GROUP 1 AUTOMOTIVE INC
Form 10-K
February 25, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission file number: 1-13461
Group 1 Automotive, Inc.
(Exact name of registrant as specified in its charter)

DELAWARE *(State or other jurisdiction of incorporation or organization)*	**76-0506313** *(I.R.S. Employer Identification No.)*
800 Gessner, Suite 500 **Houston, Texas 77024** *(Address of principal executive offices, including zip code)*	**(713) 647-5700** *(Registrant s telephone number, including area code)*

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common stock, par value $0.01 per share	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ
Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

The aggregate market value of common stock held by non-affiliates of the registrant was approximately $452.7 million based on the reported last sale price of common stock on June 30, 2008, which is the last business day of the registrant s most recently completed second quarter.

As of February 24, 2009, there were 23,991,099 shares of our common stock, par value $0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its 2009 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2008, are incorporated by reference into Part III of this Form 10-K.

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Cautionary Statement About Forward-Looking Statements

This Annual Report on Form 10-K includes certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). This information includes statements regarding our plans, goals or current expectations with respect to, among other things:

- our future operating performance;
- our ability to improve our margins;
- operating cash flows and availability of capital;
- the completion of future acquisitions;
- the future revenues of acquired dealerships;
- future stock repurchases and dividends;
- capital expenditures;
- changes in sales volumes and credit for customer financing in new and used vehicles and sales volumes in the parts and service markets;
- business trends in the retail automotive industry, including the level of manufacturer incentives, new and used vehicle retail sales volume, customer demand, interest rates and changes in industry-wide inventory levels; and
- availability of financing for inventory, working capital, real estate and capital expenditures.

Although we believe that the expectations reflected in these forward-looking statements are reasonable when and as made, we cannot assure you that these expectations will prove to be correct. When used in this Annual Report, the words anticipate, believe, estimate, expect, may and similar expressions, as they relate to our company and management, are intended to identify forward-looking statements. Forward-looking statements are not assurances of future performance and involve risks and uncertainties. Actual results may differ materially from anticipated results in the forward-looking statements for a number of reasons, including:

- the current economic recession has substantially depressed consumer confidence and limited the availability of consumer credit, causing a marked decline in demand for new and used vehicles; further deterioration in the economic environment, including consumer confidence, interest rates, the price of gasoline, the level of manufacturer incentives and the availability of consumer credit may affect the demand for new and used vehicles, replacement parts, maintenance and repair services and finance and insurance products;
- adverse domestic and international developments such as war, terrorism, political conflicts or other hostilities may adversely affect the demand for our products and services;
- the future regulatory environment, unexpected litigation or adverse legislation, including changes in state franchise laws, may impose additional costs on us or otherwise adversely affect us;

our principal automobile manufacturers, especially Toyota/Lexus, Ford, Daimler, Chrysler, Nissan/Infiniti, Honda/Acura, General Motors and BMW, because of financial distress, bankruptcy or other reasons, may not continue to produce or make available to us vehicles that are in high demand by our customers or provide financing, insurance, advertising or other assistance to us;

the immediate concerns over the financial viability of one or more of the domestic manufacturers (i.e., Chrysler, General Motors and Ford) could result in a restructuring of these companies, up to and including bankruptcy; and, as such, we would likely suffer immediate financial loss in the form of uncollectible receivables, devalued inventory or loss of franchises;

requirements imposed on us by our manufacturers may limit our acquisitions and require us to increase the level of capital expenditures related to our dealership facilities;

our existing and/or new dealership operations may not perform at expected levels or achieve expected improvements;

our failure to achieve expected future cost savings or future costs being higher than we expect;

available capital resources, increases in cost of financing and various debt agreements may limit our ability to complete acquisitions, complete construction of new or expanded facilities, repurchase shares or pay dividends;

our cost of financing could increase significantly;

foreign exchange controls and currency fluctuations;

new accounting standards could materially impact our reported earnings per share;

our inability to complete additional acquisitions or changes in the pace of acquisitions;

the inability to adjust our cost structure to offset any reduction in the demand for our products and services;

our loss of key personnel;

competition in our industry may impact our operations or our ability to complete additional acquisitions;

the failure to achieve expected sales volume from our new franchises;

insurance costs could increase significantly and all of our losses may not be covered by insurance; and

our inability to obtain inventory of new and used vehicles and parts, including imported inventory, at the cost, or in the volume, we expect.

The information contained in this Annual Report on Form 10-K, including the information set forth under the headings Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operation, identifies factors that could affect our operating results and performance. We urge you to carefully consider those factors, as well as factors described in our reports and registration statements filed from time to time with the Securities and Exchange Commission (the SEC) and other announcements we make from time to time.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We undertake no responsibility to publicly release the result of any revision of our forward-looking statements after the date they are made.

