GROUP 1 AUTOMOTIVE INC
Form 10-Q
April 27, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from to

Commission File Number: 1-13461

Group 1 Automotive, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**76-0506313**
(State or other 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 x No ¨

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

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

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

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

As of April 23, 2012, the registrant had 22,924,214 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

	March 31, 2012 (Unaudited)	December 31, 2011
	(In thousands, except per share amounts)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 21,316	$ 14,895
Contracts-in-transit and vehicle receivables, net	149,606	167,507
Accounts and notes receivable, net	85,724	92,775
Inventories, net	966,209	867,470
Deferred income taxes	18,275	16,012
Prepaid expenses and other current assets	10,112	16,925
Total current assets	1,251,242	1,175,584
PROPERTY AND EQUIPMENT, net	604,831	585,633
GOODWILL	546,346	531,458
INTANGIBLE FRANCHISE RIGHTS	182,770	170,687
OTHER ASSETS	14,635	12,981
Total assets	$ 2,599,824	$ 2,476,343
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Floorplan notes payable - credit facility	$ 800,976	$ 718,946
Offset account related to floorplan notes payable - credit facility	(110,998)	(109,207)
Floorplan notes payable - manufacturer affiliates	154,580	155,980
Current maturities of long-term debt	15,616	14,663
Current liabilities from interest rate risk management activities	4,719	7,273
Accounts payable	144,128	148,048
Accrued expenses	113,060	109,244
Total current liabilities	1,122,081	1,044,947
LONG-TERM DEBT, net of current maturities	494,745	482,601
DEFERRED INCOME TAXES	83,465	78,459
LIABILITIES FROM INTEREST RATE RISK MANAGEMENT ACTIVITIES	27,075	26,766
OTHER LIABILITIES	38,613	36,470
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
TEMPORARY EQUITY - Redeemable equity portion of the 3.00% Convertible Senior Notes	34,880	
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; 26,126 and 25,967 issued, respectively	261	260
Additional paid-in capital	330,533	363,375
Retained earnings	610,986	591,037
Accumulated other comprehensive loss	(26,436)	(29,236)
Treasury stock, at cost; 3,200 and 3,260 shares, respectively	(116,379)	(118,336)
Total stockholders equity	798,965	807,100
Total liabilities and stockholders equity	$ 2,599,824	$ 2,476,343

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
	(Unaudited, in thousands, except per share amounts)	
REVENUES:		
New vehicle retail sales	$ 912,595	$ 784,714
Used vehicle retail sales	414,974	323,447
Used vehicle wholesale sales	66,857	61,951
Parts and service sales	213,101	194,950
Finance, insurance and other, net	57,218	44,240
Total revenues	1,664,745	1,409,302
COST OF SALES:		
New vehicle retail sales	859,775	741,942
Used vehicle retail sales	378,577	294,547
Used vehicle wholesale sales	64,153	59,457
Parts and service sales	101,816	91,581
Total cost of sales	1,404,321	1,187,527
GROSS PROFIT	260,424	221,775
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	199,112	175,884
DEPRECIATION AND AMORTIZATION EXPENSE	7,236	6,455
ASSET IMPAIRMENTS	101	222
INCOME FROM OPERATIONS	53,975	39,214
OTHER EXPENSE:		
Floorplan interest expense	(7,619)	(6,760)
Other interest expense, net	(9,040)	(7,942)
INCOME BEFORE INCOME TAXES	37,316	24,512
PROVISION FOR INCOME TAXES	(14,199)	(9,150)
NET INCOME	$ 23,117	$ 15,362
BASIC EARNINGS PER SHARE	$ 1.01	$ 0.64
Weighted average common shares outstanding	21,629	22,582
DILUTED EARNINGS PER SHARE	$ 0.97	$ 0.64
Weighted average common shares outstanding	22,532	22,736
CASH DIVIDENDS PER COMMON SHARE	$ 0.14	$ 0.11

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended March 31, 2012	2011
	(Unaudited, in thousands)	
NET INCOME	$ 23,117	$ 15,362
Other comprehensive income (loss):		
Foreign currency translation adjustment	1,394	1,340
Unrealized gain (loss) on marketable securities, net of tax benefit (provision) of ($2) and $4, respectively	3	(7)
Net unrealized gain on interest rate swaps:		
Unrealized loss arising during the period, net of tax benefit of $293 and $214, respectively	(488)	(356)
Reclassification adjustment for loss included in interest expense, net of tax provision of $1,134 and $1,296, respectively	1,891	2,160
Net unrealized gain on interest rate swaps, net of tax	1,403	1,804
OTHER COMPREHENSIVE INCOME, NET OF TAXES	2,800	3,137
COMPREHENSIVE INCOME	$ 25,917	$ 18,499

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
	Shares	Amount					
				(Unaudited, in thousands)			
BALANCE, December 31, 2011	25,967	$ 260	$ 363,375	$ 591,037	$ (29,236)	$ (118,336)	$ 807,100
Comprehensive income:							
Net income				23,117			23,117
Other comprehensive income, net					2,800		2,800
3.00% Convertible Notes reclassification to temporary equity			(34,880)				(34,880)
Issuance of common and treasury shares to employee stock purchase plans	(69)	(1)	(2,678)			1,957	(722)
Proceeds from sales of common stock under employee stock purchase plans	27		1,342				1,342
Issuance of restricted stock	233	2	(2)				
Forfeiture of restricted stock	(32)						
Stock-based compensation			2,882				2,882
Tax effect from the vesting of restricted shares			494				494
Cash dividends				(3,168)			(3,168)
BALANCE, March 31, 2012	26,126	$ 261	$ 330,533	$ 610,986	$ (26,436)	$ (116,379)	$ 798,965

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31, 2012	2011
	(Unaudited, in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 23,117	$ 15,362
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	7,236	6,455
Deferred income taxes	3,063	7,048
Asset impairments	101	222
Stock-based compensation	2,894	2,744
Amortization of debt discount and issue costs	3,170	2,878
Gain on disposition of assets	(8)	
Tax effect from stock-based compensation	(491)	(325)
Other	420	152
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts payable and accrued expenses	7,838	10,436
Accounts and notes receivable	7,139	7,278
Inventories	(84,600)	5,736
Contracts-in-transit and vehicle receivables	18,046	(3,623)
Prepaid expenses and other assets	4,452	1,397
Floorplan notes payable - manufacturer affiliates	(1,654)	(804)
Deferred revenues	(173)	(501)
Net cash provided by (used in) operating activities	(9,450)	54,455
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid in acquisitions, net of cash received	(55,323)	(35,033)
Proceeds from disposition of franchises, property and equipment	139	4,235
Purchases of property and equipment, including real estate	(17,617)	(15,306)
Other	292	113
Net cash used in investing activities	(72,509)	(45,991)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on credit facility - Floorplan Line	1,357,442	1,237,710
Repayments on credit facility - Floorplan Line	(1,277,202)	(1,217,231)
Borrowings on mortgage facility	4,000	
Principal payments on mortgage facility	(533)	
Borrowings of other long-term debt	36	80
Principal payments of long-term debt related to real estate loans	(2,302)	(2,000)
Borrowings of long-term debt related to real estate	9,600	
Principal payments of other long-term debt	(840)	(767)
Proceeds from issuance of common stock to benefit plans	620	880
Tax effect from stock-based compensation	491	325
Dividends paid	(3,180)	(2,619)
Net cash provided by financing activities	88,132	16,378
EFFECT OF EXCHANGE RATE CHANGES ON CASH	248	119

NET INCREASE IN CASH AND CASH EQUIVALENTS		6,421		24,961
CASH AND CASH EQUIVALENTS, beginning of period		14,895		19,843
CASH AND CASH EQUIVALENTS, end of period	$	21,316	$	44,804
SUPPLEMENTAL CASH FLOW INFORMATION:				
Purchases of property and equipment, including real estate, accrued in accounts payable and accrued expenses	$	847	$	

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. INTERIM FINANCIAL INFORMATION

Business and Organization

Group 1 Automotive, Inc., a Delaware corporation, through its subsidiaries, is a leading operator in the automotive retailing industry with operations in 15 states in the United States of America (U.S.) and five towns in the United Kingdom (U.K.). Group 1 Automotive, Inc. and its subsidiaries are herein collectively referred to as the Company. Through its dealerships, the Company sells new and used cars and light trucks; arranges related vehicle financing; service and insurance contracts; provides automotive maintenance and repair services; and sells vehicle parts.

