

GROUP 1 AUTOMOTIVE INC  
Form 10-Q  
November 03, 2016

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

or

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 76-0506313  
(State or other (I.R.S.  
jurisdiction of Employer  
incorporation or Identification  
organization) No.)

800 Gessner, Suite  
500  
Houston, Texas  
77024  
(Address of  
principal executive  
offices) (Zip code)  
(713) 647-5700  
(Registrant's  
telephone number,  
including area  
code)

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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):

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Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of October 27, 2016, the registrant had 21,371,172 shares of common stock, par value \$0.01, outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

	September 30, 2016	December 31, 2015
	(Unaudited, in thousands, except per share amounts)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$22,918	\$13,037
Contracts-in-transit and vehicle receivables, net	206,292	252,438
Accounts and notes receivable, net	156,294	157,768
Inventories, net	1,687,379	1,737,751
Prepaid expenses and other current assets	25,555	27,376
Total current assets	2,098,438	2,188,370
PROPERTY AND EQUIPMENT, net	1,118,785	1,033,981
GOODWILL	880,393	854,915
INTANGIBLE FRANCHISE RIGHTS	310,513	307,588
OTHER ASSETS	12,935	11,862
Total assets	\$4,421,064	\$4,396,716
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Floorplan notes payable - credit facility and other	\$1,110,104	\$1,265,719
Offset account related to floorplan notes payable - credit facility	(59,684 )	(110,759 )
Floorplan notes payable - manufacturer affiliates	387,770	389,071
Offset account related to floorplan notes payable - manufacturer affiliates	(22,500 )	(25,500 )
Current maturities of long-term debt and short-term financing	62,349	54,991
Accounts payable	354,957	280,423
Accrued expenses	193,553	185,323
Total current liabilities	2,026,549	2,039,268
LONG-TERM DEBT, net of current maturities	1,232,717	1,199,534
DEFERRED INCOME TAXES	148,001	136,644
LIABILITIES FROM INTEREST RATE RISK MANAGEMENT ACTIVITIES	45,040	31,153
OTHER LIABILITIES	81,785	71,865
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value, 1,000 shares authorized; none issued or outstanding	—	—
Common stock, \$0.01 par value, 50,000 shares authorized; 25,678 and 25,706 issued, respectively	257	257
Additional paid-in capital	287,018	291,092
Retained earnings	1,027,393	926,169
Accumulated other comprehensive loss	(157,446 )	(137,984 )
Treasury stock, at cost; 4,305 and 2,291 shares, respectively	(270,250 )	(161,282 )
Total stockholders' equity	886,972	918,252
Total liabilities and stockholders' equity	\$4,421,064	\$4,396,716

The accompanying notes are an integral part of these consolidated financial statements.

Table of ContentsGROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(Unaudited, in thousands, except per share amounts)			
<b>REVENUES:</b>				
New vehicle retail sales	\$1,587,952	\$1,601,213	\$4,538,562	\$4,468,200
Used vehicle retail sales	702,620	687,637	2,106,569	1,993,124
Used vehicle wholesale sales	104,218	100,483	302,089	302,186
Parts and service sales	319,676	303,557	950,341	888,939
Finance, insurance and other, net	108,710	107,679	316,419	307,454
Total revenues	2,823,176	2,800,569	8,213,980	7,959,903
<b>COST OF SALES:</b>				
New vehicle retail sales	1,507,517	1,521,721	4,305,252	4,242,847
Used vehicle retail sales	656,652	641,055	1,963,136	1,854,361
Used vehicle wholesale sales	106,077	102,318	302,551	302,276
Parts and service sales	146,262	137,093	437,153	406,580
Total cost of sales	2,416,508	2,402,187	7,008,092	6,806,064
<b>GROSS PROFIT</b>	<b>406,668</b>	<b>398,382</b>	<b>1,205,888</b>	<b>1,153,839</b>
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b>	<b>299,006</b>	<b>289,012</b>	<b>891,692</b>	<b>841,050</b>
<b>DEPRECIATION AND AMORTIZATION EXPENSE</b>	<b>12,891</b>	<b>11,811</b>	<b>38,067</b>	<b>35,441</b>
<b>ASSET IMPAIRMENTS</b>	<b>10,855</b>	<b>916</b>	<b>12,812</b>	<b>1,955</b>
<b>INCOME FROM OPERATIONS</b>	<b>83,916</b>	<b>96,643</b>	<b>263,317</b>	<b>275,393</b>
<b>OTHER EXPENSE:</b>				
Floorplan interest expense	(11,135 )	(9,685 )	(33,737 )	(29,046 )
Other interest expense, net	(17,094 )	(13,922 )	(50,729 )	(42,061 )
<b>INCOME BEFORE INCOME TAXES</b>	<b>55,687</b>	<b>73,036</b>	<b>178,851</b>	<b>204,286</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>(20,321 )</b>	<b>(27,775 )</b>	<b>(62,614 )</b>	<b>(76,901 )</b>
<b>NET INCOME</b>	<b>\$35,366</b>	<b>\$45,261</b>	<b>\$116,237</b>	<b>\$127,385</b>
<b>BASIC EARNINGS PER SHARE</b>	<b>\$1.65</b>	<b>\$1.88</b>	<b>\$5.23</b>	<b>\$5.26</b>
Weighted average common shares outstanding	20,568	23,132	21,355	23,294
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$1.65</b>	<b>\$1.88</b>	<b>\$5.22</b>	<b>\$5.26</b>
Weighted average common shares outstanding	20,578	23,137	21,364	23,298
<b>CASH DIVIDENDS PER COMMON SHARE</b>	<b>\$0.23</b>	<b>\$0.21</b>	<b>\$0.68</b>	<b>\$0.61</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of ContentsGROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(Unaudited, in thousands)			
NET INCOME	\$35,366	\$45,261	\$116,237	\$127,385
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustment	(6,341 )	(36,307 )	(10,254 )	(56,902 )
Net unrealized gain (loss) on interest rate risk management activities:				
Unrealized gain (loss) arising during the period, net of tax benefit (provision) of \$(713), \$4,919, \$9,345 and \$7,744, respectively	1,188	(8,199 )	(15,575 )	(12,907 )
Reclassification adjustment for loss included in interest expense, net of tax benefit of \$1,267, \$1,224, \$3,822 and \$3,593, respectively	2,112	2,041	6,367	5,988
Unrealized gain (loss) on interest rate risk management activities, net of tax	3,300	(6,158 )	(9,208 )	(6,919 )
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAXES	(3,041 )	(42,465 )	(19,462 )	(63,821 )
COMPREHENSIVE INCOME	\$32,325	\$2,796	\$96,775	\$63,564

The accompanying notes are an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional	Retained	Accumulated	Treasury	Total
	Shares	Amount	Paid-in Capital	Earnings	Other Comprehensive Loss	Stock	
	(Unaudited, in thousands)						
BALANCE, December 31, 2015	25,706	\$ 257	\$291,092	\$926,169	\$ (137,984 )	\$(161,282)	\$918,252
Net income	—	—	—	116,237	—	—	116,237
Other comprehensive loss, net	—	—	—	—	(19,462 )	—	(19,462 )
Purchases of treasury stock	—	—	—	—	—	(129,187 )	(129,187 )
Net issuance of treasury shares to employee stock compensation plans	(32 )	—	(18,767 )	—	—	20,219	1,452
Stock-based compensation, including tax effect of \$145	—	—	14,693	—	—	—	14,693
Cash dividends, net of estimated forfeitures relative to participating securities	—	—	—	(15,013 )	—	—	(15,013 )
BALANCE, September 30, 2016	25,674	\$ 257	\$287,018	\$1,027,393	\$ (157,446 )	\$(270,250)	\$886,972

