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

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

Form 10-Q

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

OR

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

Commission File Number: 1-13461

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

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

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

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

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

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

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

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

As of August 4, 2008, the registrant had 23,270,471 shares of common stock, par value $0.01, outstanding.

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Certification of CEO Pursuant to Section 302
Certification of CFO Pursuant to Section 302
Certification of CEO Pursuant to Section 906
Certification of CFO Pursuant to Section 906

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PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

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

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

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

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

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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

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

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

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

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND ORGANIZATION:

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

All acquisitions of dealerships completed during the periods presented have been accounted for using the purchase method of accounting and their results of operations are included from the effective dates of the closings of the acquisitions. The allocations of purchase price to the assets acquired and liabilities assumed are assigned and recorded based on estimates of fair value. All intercompany balances and transactions have been eliminated in consolidation.

Interim Financial Information

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments of a normal and recurring nature considered necessary for a fair presentation have been included in the financial statements. Due to seasonality and other factors, the results of operations for the interim period are not necessarily indicative of the results that will be realized for the entire fiscal year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Form 10-K).

Reclassifications

During the three months ended June 30, 2008, the Company disposed of certain operations that qualified for discontinued operations accounting treatment. In order to reflect these operations as discontinued, the necessary reclassifications have been made to the Company s Consolidated Statement of Operations for the three and six months

ended June 30, 2007, as well as the Company s Consolidated Statement of Cash Flows for the six months ended June 30, 2007. In addition, the Company has made reclassifications to the Consolidated Balance Sheet as of December 31, 2007, which was derived from the audited Consolidated Balance Sheet included in the Company s 2007 Form 10-K.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Statements of Cash Flows

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

Income Taxes

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

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

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

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

order to be recognized in the financial statements (See Note 5 for additional information). No cumulative adjustment was required to effect the adoption of FIN 48.

Foreign Currency Translation

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recent Accounting Pronouncements

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

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

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

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

- certain transaction costs, which are presently treated as cost of the acquisition, will be expensed;

- restructuring costs associated with a business combination, which are presently capitalized, will be expensed subsequent to the acquisition date;

- contingencies, including contingent consideration, which are presently accounted for as an adjustment of purchase price, will be recorded at fair value with subsequent adjustments recognized in operations; and

- valuation allowances on acquired deferred tax assets, which are presently considered to be subsequent changes in consideration and are recorded as decreases in goodwill, will be recognized up front and in operations.

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

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

3. STOCK-BASED COMPENSATION:

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2007 Long Term Incentive Plan

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

Stock Option Awards

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

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

Restricted Stock Awards

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

months to five years. Performance awards are considered outstanding at the date of grant, but are restricted from disposition based on time and the achievement of certain performance criteria established by the Company. In the event the employee or director terminates his or her employment or directorship with the Company prior to the lapse of the restrictions, the shares, in most cases, will be forfeited to the Company.

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

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employee Stock Purchase Plan

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

All Stock-Based Payment Arrangements

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

4. EARNINGS PER SHARE:

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

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

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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Six Months Ended June 30,			
	2008		2007	
	Basic	Diluted	Basic	Diluted
	(In thousands, except per share amounts)			
Net Income from:				
Continuing operations, net of income taxes	$ 35,595	$ 35,595	$ 41,921	$ 41,921
Discontinued operations, net of income taxes	(2,003)	(2,003)	(258)	(258)
Net income	$ 33,592	$ 33,592	$ 41,663	$ 41,663
Weighted Average Shares Outstanding				
Basic shares outstanding	22,566	22,566	23,819	23,819
Dilutive effect of stock-based awards, net of assumed repurchase of treasury stock		162		165
Diluted shares outstanding		22,728		23,984
Earnings per share from:				
Continuing operations, net of income taxes	$ 1.58	$ 1.57	$ 1.76	$ 1.75
Discontinued operations, net of income taxes	(0.09)	(0.09)	(0.01)	(0.01)
Net income	$ 1.49	$ 1.48	$ 1.75	$ 1.74

Any options with an exercise price in excess of the average market price of the Company s common stock, during the periods presented, are not considered when calculating the dilutive effect of stock options for 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 were 0.4 million and 0.2 million for the three months ended June 30, 2008 and 2007, respectively, and 0.6 million and 0.2 million for the six months ended June 30, 2008 and 2007, respectively.

