

PENSKE AUTOMOTIVE GROUP, INC.

Form 10-Q

May 08, 2008

Table of Contents

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

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

**For the quarterly period ended March 31, 2008**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-12297**

**Penske Automotive Group, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

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

**22-3086739**

*(I.R.S. Employer  
Identification No.)*

**2555 Telegraph Road,  
Bloomfield Hills, Michigan**

*(Address of principal executive offices)*

**48302-0954**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**(248) 648-2500**

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

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of April 29, 2008, there were 95,369,709 shares of voting common stock outstanding.

## TABLE OF CONTENTS

	Page
 <b>PART I FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	
<u>Consolidated Condensed Balance Sheets as of March 31, 2008 and December 31, 2007</u>	3
<u>Consolidated Condensed Statements of Income for the three months ended March 31, 2008 and 2007</u>	4
<u>Consolidated Condensed Statements of Cash Flows for the three months ended March 31, 2008 and 2007</u>	5
<u>Consolidated Condensed Statement of Stockholders' Equity for the three months ended March 31, 2008</u>	6
<u>Notes to Consolidated Condensed Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3. Quantitative &amp; Qualitative Disclosures About Market Risk</u>	40
<u>Item 4. Controls and Procedures</u>	40
 <b>PART II OTHER INFORMATION</b>	
<u>Item 1. Legal Proceedings</u>	41
<u>Item 5. Other Information</u>	41
<u>Item 6. Exhibits</u>	42
<u>Exhibit 4.1</u>	
<u>Exhibit 4.2</u>	
<u>Exhibit 10.1</u>	
<u>Exhibit 12</u>	
<u>Exhibit 31</u>	
<u>Exhibit 32</u>	

**Table of Contents**

**PENSKE AUTOMOTIVE GROUP, INC.**  
**CONSOLIDATED CONDENSED BALANCE SHEETS**

	March 31, 2008	December 31, 2007
	(Unaudited)	
	(In thousands, except per share amounts)	
ASSETS		
Cash and cash equivalents	\$ 20,394	\$ 11,690
Accounts receivable, net of allowance for doubtful accounts of \$2,934 and \$2,935	503,463	448,985
Inventories, net	1,818,846	1,682,736
Other current assets	89,092	65,948
Assets held for sale	110,307	96,638
Total current assets	2,542,102	2,305,997
Property and equipment, net	650,360	617,874
Goodwill	1,424,773	1,422,055
Franchise value	236,470	237,733
Other assets	87,466	84,894
Total assets	\$ 4,941,171	\$ 4,668,553
LIABILITIES AND STOCKHOLDERS' EQUITY		
Floor plan notes payable	\$ 1,198,824	\$ 1,070,882
Floor plan notes payable - non-trade	502,620	476,854
Accounts payable	291,725	266,726
Accrued expenses	257,312	212,310
Current portion of long-term debt	14,437	14,522
Liabilities held for sale	68,898	54,745
Total current liabilities	2,333,816	2,096,039
Long-term debt	829,982	830,106
Other long-term liabilities	328,893	320,949
Total liabilities	3,492,691	3,247,094
Commitments and contingent liabilities		
Stockholders' Equity		
Preferred Stock, \$0.0001 par value; 100 shares authorized; none issued and outstanding		
	10	10

Edgar Filing: PENSKE AUTOMOTIVE GROUP, INC. - Form 10-Q

Common Stock, \$0.0001 par value, 240,000 shares authorized; 95,366 shares issued at March 31, 2008; 95,020 shares issued at December 31, 2007

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

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

Additional paid-in-capital	736,748	733,895
Retained earnings	612,946	587,566
Accumulated other comprehensive income	98,776	99,988

Total stockholders' equity	1,448,480	1,421,459
----------------------------	-----------	-----------

Total liabilities and stockholders' equity	\$ 4,941,171	\$ 4,668,553
--	--------------	--------------

