THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GPI - Q4 2012 Group 1 Automotive Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 19, 2013 / 3:00PM GMT

OVERVIEW:

GPI reported full-year 2012 consolidated revenues of $7.5b, adjusted net income of $108.2m and adjusted net income per diluted common share of $4.53. 4Q12 consolidated revenues were $1.94b, adjusted net income was $24m, and adjusted common diluted EPS was $0.99.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Pete DeLongchamps *Group 1 Automotive Inc - VP, Financial Services and Manufacturer Relations*

Earl Hesterberg *Group 1 Automotive Inc - President & CEO*

John Rickel *Group 1 Automotive Inc - SVP & CFO*

CONFERENCE CALL PARTICIPANTS

John Murphy *BofA Merrill Lynch - Analyst*

Ravi Shanker *Morgan Stanley - Analyst*

James Albertine *Stifel Nicolaus - Analyst*

Patrick Archambault *Goldman Sachs - Analyst*

Scott Stember *Sidoti & Company - Analyst*

Brett Hoselton *KeyBanc Capital Markets - Analyst*

Bill Armstrong *CL King & Associates - Analyst*

Matt Nemer *Wells Fargo Securities, LLC - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Group 1 Automotive' s 2012 fourth-quarter and full-year earnings conference call. All participants will be in listen-only mode.

(Operator Instructions)

Please be advised -- this call is being recorded. I would now like to turn the conference over to Mr. Pete DeLongchamps, Vice President of Financial Services and Manufacturer Relations. Please go ahead, Mr. DeLongchamps.

Pete DeLongchamps - *Group 1 Automotive Inc - VP, Financial Services and Manufacturer Relations*

Thank you, Laura. Good morning, everyone, and welcome to today's call. The Earnings Release we issued this morning, and the related slide presentation that include reconciliations related to the adjusted results we'll refer to on this call for comparison purposes, have been posted to Group 1's website. Before we begin, I'd like to make some brief remarks about forward-looking statements, and the use of non-GAAP financial measures.

Except for historical information mentioned during the conference call, statements made by management of Group 1 Automotive are forward-looking statements that are pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve both known and unknown risks and uncertainties, which may cause the Company's actual results in future periods to differ materially from forecasted results. Those risks include, but are not limited to, risks associated with pricing, volume, and the conditions of markets. Those and other risks are described in the Company's filings with the Securities and Exchange Commission over the last 12 months. Copies of these filings are available from both the SEC and the Company.

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

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

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

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Thank you, Pete, and good morning, everyone. For the full year of 2012, Group 1 retailed 128,550 new vehicles, driving a 23% revenue increase to a record $7.5 billion. Adjusted earnings per diluted share were a record $4.53 on a 25.8% net income increase to $108.2 million. Our Corporate focus in 2012 was on growth, and I'm pleased to report that Group 1's new-vehicle unit sales outpaced the industry's 13.4% increase by growing 26% on a consolidated basis and 16.4% on a same-store basis. We significantly outpaced the industry's used-vehicle retail unit sales growth of 4.5%, as reported by CNW Research, by retailing 21% more used vehicles in total, with 12.9% increase on a same-store basis.

Turning now to our fourth-quarter results, Group 1 reported a 9.4% increase in adjusted net income to $24 million or $0.99 per diluted share on a 19.3% revenue increase. While we were pleased to continue with a very strong top line growth rate, our cost leverage did not meet our expectations. I will cover the issues and the actions we're taking to address this in just a moment.

Turning first, though, to our sales performance. Same-store new-vehicle revenues grew 15.8%, as we retailed 14.6% more units compared with industry retail growth of 11% in the quarter. New-vehicle gross profit increased 3.7%, that's gross profit per unit decreased $199 to $1,897, partially reflecting the inflated margins on import vehicles in the fourth quarter last year due to inventory shortages. New-vehicle average sales price increased slightly to $34,965 due to stronger luxury sales in the quarter.

On a consolidated basis in the fourth quarter, Group 1's luxury mix expanded to 32% of new-vehicle unit sales, import brands contributed 50% and domestic brands accounted for 18% of the units sold. Toyota/Lexus sales accounted for 29% of our new-vehicle unit sales, with BMW/Mini, Honda/Acura, VW/AUDI/Porche, and Hyundai/Kia increasing their share of Group 1's new-vehicle unit sales during the quarter. New-vehicle inventory held steady a 63 days supply, or 26,615 units.

