

Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2019-02-05
Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
Current PX: 62.35
YTD Change(\$): +9.63
YTD Change(%): +18.266

Bloomberg Estimates - EPS
Current Quarter: 2.060
Current Year: 9.163
Bloomberg Estimates - Sales
Current Quarter: 2888.333
Current Year: 11597.875

Q4 2018 Earnings Call

Company Participants

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

Other Participants

- John Murphy
- David Tamberrino
- Rick Nelson
- David Whiston
- Mike Ward
- Rajat Gupta

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Group 1 Automotive 2018 Fourth Quarter and Full Year Financial Results Conference Call. Please be advised that this call is being recorded.

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

Peter C. DeLongchamps

Thank you, Denise. 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 Group 1's website.

Before we begin, I'd like to make some brief remarks about forward-looking statements and the use of non-GAAP financial measures. Except for historical information mentioned during the call, statements made by management of Group 1 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.

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

Participating with me today on the call, Earl Hesterberg, our President and Chief Executive Officer; John Rickel, our Senior Vice President and Chief Financial Officer; Daryl Kenningham, our President, U.S. Operations; and Lance Parker, our Vice President and Corporate Controller. Please note that all comparisons in the prepared remarks are of the same prior-year period unless otherwise stated.

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

Earl Julius Hesterberg

Thank you, Pete; and good morning, everyone. 2018 was a year that again presented unique industry, political and macroeconomic challenges for us. Nevertheless, our operating teams managed through these challenges and we were able to grow the topline revenue of our company as well as adjusted earnings per share.

Our U.S. business was subject to very difficult comparisons due to the unprecedented sales pace in our Houston and Beaumont markets subsequent to Hurricane Harvey's 2017 devastation. Houston/Beaumont new vehicle unit sales were down 16% in the fourth quarter this year, following a 23% decline in the third quarter. Despite these difficult comps, our U.S. Operations team delivered positive full year same-store gross profit growth through a continued focus on improving our used vehicle and aftersales business as well as record setting year in F&I.

Our UK business was once again hampered by political turmoil, as the overhang of Brexit has continued to weigh on consumer confidence driving a new vehicle retail market decline of 7%. Additionally, the WLTP legislation that was enacted across the EU in September greatly disrupted our supply chain and had a disproportionately negative impact on our most profitable business, Audi. Despite these significant headwinds, our UK team managed to keep same-store gross profit flat on a constant currency basis.

The Brazilian market had a very contentious presidential election in 2018, and the result appears to bode well for the future of the local auto industry. 2018 new vehicle industry sales increased double digits and current estimates implied that this pace should repeat in 2019. The auto industry is still less than two-thirds of the 3.8 million unit peak reached in 2012 and 2013, but recent trends suggest the local auto sector recovery continues to gain momentum.

Despite all of these [ph] factors (00:04:19), we're proud to announce that for the full year of 2018, Group 1 reported a 10% increase in net income to an all-time record of \$179.6 million and a 15% increase in adjusted earnings per diluted share to an all-time record of \$8.91. Group 1 retailed over 170,000 new and approximately 150,000 used vehicles, delivering record revenue of \$11.6 billion, an increase of 4%.

Turning to our fourth quarter results, I'm pleased to report that Group 1 earned \$43.8 million of adjusted net income for the quarter. This equates to record fourth quarter adjusted EPS of \$2.31 per diluted share, an increase of 10% over a very tough comparison from the prior year. As previously mentioned, our 2018 fourth quarter's Houston/Beaumont new vehicle unit sales were down 16% from 2017, which distorts our current U.S. same-store results.

Also our GAAP net income and EPS numbers are greatly distorted on a year-over-year basis due to the revaluation of U.S. deferred tax liabilities in the fourth quarter of 2017, associated with the new tax law passed last year. Also impacting the quarter was a fair decline in UK new vehicle unit sales due to a continuing shortage of 2019 [indiscernible] (00:05:44) as the brand works to recover from the new WLTP legislation.

Our fourth quarter same-store UK new vehicle unit sales declined 16% from the prior year, with a 48% decrease in our Audi sales driving that decline. This decrease was consistent with Audi's performance across the UK industry in total. We expect most of these sales to be recovered over the course of the next two quarters.

We were able to mitigate the financial pressure from significantly lower U.S. and UK new vehicle sales volume with solid used car and F&I performances across the company and aggressive cost reduction efforts in all of our markets. Further offsetting these headwinds there's a significant reduction in our outstanding share count. For the full year, we repurchased over 2.8 million shares which represents 14% of our beginning 2018 common share count.

