demand was more skewed toward new vehicles as opposed to used than we expected. Maybe that's because of our attracted monthly payments on a relative basis new versus used.

And then we took, we sacrifice some profit to kind of realign that. But even the most recent Manheim reports and such show that the used values are still holding up pretty well across the country even in a month like January which is weak typically. And there is still good supply in the used market. So I would think that the sales opportunities will continue to be pretty strong this year in used, but will have to work hard to maintain margins at about the current level. It will be highly competitive, but it's going to be a good part of the business going forward. And I think that you know it will present an opportunity for us to increase sales.

<Q - James J. Albertine>: Very good. Thanks again and best of luck.

Operator

Our next question comes from Irina Hodakovsky from KeyBanc. Please go ahead with your question.

<Q - Irina Hodakovsky>: Thank you. Good morning, everyone. A couple questions for you around your Texas market. Help us understand the outlook, if you exclude hurricane disruptions and the recovery after that? How did the business perform in December and January relative to the rest of the country?

<A - Earl J. Hesterberg>: Irina, this is Earl. The Texas market does have a lot of improving factors. As I mentioned earlier, I'm not sure we can tell exactly what the current state of the energy markets are yet, until we get to March. But it does seem to be a little bit better than it was a year ago even after hurricane demand, which probably evaporated in late November or early December. But these are such small months and there's a lot of activity in terms of marketing in the end of December, but we can't say for sure that we have any energy-related recovery yet.

For example, Houston did have 45,000 jobs last year, 16,000 in the previous year and zero the year before. So there are more jobs going, but it doesn't appear yet that any of these are really energy related. But there's no doubt that the consumer confidence is picking up at least in the Texas energy markets, even though we haven't seen the hiring yet. So we are optimistic that the base level of sales as we move into 2018 in the Texas energy markets should start to improve a bit.

<Q - Irina Hodakovsky>: Thank you for that. And also in UK, your used volume outperformed substantially especially when you look at how the rest of the industry did, looking at a same-store basis. Again you've been focusing on used volume in UK and you previously mentioned the opportunities, how do you view the outlook going forward into 2018 versus the industry versus the new vehicle market?

<A - Earl J. Hesterberg>: Well, the UK market is really choppy right now and it's all pretty much Brexit related, but every day there is some sensational headline about the Brexit negotiations. Again March is the plate change month in the UK. So we really don't know what we have until we see the March plate change month. I do expect it's going to be weaker until there is clarity on Brexit and I don't expect that clarity to come in the first quarter. But overall, we have a lot of operational opportunity just because we've become fairly large quickly. So we're going to do a lot of work on cost.

The used business is very inflated in the UK because the dynamics of that market are quite different from the U.S. When there's pressure on new vehicle volume in the UK, it gets pushed into the used market. There is a lot of activity with certain brands of self-registrations, increased demo fleets, increased service loan car fleets and you end up with a used car business that is really virtually new cars, low mileage, zero mile cars. And so the dramatic growth you've seen in the used vehicle business, much of that is really substitute new vehicle business.

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 Company Ticker: GPI US
 Date: 2018-02-08
 Event Description: Q4 2017 Earnings Call

Market Cap: 1,565.26
 Current PX: 75.04
 YTD Change(\$): +4.07
 YTD Change(%): +5.735

Bloomberg Estimates - EPS
 Current Quarter: 1.863
 Current Year: 8.452
 Bloomberg Estimates - Sales
 Current Quarter: 2672.200
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<Q - **Irina Hodakovsky**>: Got it. And then the last question around Brazil. Brazil has been showing a lot of signs of improvement, but as you mentioned still politically unstable. What are some of the signs of sustainability for the growth that we're seeing in the fourth quarter as we move further into 2018? And what are some of the signs of instability that you can kind of relate to us as you look at Brazil and your plans for 2018?

<A - **Earl J. Hesterberg**>: There is really only one primary swing factor on how the auto sales are going to go in Brazil this year and that will be the presidential election. Absent that, the market is on a nice recovery trend and that would continue. At this point, the lack of clarity is on who the prime presidential candidates will be and whether they will be business friendly or not.

The current president who replaced the impeached president, Dilma Rousseff, has been very market friendly and very business oriented. The interest rate – the prime interest rate called the SELIC rate dropped again about two days ago to the lowest it's ever been. So right now, we're on a very nice business friendly recovery path. If there is some hope that a market friendly candidate will become the next president this fall.

<Q - **Irina Hodakovsky**>: Understood. Thank you very much.

Operator

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

<Q - **Nicholas Todd Zangler**>: Hey guys, this is Nick Zangler on for Rick. From some competition, we heard some pretty positive comments on the acquisition pipeline, more activity in the last 60 days, in the last six months, better pricing. Do you think the flattening SAAR is beginning to weigh more on these potential sellers? And do you see elevated acquisition activity in 2018 versus 2017?

<A - **Daryl A. Kenningham**>: Well, I do think you can buy as many dealerships as you want right now, there are plenty out there. But history tells us, we are better to be prudent in where we grow, and how we grow. So I would say the opportunities are plentiful, but I think we'll move forward somewhat cautiously.

<Q - **Nicholas Todd Zangler**>: Got you. And then just one tax – or a question on Texas this year. Any chance you could provide a little bit more detail on the cadence of when sales really normalized in maybe that November-December timeframe? And do you expect there to be maybe a lull going into the first quarter or even maybe for the full year in the Texas market just as related to a pull-forward effect from the hurricane?