The accompanying notes are an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2016      2015 (Unaudited, in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 116,237	\$ 127,385
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	38,067	35,441
Deferred income taxes	14,347	13,135
Asset impairments	12,812	1,955
Stock-based compensation	14,879	14,167
Amortization of debt discount and issue costs	2,783	2,727
Gain on disposition of assets	(1,812)	(1,469)
Tax effect from stock-based compensation	148	(1,827)
Other	891	3,435
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts payable and accrued expenses	78,905	30,858
Accounts and notes receivable	370	(6,821)
Inventories	60,839	(68,454)
Contracts-in-transit and vehicle receivables	49,581	29,470
Prepaid expenses and other assets	17,957	1,501
Floorplan notes payable - manufacturer affiliates	(19,064)	49,986
Deferred revenues	(328)	(621)
Net cash provided by operating activities	386,612	230,868
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Cash paid in acquisitions, net of cash received	(57,327)	(212,252)
Proceeds from disposition of franchises, property and equipment	23,072	9,684
Purchases of property and equipment, including real estate	(125,692)	(78,339)
Other	2,924	6,047
Net cash used in investing activities	(157,023)	(274,860)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Borrowings on credit facility - floorplan line and other	5,040,726	5,529,338
Repayments on credit facility - floorplan line and other	(5,147,766)	(5,479,152)
Borrowings on credit facility - acquisition line	220,020	584,643
Repayment on credit facility - acquisition line	(220,020)	(515,944)
Borrowings on other debt	37,786	33,375
Principal payments on other debt	(31,832)	(42,929)
Borrowings on debt related to real estate, net of debt issue costs	42,654	22,430
Principal payments on debt related to real estate	(18,845)	(21,041)
Employee stock purchase plan purchases, net of employee tax withholdings	1,452	(789)
Repurchases of common stock, amounts based on settlement date	(127,606)	(66,746)
Tax effect from stock-based compensation	(148)	1,827
Dividends paid	(15,054)	(14,781)
Other	(3,420)	-
Net cash provided by (used in) financing activities	(222,053)	30,231
EFFECT OF EXCHANGE RATE CHANGES ON CASH	2,345	(5,246)



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NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,881	(19,007 )
CASH AND CASH EQUIVALENTS, beginning of period	13,037	40,975
CASH AND CASH EQUIVALENTS, end of period	\$22,918	\$21,968
SUPPLEMENTAL CASH FLOW INFORMATION:		
Purchases of property and equipment, including real estate, accrued in accounts payable	\$19,920	\$3,225
Purchases of common stock accrued in accounts payable	\$—	\$4,375

The accompanying notes are an integral part of these consolidated financial statements.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. INTERIM FINANCIAL INFORMATION

Business and Organization

Group 1 Automotive, Inc., a Delaware corporation, is a leading operator in the automotive retailing industry with business activities in 14 states in the United States of America ("U.S."), 19 towns in the United Kingdom ("U.K.") and four states in Brazil. Group 1 Automotive, Inc. and its subsidiaries are collectively referred to as the "Company" in these Notes to Consolidated Financial Statements.

The Company, through its regions, sells new and used cars and light trucks; arranges related vehicle financing; sells service and insurance contracts; provides automotive maintenance and repair services; and sells vehicle parts. As of September 30, 2016, the Company's U.S. retail network consisted of the following two regions (with the number of dealerships they comprised): (a) the East (36 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, and South Carolina), and (b) the West (76 dealerships in California, Kansas, Louisiana, Oklahoma, and Texas). The U.S. regional vice presidents report directly to the Company's 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. In addition, as of September 30, 2016, the Company had two international regions: (a) the U.K. region, which consisted of 29 dealerships in the U.K. and (b) the Brazil region, which consisted of 18 dealerships in Brazil. The operations of the Company's international regions are structured similarly to the U.S. regions, each with a regional vice president reporting directly to the Company's Chief Executive Officer.

The Company's operating results are generally subject to seasonal variations, as well as changes in the economic environment. This seasonality is generally attributable to consumer buying trends and the timing of manufacturer new vehicle model introductions. In addition, in some markets within the U.S., vehicle purchases decline during the winter months due to inclement weather. As a result, U.S. revenues and operating income are typically lower in the first and fourth quarters and higher in the second and third quarters. For the U.K., the first and third calendar quarters tend to be stronger, driven by plate change months of March and September. For Brazil, the Company expects higher volumes in the third and fourth calendar quarters. The first quarter is generally the weakest, driven by heavy consumer vacations and activities associated with Carnival. Other factors unrelated to seasonality, such as changes in economic condition, manufacturer incentive programs, or shifts in governmental taxes or regulations may exaggerate seasonal or cause counter-seasonal fluctuations in the Company's revenues and operating income.

Basis of Presentation

The accompanying unaudited condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments of a normal and recurring nature considered necessary for a fair presentation have been included in the accompanying unaudited condensed Consolidated Financial Statements. Due to seasonality and other factors, the results of operations for the interim period are not necessarily indicative of the results that will be realized for any other interim period or for the entire fiscal year. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 ("2015 Form 10-K").

All business acquisitions completed during the periods presented have been accounted for using the purchase method of accounting, and their results of operations are included from the effective dates of the closings of the acquisitions. The allocations of purchase price to the assets acquired and liabilities assumed are assigned and recorded based on estimates of fair value and are subject to change within the purchase price allocation period (generally one year from the respective acquisition date). All intercompany balances and transactions have been eliminated in consolidation.

Business Segment Information

The Company has three reportable segments: the U.S., which includes the activities of the Company's corporate office, the U.K. and Brazil. The reportable segments are the business activities of the Company for which discrete financial information is available and for which operating results are regularly reviewed by its chief operating decision maker to allocate resources and assess performance. The Company's chief operating decision maker is its Chief Executive Officer. See Note 14, "Segment Information," for additional details regarding the Company's reportable segments.