Same-store used retail gross profit increased 7.4% on a 9% higher revenues, as the gross profit per unit grew slightly to $1,635. The average selling price increased 1.8% to $20,842, reflecting an expanded mix of used-vehicle sales at our luxury stores. On a 38-day supply, used-vehicle inventory was a little higher at the end of the fourth quarter than what we've been running during the past few quarters. We're comfortable at this level, as much of it came in the last 10 days of December due to the exceptionally strong year-end new-vehicle sales trade-ins. Same-store Finance and Insurance attained $1,293 per retail unit, and revenues grew 21.1% on an 11.6% retail unit increase. Same-store Parts and Service revenue and gross profit grew 4.3%.

Relative to our cost performance, on a consolidated basis, adjusted selling general and administrative expenses as a percent of revenues improved 40 basis points to 11.1%. However, as a percent of gross profit, SG&A increased 60 basis points to 76.7%. While we did incur some additional costs in the fourth quarter for several new business initiatives we've been working on, we clearly did not deliver the leverage that we expected in the quarter.

In total, our SG&A was about 2% or $4.5 million above our expectations and the trend line we had established during the first three quarters given the gross we generated. The largest miss, about $2 million, was around variable compensation, which was pressured by further contraction in import brand gross margin as industry inventory levels have fully rebounded. We also had a workers' compensation accrual of $1.6 million resulting from an additional unfavorable development on several prior-year claims. We've implemented a variety of actions that should better align our cost structure with current sales and margin conditions in 2013. We expect continued strong sales growth, but are making some adjustments for the current vehicle margin reality.

In addition, we estimate we spent approximately $750,000 in the fourth quarter on several important initiatives that we launched in the second half of 2012. We believe these are important building blocks that will help drive future growth, but will require some upfront investments to implement them. First, as we previously announced, we're moving into the final stages of consolidation of all of our US transactional accounting services into one business support center. This project should be completed by the end of this year. In the interim, however, we need to duplicate staff for a short period of time before all the synergy savings can be fully achieved. The ongoing savings beginning in 2014 are expected to exceed $1 million annually.

Second, we have begun the process of converting all Group 1 stores to a common front-end CRM, which is customer relationship management, an F&I tool that will match and thereby commonize this across all of our US stores. This should allow for significant sharing and leverage opportunities when completed. We're about halfway through the conversion period, which is expected to stretch through October. This also involves additional training costs, which we will incur into early 2014.

Finally, we launched a major effort in the fourth quarter to improve our inbound service call handling. We're already starting to see positive results with live answer rates up to 15 to 20 percentage points higher. Once again, we've had to duplicate staff in advance of the full benefits being achieved. The ramp up in conversion to our new process should be completed by late 2013. We believe these three initiatives will improve sales volume, customer satisfaction, and operating efficiency in the long term.

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

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Thank you, Earl, and good morning, everyone. My following comments will be on a year-over-year basis, unless otherwise noted. Our adjusted net income for the fourth quarter of 2012 rose $2.1 million or 9.4% on a comparable basis to $24 million. These results for 2012 exclude $4.3 million of after-tax, non-cash asset impairment charges; $1.2 million of after-tax insurance deductibles related to Superstorm Sandy; $1.1 million of after-tax deal costs primarily associated with the previously announced pending acquisition in Brazil; and $548,000 of after-tax severance costs primarily related to a dealership closure in the UK. These adjustments were partially offset by a $276,000 after-tax net gain on dealership and real estate dispositions. The comparable prior-period results exclude $461,000 of after-tax, non-cash asset impairment charges, as well as $641,000 of after-tax charge related to an accrual for a pending legal matter.

The fourth-quarter weighted average diluted share count increased 1.2 million shares, or 5.5%, from the prior year to 23.2 million shares. This is primarily explained by an increase of 1 million shares due to the dilutive effect of our 2.25% and 3% convertible notes. The dilutive effect of these debt instruments will fluctuate with respect to our stock price in accordance with the dilution tables published on our website. For the quarter, adjusted earnings per diluted common share increased 5.3% on a comparable basis to $0.99.

On a consolidated basis, revenues grew during the fourth quarter by $313 million, or 19.3%, to $1.94 billion compared to the same period a year ago, reflecting increases in each of our business segments. New-vehicle revenues grew 22.3% to $1.16 billion. Our used-vehicle retail revenues improved 16.6% to $423.3 million. And used-vehicle wholesale revenues grew 17.3% to $69.7 million.

F&I revenues rose 26.7% to $67.7 million, or $1,270 per retail unit sold, which is yet again the Company's best-ever quarterly F&I performance. Revenues from our Parts and Service business increased $17 million, or 8.3%, to $221.7 million. Our gross profit grew $34.4 million, or 14%, to $280.3 million, which included increases of 12.4% in New Vehicles, 13.6% in total Used Vehicles, and 8.6% in Parts and Service, as well as the F&I improvement that I just mentioned.

