GROUP 1 AUTOMOTIVE INC
Form 10-Q
April 27, 2011

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

Form 10-Q

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the quarterly period ended March 31, 2011**
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the transition period from to**

Commission File Number: 1-13461

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

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

800 Gessner, Suite 500
Houston, Texas 77024
(Address of principal executive offices) (Zip Code)

(713) 647-5700
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant 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 o No o

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

Large accelerated filer o	Accelerated filer þ

Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

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

As of April 22, 2011, the registrant had 24,022,301 shares of common stock, par value $0.01, outstanding.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	March 31, 2011 (Unaudited)	December 31, 2010
	(In thousands, except per share amounts)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 44,804	$ 19,843
Contracts-in-transit and vehicle receivables, net	117,593	113,846
Accounts and notes receivable, net	68,428	75,623
Inventories	784,142	777,771
Deferred income taxes	15,517	14,819
Prepaid expenses and other current assets	10,541	17,332
Total current assets	1,041,025	1,019,234
PROPERTY AND EQUIPMENT, net	539,922	506,288
GOODWILL	510,356	507,962
INTANGIBLE FRANCHISE RIGHTS	158,764	158,694
OTHER ASSETS	9,843	9,786
Total assets	$ 2,259,910	$ 2,201,964
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Floorplan notes payable credit facility	$ 581,319	$ 560,840
Floorplan notes payable manufacturer affiliates	102,810	103,345
Current maturities of mortgage facility	42,600	42,600
Current maturities of long-term debt	10,482	10,589
Current liabilities from interest rate risk management activities	709	1,098
Accounts payable	99,752	92,799
Accrued expenses	87,668	83,663
Total current liabilities	925,340	894,934
LONG-TERM DEBT, net of current maturities	413,530	412,950

DEFERRED INCOME TAXES	67,661	58,970
LIABILITIES FROM INTEREST RATE RISK MANAGEMENT ACTIVITIES	14,630	16,426
OTHER LIABILITIES	32,274	31,036
DEFERRED REVENUES	2,779	3,280
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; 26,262 and 26,096 issued, respectively	263	261
Additional paid-in capital	365,294	363,966
Retained earnings	532,586	519,843
Accumulated other comprehensive loss	(15,618)	(18,755)
Treasury stock, at cost; 2,241 and 2,303 shares, respectively	(78,829)	(80,947)
Total stockholders equity	803,696	784,368
Total liabilities and stockholders equity	$ 2,259,910	$ 2,201,964

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 OPERATIONS

	Three Months Ended March 31,	
	2011	2010
	(Unaudited, in thousands, except per share amounts)	
REVENUES:		
New vehicle retail sales	$ 784,714	$ 646,121
Used vehicle retail sales	323,447	279,609
Used vehicle wholesale sales	61,951	42,512
Parts and service sales	194,950	185,435
Finance, insurance and other, net	44,240	37,476
Total revenues	1,409,302	1,191,153
COST OF SALES:		
New vehicle retail sales	741,942	606,747
Used vehicle retail sales	294,547	253,172
Used vehicle wholesale sales	59,457	40,849
Parts and service sales	91,581	85,864
Total cost of sales	1,187,527	986,632
GROSS PROFIT	221,775	204,521
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	175,884	166,406
DEPRECIATION AND AMORTIZATION EXPENSE	6,455	6,485
ASSET IMPAIRMENTS	222	
INCOME FROM OPERATIONS	39,214	31,630
OTHER EXPENSE:		
Floorplan interest expense	(6,760)	(7,566)
Other interest expense, net	(7,942)	(7,104)
Loss on redemption of long-term debt		(3,872)
INCOME BEFORE INCOME TAXES	24,512	13,088
PROVISION FOR INCOME TAXES	(9,150)	(5,107)
NET INCOME	$ 15,362	$ 7,981
BASIC EARNINGS PER SHARE	$ 0.68	$ 0.34
Weighted average common shares outstanding	22,582	23,135
DILUTED EARNINGS PER SHARE	$ 0.66	$ 0.34
Weighted average common shares outstanding	23,264	23,688
CASH DIVIDEND PER COMMON SHARE	$ 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 CASH FLOWS