Variable Interest Entity

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

In 2013, the Company entered into arrangements to provide a related-party entity, which owns and operates retail automotive dealerships, a fixed-interest-rate working capital loan and various administrative services for a variable fee, both of which constitute variable interests in the entity. The Company's exposure to loss as a result of its involvement in the entity includes the balance outstanding under the loan arrangement. The Company holds an 8% equity ownership interest in the entity. The Company has determined that the entity meets the criteria of a variable interest entity ("VIE"). The terms of the loan and services agreements provide the Company with the right to control the activities of the VIE that most significantly impact the VIE's economic performance, the obligation to absorb potentially significant losses of the VIE and the right to receive potentially significant benefits from the VIE. Accordingly, the Company qualified as the VIE's primary beneficiary and consolidated the assets and liabilities of the VIE as of September 30, 2016 and December 31, 2015, as well as the results of operations of the VIE beginning on the effective date of the variable interests arrangements to September 30, 2016. The floorplan notes payable liability of the VIE is securitized by the new and used vehicle inventory of the VIE. The carrying amounts and classification of assets (which can only be used to settle the liabilities of the VIE) and liabilities (for which creditors do not have recourse to the general credit of the Company) that are included in the Company's consolidated statements of financial position for the consolidated VIE as of September 30, 2016 and December 31, 2015, are as follows (in thousands):

	September 30, December 31,	
	2016	2015
Current assets	\$ 16,491	\$ 12,849
Non-current assets	13,478	11,022
Total assets	\$ 29,969	\$ 23,871
Current liabilities	\$ 15,563	\$ 8,257
Non-current liabilities	20,684	17,064
Total liabilities	\$ 36,247	\$ 25,321

Recently Adopted Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. This update requires an entity to classify deferred tax liabilities and assets as non-current within a classified statement of financial position. The Company elected to early adopt ASU 2015-17 during the first quarter of fiscal 2016, with retrospective application. Accordingly, deferred tax assets in the amount of \$14.1 million, which were previously classified as current assets at December 31, 2015, were reclassified to non-current deferred income tax liabilities on the Company's Consolidated Balance Sheets to conform to current year presentation.

In April 2015, the FASB issued ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in the accounting standard require debt issuance costs to be presented on the balance sheet as a direct reduction from the carrying amount of the related debt liability. The Company adopted ASU 2015-03 during the first quarter of fiscal 2016, with retrospective application. Accordingly, debt issuance costs in the amounts of \$0.5 million and \$3.6 million, which were previously classified as current and long-term assets, respectively, at December 31, 2015, were reclassified as a direct reduction from the carrying amount of the related debt liability on the Company's Consolidated Balance Sheets to conform to current year presentation.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in the accounting standard eliminate the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. The amendments also require that the acquirer must recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined, including the effect on earnings of any amounts they would have recorded in previous periods if the accounting had been completed at the acquisition date. The amendments in this ASU were to be applied prospectively to adjustments to provisional amounts that occur after the effective date and were effective for interim and annual periods beginning after December 15, 2015. The Company adopted ASU 2015-16 during the first quarter of fiscal 2016. The adoption of this amendment did not materially impact the Company's financial statements.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) that amends the accounting guidance on revenue recognition. The amendments in this ASU are intended to provide a framework for addressing revenue issues, improve comparability of revenue recognition practices, and improve disclosure requirements. The amendments in this accounting standard update are effective for interim and annual reporting periods beginning after December 15, 2017. The standard can be adopted either retrospectively to each reporting period presented or as a cumulative effect adjustment as of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

the date of adoption. The Company is currently evaluating the method of adoption, the impact that the adoption of the provisions of the ASU and the additional disclosure requirements will have on its consolidated financial statements. However, at this time, the Company does not expect the adoption to materially impact its consolidated financial statements and, therefore, expects to adopt as a cumulative effect adjustment as of the date of adoption.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. The amendments in the accounting standard replace the lower of cost or market test with a lower of cost and net realizable value test. The amendments in this ASU should be applied prospectively and are effective for interim and annual periods beginning after December 15, 2016. Earlier application is permitted as of the beginning of an interim or annual reporting period. The Company does not expect the adoption to materially impact its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The amendments in this ASU relate to the accounting for leasing transactions. This standard requires a lessee to record on the balance sheet the assets and liabilities for the rights and obligations created by leases with lease terms of more than 12 months. In addition, this standard requires both lessees and lessors to disclose certain key information about lease transactions. This standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is in the process of evaluating the impact that adoption will have on its consolidated balance sheet and statement of income. However, the Company expects that the adoption of the provisions of the ASU will have a significant impact on its consolidated balance sheet, as currently about half of its real estate is rented, not owned, via operating leases. Adoption of this ASU is required to be done using a modified retrospective approach. In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendment addresses several aspects of the accounting for share-based payment award transactions, including: income tax consequences; classification of awards as either equity or liabilities; and classification on the statement of cash flows. This standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact that the adoption of the provisions of the ASU will have on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments. The amendment replaces the current incurred loss impairment methodology of recognizing credit losses when a loss is probable, with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to assess credit loss estimates. The standard will be effective for fiscal years beginning after December 15, 2019, with early adoption permitted for periods after December 15, 2018. The Company is currently evaluating the impact that the adoption of the provisions of the ASU will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The amendment addresses several specific cash flow issues with the objective of reducing the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The standard will be effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of the provisions of the ASU will have on its consolidated financial statements.

## 2. ACQUISITIONS AND DISPOSITIONS

During the nine months ended September 30, 2016, the Company acquired 12 U.K. dealerships, inclusive of 17 franchises. In Brazil, the Company acquired one dealership, representing one franchise, and opened two other dealerships for one previously awarded franchises. Aggregate consideration paid for these dealerships totaled \$61.2 million, including the associated real estate and goodwill, as well as \$3.9 million of cash received in the acquisition of the dealerships. The purchase price has been allocated based upon the consideration paid and the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. The allocation of the purchase price is preliminary and based on estimates and assumptions that are subject to change within the purchase price allocation period (generally one year from the respective acquisition date). In addition, during the nine months ended

September 30, 2016, the Company disposed of four U.S. dealerships and four dealerships in Brazil. As a result of these U.S. and Brazil dealership dispositions, a net pretax gain of \$1.8 million and a net pretax loss of \$0.8 million, respectively, were recognized for the nine months ended September 30, 2016.

During the nine months ended September 30, 2015, the Company acquired three U.S. dealerships, sold one U.S. dealership and terminated one U.S. dealership franchise. The Company also terminated two franchises in Brazil. As a result of these dispositions, a net pretax gain of \$0.7 million, including related asset impairments, was recognized for the nine months ended September 30, 2015.

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### 3. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT ACTIVITIES

The periodic interest rates of the Revolving Credit Facility (as defined in Note 8, “Credit Facilities”) and certain variable-rate real estate related borrowings in the U.S. are indexed to the one-month London Inter Bank Offered Rate (“LIBOR”), plus an associated company credit risk rate. In order to minimize the earnings variability related to fluctuations in these rates, the Company employs an interest rate hedging strategy, whereby it enters into arrangements with various financial institutional counterparties with investment grade credit ratings, swapping its variable interest rate exposure for a fixed interest rate over terms not to exceed the related variable-rate debt.

The Company presents the fair value of all derivatives on its Consolidated Balance Sheets. The Company measures the fair value of its interest rate derivative instruments utilizing an income approach valuation technique, converting future amounts of cash flows to a single present value in order to obtain a transfer exit price within the bid and ask spread that is most representative of the fair value of its derivative instruments. In measuring fair value, the Company utilizes the option-pricing Black-Scholes present value technique for all of its derivative instruments. This option-pricing technique utilizes a one-month LIBOR forward yield curve, obtained from an independent external service provider, matched to the identical maturity term of the instrument being measured. Observable inputs utilized in the income approach valuation technique incorporate identical contractual notional amounts, fixed coupon rates, periodic terms for interest payments and contract maturity. The fair value estimate of the interest rate derivative instruments also considers the credit risk of the Company for instruments in a liability position or the counterparty for instruments in an asset position. The credit risk is calculated by using the spread between the one-month LIBOR yield curve and the relevant average 10 and 20-year rate according to Standard and Poor’s. The Company has determined the valuation measurement inputs of these derivative instruments to maximize the use of observable inputs that market participants would use in pricing similar or identical instruments and market data obtained from independent sources, which is readily observable or can be corroborated by observable market data for substantially the full term of the derivative instrument. Further, the valuation measurement inputs minimize the use of unobservable inputs. Accordingly, the Company has classified the derivatives within Level 2 of the hierarchy framework as described by Accounting Standards Codification (“ASC”) 820, Fair Value Measurement.