The Company will be required to include the dilutive effect, if applicable, of the net shares issuable under its 2.25% Convertible Notes and the warrants sold in connection with the 2.25% Convertible Notes. Since the average price of the Company s common stock for the three and six months ended June 30, 2008, was less than $59.43, no net shares were issuable under the 2.25% Convertible Notes or the warrants.

5. INCOME TAXES:

As discussed in Note 2, the Company adopted FIN 48 on January 1, 2007. No cumulative adjustment was required to effect the adoption of FIN 48. As of June 30, 2008, approximately $0.4 million of tax benefits, including $0.1 million of interest, remained unrecognized. The Company recognized $0.3 million of tax benefits during each of the three and six months ended June 30, 2008, that were unrecognized as of December 31, 2007, based on the expiration of the relevant statute of limitations. All of the tax benefits unrecognized as of June 30, 2008, could potentially be

recognized in the next 12 months based upon resolution with the relevant tax authorities or statute expirations.

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 United Kingdom, as a result of its dealership acquisitions in March 2007. Taxable years 2003 and subsequent remain open for examination by the Company s major taxing jurisdictions.

Consistent with prior practices, the Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

6. CREDIT FACILITIES:

Effective March 19, 2007, the Company entered into an amended and restated five-year revolving syndicated credit arrangement with 22 financial institutions, including three manufacturer-affiliated finance companies (the Revolving Credit Facility). The Company also has a $300.0 million floorplan financing arrangement with Ford Motor Credit Company (the FMCC Facility), a $235.0 million Real Estate Credit Facility (the Mortgage Facility) for financing of

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

real estate expansion, as well as, arrangements with several other automobile manufacturers for financing of a portion of its rental vehicle inventory. Floorplan notes payable credit facility reflects amounts payable for the purchase of specific new, used and rental vehicle inventory (with the exception of new and rental vehicle purchases financed through lenders affiliated with the respective manufacturer) whereby financing is provided by the Revolving Credit Facility. Floorplan notes payable manufacturer affiliates reflects amounts payable for the purchase of specific new vehicles whereby financing is provided by the FMCC Facility 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.

Revolving Credit Facility

The Revolving Credit Facility provides a total borrowing capacity of $1.35 billion that matures in March 2012. The Company can expand the facility to its maximum commitment of $1.85 billion, subject to participating lender approval. This facility 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 Pound Sterling. The capacity under these two tranches can be redesignated within the overall $1.35 billion commitment, subject to the original limits of $1.0 billion and $350.0 million. The Acquisition Line bears interest at the London Inter Bank Offered Rate (LIBOR) plus a margin that ranges from 150 to 225 basis points, depending on the Company s leverage ratio. The Floorplan Line bears interest at rates equal to LIBOR plus 87.5 basis points for new vehicle inventory and LIBOR plus 97.5 basis points for used vehicle inventory. In conjunction with the amendment to the Revolving Credit Facility, the Company capitalized $2.3 million of related costs that are being amortized over the term of the facility. In addition, the Company pays a commitment fee on the unused portion of the Acquisition Line. The first $37.5 million of available funds carry a 0.20% per annum commitment fee, while the balance of the available funds carry a commitment fee ranging from 0.35% to 0.50% per annum, depending on the Company s leverage ratio.