See Notes to Consolidated Condensed Financial Statements

**Table of Contents**

**PENSKE AUTOMOTIVE GROUP, INC.**  
**CONSOLIDATED CONDENSED STATEMENTS OF INCOME**

	Three Months Ended March 31,	
	2008	2007
	(Unaudited)	
	(In thousands, except per share amounts)	
Revenue:		
New vehicle	\$ 1,635,602	\$ 1,624,778
Used vehicle	803,456	780,345
Finance and insurance, net	75,068	67,832
Service and parts	363,385	347,954
Distribution	63,770	
Fleet and wholesale vehicle	263,189	259,106
 Total revenues	 3,204,470	 3,080,015
 Cost of sales:		
New vehicle	1,497,644	1,488,202
Used vehicle	735,849	719,240
Service and parts	159,833	154,798
Distribution	53,618	
Fleet and wholesale vehicle	263,468	256,008
 Total cost of sales	 2,710,412	 2,618,248
 Gross profit	 494,058	 461,767
Selling, general and administrative expenses	399,173	369,711
Depreciation and amortization	13,501	12,340
 Operating income	 81,384	 79,716
Floor plan interest expense	(17,312)	(15,816)
Other interest expense	(12,043)	(18,823)
Equity in earnings (losses) of affiliates	1,392	(821)
Loss on debt redemption		(18,634)
 Income from continuing operations before income taxes and minority interests	 53,421	 25,622
Income taxes	(19,147)	(8,796)
Minority interests	(435)	(294)

Income from continuing operations	33,839	16,532
Income (loss) from discontinued operations, net of tax	91	(1,950)

Net income	\$ 33,930	\$ 14,582
------------	-----------	-----------

**Basic earnings per share:**

Continuing operations	\$ 0.36	\$ 0.18
Discontinued operations	(0.00)	(0.02)
Net income	0.36	0.16
Shares used in determining basic earnings per share	94,335	93,808

**Diluted earnings per share:**

Continuing operations	\$ 0.36	\$ 0.18
Discontinued operations	(0.00)	(0.02)
Net income	0.36	0.15
Shares used in determining diluted earnings per share	94,657	94,412

<b>Cash dividends per share</b>	\$ 0.09	\$ 0.07
---------------------------------	---------	---------

See Notes to Consolidated Condensed Financial Statements

Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<b>Operating Activities:</b>		
Net income	\$ 33,930	\$ 14,582
Adjustments to reconcile net income to net cash from continuing operating activities:		
Depreciation and amortization	13,501	12,340
Undistributed earnings of equity method investments	(1,392)	821
(Income) loss from discontinued operations, net of tax	(91)	1,950
Deferred income taxes	3,163	3,172
Loss on debt redemption		18,634
Minority interests	435	294
Changes in operating assets and liabilities:		
Accounts receivable	(54,056)	(38,753)
Inventories	(136,110)	(85,930)
Floor plan notes payable	127,941	218,652
Accounts payable and accrued expenses	59,838	(25,638)
Other	(9,116)	(11,729)
 Net cash from continuing operating activities	 38,043	 108,395
<b>Investing Activities:</b>		
Purchase of equipment and improvements	(49,081)	(37,169)
Proceeds from sale-leaseback transactions	3,676	23,600
Dealership acquisitions net, including repayment of sellers' floorplan notes payable of \$0 and \$5,559, respectively		(7,282)
Other	(1,500)	8,764
 Net cash from continuing investing activities	 (46,905)	 (12,087)
<b>Financing Activities:</b>		
Proceeds from borrowings under U.S. credit agreement	138,200	71,000
Repayments under U.S. credit agreement	(138,200)	(71,000)
Redemption 9 5/8% Senior Subordinated debt		(314,439)
Net repayments of other long-term debt	(226)	(3,747)
Net borrowings of floor plan notes payable - non-trade	25,767	166,143
Proceeds from exercises of options, including excess tax benefit		333
Dividends	(8,550)	(6,566)



Net cash from continuing financing activities	16,991	(158,276)
Discontinued operations:		
Net cash from discontinued operating activities	(8,252)	19,123
Net cash from discontinued investing activities		17,956
Net cash from discontinued financing activities	8,827	36,977
Net cash from discontinued operations	575	74,056
Net change in cash and cash equivalents	8,704	12,088
Cash and cash equivalents, beginning of period	11,690	14,768
Cash and cash equivalents, end of period	\$ 20,394	\$ 26,856