	Three Months Ended March 31, 2011	2010
	(Unaudited, in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 15,362	$ 7,981
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,455	6,485
Deferred income taxes	7,048	4,330
Asset Impairments	222	
Stock-based compensation	2,744	2,697
Amortization of debt discount and issue costs	2,878	1,635
Loss on redemption of long-term debt		3,872
Tax effect from stock-based compensation	(325)	116
Other	152	233
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts payable and accrued expenses	10,436	22,960
Accounts and notes receivable	7,278	(3,091)
Inventories	5,736	(48,234)
Contracts-in-transit and vehicle receivables	(3,623)	(19,097)
Prepaid expenses and other assets	1,397	1,622
Floorplan notes payable manufacturer affiliates	(804)	(693)
Deferred revenues	(501)	(898)
Net cash provided by (used in) operating activities	54,455	(20,082)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid in acquisitions, net of cash received	(35,033)	(21,743)
Proceeds from disposition of franchise, property and equipment	4,235	(2,998)
Purchases of property and equipment, including real estate	(15,306)	2,895
Other	113	433
Net cash used in investing activities	(45,991)	(21,413)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on credit facility Floorplan Line	1,237,710	1,099,692
Repayments on credit facility Floorplan Line	(1,217,231)	(1,045,925)
Principal payments on mortgage facility		(2,578)
Proceeds from issuance of 3.00% Convertible Notes		100,000
Debt issue costs		(3,300)
Purchase of equity calls		(39,947)

Sale of equity warrants		25,486
Redemption of other long-term debt		(77,011)
Borrowings of other long-term debt	80	173
Principal payments of long-term debt related to real estate loans	(2,000)	(681)
Principal payments of other long-term debt	(767)	(103)
Proceeds from issuance of common stock to benefit plans	880	832
Tax effect from stock-based compensation	325	(116)
Dividends paid	(2,619)	
Net cash provided by financing activities	16,378	56,522
EFFECT OF EXCHANGE RATE CHANGES ON CASH	119	(76)
NET INCREASE IN CASH AND CASH EQUIVALENTS	24,961	14,951
CASH AND CASH EQUIVALENTS, beginning of period	19,843	13,221
CASH AND CASH EQUIVALENTS, end of period	$ 44,804	$ 28,172

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 STOCKHOLDERS EQUITY

	Common Stock		Additional	Retained	Accumulated Other Comprehensive Income (Loss)			Treasury	
					Unrealized Gains (Losses) on Interest Rate	Unrealized Gains (Losses) on Marketable	Unrealized Gains (Losses) on Currency		
	Shares	Amount	Paid-in Capital	Earnings	Swaps	Securities	Translation	Stock	Total
	(Unaudited, in thousands)								
LANCE, December 31, 10	26,096	$ 261	$ 363,966	$ 519,843	$ (10,953)	$ 50	$ (7,852)	$ (80,947)	$ 784,36
mprehensive income:									
t income				15,362					15,36
erest rate swap ustment, net of tax vision of $1,082					1,804				1,80
realized loss on estments, net of tax efit of $4						(7)			(
realized gain on rency translation							1,340		1,34
tal comprehensive ome									18,49
uance of common and asury shares to ployee benefit plans	(71)	(1)	(2,688)					2,118	(57
oceeds from sales of mmon stock under ployee benefit plans	24	1	879						88
uance of restricted stock	225	2	(2)						
rfeiture of restricted ck	(12)								
ck-based compensation			2,744						2,74
x effect from options ercised and the vesting restricted shares			395						39
sh dividends				(2,619)					(2,61
LANCE, March 31, 11	26,262	$ 263	$ 365,294	$ 532,586	$ (9,149)	$ 43	$ (6,512)	$ (78,829)	$ 803,69

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

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 the states of Alabama, California, Florida, Georgia, Kansas, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, Oklahoma, South Carolina and Texas in the United States of America (the U.S.) and in the towns of Brighton, Farnborough, Hailsham, Hindhead and Worthing in the United Kingdom (the U.K.). Through their dealerships, these subsidiaries sell new and used cars and light trucks; arrange related financing and sell vehicle service and insurance contracts; provide maintenance and repair services; and sell replacement parts. Group 1 Automotive, Inc. and its subsidiaries are herein collectively referred to as the Company or Group 1.

As of March 31, 2011, the Company s U.S. retail network consisted of the following three regions (with the number of dealerships they comprised): (i) the Eastern (42 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina), (ii) the Central (44 dealerships in Kansas, Oklahoma and Texas) and (iii) the Western (11 dealerships in California). 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 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 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 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, 2010 (2010 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 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Goodwill

The Company defines its reporting units as each of its three regions in the U.S. and the U.K. Goodwill represents the excess, at the date of acquisition, of the purchase price of the business acquired over the fair value of the net tangible and intangible assets acquired. Annually in the fourth quarter, based on the carrying values of the Company s regions as of October 31st, the Company performs a fair value and potential impairment assessment of its goodwill. An impairment analysis is done more frequently if certain events or circumstances arise that would indicate a change in the fair value of the non-financial asset has occurred (i.e., an impairment indicator).

