GROUP 1 AUTOMOTIVE INC
Form 10-K
February 12, 2010

Table of Contents

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, 2009

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 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 o 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. þ

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). o No þ

The aggregate market value of common stock held by non-affiliates of the registrant was approximately $605.4 million based on the reported last sale price of common stock on June 30, 2009, which is the last business day of the registrant s most recently completed second quarter.

As of February 9, 2010, there were 24,497,257 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 2010 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2009, are incorporated by reference into Part III of this Form 10-K.

TABLE OF CONTENTS

Table of Contents

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, as amended (the Securities Act) 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 recent economic recession substantially depressed consumer confidence, raised unemployment 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, including climate control changes legislation, 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, Mercedes-Benz, 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, or in the case of Chrysler and General Motors has resulted in, a restructuring of these companies, up to and including bankruptcy; and, as such, we may suffer financial loss in the form of uncollectible receivables, devalued inventory or loss of franchises;

Table of Contents

- 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;

- manufacturer quality issues may negatively impact vehicle sales and brand reputation;

- 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 ability to refinance or obtain financing in the future may be limited and the cost of financing could increase significantly;

- foreign exchange controls and currency fluctuations;

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

- the 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 volumes 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. Should one or more of the risks or uncertainties described above or elsewhere in this Annual Report or in the documents incorporated by reference occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements. We urge you to carefully consider those factors, as well as factors described in our reports 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, organized in 1995, is a leading operator in the automotive retail industry. As of December 31, 2009, we owned and operated 124 franchises at 95 dealership locations and 22 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, 2009, our retail network consisted of the following three regions (with the number of dealerships they comprised): (i) the Eastern (41 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, and South Carolina), (ii) the Central (43 dealerships in Kansas, Oklahoma and Texas) and (iii) the Western (11 dealerships in California). Each region is managed by a regional vice president who reports directly to our Chief Executive Officer and is responsible for the overall performance of their regions, as well as for overseeing the market directors and dealership general managers that report to them. Each region is also managed by a regional chief financial officer who reports directly to our Chief Financial Officer. Our dealerships in the U.K. are also 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 what we believe to be one of our key strengths the 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. We believe, as evidenced by the significant industry experience reflected in the biographical information of our executive officers, which is provided on page 16, that over the last four years we have developed a distinguished management team with substantial industry expertise.

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 completed acquisitions comprising in excess of $108.4 million in estimated aggregated annualized revenues for 2009. And, we believe that substantial opportunities for growth through acquisition remain in our industry. An acquisition target has not yet been determined for 2010, but we expect to acquire dealerships in existing or new markets that meet our stringent acquisitions and return on investment criteria. We will selectively grow our portfolio of import and luxury brands, and we will focus that growth in geographically diverse areas with bright economic outlooks over the longer-term. Further, we will continue to critically evaluate our return on invested capital in our dealership operations for disposition opportunities.

While we desire to grow through acquisitions, we continue to primarily focus on the performance of our existing dealerships to achieve internal growth goals. We believe further revenue expansion is available in our dealerships and plan to utilize enhancements to our processes and technology to help our people deliver that goal. In particular, we continue to focus on growing our higher margin used vehicle and parts and service businesses, which can be expanded even in a shrinking new vehicle market. The use of software tools in conjunction with our

Table of Contents

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 will continue to enhance the business in these areas in the future and make the requisite capital investments to expand our service business.

For 2010, 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;
- Operating efficiency and additional cost reduction/savings efforts;
- Maximize cash flow generated through operations;
- Continued 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
- Enhancement of our current dealership portfolio by strategic acquisition, dealership facility investments and the improvement or disposition of underperforming dealerships.

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.

Our focus for our used vehicle operations in 2010 will include the enhancement of our processes around the matching of inventory supply with customer demand, the sharing of inventory across markets, regions and the company, the utilization of alternative means of marketing and the continued development of technological solutions to assist in the management of our used vehicle inventory. Focus in our parts and service operations will be on targeted marketing efforts, strategic selling and operational efficiencies. We believe that these initiatives will enhance our results of operations in these business areas and our overall results.

We made significant changes in our operating model during 2008 and 2009, designed to reduce variable expenses, appropriately size our business for the reduced levels of sales and service activity and generate operating efficiencies. Specifically related to personnel expenses, we initiated various wage cuts, including a 10% wage reduction for the Board of Directors and senior management and a 5% wage reduction for all other corporate employees, as well as various other regional, market and dealership level employees. In addition, we suspended the Company s match for employee contributions to their respective 401(K) savings plans. Further, we reduced headcount from the beginning of 2008 by approximately 20% to date. As it relates to advertising, our cost reductions were primarily related to a decrease in overall advertising levels and a shift to utilization of various in-house and email marketing tools, as well as our ability to capitalize on declining media rates. Other forecasted expense reductions reflect initiatives designed to reduce software solutions, contract labor, travel and entertainment, delivery and loaner car expenses. In 2010, we will continue to look for opportunities to reduce variable costs and improve our operating efficiency. And, as the level of sales and service returns to more normalized levels in the future, we will be judicious with the expansion of our cost structure to maximize our operating results.