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

Turning to our business segments, during the quarter we've retailed over 42,000 new vehicles. So our consolidated new vehicle revenues decreased 4% on a constant currency basis, driven by a 6% decrease in unit sales related to Hurricane Harvey comps and UK emissions legislation mentioned earlier. Our new unit sales geographic mix was 75% U.S., 19% UK and 6% Brazil. Our new vehicle brand mix was led by Toyota/Lexus sales, which accounted for 26% of our new units. BMW/MINI represented 12%, VW/Audi and Honda/Acura both represented 11%, and Ford represented 10% of our new unit sales.

During the quarter, we've retailed over 36,000 used retail units driven by strong performances in both the U.S. and UK. Total consolidated used vehicle revenues grew 8% on a constant currency basis, as we sold 6% more units with the average used vehicle selling price increasing 2%. Total used vehicle gross profit increased 9% on a constant currency basis, as the unit increased combined with total used vehicle gross profit per unit increase of 3%. The used volume and per unit margin increase were the result of our corporate-wide focus in this area of our business, and especially our Val-U-Line initiative in the U.S.

Total consolidated aftersales revenue increased 4% on a constant currency basis, driven by increases in customer pay of 7%, wholesale parts of 5%, and warranty of 3%, partially offset by a 4% decline in collision. Adjusted finance and insurance gross profit increased 8% on a consolidated constant currency basis. This growth was driven by increases in retail units of 2% and F&I per retail unit of 6%.

Regarding our geographic segment results, I'd like to turn the call over to Daryl Kenningham, President of U.S. Operations, to discuss our U.S. quarterly results before I cover the UK and Brazil. Daryl?

Daryl A. Kenningham

Thank you, Earl. We were generally pleased with our performance in the U.S. in the fourth quarter, despite very difficult comps versus the year ago. As Earl mentioned, Hurricane Harvey significantly distorted our year-over-year operating metrics. Despite a 10% decline in same-store new vehicle gross profit from the prior year, we were able to generate a slight increase in total gross profit because of very strong performance in our used and F&I business segments.

On a year-over-year same-store basis, I'm particularly proud of the fact that we continue to generate strong growth in used retail unit sales, where we saw 11% improvement. Val-U-Line retail unit sales generated over 10% of our quarterly used volume during the quarter, which coupled with significantly improved wholesale results through the primary drivers in our same-store used vehicle gross profit growth. The wholesale improvement reflected lower reliance on the used vehicle wholesale markets. Our volumes declined 18%, but our total wholesale profitability improved. In addition to the 11% same-store retail sales increase, we increased our total used vehicle gross profit per unit by \$42.

Moving forward, our intention is to continue to focus on keeping more units for retail. Additionally, we are piloting new pricing models that we believe will improve our gross profit opportunities and optimize our customer traffic. Our quarterly aftersales business grew 2.1% on a same-store basis. The results were negatively impacted by a 2% decline in warranty revenues, which can be primarily explained by the lapping of Takata airbag recall campaigns and a 5% decline in collision revenues, which were up against a tough comp due to Hurricane Harvey.

Wholesale parts revenue increased 4% and customer pay service generated a strong 6% increase on a same-store basis. We are especially pleased with the customer pay growth at the 57 stores where our four-day work week was fully implemented for the entire quarter. On a same-store basis, we increased [indiscernible] (00:11:21) head count by 12% in those stores and service advisor head count by 21%. This additional staffing has allowed us to add significant capacity without any additional capital investment, and it's resulted in customer pay service growth that is double our other locations.

Looking forward to 2019, now that we have a very tough warranty comps behind us, we would expect aftersales growth to return closer to mid-single digit range. F&I income for retail unit for the quarter was a record \$1,760 and for

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

the full year was \$1,705, this despite headwinds from our Val-U-Line initiative and rising interest rates. And our digital efforts continue to show great progress. Our goal is to do business when and how our customers want to do business with us.

Toward that end, we have completed the pilot phase of our digital retailing initiative and we couldn't be happier with the results. Our closing rates were outstanding, the front and back gross profit levels were better than expected, and the customer feedback has been excellent. We've now started a nationwide rollout and expect digital retailing capability to be in all of our U.S. source before the end of the second quarter.

In addition, customer scheduling service appointments online grew 23% versus the fourth quarter of 2017, and now over 25% of our service appointments are made online. And in 2018, we're able to dramatically increase the efficiency of our marketing spend as we drove a 43% increase in our [ph] old (00:13:09) branded customer traffic. Organic web traffic is much more productive than traffic generated through third-party websites. All of these digital initiatives lower our costs and make it easier for our customers to do business with us.

And lastly, although SG&A de-levered from 69.0% to 70.3% on a same-store basis for the quarter, we were up against very tough Harvey comps. Our second half 2018 adjusted SG&A was 71.0%, a sharp decline over the first half adjusted SG&A of 72.8%, which represents the intense focus we placed on controlling costs after a slow start to the year.