PART I

Item 1. Business

General

Group 1 Automotive, Inc., a Delaware corporation, is a leading operator in the $1.0 trillion automotive retail industry. As of December 31, 2008, we owned and operated 127 franchises at 97 dealership locations and 23 collision service centers in the United States of America (the U.S.) and six franchises at three dealerships and two collision centers in the United Kingdom (the U.K.). Through our operating subsidiaries, we market and sell an extensive range of automotive products and services, including new and used vehicles and related financing, vehicle maintenance and repair services, replacement parts, warranty, insurance and extended service contracts. Our operations are primarily located in major metropolitan areas in the states of Alabama, California, Florida, Georgia, Kansas, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, Oklahoma, South Carolina and Texas in the U.S. and in the towns of Brighton, Hailsham and Worthing in the U.K.

As of December 31, 2008, our retail network consisted of the following three regions (with the number of dealerships they comprised): (i) the Eastern (40 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina), (ii) the Central (46 dealerships in Kansas, Oklahoma and Texas) and (iii) the Western (11 dealerships in California). Each region is managed by a regional vice president reporting directly to our Chief Executive Officer, as well as a regional chief financial officer reporting directly to our Chief Financial Officer. In addition, our international operations are managed locally with direct reporting responsibilities to our corporate management team.

As discussed in more detail in Note 2 to our consolidated financial statements, all of our operating subsidiaries operate as one reportable segment. Our financial information, including our revenues, is included in our consolidated financial statements and related notes beginning on page F-1.

Business Strategy

Our business strategy is to leverage one of our key strengths the considerable talent of our people to: (i) sell new and used vehicles; (ii) arrange related financing, vehicle service and insurance contracts; (iii) provide maintenance and repair services; and (iv) sell replacement parts via an expanding network of franchised dealerships located primarily in growing regions of the U.S. and the U.K., as well as acquire new dealerships in existing or new markets that provide acceptable return of investment. We believe that over the last three years we have developed one of the strongest management teams in the industry.

With this level of talent, we plan to continue empowering our operators to make appropriate decisions to grow their respective dealership operations and to control fixed and variable costs and expenses. We believe this approach allows us to continue to attract and retain talented employees, as well as provide the best possible service to our customers.

We continue with our efforts to fully leverage our scale, reduce costs, enhance internal controls and enable further growth and, as such, we are taking steps to standardize key operating processes. Our management structure supports more rapid decision making and speeds the roll-out of new processes. In 2007, we successfully completed the conversion of all of our dealerships to the same dealer management system offered by Dealer Services Group of Automatic Data Processing Inc. (ADP) and put in place a standard general ledger layout. During 2008, we consolidated portions of our dealership accounting and administrative functions into regional centers. These actions represent key building blocks that will not only enable us to bring more efficiency to our accounting and information technology processes, but will support further standardization of critical processes and more rapid integration of acquired operations going forward, significantly reducing technology costs and increasing the speed in which we can achieve the full potential of our newly acquired stores.

We completed acquisitions comprising in excess of $90.0 million in estimated aggregated annualized revenues for 2008. And, we believe that substantial opportunities for growth through acquisition remain in our industry. However, in light of the current economic downturn, we do not anticipate completing any dealership acquisitions during 2009. Beyond the present economic headwinds that we face, we will selectively grow our portfolio of import

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and luxury brands, as well as target that growth in geographically diverse areas with bright economic outlooks over the longer-term. Further, we will continue to critically evaluate our return on capital invested in our dealership operations for disposition opportunities.

While we desire to continue to grow through acquisitions, we continue to primarily focus on the performance of our existing stores to achieve internal growth goals. We believe further revenue growth is available in our existing stores and plan to utilize enhancements to our processes and technology to help our people deliver that anticipated growth. In particular, we continue to focus on growing our higher margin used vehicle and parts and service businesses, which support growth even in the absence of an expanding market for new vehicles. The use of software tools in conjunction with our management focus on proven processes in the used vehicle and parts and service operations have helped to increase retail sales and improve margins over the past several years. We are also continuing to improve service revenue by investing further capital in our facilities.

For 2009, we will primarily focus on five key areas as we continue to become a best-in-class automotive retailer. These areas are:

- Used vehicle and parts and service businesses;
- Cost reduction and operating efficiency efforts;
- generation of cash flow and reduction of debt to strengthen our balance sheet;
- Continue transition to an operating model with greater commonality of key operating processes and systems that support the extension of best practices and the leveraging of scale; and
- Improving or disposing of underperforming dealerships in our current portfolio.

Despite the recent economic downturn and resulting negative impact on our business, we remain optimistic about our business model and expect that, over the long term, industry sales will rebound, reflecting a significant level of pent-up demand.