As of March 31, 2012, the Company s U.S. retail network consisted of the following two regions (with the number of dealerships they comprised): (i) the East (43 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina), and (ii) the West (64 dealerships in California, Kansas, Oklahoma, and Texas). Each region is managed by a regional vice president who reports directly to the Company s 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 the Company s Chief Financial Officer. The Company s five dealerships in the U.K. are also managed locally with direct reporting responsibilities to the Company s corporate management team.

Basis of Presentation

The accompanying unaudited condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. 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 U.S. for complete financial statements. In the opinion of management, all adjustments of a normal and recurring nature considered necessary for a fair presentation have been included in the accompanying unaudited condensed Consolidated Financial Statements. Due to seasonality and other factors, the results of operations for the interim period are not necessarily indicative of the results that will be realized for 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, 2011 (2011 Form 10-K).

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 respective 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.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This update changes certain fair value measurement principles and enhances the disclosure requirements, particularly Level 3 fair value measurements. The Company adopted ASU 2011-04 as of March 31, 2012 and it did not have a material impact on its consolidated financial position or results of operations.

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment.* This update permits an entity to first assess qualitative factors to determine whether it is more likely than not (likelihood more than 50%) that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Company adopted ASU 2011-08 as of March 31, 2012 and it did not have an impact on its consolidated financial position or results of operations.

2. ACQUISITIONS AND DISPOSITIONS

During the first three months of 2012, the Company acquired one dealership in each of the following states: South Carolina, Texas and Kansas. Consideration paid for these dealerships totaled $55.3 million.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the first three months of 2011, the Company acquired two dealerships located in Texas. Consideration paid for these dealerships totaled $35.0 million.

3. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT ACTIVITIES

The periodic interest rates of the Revolving Credit Facility (as defined in Note 8, Credit Facilities), the Mortgage Facility (as defined in Note 9, Long-term Debt) and certain variable-rate real estate related borrowings are indexed to one-month London Inter Bank Offered Rate (LIBOR) plus an associated company credit risk rate. In order to minimize the earnings variability related to fluctuations in these rates, the Company employs an interest rate hedging strategy, whereby it enters into arrangements with various financial institutional counterparties with investment grade credit ratings, swapping its variable interest rate exposure for a fixed interest rate over terms not to exceed the related variable-rate debt.

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

The related gains or losses on these interest rate derivatives are deferred in stockholders equity as a component of accumulated other comprehensive loss. These deferred gains and losses are recognized in income in the period in which the related items being hedged are recognized in expense. However, to the extent that the change in value of a derivative contract does not perfectly offset the change in the value of the items being hedged, that ineffective portion is immediately recognized in other income or expense. Monthly contractual settlements of these swap positions are recognized as floorplan or other interest expense in the Company s accompanying Consolidated Statements of Operations. All of the Company s interest rate hedges are designated as cash flow hedges.

As of March 31, 2012, the Company held interest rate swaps in effect of $275.0 million in notional value that fixed its underlying one-month LIBOR at a weighted average rate of 4.4%. For the three months ended March 31, 2012 and 2011, the impact of the Company s interest rate hedges in effect increased floorplan interest expense by $2.8 million and $3.3 million, respectively. Total floorplan interest expense was $7.6 million and $6.8 million for the three months ended March 31, 2012 and 2011, respectively.

As of March 31, 2012 and December 31, 2011, the Company reflected liabilities from interest risk management activities of $31.8 million and $34.0 million, respectively, in its Consolidated Balance Sheets. Several of the Company s interest rate swaps expire in 2012, as such, the fair value of these instruments are classified as current liabilities in the accompanying Consolidated Balance Sheet. Included in accumulated other comprehensive loss at March 31, 2012 and 2011 are unrealized losses, net of income taxes, totaling $19.9 million and $9.1 million, respectively, related to these hedges.

At March 31, 2012, all of the Company s derivative contracts were determined to be effective. The Company had no gains or losses related to ineffectiveness or amounts excluded from effectiveness testing recognized in the Statements of Operations for either the three months ended March 31, 2012 or 2011 respectively.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Derivatives in Cash Flow Hedging Relationship	Amount of Unrealized Loss, Net of Tax, Recognized in OCI Three Months Ended March 31, 2012	2011
	(In thousands)	
Interest rate swap contracts	$ 488	$ 356

Location of Loss Reclassified from OCI into Statements of Operations	Amount of Loss Reclassified from OCI into Statements of Operations Three Months Ended March 31, 2012	2011
	(In thousands)	
Floorplan interest expense	$ (2,762)	$ (3,251)
Other interest expense	$ (263)	$ (205)

The amount expected to be reclassified out of other comprehensive income into earnings (through floorplan interest expense or other interest expense) in the next twelve months is $10.1 million.

4. STOCK-BASED COMPENSATION PLANS

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

2007 Long Term Incentive Plan

The Group 1 Automotive, Inc. 2007 Long Term Incentive Plan (Incentive Plan) was amended and restated in May 2010 to increase the number of shares available for issuance under the plan to 7.5 million, for grants to non-employee directors, officers and other employees of the Company and its subsidiaries of: (1) options (including options qualified as incentive stock options under the Internal Revenue Code of 1986 and options that are non-qualified), the exercise price of which may not be less than the fair market value of the common stock on the date of the grant, and (2) stock appreciation rights, restricted stock, performance awards, and bonus stock, each granted at the market price of the Company s stock at the date of grant. The Incentive Plan expires on March 8, 2017. The

terms of the awards (including vesting schedules) are established by the Compensation Committee of the Company s Board of Directors. All outstanding option awards are exercisable over a period not to exceed ten years and vest over a period not to exceed five years. Certain of the Company s option awards are subject to graded vesting over a service period for the entire award. As of March 31, 2012, there were 1,070,540 shares available for issuance under the Incentive Plan.

Restricted Stock Awards

In 2005, the Company began granting to non-employee directors and certain employees, at no cost to the recipient, restricted stock awards or, at their election, restricted stock units pursuant to the Incentive Plan. In 2006, the Company began granting to certain employees, at no cost to the recipient, performance awards pursuant to the Incentive Plan. Restricted stock awards and performance awards qualify as participating securities as each contain non-forfeitable rights to dividends. As such, the two-class method is required for the computation of earnings per share. See Note 5, Earnings Per Share for further details. Restricted stock awards are considered outstanding at the date of grant but are subject to forfeiture provisions for periods ranging from six months to five years. Vested restricted stock units, which are not considered outstanding at the grant date, will settle in shares of common stock upon the termination of the grantees employment or directorship. Performance awards are considered outstanding at the date of grant and have forfeiture provisions that lapse based on the passage of time and the achievement of certain performance criteria established by the Compensation Committee of the Board of Directors. During the first three months of March 31, 2012, there were no outstanding performance awards and none were granted. In the event the employee or non-employee director terminates his or her employment or directorship with the Company prior to the lapse of the restrictions, the shares, in most cases, will be forfeited to the Company.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Compensation expense for these awards is calculated based on the price of the Company s common stock at the date of grant and recognized over the requisite service period. Forfeitures are estimated at the time of valuation and reduce expense ratably over the vesting period. This estimate is adjusted periodically based on the extent to which actual or expected forfeitures differ from the previous estimate.

A summary of these awards as of March 31, 2012, along with the changes during the three months then ended, is as follows:

	Awards	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2011	1,154,004	$ 23.57
Granted	232,624	54.62
Vested	(42,132)	25.47
Forfeited	(31,022)	28.61
Nonvested at March 31, 2012	1,313,474	$ 33.05

Employee Stock Purchase Plan

In 1997, the Company adopted the Group 1 Automotive, Inc. Employee Stock Purchase Plan as amended (the Purchase Plan). The Purchase Plan authorizes the issuance of up to 3.5 million shares of common stock and provides that no options to purchase shares may be granted under the Purchase Plan after March 6, 2016. The Purchase Plan is available to all employees of the Company and its participating subsidiaries and is a qualified plan as defined by Section 423 of the Internal Revenue Code. At the end of each fiscal quarter (the Option Period) during the term of the Purchase Plan, the employee acquires shares of common stock from the Company at 85% of the fair market value of the common stock on the first or the last day of the Option Period, whichever is lower. As of March 31, 2012, there were 803,878 shares remaining in reserve for future issuance under the Purchase Plan. During the three months ended March 31, 2012 and 2011, the Company issued 27,163 and 23,298 shares, respectively, of common stock to employees participating in the Purchase Plan.