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In evaluating its goodwill, the Company compares the carrying value of the net assets of each reporting unit to its respective fair value. This represents the first step of the impairment test. If the fair value of a reporting unit is less than the carrying value of its net assets, the Company must proceed to step two of the impairment test. Step two involves allocating the calculated fair value to all of the tangible and identifiable intangible assets of the reporting unit as if the calculated fair value was the purchase price in a business combination. The Company then compares the value of the implied goodwill resulting from this second step to the carrying value of the goodwill in the reporting unit. To the extent the carrying value of the goodwill exceeds its implied fair value under step two of the impairment test, an impairment charge equal to the difference is recorded.

At March 31, 2011, the Company did not identify an impairment indicator relative to its goodwill. As a result, the Company was not required to conduct the first step of the impairment test. However, if in future periods the Company determines that the carrying amount of the net assets of one or more of its reporting units exceeds the respective fair value as a result of step one, the Company believes that the application of step two of the impairment test could result in a material impairment charge to the goodwill associated with the reporting unit(s).

Intangible Franchise Rights

The Company s only significant identifiable intangible assets, other than goodwill, are rights under franchise agreements with manufacturers, which are recorded at an individual dealership level. The Company expects these franchise agreements to continue for an indefinite period and, when these agreements do not have indefinite terms, the Company believes that renewal of these agreements can be obtained without substantial cost. As such, the Company believes that its franchise agreements will contribute to cash flows for an indefinite period and, therefore, the carrying amounts of the franchise rights are not amortized. The Company evaluates these franchise rights for impairment annually in the fourth quarter, based on the carrying values of the Company s individual dealerships as of October 31st, or more frequently if events or circumstances indicate possible impairment has occurred.

In performing its impairment assessments, the Company tests the carrying value of each individual franchise right that was recorded by using a direct value method, discounted cash flow model, or income approach, specifically the excess earnings method. During the three months ended March 31, 2011, the Company did not identify an impairment indicator relative to its capitalized value of intangible franchise rights and, therefore, no impairment evaluation was required.

3. ACQUISITIONS AND DISPOSITIONS

During the first three months of 2011, the Company acquired one Ford dealership located in Houston, Texas and one Volkswagen dealership located in Irving, Texas. Consideration paid for these dealerships totaled $35.0 million, including amounts paid for vehicle inventory, parts inventory, equipment, and furniture and fixtures, as well as the purchase of the associated real estate. The vehicle inventory was subsequently financed through borrowings under FMCC Facility and Floorplan Line, respectively, as defined in Note 9. In addition, the Company sold one of its non-operational dealership facilities that qualified as a held-for-sale asset as of December 31, 2010 for $4.1 million. No gain or loss was recognized related to this sale.

During the first three months of 2010, the Company was awarded two Sprinter franchises located in two separate Mercedes-Benz stores in Georgia and New York. The Company also acquired two BMW/MINI dealerships in the Southeast region of the U.K. Consideration paid for these two dealerships totaled $21.7 million, including amounts paid for vehicle inventory, parts inventory, equipment, and furniture and fixtures, as well as the purchase of the associated real estate. The vehicle inventory was subsequently financed through borrowings under the Company s credit facility with BMW Financial Services. In addition, the Company disposed of real estate holdings of non-operating facilities in Texas and Massachusetts during the three months ended March 31, 2010.

Subsequent to March 31, 2011, the Company acquired a BMW/MINI dealership in El Paso, Texas.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT ACTIVITIES

The periodic interest rates of the Revolving Credit Facility (as defined in Note 9), the Mortgage Facility (as defined in Note 10) 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 reflects the current 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 average 10 and 20-year industrial 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 in Accounting Standards Codification (ASC) 820.

The related gains or losses on these interest rate derivatives are deferred in stockholders equity as a component of accumulated other comprehensive income or 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, 2011, the Company held interest rate swaps in effect of $350.0 million in notional value that fixed its underlying one-month LIBOR at a weighted average rate of 4.2%. At March 31, 2011, all of the Company s derivative contracts were determined to be effective. For the three months ended March 31, 2011 and 2010, the impact of the Company s interest rate hedges in effect increased floorplan interest expense by $3.3 million and $5.0 million, respectively. Total floorplan interest expense was $6.8 million and $7.6 million for the three months ended March 31, 2011 and 2010, respectively.

In addition to the $350.0 million of swaps in effect as of March 31, 2011, the Company entered into four additional interest rate swaps during the three months ended March 31, 2011 with forward start dates in August 2012 and expiration dates in August 2015. The aggregate notional value of these four forward-starting swaps is $100.0 million and the weighted average interest rate of these swaps is 2.8%.

As of March 31, 2011 and December 31, 2010, the Company reflected liabilities from interest risk management activities of $15.3 million and $17.5 million, respectively, in its Consolidated Balance Sheets. One of the Company s interest rate swaps with a notional amount of $50.0 million expires in August 2011. As such, the fair

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

value of this instrument is classified as a current liability in the accompanying Consolidated Balance Sheet. In addition, as of March 31, 2011, the Company reflected assets from interest rate risk management activities of $0.7 million in its consolidated Balance Sheet. Included in accumulated other comprehensive loss at March 31, 2011 and 2010 are unrealized losses, net of income taxes, totaling $9.1 million and $18.5 million, respectively, related to these hedges.