As of June 30, 2008, after considering outstanding balances, the Company had $245.0 million of available floorplan capacity under the Floorplan Line. Included in the $245.0 million available balance under the Floorplan Line is $15.8 million of immediately available funds. In addition, the weighted average interest rate on the Floorplan Line was 3.4% as of June 30, 2008. Under the Acquisition Line, the Company had $50.0 million outstanding in Acquisition Line borrowings at June 30, 2008. After considering $18.0 million of outstanding letters of credit, there was $282.0 million of available borrowing capacity as of June 30, 2008. The weighted average interest rate on the Acquisition Line was 4.6% as of June 30, 2008. The amount of available borrowings 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 ratio, leverage, and a minimum net worth requirement, among others. Additionally, under the terms of the Revolving Credit Facility, the Company is limited in its ability to make cash dividend payments to its stockholders and to repurchase shares of its outstanding stock, based primarily on the quarterly net income of the Company. As of June 30, 2008, the Company was in compliance with these covenants. 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.

Effective January 17, 2008, the Company amended the Revolving Credit Facility to, among other things, increase the limit on both the senior secured leverage and total leverage ratios, as well as to add a borrowing base calculation that governs the amount of borrowings available under the Acquisition Line.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FMCC Facility

The FMCC Facility provides for the financing of, and is collateralized by, the Company s entire Ford, Lincoln and Mercury new vehicle inventory. This arrangement provides for $300.0 million of floorplan financing and matures on December 16, 2008. The Company expects to renew the FMCC Facility upon its maturity. As of June 30, 2008, the Company had an outstanding balance of $123.5 million with an available floorplan capacity of $176.5 million. This facility bears interest at a rate of Prime plus 100 basis points minus certain incentives. As of June 30, 2008, the interest rate on the FMCC Facility was 6.0%, before considering the applicable incentives. After considering all incentives received during 2008, the total cost to the Company of borrowings under the FMCC Facility approximates what the cost would be under the Floorplan Line. The Company is required to maintain a $1.5 million balance in a restricted money market account as additional collateral under the FMCC Facility. This amount is reflected in prepaid expenses and other current assets on the accompanying 2008 and 2007 consolidated balance sheets.

Mortgage Facility

The Mortgage Facility is a five-year term real estate credit facility with Bank of America, N.A., that matures in March 2012. The Mortgage Facility provides a maximum commitment of $235.0 million of financing for real estate expansion and is syndicated with nine financial institutions. The proceeds of the Mortgage Facility are used primarily for acquisitions of real property associated with the Company s dealerships and other operations. At the Company s option, any loan under the Mortgage Facility will bear interest at a rate equal to (i) one month LIBOR plus 1.05% or (ii) the Base Rate plus 0.50%. Prior to the maturity of the Mortgage Facility, quarterly principal payments are required of each loan outstanding under the facility at an amount equal to one-eightieth of the original principal amount, with any remaining unpaid principal amount due at the end of the term. As of June 30, 2008, borrowings under the facility totaled $182.7 million, with $9.4 million recorded as a current maturity. The Company capitalized $1.3 million of related debt financing costs that are being amortized over the term of the facility.

The Mortgage Facility is guaranteed by the Company and essentially all of the existing and future direct and indirect domestic subsidiaries of the Company that guarantee or are required to guarantee the Company s Revolving Credit Facility. So long as no default exists, the Company is entitled to (i) sell any property subject to the facility on fair and reasonable terms in an arm s length transaction, (ii) remove it from the facility, (iii) repay in full the entire outstanding balance of the loan relating to such sold property, and then (iv) increase the available borrowings under the Mortgage Facility by the amount of such loan repayment. Each loan is secured by real property (and improvements related thereto) specified by the Company and located at or near a vehicle dealership operated by a subsidiary of the Company or otherwise used or to be used by a vehicle dealership operated by a subsidiary of the Company. As of June 30, 2008, available borrowings from the Mortgage Facility totaled $52.3 million.

The Mortgage Facility contains certain covenants, including financial ratios that must be complied with: fixed charge coverage ratio; senior secured leverage ratio; dispositions of financed properties; ownership of equity interests in a lessor subsidiary; and occupancy or sublease of any financed property. As of June 30, 2008, the Company was in compliance with all of these covenants. Effective as of January 16, 2008, the Company entered into an amendment to the Mortgage Facility to increase the senior secured leverage ratio.

