Q4 2019 Earnings Call

Company Participants

- Peter C. DeLongchamps, Senior Vice President, Manufacturer Relations, Financial Services and Public Affairs
- Earl J. Hesterberg, President and Chief Executive Officer
- Daryl Kenningham, President, U.S. Operations
- John C. Rickel, Senior Vice President and Chief Financial Officer

Other Participants

- Yarden Amsalem
- Rajat Gupta
- Armintas Sinkevicius
- N. Richard Nelson

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Group 1 Automotive's 2019 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's Senior Vice President of Manufacturer Relations, Financial Services and Public Affairs. Please go ahead, Mr.DeLongchamps.

Peter C. DeLongchamps, Senior Vice President, Manufacturer Relations, Financial Services and Public Affairs

Thank you, Chad, and good morning everyone and welcome to today's call. The earnings release we issued this morning and a related slide presentation that includes reconciliations related to the adjusted results that 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 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 on both the SEC and the company.

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

Participating today 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 of U.S. Operations and Brazilian Operations; and Michael Welch, our Vice President and Corporate Controller. Please note that all the comparisons in the prepared remarks are of the same prior period, unless otherwise stated.

I'd now hand the call over to Earl.

Earl J. Hesterberg, President and Chief Executive Officer

Thank you, Pete. And good morning, everyone. 2019 was a record year for Group 1 Automotive. Despite a new vehicle industry in both of our key markets, we were able to achieve record adjusted net income of $203.6 million and record adjusted earnings per share of $10.93 per share. By concentrating on areas of the business where we exert greater control, used vehicles, parts and service, F&I and cost.

Our adjusted net income number represented 13.4% increased and our adjusted earnings per share performance of 22.7% increase over last year. This strong performance was driven by our U.S. operations. On a full year same-store basis we grew used retail unit sales by 8.4% and after sales gross profit by 9.5%, two remarkable numbers. Along with a 4% increase in F&I penetration, this drove an overall increase of 8% in total same-store gross profit. At the same time, we maintain good cost discipline in the U.S.. As evidenced by our 70 basis point decline and adjusted same-store SG&A as a percent of gross profit.

Our powerful U.S. performance was able to overcome the serious challenges presented by Brexit uncertainty in the UK market last year. New and used vehicle margin declines of approximately 15% in the U.K. last year were the result of weak overall demand in the market and excess supply. We also suffered from supply shortages of key models in our biggest business Audi due to the latest round of new vehicle emissions regulations impacting new OEM supply chain.

However, we're optimistic about the U.K. market in 2020 as the new and used margin declines improved to approximately 4% in the fourth quarter. The Audi supply chain issues are mostly resolved and we've seen more foot traffic in many of our stores following the December 12 General election. We're also optimistic that our 2019 cost cutting efforts will pay benefits in 2020.

In Brazil, the auto market continued to recover in 2019. We were able to increase same-store used vehicle gross profit by 17% and after sales gross profit by 8.2% in local currency for the full-year. This is evidence of continuing maturation of this business. Daryl will provide some more detail on both our U.S. and Brazilian performances shortly.

Looking at the full-year end total, we sold approximately 170,000 new vehicles and 160,000 used vehicles, which drove record revenues of $12 billion. We were also able to expand our overall gross margin, while further reducing SG&A as a percent of gross profit which was the key to achieving the record adjusted earnings per share of $10.93 which I mentioned earlier.

Turning to our fourth quarter results. During the quarter we retailed over 43,000 new vehicles. Total consolidated new vehicle revenues increased 7% on a constant currency basis. Driven by 4% increase in average selling price and 3% increase in retail unit sales. Additionally, our U.S. new vehicle same-store unit sales increased 2.5% which outperformed the overall retail market.

Our new unit sales geographic mix was 74% U.S., 20% U.K. and 6% Brazil. Our new vehicle brand mix was led by Toyota and Lexus sales which accounted for 25% of our new units. VW and Audi represented 15%, BMW and MINI represented 12%, Honda and Acura 11%, and Ford represented 10% of our new unit sales.