The related gains or losses on these interest rate derivatives are deferred in stockholders’ equity as a component of accumulated other comprehensive loss. These deferred gains and losses are recognized in income in the period in which the related items being hedged are recognized in expense. However, to the extent that the change in value of a derivative contract does not perfectly offset the change in the value of the items being hedged, that ineffective portion is immediately recognized in other income or expense. Monthly contractual settlements of these swap positions are recognized as floorplan or other interest expense in the Company’s accompanying Consolidated Statements of Operations. All of the Company’s interest rate hedges are designated as cash flow hedges. At September 30, 2016, all of the Company’s derivative contracts that were in effect were determined to be effective. The Company had no gains or losses related to ineffectiveness or amounts excluded from effectiveness testing recognized in the Consolidated Statements of Operations for either the three or nine months ended September 30, 2016 or 2015, respectively.

The Company held interest rate swaps in effect as of September 30, 2016 of \$616.0 million in notional value that fixed its underlying one-month LIBOR at a weighted average rate of 2.6%. The Company records the majority of the impact of the periodic settlements of these swaps as a component of floorplan interest expense. For the three and nine months ended September 30, 2016, the impact of the Company’s interest rate hedges in effect increased floorplan interest expense by \$2.8 million and \$8.4 million, respectively. For the three and nine months ended September 30, 2015, the impact of the Company’s interest rate hedges in effect increased floorplan interest expense by \$2.8 million and \$8.3 million, respectively. Total floorplan interest expense was \$11.1 million and \$9.7 million for the three months ended September 30, 2016 and 2015, respectively, and \$33.7 million and \$29.0 million for the nine months ended September 30, 2016 and 2015, respectively.

In addition to the \$616.0 million of swaps in effect as of September 30, 2016, the Company held 19 additional interest rate swaps with forward start dates between December 2016 and December 2020 and expiration dates between December 2019 and December 2030. The aggregate notional value of these 19 forward-starting swaps was \$975.0 million, and the weighted average interest rate was 2.3%. The combination of the interest rate swaps currently in



effect and these forward-starting swaps is structured such that the notional value in effect through December 2030 does not exceed \$908.6 million, which is less than the Company's expectation for variable rate debt outstanding during such period.

As of September 30, 2016 and December 31, 2015, the Company reflected liabilities from interest rate risk management activities of \$45.9 million and \$31.2 million, respectively, in its Consolidated Balance Sheets. Included in Accumulated Other Comprehensive Loss at September 30, 2016 and 2015 were accumulated unrealized losses, net of income taxes, totaling \$28.7 million and \$24.8 million, respectively, related to these interest rate swaps.

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The following table presents the impact during the current and comparative prior year periods for the Company's derivative financial instruments on its Consolidated Statements of Operations and Consolidated Balance Sheets.

	Amount of Unrealized Loss, Net of Tax, Recognized in Other Comprehensive Income (Loss)	
	Nine Months Ended September 30,	
	2016	2015
	(In thousands)	
Derivatives in Cash Flow Hedging Relationship		
Interest rate swap contracts	\$ (15,575 )	\$ (12,907 )
	Amount of Loss Reclassified from Other Comprehensive Income (Loss) into Statements of Operations	
	Nine Months Ended September 30,	
	2016	2015
	(In thousands)	
Location of Loss Reclassified from Other Comprehensive Income (Loss) into Statements of Operations		
Floorplan interest expense	\$ (8,414 )	\$ (8,306 )
Other interest expense	(1,775 )	(1,275 )

The amount expected to be reclassified out of other comprehensive income (loss) into earnings as additional floorplan interest expense or other interest expense in the next twelve months is \$12.8 million.

#### 4. STOCK-BASED COMPENSATION PLANS

The Company provides stock-based compensation benefits to employees and non-employee directors pursuant to its 2014 Long Term Incentive Plan (the "Incentive Plan"), as well as to employees pursuant to its Employee Stock Purchase Plan, as amended (the "Purchase Plan", formerly named the 1998 Employee Stock Purchase Plan).

##### Long Term Incentive Plan

The Incentive Plan provides for the grant of options (including options qualified as incentive stock options under the Internal Revenue Code of 1986 and options that are non-qualified), restricted stock, performance awards, bonus stock, and phantom stock to the Company's employees, consultants, non-employee directors and officers. The Incentive Plan expires on May 21, 2024. The terms of the awards (including vesting schedules) are established by the Compensation Committee of the Company's Board of Directors. As of September 30, 2016, there were 1,232,361 shares available for issuance under the Incentive Plan.

##### Restricted Stock Awards

Under the Incentive Plan, the Company grants to non-employee directors and certain employees restricted stock awards or, at their election, restricted stock units at no cost to the recipient. Restricted stock awards qualify as participating securities as each award contains non-forfeitable rights to dividends. As such, the two-class method is required for the computation of earnings per share. See Note 5, "Earnings Per Share," for further details. Restricted stock awards are considered outstanding at the date of grant but are subject to vesting periods upon issuance up to five years. Restricted stock units are considered vested at the time of issuance, however, since they convey no voting rights, they are not considered outstanding when issued. Restricted stock units settle in cash upon the termination of the grantees' employment or directorship. In the event an employee or non-employee director terminates his or her employment or directorship with the Company prior to the lapse of the restrictions, the shares, in most cases, will be forfeited to the Company. The Company issues new shares or treasury shares, if available, when restricted stock vests. Compensation expense for restricted stock awards is calculated based on the market price of the Company's common stock at the date of grant and recognized over the requisite service period. Forfeitures are estimated at the time of valuation and reduce expense ratably over the vesting period. This estimate is adjusted annually based on the extent to which actual or expected forfeitures differ from the previous estimate.



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A summary of the restricted stock awards as of September 30, 2016, along with the changes during the nine months then ended, is as follows:

	Awards	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2015	893,360	\$ 69.16
Granted	244,820	54.35
Vested	(243,730)	58.48
Forfeited	(29,380 )	73.22
Nonvested at September 30, 2016	865,070	\$ 67.87

#### Employee Stock Purchase Plan

The Purchase Plan authorizes the issuance of up to 4.5 million shares of common stock and provides that no options to purchase shares may be granted under the Purchase Plan after May 19, 2025. The Purchase Plan is available to all employees of the Company and its participating subsidiaries and is a qualified plan as defined by Section 423 of the Internal Revenue Code. At the end of each fiscal quarter (the “Option Period”) during the term of the Purchase Plan, employees can acquire shares of common stock from the Company at 85% of the fair market value of the common stock on the first or the last day of the Option Period, whichever is lower. As of September 30, 2016, there were 1,289,527 shares available for issuance under the Purchase Plan. During the nine months ended September 30, 2016 and 2015, the Company issued 125,154 and 76,694 shares, respectively, of common stock to employees participating in the Purchase Plan. With respect to shares issued under the Purchase Plan, the Company's Board of Directors has authorized specific share repurchases to fund the shares issuable under the Purchase Plan.

