

GROUP 1 AUTOMOTIVE INC

Form 10-K

February 19, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

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, including zip code)

(713) 647-5700

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class Name of exchange on which registered

Common stock, par value \$0.01 per share New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if that registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of common stock held by non-affiliates of the registrant was approximately \$1.2 billion based on the reported last sale price of common stock on June 30, 2018, which was the last business day of the registrant's most recently completed second quarter.

As of February 1, 2019, there were 18,340,482 shares of our common stock, par value \$0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2019 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2018, are incorporated by reference into Part III of this Form 10-K.

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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (“Form 10-K”) 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 (“Exchange Act”). This information includes statements regarding our strategy, 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 and divestitures;
- the future revenues of acquired dealerships;
- future stock repurchases, refinancing of debt, 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;
- changes in regulatory practices, tariffs and taxes, including Brexit; and
- availability of financing for inventory, working capital, real estate and capital expenditures.

Although we believe that the expectations reflected in these forward-looking statements are reasonable when and as made, we cannot assure you that these expectations will prove to be correct or that future developments affecting us will be those that we anticipate. When used in this Form 10-K, the words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may” and similar expressions, as they relate to our company and management, are intended to identify forward-looking statements, which are generally not historical in nature. These forward-looking statements are based on our current expectations and beliefs concerning future developments and their potential effect on our existing operations and do not include the potential impact of any future acquisitions. Our forward-looking statements involve significant risks and uncertainties (some of which are beyond our control) and assumptions that could cause actual results to differ materially from our historical experience and our present expectations or projections. Known material factors that could cause our actual results to differ from those in the forward-looking statements are those described in Part I, “Item 1A. Risk Factors.”

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, except as required by law.

PART I

Item 1. Business

General

Group 1 Automotive, Inc., a Delaware corporation organized in 1995, is a leading operator in the automotive retail industry. As of December 31, 2018, we owned and operated 238 franchises, representing 30 brands of automobiles, at 183 dealership locations and 47 collision centers worldwide. We own 152 franchises at 118 dealership locations and 29 collision centers in the United States of America (“U.S.”), 63 franchises at 47 dealership locations and 11 collision centers in the United Kingdom (“U.K.”) and 23 franchises at 18 dealership locations and seven collision centers in Brazil. 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 Mexico, Oklahoma, South Carolina, and Texas in the U.S., in 32 towns in the U.K., and in key metropolitan markets in the states of Sao Paulo, Parana, Mato Grosso do Sul and Santa Catarina in Brazil.

As discussed in more detail in Note 2, “Summary of Significant Accounting Policies and Estimates”, within our Notes to Consolidated Financial Statements, all of our operating subsidiaries are aligned into one of three operating segments (or regions): the U.S., the U.K. and Brazil. The President of U.S. Operations reports directly to the Company's Chief Executive Officer and is responsible for the overall performance of the U.S. region, as well as for overseeing the market directors and dealership general managers. The operations of the Company's two international regions are structured similar to the U.S. region. Our financial information, including our revenues from external customers, a measure of profit or loss, and total assets, is segregated into our three operating segments and included in our Consolidated Financial Statements and related notes beginning on page F-1.

Business Strategy

Our business strategy primarily focuses on the performance of our existing dealerships to achieve growth, capture market share, and maximize the investment return to our stockholders. We are constantly evaluating opportunities to improve the overall profitability of our dealerships. For 2019, our priorities will be on three key areas as we continue to become a best-in-class automotive retailer. These areas are:

sustained growth of our higher margin parts and service business. Our focus on growth in our parts and service operations continues to hinge on the retention and expansion of our service professionals, targeted marketing efforts, strategic selling and operational efficiencies, as well as capital investments designed to support our growth targets; promotion of the customer experience and customer satisfaction, in all areas of our business; and improvement of operating efficiencies, through further development of our operating model that promotes commonality of processes, systems and training, to further leverage our cost base. We made significant changes in our operating model during the last five years, which were designed to reduce variable and fixed expenses. And, we continue our efforts to fully leverage our scale, reduce costs, enhance internal controls, and enable further growth. As our business grows in 2019 and beyond, we intend to manage our costs carefully and to look for additional opportunities to improve our processes and disseminate best practices. We believe that our management structure supports more rapid decision making and facilitates an efficient and effective roll-out of new processes.

A key to the execution of our business strategy is the leverage of what we believe to be one of our key strengths — the talent of our people. We believe that we have developed a distinguished management team with substantial industry expertise. With our management structure and level of executive talent, we plan to continue empowering the operators of our dealerships to make appropriate decisions to grow their respective dealership operations and to control fixed and variable costs. We believe this approach allows us to provide the best possible service to our customers, as well as attract and retain talented employees.

We will continue to focus on opportunities to enhance our current dealership portfolio by strategic acquisitions and improving or disposing any underperforming dealerships. We believe that substantial opportunities for growth through acquisitions remain in our industry in the U.S., the U.K. and Brazil. An absolute acquisition target has not been established for 2019, but we expect to acquire dealerships that provide attractive returns on investment. We believe that as of December 31, 2018, we have sufficient financial resources to support additional acquisitions. We plan to focus our future growth in geographically diverse areas with positive economic outlooks over the longer-term.

Further, we intend to critically evaluate our return on invested capital in our current dealership portfolio for disposition opportunities. In 2018, we completed the acquisition of five U.K. dealerships, inclusive of eight franchises, added one franchise and opened one additional dealership for one awarded franchise in the U.K., with expected aggregate annualized revenues of \$315.0 million, as estimated at the time of the

acquisitions. The Company acquired four dealerships in the U.S., inclusive of four franchises, and opened one additional dealership, representing one franchise with expected aggregate annualized revenues of \$230.0 million. Further, the Company acquired one dealership in Brazil, representing one franchise, and opened one additional dealership, representing one franchise, with expected aggregate annualized revenues of \$70.0 million. For more information on our acquisitions and dispositions, including those occurring in 2018, see “Acquisition and Divestiture Program” for further details.