During the quarter, we also retailed over 38,000 used units. Total consolidated used vehicle revenues grew 8% and gross profit increased 13% on a constant currency basis, driven by continued strong performance in the U.S. and Brazil. And 8% U.S. same-store unit volume increase while expanding our per unit retail margins by 5% is another very impressive performance by the U.S. operating team. And as I mentioned previously, this growth did not come at the expense of our new vehicle sales.

Total consolidated after sales revenue increased 7% on a constant currency basis, driven by increases in customer pay of 11%, collision of 11%, wholesale parts of 3% and warranty of 1%. Gross margin expansion of 150 basis points, helped increase our total consolidated after sales gross profit by 10% on a constant currency basis. And our U.S. same-store after sales gross profit growth of 12% was an all-time company record.

Finance and insurance gross profit increased 5% on the consolidated constant currency basis. This growth was driven by a strong increase in U.S. penetration as well as total retail unit growth of 5%.

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

Daryl Kenningham, President, U.S. Operations

Thank you, Earl. We are very pleased with our record fourth quarter performance in the U.S.. Due to strong growth and used vehicles F&I and aftersales, we were able to generate 9% increase in total same-store gross profit for the third consecutive quarter. During the quarter, our new vehicles same store unit sales grew by 2.5% while the industry was down 2.1%. The new vehicle sales increase did not come at the expense of used volume, as our same store used retail unit sales grew 8%, and we are also able to expand our margins by $40 per unit.

The shift of more business to the retail channel along with our recently implemented big data driven pricing strategies have been critical in driving used vehicle gross profit growth, which was up 12% over prior year on a same-store basis. As we look forward to 2020, our focus will be on continued growth of the value line initiative, an improvement in lowering discounts off of advertised pricing and further development of better sourcing alternatives.

Our quarterly aftersales revenue grew by 8% on the same store basis and gross profit increased by 12% which again was an all-time record for the company. Same-store customer pay and collision gross profit both increased 13%, with warranty up 5% and wholesale parts growth of 4%. We've implemented our four-day work week in 75 stores and are thrilled with the results. Its driving better employee retention and we increased our same-store headcount by over 300 technicians in 2019, 13% increase.

Looking forward to 2020, we would expect total aftersales growth to continue to expand by at least mid-single-digit rates. F&I income for retail unit for the quarter increased $57 per unit to $1,835, driven by strong product penetration and income per contract increases. Full year US F&I, PRU was $1,782. And we expect 2022 to once again be in the $1,750 to $1,800 range.

Turning to an update on our digital efforts. The accelerate platform, our online retailing initiative is now in all of our U.S. dealerships and we remain pleased with the traffic, gross margins and customer feedback. During the quarter over 2,100 customers used AcceleRide as a tool in their vehicle purchase, up from 600 in the fourth quarter -- first quarter of 2019. And the AcceleRide closing rates are pacing at more than double on other lead sources. We look forward to more improvements in AcceleRide in 2020.

In addition, our omnichannel efforts and aftersales are continuing. Customers scheduling service appointments online grew 15% versus Q4 of 2018. And in December 2019, nearly 29% of our service appointments were made online. Our trends in digital traffic also continued on a very positive track, as total website visits increased 27% and organic visits increased 19%. Both supported by our reputation management and SEO initiatives.

Lastly, our team was able to leverage adjusted SG&A by 200 basis points from 71.4% down to 69.4%. We anticipate continuing to leverage SG&A as we increase gross profit from used and aftersales efforts. In Brazil, we generated very strong year-over-year bottom line growth behind impressive used vehicle, aftersales and SG&A performance.

Same-store used vehicle gross profit increased 13% on a constant currency basis, largely driven by the continued efficiencies from our centralized appraisal desk initiative. Brazil after sales growth profit increased 10% on a same store local currency basis driven by an increase in technician headcount of 11%.