I will now turn the call back over to Earl.

Earl Julius Hesterberg

Thanks, Daryl. As mentioned earlier, our UK operations have once again significantly disrupted in the quarter due to the WLTP legislation that came into effect on September 1. The total industry was down 4% for the quarter for the Audi brand in the UK was disproportionately affected with a 46% decline.

In the areas that we can control used vehicles, aftersales and F&I, our team once again delivered strong same-store growth. Our used retail unit sales increased 10% and total used gross profit increased 5% on a constant currency basis. F&I per unit increased 7% and aftersales gross profit increased 3%, both on a constant currency basis.

Now turning to Brazil, which had another very strong quarter as we continue to benefit from the ongoing economic recovery, coupled with our process improvements and strong cost control. Total same-store gross profit increased 11% on a constant currency basis, driven by a 44% increase in F&I, a 12% increase in new vehicles and a 5% increase in aftersales.

Our team did a tremendous job leveraging this additional gross profit as SG&A declined 570 basis points to 83.4% and operating margin increased 70 basis points to 1.7%. We continued to be very proud of the work our local team has done and are well-positioned to take full advantage of the recovering market.

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

John C. Rickel

Thank you, Earl, and good morning, everyone. Before I cover my prepared remarks, I want to take just a moment and address some fusion around our earnings consensus that's arisen this morning.

As of 10:30 P.M. Central Standard Time last night, the consensus in Bloomberg and in FactSet was basically \$2.29 per share. Sometime over the overnight hours, a new estimate was entered into the system from our Morgan Stanley analyst, who increased his quarterly estimate from \$2.25 to \$2.58, an almost 15% increase in expected earnings. I would note there was no covering note that went with this increase, so I could not be able to address what changed his expectations.

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

If you look now in FactSet it still reflects \$2.29, which we believe is the more appropriate estimate. Bloomberg, however, has picked up this inflated estimate that came out late and it's now reflecting a higher number. We would respectfully suggest to our covering analysts and to our investors that the appropriate thing to do is to ignore that higher estimate that came in late and continue to reflect what is in FactSet at \$2.29 as our agreed consensus for the quarter.

With that, for the fourth quarter of 2018, our adjusted net income decreased \$0.5 million or 1.1% over our comparable 2017 results to \$43.8 million. These 2018 adjusted quarterly results exclude \$13.1 million of net charges, primarily consisting of \$12.7 million of non-cash franchise rights impairment arising from our annual intangible asset testing.

The prior year's adjusted result excludes \$66.2 million of net after-tax gains primarily related to reduction in the corporate income tax rate enacted in the U.S. tax reform bill. This lower tax rate reduced our deferred income tax liabilities by approximately \$73 million. This benefit was partially offset by net non-cash asset impairment charges of approximately \$6.5 million.

On a fully diluted per share basis, adjusted earnings increased 9.5% to \$2.31, a fourth quarter record. For the quarter, we generated \$2.9 billion in total revenues, which was a slight decrease from the prior year with headwinds due to Hurricane Harvey comps, the impact of the WLTP legislation on new vehicle sales in the UK, and the impact of exchange rates.

Our gross profit increased 1.2% however, as gross margin increased 20 basis points to 14.8%. As a percent of gross profit, adjusted SG&A increased 220 basis points to 74.8% [indiscernible] (00:18:42) the above-average gross profit generated by strong Hurricane Harvey replacement demand significantly contributed to a very difficult SG&A comp.

Floorplan interest expense increased by \$2.8 million or 21% from the prior year to \$16.5 million, reflecting higher LIBOR interest rates versus the fourth quarter of last year. Other interest expense was basically flat. Our consolidated adjusted effective tax rate for the fourth quarter was 22.7% and for the full year was 23.4%. We forecast our full year 2019 tax rate to be between 23% and 23.5%.

Turning to our consolidated liquidity and capital structure. As of December 31, we had \$15.9 million of cash on hand and another \$33.7 million that was invested in our floorplan offset account, bringing immediately available funds to the total of \$49.6 million. Additionally, there is \$277 million of available capacity under our U.S. acquisition line.

For the year 2018, adjusted operating cash flow was \$309 million. During the fourth quarter, we've repurchased 1.3 million shares at an average price of \$57.31 for a total of \$75.3 million. We have \$49.7 million of repurchase authorization remaining. As Earl stated, for the full year we've repurchased over 2.8 million shares at an average price of \$63.75 for a total of \$181.7 million. These repurchases totaled 14% of our beginning of the year share float.

Our outstanding common share count as of today is 17.7 million shares. Also during the fourth quarter, we used \$4.8 million to pay dividends of \$0.26 per share, an increase of 4% per share over the fourth quarter a year ago and an annualized yield of approximately 1.7%. 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.

