GROUP 1 AUTOMOTIVE INC
Form 10-Q
August 08, 2008

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

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2008

OR

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

Commission File Number: 1-13461

Group 1 Automotive, Inc.
(Exact name of registrant as specified in its charter)

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

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

Large accelerated filer þ	Accelerated filer o	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 Exchange Act). Yes o   No þ

As of August 4, 2008, the registrant had 23,270,471 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

	June 30, 2008 (Unaudited)	December 31, 2007
	(In thousands, except per share amounts)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 39,968	$ 34,248
Contracts-in-transit and vehicle receivables, net	146,818	189,400
Accounts and notes receivable, net	84,179	82,698
Inventories	934,706	878,168
Assets related to discontinued operations		30,531
Deferred income taxes	18,933	18,287
Prepaid expenses and other current assets	22,286	29,651
Total current assets	1,246,890	1,262,983
PROPERTY AND EQUIPMENT, net	542,453	427,223
GOODWILL	500,388	486,775
INTANGIBLE FRANCHISE RIGHTS	307,304	300,470
OTHER ASSETS	25,961	28,730
Total assets	$ 2,622,996	$ 2,506,181
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Floorplan notes payable credit facility	$ 755,009	$ 648,469
Floorplan notes payable manufacturer affiliates	168,901	170,911
Current maturities of long-term debt	13,667	12,260
Accounts payable	110,321	111,458
Liabilities related to discontinued operations		35,180
Accrued expenses	101,760	100,000
Total current liabilities	1,149,658	1,078,278
LONG-TERM DEBT, net of current maturities	587,710	641,821

OTHER REAL ESTATE RELATED AND LONG-TERM DEBT, net of current maturities	37,296	6,104
CAPITAL LEASE OBLIGATIONS RELATED TO REAL ESTATE, net of current maturities	40,225	26,913
DEFERRED INCOME TAXES	29,772	6,849
LIABILITIES FROM INTEREST RATE RISK MANAGEMENT ACTIVITIES	15,395	16,188
OTHER LIABILITIES	32,089	29,016
Total liabilities before deferred revenues	1,892,145	1,805,169
DEFERRED REVENUES	13,693	16,531
STOCKHOLDERS EQUITY:		
Preferred stock, $0.01 par value, 1,000 shares authorized; none issued or outstanding		
Common stock, $0.01 par value, 50,000 shares authorized; 25,554 and 25,532 issued, respectively	256	255
Additional paid-in capital	292,807	293,675
Retained earnings	529,892	502,783
Accumulated other comprehensive loss	(9,097)	(9,560)
Treasury stock, at cost; 2,289 and 2,427 shares, respectively	(96,700)	(102,672)
Total stockholders equity	717,158	684,481
Total liabilities and stockholders equity	$ 2,622,996	$ 2,506,181

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(In thousands, except per share amounts)			
REVENUES:				
New vehicle retail sales	$ 971,281	$ 1,039,549	$ 1,860,062	$ 1,952,993
Used vehicle retail sales	298,593	296,650	602,588	576,651
Used vehicle wholesale sales	67,496	81,590	134,723	154,746
Parts and service sales	192,753	176,437	383,589	349,200
Finance, insurance and other, net	52,992	52,051	105,416	101,088
Total revenues	1,583,115	1,646,277	3,086,378	3,134,678
COST OF SALES:				
New vehicle retail sales	908,262	970,248	1,739,899	1,820,301
Used vehicle retail sales	266,192	261,684	536,605	506,507
Used vehicle wholesale sales	68,290	82,139	135,458	154,097
Parts and service sales	88,960	80,029	175,426	160,451
Total cost of sales	1,331,704	1,394,100	2,587,388	2,641,356
GROSS PROFIT	251,411	252,177	498,990	493,322
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	195,337	191,998	390,399	385,000
DEPRECIATION AND AMORTIZATION EXPENSE	6,497	5,103	12,315	9,838
ASSET IMPAIRMENTS		356		356
INCOME FROM OPERATIONS	49,577	54,720	96,276	98,128
OTHER INCOME AND (EXPENSES):				
Floorplan interest expense	(12,392)	(11,477)	(24,400)	(23,388)
Other interest expense, net	(7,066)	(6,141)	(14,904)	(10,661)
Gain on redemption of senior subordinated notes				
Other income, net	(36)	95	723	191
INCOME BEFORE INCOME TAXES	30,083	37,197	57,695	64,270
PROVISION FOR INCOME TAXES	11,591	12,908	22,100	22,349
INCOME FROM CONTINUING OPERATIONS	$ 18,492	$ 24,289	$ 35,595	$ 41,921
DISCONTINUED OPERATIONS				
Loss related to discontinued operations	(2,367)	(104)	(3,481)	(381)
Income tax benefit related to losses on discontinued operations	1,091	31	1,478	123