The weighted average fair value of employee stock purchase rights issued pursuant to the Purchase Plan was \$13.05 and \$18.66 during the nine months ended September 30, 2016 and 2015, respectively. The fair value of stock purchase rights is calculated using the grant date stock price, the value of the embedded call option and the value of the embedded put option.

#### Stock-Based Compensation

Total stock-based compensation cost was \$4.7 million and \$4.7 million for the three months ended September 30, 2016 and 2015, respectively, and \$14.9 million and \$14.2 million for the nine months ended September 30, 2016 and 2015, respectively. Cash received from Purchase Plan purchases was \$5.6 million and \$5.6 million for the nine months ended September 30, 2016 and 2015, respectively. The tax deductions for restricted stock vested were less than the associated book expense previously recognized, which resulted in a reduction of additional paid-in capital of \$0.1 million for the nine months ended September 30, 2016. Comparatively, the tax benefit realized for the tax deductions from vesting of restricted shares totaled \$1.8 million and resulted in an increase of additional paid in capital for the nine months ended September 30, 2015.

#### 5. EARNINGS PER SHARE

The two-class method is utilized for the computation of the Company's earnings per share (“EPS”). The two-class method requires a portion of net income to be allocated to participating securities, which are unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents, including the Company's restricted stock awards. Income allocated to these participating securities is excluded from net earnings available to common shares, as shown in the table below. Basic EPS is computed by dividing net income available to basic common shares by the weighted average number of basic common shares outstanding during the period. Diluted EPS is computed by dividing net income available to diluted common shares by the weighted average number of dilutive common shares outstanding during the period.

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The following table sets forth the calculation of EPS for the three and nine months ended September 30, 2016 and 2015.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands, except per share amounts)			
Weighted average basic common shares outstanding	20,568	23,132	21,355	23,294
Dilutive effect of employee stock purchases, net of assumed repurchase of treasury stock	10	5	9	4
Weighted average dilutive common shares outstanding	20,578	23,137	21,364	23,298
Basic:				
Net Income	\$35,366	\$45,261	\$116,237	\$127,385
Less: Earnings allocated to participating securities	1,427	1,729	4,652	4,906
Earnings available to basic common shares	\$33,939	\$43,532	\$111,585	\$122,479
Basic earnings per common share	\$1.65	\$1.88	\$5.23	\$5.26
Diluted:				
Net Income	\$35,366	\$45,261	\$116,237	\$127,385
Less: Earnings allocated to participating securities	1,426	1,729	4,651	4,905
Earnings available to diluted common shares	\$33,940	\$43,532	\$111,586	\$122,480
Diluted earnings per common share	\$1.65	\$1.88	\$5.22	\$5.26

## 6. INCOME TAXES

The Company is subject to U.S. federal income taxes and income taxes in numerous U.S. states. In addition, the Company is subject to income tax in the U.K. and Brazil relative to its foreign subsidiaries. The Company's effective income tax rate of 36.5% for the three months ended September 30, 2016 was more than the U.S. federal statutory rate 35.0%, due primarily to taxes provided for in U.S. state jurisdictions and valuation allowances provided for net operating losses and other deferred tax assets in certain U.S. states and in Brazil, partially offset by taxes provided for in the U.K. at the applicable statutory rate. The Company's effective income tax rate of 35.0% of pretax income for the nine months ended September 30, 2016, was approximately equal to the U.S. federal statutory rate of 35.0%, as taxes provided for in U.S. state jurisdictions and valuation allowances provided for net operating losses and other deferred tax assets in certain U.S. states and in Brazil were offset by taxes provided for in the U.K. at the applicable statutory rate and the tax impact of a dealership disposition in Brazil.

For the three and nine months ended September 30, 2016, the Company's effective tax rate decreased to 36.5% and 35.0%, respectively, as compared to 38.0% and 37.6% for the same periods in 2015. This decrease was primarily due to the mix effect resulting from proportionately more pretax income generated in the Company's U.K. region, as well as changes to valuation allowances provided for net operating losses and other deferred tax assets in certain U.S. states and in Brazil, in addition to the tax impact of a dealership disposition in Brazil during the nine months ended September 30, 2016.

As of September 30, 2016 and December 31, 2015, the Company had no unrecognized tax benefits with respect to uncertain tax positions and did not incur any interest and penalties nor did it accrue any interest for the nine months ended September 30, 2016. When applicable, consistent with prior practice, the Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

Taxable years 2011 and subsequent remain open for examination by the Company's major taxing jurisdictions.

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## 7. DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS

Accounts and notes receivable consisted of the following:

	September 30, 2016	December 31, 2015
	(unaudited)	
	(In thousands)	
Amounts due from manufacturers	\$92,700	\$93,206
Parts and service receivables	35,548	32,479
Finance and insurance receivables	21,318	22,374
Other	9,464	12,913
Total accounts and notes receivable	159,030	160,972
Less allowance for doubtful accounts	2,736	3,204
Accounts and notes receivable, net	\$156,294	\$157,768

Inventories consisted of the following:

	September 30, 2016	December 31, 2015
	(unaudited)	
	(In thousands)	
New vehicles	\$1,166,128	\$1,262,797
Used vehicles	315,277	275,508
Rental vehicles	137,600	134,509
Parts, accessories and other	75,986	72,917
Total inventories	1,694,991	1,745,731
Less lower of cost or market reserves	7,612	7,980
Inventories, net	\$1,687,379	\$1,737,751

New and used vehicles are valued at the lower of specific cost or market and are removed from inventory using the specific identification method. Parts and accessories are valued at lower of cost (determined on either a first-in, first-out or an average cost basis) or market.

Property and equipment consisted of the following:

	Estimated Useful Lives in Years	September 30, 2016	December 31, 2015
		(unaudited)	
		(dollars in thousands)	
Land	—	\$395,358	\$364,475
Buildings	25 to 50	545,669	505,414
Leasehold improvements	varies	169,742	155,585
Machinery and equipment	7 to 20	98,341	90,993
Furniture and fixtures	3 to 10	87,603	82,688
Company vehicles	3 to 5	11,714	11,603
Construction in progress	—	69,511	58,361
Total		1,377,938	1,269,119
Less accumulated depreciation		259,153	235,138
Property and equipment, net		\$1,118,785	\$1,033,981

During the nine months ended September 30, 2016, the Company incurred \$78.9 million of capital expenditures for the construction of new or expanded facilities and the purchase of equipment and other fixed assets in the maintenance of the



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Company's dealerships and facilities, excluding \$32.7 million of capital expenditures accrued as of December 31, 2015. As of September 30, 2016, the Company had accrued \$19.9 million of capital expenditures. In addition, the Company purchased real estate (including land and buildings) during the nine months ended September 30, 2016 associated with existing dealership operations totaling \$34.0 million. And, in conjunction with the acquisition of dealerships and franchises in the nine months ended September 30, 2016, the Company acquired \$28.8 million of real estate and other property and equipment. The Company recognized \$2.0 million in asset impairments related to property and equipment for the nine months ended September 30, 2016.