**Supplemental disclosures of cash flow information:**

Cash paid for:

Interest	\$ 20,060	\$ 33,592
Income taxes	660	5,423

See Notes to Consolidated Condensed Financial Statements

Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY**

	Common Stock Issued Shares	Amount	Additional Paid-In Capital	Retained Earnings (Unaudited) (Dollars in thousands)	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balances, January 1, 2008	95,019,763	\$ 10	\$ 733,895	\$ 587,566	\$ 99,988	\$ 1,421,459
Equity compensation	346,608		2,853			2,853
Dividends				(8,550)		(8,550)
Foreign currency translation					4,060	4,060
Other					(5,272)	(5,272)
Net income				33,930		33,930
Balances, March 31, 2008	95,366,371	\$ 10	\$ 736,748	\$ 612,946	\$ 98,776	\$ 1,448,480

See Notes to Consolidated Condensed Financial Statements

Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**(In thousands, except per share amounts)**

**1. Interim Financial Statements*****Basis of Presentation***

The following unaudited consolidated condensed financial statements of Penske Automotive Group, Inc. (the Company ) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and disclosures normally included in the Company s annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the SEC rules and regulations. The information presented as of March 31, 2008 and December 31, 2007 and for the three month periods ended March 31, 2008 and 2007 is unaudited, but includes all adjustments which the management of the Company believes to be necessary for the fair presentation of results for the periods presented. The consolidated condensed financial statements for prior periods have been revised for entities which have been treated as discontinued operations through March 31, 2008. The results for the interim periods are not necessarily indicative of results to be expected for the year. These consolidated condensed financial statements should be read in conjunction with the Company s audited financial statements for the year ended December 31, 2007, which are included as part of the Company s Annual Report on Form 10-K.

***Discontinued Operations***

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

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Revenues	\$ 87,981	\$ 165,543
Pre-tax income	79	179
Gain (loss) on disposal		(2,960)
	<b>March 31,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>
Inventories	\$ 64,730	\$ 53,052
Other assets	45,577	43,586
Total assets	\$ 110,307	\$ 96,638
Floor plan notes payable (trade and non-trade)	\$ 52,119	\$ 42,717

Other liabilities	16,779	12,028
Total Liabilities	\$ 68,898	\$ 54,745

**Table of Contents****PENSKE AUTOMOTIVE GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)*****Estimates***

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

***Intangible Assets***

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

Automotive retailing is a mature industry and is based on franchise agreements with the vehicle manufacturers;

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

Certain franchise agreement terms are indefinite;

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

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

The following is a summary of the changes in the carrying amount of goodwill and franchise value for the three months ended March 31, 2008:

	<b>Goodwill</b>	<b>Franchise Value</b>
Balance January 1, 2008	\$ 1,422,055	\$ 237,733
Additions during period		
Deletions during period		(1,754)
Foreign currency translation	2,718	491
 Balance March 31, 2008	 \$ 1,424,773	 \$ 236,470

As of March 31, 2008, approximately \$652,584 of the Company's goodwill is deductible for tax purposes. The Company has established deferred tax liabilities related to the temporary differences arising from such tax deductible goodwill.

**Table of Contents**

**PENSKE AUTOMOTIVE GROUP, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

***New Accounting Pronouncements***

SFAS No. 157, *Fair Value Measurements* defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure requirements relating to fair value measurements. The FASB provided a one year deferral of the provisions of this pronouncement for non-financial assets and liabilities, however, the relevant provisions of SFAS 157 required by SFAS 159 was adopted as of January 1, 2008. SFAS 157 thus becomes effective for our non-financial assets and liabilities on January 1, 2009. We continue to evaluate the impact of those elements of this pronouncement.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* permits entities to choose to measure many financial instruments and certain other items at fair value and consequently report unrealized gains and losses on such items in earnings. We did not elect the fair value option with respect to any of our current financial assets or financial liabilities on January 1, 2008 when the provisions of this statement became effective. As a result, there was no impact upon adoption.