Subsequent to March 31, 2011, the Company entered into an interest rate swap with a forward start date in August 2012 and an expiration date in August 2015, a notional value of $25.0 million and an interest rate of 2.65%.

The following table presents the impact during the current and comparative prior year period for the Company s derivative financial instruments on its Consolidated Statements of Operations and Consolidated Balance Sheets. 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, 2011 or 2010, respectively.

Derivatives in Cash Flow Hedging Relationship	Amount of Unrealized Gain, Net of Tax, Recognized in OCI Three Months Ended March 31, 2011	2010
	(In thousands)	
Interest rate swap contracts	$ 1,804	$ 637

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, 2011	2010
	(In thousands)	
Floorplan interest expense	$ (3,251)	$ (5,042)
Other interest expense	(205)	(1,107)

The amount expected to be reclassified out of accumulated other comprehensive income into earnings (through floorplan interest expense or other interest expense) in the next twelve months is $12.5 million.

5. STOCK-BASED COMPENSATION PLANS

The Company provides 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 (the 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 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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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. 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. As of March 31, 2011, there were 1,300,140 shares available under the Incentive Plan for future grants of these awards.

Stock Option Awards

No stock option awards have been granted since November 2005. The following table summarizes the Company s outstanding stock options as of March 31, 2011, and the changes during the three months then ended:

	Number	Weighted Average Exercise Price
Options outstanding, December 31, 2010	68,908	$ 33.11
Granted		
Exercised	(11,300)	24.65
Forfeited		
Options outstanding, March 31, 2011	57,608	34.77
Options vested at March 31, 2011	57,608	34.77
Options exercisable at March 31, 2011	57,608	$ 34.77

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 November 2006, the Company began granting to certain employees, at no cost to the recipient, performance awards pursuant to the Incentive Plan. 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 based on time and the achievement of certain performance criteria established by the Compensation Committee of the Board of Directors. 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. 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 or as the performance criteria are met.

A summary of these awards as of March 31, 2011, along with the changes during the three months then ended, is as follows:

	Awards		Weighted Average Grant Date Fair Value
Nonvested at December 31, 2010	1,283,794	$	23.57
Granted	225,436		40.45
Vested	(47,798)		23.97
Forfeited	(11,500)		39.44
Nonvested at March 31, 2011	1,449,932	$	26.05

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employee Stock Purchase Plan

In September 1997, the Company adopted the Group 1 Automotive, Inc. 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, 2011, there were 917,344 shares remaining in reserve for future issuance under the Purchase Plan. During the three months ended March 31, 2011 and 2010, the Company issued 23,298 and 29,794 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 $10.22 and $9.30 during the three months ended March 31, 2011 and 2010, 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 $2.7 million for both the three months ended March 31, 2011 and 2010. Cash received from option exercises and Purchase Plan purchases was $0.9 million and $0.8 million for the three months ended March 31, 2011 and 2010, respectively. Additional paid-in capital was increased by $0.4 million and reduced by $0.1 million for the three months ended March 31, 2011 and 2010, respectively, for the effect of tax deductions for options exercised and vesting of restricted shares that were less 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, 2011 and 2010.

The Company issues new shares when options are exercised or restricted stock vests or will use treasury shares, if available. 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.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. EARNINGS PER SHARE

Basic earnings per share (EPS) is computed based on weighted average shares outstanding and excludes dilutive securities. Diluted EPS is computed by including the impact of all potentially dilutive securities. The following table sets forth the calculation of EPS for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31, 2011		Three Months Ended March 31, 2010	
	(In thousands, except per share amounts)			
Net income	$	15,362	$	7,981
Weighted average basic shares outstanding		22,582		23,135
Dilutive effect of contingently Convertible 3.00% Notes		139		
Dilutive effect of stock options, net of assumed repurchase of treasury stock		12		15
Dilutive effect of restricted stock and employee stock purchases, net of assumed repurchase of treasury stock		531		538
Weighted average dilutive shares outstanding		23,264		23,688
Earnings per share from:				
Basic	$	0.68	$	0.34
Diluted	$	0.66	$	0.34

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 earnings per share calculations. The weighted average number of stock-based awards not included in the calculation of the dilutive effect of stock-based awards was less than 0.1 million for both the three months ended March 31, 2011 and 2010.