I'll now turn the call back over to Earl.

Earl Julius Hesterberg

Thanks, John. Related to our corporate development efforts, the company is pleased to announce the opening of four OEM granted add points. In November, in the U.S., a new Acura dealership was opened in Sugar Land, Texas, a suburb of Houston, which increases our total Houston area dealership count to 17. Also in November, in Brazil, we opened a Toyota add point in the city of São Paulo adjacent to our highest volume Honda dealership which increases our Brazil dealership count to 18.

In December, in the UK, we opened a Skoda add point in Southend, North of London, using a facility that our Land Rover franchise recently vacated. And finally in January, in the U.S., we opened a Porsche dealership in El Paso, which

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

brings our total dealership count in that market to 6. These acquisitions brought our total 2018 acquisition activity to 17 franchises, generating \$615 million of the annual revenues; and our year-to-date 2019 acquisition activity to 1 franchise, generating \$25 million in annual revenues.

Since our last earnings call, we have also disposed of a Hyundai franchise in Kansas City and a Mazda franchise in Houston, as well as terminated a Vauxhall franchise in the UK and a Volvo franchise in Georgia. In total, these four franchises generated \$65 million in trailing 12-month revenue. These dispositions are consistent with our strategy of disposing of underperforming assets and redeploying capital in ways that are beneficial to our shareholders.

Finally, before I turn the call over to the operator for your questions, let me update our market outlook for 2019. For the U.S., we expect to see a slight pullback in the overall new vehicle industry. Total new vehicle sales in 2018 came in at 17.3 million units, a slight increase over 2017. We're anticipating a 2% decline in 2019 to around 17 million units.

For the UK, the new vehicle industry declined 7% in 2018 from 2.5 million unit sales in 2017, down to less than 2.4 million units. We expect the market to continue on the same path in 2019 with another 5% to 10% decline, which would equate the industry sales of around 2.2 million units. 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, the market improved more than we had anticipated at the beginning of the year. Industry unit sales increased from 2.2 million to 2.5 million units, a gain of nearly 14%. Given the positive signals we're seeing in the economy, we expect this trend to continue with an increase of another 10% or so to around 2.75 million units. This concludes our prepared remarks.

I'll now turn the call over to the operator to begin the question-and-answer session. Operator?

Q&A

Operator

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

<Q - John Murphy>: Good morning, guys, and thanks for the detail. Just a first question around WLTP and sort of the bounce back that you're expecting sort of here in the near term, Earl, just based on your comments. You seem to think that you'll be able to catch up some of the lost demand, particularly your Audi dealerships. I'm just curious what gives you that confidence. Do you have sort of a backlog of orders in folks that are waiting, where we'll see kind of a little bit of a boost early in 2019 as VW gets through these issues?

<A - Earl Julius Hesterberg>: Well, we don't really have a big backlog just because we didn't have cars to show to people. But this is the time year where you're starting to build an order bank for March, the plate-change month. So, that's just beginning. But I would say, I got my first level of confidence today. I saw January UK data and Audi retail sales, just retail – private retail, only dropped 14% and they've been dropping more than 40% each of the previous three or four months.

So, it looks like things are starting to normalize. I don't think we have enough time to catch up through March, but I would certainly think by the mid-year point we should be okay. And what we do find is demand for the Audi brand is continuously strong. It's a very powerful brand in the UK. Their business is very retail-driven, not fleet-driven. So, we're starting to gain confidence by mid-year things will be back to normal.

<Q - John Murphy>: But would it be fair to say, there is a little bit of pent-up demand and that some of those consumers kind of held off. Is that...

<A - Earl Julius Hesterberg>: Yeah, sure. Sure. Yeah. Yeah, no doubt. No doubt.

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

<Q - John Murphy>: Okay. And then just a second question. With the slight pressure we're seeing on a dollar basis on new vehicle grosses in the U.S., you guys have done a great job of offsetting that with continuing to press F&I PVR. I'm just curious how long do you think that sort of dynamic can go? And really simplistically, do you see more pressure on new vehicle grosses in upside in F&I PVR?

Or are we kind of reaching – and I ask this question all the time and I apologize, but I mean you keep beating us, on the F&I PVR side, I mean is that something at some point you stop giving up the new vehicle gross because you just can't get a whole lot more F&I PVR and we see it sort of correspond or sort of result in lower volumes. I'm just trying to understand that dynamic and how far you can press it and how much the automakers are pressing on these grosses as well?

<A - Peter C. DeLongchamps>: So John, it's Pete DeLongchamps. Certainly, we never intentionally work on giving up gross, but the margin pressure continues. We've performed in F&I in all three countries and I think that the dealerships remain resilient in their pricing models. Daryl mentioned some of the initiatives we have in place, especially on the used front. But we think that we can continue to hold kind of where we are at the margins, but there is continued pressure on the front-end.