Other Credit Facilities

Financing for rental vehicles is typically obtained directly from the automobile manufacturers, excluding rental vehicles financed through the Revolving Credit Facility. These financing arrangements generally require small monthly payments and mature in varying amounts throughout 2008. The weighted average interest rate charged as of June 30, 2008 was 5.8%. Rental vehicles are typically moved to used vehicle inventory when they are removed from rental service and repayment of the borrowing is required at that time.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Interest Rate Risk Management Activities

The periodic interest rates of the Revolving Credit Facility and the Mortgage Facility are indexed to LIBOR rates plus an associated company credit risk rate. In order to stabilize earnings exposure 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 the same terms as the Revolving Credit Facility and the Mortgage Facility.

The Company accounts for these derivatives under SFAS 133, which establishes accounting and reporting standards for derivative instruments. The Company reflects the current fair value of all derivatives on its Consolidated Balance Sheet. The related gains or losses on these transactions 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 income. All of the Company s interest rate hedges are designated as cash flow hedges.

During the six months ended June 30, 2008, the Company entered into an interest rate swap that expires in March 2012, with a $25.0 million notional value, effectively locking in a rate of 3.1%. As of June 30, 2008, the Company held interest rate swaps of $500.0 million in notional value with an overall weighted average fixed interest rate of 4.8%. At June 30, 2008, all of the Company s derivative contracts were determined to be highly effective, and no ineffective portion was recognized in income. Included in Accumulated Other Comprehensive Income at June 30, 2008 and 2007 are unrealized losses, net of income taxes, totaling $9.6 million and unrealized gains, net of income taxes, totaling $2.2 million, respectively, related to these hedges. The income statement impact from interest rate hedges was a $2.9 million and $4.2 million increase in interest expense for the three and six months ended June 30, 2008, respectively, and a $0.3 million and $0.6 million reduction in interest expense for the three and six months ended June 30, 2007, respectively. Total floorplan interest expense was $12.4 million and $11.5 million for the three months ended June 30, 2008 and 2007, respectively, and $24.4 million and $23.4 million for the six months ended June 30, 2008 and 2007, respectively.

7. PROPERTY AND EQUIPMENT:

The Company s property and equipment consists of the following:

	Estimated Useful Lives in Years	June 30, 2008	December 31, 2007
		(In thousands)	
Land		$ 198,575	$ 137,344
Buildings	30 to 40	215,149	168,763
Leasehold improvements	7 to 15	63,335	58,663
Machinery and equipment	7 to 20	61,553	57,079

Furniture and fixtures	3 to 10	64,963	60,978
Company vehicles	3 to 5	11,414	11,338
Construction in progress		37,249	30,558
Total		652,238	524,723
Less accumulated depreciation and amortization		109,785	97,500
Property and equipment, net		$ 542,453	$ 427,223

During the six months ended June 30, 2008, the Company incurred $115.0 million of capital expenditures, including $52.3 million for land, $34.6 million for existing buildings and $27.5 million 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, during the six months ended June 30, 2008, the Company acquired fixed assets of $16.7 million in connection with its dealership acquisitions. The Company financed the purchase of real

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

estate during the first half of 2008 by drawing $54.6 million against the Mortgage Facility, based upon the applicable loan to value ratio, and through the execution of additional long-term notes payable of $33.6 million.

8. FAIR VALUE MEASUREMENTS:

SFAS 157, which the Company prospectively adopted effective January 1, 2008, 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. SFAS 157 requires disclosure of the extent to which fair value is used to measure 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. SFAS 157 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 evaluated its financial assets and liabilities for those financial assets and liabilities that met the criteria of the disclosure requirements and fair value framework of SFAS 157. The Company identified investments in marketable securities and debt instruments and interest rate financial derivative instruments as having met such criteria.