SFAS No. 141(R) *Business Combinations* requires almost all assets acquired and liabilities assumed to be recorded at fair value as of the acquisition date, liabilities related to contingent consideration to be remeasured at fair value in each subsequent reporting period and all acquisition related costs to be expensed as incurred. The pronouncement also clarifies the accounting under various scenarios such as step purchases or where the fair value of assets and liabilities acquired exceeds the consideration. SFAS 141(R) will be effective for us on January 1, 2009.

SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51* clarifies that a noncontrolling interest in a subsidiary must be measured at fair value and classified as a separate component of equity. This pronouncement also outlines the accounting for changes in a parent's ownership in a subsidiary. SFAS 160 will be effective for us on January 1, 2009 and will require us to reclassify our minority interest liabilities to shareholders equity for the Company's non-wholly owned consolidated subsidiaries.

SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* amends and expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* to explain why and how an entity uses derivative instruments, how the hedged items are accounted for under the relevant literature and how the derivative instruments affect an entity's financial position, financial performance and cash flows. SFAS 161 will be effective for us on January 1, 2009. While the pronouncement will have no impact on the Company's accounting, we are currently evaluating the additional disclosure requirements.

**Table of Contents****PENSKE AUTOMOTIVE GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****2. Inventories**

Inventories consisted of the following:

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
New vehicles	\$ 1,326,955	\$ 1,220,558
Used vehicles	408,940	378,488
Parts, accessories and other	82,951	83,690
 Total inventories	 \$ 1,818,846	 \$ 1,682,736

The Company receives non-refundable credits from certain vehicle manufacturers which are treated as a reduction of cost of sales when the vehicles are sold. Such credits amounted to \$6,465 and \$6,934 during the three months ended March 31, 2008 and 2007, respectively.

**3. Business Combinations**

The Company acquired three franchises during the three months ended March 31, 2007 and made no acquisitions during the three months ended March 31, 2008. The Company's financial statements include the results of operations of the acquired dealerships from the date of acquisition. Purchase price allocations may be subject to final adjustment. A summary of the aggregate purchase price allocations for the three months ended March 31, 2007 follows:

	<b>2007</b>
Inventory	5,403
Other current assets	10
Property and equipment	518
Goodwill	1,377
Current liabilities	(26)

Cash used in dealership acquisitions	\$ 7,282
--------------------------------------	----------

The following unaudited consolidated pro forma results of operations of the Company for the three months ended March 31, 2007 give effect to acquisitions consummated during 2007 as if they had occurred on January 1, 2007.

	<b>2007</b>
Revenues	\$ 3,204,655
Income from continuing operations	17,763
Net income	15,813
Income from continuing operations per diluted common share	0.19
Net income per diluted common share	\$ 0.17

**Table of Contents****PENSKE AUTOMOTIVE GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****4. Floor Plan Notes Payable Trade and Non-trade**

The Company finances the majority of its new and a portion of its used vehicle inventories under revolving floor plan arrangements with various lenders. In the U.S., the floor plan arrangements are due on demand; however, the Company is generally not required to repay floor plan advances prior to the sale of the vehicles that have been financed. The Company typically makes monthly interest payments on the amount financed. Outside the U.S., substantially all of the floor plan arrangements are payable on demand or have an original maturity of 90 days or less and the Company is generally required to repay floor plan advances at the earlier of the sale of the vehicles that have been financed or the stated maturity. All of the floor plan agreements grant a security interest in substantially all of the assets of the Company's dealership subsidiaries and in the U.S. are guaranteed by the Company. Interest rates under the floor plan arrangements are variable and increase or decrease based on changes in various benchmarks. The Company classifies floor plan notes payable to a party other than the manufacturer of a particular new vehicle, and all floor plan notes payable relating to pre-owned vehicles, as floor plan notes payable non-trade on its consolidated condensed balance sheets and classifies related cash flows as a financing activity on its consolidated condensed statements of cash flows.