As of December 31, 2015, the Company determined that certain real estate investments qualified for held-for-sale treatment. As a result, the Company classified the carrying value, after adjustment to estimated fair market value, of the real estate, totaling \$1.4 million, in prepaid and other current assets in its Consolidated Balance Sheets.

## 8. CREDIT FACILITIES

In the U.S., the Company has a \$1.8 billion revolving syndicated credit arrangement that matures on June 17, 2021 and is comprised of 24 financial institutions, including six manufacturer-affiliated finance companies ("Revolving Credit Facility"). The Company also has a \$300.0 million floorplan financing arrangement ("FMCC Facility") with Ford Motor Credit Company ("FMCC") for financing of new Ford vehicles in the U.S. and other floorplan financing arrangements with several other automobile manufacturers for financing of a portion of its U.S. rental vehicle inventory. In the U.K., the Company has financing arrangements with BMW Financial Services, Volkswagen Finance and FMCC for financing of its new and used vehicles. In Brazil, the Company has financing arrangements for new, used, and rental vehicles with several financial institutions, most of which are manufacturer affiliated. Within the Company's Consolidated Balance Sheets, Floorplan notes payable - credit facility and other primarily reflects amounts payable for the purchase of specific new, used and rental vehicle inventory (with the exception of new and rental vehicle purchases financed through lenders affiliated with the respective manufacturer) whereby financing is provided by the Revolving Credit Facility. Floorplan notes payable - manufacturer affiliates reflects amounts related to the purchase of vehicles whereby financing is provided by the FMCC Facility, the financing of a portion of the Company's rental vehicles in the U.S., as well as the financing of new, used, and rental vehicles in both the U.K. and Brazil. Payments on the floorplan notes payable are generally due as the vehicles are sold. As a result, these obligations are reflected in the accompanying Consolidated Balance Sheets as current liabilities.

### Revolving Credit Facility

On June 17, 2016, the Company amended its Revolving Credit Facility principally to increase the total borrowing capacity from \$1.7 billion to \$1.8 billion and to extend the term from an expiration date of June 20, 2018 to June 17, 2021. The Revolving Credit Facility consists of two tranches, providing a maximum of \$1.75 billion for U.S. vehicle inventory floorplan financing ("Floorplan Line"), as well as a maximum of \$360.0 million and a minimum of \$50.0 million for working capital and general corporate purposes, including acquisitions ("Acquisition Line"). The capacity under these two tranches can be re-designated within the overall \$1.8 billion commitment, subject to the aforementioned limits. Up to \$125.0 million of the Acquisition Line can be borrowed in either euros or British pound sterling. The Revolving Credit Facility can be expanded to a maximum commitment of \$2.1 billion, subject to participating lender approval. The Floorplan Line bears interest at rates equal to the LIBOR plus 125 basis points for new vehicle inventory and the LIBOR plus 150 basis points for used vehicle inventory. The Acquisition Line bears interest at the LIBOR plus 150 basis points plus a margin that ranges from zero to 100 basis points, depending on the Company's total adjusted leverage ratio, for borrowings in U.S. dollars and a LIBOR equivalent plus 125 to 250 basis points, depending on the Company's total adjusted leverage ratio, on borrowings in euros or British pound sterling. The Floorplan Line requires a commitment fee of 0.15% per annum on the unused portion. Amounts borrowed by the Company under the Floorplan Line for specific vehicle inventory are to be repaid upon the sale of the vehicle financed, and in no case is a borrowing for a vehicle to remain outstanding for greater than one year. The Acquisition Line also requires a commitment fee ranging from 0.20% to 0.45% per annum, depending on the Company's total adjusted leverage ratio, based on a minimum commitment of \$50.0 million less outstanding borrowings. In conjunction with the Revolving Credit Facility, the Company has \$5.7 million of related unamortized costs as of



September 30, 2016, which are included in Prepaid expenses and other current assets and Other Assets on the accompanying Consolidated Balance Sheets and amortized over the term of the facility.

After considering the outstanding balance of \$1,043.8 million at September 30, 2016, the Company had \$396.2 million of available floorplan borrowing capacity under the Floorplan Line. Included in the \$396.2 million available borrowings under the Floorplan Line was \$59.7 million of immediately available funds. The weighted average interest rate on the Floorplan Line was 1.7% as of September 30, 2016 and December 31, 2015, excluding the impact of the Company's interest rate swaps. With regards to the Acquisition Line, there were no borrowings outstanding as of September 30, 2016 and December 31, 2015. After considering \$37.1 million of outstanding letters of credit and other factors included in the Company's available borrowing base

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calculation, there was \$313.9 million of available borrowing capacity under the Acquisition Line as of September 30, 2016. The amount of available borrowing capacity under the Acquisition Line is limited from time to time based upon certain debt covenants.

All of the U.S. dealership-owning subsidiaries are co-borrowers under the Revolving Credit Facility. The Company's obligations under the Revolving Credit Facility are secured by essentially all of the Company's U.S. personal property (other than equity interests in dealership-owning subsidiaries), including all motor vehicle inventory and proceeds from the disposition of dealership-owning subsidiaries, excluding inventory financed directly with manufacturer-affiliates and other third-party financing institutions. The Revolving Credit Facility contains a number of significant covenants that, among other things, restrict the Company's ability to make disbursements outside of the ordinary course of business, dispose of assets, incur additional indebtedness, create liens on assets, make investments and engage in mergers or consolidations. The Company is also required to comply with specified financial tests and ratios defined in the Revolving Credit Facility, such as the fixed charge coverage and total adjusted leverage ratios. Further, the Revolving Credit Facility restricts the Company's ability to make certain payments, such as dividends or other distributions of assets, properties, cash, rights, obligations or securities ("Restricted Payments"). The Restricted Payments cannot exceed the sum of \$208.5 million plus (or minus if negative) (a) one-half of the aggregate consolidated net income for the period beginning on April 1, 2014 and ending on the date of determination and (b) the amount of net cash proceeds received from the sale of capital stock after June 2, 2014 and ending on the date of determination less (c) cash dividends and share repurchases after June 2, 2014 ("Credit Facility Restricted Payment Basket"). For purposes of the calculation of the Credit Facility Restricted Payment Basket, net income represents such amounts per the consolidated financial statements adjusted to exclude the Company's foreign operations, non-cash interest expense, non-cash asset impairment charges, and non-cash stock-based compensation. As of September 30, 2016, the Credit Facility Restricted Payment Basket totaled \$112.9 million. The Company was in compliance with all applicable covenants and ratios under the Revolving Credit Facility as of September 30, 2016.

#### Ford Motor Credit Company Facility

The FMCC Facility provides for the financing of, and is collateralized by, the Company's Ford new vehicle inventory in the U.S., including affiliated brands. This arrangement provides for \$300.0 million of floorplan financing and is an evergreen arrangement that may be canceled with 30 days' notice by either party. As of September 30, 2016, the Company had an outstanding balance of \$145.9 million under the FMCC Facility with an available floorplan borrowing capacity of \$154.1 million. Included in the \$154.1 million available borrowings under the FMCC Facility was \$22.5 million of immediately available funds. This facility bears interest at a rate of Prime plus 150 basis points minus certain incentives. The interest rate on the FMCC Facility was 5.00% before considering the applicable incentives as of September 30, 2016.

