

UNITED AUTO GROUP INC

Form 10-Q

May 10, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2007

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 1-12297
United Auto Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

22-3086739
*(I.R.S. Employer
Identification No.)*

**2555 Telegraph Road,
Bloomfield Hills, Michigan**
(Address of principal executive offices)

48302-0954
(Zip Code)

**Registrant's telephone number, including area code:
(248) 648-2500**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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

As of May 1, 2007, there were 94,880,292 shares of voting common stock outstanding.

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UNITED AUTO GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

	March 31, 2007	December 31, 2006
	(Unaudited)	
	(In thousands, except per share amounts)	
ASSETS		
Cash and cash equivalents	\$ 25,202	\$ 13,147
Accounts receivable, net of allowance for doubtful accounts of \$2,664 and \$2,865	509,348	469,601
Inventories, net	1,602,193	1,521,424
Other current assets	85,078	71,524
Assets held for sale	181,598	200,083
Total current assets	2,403,419	2,275,779
Property and equipment, net	584,710	582,220
Goodwill	1,264,908	1,255,949
Franchise value	246,789	246,118
Other assets	94,318	109,736
Total assets	\$ 4,594,144	\$ 4,469,802
 LIABILITIES AND STOCKHOLDERS EQUITY		
Floor plan notes payable	\$ 1,072,369	\$ 874,326
Floor plan notes payable non-trade	476,224	297,069
Accounts payable	272,727	301,221
Accrued expenses	214,882	214,406
Current portion of long-term debt	14,513	13,385
Liabilities held for sale	103,115	52,703
Total current liabilities	2,153,830	1,753,110
Long-term debt	864,510	1,168,666
Other long-term liabilities	272,805	252,373
Total liabilities	3,291,145	3,174,149
Commitments and contingent liabilities		
Stockholders Equity		
Preferred Stock, \$0.0001 par value; 100 shares authorized; none issued and outstanding		

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Common Stock, \$0.0001 par value, 240,000 shares authorized; 94,755 shares issued at March 31, 2007; 94,468 shares issued at December 31, 2006

Non-voting Common Stock, \$0.0001 par value, 7,125 shares authorized; none issued and outstanding

Class C Common Stock, \$0.0001 par value, 20,000 shares authorized; none issued and outstanding

Additional paid-in-capital	770,277	768,794
Retained earnings	496,290	492,704
Accumulated other comprehensive income (loss)	81,656	79,379
Treasury stock, at cost; 5,306 shares at March 31, 2007 and December 31, 2006	(45,233)	(45,233)

Total stockholders' equity	1,302,999	1,295,653
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Total liabilities and stockholders' equity	\$ 4,594,144	\$ 4,469,802
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See Notes to Consolidated Condensed Financial Statements

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UNITED AUTO GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF INCOME

	Three Months Ended	
	March 31,	
	2007	2006
	(Restated)*	
	(Unaudited)	
	(In thousands, except per share amounts)	
Revenue:		
New vehicle	\$ 1,645,014	\$ 1,432,768
Used vehicle	786,910	555,102
Finance and insurance, net	68,894	58,049
Service and parts	352,570	293,656
Fleet and wholesale vehicle	249,782	213,211
Total revenues	3,103,170	2,552,786
Cost of sales:		
New vehicle	1,506,668	1,306,680
Used vehicle	725,763	504,955
Service and parts	156,934	131,916
Fleet and wholesale vehicle	246,848	210,478
Total cost of sales	2,636,213	2,154,029
Gross profit	466,957	398,757
Selling, general and administrative expenses	374,971	322,321
Depreciation and amortization	12,803	10,175
Operating income	79,183	66,261
Floor plan interest expense	(16,112)	(13,950)
Other interest expense	(18,859)	(11,947)
Equity in (losses) earnings of affiliates	(821)	1,150
Loss on debt redemption	(18,634)	
Income from continuing operations before income taxes and minority interests	24,757	41,514
Income taxes	(8,412)	(15,122)
Minority interests	(294)	(422)
Income from continuing operations	16,051	25,970
Loss from discontinued operations, net of tax	(1,469)	(2,015)