**5. Earnings Per Share**

Basic earnings per share is computed using net income and weighted average shares of voting common stock outstanding. Diluted earnings per share is computed using net income and the weighted average shares of voting common stock outstanding, adjusted for the dilutive effect of stock options and restricted stock. A reconciliation of the number of shares used in the calculation of basic and diluted earnings per share for the three months ended March 31, 2008 and 2007 follows:

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Weighted average shares outstanding	94,335	93,808
Effect of stock options	115	274
Effect of restricted stock	207	330
 Weighted average shares outstanding, including effect of dilutive securities	 94,657	 94,412

In addition, the Company has senior subordinated convertible notes outstanding which, under certain circumstances discussed in Note 6, may be converted to voting common stock. As of March 31, 2008 and 2007, no shares related to the senior subordinated convertible notes were included in the calculation of diluted earnings per share because the effect of such securities was not dilutive.

**6. Long-Term Debt**

Long-term debt consisted of the following:

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
U.S. credit agreement	\$	\$
U.K. credit agreement	91,175	91,265
7.75% Senior Subordinated Notes due 2016	375,000	375,000
3.5% Senior Subordinated Convertible Notes due 2026	375,000	375,000
Other	3,244	3,363



Total long-term debt	844,419	844,628
Less: Current portion	(14,437)	(14,522)
Net long-term debt	\$ 829,982	\$ 830,106

**Table of Contents**

**PENSKE AUTOMOTIVE GROUP, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

***U.S. Credit Agreement***

The Company is party to a credit agreement with DCFS USA LLC and Toyota Motor Credit Corporation, as amended (the U.S. Credit Agreement), which provides for up to \$250,000 of borrowing capacity for working capital, acquisitions, capital expenditures, investments and for other general corporate purposes, including \$10,000 of availability for letters of credit, through September 30, 2010. The revolving loans bear interest at defined LIBOR plus 1.75%.

The U.S. Credit Agreement is fully and unconditionally guaranteed on a joint and several basis by the Company's domestic subsidiaries and contains a number of significant covenants that, among other things, restrict the Company's ability to dispose of assets, incur additional indebtedness, repay other indebtedness, pay dividends, create liens on assets, make investments or acquisitions and engage in mergers or consolidations. The Company is also required to comply with specified financial and other tests and ratios, each as defined in the U.S. Credit Agreement, including: a ratio of current assets to current liabilities, a fixed charge coverage ratio, a ratio of debt to stockholders' equity, a ratio of debt to earnings before interest, taxes, depreciation and amortization (EBITDA), a ratio of domestic debt to domestic EBITDA, and a measurement of stockholders' equity. A breach of these requirements would give rise to certain remedies under the agreement, the most severe of which is the termination of the agreement and acceleration of the amounts owed. As of March 31, 2008, the Company was in compliance with all covenants under the U.S. Credit Agreement.

The U.S. Credit Agreement also contains typical events of default, including change of control, non-payment of obligations and cross-defaults to the Company's other material indebtedness. Substantially all of the Company's domestic assets are subject to security interests granted to lenders under the U.S. Credit Agreement. Other than \$500 of letters of credit, no amounts were outstanding under this facility as of March 31, 2008.

***U.K. Credit Agreement***

The Company's subsidiaries in the U.K. (the U.K. Subsidiaries) are party to an agreement with the Royal Bank of Scotland plc, as agent for National Westminster Bank plc, which provides for a multi-option credit agreement, a fixed rate credit agreement and a seasonally adjusted overdraft line of credit (collectively, the U.K. Credit Agreement) to be used to finance acquisitions, working capital, and general corporate purposes. The U.K. Credit Agreement provides for (1) up to £70,000 in revolving loans through August 31, 2011, which have an original maturity of 90 days or less and bear interest between defined LIBOR plus 0.65% and defined LIBOR plus 1.25%, (2) a £30,000 funded term loan which bears interest between 5.94% and 6.54% and is payable ratably in quarterly intervals through June 30, 2011, and (3) a seasonally adjusted overdraft line of credit for up to £30,000 that bears interest at the Bank of England Base Rate plus 1.00% and matures on August 31, 2011.