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Dealership Operations

Our operations are located in geographically diverse markets that extend domestically from New Hampshire to California and, beginning in 2007, internationally in the U.K. By geographic area, our revenues from external customers for the year ended December 31, 2008 were $5,491.8 million and $162.3 million from our domestic and foreign operations, respectively. Our domestic and foreign long-lived assets other than goodwill, intangible assets and financial instruments as of December 31, 2008 were $531.3 million and $20.3 million, respectively. The following table sets forth the regions and geographic markets in which we operate, the percentage of new vehicle retail units sold in each region in 2008 and the number of dealerships and franchises in each region:

Region	Geographic Market	Percentage of Our New Vehicle Retail Units Sold During the Twelve Months Ended December 31, 2008	As of December 31, 2008 Number of Dealerships	As of December 31, 2008 Number of Franchises
Eastern	Massachusetts	12.1%	9	10
	New Jersey	6.6	6	7
	New York	4.1	5	5
	New Hampshire	3.5	3	3
	Louisiana	3.3	3	7
	Georgia	3.4	4	4
	Florida	2.5	3	3
	Mississippi	1.5	3	3
	Alabama	0.8	1	1
	Maryland	0.6	2	2
	South Carolina	0.3	1	1
		38.9	40	46
Central	Texas	32.7	31	44
	Oklahoma	9.4	13	20
	Kansas	1.3	2	2
		43.4	46	66
Western	California	16.0	11	15
International	United Kingdom	1.7	3	6
Total		100.0%	100	133

Each of our local operations has a management structure that promotes and rewards entrepreneurial spirit and the achievement of team goals. The general manager of each dealership, with assistance from the managers of new vehicle sales, used vehicle sales, parts and service, and finance and insurance, is ultimately responsible for the operation, personnel and financial performance of the dealership. Our dealerships are operated as distinct profit centers, and our general managers have a reasonable degree of empowerment within our organization. In the U.S., each general manager reports to one of our market directors or one of three regional vice presidents. Our regional vice presidents report directly to our Chief Executive Officer and are responsible for the overall performance of their regions, as well as for overseeing the market directors and dealership general managers that report to them. Our U.K. operations are structured similarly, with a director of operations reporting directly to our Chief Executive Officer.

New Vehicle Sales

In 2008, we sold or leased 110,705 new vehicles representing 32 brands in retail transactions at our dealerships. Our retail sales of new vehicles accounted for approximately 23.5% of our gross profit in 2008. In addition to the profit related to the transactions, a typical new vehicle retail sale or lease creates the following additional profit opportunities for a dealership:

manufacturer incentives, if any;

the resale of any trade-in purchased by the dealership;

the sale of third-party finance, vehicle service and insurance contracts in connection with the retail sale; and

the service and repair of the vehicle both during and after the warranty period.

Brand diversity is one of our strengths. Our mix of domestic, import and luxury franchises is also critical to our success. Over the past five years, we have strategically managed our exposure to the declining domestic market and emphasized the faster growing luxury and import markets, shifting our sales mix from 41% domestic and 59% luxury and import in 2004 to 19% and 81% in 2008, respectively. The following table sets forth new vehicle sales revenue by brand and the number of new vehicle retail units sold in the year ended, and the number of franchises we owned as of December 31, 2008:

	New Vehicle Revenues (In thousands)	New Vehicle Unit Sales	% of Total Units Sold	Franchises Owned As of December 31, 2008
Toyota	$ 782,626	31,249	28.2%	13(1)
Nissan	320,746	12,884	11.6%	12
Honda	302,801	12,864	11.6%	8
Scion	31,895	1,780	1.6%	N/A(1)
Volkswagen	23,347	978	0.9%	2
Mazda	22,728	1,010	0.9%	2
Subaru	14,350	589	0.5%	1
Hyundai	6,162	282	0.3%	1
Kia	5,601	290	0.3%	2
Mitsubishi	2,841	124	0.1%	1
Total import	$ 1,513,097	62,050	56.0%	42
BMW	384,112	7,607	6.9%	12
Mercedes-Benz	329,203	5,882	5.3%	6
Lexus	258,230	5,789	5.2%	3
Acura	91,376	2,609	2.4%	4
Infiniti	44,916	1,191	1.1%	1
Volvo	35,430	1,019	0.9%	2
Audi	19,010	409	0.4%	1
Mini	54,636	2,063	1.9%	6
smart	10,480	619	0.6%	1
Lincoln	9,469	229	0.2%	3
Porsche	7,315	96	0.1%	1

Maybach	4,491	11	0.0%	1
Cadillac	2,061	43	0.0%	
Total luxury	$ 1,250,729	27,567	25.0%	41
Ford	274,017	9,120	8.2%	11
Dodge	121,393	4,201	3.8%	8
Chevrolet	107,914	3,543	3.2%	5
GMC	40,326	1,164	1.0%	2
Jeep	40,115	1,541	1.4%	8
Chrysler	28,599	884	0.8%	8
Pontiac	6,447	296	0.3%	2
Buick	5,280	147	0.1%	2
Mercury	4,971	192	0.2%	4
Total domestic	629,062	21,088	19.0%	50