The weighted average fair value of employee stock purchase rights issued pursuant to the Purchase Plan was $12.96 and $10.22 during the three months ended March 31, 2012 and 2011, respectively. The fair value of stock purchase rights is calculated using the quarter-end stock price, the value of the embedded call option and the value of the embedded put option.

Stock-Based Compensation

Total stock-based compensation cost was $2.9 million and $2.7 million for the three months ended March 31, 2012 and 2011, respectively. Cash received from option exercises and Purchase Plan purchases was $1.3 million and $0.9 million for the three months ended March 31, 2012 and 2011, respectively. Additional paid-in capital increased by $0.5 million and $0.4 million for the three months ended March 31, 2012 and 2011, respectively, for the effect of tax deductions for options exercised and vesting of restricted shares that were more than the associated book expense previously recognized. Total income tax benefit recognized for stock-based compensation arrangements was $0.8 million for both the three months ended March 31, 2012 and 2011.

The Company issues new shares or treasury shares, if available, when options are exercised or restricted stock vests. With respect to shares issued under the Purchase Plan, the Company s Board of Directors has authorized specific share repurchases to fund the shares issuable under the Purchase Plan.

5. EARNINGS PER SHARE

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the calculation of EPS for the three months ended March 31, 2012 and 2011:

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
	(In thousands, except per share amounts)	
Weighted average basic common shares outstanding	21,629	22,582
Dilutive effect of contingently Convertible 3.00% Notes	892	139
Dilutive effect of stock options, net of assumed repurchase of treasury stock	5	12
Dilutive effect of employee stock purchases, net of assumed repurchase of treasury stock	6	3
Weighted average dilutive common shares outstanding	22,532	22,736
Basic:		
Net Income	$ 23,117	$ 15,362
Less: Earnings allocated to participating securities	1,206	916
Earnings available to basic common shares	$ 21,911	$ 14,446
Basic earnings per common share	$ 1.01	$ 0.64
Diluted:		
Net Income	$ 23,117	$ 15,362
Less: Earnings allocated to participating securities	1,165	911
Earnings available to diluted common shares	$ 21,952	$ 14,451
Diluted earnings per common share	$ 0.97	$ 0.64

Any options with an exercise price in excess of the average market price of the Company s common stock during each of the quarterly periods in the years presented are not considered when calculating the dilutive effect of stock options for the diluted EPS calculations. The weighted average number of stock-based awards not included in the calculation of the dilutive effect of stock-based awards was immaterial for both the three months ended March 31, 2012 and 2011.

As discussed in Note 9, Long-term Debt, below, the Company is required to include the dilutive effect, if applicable, of the net shares issuable under the 2.25% Notes (as defined in Note 9) and the 2.25% Warrants sold in connection with the 2.25% Notes (2.25% Warrants) in its diluted common shares outstanding for the diluted earnings calculation. Although the ten-year call options the Company purchased on its common stock in connection with the issuance of the 2.25% Notes (2.25% Purchased Options) have the economic benefit of decreasing the dilutive effect of the 2.25% Notes, the Company cannot factor this benefit into the diluted common shares outstanding for the diluted earnings calculation since the impact would be anti-dilutive. Since the average price of the Company s common stock for the three months ended March 31, 2012 was less than $59.43, no net shares were included in the computation of diluted EPS for such period, as the impact would have been anti-dilutive.

In addition, the Company is required to include the dilutive effect, if applicable, of the net shares issuable under the 3.00% Notes (as defined in Note 9) and the 3.00% Warrants sold in connection with the 3.00% Notes (3.00% Warrants). Although the ten-year call options the Company purchased on its common stock in connection with the issuance of the 3.00% Notes (3.00% Purchased Options) have the economic benefit of decreasing the dilutive effect of the 3.00% Notes, the Company cannot factor this benefit into the diluted common shares outstanding for the diluted earnings calculation since the impact would be anti-dilutive. Since the average price of the Company s common stock for the three months ended March 31, 2012 was more than the conversion price in effect at the end of the respective periods, the dilutive effect of the 3.00% Notes and 3.00% Warrants was included in the computation of diluted earnings per share. Refer to Note 9 for a description of the change to the conversion price, which occurred during the three months ended March 31, 2012 as a result of the Company s decision to pay a cash dividend, as well as the change in the convertibility of the 3.00% Notes as of March 31, 2012.

6. INCOME TAXES

The Company is subject to U.S. federal income taxes and income taxes in numerous states. In addition, the Company is subject to income tax in the U.K. relative to its foreign subsidiaries. The effective income tax rate of 38.1% of pretax income for the three months ended March 31, 2012 differed from the federal statutory rate of 35.0% due primarily to taxes provided for the taxable state jurisdictions in which the Company operates.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the three months ended March 31, 2012, the Company s effective tax rate increased to 38.1% from 37.3% for the same period in 2011. The change was primarily due to the mix of pretax income from the taxable state jurisdictions in which the Company operates, as well as a change in valuation allowances for certain state net operating losses that occurred during the three months ended March 31, 2011.

As of March 31, 2012 and December 31, 2011, the Company had no unrecognized tax benefits. Consistent with prior practices, the Company recognizes interest and penalties related to uncertain tax positions in income tax expense. The Company did not incur any interest and penalties nor did it accrue any interest for the three months ended March 31, 2012.

Taxable years 2007 and subsequent remain open for examination by the Company s major taxing jurisdictions.

7. DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS

Accounts and notes receivable consisted of the following:

	March 31, 2012 (unaudited)	December 31, 2011
	(In thousands)	
Amounts due from manufacturers	$ 43,982	$ 48,912
Parts and service receivables	16,244	16,956
Finance and insurance receivables	13,633	16,755
Other	12,943	11,395
Total accounts and notes receivable	86,802	94,018
Less allowance for doubtful accounts	1,078	1,243
Accounts and notes receivable, net	$ 85,724	$ 92,775

Inventories consisted of the following:

	March 31, 2012 (unaudited)	December 31, 2011
	(In thousands)	
New vehicles	$ 684,929	$ 610,694
Used vehicles	172,804	153,648
Rental vehicles	62,236	57,790
Parts, accessories and other	46,240	45,338
Inventories, net	$ 966,209	$ 867,470

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property and equipment consisted of the following:

	Estimated Useful Lives in Years	March 31, 2012 (unaudited)	December 31, 2011
		(Dollars in thousands)	
Land		$ 219,487	$ 211,754
Buildings	30 to 40	293,507	284,638
Leasehold improvements	up to 30	88,710	86,084
Machinery and equipment	7 to 20	60,465	59,316
Furniture and fixtures	3 to 10	55,865	54,406
Company vehicles	3 to 5	9,992	9,877
Construction in progress		20,750	16,719
Total		748,776	722,794
Less accumulated depreciation		143,945	137,161
Property and equipment, net		$ 604,831	$ 585,633

During the three months ended March 31, 2012, the Company incurred $9.7 million of capital expenditures for the construction of new or expanded facilities and the purchase of equipment and other fixed assets in the maintenance of the Company s dealerships and facilities. In addition, the Company purchased real estate during the three months ended March 31, 2012 associated with existing dealership operations totaling $0.8 million. Also, in conjunction with the Company s acquisition of three separate dealerships during the three months ended March 31, 2012, the Company acquired $14.7 million of real estate and other property and equipment.

8. CREDIT FACILITIES

The Company has a $1.35 billion revolving syndicated credit arrangement with 21 financial institutions including four manufacturer-affiliated finance companies (Revolving Credit Facility). The Company also has a $150.0 million floorplan financing arrangement with Ford Motor Credit Company (FMCC Facility), as well as arrangements with BMW Financial Services for financing of its new and used vehicles in the U.K. and with several other automobile manufacturers for financing of a portion of its rental vehicle inventory. Within the Company s Consolidated Balance Sheets, Floorplan Notes Payable Credit Facility reflects amounts payable for the purchase of specific new, used and rental vehicle inventory (with the exception of new and rental vehicle purchases financed through lenders affiliated with the respective manufacturer) whereby financing is provided by the Revolving Credit Facility. Floorplan Notes Payable Manufacturer Affiliates reflects amounts payable for the purchase of specific new vehicles whereby financing is provided by the FMCC Facility, the financing of new and used vehicles in the U.K. with BMW Financial Services and the financing of rental vehicle inventory with several other manufacturers. Payments on the floorplan notes payable are generally due as the vehicles are sold. As a result, these obligations are reflected on the accompanying Consolidated Balance Sheets as current liabilities.