The U.K. Credit Agreement is fully and unconditionally guaranteed on a joint and several basis by the U.K. Subsidiaries, and contains a number of significant covenants that, among other things, restrict the ability of the U.K. Subsidiaries to pay dividends, dispose of assets, incur additional indebtedness, repay other indebtedness, create liens on assets, make investments or acquisitions and engage in mergers or consolidations. In addition, the U.K. Subsidiaries are required to comply with specified ratios and tests, each as defined in the U.K. Credit Agreement, including: a ratio of earnings before interest and taxes plus rental payments to interest plus rental payments (as defined), a measurement of maximum capital expenditures, and a debt to EBITDA ratio (as defined). A breach of these requirements would give rise to certain remedies under the agreement, the most severe of which is the termination of the agreement and acceleration of the amounts owed. As of March 31, 2008, the U.K. subsidiaries were in compliance with all covenants under the U.K. Credit Agreement.

The U.K. Credit Agreement also contains typical events of default, including change of control and non-payment of obligations and cross-defaults to other material indebtedness of the U.K. Subsidiaries. Substantially all of the U.K. Subsidiaries' assets are subject to security interests granted to lenders under the U.K. Credit Agreement. As of March 31, 2008, outstanding loans under the U.K. Credit Agreement amounted to £45,941 (\$91,175).



**Table of Contents**

**PENSKE AUTOMOTIVE GROUP, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

***7.75% Senior Subordinated Notes***

On December 7, 2006, the Company issued \$375,000 aggregate principal amount of 7.75% Senior Subordinated Notes (the "7.75% Notes") due 2016. The 7.75% Notes are unsecured senior subordinated notes and are subordinate to all existing and future senior debt, including debt under the Company's credit agreements and floor plan indebtedness. The 7.75% Notes are guaranteed by substantially all wholly-owned domestic subsidiaries on an unsecured senior subordinated basis. Those guarantees are full and unconditional and joint and several. The Company can redeem all or some of the 7.75% Notes at its option beginning in December 2011 at specified redemption prices, or prior to December 2011 at 100% of the principal amount of the notes plus an applicable "make-whole" premium, as defined. In addition, the Company may redeem up to 40% of the 7.75% Notes at specified redemption prices using the proceeds of certain equity offerings before December 15, 2009. Upon certain sales of assets or specific kinds of changes of control the Company is required to make an offer to purchase the 7.75% Notes. The 7.75% Notes also contain customary negative covenants and events of default. As of March 31, 2008, the Company was in compliance with all negative covenants and there were no events of default.

***Senior Subordinated Convertible Notes***

On January 31, 2006, the Company issued \$375,000 aggregate principal amount of 3.50% senior subordinated convertible notes due 2026 (the "Convertible Notes"). The Convertible Notes mature on April 1, 2026, unless earlier converted, redeemed or purchased by the Company. The Convertible Notes are unsecured senior subordinated obligations and are guaranteed on an unsecured senior subordinated basis by substantially all of the Company's wholly owned domestic subsidiaries. Those guarantees are full and unconditional and joint and several. The Convertible Notes also contain customary negative covenants and events of default. As of March 31, 2008, the Company was in compliance with all negative covenants and there were no events of default.

Holders of the convertible notes may convert them based on a conversion rate of 42.2052 shares of common stock per \$1,000 principal amount of the Convertible Notes (which is equal to a conversion price of approximately \$23.69 per share), subject to adjustment, only under the following circumstances: (1) in any quarterly period, if the closing price of the common stock for twenty of the last thirty trading days in the prior quarter exceeds \$28.43 (subject to adjustment), (2) for specified periods, if the trading price of the Convertible Notes falls below specific thresholds, (3) if the Convertible Notes are called for redemption, (4) if specified distributions to holders of common stock are made or specified corporate transactions occur, (5) if a fundamental change (as defined) occurs, or (6) during the ten trading days prior to, but excluding, the maturity date.

Upon conversion of the Convertible Notes, for each \$1,000 principal amount of the Convertible Notes, a holder will receive an amount in cash, in lieu of shares of the Company's common stock, equal to the lesser of (i) \$1,000 or (ii) the conversion value, determined in the manner set forth in the related indenture covering the Convertible Notes, of the number of shares of common stock equal to the conversion rate. If the conversion value exceeds \$1,000, the Company will also deliver, at its election, cash, common stock or a combination of cash and common stock with respect to the remaining value deliverable upon conversion.