Loss from discontinued operations	(1,276)	(73)	(2,003)	(258)
NET INCOME	$ 17,216	$ 24,216	$ 33,592	$ 41,663
BASIC EARNINGS (LOSS) PER SHARE:				
Earnings per share from continuing operations	$ 0.82	$ 1.02	$ 1.58	$ 1.76
Loss per share from discontinuing operations	(0.06)		(0.09)	(0.01)
Earnings per share	$ 0.76	$ 1.02	$ 1.49	$ 1.75
Weighted average common shares outstanding	22,478	23,744	22,566	23,819
DILUTED EARNINGS (LOSS) PER SHARE:				
Earnings per share from continuing operations	$ 0.82	$ 1.02	$ 1.57	$ 1.75
Loss per share from discontinuing operations	(0.06)	(0.01)	(0.09)	(0.01)
Earnings per share	$ 0.76	$ 1.01	$ 1.48	$ 1.74
Weighted average common shares outstanding	22,661	23,888	22,728	23,984
CASH DIVIDENDS PER COMMON SHARE	$ 0.14	$ 0.14	$ 0.28	$ 0.28

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2008	2007
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 33,592	$ 41,663
Net loss from discontinued operations	2,003	258
Adjustments to reconcile net income to net cash provided by operating activities:		
Asset impairments		356
Depreciation and amortization	12,315	9,838
Deferred income taxes	22,277	12,243
Other	4,283	3,395
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Contracts-in-transit and vehicle receivables	44,182	15,937
Accounts and notes receivable	(970)	(4,677)
Inventories	(44,274)	3,087
Prepaid expenses and other assets	15,212	10,777
Floorplan notes payable manufacturer affiliates	(3,522)	(10,365)
Accounts payable and accrued expenses	(428)	19,929
Deferred revenues	(2,838)	(2,380)
Net cash provided by operating activities, from continuing operations	81,832	100,061
Net cash used in operating activities, from discontinued operations	(13,373)	(3,551)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(114,994)	(55,697)
Proceeds from sales of franchises, property and equipment	18,445	9,667
Cash paid in acquisitions, net of cash received	(48,389)	(111,116)
Other	1,088	2,479
Net cash used in investing activities, from continuing operations	(143,850)	(154,667)
Net cash provided by (used in) investing activities, from discontinued operations	23,051	(137)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on credit facility Floorplan Line	2,876,729	2,835,096
Repayments on credit facility Floorplan Line	(2,771,438)	(2,813,998)
Repayments on credit facility Acquisition Line	(150,000)	
Borrowings on credit facility Acquisition Line	65,000	
Borrowings on mortgage facility	54,625	
Borrowings of long-term debt related to real estate purchases	33,515	75,050
Repurchase of senior subordinated notes	(17,762)	

Dividends paid		(6,483)		(6,775)
Principal payments of long-term debt		(5,050)		(521)
Principal payments on mortgage facility		(3,236)		
Proceeds from issuance of common stock to benefit plans		1,990		2,894
Borrowings on other facilities for acquisitions		1,490		
Debt issue costs		(365)		(3,550)
Excess tax benefits from stock-based compensation		178		103
Repayments on other facilities for divestitures				(2,498)
Repurchases of common stock, amounts based on settlement date				(16,003)
Net cash provided by financing activities, from continuing operations		79,193		69,798
Net cash provided by (used in) financing activities, from discontinued operations		(21,103)		1,221
EFFECT OF EXCHANGE RATE CHANGES ON CASH		(30)		(9)
NET INCREASE IN CASH AND CASH EQUIVALENTS		5,720		12,716
CASH AND CASH EQUIVALENTS, beginning of period		34,248		39,340
CASH AND CASH EQUIVALENTS, end of period	$	39,968	$	52,056
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid for:				
Interest	$	44,655	$	34,398
Income tax expenses, net of (refunds) received	$	5,210	$	