#### Other Credit Facilities

The Company has credit facilities with BMW Financial Services, Volkswagen Finance, FMCC, and another third-party financial institution for the financing of new, used and rental vehicle inventories related to its U.K. operations. These facilities are denominated in British pound sterling and are evergreen arrangements that may be canceled with notice by either party and bear interest at a base rate, plus a surcharge that varies based upon the type of vehicle being financed. The annual interest rates charged on borrowings outstanding under these facilities range from 1.10% to 3.50%. As of September 30, 2016, borrowings outstanding under these facilities totaled \$94.4 million.

The Company has credit facilities with financial institutions in Brazil, most of which are affiliated with the manufacturers, for the financing of new, used and rental vehicle inventories related to its Brazilian operations. These facilities are denominated in Brazilian real and have renewal terms ranging from one month to twelve months. They may be canceled with notice by either party and bear interest at a benchmark rate, plus a surcharge that varies based upon the type of vehicle being financed. The annual interest rates charged on borrowings outstanding under these facilities, after the grace period of zero to 90 days, range from 16.77% to 24.45%. As of September 30, 2016, borrowings outstanding under these facilities totaled \$23.1 million.

Excluding rental vehicles financed through the Revolving Credit Facility, financing for U.S. rental vehicles is typically obtained directly from the automobile manufacturers. These financing arrangements generally require small

monthly payments and mature in varying amounts over a period of two years. The interest rate charged on borrowings related to the Company's rental vehicle fleet varies up to 5.00%. Rental vehicles are typically transferred to used vehicle inventory when they are removed from service and repayment of the borrowing is required at that time. As of September 30, 2016, borrowings outstanding under these facilities totaled \$108.6 million.

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## 9. LONG-TERM DEBT

The Company carries its long-term debt at face value, net of applicable discounts and capitalized debt issuance costs. Long-term debt consisted of the following:

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
5.00% Senior Notes (aggregate principal of \$550,000 at September 30, 2016 and December 31, 2015)	\$ 540,075	\$ 538,933
5.25% Senior Notes (aggregate principal of \$300,000 at September 30, 2016 and December 31, 2015)	295,455	295,156
Real Estate Related and Other Long-Term Debt	393,813	365,564
Capital lease obligations related to real estate, maturing in varying amounts through June 2034 with a weighted average interest rate of 9.8%	48,679	51,902
	1,278,022	1,251,555
Less current maturities of other long-term debt	45,305	52,021
	\$ 1,232,717	\$ 1,199,534

Included in current maturities of long-term debt and short-term financing in the Company's Consolidated Balance Sheets as of September 30, 2016, and December 31, 2015, was \$17.0 million and \$3.0 million, respectively, of short-term financing that was due within one year.

### 5.00% Senior Notes

On June 2, 2014, the Company issued \$350.0 million aggregate principal amount of its 5.00% Senior Notes due 2022 ("5.00% Notes"). Subsequently, on September 9, 2014, the Company issued an additional \$200.0 million of 5.00% Notes at a discount of 1.5% from face value. The 5.00% Notes will mature on June 1, 2022 and pay interest semiannually, in arrears, in cash on each June 1 and December 1, beginning December 1, 2014. Using proceeds of certain equity offerings, the Company may redeem up to 35.0% of the 5.00% Notes prior to June 1, 2017, subject to certain conditions, at a redemption price equal to 105% of principal amount of the 5.00% Notes plus accrued and unpaid interest. Otherwise, the Company may redeem some or all of the 5.00% Notes prior to June 1, 2017 at a redemption price equal to 100% of the principal amount of the 5.00% Notes redeemed, plus an applicable premium, and plus accrued and unpaid interest. On or after June 1, 2017, the Company may redeem some or all of the 5.00% Notes at specified prices, plus accrued and unpaid interest. The Company may be required to purchase the 5.00% Notes if it sells certain assets or triggers the change in control provisions defined in the 5.00% Notes indenture. The 5.00% Notes are senior unsecured obligations and rank equal in right of payment to all of the Company's existing and future senior unsecured debt and senior in right of payment to all of its future subordinated debt. The 5.00% Notes are guaranteed by substantially all of the Company's U.S. subsidiaries. The U.S. subsidiary guarantees rank equally in the right of payment to all of the Company's U.S. subsidiary guarantor's existing and future subordinated debt. In addition, the 5.00% Notes are structurally subordinated to the liabilities of its non-guarantor subsidiaries and are subject to customary covenants, including a restricted payment basket and debt limitations. The restricted payment basket calculation under the terms of the 5.00% Notes is the same as under the Credit Facility Restricted Payment Basket. The 5.00% Notes were registered with the Securities and Exchange Commission in June 2015.

The underwriters' fees, discount and capitalized debt issuance costs relative to the 5.00% Notes totaled \$13.1 million. These amounts are included as a direct reduction of the 5.00% Notes on the accompanying Consolidated Balance Sheets and are being amortized over a period of eight years in conjunction with the term of the 5.00% Notes. The 5.00% Notes are presented net of unamortized underwriters' fees, discount and debt issuance costs of \$9.9 million as of September 30, 2016.

### 5.25% Senior Notes

On December 8, 2015, the Company issued 5.25% senior unsecured notes with a face amount of \$300.0 million due to mature on December 15, 2023 ("5.25% Notes"). The 5.25% Notes pay interest semiannually, in arrears, in cash on each June 15 and December 15, beginning June 15, 2016. Using proceeds of certain equity offerings, the Company may

redeem up to 35.0% of the 5.25% Notes prior to December 15, 2018, subject to certain conditions, at a redemption price equal to 105.25% of principal amount of the 5.25% Notes plus accrued and unpaid interest. Otherwise, the Company may redeem some or all of the 5.25% Notes prior to December 15, 2018 at a redemption price equal to 100% of the principal amount of the 5.25% Notes redeemed, plus an applicable make-whole premium, and plus accrued and unpaid interest. On or after December 15, 2018, the Company may redeem some or all of the 5.25% Notes at specified prices, plus accrued and unpaid interest. The Company may be required to purchase the 5.25% Notes if it sells certain assets or triggers the change in control provisions defined in the 5.25% Notes indenture. The 5.25% Notes are senior unsecured obligations and rank equal in right of payment to all of the Company's existing and future senior unsecured debt and senior in right of payment to all of its future

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subordinated debt. The 5.25% Notes are guaranteed by substantially all of the Company's U.S. subsidiaries. The U.S. subsidiary guarantees rank equally in the right of payment to all of the Company's U.S. subsidiary guarantor's existing and future subordinated debt. In addition, the 5.25% Notes are structurally subordinated to the liabilities of its non-guarantor subsidiaries and are subject to customary covenants, including a restricted payment basket and debt limitations. The restricted payment basket calculation under the terms of the 5.25% Notes is the same as under the Credit Facility Restricted Payment Basket.