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Net income	\$ 14,582	\$ 23,955
Basic earnings per share:		
Continuing operations	\$ 0.17	\$ 0.28
Discontinued operations	(0.02)	(0.02)
Net income	0.16	0.26
Shares used in determining basic earnings per share	93,808	93,024
Diluted earnings per share:		
Continuing operations	\$ 0.17	\$ 0.28
Discontinued operations	(0.02)	(0.02)
Net income	0.15	0.25
Shares used in determining diluted earnings per share	94,412	94,272
Cash dividends per share	\$ 0.07	\$ 0.06

* See Note 1

See Notes to Consolidated Condensed Financial Statements

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UNITED AUTO GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	March 31,	
	2007	2006
		(Restated)*
		(Unaudited)
		(In thousands)
Operating Activities:		
Net income	\$ 14,582	\$ 23,955
Adjustments to reconcile net income to net cash from continuing operating activities:		
Depreciation and amortization	12,803	10,175
Undistributed losses (earnings) of equity method investments	821	(1,107)
Loss from discontinued operations, net of tax	1,469	2,015
Deferred income taxes	3,172	3,961
Debt redemption premium	18,634	
Minority interests	294	422
Changes in operating assets and liabilities:		
Accounts receivable	(35,763)	26,015
Inventories	(80,782)	(68,682)
Floor plan notes payable	198,044	40,448
Accounts payable and accrued expenses	(26,144)	84,440
Other	(11,390)	(26,405)
Net cash from continuing operating activities	95,740	95,237
Investing Activities:		
Purchase of equipment and improvements	(36,837)	(43,406)
Proceeds from sale-leaseback transactions	23,600	19,739
Dealership acquisitions net, including repayment of sellers' floorplan notes payable of \$0 and \$66,449, respectively	(1,373)	(176,230)
Other	8,764	
Net cash from continuing investing activities	(5,846)	(199,897)
Financing Activities:		
Proceeds from borrowings under U.S. credit agreement	71,000	132,000
Repayments under U.S. credit agreement	(71,000)	(396,000)
Redemption 9 5/8% Senior Subordinated debt	(314,439)	
Issuance of convertible subordinated debt		375,000
Net repayments of other long-term debt	(3,748)	(2,784)
Net borrowings of floor plan notes payable - non-trade	179,155	19,728
Payment of deferred financing costs		(11,513)

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Proceeds from exercises of options, including excess tax benefit	333	11,868
Repurchase of common stock		(18,955)
Dividends	(6,566)	(5,522)
Net cash from continuing financing activities	(145,265)	103,822
Discontinued operations:		
Net cash from discontinued operating activities	24,272	(2,861)
Net cash from discontinued investing activities	19,175	7,046
Net cash from discontinued financing activities	23,979	(2,513)
Net cash from discontinued operations	67,426	1,672
Net change in cash and cash equivalents	12,055	834
Cash and cash equivalents, beginning of period	13,147	8,957
Cash and cash equivalents, end of period	\$ 25,202	\$ 9,791

Supplemental disclosures of cash flow information:

Cash paid for:		
Interest	\$ 33,592	\$ 34,659
Income taxes	5,423	2,815

* See Note 1

See Notes to Consolidated Condensed Financial Statements

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UNITED AUTO GROUP, INC.
CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS EQUITY

	Common Stock		Additional	Retained	Accumulated	Treasury	Total
	Issued	Amount	Paid-In	Earnings	Other	Stock	Stockholders
	Shares		Capital		Comprehensive		Equity
					Income		
	(Unaudited)						
	(Dollars in thousands)						
Balances, January 1, 2007	94,468,013	\$ 9	\$ 768,794	\$ 492,704	\$ 79,379	\$ (45,233)	\$ 1,295,653
Adoption of FIN 48 (Note 1)				(4,430)			(4,430)
Restricted stock	262,244		1,150				1,150
Exercise of options, including tax benefit of \$144	24,469		333				333
Dividends				(6,566)			(6,566)
Foreign currency translation					2,099		2,099
Other					178		178
Net income				14,582			14,582
Balances, March 31, 2007	94,754,726	\$ 9	\$ 770,277	\$ 496,290	\$ 81,656	\$ (45,233)	\$ 1,302,999