Marketable Securities and Debt Instruments

The Company accounts for its investments in marketable securities and debt instruments under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Instruments (as amended), which established standards of financial accounting and reporting for investments in equity instruments that have readily determinable fair values and for all investments in debt securities. Accordingly, the Company designates these investments as available-for-sale, measures them at fair value and classifies them as either cash and cash equivalents or other assets in the accompanying Consolidated Balance Sheets based upon maturity terms and certain contractual restrictions.

The Company maintains multiple trust accounts comprised of money market funds with short-term investments in marketable securities, such as U.S. government securities, commercial paper and bankers acceptances, that have maturities of less than three months. The Company determined that the valuation measurement inputs of these marketable securities represent unadjusted quoted prices in active markets and, accordingly, has classified such investments within Level 1 of the SFAS 157 hierarchy framework.

Also within its trust accounts, the Company 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 SFAS 157 hierarchy framework.

Interest Rate Derivative Instruments

As described in Note 6 to the Consolidated Financial Statements, the Company utilizes an interest rate hedging strategy in order to stabilize earnings exposure related to fluctuations in interest rates. 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

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

technique utilizes a 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 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 SFAS 157 hierarchy framework.

The fair value of our short-term investments, debt securities and interest rate derivative instruments as of June 30, 2008 were as follows:

	Level 1	Level 2	Level 3	Total
		(In thousands)		
Assets				
Short-term investments	$ 2,454	$	$	$ 2,454
Debt securities		8,760		8,760
Total	$ 2,454	$ 8,760	$	$ 11,214
Liabilities				
Interest rate derivative financial instruments	$	$ (15,395)	$	$ (15,395)

9. COMMITMENTS AND CONTINGENCIES:

Legal Proceedings

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 manufacture 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. In addition, the manufacturers of the vehicles 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 litigation are included in Selling, General and Administrative Expenses in the Company s Consolidated Statements of Operations.

Through relationships with insurance companies, the Company s dealerships sold credit insurance policies to its vehicle customers and received payments for these services. Recently, allegations have been made against insurance companies with which the Company does business that they did not have adequate monitoring processes in place and, as a result, failed to remit to policyholders the appropriate amount of unearned premiums when the policy was cancelled in conjunction with early payoffs of the associated loan balance. Some of the Company s dealerships have received notice from insurance companies advising that they have entered into settlement agreements and indicating that the insurance companies expect the dealerships to return commissions on the dealerships portion of the premiums that are required to be refunded to customers. The commissions received on sale of credit insurance products are deferred and recognized as revenue over the life of the policies, in accordance with SFAS No. 60, Accounting and Reporting by Insurance Enterprises. As such, a portion of any payout would be offset against deferred revenue, while the remainder would be recognized as a finance and insurance chargeback expense. The Company anticipates paying some amount of claims in the future, though the exact amounts cannot be estimated with any certainty at this time.

Notwithstanding the foregoing, the Company is not party to any legal proceedings, including class action lawsuits to which the Company is a party that, individually or in the aggregate, are reasonably expected to have a

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

material adverse effect on the results of operations, financial condition or cash flows. However, the results of these matters cannot be predicted with certainty, and an unfavorable resolution of one or more of these 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 a number of 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 sublease to the dealership purchaser the subsidiaries interests in any real property leases associated with the dealerships. In general, the Company s subsidiaries retain responsibility for the performance of certain obligations under the assignments or subleases 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 the assignments and subleases. Although the Company generally has indemnification rights against the assignee or sublessee in the event of non-performance under the assignments and subleases, and in some cases personal guarantees of the purchaser principal, 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 the assignments and subleases were $33.8 million at June 30, 2008. The Company and its subsidiaries also may be called on to perform other obligations under the assignment and subleases, 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. The Company s exposure under the assignments and subleases is difficult to estimate and there can be no assurance that any performance of the Company or its subsidiaries required under the assignments and subleases would not have a material adverse effect on the Company s business, financial condition and cash flows.