The underwriters' fees and capitalized debt issuance costs relative to the 5.25% Notes totaled \$5.0 million. These amounts are included as a direct reduction of the 5.25% Notes on the accompanying Consolidated Balance Sheets and are being amortized over a period of eight years in conjunction with the term of the 5.25% Notes. The 5.25% Notes are presented net of unamortized underwriters' fees and debt issuance costs of \$4.5 million as of September 30, 2016.

#### Acquisition Line

See Note 8, "Credit Facilities," for further discussion on the Company's Revolving Credit Facility and Acquisition Line.

#### Real Estate Related and Other Long-Term Debt

The Company, as well as certain of its wholly-owned subsidiaries, has entered into separate term mortgage loans in the U.S. with three of its manufacturer-affiliated finance partners, Toyota Motor Credit Corporation ("TMCC"), BMW Financial Services NA, LLC ("BMWFS") and FMCC, as well as several third-party financial institutions. These mortgage loans may be expanded for borrowings related to specific buildings and/or properties and are guaranteed by the Company. Each mortgage loan was made in connection with, and is secured by mortgage liens on, the real property owned by the Company that is mortgaged under the loans. The mortgage loans bear interest at fixed rates between 3.00% and 4.69%, and at variable indexed rates plus a spread between 1.50% and 2.50% per annum. The Company capitalized \$2.7 million of related debt issuance costs related to the mortgage loans that are included as a direct reduction to the mortgage loans on the accompanying Consolidated Balance Sheets and are being amortized over the terms of the mortgage loans. As of September 30, 2016, \$0.7 million remained unamortized.

The mortgage loans consist of 55 term loans for an aggregate principal amount of \$363.0 million. As of September 30, 2016, borrowings outstanding under these notes totaled \$326.3 million, with \$28.8 million classified as a current maturity of long-term debt. For the nine months ended September 30, 2016, the Company made additional net borrowings and principal payments of \$42.2 million and \$12.1 million, respectively. The agreements provide for monthly payments based on 15 or 20-year amortization schedules and mature between May 2017 and December 2024. These mortgage loans are cross-collateralized and cross-defaulted with each other.

The Company has entered into 13 separate term mortgage loans in the U.K. with other third-party financial institutions which are secured by the Company's U.K. properties. These mortgage loans (collectively, "U.K. Notes") are denominated in British pound sterling and are being repaid in monthly installments that will mature by September 2034. As of September 30, 2016, borrowings under the U.K. Notes totaled \$54.1 million, with \$4.5 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets. For the nine months ended September 30, 2016, the Company assumed \$8.3 million of term mortgage loans in conjunction with U.K. dealership acquisitions, made no additional borrowings and made principal payments of \$3.6 million associated with the U.K. Notes.

The Company also has a working capital loan agreement with a third-party financial institution in the U.K. As of September 30, 2016, borrowings under the U.K. third-party loan totaled \$7.7 million and were due in October 2016. For the nine months ended September 30, 2016, the Company made \$7.8 million of additional borrowings and made principal payments of \$3.0 million.

The Company has a separate term mortgage loan in Brazil with a third-party financial institution (the "Brazil Note"). The Brazil Note is denominated in Brazilian real and is secured by one of the Company's Brazilian properties, as well as a guarantee from the Company. The Brazil Note is being repaid in monthly installments that will mature by April 2025. As of September 30, 2016, borrowings under the Brazil Note totaled \$4.0 million, with \$0.4 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets. For the nine months ended September 30, 2016, the Company made no additional borrowings and made principal payments of \$0.3 million

associated with the Brazil Note.

The Company also has a working capital loan agreement with a third-party financial institution in Brazil. The principal balance on this loan is due by February 2017 with interest only payments being made until the due date. As of September 30, 2016, borrowings under the Brazilian third-party loan totaled \$6.8 million. For the nine months ended September 30, 2016, the Company made no additional borrowings.

**Fair Value of Long-Term Debt**

The Company's outstanding 5.00% Notes had a fair value of \$552.8 million and \$545.9 million as of September 30, 2016 and December 31, 2015, respectively. The Company's outstanding 5.25% Notes had a fair value of \$302.1 million and \$297.8

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million as of September 30, 2016 and December 31, 2015, respectively. The Company's fixed interest rate borrowings included in real estate related and other long-term debt totaled \$95.6 million and \$100.7 million as of September 30, 2016 and December 31, 2015, respectively. The fair value of such fixed interest rate borrowings was \$96.5 million and \$102.4 million as of September 30, 2016 and December 31, 2015, respectively. The fair value estimates are based on Level 2 inputs of the fair value hierarchy available as of September 30, 2016 and December 31, 2015. The Company determined the estimated fair value of its long-term debt using available market information and commonly accepted valuation methodologies. Considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, these estimates are not necessarily indicative of the amounts that the Company, or holders of the instruments, could realize in a current market exchange. The use of different assumptions and/or estimation methodologies could have a material effect on estimated fair values. The carrying value of the Company's variable rate debt approximates fair value due to the short-term nature of the interest rates.

#### 10. FAIR VALUE MEASUREMENTS

ASC 820 defines fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; requires disclosure of the extent to which fair value is used to measure financial and non-financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date; and establishes a three-level valuation hierarchy based upon the transparency of inputs utilized in the measurement and valuation of financial assets or liabilities as of the measurement date:

- Level 1 — unadjusted, quoted prices for identical assets or liabilities in active markets;
- Level 2 — quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable or that can be corroborated by observable market data by correlation; and
- Level 3 — unobservable inputs based upon the reporting entity's internally developed assumptions that market participants would use in pricing the asset or liability.

The Company's financial instruments consist primarily of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, investments in debt and equity securities, accounts payable, credit facilities, long-term debt and interest rate swaps. The fair values of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, accounts payable, and credit facilities approximate their carrying values due to the short-term nature of these instruments or the existence of variable interest rates. The Company evaluated its assets and liabilities for those that met the criteria of the disclosure requirements and fair value framework of ASC 820 and identified demand obligations, interest rate derivative instruments, and investment balances in certain financial institutions as having met such criteria.

The Company periodically invests in unsecured, corporate demand obligations with manufacturer-affiliated finance companies, which bear interest at a variable rate and are redeemable on demand by the Company. Therefore, the Company has classified these demand obligations as cash and cash equivalents in the accompanying Consolidated Balance Sheets. The Company determined that the valuation measurement inputs of these instruments include inputs other than quoted market prices, that are observable or that can be corroborated by observable data by correlation. Accordingly, the Company has classified these instruments within Level 2 of the hierarchy framework.

In addition, the Company maintains an investment balance with certain of the financial institutions in Brazil that provide credit facilities for the financing of new, used and rental vehicle inventories. The investment balances bear interest at a variable rate and are redeemable by the Company in the future under certain conditions. The Company has classified these investment balances as long-term assets in the accompanying Consolidated Balance Sheets. The Company determined that the valuation measurement inputs of these instruments include inputs other than quoted market prices, that are observable or that can be corroborated by observable data by correlation. Accordingly, the Company has classified these instruments within Level 2 of the hierarchy framework.

The Company's derivative financial instruments are recorded at fair market value. See Note 3, "Derivative Instruments and Risk Management Activities" for further details regarding the Company's derivative financial instruments. See



Note 9, "Long-term Debt" for details regarding the fair value of the Company's long-term debt.

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