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

	Common Stock		Additional	Retained	Accumulated Other Comprehensive Income (Loss)			Treasury	
					Unrealized Gains (Losses) on	Unrealized Gains (Losses) on	Unrealized Gains on		
			Paid-in		Interest Rate	Marketable	Currency		
	Shares	Amount	Capital	Earnings	Swaps	Securities	Translation	Stock	Total
				(In thousands)					
ALANCE, December 31, 07	25,532	$ 255	$ 293,675	$ 502,783	$ (10,118)	$ (76)	$ 634	$ (102,672)	$ 684,48
mprehensive income:									
t income				33,592					33,59
erest rate swap ustment, net of tax nefit of $297					496				49
in on investments, net of es of $6						10			1
realized loss on rency translation							(43)		(4
tal comprehensive come									34,05
uance of common and asury shares to ployee benefit plans	(143)	(1)	(6,041)					5,951	(9
oceeds from sales of mmon stock under ployee benefit plans	108	1	1,967					21	1,98
uance of restricted stock	83	1	(1)						
rfeiture of restricted ck	(26)								
ock-based compensation			3,387						3,38
x benefit from options ercised and the vesting restricted shares			(180)						(18
sh dividends				(6,483)					(6,48
ALANCE, June 30, 2008	25,554	$ 256	$ 292,807	$ 529,892	$ (9,622)	$ (66)	$ 591	$ (96,700)	$ 717,15

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND ORGANIZATION:

Group 1 Automotive, Inc., a Delaware corporation, through its subsidiaries, is a leading operator in the automotive retailing industry with operations 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 United States and in the towns of Brighton, Hailsham and Worthing in the United Kingdom (U.K.). Through their dealerships, these subsidiaries sell new and used cars and light trucks; arrange related financing, and sell vehicle service and insurance contracts; provide maintenance and repair services; and sell replacement parts. Group 1 Automotive, Inc. and its subsidiaries are collectively referred to as the Company or Group 1 in these notes.

As of June 30, 2008, the Company s retail network consisted of the following three regions (with the number of dealerships they comprised): (i) Eastern (40 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina); (ii) Central (47 dealerships in Kansas, Oklahoma and Texas); and (iii) Western (11 dealerships in California). Each region is managed by a regional vice president reporting directly to the Company s Chief Executive Officer, who 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, the Company s international operations consist of three dealerships in the U.K. also managed locally with direct reporting responsibilities to the Company s corporate management team.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

All acquisitions of dealerships 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. All intercompany balances and transactions have been eliminated in consolidation.

Interim Financial Information

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States 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 accounting principles generally accepted in the United States 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 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 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, 2007 (2007 Form 10-K).

Reclassifications

During the three months ended June 30, 2008, the Company disposed of certain operations that qualified for discontinued operations accounting treatment. In order to reflect these operations as discontinued, the necessary reclassifications have been made to the Company s Consolidated Statement of Operations for the three and six months ended June 30, 2007, as well as the Company s Consolidated Statement of Cash Flows for the six months ended June 30, 2007. In addition, the Company has made reclassifications to the Consolidated Balance Sheet as of December 31, 2007, which was derived from the audited Consolidated Balance Sheet included in the Company s 2007 Form 10-K.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Statements of Cash Flows

With respect to all new vehicle floorplan borrowings, vehicle manufacturers draft the Company s credit facilities directly with no cash flow to or from the Company. With respect to borrowings for used vehicle financing, the Company chooses which vehicles to finance and the funds flow directly to the Company from the lender. All borrowings from, and repayments to, lenders affiliated with the vehicle manufacturers (excluding the cash flows from or to affiliated lenders participating in our syndicated lending group) are presented within cash flows from operating activities on the Consolidated Statements of Cash Flows and all borrowings from, and repayments to, the syndicated lending group under the revolving credit facility (including the cash flows from or to affiliated lenders participating in the facility) are presented within cash flows from financing activities.

Income Taxes

Currently, the Company operates in 15 states in the U.S. and three cities in the U.K. Each of these tax jurisdictions has unique tax rates and payment calculations. As the amount of income generated in each jurisdiction varies from period to period, the Company s estimated effective tax rate can vary based on the proportion of taxable income generated in each jurisdiction.