Finally, our local team delivered on our cost reduction initiatives and lowered SG&A by 380 basis points to 77.8%. We look forward to continued growth in 2020 as we further implement U.S. learnings into our Brazilian business and benefit from the rebounding new vehicle industry sales environment.

I will now turn the call back over to Earl.

Earl J. Hesterberg, President and Chief Executive Officer

Thanks, Darryl. As we previously mentioned, market conditions in the UK remain very challenging in the fourth quarter, primarily caused by continuing Brexit overhang. The total new vehicle industry was down roughly 2% for the quarter, but we were able to increase same-store new vehicle sales by 4.8% and used vehicle sales by 3.5%.

New vehicle market pressure also resulted in continued downward pressure on vehicle margins as we saw same-store gross profit for retail unit declines of 6% for new vehicles and 4% for used vehicles on a constant currency basis. As I noted earlier immediately following the election outcome in Mid-December, we have noticed an uptick in new vehicle inquiries and orders. Importantly, we are seeing that improvement continue in January, so we are somewhat optimistic about the UK market in 2020.

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

John C. Rickel, Senior Vice President and Chief Financial Officer

Thank you, Earl, good morning, everyone. For the fourth quarter of 2019, our adjusted net income increased $12.5 million, or 28.6% over our comparable 2018 results to a fourth quarter record of $56.3 million. These 2019 adjusted quarterly results exclude $8.2 million of net after tax charges, more than explained by $8.8 million of non-cash asset impairments primarily resulting from our annual franchise valuation modeling.

On a fully diluted per share basis adjusted earnings increased 30.3% to $3.01 a fourth quarter record. Floorplan interest expense decreased by $1.9 million, or 12% from prior year to $14.6 million, primarily explained by lower U.S. interest rates.

We should continue to see a year-over-year benefit from lower rates in the first three quarters of 2020. Other interest expense increased by $600,000 or 3% from the prior year to $19 million, primarily reflecting higher acquisition line borrowings. Our consolidated adjusted effective tax rate for the fourth quarter was 23.5% bringing our 2019 full year adjusted rate to 23%, this would be our rough expectation for 2020 as well.

Turning to our consolidated liquidity and capital structure. As of December 31, we had $24 million of cash on hand and another $11 million that was invested in our floorplan offset accounts, bringing total cash liquidity to $135 million. In addition, there was $265 million of additional borrowing capacity on our U.S. syndicated acquisition line, bringing total immediate liquidity to $400 million. Our U.S. credit facility rent adjusted leverage ratio decreased to 3.26 times at the end of the fourth quarter leaving plenty of flexibility for capital deployment.

During the fourth quarter, we used $5.5 million pay dividends of $0.29 per share which is currently an annualized yield of approximately 1.1%. We also repurchased 163,000 shares of our common stock at an average price of $98.28 per share during December and January for a total of $16.1 million. We have $58.9 million of our Board authorization remaining.

Total CapEx for 2019 came in at $95 million and we're targeting $125 million or less for 2020. 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 will now turn the call back over to Earl.

Earl J. Hesterberg, President and Chief Executive Officer

Thanks John. Related to our corporate development efforts, as previously announced in the fourth quarter we purchased two Lexus dealerships in New Mexico and opened a Jaguar/Land Rover dealership in Northwest London. For the full year of 2019, we acquired 15 franchises that will generate approximately $430 million in revenues. We also disposed of 12 franchises that generated $240 million in trailing 12-month revenues.

Finally, before I turn the call over to the operator for your questions let me update our market outlook for 2020. For the U.S. we expect to again see a slight pullback in the overall new vehicle industry. Total new vehicle sales in 2019 came in at 17 million units and we're anticipating about 2% declined in 2020 to around 16.7 million units. For the UK, the new vehicle industry declined 2% in 2019 to 2.3 million units. We expect the 2020 industry to grow in the low single-digits to around 2.4 million units as the industry recovers from emissions legislation related supply shortages. And as we see the overhang from Brexit finally starts to ease.