Our consolidated adjusted SG&A, as a percent of gross profit, at 76.7% for the quarter was 60 basis points higher than the prior year. This is above our expectations, and reflects the variable compensation miss, as well as the investment in new initiatives that Earl covered in his comments. In addition, the ratio was also impacted by recent acquisitions still in the assimilation process, heightened seasonality from our recent large UK acquisition, and a $1.6 million non-cash charge to adjust our workers' comp claims accrual related primarily to our California dealerships.

The primary driver of the workers' comp accrual was further unfavorable development of prior-year claims that were incurred during the recession. A handful of these claims have had significant adverse development as they have matured. Going forward we would expect our workers' comp costs to grow more in line with our headcount.

Regarding the investment in new initiatives, we would expect to continue to incur additional expenses throughout the first half of the year in the range of $750,000 per quarter, with the cost dropping to $500,000 per quarter in the second half, before implementation is complete. Floorplan interest expense increased $930,000, or 12.5%, to $8.4 million. This increase is primarily explained by a $320.5 million increase in weighted average borrowings, as Japanese brand inventory has normalized.

In addition, overall inventory increases were required to support rising sales and recent dealership acquisitions. Partially offsetting this increase in borrowings was a lower weighted average interest rate, which was mainly attributable to the expiration of several higher rate swaps during 2012.

At December 31, 2012, our new-vehicle inventory stood at 26,615 units with a value of $906 million, compared to 18,766 units with a value of $619.2 million as of December 31, 2011. Manufacturers' interest assistance, which we record as a reduction of new-vehicle cost of sales at the time vehicles are sold, covered 103.2% of total floorplan interest expense in the fourth quarter, which is up from 98.2% in the fourth quarter a year ago. Other interest expense increased $705,000, or 7.9%, to $9.6 million, explained by increased mortgage borrowings associated with recent dealership acquisitions, which was partially offset by a lower weighted average interest rate. Our consolidated interest expense includes non-cash discount amortization of $2.6 million related to our convertible notes.

Our effective tax rate for the quarter was 38.6%, which was an increase of 100 basis points from the prior year. This change was primarily due to the change in mix of our pre-tax income from the taxable state jurisdictions in which we operate. We expect our effective tax rate in 2013 will be approximately 38%, which includes the impact of our pending acquisition in Brazil. The first quarter, however, should be slightly higher at 38.5%, as there'll only be a limited impact from the UAB acquisition.

For the full year of 2012, we generated all-time record for adjusted net income of $4.53 per diluted common share, which is an increase of 25.1% over the comparable prior-year results. Our consolidated revenues were also an all-time record at $7.5 billion, and were up 23% from our 2011 results. New-vehicle unit sales rose 26% to 128,550 units, while used retail vehicle unit sales increased 21.1% to 85,366 units. Total gross profit improved 16.3% to $1.1 billion, including a 17.6% increase in our New-Vehicle gross profit, a 17.3% improvement in Used-Vehicle retail gross profit, a 32.8% rise in F&I, and an 8.4% increase in our Parts and Service gross profit. Adjusted SG&A expense as a percent of gross profit improved 100 basis points from 2011 results to 75.4%.

Now turning to fourth-quarter same-store results, again, statements are on a year-over-year basis unless otherwise noted. In the fourth quarter, we recorded revenues of $1.8 billion, which was an increase of $202.2 million, or 12.6%. Within this total, New-Vehicle revenue was up 15.8% to $1.1 billion, primarily explained by a 14.6% increase in new-vehicle retail unit sales, as well as a $375 increase in sales price per retail unit. In total, our Used-Vehicle revenues rose 8.5% to $451.1 million. Within that, our Used Retail revenues improved 9% to $389.7 million, primarily explained by a 7.1% increase in used-vehicle retail unit sales, as well as a $373 increase in sales per retail unit. Our wholesale used-vehicle revenues increased 5.7% to $61.5 million on 11.2% more unit sales.

F&I income per retail unit rose 8.6% to $1,293, driven by increases in our penetration rates for both vehicle and finance contracts, as well as improvements in our income per contract for most of our F&I product offerings. In total, F&I revenues were up $11.2 million or 21.1%.

We posted another strong quarter in our Parts and Service business, as revenues grew 4.3%. The overall revenue increase is explained by a growth of 11.7% in warranty, 7.7% in collision, 5.7% in parts wholesale, and 0.1% in customer pay. It should be noted that manufacturer free maintenance programs, such as Toyota Care, have shifted what once were classified as customer pay revenues over to the warranty segment, partially explaining the relative under-performance of customer pay growth. As a reminder, our Parts and Service revenues are not inflated by increases in internal business. The revenue associated with internal work is eliminated in consolidation. This varies across the sector, as some of our competitors account for internal work differently.