As discussed in Note 10 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 10) and the 2.25% Warrants sold in connection with the 2.25% Notes. Although the 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 dilutive 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, 2011 was less than $59.43, no net shares were included in the computation of diluted earnings per share, 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 10) and the 3.00% Warrants sold in connection with the 3.00% Notes (the 3.00% Warrants). Although the 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 dilutive 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, 2011 was more than the conversion price in effect at the end of the period, 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 10 for a description of the change to the conversion price, which occurred during the three months ended March 31, 2011 as a result of the Company s decision to pay a cash dividend of $0.11 per share of common stock for the fourth quarter of 2010 to holders of record on March 1, 2011.

7. 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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

37.3% of pretax income for the three months ended March 31, 2011 differed from the federal statutory rate of 35.0% due primarily to taxes provided for the taxable state jurisdictions in which the Company operates.

For the three months ended March 31, 2011, the Company s effective tax rate decreased to 37.3% from 39.0% for the same period in 2010. 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, 2011 and December 31, 2010, 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, 2011.

Taxable years 2006 and subsequent remain open for examination by the Company s major taxing jurisdictions.

8. PROPERTY AND EQUIPMENT

The Company s property and equipment consists of the following:

	Estimated Useful Lives in Years	March 31, 2011	December 31, 2010
		(Dollars in thousands)	
Land		$ 194,471	$ 183,391
Buildings	30 to 40	256,468	241,355
Leasehold improvements	up to 30	76,672	68,808
Machinery and equipment	7 to 20	54,259	53,473
Furniture and fixtures	3 to 10	51,504	49,893
Company vehicles	3 to 5	9,260	9,182
Construction in progress		19,795	17,333
Total		662,429	623,435
Less accumulated depreciation and amortization		122,507	117,147
Property and equipment, net		$ 539,922	$ 506,288

During the three months ended March 31, 2011, the Company incurred $5.3 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, 2011 associated with existing dealership operations totaling $10.5 million. Also, in conjunction with the Company s acquisition of two separate dealerships during the three months ended March 31, 2011, the Company acquired $21.5 million of real estate and other property and equipment.

9. CREDIT FACILITIES

The Company has a $1.35 billion revolving syndicated credit arrangement with 20 financial institutions including four manufacturer-affiliated finance companies (the Revolving Credit Facility). The Company also has a $150.0 million floorplan financing arrangement with Ford Motor Credit Company (the 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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 49.9% in the fourth quarter of 2008 to 91.9% for the three months ended March 31, 2011.

Revolving Credit Facility

The Revolving Credit Facility expires in March 2012 and consists of two tranches: $1.0 billion for vehicle inventory floorplan financing (the Floorplan Line) and $350.0 million for working capital, including acquisitions (the Acquisition Line). Up to half of the Acquisition Line can be borrowed in either Euros or Pounds 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 $1.0 billion for the Floorplan Line and maximum of $350.0 million for the Acquisition Line. The Revolving Credit Facility can be expanded to its maximum commitment of $1.85 billion, subject to participating lender approval. 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 bears interest at rates equal to one-month LIBOR plus 87.5 basis points for new vehicle inventory and one-month LIBOR plus 97.5 basis points for used vehicle inventory. In addition, the Company pays a commitment fee on the unused portion of the Acquisition Line, as well as the Floorplan Line. The available funds on the Acquisition Line carry a commitment fee ranging from 0.25% to 0.375% per annum, depending on the Company s leverage ratio, based on a minimum commitment of $200.0 million. The Floorplan Line requires a 0.20% commitment fee on the unused portion. In conjunction with the Revolving Credit Facility, the Company had $1.0 million of related unamortized costs as of March 31, 2011 that are being amortized over the term of the facility.

After considering outstanding balances of $581.3 million at March 31, 2011, the Company had $418.7 million of available floorplan borrowing capacity under the Floorplan Line. Included in the $418.7 million available borrowings under the Floorplan Line is $107.7 million of immediately available funds. The weighted average interest rate on the Floorplan Line was 1.1% as of March 31, 2011 and December 31, 2010, excluding the impact of the Company s interest rate swaps. Amounts borrowed by the Company under the Floorplan Line of the Revolving Credit Facility must be repaid upon the sale of the specific vehicle financed, and in no case may a borrowing for a vehicle remain outstanding for greater than one year. With regards to the Acquisition Line, no borrowings were outstanding as of March 31, 2011 or December 31, 2010. After considering $17.3 million of outstanding letters of credit, and other factors included in the Company s available borrowing base calculation, there was $204.2 million of available borrowing capacity under the Acquisition Line as of March 31, 2011. The amount of available borrowing capacity under the Acquisition Line may be limited from time to time based upon certain debt covenants.