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. LONG-TERM DEBT:

Long-term debt consists of the following:

	June 30, 2008	December 31, 2007
	(In thousands)	
2.25% Convertible Senior Notes due 2036	$ 282,214	$ 281,915
8.25% Senior Subordinated Notes due 2013	82,205	100,273
Acquisition Line (see Note 6)	50,000	135,000
Mortgage Facility (see Note 6)	182,706	131,317
Real estate notes and various notes payable, maturing in varying amounts through August 2018	39,946	11,014
Capital lease obligations related to real estate	41,827	27,579
	$ 678,898	$ 687,098
Less current maturities	13,667	12,260
	$ 665,231	$ 674,838

8.25% Senior Subordinated Notes

During the six months ended June 30, 2008, the Company repurchased $18.6 million par value of the 8.25% Senior Subordinated Notes and realized a net gain of approximately $0.4 million.

Acquisition Line

During the six months ended June 30, 2008, the Company repaid a net $85.0 million of the amounts borrowed under its Acquisition Line as of December 31, 2007.

Mortgage Facility

During the six months ended June 30, 2008, the Company borrowed $54.8 million under its Mortgage Facility to fund the acquisition of real estate related to several dealership facilities.

Real Estate Notes

During March 2008, the Company executed a series of four note agreements with a third-party financial institution for an aggregate principal of $18.6 million (the March 2008 Real Estate Notes), of which one matures in May 2010, and the remaining three mature in June 2010. The Real Estate Notes pay interest monthly at various rates ranging from approximately 5.2 to 7.0%. The proceeds from the March 2008 Real Estate Notes were utilized to facilitate the

acquisition of a dealership-related building and the associated land. The cumulative balance of these notes total $18.4 million as of June 30, 2008.

During June 2008, the Company executed a bridge loan agreement with a third-party financial institution for an aggregate principal of approximately $15.0 million (the June 2008 Real Estate Note) that was scheduled to mature in September 2008. The June 2008 Real Estate Note paid interest monthly at an annual rate equal to LIBOR plus 1.5%. The proceeds from the June 2008 Real Estate Note were utilized to facilitate the acquisition of a dealership-related building and the associated land. In July 2008, the Company renegotiated the June 2008 Real Estate Note to extend the maturity date to July 2010 and amend the annual interest rate to LIBOR plus 1.65%.

Capital Leases

During the six months ended June 30, 2008, the Company sold and leased back the property and building related to one of its dealership facilities under a long-term lease arrangement with a third-party. In addition, the Company also sold and leased back property and buildings related to one of its dealership facilities under a long-term lease to a party that was formerly related to the Company, based upon contractual commitments entered into

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

when the parties were related. The Company accounted for both of these leases as capital leases, resulting in the recognition of $14.7 million of capital lease assets and obligations, which are included in property and equipment and notes payable, respectively, in the Company s Consolidated Balance Sheets.

11. ACQUISITIONS AND DISPOSITIONS:

During the six months ended June 30, 2008, the Company acquired two automobile dealership franchises located in Austin, Texas, one automobile dealership franchise in Beverly Hills, California and two dealership franchises located in Annapolis, Maryland. Total consideration paid of $46.7 million consisted of $36.9 million to the sellers and $9.8 million to the sellers financing sources to pay off outstanding floorplan borrowings, which the Company replaced with borrowings from its Revolving Credit Facility. Of the $36.9 million paid to the sellers, $16.5 million was for land and buildings. The accompanying Consolidated Balance Sheet as of June 30, 2008, includes preliminary allocations of the purchase price for all of the acquired assets and liabilities assumed based on their estimated fair market values at the dates of acquisition and, are subject to final adjustment.

Also, during the six months ended June 30, 2008, the Company disposed of nine automobile dealership franchises for total consideration of $1.9 million. See Note 12 for additional information regarding discontinued operations.