And for Brazil, the market improved by nearly 8% in 2019 to almost 2.7 million units. Given the positive signals we continue to see in the economy, we expect this trend to continue with an increase of another 5% or so to around 2.8 million units.

In this environment we remain confident that we can continue to grow earnings. We see opportunities to further grow aftersales and used vehicles in all three markets. In addition, with a firm direction for Brexit, we believe significant improvements are available from our UK operations.

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

Questions And Answers

Operator

(Question And Answer)

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions). And the first question will come from John Murphy with Bank of America. Please go ahead.

Yarden Amsalem

Good morning, guys, this is Yarden on for John. First question, on the Floorplan interest expense given it was much lower this quarter, was these a function of lower rates, or are there any specific actions you're taking in terms of inventory management or maybe it was something else?

John C. Rickel, Senior Vice President and Chief Financial Officer

Yes. This is John Rickel, theirs the team has done good job of managing inventory, but it is basically kind of flat on year-over-year basis. So the improvement is all basically attributed to lower U.S. LIBOR rates; that is the fed cup rate. So we anticipate that will continue into 2020 at least for the first three quarters.

Yarden Amsalem

Okay. Great. Thank you. And then for the used vehicle business. Can you maybe talk about the key drivers of the improvement in the margins? And to what extent was that impacted by value line?

Daryl Kenningham, President, U.S. Operations

Daryl Kenningham here. One area significant focus for us is we price our vehicles to the market from the today, they are available for sale, and concert with that we try to limit the discounts that we offer following that. So the better you price your vehicles to market and then the fewer discounts you offer the better [ph] gross profit is and we saw some improvement in that during the quarter. We continue to work on sourcing efforts, and that's a continual focus for us as well. Those were two of the larger drivers in that gross profit improvement in U.S.

Yarden Amsalem

Okay. And then just a quick follow-up. Given how well value was doing for you guys last year. Would you consider expanding it to other regions as well?

Daryl Kenningham, President, U.S. Operations

Expanding what are the regions -- I missed that?

Yarden Amsalem

Value line.

Daryl Kenningham, President, U.S. Operations

We're experimenting with it in Brazil, and we're open the course peak to the UK, but we're looking at in Brazil we have some other things on Brazil going on -- wouldn't be a [ph].

Earl J. Hesterberg, President and Chief Executive Officer

Yes, we do test a bit of that in the UK, but it's the UK used car market is structured differently, dealerships generally retail used cars of the brand they represent with a new car franchise. So what we've tested is putting our non-franchise used cars into a separate location. So for example, if you have a Mercedes dealership, you put your BMW, and Land Rover trades onto a separate lot, and so we're taking a look to see if that makes sense, as opposed to really focusing on low price used cars most of our franchises in the UK, our luxury brand franchises so our used vehicles tend to be more luxury brand.

Yarden Amsalem

Okay. Thank you very much. That's it for me.

Daryl Kenningham, President, U.S. Operations

Thank you.

Operator

And the next question comes from Rajat Gupta with JP Morgan, please go ahead.

Rajat Gupta

Hey thanks for taking my questions. Good morning. I just kind -- just had a question the beginning on the 2020, moving parts on the earning bridge you've talked about your expectations for new vehicle sales. I think, you briefly mentioned your expectation for public services, but and clearly you're seeing a lot of strength on the used vehicle side as well one from a gross profit perspective the internal the initiatives in 2019, you know F&I seems to be -- seems to continue to grow from a GP perspective. You have taken from Floorplan and interest, I mean is it -- would it be unreasonable to expect similar to better earnings growth year-over-year in 2020 versus 2019 or is there anything different that we should be expecting? Just broadly.

Earl J. Hesterberg, President and Chief Executive Officer

My -- this is Earl. My recollection in my assumption so far with only one month under our bill. Is the market is quite stable and I don't see any major shifts occurring at the moment. So the way we're approaching the business is kind of steady as she goes relative to what we did last year. There's a great used car market that's been out there for more than a year, and a lot of that has to do with the relative value of a used car compared to the rising prices of new cars.