<A - Daryl A. Kenningham>: Yeah. John, Daryl Kenningham. Nothing I would add about the F&I comments that Pete made. The front-end margins are a continual focus for us. It's a continual focus for the OEMs. They seem to be as interested in it as well. And so, we don't trade one for the other ever; we try to get as much as we can on both.

<A - John C. Rickel>: John, this is John Rickel. Let me also add to kind of build there on Daryl's point. If you look other than kind of the fourth quarter this year when we were up against some pretty tough comps from the pretty robust demand that happened after Hurricane Harvey, our front margins have actually been pretty stable for two-plus years. Daryl and the operating team have been focused on this.

And unlike a lot of the others in the sector, I don't think we get the credit that we should for the ability that the guys have done on holding margin. I'm looking at the numbers in front of me and they haven't dropped by more than kind of \$50 over a two-year period. So the operating team is actually doing a really good job of managing the front margin, and then what we're able to deliver on the F&I is actually been able to grow the overall margins for us.

<Q - John Murphy>: Okay. That's helpful. And then just on Val-U-Line real quick, I mean it sounds like that is going gangbusters for you out of the gate very quickly in the last couple of quarters. Are there any kind of lessons learned there or any more opportunities on the used side, as you're seeing something like this just have such great success so early on in the process?

<A - Daryl A. Kenningham>: We're pleased with Val-U-Line. We think around 10% of the mix is where the right level for us. We're always wanting to make sure it's incremental, that it's not substitutional. That's a continual focus for us. John, we're doing some other things that are – it's kind of early right now, but surprising that we started testing some things late in the fourth quarter and early in the first quarter that we may have [indiscernible] (00:29:43) later on. But for now we're continually testing things like Val-U-Line and like additional internal auction capabilities and things like that. So short answer is, yes, we continue to want to push some of those kind of initiatives.

<Q - John Murphy>: Okay. And then just lastly real quickly on the digital efforts. It sounds like one of the big benefits is, it's much more efficient and lower-cost advertising. My rough rule of thumb as I think about advertising, it's above 15% of SG&A that might be a gated thought. I'm just curious, Daryl, if you would sort of underwrite that kind of rough guesstimate. And as you get more efficient with this digital advertising, I mean where could that number maybe go over time, specifically in the U.S.?

<A - Daryl A. Kenningham>: I don't have a guess on where we'd go over time, John. We are continually though trying to make our traffic more productive. It's not always a matter of just driving more traffic; it's a matter of driving productive traffic. And that's what the organic shift allowed us to do in 2018 and we're continuing to do that with a lot of the digital efforts in 2019, including digital retail in which we've been very happy with.

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

<Q - **John Murphy**>: I'm sorry. Just one follow up. Does that mean that the market reach on that dollar spend and your efforts is further than it traditionally has been, meaning you're impacting a larger metro or market area?

<A - **Daryl A. Kenningham**>: I think we're getting, yes, better reach on it. Yes.

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

Operator

The next question will be from David Tamberrino of Goldman Sachs. Please go ahead.

<Q - **David Tamberrino**>: Great. Good morning, gentlemen. There were just a lot of questions from the previous analysts, but I think I still have a few more. On the parts and service side, you get about 100 basis points of margin pressure year-over-year. I don't know if you addressed in your prepared remarks if that's just from a mix shift or there's some incremental labor costs related to your capacity increases like higher labor rates you need to pay. Maybe just walk me through that and if that should improve?

<A - **Daryl A. Kenningham**>: You hit it on the head there. We've brought on a number of additional technicians. Our technician count's up double digits percentage wise year-over-year and that cost is in the cost of sales and lowers the margin effectively. So, our focus is on driving margin and revenue across that capacity base now.

<Q - **David Tamberrino**>: Okay. So then...

<A - **Daryl A. Kenningham**>: [indiscernible] (00:32:20) technician head count, we feel like we made a lot of [ph] headroom with that in (00:32:24) 2018.

<A - **John C. Rickel**>: Yeah. David, this is John Rickel. I'd add to that. We think it is temporary, right. You bring them on they're not as productive in the initial phase, but as the volumes grow, that margin should return back to those more normalized levels.

<Q - **David Tamberrino**>: Yeah. Got it. So [indiscernible] (00:32:42) 47 stores, so maybe about half of your footprint right now [ph] sort of (00:32:49) progressed throughout the year, you'll staff up and then we should start to see that growth be a little bit more profitable as you start exiting 2019?

<A - **Daryl A. Kenningham**>: Yeah. And just to be clear, we won't put four-day work week in all of our stores; some of them are too small. But we will have it in over 80% of the revenue that's represented in the parts and service.