12. DISCONTINUED OPERATIONS:

On June 30, 2008, the Company sold three dealerships, with a total of seven franchises, in Albuquerque, New Mexico (the Disposed Dealerships), constituting the Company s entire dealership holdings in that market. The disposal transaction resulted in a pre-tax loss of $0.7 million. The Disposed Dealerships are presented in the Company s financial statements as discontinued operations. Revenues, cost of sales, operating expenses and income taxes attributable to the Disposed Dealerships have been aggregated to a single line in the Company s Consolidated Statement of Operations for all periods presented, as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Revenues	$ 23,009	$ 33,313	$ 49,192	$ 67,649
Loss on the sale of discontinued operations before income taxes	(2,367)	(106)	(3,481)	(381)
Income tax benefit	1,091	31	1,478	123
Net loss from discontinued operations	$ (1,276)	$ (75)	$ (2,003)	$ (258)

Assets and liabilities of the Disposed Dealerships have been segregated from continuing operations and presented as assets and liabilities of discontinued operations in the Company s Consolidated Balance Sheet for all periods presented, as follows:

	June 30, 2008	December 31, 2007
	(In thousands)	
Current assets	$	$ 28,515
Property, plant, and equipment, net		2,015
Other long term assets		1
Current liabilities		(27,317)
Other long term liabilities		(7,863)
Net liabilities of discontinued operations	$	$ (4,649)

The Company allocates corporate level interest expense to discontinued operations based on the net assets of the discontinued operations.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. CONDENSED CONSOLIDATING FINANCIAL INFORMATION:

The following tables include condensed consolidating financial information as of June 30, 2008, and December 31, 2007, and for the three and six months ended June 30, 2008 and 2007, for Group 1 Automotive, Inc. s (as issuer of the 8.25% Senior Subordinated Notes), guarantor subsidiaries and non-guarantor subsidiaries (representing foreign entities). The condensed consolidating financial information includes certain allocations of balance sheet, income statement and cash flow items that are not necessarily indicative of the financial position, results of operations or cash flows of these entities on a stand-alone basis.

CONDENSED CONSOLIDATING BALANCE SHEET
June 30, 2008

	Total Company	Elimination	Group 1 Automotive, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries
			(In thousands)		
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	$ 39,968	$	$	$ 39,410	$ 558
Accounts and other receivables, net	230,997			225,093	5,904
Inventories	934,706			911,299	23,407
Deferred and other current assets	41,219			28,887	12,332
Total current assets	1,246,890			1,204,689	42,201
PROPERTY AND EQUIPMENT, net	542,453			514,534	27,919
GOODWILL AND OTHER INTANGIBLES	807,692			799,204	8,488
INVESTMENT IN SUBSIDIARIES		(968,732)	968,732		
OTHER ASSETS	25,961		2,891	4,518	18,552
Total assets	$ 2,622,996	$ (968,732)	$ 971,623	$ 2,522,945	$ 97,160
LIABILITIES AND STOCKHOLDERS EQUITY					
CURRENT LIABILITIES:					
Floorplan notes payable credit facility	$ 755,009	$	$	$ 751,906	$ 3,103
Floorplan notes payable manufacturer affiliates	168,901			160,209	8,692
Current maturities of long-term debt	13,667			13,429	238
Accounts payable	110,321			94,711	15,610
Intercompany accounts payable			245,368	(245,381)	13

Accrued expenses	101,760			100,031	1,729
Total current liabilities	1,149,658		245,368	874,905	29,385
LONG TERM DEBT, net of current maturities	665,231			665,022	209
LIABILITIES FROM INTEREST RISK MANAGEMENT ACTIVITIES	15,395			15,395	
DEFERRED AND OTHER LIABILITIES	61,861			59,846	2,015
DEFERRED REVENUES	13,693			1,916	11,777
Total liabilities	1,905,838		245,368	1,617,084	43,386
STOCKHOLDERS EQUITY:					
TOTAL STOCKHOLDERS EQUITY	717,158	(968,732)	726,255	905,861	53,774
Total liabilities and stockholders equity	$ 2,622,996	$ (968,732)	$ 971,623	$ 2,522,945	$ 97,160