And there's still massive service capacity for us and potential. So we don't see a big change in change in the market as we sit here today. The biggest change in our business overall as we think we'll have a lot more potential in the UK and the year ahead.

Rajat Gupta

Got it. And from an SG&A to gross perspective, is there any range we should be expecting for 2020? And we obviously pretty good performance in 2019 despite the headwinds in UK. Should we expect this to continue to step down further in 2020?

John C. Rickel, Senior Vice President and Chief Financial Officer

Yes, Rajat, this is John Rickel. Yes, we think that as long as we're able to continue to grow gross profit, Daryl outlined the opportunities in the U.S. continue to be in parts and service and use, we think we can certainly leverage that if we're able to grow gross profit there.

Clearly with our outlook for the UK, we definitely anticipate being able to deliver some SG&A leverage there as well, I would think that if you get the market rebound and the cost cutting that we're working on, we ought to be able to get that back to at least 2018 levels, and then the Brazilian team you saw really good progress in the fourth quarter there, so when you add all that together, I do think we'll be able to continue to show leverage in 2020 on the SG&A as percent of gross.

Rajat Gupta

Got it. Just last one for me, I mean really this question to the earnings but a lot of OEM are set to launch some new electric vehicle products and later this year or next year, we've already had the experience with the neutron [ph] and or Audi stores. What kind of how are you preparing for the surge in terms of like CapEx investments that might be required or like dealing capacity or technician training? I mean, would we expect this to move the needle significantly from what CapEx or SG&A perspective just to get -- that you prepared for the surge. That's it. Thanks.

Earl J. Hesterberg, President and Chief Executive Officer

This is Earl. I don't see any material CapEx or investment required to move with the auto manufacturers as they shift toward more electric vehicle offerings. We put in charging stations, we trained technicians and there are some tools and such but -- but this is kind of a slow, steady migration, and its been underway for more than a year, and we can go back to the Nissan Leaf good number years ago. So we don't see that as an obstacle in our business.

Rajat Gupta

Got it. Thank you. I will pass on.

Operator

The next question will come from Armintas Sinkevicius with Morgan Stanley. Please, go ahead.

Armintas Sinkevicius

Great. Thank you for taking the question. As I look at the parts and services growth in the U.S. the same store sales, revenue growth, there is a bit of a detail in the fourth quarter relative to the third quarter, the comps roughly similar, just was hoping for more color on that? And then, what gives you confidence into 2020?

Daryl Kenningham, President, U.S. Operations

Some of the diesel was a little lighter warranty boards in the fourth quarter, than we have see in the last three quarters, so that was the main driver behind that. We're happy with our customer pay growth, and we continue to see benefits from the four-day work week in the capacity, we're adding there as we continue to see up something.

Armintas Sinkevicius

Okay, and how do you think about the various growth components or the various business component? You know how they project the grow in 2020?

Earl J. Hesterberg, President and Chief Executive Officer

I think our Armintas as you look at it, you're talking about parts and service. Clearly, we're going to continue to drive customer pay, we had a lot of success there in 2019 with the capacity we've added. With the expansion of hours, we think there's certainly more to go there, collision continues to also be a bright spot for us. So we think there's an opportunity to grow that. Warranty you're somewhat at the manufacturers -- [ph] is the recalls are announce that there seems to always be some of those coming up. And then wholesales are another area where we can continue to move the needle, but I'd say our primary focus is on customer base.

Armintas Sinkevicius

Okay. And then, when you mentioned 13% growth in technician count, what's the reason that parts and services can grow 13%? Is it just the mix of customer pays, that the proportion that customer pay makes up relative to the rest of the business or any other moving pieces to be mindful?

Daryl Kenningham, President, U.S. Operations

Yes. I mean, that's some of it, there's also ramp up with getting the technicians fully productive.