Overall, our same-store gross profit improved by $19.9 million, or 8.2%. Our New-Vehicle gross profit dollars improved 3.7%, which is the result of the higher unit volume. As we have previously mentioned, New-Vehicle gross profit per unit was inflated last year as a result of the severe industry-wide inventory constraints that resulted from the natural disasters in Japan. Given that, we would suggest a sequential comparison is more appropriate. Compared with third-quarter 2012, our consolidated New-Vehicle gross profit per retail unit increased $10 to $1,937. Our

Used-Vehicle retail gross profit dollars increased 7.4%, primarily explained by the 7.1% increase in units sold, while gross profit per retail unit sold increased $5 to $1,635.

Parts and Service gross profit grew 4.3%, or $4.5 million, reflecting improvement in each business line. Our adjusted SG&A as a percent of gross profit improved 20 basis points, 75.6%, which, for reasons we previously discussed, is above what we would have expected given the gross profit generated in the quarter.

Now, turning to liquidity and capital structure. During 2012, we generated adjusted cash flow from operations of $159.2 million. As of December 31, 2012, we had $4.7 million of cash on hand, another $112.3 million that was invested in our floorplan offset account, bringing immediately available funds to a total of $117 million. In addition, we had $220.7 million available on our acquisition line that can also be used for general corporate purposes. As such, our total liquidity at December 31, 2012 was $337.7 million. As previously announced, we expect that the acquisition costs of the 18 dealerships in Brazil will be funded entirely through excess cash. We do not anticipate having to utilize our acquisition line.

During the quarter, we used $3.4 million to pay dividends of $0.15 per share, which is an increase of $0.02 per share over the fourth-quarter 2011. We also used $22.3 million for capital expenditures during the quarter to construct new facilities, purchase equipment, and improve existing facilities. Our full-year capital spending was [$62] million for 2012, which was in line with our target. We will continue to critically evaluate all planned capital spending, and work with our manufacturer partners to maximize the return on our investments. We estimate the capital spending for 2013 will be less than $70 million.

With regards to our real estate investment portfolio, we own $518 million of land and buildings at December 31, which represents 40% of our total real estate. To finance these holdings, we utilized our mortgage facility, and executed borrowings under other real estate specific debt agreements. As of December 31, we had $56.7 million outstanding under our mortgage facility, and $244.5 million of other real estate debt, excluding capital leases. For additional detail regarding our financial condition, please refer to the schedules of additional information attached to the news release, as well as the investor presentation posted on our website.

With that, I'll now turn it back over to Earl.

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Thanks, John. Before I turn the call over to the operator for your questions, looking at full-year results, Group 1 turned in a record year in both sales and net income, and added scale through acquisitions. We've also launched a series of new initiatives that will benefit Group 1 shareholders for the long term, that I noted a moment ago. In addition, we are also looking forward to completing the previously announced acquisition of UAB Motors that will give Group 1 entry into the rapidly growing Brazilian automotive market. And we're continuing to seek qualified acquisitions to expand our presence in the US and UK markets as well.

In addition to proceeding on these initiatives that will drive future growth, we anticipate new-vehicle industry sales will range from 15.3 million to 15.5 million units in the US in 2013. We're confident that Group 1's brand and geographic mix will allow us to gain share in the markets we serve.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

John Murphy, Bank of America Merrill Lynch.

John Murphy - *BofA Merrill Lynch - Analyst*

Good morning, guys. A first question on SG&A to maybe get some clarity, as we think about what happened here in the Northeast in New York and New Jersey, there was a fair amount of interruption in -- around Superstorm Sandy, and I mean you've called out some stuff here, but just curious, are there other operating expenses that you're running through the P&L that you're not calling out here? Sort of secondarily, obviously you lost a number of days and potentially sales, did that snap back in the quarter or is that something that is still on the com? I'm just trying to understand really the operating impact that you felt here in the Northeast?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Yes, there was some disruption with Sandy. I would not try to imply that that was a significant cost issue when we looked at this $4.5 million overrun or a 2% problem. There's a little bit of that in there, but I don't think it would be fair to hang our hat on that. We did lose quite a bit of vehicle sales early on, but then there was a spurt later in the quarter. I can't really tell you if we got it all back, but it was the typical famine and then feast. What we did lose was some parts and service business no doubt. We lost maybe seven or eight days that you just really never get back. With that said, our same-store parts and service sales grew 4.3% for the quarter, which was pretty good. So I expect we could have done better without Sandy, but that's just the way it goes. But I don't think Sandy was a big cost issue at the end of the day.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay. And if we think about the three items or buckets that you've laid out here, it sounds like some of them will continue into 2013 and are focused on future efficiencies, so they seem like they make a lot of sense. I'm just curious, as we think about the flow through of gross profit to operating profit, you guys have been ranging about 35% over the last couple of years, sort of vacillating between 30 and 40%. This quarter was a bit weaker than that. I'm just curious, as we think about of the flow through of gross profit to operating income in 2013, will that get back into that mid-30% range, or do you think this is this investment year in future efficiency which will limit that flow through?