<Q - **David Tamberrino**>: Got it. Okay. And then I do want to follow up on it, because there was a – it's an interesting question for the spend associated with the digital initiatives and trying to understand what type of returns you're targeting getting out of that. Is there any rule of thumb you can share with us on dollars spent on third-party leads versus what you think it's going to be per GPI-driven digital initiated leads? And how that's going to accrue over time, as you make that shift and bring in a different customer or to have a different lead generation for the customer?

<A - **Daryl A. Kenningham**>: I can't say we have a target per se. I can tell you that what we have found is that, when can drive traffic organically it's more productive [indiscernible] (00:33:56) to do it. Now, at some point that dynamic might change, but that's what we see today and that's how we'll continue to [ph] progress. (00:34:03)

<Q - **David Tamberrino**>: Okay. And then the last question from me definitively is, you still been active in the M&A market. What are you seeing from the smaller dealers and what are they looking to do? How are they addressing some of the headwinds that are happening in the industry as you are – again, you're moving towards more digital, adding more [ph] service in that (00:34:23) capacity. Is this something that they're able to do? And if not, is that going to present more opportunities for you to add and then make more acquisitions going forward?

<A - **Earl Julius Hesterberg**>: Yeah. This is Earl. I think the biggest headwind for small dealers right now is probably similar to the one we have and that's increased floorplan cost, interest rate. We're artificially low for a long time. I think also when times get a little tougher and the market growth goes away, scale has a little more benefit.

Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2019-02-05
Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
Current PX: 62.35
YTD Change(\$): +9.63
YTD Change(%): +18.266

Bloomberg Estimates - EPS
Current Quarter: 2.060
Current Year: 9.163
Bloomberg Estimates - Sales
Current Quarter: 2888.333
Current Year: 11597.875

So, I also think there's a lot of unease in smaller dealerships about emerging trends like electric vehicles and so forth. So, there – I know for a fact there are many more smaller dealerships that are considering selling. Right now the math doesn't work well for companies like ours, at least for large or high-quality acquisitions just because of the reduced valuations of all the companies in our sector. But there will be more and more dealerships for sale I think continuously over time.

<Q - David Tamberrino>: Okay. Thank you, all.

Operator

The next question will be from Rick Nelson of Stephens. Please go ahead.

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

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

<Q - Rick Nelson>: [indiscernible] (00:35:54) your comments on the Texas market, how are you thinking about that in 2019 that we fully lapped now this hurricane replacement demand?

<A - John C. Rickel>: Yeah. Rick, this is John Rickel. On that front, yes. The tough comps from that are behind us. So, that's cleaned all that Daryl kind of addressed the overall demand environment, but the comps at least are now leveled out.

<A - Daryl A. Kenningham>: Yeah. We feel good about Texas. And after the spike in Q4 2017 due to Harvey, we feel like we're back in a more normal sales rate, but generally we feel good about the market itself.

<Q - Rick Nelson>: Thanks for that. And Earl, you had mentioned you have lots of electric product coming down the pipeline. And I'd like to get your thoughts on how you think that will impact parts and service and...

<A - Earl Julius Hesterberg>: Well, there is no doubt that electric vehicles will have less service potential per unit. But it seems to be quite a long way off before they are a meaningful part of the units in operation. But it also seems that the amount of maintenance are required in terms of software updates and electrical diagnosis and so forth. Motor repairs and – drive motor repairs and things like that are still to be determined. It seems like it will be a bigger issue in Europe and the UK long before it is here.

We're looking forward to getting some experience with the Audi e-tron, which I think will be our first interesting experience in one of our primary brands. We have reasonable number of orders for that, and they should be fulfilled starting in April or May. So as we get experience, we'll be able to tell you more. But just functionally the way the parts rack out; moving parts, they will be less per unit. But I don't see that being any material impact on our business for a long, long time.

<Q - Rick Nelson>: And eventually, I guess those batteries get replaced and I would take that [indiscernible] (00:38:12) a big ticket.

<A - Earl Julius Hesterberg>: Yeah, yeah. And we don't understand that dynamic yet. There's a lot of discussion right now in the winter in the northern U.S. and throughout Europe about the range impact of cold weather on some of these batteries. So, we're all going to learn together, I think, as the take rate for these vehicles increases.

<Q - Rick Nelson>: Thanks for that. I also would like to get the early learnings with this pilot online purchase saying exactly what that [indiscernible] (00:38:52) including F&I, and maybe some of the opportunities or headwinds you see there?