The Company receives interest assistance from certain automobile manufacturers. Over the past three years, manufacturers interest assistance as a percentage of the Company s total consolidated floorplan interest expense has ranged from 60.1% for the second quarter of 2009 to 98.2% for the fourth quarter of 2011. And, for the first quarter of 2012, manufacturers interest assistance, as a percentage of the Company s total consolidated floorplan interest expense, was 97.3%.

Revolving Credit Facility

The Revolving Credit Facility expires on June 1, 2016 and consists of two tranches: $1.1 billion for vehicle inventory floorplan financing (Floorplan Line) and $250.0 million for working capital, including acquisitions (Acquisition Line). Up to half of the Acquisition Line can be borrowed in either Euros or Pound Sterling. The capacity under these two tranches can be re-designated within the overall $1.35 billion commitment, subject to the original limits of a minimum of $1.1 billion for the Floorplan Line and maximum of $250.0 million for the Acquisition Line. The Revolving Credit Facility can be expanded to its maximum commitment of $1.6 billion, subject to participating lender approval. The Floorplan Line bears interest at rates equal to one-month LIBOR plus 150 basis points for new vehicle inventory and one-month LIBOR plus 175 basis points for used vehicle inventory. The Acquisition Line bears interest at the one-month LIBOR plus a margin that ranges from 150 to 250 basis points, depending on the Company s leverage ratio. The Floorplan Line also requires a commitment fee of 0.20% per annum on the unused portion. The Acquisition Line requires a commitment fee ranging from 0.25% to 0.45% per annum, depending on the Company s leverage ratio, based on a minimum commitment of $100.0 million less outstanding borrowings. In conjunction with the Revolving Credit Facility, the Company had $6.2 million of related unamortized costs as of March 31, 2012 that are being amortized over the term of the facility.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

After considering outstanding balances of $690.0 million at March 31, 2012, the Company had $410.0 million of available floorplan borrowing capacity under the Floorplan Line. Included in the $410.0 million available borrowings under the Floorplan Line was $111.0 million of immediately available funds. The weighted average interest rate on the Floorplan Line was 1.7% and 1.8% as of March 31, 2012 and December 31, 2011, respectively, excluding the impact of the Company s interest rate swaps. Amounts borrowed by the Company under the Floorplan Line of the Revolving Credit Facility for specific vehicle inventory are to be repaid upon the sale of the vehicle financed, and in no case is a borrowing for a vehicle to remain outstanding for greater than one year. With regards to the Acquisition Line, no borrowings were outstanding as of March 31, 2012 or December 31, 2011. The amount of available borrowing capacity under the Acquisition Line is limited from time to time based upon certain debt covenants. After considering $24.3 million of outstanding letters of credit, and other factors included in the Company s available borrowing base calculation, there was $225.7 million of available borrowing capacity under the Acquisition Line as of March 31, 2012.

All of the Company s domestic dealership-owning subsidiaries are co-borrowers under the Revolving Credit Facility. The Company s obligations under the Revolving Credit Facility are secured by essentially all of the Company s domestic personal property (other than equity interests in dealership-owning subsidiaries) including all motor vehicle inventory and proceeds from the disposition of dealership-owning subsidiaries. The Revolving Credit Facility contains a number of significant covenants that, among other things, restrict the Company s ability to make disbursements outside of the ordinary course of business, dispose of assets, incur additional indebtedness, create liens on assets, make investments and engage in mergers or consolidations. The Company is also required to comply with specified financial tests and ratios defined in the Revolving Credit Facility, such as fixed charge coverage, total leverage, and senior secured leverage. Further, the Revolving Credit Facility restricts the Company s ability to make certain payments, such as dividends or other distributions of assets, properties, cash, rights, obligations or securities (Restricted Payments). The Restricted Payments shall not exceed the sum of $100.0 million plus (or minus if negative) (a) one-half of the aggregate consolidated net income of the Company for the period beginning on January 1, 2011 and ending on the date of determination and (b) the amount of net cash proceeds received from the sale of capital stock on or after January 1, 2011 and ending on the date of determination (Restricted Payment Basket). For purposes of the calculation of the Restricted Payment Basket, net income represents such amounts per the consolidated financial statements adjusted to exclude the Company s foreign operations, non-cash interest expense, non-cash asset impairment charges, and non-cash stock-based compensation. As of March 31, 2012, the Restricted Payment Basket totaled $95.4 million. As of March 31, 2012, the Company was in compliance with all applicable covenants and ratios under the Revolving Credit Facility.

Ford Motor Credit Company Facility

The FMCC Facility provides for the financing of, and is collateralized by, the Company s Ford new vehicle inventory, including affiliated brands. This arrangement provides for $150.0 million of floorplan financing and is an evergreen arrangement that may be canceled with 30 days notice by either party. As of March 31, 2012, the Company had an outstanding balance of $97.8 million under the FMCC Facility with an available floorplan borrowing capacity of $52.2 million. This facility bears interest at a rate of Prime plus 150 basis points minus certain incentives; however, the prime rate is defined to be a minimum of 3.75%. As of March 31, 2012, the interest rate on the FMCC Facility was 5.25% before considering the applicable incentives.

Other Credit Facilities

The Company has a credit facility with BMW Financial Services for the financing of new, used and rental vehicle inventories related to its U.K. operations. This facility is an evergreen arrangement that may be canceled with notice by either party and bears interest of a base rate, plus a surcharge that varies based upon the type of vehicle being financed. Dependent upon the type of inventory financed, the interest rates charged on borrowings outstanding under this facility ranged from 1.1% to 4.5%, as of March 31, 2012.

Excluding rental vehicles financed through the Revolving Credit Facility, financing for rental vehicles is typically obtained directly from the automobile manufacturers. These financing arrangements generally require small monthly payments and mature in varying amounts over the next two years. As of March 31, 2012, the interest rate charged on borrowings related to the Company s rental vehicle fleet ranged from 2.5% to 5.3%. Rental vehicles are typically transferred to used vehicle inventory when they are removed from rental service and repayment of the borrowing is required at that time.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. LONG-TERM DEBT

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

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
2.25% Convertible Senior Notes	$ 146,777	$ 144,985
3.00% Convertible Senior Notes	78,201	77,401
Mortgage Facility	44,470	41,003
Other Real Estate Related and Long-Term Debt	202,151	194,580
Capital lease obligations related to real estate, maturing in varying amounts through November 2032 with a weighted average interest rate of 9.4%	38,762	39,295
	510,361	497,264
Less current maturities of mortgage facility and other long-term debt	15,616	14,663
	$ 494,745	$ 482,601

Fair Value of Long-Term Debt

The Company s outstanding 2.25% Convertible Senior Notes (2.25% Notes), had a fair value of $202.6 million and $192.3 million as of March 31, 2012 and December 31, 2011, respectively. The Company s outstanding 3.00% Convertible Senior Notes (3.00% Notes), had a fair value of $185.5 million and $170.6 million as of March 31, 2012 and December 31, 2011, respectively. The carrying value of the Company s variable rate debt approximates fair value due to the short-term nature of the interest rates.

The fair value estimates are based on Level 2 inputs of the fair value hierarchy available as of March, 31, 2012 and December 31, 2011. The Company determined the estimated fair value of its long-term debt using available market information and commonly accepted valuation methodologies. Considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, these estimates are not necessarily indicative of the amounts that the Company, or holders of the instruments, could realize in a current market exchange. The use of different assumptions and/or estimation methodologies could have a material effect on estimated fair values. These amounts have not been revalued since those dates, and current estimates of fair value could differ significantly from the amounts presented.