During 2009, which was one of the most challenging years in the history of the automotive retail industry, we generated positive cash flow from operations. We expect to be cash flow positive from operations in 2010, as well. We will, therefore, be focused on opportunities to use the cash generated in the best interest of our company and our stockholders.

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. Since 2005, we have consolidated our operational structure from over 15 platforms led by Platform Presidents who directly reported to the President and CEO to our current structure of three regions and the United Kingdom, led by Regional Vice Presidents who report directly to our President and CEO. 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 we are using to effectively manage the business operations and strategically consolidate operational and administrative functions, further developing the operating model and supporting the extension of best practices and the leverage of scale.

With regards to our efforts to improve or dispose of underperforming dealerships, we are constantly evaluating the opportunity to improve the profitability of our dealerships. We attempt to capitalize on our size, leverage and ability to disseminate best practices, in order to expedite these efforts. We believe that our efforts will improve our financial condition and operating results.

Table of Contents

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 years ended December 31, 2009, 2008 and 2007 were $4,401.3 million, $5,491.8 million and $6,086.9 million from our domestic operations, and $124.4 million, $162.3 million and $173.3 million from our foreign operations, respectively. As of December 31, 2009, 2008, and 2007 our aggregate long-lived assets other than goodwill, intangible assets and financial instruments in our domestic operations were $462.1 million, $531.3 million and $418.3 million, and in our foreign operations were $21.6 million, $20.3 million and $28.4 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 2009 and the number of dealerships and franchises in each region:

Region	Geographic Market	Percentage of Our New Vehicle Retail Units Sold During the Year Ended December 31, 2009	As of December 31, 2009 Number of Dealerships	As of December 31, 2009 Number of Franchises
Eastern	Massachusetts	15.1%	10	10
	New Jersey	6.5	6	7
	New Hampshire	4.2	3	3
	New York	4.1	4	4
	Georgia	3.7	4	4
	Louisiana	3.1	4	8
	Mississippi	1.8	3	3
	Florida	1.7	2	4
	Maryland	0.9	2	2
	Alabama	0.7	2	2
	South Carolina	0.3	1	1
		42.1	41	48
Central	Texas	32.1	29	39
	Oklahoma	8.3	12	20
	Kansas	1.2	2	2
		41.6	43	61
Western	California	14.0	11	15
International	United Kingdom	2.3	3	6
Total		100.0%	98	130

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, 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 2009, we sold or leased 83,182 new vehicles representing 31 brands in retail transactions at our dealerships. Our retail sales of new vehicles accounted for approximately 19.9% of our gross profit in 2009. In addition to the

Table of Contents

profit related to the transactions, a typical new vehicle retail sale or lease creates the following additional profit opportunities for our dealerships:

- manufacturer incentives, if any;
- the resale of any used vehicle 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 critical to our success. Over the past five years, we have strategically managed our exposure to the declining domestic brands and emphasized the faster growing luxury and import brands, shifting our sales mix from 36.2% domestic and 63.8% luxury and import in 2005 to 16.5% and 83.5% in 2009, 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, 2009:

	New Vehicle Revenues (In thousands)	New Vehicle Unit Sales	% of Total Units Sold	Franchises Owned As of December 31, 2009
Toyota	$ 618,730	25,079	30.2%	13(1)
Nissan	248,209	9,943	12.0%	12
Honda	203,590	8,766	10.5%	8
Mazda	18,951	825	1.0%	2
Hyundai	18,084	870	1.0%	3
Volkswagen	17,735	719	0.9%	2
Subaru	16,490	688	0.8%	1
Scion	14,588	826	1.0%	N/A(1)
Kia	6,276	326	0.4%	2
Mitsubishi	864	39	0.0%	1
Total import	1,163,517	48,081	57.8%	44
BMW	306,140	6,169	7.4%	13
Mercedes-Benz	250,916	4,696	5.6%	6
Lexus	199,038	4,570	5.5%	3
Acura	60,880	1,711	2.1%	4
Mini	49,583	1,988	2.4%	6
Infiniti	29,105	741	0.9%	1
Volvo	21,147	648	0.8%	1
Audi	19,095	437	0.5%	1

Lincoln	6,369	148	0.2%	4
Porsche	4,252	59	0.1%	1
Maybach	3,858	8	0.0%	1
smart	3,218	193	0.2%	1
Total luxury	953,601	21,368	25.7%	42
Ford	199,897	6,310	7.6%	10
Dodge	75,794	2,539	3.1%	6
Chevrolet	72,881	2,268	2.7%	5
Jeep	27,766	1,083	1.3%	6