<A - **Daryl A. Kenningham**>: Well, we still had hurricane replacement demand in early November that was visible to us. It became more difficult to see in the second half of November. There may have been some there, but certainly by the time we got to December, I couldn't see any incremental business from hurricane replacement. As I mentioned earlier, it's just awful hard to tell in these small volume months like January and February what the factors are that are driving the market. But the most important thing is that consumer confidence is improving throughout Texas, and as we know that's the number one factor in auto sales.

<Q - **Nicholas Todd Zangler**>: Great. Thanks, guys.

Operator

[Operator Instructions] Our next question comes from David Whiston from Morningstar. Please go ahead with your question.

<Q - **David Whiston**>: Thanks. Good morning. I guess, I'm still not totally clear on the U.S. How did you keep your new vehicle GPU growing despite it being a tough incentive environment?

<A - **Earl J. Hesterberg**>: Well. It's something we focus on every day is one thing down to the vehicle level. And we also saw some improvements in some brands and that helps us quite a bit, also when our inventory drops that gives us

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more gross profit leverage. That was something that certainly help as well.

<Q - David Whiston>: Okay. And you talked about an efficient cost structure in the UK. Are you able to say at this time, or maybe a few years out where you see margins going there over time?

<A - Earl J. Hesterberg>: Well, I believe the margin story in the UK is more one of supply and demand. In addition to the demand dropping from this Brexit-related uncertainty, there have been several manufacturers who have not reacted quickly enough in reducing production. So we will have to see how that plays out. Several of these OEMs have told us, they are reducing production but that's a number one factor in determining the margins. So I'll have to see how that plays out. There does need to be some adjustments in that regard.

<Q - David Whiston>: And just one more question on pickup trucks, especially for your Texas, Oklahoma customers with Ram doing the new generation, fairly early this year, but also doing the old generation for the whole year, do you see customers maybe going more for value with that old generation or are you getting a lot of buzz about the new truck?

<A - Earl J. Hesterberg>: Well, I think we always see in the truck market a heavy value component. Every time there's a new truck, there's more equipment and more specifications and the price goes up dramatically whether it's a new Ford truck, General Motors truck, Ram truck and you can always see that, that drives increased sales velocity on the previous model. There are so many of these, these truck buyers are very value-sensitive. So we always see that when there's a major model shift.

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

Operator

[Operator Instructions] Our next question comes from David Tamberrino from Goldman Sachs. Please go ahead with your question.

<Q - David Tamberrino>: Great. Thank you and good morning. I wanted to hear what you're seeing from your OEM partners heading into this year, I think we're in year two of probably continued softening demand environment. Are you seeing expectations of market share rising as they're launching new products particularly in the crossover segment? Are you getting incremental levels to support? How is that relationship playing out for 2018?

<A - Earl J. Hesterberg>: Well, I think the biggest problem that continued through most of last year which does seem to be getting better is the rebalancing of cars versus SUVs and trucks within some of our major brands that we deal with. I'm thinking Toyota and BMW in particular. They have done a much better job of getting the model mix more appropriate for the demand in the market. That's one of the things that helped us get our inventories down to such an optimal level at the end of the fourth quarter. Now, we start all over again in a new calendar year, because January and February are slow months. The inventory tends to build, and we have to see how well the sales rate is in March. But that has been a big problem for many OEMs over the last two years is they haven't been able to react quickly to this shift toward truck and SUV and that does seem to be getting better.

<A - Daryl A. Kenningham>: So I think that's true. And you saw evidence in the fourth quarter [Technical Difficulty] (47:42) new products are doing well, the new Camry was launched, and it did great in a segment that theoretically shrinking and the Accord is doing well. So I think these new product still drives incremental volumes.

<Q - David Tamberrino>: That's fairness to have that greater availability. Are you expecting an intensified competition within those segments, call it the crossovers if you will?

<A - Daryl A. Kenningham>: Well, there is more entries today for sure and more offerings and more great offering coming. So – but that segment is also growing like crazy. You know every time we think it's going to grow to 60%, I think the industry was at 64% in January in truck and SUV. So it seems like there is still more room there to grow.

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<Q - David Tamberrino>: Got it. And then from a strategic standpoint, I think you're one of the lone dealers that hasn't really branched off in the standalone used, seen a couple of experiment with that. We've seen one of your competitors announced an agreement working with some of the ride hailers and AD platforms for vehicle maintenance. Is that something that you would consider? And is that in your discussions right now with your OEM partners as potentially supporting from a vehicle maintenance perspective? Is it something that also could come up from a ride-hailing perspective with Ubers in the rest of the world?

<A - Earl J. Hesterberg>: Yeah, I think all of these things are interesting just because there is change going to come to the market. You know we've looked at standalone views quite a bit. I believe, both Asbury and Lithia have tried that and closed some of their operations in the past. I think, AutoNation closed one about a decade or more ago also. So we see that expansion back into that concept. We're certainly studying it to see, who's successful. Thus far, it seems like the only real success has been with those who want to be the bank also, which you know, which is the interesting concept and not one we've considered.

And obviously, there was a lot of people experimenting and dipping their toe into the water on various ride sharing things and fleet servicing and so forth. There really aren't very many barriers to entry into those types of things. If you want investor money, there's a lot of people looking for money. But yeah, we are studying those things and discussing them with our board. So we have the interest, we just don't know exactly how to make a reasonable investment for our shareholders into some of those emerging trends but we're interested.

<Q - David Tamberrino>: Understood, appreciate the insight. Thank you.

Operator

And ladies and gentlemen, at this time, I'm showing no additional questions. I'd like to turn the conference call back over to management for any closing remarks.

Earl J. Hesterberg

Okay. Thanks to 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, that does conclude today's conference call. We do thank you for attending. You may now disconnect your lines.

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