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

John, this is John Rickel. The way we look at that metric is actually on a same-store basis because anytime you have acquisitions it obviously distorts it. And on a same-store basis we think that we should be able to get back to that $0.50 on the dollar for each incremental gross profit dollar flowing through. I would give us a quarter, Earl's put a number of actions in place at the start of the first quarter. I would give us a quarter for those to gain traction, but I think as we get into second quarter and then later in the year, we should be able to get back on that track even with the growth initiatives that we're working on.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay. That's incredibly helpful. Then if we think about the grosses on the midline imports, obviously on a year-over-year basis there's been some pressure, but it sounds like it's a little bit more than just a tough comparison. I mean what's going on, or what are you seeing in that slice of the market? Is that something you expect to persist? Would they get more aggressive on pricing or are they really leaning on the dealers to move the metal?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

There was a lot of pressure to move the metal, a lot of competition out there. I have to say, our focus last year was also to move the metal. Our same-store new vehicle sales were up 16.4% for the year and 14.6% for the quarter. We maybe had a little too much emphasis on moving metal, also. But, we're working to temper that a little bit. Our F&I has gotten so strong we've been too willing to sell cars at or near losses, I think, to make the F&I money. So, we're trying to work on that a little bit, too. I don't think the competitive environment is going to relax a lot, and that drives most of that. There's an awful lot of competition right now, a lot of strong manufacturers out there vying for share. I think the competition generally is going to stay pretty intense.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay. And then just lastly, as you guys are moving towards owning more of your real estate, you're up to 40% at this point, are there more opportunities on any leases or rental situations that would allow that to step up in 2013? Or should we just think of that as a slow, steady grind higher?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

I think it's a slow and steady grind higher. We look for opportunities as we acquire dealerships to acquire the real estate. We don't have a lot of existing lease opportunities to buy those out.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay. Great. Thank you very much.

Operator

Ravi Shanker, Morgan Stanley.

Ravi Shanker - *Morgan Stanley - Analyst*

Good morning, everyone. I noticed that you made a number of franchise disposals in the fourth quarter and even the first quarter even more than you acquired actually, but for a net gain of revenues. So, is it fair to assume that you're getting rid of underperforming dealers and acquiring better dealers so that should be a bit of a margin boost into 2013 and beyond?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Yes, that's correct.

Ravi Shanker - *Morgan Stanley - Analyst*

Okay. And any way to quantify that in terms of what the margins of the disposed dealers were compared to Corporate average?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

No, it's not really possible, and it's kind of funny, Ravi. It was just the way the timing worked. We actually, in a couple cases, had been trying to dispose of a couple of those for some period of time, and they all hit at one time. It's safe to assume that these are not significantly profitable dealerships and weren't adding anything to the Company and were probably tying up capital and robbing management time.

Ravi Shanker - *Morgan Stanley - Analyst*

Got it. And can you remind us again what's the timing around UAB hitting your financials? And is there going to be any volatility around SG&A when that happens as well?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Well, our goal is to close on that by March 1, so to begin operating that business with our new partners on March 1. That remains to be seen, but we're on track to do that. That business is a little lower operating margin than what we have, and probably a little higher SG&A business than we have. Until we can operate it for a few months, it's hard to quantify that.

Ravi Shanker - *Morgan Stanley - Analyst*

Understood. Lastly, we've all seen what the yen has done in terms of depreciation and what that might mean for the potential of J3 OEMs. Earl, would love your thoughts on what do you think this means for the industry? Do you think the J3 brands will eat the profitability, or do you think they'll get more competitive on either price or content or anything else?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Despite the fact that Lexus increased prices on a couple models the over day, which is mildly confusing, I would expect them to get more aggressive in the marketplace. They were aggressive last year, but I think that continues. There's a lot of new model launches for these -- I'm thinking of Honda and Toyota, and I would think they'll be very, very strong in marketing their new model launches.

Ravi Shanker - *Morgan Stanley - Analyst*

And do you see that coming through price or through content or advertising?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

I would expect general marketing support, which would include advertising. I still think there's a certain feeling that they were disadvantaged in the market for a long time with lack of supply, and I think they're still fighting to recapture some of that share.

Ravi Shanker - *Morgan Stanley - Analyst*

Very good. Thank you.

Operator

James Albertine, Stifel Nicolaus.