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2007

	Total Company	Elimination	Group 1 Automotive, Inc (In thousands)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	$ 34,248	$	$	$ 33,666	$ 582
Accounts and other receivables, net	272,098			266,844	5,254
Inventories	878,168			859,396	18,772
Assets related to discontinue operations	30,531			30,531	
Deferred and other current assets	47,938			34,984	12,954
Total current assets	1,262,983			1,225,421	37,562
PROPERTY AND EQUIPMENT, net	427,223			399,148	28,075
GOODWILL AND OTHER INTANGIBLES	787,245			778,793	8,452
INVESTMENT IN SUBSIDIARIES		(781,792)	781,792		
OTHER ASSETS	28,730		2,884	4,854	20,992
Total assets	$ 2,506,181	$ (781,792)	$ 784,676	$ 2,408,216	$ 95,081
LIABILITIES AND STOCKHOLDERS EQUITY					
CURRENT LIABILITIES:					
Floorplan notes payable credit facility	$ 648,469	$	$	$ 648,469	$
Floorplan notes payable manufacturer affiliates	170,911			162,219	8,692
Current maturities of long-term debt	12,260			8,000	4,260
Accounts payable	111,458			99,259	12,199
Intercompany accounts payable			100,195	(100,195)	
Liabilities related to discontinued operations	35,180			35,180	
Accrued expenses	100,000			98,746	1,254
Total current liabilities	1,078,278		100,195	951,678	26,405

LONG TERM DEBT, net of current maturities	674,838			674,567	271
LIABILITIES FROM INTEREST RISK MANAGEMENT ACTIVITIES	16,188			16,188	
DEFERRED AND OTHER LIABILITIES	35,865			33,966	1,899
DEFERRED REVENUES	16,531			2,098	14,433
Total liabilities before deferred revenues	1,821,700		100,195	1,678,497	43,008
STOCKHOLDERS EQUITY:					
TOTAL STOCKHOLDERS EQUITY	684,481	(781,792)	684,481	729,719	52,073
Total liabilities and stockholders equity	$ 2,506,181	$ (781,792)	$ 784,676	$ 2,408,216	$ 95,081

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Three Months Ended June 30, 2008

	Total Company	Elimination	Group 1 Automotive, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries
			(Unaudited) (In thousands)		
Revenue	$ 1,583,115	$	$	$ 1,534,759	$ 48,356
Cost of sales	1,331,704			1,289,734	41,970
Gross profit	251,411			245,025	6,386
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	195,337		462	189,979	4,896
DEPRECIATION AND AMORTIZATION EXPENSE	6,497			6,150	347
INCOME (LOSS) FROM OPERATIONS	49,577		(462)	48,896	1,143
OTHER INCOME (EXPENSE)					
Floorplan interest expense	(12,392)			(12,092)	(300)
Other interest expense, net	(7,066)			(7,012)	(54)
Other income, net	(36)			(26)	(10)
Equity in earnings of subsidiaries		(17,678)	17,678		
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	30,083	(17,678)	17,216	29,766	779
PROVISION FOR INCOME TAXES	11,591			11,315	276
NET INCOME FROM CONTINUING OPERATIONS	18,492	(17,678)	17,216	18,451	503
LOSS RELATED TO DISCONTINUED OPERATIONS	(1,276)			(1,276)	
NET INCOME	$ 17,216	$ (17,678)	$ 17,216	$ 17,175	$ 503

GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Three Months Ended June 30, 2007

	Total Company	Elimination	Group 1 Automotive, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries
			(Unaudited) (In thousands)		
Revenue	$ 1,646,277	$	$	$ 1,598,160	$ 48,117
Cost of sales	1,394,100			1,352,166	41,934
Gross profit	252,177			245,994	6,183
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	191,998		357	186,081	5,560
DEPRECIATION AND AMORTIZATION EXPENSE	5,103			4,713	390
ASSET IMPAIRMENTS	356			356	
INCOME (LOSS) FROM OPERATIONS	54,720		(357)	54,844	233
OTHER INCOME (EXPENSE)					
Floorplan interest expense	(11,477)				