2.25% Convertible Senior Notes

As of March 31, 2012 and December 31, 2011, the carrying value of the 2.25% Notes, related discount and equity component consisted of the following:

	March 31, 2012	December 31, 2011
	(In thousands)	
Carrying amount of equity component	$ 65,270	$ 65,270
Allocated underwriter fees, net of taxes	(1,475)	(1,475)
Allocated debt issuance cost, net of taxes	(58)	(58)

Total net equity component	$ 63,737	$ 63,737
Deferred income tax component	$ 12,820	$ 13,452
Principal amount of 2.25% Notes	$ 182,753	$ 182,753
Unamortized discount	(34,620)	(36,344)
Unamortized underwriter fees	(1,356)	(1,424)
Net carrying amount of liability component	$ 146,777	$ 144,985
Net impact on retained earnings	$ (42,479)	$ (41,426)
Unamortized debt issuance cost	$ 54	$ 56

The Company determined the discount using the estimated effective interest rate for similar debt with no convertible features. The original effective interest rate of 7.5% was estimated by comparing debt issuances from companies with similar credit ratings during the same annual period as the Company. The effective interest rate differs due to the impact of underwriter fees associated with this issuance that were capitalized as an additional discount and are being amortized to interest expense through 2016. The effective interest rate may change in the future as a result of future repurchases of the 2.25% Notes. The Company utilized a ten-year term for the assessment of the fair value of its 2.25% Notes.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the three months ended March 31, 2012 and 2011, the contractual interest expense and the discount amortization, which is recorded as interest expense in the accompanying Consolidated Statements of Operations, were as follows:

	Three Months Ended March 31, 2012	2011
	(Dollars in thousands)	
Year-to-date contractual interest expense	$ 1,028	$ 1,028
Year-to-date discount amortization	$ 1,685	$ 1,554
Effective interest rate of liability component	7.7%	7.7%

The 2.25% Notes are convertible into cash and, if applicable, common stock based on the conversion rate of 16.8267 shares of common stock per $1,000 principal amount (which is equal to an initial conversion price of approximately $59.43 per common share), subject to adjustment, including a quarterly cash dividend in excess of $0.14 per share, under the following circumstances: (1) during any calendar quarter (and only during such calendar quarter) beginning after September 30, 2006, if closing price of the Company s common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the applicable conversion price per share (such threshold closing price initially and as of March 31, 2012 being $77.26); (2) during the five business day period after any ten consecutive trading day period in which the trading price per $1,000 principal amount for each day of the ten day trading period was less than 98% of the product of the last reported sale/bid price of the Company s common stock and the conversion rate on that day; and (3) upon the occurrence of specified corporate transactions set forth in the 2.25% Notes Indenture. Upon conversion, a holder will receive an amount in cash and common shares of the Company s common stock, determined in the manner set forth in the 2.25% Notes Indenture.

3.00% Convertible Senior Notes

As of March 31, 2012 and December 31, 2011, the carrying value of the 3.00% Notes, related discount and equity component consisted of the following:

	March 31, 2012	December 31, 2011
	(In thousands)	
Carrying amount of equity component (including $34.9 million classified as temporary equity as of March 31, 2012	$ 25,359	$ 25,359
Allocated underwriter fees, net of taxes	(760)	(760)
Allocated debt issuance cost, net of taxes	(112)	(112)
Total net equity component	$ 24,487	$ 24,487
Deferred income tax component	$ 12,688	$ 12,956
Principal amount of 3.00% Notes	$ 115,000	$ 115,000
Unamortized discount	(34,880)	(35,638)
Unamortized underwriter fees	(1,919)	(1,961)
Net carrying amount of liability component	$ 78,201	$ 77,401
Net impact on retained earnings	$ (3,341)	$ (2,893)

Unamortized debt issuance cost	$ 283	$ 289

The Company determined the discount using the estimated effective interest rate for similar debt with no convertible features. The original effective interest rate of 8.25% was estimated by receiving a range of quotes from the underwriters for the estimated rate that the Company could reasonably expect to issue non-convertible debt for the same tenure. The effective interest rate differs from the 8.25%, due to the impact of underwriter fees associated with this issuance that were capitalized as an additional discount and are being amortized to interest expense through 2020. The effective interest rate may change in the future as a result of future repurchases of the 3.00% Notes. The Company utilized a ten-year term for the assessment of the fair value of its 3.00% Notes.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the three months ended March 31, 2012 and 2011, the contractual interest expense and the discount amortization, which is recorded as interest expense in the accompanying Consolidated Statements of Operations, were as follows:

	Three Months Ended March, 31	
	2012	2011
	(Dollars in thousands)	
Year-to-date contractual interest expense	$ 863	$ 874
Year-to-date discount amortization	$ 716	$ 653
Effective interest rate of liability component	8.6%	8.6%

The 3.00% Notes are convertible into cash and, if applicable, common stock based on the conversion rate, subject to adjustment, on the business day preceding September 15, 2019, under the following circumstances: (1) during any fiscal quarter (and only during such fiscal quarter) beginning after June 30, 2010, if the last reported sale price of the Company s common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the applicable conversion price per share (or $49.36 as of March 31, 2012) (Stock Price Trigger); (2) during the five business day period after any ten consecutive trading day period in which the trading price per $1,000 principal amount for each day of the ten day trading period was less than 98% of the product of the last reported sale/bid price of the Company s common stock and the conversion rate on that day; and (3) upon the occurrence of specified corporate transactions set forth in the 3.00% Notes Indenture. Upon conversion, a holder will receive an amount in cash and common shares of the Company s common stock, determined in the manner set forth in the 3.00% Notes Indenture. As a result of the Stock Price Trigger on March 31, 2012, the 3.00% Notes are convertible at the option of the holders during the three months ended June 30, 2012. As such, the Company reclassified the redeemable equity portion of the 3.00% Notes to temporary equity from the additional paid-in capital component of permanent equity on the Consolidated Balance Sheet as of March 31, 2012. The debt portion of the 3.00% Notes continued to be classified as a long-term liability as of March 31, 2012, since the Company has the intent and ability to refinance any conversion of the 3.00% Notes with another long-term debt instrument. The combination of the debt portion and temporary equity portion represents the aggregate principal obligation of the 3.00% Notes redeemable at the option of the holders as of March 31, 2012. The if-converted value of the 3.00% Notes exceeded the principal amount of the 3.00% Notes by $56.6 million at March 31, 2012.

As of March 31, 2012, the conversion rate was 26.3345 shares of common stock per $1,000 principal amount of 3.00% Notes, with a conversion price of $37.97 per share, which was reduced during the first quarter of 2012 as the result of the Company s decision to pay a cash dividend. If any cash dividend or distribution is made to all, or substantially all, holders of the Company s common stock in the future, the conversion rate will be adjusted based on the formula defined in the 3.00% Notes Indenture.

As of March 31, 2012, the exercise price of the 3.00% Warrants, which are related to the issuance of the 3.00% Notes, was $55.80 due to the Company s decision to pay a cash dividend. If any cash dividend or distribution is made to all, or substantially all, holders of the Company s common stock in the future, the conversion rate will be adjusted based on the formula defined in the 3.00% Notes Indenture.

Under the terms of the 3.00% Purchased Options, which become exercisable upon conversion of the 3.00% Notes, the Company has the right to receive a total of 3.0 million shares of its common stock at the conversion price then in effect. The exercise price is subject to certain adjustments that mirror the adjustments to the conversion price of the 3.00% Notes (including payments of cash dividends).

Real Estate Credit Facility

As amended and restated, the Company s real estate credit facility with Bank of America, N.A. and Comerica Bank (Mortgage Facility) provides only term loans with the right to expand to $75.0 million of term loans and no longer has a revolving feature. The term loans can be expanded provided that (i) no default or event of default exists under the Mortgage Facility; (ii) the Company obtains commitments from the lenders who would qualify as assignees for such increased amounts; and (iii) certain other agreed upon terms and conditions have been satisfied. This facility is guaranteed by the Company and substantially all of the domestic subsidiaries of the Company and is secured by the relevant real property owned by the Company that is mortgaged under the Mortgage Facility. The Company capitalized $0.9 million of debt issuance costs related to the Mortgage Facility that are being amortized over the term of the facility, $0.7 million of which were still unamortized as of March 31, 2012.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The interest rate is equal to (i) the per annum rate equal to one-month LIBOR plus between 2.50% and 3.00% per annum, determined on the first day of each month, or (ii) between 1.45% and 1.95% per annum in excess of the higher of (a) the Bank of America prime rate (adjusted daily on the day specified in the public announcement of such price rate), (b) the Federal Funds Rate adjusted daily, plus 0.5%, or (c) the per annum rate equal to one-month LIBOR plus 1.05% per annum. The Federal Funds Rate is the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published by the Federal Reserve Bank of New York on the business day succeeding such day.

The Company is required to make quarterly principal payments equal to 1.25% of the principal amount outstanding, which began in April 2011, and is required to repay the aggregate principal amount outstanding on the maturity date, which is December 29, 2015. During the three months ended March 31, 2012, the Company borrowed an additional $4.0 million to finance the acquisition of a dealership facility and made a principal payment of $0.5 million on outstanding borrowings from the Mortgage Facility. As of March 31, 2012, borrowings under the amended and restated Mortgage Facility totaled $44.5 million, with $2.3 million recorded as a current maturity of long-term debt in the accompanying Consolidated Balance Sheet.