James Albertine - *Stifel Nicolaus - Analyst*

Great. Thanks for taking my question and good morning, everyone. First, I just wanted to ask a quick question on the Parts and Service side. Digging into warranty a little bit, you did mention a shift from what had been accounted for customer pay into warranty, but really wanted to understand how much of that was underpinned by recalls, and really what your thought is on warranty trends as we look forward to 2013?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Well, we still assume that we're not going to get growth from warranty. If we do, we do, and yes, there have been more industry recalls. I think in our books we've also reclassified some of the Toyota two-year free maintenance from customer pay to warranty because Toyota actually pays that like they do a warranty claim. So, there's a little bit of noise maybe in our numbers. I think the most important, overriding concept for all of us is that we should have a little bit of tailwind coming for the first time in several years on the unit in operation profile. You can see we grew our Parts and Service business by 2%, same-store, in last year, but 4.3% in the fourth quarter. So, I think the Parts and Service business should be a bigger growth factor for us in the year ahead. To split that between warranty and customer pay, we focus on customer pay and collision, and the warranty just happens.

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Right. Jamie, just to put a little more color around that, we estimate that the -- just the Toyota Customer Care piece, moving that from customer pay to warranty, probably cost us 50 to 60 basis points of growth in customer pay. We've been closer to 1% growth there. Conversely, because warranty's a smaller number, probably added about 150 basis points to the warranty growth. Warranty would have been closer to 10% without that change. And we are seeing additional manufacturers offering that. VW's got some free maintenance programs. The Nissan Altima has free maintenance for three years. We're going to continue to see a bit of that trend as we go forward with more manufacturers offering the free maintenance, which we actually find very positive, because it really helps lock the customers in to the dealership experience.

James Albertine - *Stifel Nicolaus - Analyst*

That's very helpful. And then if I may add just one quick one on F&I. Very, obviously, very strong aggregate number, I think you said $1,293 for the quarter. Wanted to get an idea, though, within your portfolio what the range looks like? Trying to get a sense for maybe midline imports versus -- and midline domestics versus more of the luxury brands and where you see the opportunity for improvement there, if any, going forward? Thanks.

Pete DeLongchamps - *Group 1 Automotive Inc - VP, Financial Services and Manufacturer Relations*

Sure, it's Pete DeLongchamps and thank you for your comments. Clearly, the domestic piece of our business has the higher PRU associated with it, and that's a result of higher VSC penetrations. On the bottom side there's still opportunity with some of our midline imports, and we've just been focusing on dealership by dealership and ensuring that we're providing as much opportunity for the customer to participate with service contracts and capture as much of the financing as possible. It's been good execution and good partnerships with our lenders and vendors and field team. It's been fruitful for us, but we still think that there's some additional opportunity for the Company.

James Albertine - *Stifel Nicolaus - Analyst*

Very good. Thanks for your help and good luck this quarter.

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Thanks.

Operator

Patrick Archambault, Goldman Sachs.

Patrick Archambault - *Goldman Sachs - Analyst*

Thank you. Good morning. I had a couple quick questions here. One on Used sales, it looks like you're used to new ratio ticked down to 0.61, which is the lowest it's been for a while. I note that seems to have been the case in the fourth quarter for pretty much everybody who's reported so far, so it's not specific to you. Maybe, could you give us a little bit of color on that? I mean how much of this is just the stage of the cycle where, maybe new is gaining share and how much of it is your initiative that are sort of causing this little dip here in that ratio?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Yes, Patrick, first point is we never use that ratio for any Management analysis. That ratio number is more a function of brand and geographic footprint. That ratio number changes if we buy dealerships in the UK, if we buy or dispose of dealerships in the Northeast or California, when we add Brazilian business, these things are structurally different. They don't indicate performance. Also, last year when the Japanese didn't have new vehicle inventory, new vehicle sales dropped, so you might have thought someone was doing a better job in used cars. So, we don't look at that. We look at our growth rate in used cars, because that comes from the footprint we already operate in. In Boston, in Massachusetts, there are laws that make it tougher to do used business. There are space constraints in Los Angeles and places we can't display used cars outside, things like that. So, the footprint determines our used to new ratio, generally.

We grew 7.1% same-store in the fourth quarter, which I think was a pretty good job. We grew 12.9% same-store for the full year, which I think was a pretty good job. I'm looking at four companies that reported already in the fourth quarter, and they're all very good companies in my opinion. One was up 1%. One was up 1.8%. We were up 7.1% and the other was up 0.3% more than us. I'm pretty sure we're significantly outperformed the market for a long time in used car sales. That's the way we look at it.

I will tell you that December was not a good used car sales month, but it seldom is. What happens in December is there's so much emphasis from the OEMs on new vehicle sales, to close the year and so forth, that the OEMs and many of the dealers like Group 1 get a little carried away with new vehicle sales at the expense of used vehicle sales in December. I found the month of December to be a disappointing used vehicle sales month, but I was not surprised by that.