<A - Daryl A. Kenningham>: This is Daryl, Rick. We tested three different models. One of them included F&I, two of them did not. Before the end of this year, we expect F&I will be incorporated in all of them. We were encouraged by the F&I results, both online and offline, of those customers who've started their process online. And it was in line with

Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2019-02-05
Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
Current PX: 62.35
YTD Change(\$): +9.63
YTD Change(%): +18.266

Bloomberg Estimates - EPS
Current Quarter: 2.060
Current Year: 9.163
Bloomberg Estimates - Sales
Current Quarter: 2888.333
Current Year: 11597.875

what we see on just terrestrial purchases. So, that was the learning for us.

Also these customers that once they start this process online, they tend to buy a car at about double the rate [ph] that another customer that places an inquiry with us (00:39:47). So, those are both things that we were extremely encouraged by and quite honestly surprised by. So, we're comfortable enough. We're going to roll it out to the rest of the country and we're excited about that.

<Q - Rick Nelson>: And has this include home delivery as well?

<A - Daryl A. Kenningham>: We offer that. Yes, we do.

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

<A - Daryl A. Kenningham>: Thank you.

<A - Earl Julius Hesterberg>: Thanks.

Operator

[Operator Instructions] The next question will be from David Whiston of Morningstar. Please go ahead.

<Q - David Whiston>: Thanks. Good morning. In the U.S. your used vehicle GPU was down over 10%, but volume was up about 13%. So can you just talk about is that mostly a Val-U-Line impact or are you overly discounting trying to get more volume right now?

<A - Daryl A. Kenningham>: Daryl Kenningham. Some of it is Val-U-Line impact, some of it is volume. When we sell something, we also generate internal gross profit in our aftersales department, in F&I [indiscernible] (00:41:02) as well. So, we didn't purposely discount or give up margin, but we're focused on trying to drive volume. John, I think that's [indiscernible] (00:41:11)

<A - John C. Rickel>: Yeah. David, this is John Rickel. The other thing I would point out is, what we really look at is total used profitability. And if you look at total used, we actually were up on a same-store basis in the quarter in the U.S. And that's basically as we're redeploying units from wholesale to retail, which is a key part of the Val-U-Line strategy. We're basically minimizing wholesale losses actually generated some wholesale gains. And so, the overall profitability of the used business was up \$36 a unit in the quarter.

<Q - David Whiston>: Okay. That's helpful. Thanks. Also on – going back to electrification, there was a lot of talk at the end of the year with Rivian and their truck at the LA Auto Show and now you got Ford doing a pure electric F-Series at some point and [ph] Tassel too (00:41:59). Do you think mid-size and full-size pickup truck customers really want a pure electric pickup? Or is it something you think will just remain more in the domain for someone who really want to spend a lot of money for something just very unique.

<A - Earl Julius Hesterberg>: We haven't heard any customer demand [ph] express to our share (00:42:21) and we're pretty dominated in Texas and Oklahoma. But I think the OEMs are just trying to cover their bases at this point. And there could be a change in the cost of fossil fuels or tax breaks could be greater or something. So, it seems to me all the OEMs are just trying to cover their bases so they can react to any changes in market preference or taxation or whatever. But no, we don't have anybody knocking the doors down yet. But yeah, the dealer network and the OEMs we have to be ready for change, so we'll adapt as it goes.

<Q - David Whiston>: Okay. Thanks.

Operator

The next question will be from Michael Ward of Williams Trading. Please go ahead.

Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2019-02-05
Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
Current PX: 62.35
YTD Change(\$): +9.63
YTD Change(%): +18.266

Bloomberg Estimates - EPS
Current Quarter: 2.060
Current Year: 9.163
Bloomberg Estimates - Sales
Current Quarter: 2888.333
Current Year: 11597.875

<Q - **Mike Ward**>: Thank you. Good morning, everyone.

<A - **Earl Julius Hesterberg**>: Good morning, Mike.

<Q - **Mike Ward**>: Two things. It looks like in the U.S. your new vehicle truck mix is about equal with the overall market. Now, trucks sell for more than cars. Do you see a corresponding increase in F&I, and auto service and repair in trucks versus cars?

<A - **Daryl A. Kenningham**>: Well, [ph] the finance carry (00:43:35) is heavier on trucks just for the reason you mentioned. And so, they provide a little more opportunity. Pete, might add...

<A - **John C. Rickel**>: And on the F&I side, Mike, we do have higher penetration of vehicle service contracts and maintenance contracts on trucks.

<Q - **Mike Ward**>: A higher penetration in trucks versus cars?

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

<Q - **Mike Ward**>: Okay. And then now just going back to the digital, I just want to make sure I understand it. So you have three different components where you're working on the digital. You have the retailing side of it, which includes some of the advertising and then you have the service side. Now, is all of the service nationally going through the service center there in Houston? And then lastly, I think the third part is on the used vehicle side. Is that correct?