All of the Company s domestic dealership-owning subsidiaries are co-borrowers under the Revolving Credit Facility. 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, current, total leverage, and senior secured leverage, among others. Further, provisions of the Revolving Credit Facility require the Company to maintain financial ratios and a minimum level of stockholders equity (the Required Stockholders Equity), which effectively limits the amount of disbursements (or Restricted Payments) that the Company may make outside the ordinary course of business (e.g., cash dividends and stock repurchases). The Required Stockholders Equity is defined as a base of $520.0 million, plus 50% of cumulative adjusted net income, plus 100% of the proceeds from any equity issuances and less non-cash

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

asset impairment charges. The amount by which adjusted stockholders equity exceeds the Required Stockholders Equity is the amount available for Restricted Payments (the Amount Available for Restricted Payments). For purposes of this covenant calculation, net income and stockholders equity represents such amounts per the consolidated financial statements, adjusted to exclude the Company s foreign operations and the impact of the adoption of the accounting standard for convertible debt that became effective on January 1, 2009 and was primarily codified in ASC 470. As of March 31, 2011, the Amount Available for Restricted Payments was $189.2 million. However, the Mortgage Facility (as defined in Note 10) provides for a similar restricted payment basket and was more restrictive as of March 31, 2011 (see discussion of the Mortgage Facility Restricted Payment Basket in Note 10).

As of March 31, 2011 and December 31, 2010, the Company was in compliance with all applicable covenants and ratios 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.

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 cancelled with 30 days notice by either party. As of March 31, 2011, the Company had an outstanding balance of $52.5 million with an available floorplan borrowing capacity of $97.5 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 4.0%. As of March 31, 2011, the interest rate on the FMCC Facility was 5.5% 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 cancelled 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. As of March 31, 2011, the interest rates charged on borrowings outstanding under this facility ranged from 1.5% to 4.5%.

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, 2011, the interest rate charged on borrowings related to the Company s rental vehicle fleet ranged from 1.1% to 6.8%. 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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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. LONG-TERM DEBT

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

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
2.25% Convertible Senior Notes due 2036 (principal of $182,753 at March 31, 2011 and December 31, 2010)	$ 139,814	$ 138,155
3.00% Convertible Senior Notes due 2020 (principal of $115,000 at March 31, 2011 and December 31, 2010)	75,099	74,365
Mortgage Facility	42,600	42,600
Other Real Estate Related and Long-Term Debt	168,701	170,291
Capital lease obligations related to real estate, maturing in varying amounts through November 2032 with a weighted average interest rate of 8.9%	40,398	40,728
	466,612	466,139
Less current maturities of mortgage facility and other long-term debt	53,082	53,189
	$ 413,530	$ 412,950

2.25% Convertible Senior Notes

The Company s outstanding 2.25% Convertible Senior Notes due 2036 (the 2.25% Notes), which had a face value of $182.8 million, had a fair value based on quoted market prices of $185.5 million and $180.0 million as of March 31, 2011 and December 31, 2010, respectively. The Company determined the discount applicable to its 2.25% Notes 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 from the 7.5%, due to the impact of underwriter fees associated with this issuance that were capitalized as an additional discount to the 2.25% Notes 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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As of March 31, 2011 and December 31, 2010, the carrying value of the 2.25% Notes, related discount and equity component consisted of the following:

	March 31, 2011	December 31, 2010
	(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	$ 15,273	$ 15,855
Principal amount of 2.25% Notes	$ 182,753	$ 182,753
Unamortized discount	(41,320)	(42,916)
Unamortized underwriter fees	(1,619)	(1,682)
Net carrying amount of liability component	$ 139,814	$ 138,155
Net impact on retained earnings	$ (38,392)	$ (37,420)
Unamortized debt issuance cost	$ 64	$ 67

For the three months ended March 31, 2011 and 2010, 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,	
	2011	2010
	(Dollars in thousands)	
Year-to-date contractual interest expense	$ 1,028	$ 1,028
Year-to-date discount amortization	$ 1,554	$ 1,411
Effective interest rate of liability component	7.7%	7.7%

3.00% Convertible Senior Notes

The Company s outstanding 3.00% Convertible Senior Notes due 2020 (the 3.00% Notes), which had a face value of $115.0 million, had a fair value based on quoted market prices of $147.2 million and $143.3 million as of March 31, 2011 and December 31, 2010, respectively. The Company also determined the discount applicable to of its 3.00% Notes using the estimated effective interest rate for similar debt with no convertible features. The interest rate of 8.25% was estimated by receiving a range of quotes from the underwriters of the 3.00% Notes 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 to the 3.00% Notes 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. As of March 31, 2011 and

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December 31, 2010, the carrying value of the 3.00% Notes, related discount and equity component consisted of the following:

	March 31, 2011	December 31, 2010
	(In thousands)	
Carrying amount of equity component	$ 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	$ 13,726	$ 13,971
Principal amount of 3.00% Notes	$ 115,000	$ 115,000
Unamortized discount	(37,820)	(38,516)
Unamortized underwriter fees	(2,081)	(2,119)
Net carrying amount of liability component	$ 75,099	$ 74,365
Net impact on retained earnings	$ (1,610)	$ (1,202)
Unamortized debt issuance cost	$ 307	$ 313