Patrick Archambault - *Goldman Sachs - Analyst*

Okay. Very helpful color. I guess while we're on the topic of used, can you just give us your sense of the margin opportunity? Now that new is coming back, there's more trade-ins, is this an area where margins could conceivably improve from here, or is the competitive nature of it still pretty tough out there?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

I think your point's valid there. I'd like to think we could get a little upside from here, and I do think we're still short of good quality used cars. We're still 60/40 on the split between trade-ins and acquiring outside. We've seen the used vehicle margins erode over the last few years, and I think there's a chance to bounce those up a little bit in the year ahead. We will make an effort to do that.

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Pat, this is John. I agree with that and I think Earl makes a really good point that some of this is still driven by the trade-in percents. We're still not back to historical levels of where we're sourcing our used vehicles from. And the other thing to bear in mind is the age of the fleet that we're getting dealt from out there is significantly older, so even where we are getting trades now, they're not quite at the optimal level. So, I think over time, as the age of the fleet starts to come back down as the sales rates have continued to pick up, there will be opportunity. Lease rates are starting to come back. That's another great source of used vehicles for us. I think that's probably a little further out. You're probably looking next year before you start to see much opportunity there.

Patrick Archambault - *Goldman Sachs - Analyst*

Okay. Terrific. Thanks a lot, guys.

Operator

Scott Stember, Sidoti and Company.

Scott Stember - *Sidoti & Company - Analyst*

Good morning. Can you guys talk about the gross profit on the new car side once again? I think you, John, when you were talking about the performance on a sequential basis, there seemed to be some improvement there. Can you talk about how much of that might have come from better luxury sales, which typically don't carry as much discount activity? And what would the outlook be going forward into '13?

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Yes, Scott, this is John. Clearly, fourth quarter you do get a little help from luxury mix. We're still, I think, comfortable with a view that around $1,900 a unit is the normalized range. Obviously, when we bring Brazil in, we'll have to see what that looks like. We want to see how that operates for a month or two. But, ex Brazil, I think $1,900 is a fair level to assume for the time being.

Scott Stember - *Sidoti & Company - Analyst*

Okay. And on the SG&A front, just looking out, if I heard you correct. Is it fair to assume that out of that $4 million in costs that the majority, $3.5 million, $3.6 million of it will essentially go away as the year progresses?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

We better make it go away. (laughter) Yes, I think that's fair, Scott. That's what -- we've been working on that for about six weeks.

Scott Stember - *Sidoti & Company - Analyst*

Okay. And can you maybe just talk about some of the mechanics on the compensation side, on how that's going to work, and the timing on that?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

It's hard to get into that kind of micro detail, but let me see if I can give you a general thought or two that might help you. You know that we were very aggressive in trying to gain share last year and sell new and used vehicles, and we were successful in that regard. I think some of the structures we had in place relative to incentive compensation were probably better served in a 13 million unit industry than a 15 million or a 15.5 million unit industry. I also think that some of our structures may have been weighted too much toward volume and not enough towards gross profit. I mentioned earlier in the call that we may be selling too many vehicles at virtually no vehicle gross profit because we're so strong in F&I. So, there's a lot of things we're working on there, but I hope that gives you a little flavor.

Scott Stember - *Sidoti & Company - Analyst*

Yes, that's very help helpful Could you just maybe comment really quick on how sales have looked so far in the first quarter?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

I have to tell you our business is very, very strong in every sales area. Obviously, we've talked about the cost issue we need to address, but you saw the SAAR in January and the prognostication for February from most of the experts. And, our New Vehicle, our Used Vehicle, our Parts and Service business, I mean, this is a good time for top line growth. Our sales are strong.

Scott Stember - *Sidoti & Company - Analyst*

Got you. That's all I have. Thank you so much.

Operator

Brett Hoselton, KeyBanc.

Brett Hoselton - *KeyBanc Capital Markets - Analyst*

Good morning gentlemen. I wanted to dig a little bit more into the SG&A here. It sounds like your workers' comp accrual bumped up $1.6 million.

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Correct.

Brett Hoselton - *KeyBanc Capital Markets - Analyst*

And is that going to go away next quarter, or is it just a one-time accrual issue or does that continue on for some period of time?

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Well, Brett, this is John. We think most of that was catch up for adverse development of claims that came really out of the recession period. At this point, I think that our absolute level of worker comp cost is at the right levels. You should see that cost grow in line with whatever our headcount grows going forward.

Brett Hoselton - *KeyBanc Capital Markets - Analyst*

And then, if I take that amount, I take your new initiatives of like $750,000, and it appears as though, based on my calculations, that accounts for about half of the bump up in SG&A leverage, or -- and the other half I would attribute to the higher variable comp. I mean, proportionally, is that roughly what you're seeing too?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Yes, I think that's an accurate assessment, Brett. I mean that's the way we're looking at it, and I don't know if you could hear the last call, but that's -- some of those comp structures, particularly volume related and so forth, but that's some of the work we've been doing and we need to get fixed.