The effective income tax rate of 38.5% and 38.3% of pretax income from continuing operations for the three and six months ended June 30, 2008, respectively, differed from the federal statutory rate of 35% due primarily to the taxes provided for the taxable state jurisdictions in which the Company operates. For the three and six months ended June 30, 2008, our effective tax rate related to continuing operations increased to 38.5% and 38.3% from 34.7% and 34.8%, respectively, for the same periods in 2007, due primarily to the benefit received from tax-deductible goodwill for 2007 dealership dispositions and changes in the mix of our pretax income from the taxable state jurisdictions in which we operate.

The Company s option grants include options that qualify as incentive stock options for income tax purposes. The treatment of the potential tax deduction, if any, related to incentive stock options may cause variability in the Company s effective tax rate in future periods. In the period in which compensation cost related to incentive stock options is recorded in accordance with Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (SFAS 123(R)), a corresponding tax benefit is not recorded, as based on the design of these incentive stock options, the Company is not expected to receive a tax deduction related to such incentive stock options when exercised. However, if upon exercise the incentive stock options fail to continue to meet the qualifications for treatment as incentive stock options, the Company may be eligible for certain tax deductions in subsequent periods. In those cases, the Company would record a tax benefit for the lower of the actual income tax deduction or the amount of the corresponding cumulative stock compensation cost recorded in the financial statements for the particular options multiplied by the statutory tax rate.

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement 109 (FIN 48). This statement clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company s financial statements. FIN 48 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order to be recognized in the financial statements (See Note 5 for additional information). No cumulative adjustment was required to effect the adoption of FIN 48.

Foreign Currency Translation

The functional currency for our foreign subsidiaries is the Pound Sterling. The financial statements of all our foreign subsidiaries have been translated into U.S. dollars in accordance with SFAS No. 52, Foreign Currency Translation. All assets and liabilities of foreign operations are translated into U.S. Dollars using period-end exchange rates and all revenues and expenses are translated at average rates during the respective period. The U.S. Dollar results that arise from the translation of all assets and liabilities are included in the cumulative currency translation adjustments in accumulated other comprehensive income of stockholders equity.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recent Accounting Pronouncements

Effective January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements, (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements, for all of its financial assets and liabilities. The statement does not require new fair value measurements, but (i) emphasizes that fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability and (ii) provides guidance on how to measure fair value by providing a fair value hierarchy for classification of financial assets or liabilities based upon measurement inputs. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. The adoption of SFAS 157 did not have a material effect on the Company s results of operations or financial position. See Note 8 for additional information regarding the application of SFAS 157 and further details regarding fair value measurement of the Company s financial assets and liabilities as of June 30, 2008.

In November 2007, the FASB deferred for one year the implementation of SFAS No. 157 for non-financial assets and liabilities. At this time, the Company does not expect that the adoption of SFAS No. 157 for non-financial assets and financial liabilities will have a material impact on its financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 expands the use of fair value accounting but does not affect existing standards, which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use a fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. The Company adopted SFAS 159 effective January 1, 2008, and elected not to measure any of its currently eligible financial assets and liabilities at fair value.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS 141(R)), which significantly changes the accounting for business acquisitions both during the period of the acquisition and in subsequent periods. The more significant changes in the accounting for acquisitions that could impact the Company s financial position and results of operations are:

- certain transaction costs, which are presently treated as cost of the acquisition, will be expensed;
- restructuring costs associated with a business combination, which are presently capitalized, will be expensed subsequent to the acquisition date;
- contingencies, including contingent consideration, which are presently accounted for as an adjustment of purchase price, will be recorded at fair value with subsequent adjustments recognized in operations; and
- valuation allowances on acquired deferred tax assets, which are presently considered to be subsequent changes in consideration and are recorded as decreases in goodwill, will be recognized up front and in operations.