Dealership Operations

Our operations are located in geographically diverse markets that extend domestically across 15 states aggregated into one U.S. region, and internationally in the U.K. and Brazil, representing our three reportable segments: U.S., U.K. and Brazil. See Note 21, “Segment Information” within the Notes to Consolidated Financial Statements for further financial information on our three reportable segments. For a discussion of the risks associated with our operations in the U.S., U.K. and Brazil, please see Part I, “Item 1A. Risk Factors.” The following table sets forth the regions and geographic markets in which we operate, the percentage of new vehicle retail units sold in each region in 2018 and the number of dealerships and franchises in each region:

Region	Geographic Market	Percentage of Our New Vehicle Retail Units Sold During the Year Ended December 31, 2018	As of December 31, 2018	
			Number of Dealerships	Number of Franchises
United States	Texas	36.4 %	56	74
	Oklahoma	6.3	13	20
	California	6.2	5	9
	Massachusetts	4.9	5	5
	Georgia	4.5	7	9
	Florida	2.7	4	4
	Louisiana	2.1	5	7
	New Hampshire	1.8	3	3
	South Carolina	1.6	3	3
	New Jersey	1.6	4	4
	Kansas	1.4	4	4
	Mississippi	1.2	3	3
	Alabama	0.7	2	2
	Maryland	0.5	2	2
	New Mexico	0.2	2	3
		72.1	118	152
International	United Kingdom	22.7	47	63
	Brazil	5.2	18	23
Total		100.0 %	183	238

Each of our local operations has a management structure designed to promote and reward entrepreneurial spirit and the achievement of team goals. The general manager of each dealership, with assistance from the managers of new vehicle sales, used vehicle sales, parts, service, collision and finance and insurance departments, is ultimately responsible for the operation, personnel and financial performance of the dealership. Our dealerships are operated as distinct profit centers, and our general managers have a reasonable degree of empowerment within our organization.

New Vehicle Retail Sales

In 2018, we sold 170,517 new vehicles in retail transactions at our dealerships, representing 32 brands. Our retail sales of new vehicles accounted for 18.0% of our gross profit in 2018. In addition to the profit related to the transactions, a typical new vehicle retail sale or lease may create the following additional profit opportunities for our dealerships:

- manufacturer dealer incentives;
- the resale of any used vehicle trade-in purchased by the dealership;

arrangement of third-party financing in connection with the retail sale;
the sale of vehicle service and insurance contracts;
the sale of vehicle parts, accessories or other after-market products; and

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the service and repair of the vehicle both during and after the warranty period.

We consider brand diversity to be one of our strengths. The following table sets forth our consolidated new vehicle sales revenue by brand and number of new vehicle retail units sold in the year ended, as well as the number of franchises we owned as of December 31, 2018:

	New Vehicle Revenues	New Vehicle Unit Sales	% of Total Units Sold	Franchises Owned
	(In thousands)			
Toyota	\$ 1,104,381	36,687	21.5 %	19
BMW	744,436	15,881	9.3 %	27
Ford	693,030	18,361	10.8 %	18
Audi	599,885	15,402	9.0 %	14
Mercedes-Benz	418,784	7,692	4.5 %	12
Honda	382,597	13,796	8.1 %	13
Nissan	327,929	11,085	6.5 %	9
Lexus	317,914	6,345	3.7 %	4
Chevrolet	254,984	6,376	3.7 %	6
Volkswagen	146,640	5,572	3.3 %	12
Land Rover	137,619	2,146	1.3 %	8
MINI	124,866	4,653	2.7 %	18
Jeep	113,189	3,132	1.8 %	6
Acura	108,713	2,673	1.6 %	5
GMC	108,498	2,168	1.3 %	5
RAM	98,520	2,095	1.2 %	6
Kia	85,318	3,468	2.0 %	5
Hyundai	79,982	3,118	1.8 %	5
Cadillac	67,291	1,175	0.7 %	2
Subaru	66,774	2,231	1.3 %	3
Jaguar	52,473	1,003	0.6 %	7
Dodge	41,836	1,143	0.7 %	6
Buick	21,725	624	0.4 %	5
Sprinter	18,150	393	0.2 %	5
Chrysler	16,955	396	0.2 %	6
SEAT	12,485	1,631	1.0 %	1
Lincoln	11,153	197	0.1 %	3
Mazda	10,830	378	0.2 %	1
SKODA	7,039	300	0.2 %	2
Vauxhall	3,968	209	0.1 %	—
Smart	2,246	162	0.1 %	5
Volvo	1,161	25	— %	—
Total	\$ 6,181,371	170,517	100.0 %	238

Our diversity by manufacturer, based on new vehicle unit sales for the years ended December 31, 2018, 2017, and 2016, is set forth below:

	For the Years Ended December 31,					
	2018	% of Total	2017	% of Total	2016	% of Total
Toyota/Lexus	43,032	25.2%	43,557	25.3%	42,922	24.9%
Volkswagen/Audi/Porsche/SEAT/SKODA	22,905	13.4	23,686	13.8	20,219	11.8
BMW/MINI	20,534	12.0	21,903	12.7	23,305	13.5
Ford/Lincoln	18,558	10.9	19,733	11.5	18,925	11.0
Honda/Acura	16,469	9.7	15,882	9.2		