Brett Hoselton - *KeyBanc Capital Markets - Analyst*

And it sounds like based on your former commentary you're making those changes here in the first quarter and you anticipate the benefit of that in the second quarter?

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

That's our goal.

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

John thinks we'll take a little longer to get traction, but I don't think we can approach it that way.

Brett Hoselton - *KeyBanc Capital Markets - Analyst*

Okay. And then switching gears on acquisitions, generally speaking you guys seem to target around $500 million to $750 million. UAB's an additional $540 million. I guess my question is, is UAB -- it's a pretty significant move, change, going down into Brazil. I'm wondering is it, look, we've made this pretty significant acquisition down in Brazil. We're going to sit back, take some time to digest that, or is it, you know what, I can see us picking up another $100 million, $150 million, $200 million in acquisition revenue throughout the remainder of this year?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Well, although we don't really target it on a dollar basis like that, Brett, we are not going to preclude ourselves from expanding in the US and the UK. So, that's quite possible. The Brazilian operation does not put a load on our US or UK operating teams, which have more capacity. So to the degree we can find expansion opportunities that we can afford, that are a good return on investment for our shareholders in the US and the UK, we will continue to expand there.

Brett Hoselton - *KeyBanc Capital Markets - Analyst*

Okay. Thank you gentlemen.

Operator

Bill Armstrong, CL King & Associates.

Bill Armstrong - *CL King & Associates - Analyst*

Good morning. I just want to talk about revenues. Your same-store revenues were pretty strong, obviously. What about in the non-comparable stores that are not in the comp base, whether they're new stores or acquired stores? They seem to be maybe a little less productive on a top line basis than your comp stores. Is that true, and is that also typical of acquired stores? What's the process for getting them more up to speed?

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Yes, Bill, this is John Rickel. I think part of what may be distorting that for you is one of the large acquisitions we had in 2012, were stores in the UK and you have to bear in mind there's pretty significant seasonality in the UK. Fourth quarter is significantly weaker for those UK stores than what you'd see for our normal stores. March and September are the big sales months there. So that may be part of what's distorting that. In general, the acquired stores are basically on the same sales performance rate as the other stores. There's always opportunity, but I don't think there's a significant difference between the groups.

Bill Armstrong - *CL King & Associates - Analyst*

So, it's really an issue of seasonality then, which would make the Q4 numbers appear to be weaker then?

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

I believe so.

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Yes, because in the UK there's a plate change in September, which is third quarter and then there's another one in March which is first quarter. So, the sales in the UK tend to be quite a bit depressed in the fourth quarter.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. Thanks for that clarification.

Operator

Matt Nemer, Wells Fargo.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Good morning, everyone. Just a couple follow ups. First, notwithstanding your comments about the strong Q1 start, are you hearing any noise from your GMs related to late tax refunds and the payroll tax perhaps on the lower MSRP models?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Not yet. Not yet. We're sensitive to that because we have heard about it, and it's an issue, but it's not been brought to our attention from our operating people yet.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Okay. And then just a quick follow-up on Service. You already touched on the warranty piece, but was there any impact of Sandy in the collision growth? It looked like that accelerated pretty nicely from last quarter.

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

I would say there was a small impact for us. Most of our big body shops are not in that area, but we have one on Long Island, for example, and obviously, it got filled right up after a few weeks following the storm, and so forth. Our big shops tend to be along the southern half of the US.

THOMSON REUTERS

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Okay. And then just lastly, if we look at your SG&A and compare the same-store performance to the consolidated performance, same-store it looks like it was up -- it grew slower than gross profit and on a consolidated basis it grew faster than gross profit, which suggests that a lot of the pressure was in on the acquisition side. Is that fair? Has the SG&A been more elevated with acquisitions and is that just a function of the fact that they haven't been in the base that long?

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

That's accurate. That's true. We actually got about 0.2 of a point of leverage on the same-store basis on SG&A, which I wouldn't say is good, Matt, but we -- but there is a bigger issue with new stores and getting the costs out of them.

John Rickel - *Group 1 Automotive Inc - SVP & CFO*

Sure, and the other piece, Matt, -- this is John, that feeds into that same comment on the UK, the UK acquisition, there's more seasonality. Those Audi stores that we picked up were probably 25 basis points of the move just themselves from that seasonality.

Matt Nemer - *Wells Fargo Securities, LLC - Analyst*

Got it. Okay. That's helpful. Thanks and good luck in 2013.

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

Thank you, Matt.

Operator

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

Earl Hesterberg - *Group 1 Automotive Inc - President & CEO*

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

Operator

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