SFAS 141 (R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 31, 2008, with an exception related to the accounting for valuation allowances on deferred taxes and acquired contingencies related to acquisitions completed before the effective date.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161), an amendment of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), which requires disclosures of the objectives of derivative instruments and hedging activities, the method of accounting for such instruments and activities under SFAS No. 133 and its related interpretations, and disclosure of the affects of such instruments and related hedged items on an entity s financial position, financial performance, and cash flows. The statement encourages but does not require comparative disclosures for earlier periods at initial application. SFAS 161 is effective for financial statements issued for years and interim periods beginning after

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

November 15, 2008, with early application encouraged. The Company is currently evaluating the impact that the adoption of this statement will have on the disclosures contained within its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) Financial Accounting Standard (FAS) 142-3, Determination of the Useful Life of Intangible Assets, or FSP FAS 142-3, which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets. FSP FAS 142-3 enhances the guidance over the consistency between the useful life of a recognized intangible asset under Statement No. 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141, Business Combinations . FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The measurement provision of this standard will apply only to intangible assets acquired after the effective date. The Company is currently evaluating the impact of this pronouncement on its determination and evaluation of the useful life as related to its intangible assets.

In May 2008, the FASB finalized FSP APB 14-1, Accounting for Convertible Debt Instruments that may be Settled in Cash upon Conversion (APB 14-1), which specifies the accounting for certain convertible debt instruments, including the Company s 2.25% Convertible Senior Notes, due 2036 (2.25% Convertible Notes). For convertible debt instruments that may be settled entirely or partially in cash upon conversion, APB 14-1 requires an entity to separately account for the liability and equity components of the instrument in a manner that reflects the issuer s economic interest cost. The adoption of APB 14-1 for the Company s 2.25% Convertible Notes will require the equity component of the 2.25% Convertible Notes to be initially included in the paid-in-capital section of stockholders equity on the Company s Consolidated Balance Sheets and the value of the equity component to be treated as an original issue discount for purposes of accounting for the debt component of the 2.25% Convertible Notes. Higher interest expense will result by recognizing the accretion of the discounted carrying value of the 2.25% Convertible Notes to their face amount as interest expense over the expected term of the 2.25% Convertible Notes using an effective interest rate method of amortization. APB 14-1 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. APB 14-1 is not permitted to be adopted early and will be applied retrospectively to all periods presented. The Company continues to evaluate the impact that the adoption of APB 14-1 will have on its financial position and results of operations, but has preliminarily estimated that the Company s Other Long-Term Debt will be initially reduced by approximately $110.0 million with a corresponding increase in Additional Paid In Capital, which will be amortized as an accretion to the value of the 2.25% Convertible Notes, thereby increasing the Company s Other Interest Expense by an average of approximately $11.0 million per year, before income taxes, through the expected redemption of the 2.25% Convertible Notes.

In June 2008, the EITF reached a consensus on EITF No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities . EITF No. 03-6-1 clarifies when instruments granted in share-based payment transactions are participating securities prior to vesting, the impact of the shares should be included in the earnings allocation in computing earnings per share (EPS) under the two-class method described in SFAS No. 128, Earnings per Share, and indicates that the objective of EPS is to measure the performance of an entity over the reporting period. The consensus states all outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends which participate in undistributed earnings with common shareholders should be included in the calculation of basic and diluted EPS. EITF No. 03-6-1 would apply retrospectively to all prior-period EPS data presented for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Earlier application is not permitted. We are currently evaluating the impact of the adoption of EITF 03-6-1 on the

Company, but, do not expect it will not have a material impact on our consolidated financial statements and related disclosures.

3. STOCK-BASED COMPENSATION:

The Company provides compensation benefits to employees and non-employee directors pursuant to its 2007 Long Term Incentive Plan, as amended, and 1998 Employee Stock Purchase Plan, as amended.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2007 Long Term Incentive Plan

In March 2007, the Company s Board of Directors adopted an amendment and restatement of the 1996 Stock Incentive Plan to, among other things, (i) rename the plan as the Group 1 Automotive, Inc. 2007 Long Term Incentive Plan (the Incentive Plan), (ii) increase the number of shares of common stock available for issuance under the plan from 5.5 million to 6.5 million shares and (iii) extend the duration of the plan from March 9, 2014 to March 8, 2017. The Incentive Plan reserves shares of common stock for grants of options (including options qualified as incentive stock options under the Internal Revenue Code of 1986 and options that are non-qualified) at the fair value of each stock option as of the date of grant and, stock appreciation rights, restricted stock, performance awards, bonus stock and phantom stock awards at the market price at the date of grant to directors, officers and other employees of the Company and its subsidiaries. As of June 30, 2008, there were 1,776,070 shares available under the Incentive Plan for future grants of these awards.