<A - **Daryl A. Kenningham**>: If I understand your – this is Daryl. If I understand your question correctly, let me break it up a little bit. On our digital retailing which is where we want to offer our customer an opportunity to purchase the vehicle online, we had a pilot going with a little less than 30 dealerships and we use three different providers to enable that.

<Q - **Mike Ward**>: Okay.

<A - **Daryl A. Kenningham**>: Some of that is OEM mandated, some of that is based on the direction we want to go.

<Q - **Mike Ward**>: And that's for both new and used?

<A - **Daryl A. Kenningham**>: Yes, sir.

<Q - **Mike Ward**>: Okay.

<A - **Daryl A. Kenningham**>: On service, yes, our service development center in Houston does take all of our in-bound phone calls for service appointments and service departments. That happens. We also have enabled our website, including mobile, to take service appointments. And 25% of our service appointments today that are taken are taken online from a customer. Those calls don't come into our service development center in Houston. Does that answer your question?

<Q - **Mike Ward**>: Yeah. And I thought you said something in your prepared remarks that you said, by the second quarter all stores would be active. Was that on the service side?

<A - **Daryl A. Kenningham**>: No, sir. That was on the new and used vehicle purchases. We're taking this pilot that we did with 28 dealerships, and we're now going to roll that out to all 117 of our dealerships in the U.S. It's on new news. The service side is in all the stores today.

<Q - **Mike Ward**>: It's already there. Okay. Beautiful. Thank you.

Operator

The next question will be from Rajat Gupta of JPMorgan. Please go ahead.

Company Name: Group 1 Automotive
 Company Ticker: GPI US
 Date: 2019-02-05
 Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
 Current PX: 62.35
 YTD Change(\$): +9.63
 YTD Change(%): +18.266

Bloomberg Estimates - EPS
 Current Quarter: 2.060
 Current Year: 9.163
 Bloomberg Estimates - Sales
 Current Quarter: 2888.333
 Current Year: 11597.875

<Q - Rajat Gupta>: Hey, guys. Thanks for taking my question. I just had a question on the 2019 SG&A leverage that you see, particularly the context of used GPU pressure in the U.S., and then you're also making some investments on the parts and services side to increase capacity. I mean, do you think you can grow the adjusted SG&A to GPU in 2019? Or I mean how should we think about the trajectory there going forward? And I had a follow-up.

<A - John C. Rickel>: Yeah. This is John Rickel. In general, we're comfortable with the view that as long as we continue to grow gross profit dollars, we should be able to leverage those and the normal flow-through is kind of 40% to 50%. So yeah, given that we anticipate even with kind of a flattish [indiscernible] (00:46:45) environment that the initiatives on parts and service on used and on F&I, should allow us to continue to grow our gross profit dollars. Yes, we would expect to be able to leverage our SG&A as a percent of growth as we go forward this year.

<Q - Rajat Gupta>: Great. Thanks for clarifying that. And then based on the capital allocation strategy going forward, I mean should we expect 2019 to be somewhat of the similar year in terms of the way you've mixed your capital allocation? Or is there anything different we could expect at least, particularly in terms of M&A. Thanks.

<A - Earl Julius Hesterberg>: Yeah. This is Earl. Obviously, that's a dynamic situation. But as we sit here today, I don't think the priorities have changed dramatically. We still believe our stock price is undervalued. And if there is nice accretion to share repurchases and we have about \$15 million left, a little less than that on the board authorization, we're interested to keep growing the company in terms of brands and geographies that we can leverage our existing strengths.

But it's just awful hard to make the math work right now and not destroy capital on really high-quality acquisitions of some of the top brands in some of the top markets. Possible that sellers will get a little more realistic and we can find some of that work we're certainly looking for that, but it does seem that our best accretion at this point in time still looks like share repurchases.

<Q - Rajat Gupta>: Understood. Great. That's all I have. Thanks.

<A - Earl Julius Hesterberg>: Thank you.

Operator

And ladies and gentlemen, this will conclude our question-and-answer session. I would like to turn the conference back over to Earl Hesterberg, for his closing comments.

Earl Julius Hesterberg

Okay. Well, thanks to everyone for joining us today. We look forward to listening with you in about three months for our first quarter results.

Operator

Thank you, sir. Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. At this time you may disconnect your lines.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities

Company Name: Group 1 Automotive
Company Ticker: GPI US
Date: 2019-02-05
Event Description: Q4 2018 Earnings Call

Market Cap: 1,195.52
Current PX: 62.35
YTD Change(\$): +9.63
YTD Change(%): +18.266

Bloomberg Estimates - EPS
Current Quarter: 2.060
Current Year: 9.163
Bloomberg Estimates - Sales
Current Quarter: 2888.333
Current Year: 11597.875

or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP.

© COPYRIGHT 2019, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.