See Notes to Consolidated Condensed Financial Statements

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UNITED AUTO GROUP, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

(In thousands, except per share amounts)

1. Interim Financial Statements

Basis of Presentation

The following unaudited consolidated condensed financial statements of United Auto Group, Inc. (the Company) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and disclosures normally included in the Company's annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the SEC rules and regulations. The information presented as of March 31, 2007 and December 31, 2006 and for the three month periods ended March 31, 2007 and 2006 is unaudited, but includes all adjustments which the management of the Company believes to be necessary for the fair presentation of results for the periods presented. The consolidated condensed financial statements for prior periods have been revised for entities which have been treated as discontinued operations through March 31, 2007. The results for the interim periods are not necessarily indicative of results to be expected for the year. These consolidated condensed financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2006, which are included as part of the Company's Annual Report on Form 10-K.

On June 1, 2006, the Company effected a two-for-one split of its voting common stock in the form of a dividend. Shareholders of record as of May 11, 2006 received one additional share for each share they owned. All share and per share information herein reflects the stock split.

Tax returns filed by the Company in all jurisdictions are subject to periodic audit by various tax authorities, certain of which are currently underway. To date, no material adjustments have been proposed in connection with these audits, and we do not anticipate that these audits will result in a material change to our financial position or results of operations. FASB Interpretation (FIN) No. 48 Accounting for Uncertainty in Income Taxes clarifies the accounting for uncertain tax positions, prescribing a minimum recognition threshold a tax position is required to meet before being recognized, and providing guidance on the derecognition, measurement, classification and disclosure relating to income taxes.

The Company adopted FIN No. 48 as of January 1, 2007, pursuant to which the Company recorded a \$4,430 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. As of January 1, 2007, the Company's total amount of unrecognized tax benefit was approximately \$36,600, of which approximately \$23,600 could favorably impact the Company's effective tax rate in the future.

We recognize interest and penalties related to income tax matters in income tax expense. As of March 31, 2007, we had approximately \$5,500 of interest and penalties accrued relating to uncertain tax positions. We do not expect the amount of accrued interest and penalties to change materially in the next twelve months.

In September 2006, the SEC released Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements (SAB 108), which permitted the Company to adjust for the cumulative effect of prior period immaterial errors in the carrying amount of assets and liabilities as of the beginning of 2006, with an offsetting adjustment to retained earnings as of January 1, 2006. SAB 108 requires the adjustment of any previously issued quarterly financial statements within 2006 for the effects of such errors on the quarters when the information is next presented. Such adjustments do not require previously filed reports with the SEC to be amended. In accordance with SAB 108, the Company adjusted its opening retained earnings as of January 1, 2006 and its financial results for the first three quarters of fiscal 2006 to correct an error related to operating leases with scheduled rent increases which were not accounted for on a straight line basis over the rental period. The error, which was previously determined to be immaterial on a quantitative and qualitative basis under the Company's assessment methodology for each individual period, impacted net income by \$804 and \$2,115 during the years ended December 31, 2005 and 2004, respectively. A summary of the impact of the error on previously issued 2006 quarterly financial statements follows:

	2006
Cumulative effect on stockholders' equity as of January 1,	\$(10,792)
Effect on:	
Net income for the three months ended March 31,	\$ (138)
Net income for the three months ended June 30,	\$ (143)
Net income for the three months ended September 30,	\$ (143)

Table of Contents**UNITED AUTO GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)*****Discontinued Operations***