Stock Option Awards

The fair value of each stock option award is estimated as of the date of grant using the Black-Scholes option-pricing model. The Company has not issued stock option awards since November 2005. The following summary presents information regarding outstanding options as of June 30, 2008, and the changes during six months then ended:

	Shares Under Option	Weighted Average Exercise Price per Share
Outstanding December 31, 2007	211,774	$ 28.33
Grants		
Exercised	(500)	15.50
Canceled	(15,330)	28.05
Outstanding June 30, 2008	195,944	28.39
Vested or expected to vest at June 30, 2008	193,312	28.31
Exercisable at June 30, 2008	172,964	$ 28.36

Restricted Stock Awards

Beginning in 2005, the Company began granting directors and certain employees, at no cost to the recipient, restricted stock awards or, at their election, phantom stock awards, pursuant to the Company s 2007 Long Term Incentive Plan, as amended. Restricted stock awards are considered outstanding at the date of grant, but are restricted from disposition for periods ranging from six months to five years. The phantom stock awards will settle in shares of common stock upon the termination of the grantees employment or directorship and have vesting periods also ranging from six months to five years. Performance awards are considered outstanding at the date of grant, but are restricted from disposition based on time and the achievement of certain performance criteria established by the Company. In the event the employee or 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.

A summary of these awards as of June 30, 2008, and the changes during the six months then ended, is as follows:

	Awards	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2007	720,069	$ 37.40
Granted	82,874	25.04
Vested	(35,009)	38.84
Forfeited	(25,900)	39.79
Nonvested at June 30, 2008	742,034	$ 35.87

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employee Stock Purchase Plan

In September 1997, the Company adopted the Group 1 Automotive, Inc. 1998 Employee Stock Purchase Plan, as amended (the Purchase Plan). The Purchase Plan authorizes the issuance of up to 2.5 million shares of common stock and provides that no options to purchase shares may be granted under the Purchase Plan after March 6, 2016. As of June 30, 2008, there were 381,295 shares remaining available for future issuance under the Purchase Plan. During the six months ended June 30, 2008 and 2007, the Company issued 108,101 and 69,462 shares, respectively, of common stock to employees participating in the Purchase Plan.

All Stock-Based Payment Arrangements

Total stock-based compensation cost was $1.7 million and $1.3 million for the three months ended June 30, 2008 and 2007, respectively, and $3.4 million and $2.3 million for the six months ended June 30, 2008 and 2007, respectively. Total income tax benefit recognized for stock-based compensation arrangements was $0.4 million and $0.3 million for the three months ended June 30, 2008 and 2007, respectively, and $0.9 million and $0.4 million for the six months ended June 30, 2008 and 2007, respectively. Cash received from restricted stock awards vested and Purchase Plan purchases was $2.0 million and $2.9 million for the six months ended June 30, 2008 and 2007, respectively. Additional paid-in capital was reduced by $0.2 million for the six months ended June 30, 2008 for the effect of tax deductions for options exercised and vesting of restricted shares that was less than the associated book expense previously recognized. Comparatively, for the six months ended June 30, 2007, additional paid-in capital was increase by $0.2 million for the effect of tax deductions for options exercised and vesting of restricted shares that were in excess of the book expense previously recognized.

4. EARNINGS PER SHARE:

Basic earnings per share is computed by dividing net income by the weighted average shares outstanding (excluding dilutive securities). Diluted earnings per share is computed including the impact of all potentially dilutive securities. The following table sets forth the calculation of earnings per share for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,			
	2008		2007	
	Basic	Diluted	Basic	Diluted
	(In thousands, except per share amounts)			
Net Income from:				
Continuing operations, net of income taxes	$ 18,492	$ 18,492	$ 24,289	$ 24,289
Discontinued operations, net of income taxes	(1,276)	(1,276)	(75)	(75)
Net income	$ 17,216	$ 17,216	$ 24,214	$ 24,214
Weighted Average Shares Outstanding				
Basic shares outstanding	22,478	22,478	23,744	23,744

Dilutive effect of stock-based awards, net of assumed repurchase of treasury stock		183		144
Diluted shares outstanding		22,661		23,888
Earnings per share from:				
Continuing operations, net of income taxes	$ 0.82	$ 0.82	$ 1.02	$ 1.02
Discontinued operations, net of income taxes	(0.06)	(0.06)		(0.01)
Net income	$ 0.76	$ 0.76	$ 1.02	$ 1.01

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)