The Mortgage Facility also contains usual and customary provisions limiting the Company s ability to engage in certain transactions, including limitations on the Company s ability to incur additional debt, additional liens, make investments, and pay distributions to its stockholders. In addition, effective December 31, 2011, the Mortgage Facility was amended to require certain financial covenants that are identical to those contained in the Company s Revolving Credit Facility. As of March 31, 2012, the Company was in compliance with all applicable covenants and ratios under the Revolving Credit Facility.

Real Estate Related Debt

The Company has entered into separate term mortgage loans with three of its manufacturer-affiliated finance partners Toyota Motor Credit Corporation (TMCC), Mercedes-Benz Financial Services USA, LLC (MBFS), BMW Financial Services NA, LLC (BMWFS) and a third-party financial institution (collectively, Real Estate Notes). The Real Estate Notes may be expanded, are on specific buildings and/or properties, and are guaranteed by the Company. Each loan was made in connection with, and is secured by mortgage liens on, the relevant real property owned the Company that is mortgaged under the Real Estate Notes. The Real Estate Notes bear interest at fixed rates between 4.56% and 5.47%, and at variable indexed rates plus a spread between 2.25% and 3.35% per annum. The Company capitalized $1.3 million of related debt issuance costs related to the Real Estate Notes that are being amortized over the terms of the notes, $1.1 million of which were still unamortized as of March 31, 2012.

The loan agreements with TMCC consist of six term loans, one of which was added during the first quarter of 2012 for $4.0 million. As of March 31, 2012, $41.5 million was outstanding under the TMCC term loans with $1.3 million classified as current. The maturity dates vary from two to seven years and provide for monthly payments based on a 20-year amortization schedule. These six loans are cross-collateralized and cross-defaulted with each other and are cross-defaulted with the Revolving Credit Facility.

The loan agreements with MBFS consist of three term loans. As of March 31, 2012, $48.3 million was outstanding under the MBFS term loans with $1.6 million classified as current. The agreements provide for monthly payments based on a 20-year amortization schedule and have a maturity date of five years. These three loans are cross-collateralized and cross-defaulted with each other. They are also cross-defaulted with the Revolving Credit Facility.

The loan agreements with BMWFS consist of 14 term loans, one of which was added during the first quarter of 2012 for $5.6 million to finance the acquisition of a dealership facility. As of March 31, 2012, $75.2 million was outstanding under the BMWFS term loans with $3.8 million classified as current. The agreements provide for monthly payments based on a 15-year amortization schedule and have a maturity date of seven years. In the case of three properties owned by subsidiaries, the applicable loan is also guaranteed by the subsidiary real property owner. These 14 loans are cross-collateralized with each other. In addition, they are cross-defaulted with each other, the Revolving Credit Facility, and certain dealership franchising agreements with BMW of North America, LLC.

The loan agreements with a third-party financial institution consist of three term loans for an aggregate principal amount of $16.5 million, to finance real estate associated with three of the Company s dealerships. The loans are being repaid in monthly installments that began in

September 2011 and will mature in August 2016. As of March 31, 2012, borrowings under these notes totaled $16.0 million, with $0.8 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets. These three loans are cross-defaulted with the Revolving Credit Facility.

In addition, the Company executed a note agreement with another third-party financial institution in 2008 for an aggregate principal amount of £10.0 million (Foreign Note), which is secured by the Company s foreign subsidiary properties. The Foreign Note is

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

being repaid in monthly installments that began in March 2010 and matures in August 2018. As of March 31, 2012, borrowings under the Foreign Note totaled $12.1 million, with $1.9 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

10. FAIR VALUE MEASUREMENTS

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

Level 1 unadjusted, quoted prices for identical assets or liabilities in active markets;

Level 2 quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable or that can be corroborated by observable market data by correlation; and

Level 3 unobservable inputs based upon the reporting entity s internally developed assumptions that market participants would use in pricing the asset or liability.

The Company s financial instruments consist primarily of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, investments in debt and equity securities, accounts payable, credit facilities, long-term debt and interest rate swaps. The fair values of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, accounts payable, and credit facilities approximate their carrying values due to the short-term nature of these instruments or the existence of variable interest rates.

The Company designates its investments in marketable securities and debt instruments as available-for-sale, measures them at fair value, and classifies them as either cash and cash equivalents or other assets in the accompanying Consolidated Balance Sheets based upon maturity terms and certain contractual restrictions. The Company maintains multiple trust accounts comprised of money market funds with short-term investments in marketable securities, such as U.S. government securities, commercial paper and bankers acceptances, that have maturities of less than three months. The Company determined that the valuation measurement inputs of these marketable securities represent unadjusted quoted prices in active markets and, accordingly, has classified such investments within Level 1 of the hierarchy framework.

The Company, within its trust accounts, also holds investments in debt instruments, such as government obligations and other fixed income securities. The debt securities are measured based upon quoted market prices utilizing public information, independent external valuations from pricing services or third-party advisors. Accordingly, the Company has concluded the valuation measurement inputs of these debt securities to represent, at their lowest level, quoted market prices for identical or similar assets in markets where there are few transactions for the assets and has categorized such investments within Level 2 of the hierarchy framework. In addition, the Company periodically invests in unsecured, corporate demand obligations with manufacturer-affiliated finance companies, which bear interest at a variable rate and are redeemable on demand by the Company. Therefore, the Company has classified these demand obligations as cash and cash equivalents on the Consolidated Balance Sheet. The Company determined that the valuation measurement inputs of these instruments include inputs other than quoted market prices, that are observable or that can be corroborated by observable data by correlation. Accordingly, the Company has classified these instruments within Level 2 of the hierarchy framework.

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company evaluated its assets and liabilities for those that met the criteria of the disclosure requirements and fair value framework of ASC 820 and identified investments in marketable securities, debt instruments, and interest rate derivative financial instruments as having met such criteria. The respective fair values measured on a recurring basis as of March 31, 2012 and December 31, 2011, respectively, were as follows:

	As of March 31, 2012		
	Level 1	Level 2	Total
	(In thousands)		
Assets:			
Marketable securities - money market	$ 1,805	$	$ 1,805
Debt securities:			
Demand obligations		5,154	5,154
Corporate bonds		349	349
Municipal obligations		380	380
Mortgage backed		608	608
Total debt securities		6,491	6,491
Total	$ 1,805	$ 6,491	$ 8,296
Liabilities:			
Interest rate derivative financial instruments	$	$ 31,794	$ 31,794
Total	$	$ 31,794	$ 31,794

	As of December 31, 2011		
	Level 1	Level 2	Total
	(In thousands)		
Assets:			
Marketable securities - money market	$ 1,571	$	$ 1,571
Debt securities:			
Demand obligations		271	271
Collateralized mortgage obligations		19	19
Corporate bonds		338	338
Municipal obligations		683	683
Mortgage backed		632	632
Total debt securities		1,943	1,943
Total	$ 1,571	$ 1,943	$ 3,514
Liabilities:			
Interest rate derivative financial instruments	$	$ 34,040	$ 34,040
Total	$	$ 34,040	$ 34,040

11. COMMITMENTS AND CONTINGENCIES

From time to time, the Company s dealerships are named in various types of litigation involving customer claims, employment matters, class action claims, purported class action claims, as well as claims involving the manufacturer of automobiles, contractual disputes and other matters arising in the ordinary course of business. Due to the nature of the automotive retailing business, the Company may be involved in legal proceedings or suffer losses that could have a material adverse effect on the Company s business. In the normal course of business, the Company is required to respond to customer, employee and other third-party complaints. Amounts that have been accrued or paid related to the settlement of litigation are included in selling, general and administrative (SG&A) expenses in the Company s Consolidated Statements of Operations. In addition, the manufacturers of the vehicles that the Company sells and services have audit rights allowing them to review the validity of amounts claimed for incentive, rebate or warranty-related items and charge the Company back for amounts determined to be invalid rewards under the manufacturers programs, subject to the Company s right to appeal any such decision. Amounts that have been accrued or paid related to the

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

settlement of manufacturer charge backs of recognized incentives and rebates are included in cost of sales in the Company s Consolidated Statements of Operations, while such amounts for manufacturer chargebacks of recognized warranty-related items are included as a reduction of revenues in the Company s Consolidated Statements of Operations.