For the three months ended March 31, 2011 and 2010, 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, 2011	2010
	(Dollars in thousands)	
Year-to-date contractual interest expense	$ 874	$ 95
Year-to-date discount amortization	$ 653	$ 52
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 $49.933 as of March 31, 2011); (2) during the five business day period after any ten consecutive

trading day period in which the trading price per $1,000 principal amount of 3.00% Notes for each day of the ten day trading period was less than 98% of the product of the last reported sale price of the Company s common stock and the conversion rate of the 3.00% Notes 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. Although none of the conversion features of the Company s 3.00% Notes were triggered in the first quarter of 2011, the if-converted value exceeded the principal amount of the 3.00% Notes by $11.1 million as of March 31, 2011.

As of March 31, 2011, the conversion rate was 26.0325 shares of common stock per $1,000 principal amount of 3.00% Notes, with a conversion price of $38.41 per share, which was reduced during the first quarter of 2011 as the result of the Company s decision to pay a cash dividend of $0.11 per share of common stock for the fourth quarter of 2010 to holders of record on March 1, 2011. If any cash dividend or distribution is made to all, or substantially all,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, 2011, the exercise price of the 3.00% Warrants, which are related to the issuance of the 3.00% Notes, was $56.45 due to the Company s decision to pay a cash dividend of $0.11 per share of common stock for the fourth quarter of 2010 to holders of record on March 1, 2011. 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 purchase a total of 3.0 million shares of its common stock at a purchase price of $38.41 per share, the conversion price, as of March 31, 2011. 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

On December 29, 2010, the Company amended and restated its $235.0 million five-year real estate credit facility with Bank of America, N.A. and Comerica Bank. As amended and restated, the Real Estate Credit Facility (Mortgage Facility) provides for $42.6 million of term loans with the right to expand to $75.0 million 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.

As amended and restated, the Mortgage Facility now provides for only term loans and no longer has a revolving feature. The interest rate is now equal to (i) the per annum rate equal to one-month LIBOR plus 3.00% per annum, determined on the first day of each month, or (ii) 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 beginning in April 2011 and is required to repay the aggregate principal amount outstanding on the maturity date, which is defined as the earliest of (1) December 29, 2015 or (2) November 30, 2011 if the Revolving Credit Facility is not modified, renewed or refinanced on or before November 30, 2011 to extend the Revolving Credit Facility maturity date, or (3) the revised Revolving Credit Facility maturity date if the Revolving Credit Facility is modified, renewed or refinanced to extend its maturity date.

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. As amended, the Mortgage Facility contains certain covenants, including financial ratios that must be complied with, including: fixed charge coverage ratio, total funded lease adjusted indebtedness to proforma EBITDAR ratio, and current ratio. For covenant calculation purposes, EBITDAR is defined as earnings before non-floorplan interest expense, taxes, depreciation and amortization and rent expense. EBITDAR also includes interest income and is further adjusted for certain non-cash income charges. Additionally, the Company is limited under the terms of the Mortgage Facility in its ability to make cash dividend payments to its stockholders and to repurchase shares of its outstanding common stock, based

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

primarily on the quarterly net income or loss of the Company (the Mortgage Facility Restricted Payment Basket). As of March 31, 2011, the Mortgage Facility Restricted Payment Basket was $107.3 million and will increase in the future periods by 50.0% of the Company s cumulative net income (as defined in terms of the Mortgage Facility), as well as the net proceeds from stock option exercises, and decrease by subsequent payments for cash dividends and share repurchases. As of March 31, 2011, the Company was in compliance with all of these covenants. Based upon current operating and financial projections, the Company believes that it will remain compliant with such covenants in the future.

During the three months ended March 31, 2011, the Company did not make any principal payments on outstanding borrowings from the Mortgage Facility. As of March 31, 2011, borrowings under the amended and restated Mortgage Facility totaled $42.6 million, all of which was recorded as a current maturity of long-term debt in the accompanying Consolidated Balance Sheet. If the Company is successful in its plan to amend the Revolving Credit Facility by November 30, 2011, and extend its maturity beyond December 29, 2015, then the long-term portion of the outstanding borrowings will be reclassified as long-term debt in the Consolidated Balance Sheet.

Real Estate Related Debt

In addition to the amended and restated Mortgage Facility, the Company entered into separate term loans in 2010, totaling $146.0 million, with three of its manufacturer-affiliated finance partners Toyota Motor Credit Corporation (TMCC), Mercedes-Benz Financial Services USA, LLC (MBFS) and BMW Financial Services NA, LLC (BMWFS) (collectively, the Real Estate Notes). The Company used $116.4 million of these borrowings to refinance a portion of its Mortgage Facility and the remaining amount to finance owned or purchased real estate to be utilized in existing dealership operations. 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 by the Company that is mortgaged under the Real Estate Notes. The Real Estate Notes bear interest at fixed rates between 4.62% and 5.47%, and at variable rates of three-month LIBOR plus between 3.15% 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, $1.2 million of which are still unamortized as of March 31, 2011.