The Company accounts for dispositions as discontinued operations when it is evident that the operations and cash flows of a franchise being disposed of will be eliminated from the Company's on-going operations and that the Company will not have any significant continuing involvement in its operations. In reaching the determination as to whether the cash flows of a dealership will be eliminated from ongoing operations, the Company considers whether it is likely that customers will migrate to similar franchises that it owns in the same geographic market. The Company's consideration includes an evaluation of the brands sold at other dealerships it operates in the market and their proximity to the disposed dealership. When the Company disposes of franchises, it typically does not have continuing brand representation in that market. If the franchise being disposed of is located in a complex of Company dealerships, the Company does not treat the disposition as a discontinued operation if the Company believes that the cash flows generated by the disposed franchise will be replaced by expanded operations of the remaining franchises. Combined financial information regarding dealerships accounted for as discontinued operations follows:

	Three Months Ended March 31,	
	2007	2006
Revenues	\$ 142,384	\$ 228,175
Pre-tax loss	(2,147)	(1,751)
Gain (loss) on disposal	231	(1,568)
	March 31, 2007	December 31, 2006
Inventories	\$ 90,675	\$ 105,341
Other assets	90,923	94,742
Total assets	\$ 181,598	\$ 200,083
Floor plan notes payable (trade and non-trade)	\$ 83,858	\$ 30,190
Other liabilities	19,257	22,513
Total Liabilities	\$ 103,115	\$ 52,703

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The accounts requiring the use of significant estimates include accounts receivable, inventories, income taxes, intangible assets and certain reserves.

Intangible Assets

The Company's principal intangible assets relate to its franchise agreements with vehicle manufacturers, which represent the estimated value of franchises acquired in business combinations, and goodwill, which represents the excess of cost over the fair value of tangible and identified intangible assets acquired in connection with business combinations. Intangible assets are amortized over their estimated useful lives. The

Table of Contents**UNITED AUTO GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

Company believes the franchise value of its dealerships has an indefinite useful life based on the following facts: Automotive retailing is a mature industry and is based on franchise agreements with the vehicle manufacturers;

There are no known changes or events that would alter the automotive retailing franchise environment;

Certain franchise agreement terms are indefinite;

Franchise agreements that have limited terms have historically been renewed without substantial cost; and

The Company's history shows that manufacturers have not terminated franchise agreements.

The following is a summary of the changes in the carrying amount of goodwill and franchise value for the three months ended March 31, 2007:

	Goodwill	Franchise Value
Balance January 1, 2007	\$ 1,255,949	\$ 246,118
Additions during period	6,960	
Foreign currency translation	1,999	671
Balance March 31, 2007	\$ 1,264,908	\$ 246,789

As of March 31, 2007, approximately \$674,475 of the Company's goodwill is deductible for tax purposes. The Company has established deferred tax liabilities related to the temporary differences arising from such tax deductible goodwill.

New Accounting Pronouncements

SFAS No. 157, *Fair Value Measurements* defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure requirements relating to fair value measurements. SFAS No. 157 will be effective for the Company on January 1, 2008. The Company is currently evaluating the impact of this pronouncement.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* permits entities to choose to measure many financial instruments and certain other items at fair value and consequently report unrealized gains and losses on such items in earnings. SFAS No. 159 will be effective for the Company on January 1, 2008. The Company is currently evaluating the impact of this pronouncement.

2. Inventories

Inventories consisted of the following:

	March 31, 2007	December 31, 2006
New vehicles	\$ 1,124,360	\$ 1,080,822
Used vehicles	399,799	361,984
Parts, accessories and other	78,034	78,618
Total inventories	\$ 1,602,193	\$ 1,521,424

The Company receives non-refundable credits from certain vehicle manufacturers which are treated as a reduction of cost of goods sold when the vehicles are sold. Such credits amounted to \$7,056 and \$6,480 during the three months ended March 31, 2007 and 2006, respectively.

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UNITED AUTO GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

3. Business Combinations

The Company acquired 31 franchises during the three months ended March 31, 2006. The Company's financial statements include the results of operations of the acquired dealerships from the date of acquisition. Purchase price allocations may be subject to final adjustment. A summary of the aggregate purchase price allocations for the three months ended March 31, 2007 and 2006 follows:

	March 31,	
	2007	2006
Accounts receivable	\$	\$