Legal Proceedings

In December 2011, an adverse jury verdict was rendered against the Company in the San Diego County Superior Court, awarding $7.5 million to the plaintiff who sought reimbursement for medical expenses, lost wages and pain and suffering arising from an accident involving one of the Company s customer shuttle vans and the plaintiff s motorcycle. In February 2012, the trial judge entered a judgment on the jury verdict. The Company has meritorious defenses and has filed for a new trial. The Company maintains insurance coverage for any loss in excess of the Company s $1.0 million self-insured retention. The Company has fully accrued the amount of the award and the related insurance charge as a current account receivable and a current accrued expense, respectively, in the accompanying Consolidated Balance Sheet as of March 31, 2012. The Company s insurance deductible was recognized as SG&A expense during the year ended December 31, 2011.

Other Matters

The Company, acting through its subsidiaries, is the lessee under many real estate leases that provide for the use by the Company s subsidiaries of their respective dealership premises. Pursuant to these leases, the Company s subsidiaries generally agree to indemnify the lessor and other parties from certain liabilities arising as a result of the use of the leased premises, including environmental liabilities, or a breach of the lease by the lessee. Additionally, from time to time, the Company enters into agreements in connection with the sale of assets or businesses in which it agrees to indemnify the purchaser, or other parties, from certain liabilities or costs arising in connection with the assets or business. Also, in the ordinary course of business in connection with purchases or sales of goods and services, the Company enters into agreements that may contain indemnification provisions. In the event that an indemnification claim is asserted, liability would be limited by the terms of the applicable agreement.

From time to time, primarily in connection with dealership dispositions, the Company s subsidiaries assign or sublet to the dealership purchaser the subsidiaries interests in any real property leases associated with such dealerships. In general, the Company s subsidiaries retain responsibility for the performance of certain obligations under such leases to the extent that the assignee or sublessee does not perform, whether such performance is required prior to or following the assignment or subletting of the lease. Additionally, the Company and its subsidiaries generally remain subject to the terms of any guarantees made by the Company and its subsidiaries in connection with such leases. Although the Company generally has indemnification rights against the assignee or sublessee in the event of non-performance under these leases, as well as certain defenses, and the Company presently has no reason to believe that it or its subsidiaries will be called on to perform under any such assigned leases or subleases, the Company estimates that lessee rental payment obligations during the remaining terms of these leases were $19.4 million as of March 31, 2012. The Company s exposure under these leases is difficult to estimate and there can be no assurance that any performance of the Company or its subsidiaries required under these leases would not have a material adverse effect on the Company s business, financial condition, or cash flows. The Company and its subsidiaries also may be called on to perform other obligations under these leases, such as environmental remediation of the leased premises or repair of the leased premises upon termination of the lease. However, the Company does not have any known material environmental commitments or contingencies and presently has no reason to believe that it or its subsidiaries will be called on to so perform.

In the ordinary course of business, the Company is subject to numerous laws and regulations, including automotive, environmental, health and safety, and other laws and regulations. The Company does not anticipate that the costs of such compliance will have a material adverse effect on its business, consolidated results of operations, financial condition, or cash flows, although such outcome is possible given the nature of its operations and the extensive legal and regulatory framework applicable to its business. The Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law on July 21, 2010, established a new consumer financial protection agency with broad regulatory powers. Although automotive dealers are generally excluded, the Dodd-Frank Act could lead to additional, indirect regulation of automotive dealers through its regulation of automotive finance companies and other financial institutions. In addition, the Patient Protection and Affordable Care Act, which was signed into law on March 23, 2010, has the potential to increase the Company s future annual employee health care costs. Further, new laws and regulations, particularly at the federal level, may be enacted, which could also have a materially adverse impact on its business.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. ACCUMULATED OTHER COMPREHENSIVE LOSS

Changes in the balances of each component of accumulated other comprehensive loss for the three months ended March 31, 2012 and 2011 were as follows:

	Unrealized Loss on Foreign Currency Translation	Unrealized Gain on Marketable Securities	Unrealized Loss on Interest Rate Swaps	Accumulated Other Comprehensive Loss
		(In thousands)		
Balance, December 31, 2010	$ (7,852)	$ 50	$ (10,953)	$ (18,755)
Other comprehensive income (loss), net of tax	1,340	(7)	1,804	3,137
Balance, March 31, 2011	$ (6,512)	$ 43	$ (9,149)	$ (15,618)
Balance, December 31, 2011	$ (7,969)	$ 8	$ (21,275)	$ (29,236)
Other comprehensive income, net of tax	1,394	3	1,403	2,800
Balance, March 31, 2012	$ (6,575)	$ 11	$ (19,872)	$ (26,436)

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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (Form 10-Q) includes certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (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 maintain or 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;
- future capital expenditures;
- changes in sales volumes and availability of 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 that these expectations will prove to be correct. When used in this quarterly report, the words anticipate, believe, estimate, expect, may and simil 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; future 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 similarly 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 legislation related to the Dodd-Frank Wall Street Reform and Consumer Protection Act, climate control changes legislation, and 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, Nissan, Honda, BMW, Ford, Daimler, General Motors, Chrysler, and Volkswagen, because of financial distress, bankruptcy, natural disasters that disrupt production 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;

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restructuring by one or more of our principal manufacturers, up to and including bankruptcy may cause us to suffer financial loss in the form of uncollectible receivables, devalued inventory or loss of franchises;

requirements imposed on us by our manufacturers may require dispositions, limit our acquisitions or increases in 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 may be 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.

These factors, as well as additional factors that could affect our operating results and performance are described in our 2011 Form 10-K, under the headings Item 1A. Risk Factors and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere within this quarterly report. Should one or more of the risks or uncertainties described above or elsewhere in this quarterly 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 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.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements because of various factors. See Cautionary Statement about Forward-Looking Statements.

Overview

We are a leading operator in the automotive retail industry. As of March 31, 2012, we owned and operated 134 franchises, representing 31 brands of automobiles, at 107 dealership locations and 25 collision service centers in the U.S. and ten franchises at five dealerships and three collision centers in the U.K. Through our dealerships, we sell new and used cars and light trucks; arrange related vehicle financing; sell service and insurance contracts; provide automotive maintenance and repair services; and sell vehicle parts. Our operations are primarily located in major metropolitan areas in 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, Farnborough, Hailsham, Hindhead and Worthing in the U.K.

As of March 31, 2012, our U.S. retail network consisted of the following two regions (with the number of dealerships they comprised): (i) the East (43 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina) and (ii) the West (64 dealerships in California, Kansas, Oklahoma and Texas). 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.

Outlook

From September 2008 through most of 2009, the U.S. and global economies suffered from, among other things, a substantial decline in consumer confidence, a rise in unemployment and a tightening of credit availability. As a result, the retail automotive industry was negatively impacted by decreasing customer demand for new and used vehicles, vehicle margin pressures and higher inventory levels. Through 2011 and the first three months of 2012, economic trends have stabilized and consumer demand for new and used vehicles has shown improvement. According to industry experts, the March 2012 seasonally adjusted annual rate of sales (or SAAR) was 14.4 million units, compared to 13.0 million units a year ago. But given the depth of the downturn, we believe the recovery to historically normalized industry selling levels will probably be extended.

Our operations have, and we believe that our operations will continue to generate positive cash flow. As such, we are focused on maximizing the return on the capital that we generate from our operations and positioning our balance sheet to take advantage of investment opportunities as they arise. We believe that the stabilizing economic trends provide opportunities for us to improve our operating results as we: (i) expand our new and used vehicle sales results and improve our sales efficiency; (ii) continue to focus on our higher margin parts and service business by enhancing the cost effectiveness of our marketing efforts, implementing strategic selling methods, and improving operational efficiencies; (iii) invest capital where necessary to support the anticipated growth, particularly in our parts and service business; and (iv) further leverage of our revenue and gross profit growth through continued cost rationalization.

We continue to closely scrutinize all planned future capital spending and work closely with our manufacturer partners in this area to make prudent investment decisions that are expected to generate an adequate return and/or improve the customer experience. We anticipate that 2012 capital spending will be less than $55.0 million, which includes $15.0 million for specific growth initiatives in our parts and service business.

We remain committed to our growth-by-acquisition strategy, and with the prolonged nature of the anticipated economic recovery, we believe that significant opportunities exist to enhance our portfolio with dealerships that meet our stringent investment criteria. During the first three months of 2012, we completed the acquisition of three dealerships. We will continue to pursue dealership investment opportunities that we believe will add value for our stockholders.