The loan agreements with TMCC consist of four term loans. As of March 31, 2011, $27.3 million remained outstanding with $0.5 million classified as current and the remainder in long-term debt. The maturity dates vary from two to seven years and provide for monthly payments based on a 20-year amortization schedule. These four loans are cross-collateralized and cross-defaulted with each other. During the first three months of 2011, the loan agreements were amended to also be cross-defaulted with the Revolving Credit Facility.

The loan agreements with MBFS consist of three term loans. As of March 31, 2011, $49.7 million remained outstanding with $1.5 million classified as current and the remainder in long-term debt. 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 twelve term loans. As of March 31, 2011, $67.5 million remained outstanding with $3.0 million classified as current and the remainder in long-term debt. 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 twelve 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.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

subsidiary properties. The Foreign Note is being repaid in monthly installments which began in March 2010 and matures in August 2018. As of March 31, 2011, borrowings under the Foreign Note totaled $14.0 million, with $1.9 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

11. FAIR VALUE MEASUREMENTS

Guidance primarily codified within 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. ASC 820 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. ASC 820 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 banker s 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 as described in ASC 820.

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.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s derivative financial instruments are recorded at fair market value. See Note 4 Derivative Instruments and Risk Management Activities for further details regarding the Company s derivative financial instruments.

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 as of March 31, 2011 were as follows:

	As of March 31, 2011		
	Level 1	Level 2	Total
		(In thousands)	
Assets:			
Marketable securities money market	$ 1,534	$	$ 1,534
Interest rate derivative financial instruments		702	702
Debt securities:			
Demand obligations		30,245	30,245
Collateralized mortgage obligations		73	73
Corporate bonds		1,117	1,117
Municipal obligations		993	993
Mortgage backed		718	718
Total debt securities		33,146	33,146
Total	$ 1,534	$ 33,848	$ 35,382
Liabilities:			
Interest rate derivative financial instruments	$	$ 15,339	$ 15,339
Total	$	$ 15,339	$ 15,339

12. 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 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 settlement of manufacturer chargebacks 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.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Legal Proceedings

Currently, the Company is not party to any legal proceedings, including class action lawsuits that, individually or in the aggregate, are reasonably expected to have a material adverse effect on the Company s results of operations, financial condition or cash flows. However, the results of these or future matters cannot be predicted with certainty, and an unfavorable resolution of one or more of such matters could have a material adverse effect on the Company s results of operations, financial condition, or cash flows.

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 $24.3 million as of March 31, 2011. 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 and 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 presently has no reason to believe that it or its subsidiaries will be called on to so perform and such obligations cannot be quantified at this time.

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, cash flows, or financial condition, 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 its future annual employee health care costs. Further, new laws and regulations, particularly at the federal level, may be enacted, which could also materially adversely impact its business. The Company does not have any material known environmental commitments or contingencies.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. COMPREHENSIVE INCOME

The following table provides a reconciliation of net income to comprehensive income for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
	(In thousands)	
Net income	$ 15,362	$ 7,981
Other comprehensive income (loss):		
Change in fair value of interest rate swaps	1,804	637
Unrealized loss on investments	(7)	(12)
Unrealized gain (loss) on currency translation	1,340	(1,637)
Total comprehensive income	$ 18,499	$ 6,969

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

This quarterly report includes certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, 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 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 you that these expectations will prove to be correct. When used in this quarterly report, the words anticipate, believe, estimate, expect, may and similar 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; further 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 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, Ford, Mercedes-Benz, Chrysler, Nissan, Honda, General Motors and BMW, 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;

restructuring by one or more of our principal manufactures, 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 or limit our acquisitions and require us to increase the level of capital expenditures related to our dealership facilities;

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- 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 being 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 2010 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.

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, 2011, we owned and operated 121 franchises, representing 30 brands of automobiles, at 97 dealership locations and 24 collision service centers in the United States of America (the U.S.) and ten franchises, representing two brands, at five dealerships and three collision centers in the United Kingdom (the U.K.). We market and sell an extensive range of automotive products and services, including new and used vehicles and related financing, vehicle maintenance and repair services, replacement parts, and warranty, insurance and extended service contracts. 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, 2011, our U.S. retail network consisted of the following three regions (with the number of dealerships they comprised): (i) the Eastern (42 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York and South Carolina); (ii) the Central (44 dealerships in Kansas, Oklahoma and Texas); and (iii) the Western (11 dealerships in California). 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 financ