Armintas Sinkevicius

Okay, and then one last one here. With regards to the UK, you mentioned that there's opportunity here, and the cost cutting benefits will pay in 2020 that just trying to think through, are there any initiatives that you are looking to take now that we have more certainty around the environment that had been put on hold, and now you're able to sort of move forward with them?

Earl J. Hesterberg, President and Chief Executive Officer

I would say the biggest changes, we should have a better environment to trim our portfolio up a bit. There's probably some dispositions we need to make based on some large acquisitions, we made in the previous three years, and there hasn't been much of a seller's market in the U.K. The last year or two.

So we're still in a consolidating mode in the UK, we need to right-size our portfolio bit. But, what we're encouraged by and is probably too early to go crazy on this is simply the order taken our major brands for the last six weeks or so. March will be the key as it is in the U.S. and the U.K. for us to see how much true growth there is in the market, but we're fairly optimistic at the moment.

Armintas Sinkevicius

Great. Appreciate it.

Operator

The next question comes from Rick Nelson with Stephens, please go ahead.

N. Richard Nelson

Thanks. Good morning. Earl, wanted to ask you about the acquisition environment you require [ph] to stores in December 15 stores In 2019, how you see that the environment the multiples your appetite in the U.S., UK, sounds like you're consolidating in the UK -- versus acquiring, maybe Brazil commentary as well?

Earl J. Hesterberg, President and Chief Executive Officer

Yes. Hi, Rick. It's Earl. There is a good supply of acquisitions in the U.S. However, we are very cautious about acquisitions in the U.S. Clearly we found some that meet our needs and hurdles in the last year or so, but it's very possible that you can destroy capital in a market that settling down as the U.S. new vehicle market has been the last three years plus.

So we're opportunistic, and we're interested in growing in the U.S., but we don't -- we're not going to be too aggressive. We want to make sure, we get a good return on our capital in the pricing, I see in most of these deals wouldn't make that possible. The U.K. -- I wouldn't say, we wouldn't expand because we have some of our OEM partners that want us to expand, but as I mentioned a few minutes ago, we're more in a right-sizing mode there right now, we probably need to do a couple dispositions more than we need to do acquisitions.

And relative to Brazil, we will -- we are willing to grow there with the cash flow we generate in that market, which we are generating cash there. But acquisitions are more difficult in Brazil, because asset purchases are unusual and you frequently inherit liabilities from the seller and we don't do that. So yes, we want to grow the company, we clearly have the financial wherewithal to do it. But we are very cautious these days on that.

N. Richard Nelson

That's it. Thanks for the color and for Daryl that of GPUs in the U.S. We've start year-over-year improvement on the new [ph] started to -- to use this side earlier, the effectively set a floor here as a specific brand that drove [ph] performance or any color on that would be helpful.

Daryl Kenningham, President, U.S. Operations

Good morning, Rick. It was across the board on brands and geography, and what I attributed to was a lot of the digital efforts that the team has worked on to drive we recorded some of our traffic counts on organic traffic, and website traffic, and I believe that's really, really helping us drive [ph] people in our dealerships and some of that's what I attributed to.

N. Richard Nelson

Great. And then any comments within the U.S. and Texas would be interesting?

Daryl Kenningham, President, U.S. Operations

I'm sorry in Texas?

N. Richard Nelson

How that performance for Texas. Yes how that performed versus the rest of the chain?

John C. Rickel, Senior Vice President and Chief Financial Officer

Yes, this is John Rickel. Texas was basically in line with what the rest of our operations did, but since we are pretty heavy with the Texas footprint that kind of gives you some idea, and we clearly outperformed the U.S. market with our results.

N. Richard Nelson

That's it, great, thanks, and good luck.

John C. Rickel, Senior Vice President and Chief Financial Officer

Thanks.

Operator

Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Earl Hesterberg for any closing remarks.

Earl J. Hesterberg, President and Chief Executive Officer

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

Operator

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