Financial and Operational Highlights

Our operating results reflect the combined performance of each of our interrelated business activities, which include the sale of new vehicles, used vehicles, finance and insurance products, and parts, as well as maintenance and collision repair services. Historically, each of these activities has been directly or indirectly impacted by a variety of supply/demand factors, including vehicle inventories, consumer confidence, discretionary spending, availability and affordability of consumer credit, manufacturer incentives, weather patterns, fuel prices and interest rates.

For example, during periods of sustained economic downturn or significant supply/demand

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imbalances, new vehicle sales may be negatively impacted as consumers tend to shift their purchases to used vehicles. Some consumers may even delay their purchasing decisions altogether, electing instead to repair their existing vehicles. In such cases, however, we believe the new vehicle sales impact on our overall business is mitigated by our ability to offer other products and services, such as used vehicles and parts, as well as maintenance and collision repair services. In addition, our ability to reduce our costs in response to lower sales also tempers the impact of lower new vehicle sales volume.

We generally experience higher volumes of vehicle sales and service in the second and third calendar quarters of each year. This seasonality is generally attributable to consumer buying trends and the timing of manufacturer new vehicle model introductions. In addition, in some regions of the U.S., vehicle purchases decline during the winter months due to inclement weather. As a result, our revenues and operating income are typically lower in the first and fourth quarters and higher in the second and third quarters. Other factors unrelated to seasonality, such as changes in economic condition and manufacturer incentive programs, may exaggerate seasonal or cause counter-seasonal fluctuations in our revenues and operating income.

For the three months ended March 31, 2012, total revenues increased 18.1% from 2011 levels to $1.7 billion and gross profit improved 17.4% to $260.4 million. Operating income rose for the three months ended March 31, 2012 by 37.6% from 2011 to $54.0 million. Income before income taxes improved to $37.3 million for the first quarter of 2012, which was a 52.2% improvement over the same period from the prior year. For the three months ended March 31, 2012 and 2011, we realized net income of $23.1 million and $15.4 million, respectively, and diluted income per share of $0.97 and $0.64, respectively. We generated cash flow of $6.4 million and $25.0 million for the three months ended March 31, 2012 and 2011, respectively.

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Key Performance Indicators

The following table highlights certain of the key performance indicators we use to manage our business:

Consolidated Statistical Data

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Unit Sales		
Retail Sales		
New Vehicle	27,930	24,704
Used Vehicle	20,749	16,730
Total Retail Sales	48,679	41,434
Wholesale Sales	9,994	9,055
Total Vehicle Sales	58,673	50,489
Gross Margin		
New Vehicle Retail Sales	5.8%	5.5%
Total Used Vehicle Sales	8.1%	8.1%
Parts and Service Sales	52.2%	53.0%
Total Gross Margin	15.6%	15.7%
SG&A[(1)] as a % of Gross Profit	76.5%	79.3%
Operating Margin	3.2%	2.8%
Pretax Margin	2.2%	1.7%
Finance and Insurance Revenues per Retail Unit Sold	$ 1,175	$ 1,068

(1) Selling, general and administrative expenses.

The following discussion briefly highlights certain of the results and trends occurring within our business. Throughout the following discussion, references are made to Same Store results and variances which are discussed in more detail in the Results of Operations section that follows.

While SAAR is still low relative to the years before the recession, it has risen from 13.0 million at March 31, 2011 to 14.4 million at March 31, 2012. Bolstered by this improved sales environment, our new vehicle retail sales revenues increased 16.3% during the first quarter of 2012 as compared to the same period in 2011. The improvement reflects higher new vehicle unit sales of 13.1%, as well as an increase of 2.9% in average sales price driven by brand mix and a shift towards more truck sales. New vehicle retail gross margin improved 30 basis points during the first quarter of 2012, reflecting improvement in our import and luxury brands. Gross profit per new vehicle sold improved $160 from the first quarter of 2011 to $1,891.

Our used vehicle results are directly affected by economic conditions, the level of manufacturer incentives on new vehicles and new vehicle financing, the number and quality of trade-ins and lease turn-ins and the availability of consumer credit. The stabilizing economic environment that benefited new vehicle sales also supported improved used vehicle demand that positively impacted our used vehicle retail sales in comparison to our 2011 results. As a result, we experienced a 24.0% increase in retail used vehicle volumes through the first three months of 2012 as compared to the same period in 2011. In addition, our average used vehicle retail sales price increased $666, or 3.4%, in the first quarter of 2012 over the comparable 2011 period to $20,000. Compared to the same period in 2011, used vehicle retail gross profit per retail unit improved 1.6% for the three months ended March 31, 2012 to $1,754. Further, the wholesale side of the business experienced increases in unit sales and gross profit for the three months ended March 31, 2012 as compared to the same period in 2011.

Our parts and service sales increased by 9.3% for the three months ended March 31, 2012 as compared to the same period in 2011 primarily driven by increases in our customer-pay parts and service revenues. We also realized increases in our wholesale parts and collision business segments. These increases more than offset the 4.3% decline in our warranty parts and service revenue. Our parts and service margins declined for the first quarter of 2012 as compared to the same period in 2011, primarily reflecting a mix shift

away from our warranty business and toward our collision and wholesale parts businesses, which on a relative basis generate lower margins. However, on a sequential quarter basis, our margin increased from 51.8% for the fourth quarter of 2011 to 52.2% for the first quarter of 2012.

Our consolidated finance and insurance income per retail unit sold increased $107 for the first quarter of 2012 as compared to the same period in 2011 to $1,175, primarily driven by increases in vehicle service contract penetration rates and finance income per contract.

Our total gross margin declined ten basis points to 15.6% for the three months ended March 31, 2012, primarily due to the decline in parts and service margins and the shift in our business mix, as we experienced more rapid growth in our new and used vehicle businesses, which generally produce lower margins than the other business units.

Our consolidated SG&A expenses increased in absolute dollars, but decreased as a percentage of gross profit by 280 basis points to 76.5% for the three months ended March 31, 2012, from the comparable period in 2011, reflecting ongoing cost control and the leverage on our cost structure that higher gross profit provides.

The combination of all of these factors contributed to a 40 basis-point increase in our operating margin to 3.2% for the three months ended March 31, 2012 over 2011 levels.

Our floorplan interest expense increased 12.7% for the three months ended March 31, 2012, as compared to the first quarter of 2011, primarily as a result of an increase in both our weighted average floorplan interest rates and our floorplan borrowings. Other interest expense increased 13.8% for the three months ended March 31, 2012 as a result of increased real estate borrowings associated primarily with dealership acquisitions. Despite these increases, our pretax margin for the three months ended March 31, 2012 increased 50 basis points to 2.2% as compared to the first quarter of 2011.

We address these items further, and other variances between the periods presented, in the Results of Operations section below.

Critical Accounting Policies and Accounting Estimates

The preparation of our Consolidated Financial Statements in conformity with U.S. generally accepted accounting principles requires management to make certain estimates and assumptions.

We disclosed certain critical accounting policies and estimates in our 2011 Annual Report on Form 10-K, and no significant changes have occurred since that time.

Results of Operations

The following tables present comparative financial and non-financial data for the three months ended March 31, 2012 and 2011, of (a) our Same Store locations, (b) those locations acquired or disposed of during the periods (Transactions), and (c) the total company. Same Store amounts include the results of dealerships for the identical months in each period presented in the comparison, commencing with the first full month in which the dealership was owned by us and, in the case of dispositions, ending with the last full month it was owned by us. Same Store results also include the activities of our corporate headquarters.

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The following table summarizes our combined Same Store results for the three months ended March 31, 2012 as compared to 2011:

Total Same Store Data

(dollars in thousands, except per unit amounts)

	Three Months Ended March 31,		
	2012	**% Change**	**2011**
Revenues			
New vehicle retail	$ 840,731	7.3%	$ 783,652
Used vehicle retail	385,501	19.3%	323,044
Used vehicle wholesale	61,215	(1.2)%	61,936
Parts and service	198,536	2.3%	194,075
Finance, insurance and other	53,212	20.4%	44,193
Total revenues	1,539,195	9.4%	1,406,900
Cost of Sales			
New vehicle retail	$ 791,966	6.9%	$ 740,971
Used vehicle retail	352,096	19.7%	294,191
Used vehicle wholesale	58,729	(1.2)%	59,445
Parts and service	94,187	3.5%	90,975
Total cost of sales	$ 1,296,978	9.4%	$ 1,185,582
Gross profit	242,217	9.4%	221,318
Selling, general and administrative expenses	185,277	5.6%	175,511
Depreciation and amortization expenses	6,918	7.8%	6,420