In the event of a change of control on or before April 6, 2011, the Company will pay, to the extent described in the indenture, a make-whole premium by increasing the conversion rate applicable to such Convertible Notes. In addition, the Company will pay contingent interest in cash, commencing with any six-month period from April 1 to September 30 and from October 1 to March 31, beginning on April 1, 2011, if the average trading price of a Convertible Note for the five trading days ending on the third trading day immediately preceding the first day of that six-month period equals 120% or more of the principal amount of the Convertible Notes.

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

On or after April 6, 2011, the Company may redeem the Convertible Notes, in whole at any time or in part from time to time, for cash at a redemption price of 100% of the principal amount of the Convertible Notes to be redeemed, plus any accrued and unpaid interest to the applicable redemption date. Holders of the Convertible Notes may require the Company to purchase all or a portion of their Convertible Notes for cash on each of April 1, 2011, April 1, 2016 or April 1, 2021 at a purchase price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus accrued and unpaid interest, if any, to the applicable purchase date.

**9.625% Senior Subordinated Notes**

In March 2007, the Company redeemed its \$300,000 aggregate principal amount of 9.625% Senior Subordinated Notes due 2012 (the "9.625% Notes") at a price of 104.813%. The 9.625% Notes were unsecured senior subordinated notes and were subordinate to all existing senior debt, including debt under the Company's credit agreements and floor plan indebtedness. The Company incurred an \$18,634 pre-tax charge in connection with the redemption, consisting of a \$14,439 redemption premium and the write-off of \$4,195 of unamortized deferred financing costs.

**7. Stockholders' Equity***Comprehensive income*

Other comprehensive income includes changes in the fair value of interest rate swap agreements, foreign currency translation gains and losses, and available for sale securities valuation adjustments that have been excluded from net income and reflected in equity. Total comprehensive income is summarized as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Net income	\$ 33,930	\$ 14,582
Other comprehensive income (loss):		
Foreign currency translation	4,060	2,099
Other	(5,272)	178
Comprehensive Income	\$ 32,718	\$ 16,859

**8. Interest Rate Swaps**

The Company is party to interest rate swap agreements through January 7, 2011 pursuant to which the LIBOR portion of \$300,000 of the Company's floating rate floor plan debt was fixed at 3.67%. We may terminate these arrangements at any time subject to the settlement at that time of the fair value of the swap arrangements. The swaps are designated as cash flow hedges of future interest payments of LIBOR based U.S. floor plan borrowings. During the three months ended March 31, 2008, the swaps had an immaterial impact on the weighted average interest rate on floor plan borrowings. As of March 31, 2008, the Company expects approximately \$3,831 associated with the swaps to be recognized as an increase of interest expense over the next twelve months.

The Company was party to an interest rate swap agreement through January 2008, pursuant to which a notional \$200,000 of its U.S. floating rate debt was exchanged for fixed rate debt. The swap was designated as a cash flow hedge of future interest payments of the LIBOR based U.S. floor plan borrowings.

**Table of Contents**

**PENSKE AUTOMOTIVE GROUP, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

**9. Commitments and Contingent Liabilities**

The Company is involved in litigation which may relate to issues with customers, employment related matters, class action claims, purported class action claims, and claims brought by governmental authorities. As of March 31, 2008, 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 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. See MD&A forward looking statements.

The Company is party to a joint venture agreement with respect to one of the Company's franchises pursuant to which the Company is required to repurchase its partner's interest in July 2008. The Company expects this payment to be approximately \$4.7 million.

The Company leases the majority of its dealership facilities and corporate offices under non-cancelable operating lease agreements with expirations through 2062, including all option periods available to the Company. The Company's lease arrangements typically allow for a base term with options for extension in the Company's favor and include escalation clauses tied to the Consumer Price Index.

Table of Contents**PENSKE AUTOMOTIVE GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****10. Segment Information**

The Company has two reportable operating segments as defined in SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information : (i) Retail, consisting of our automotive retail operations, and (ii) Distribution, consisting of our distribution of the smart fortwo vehicle, parts and accessories in the U.S. and Puerto Rico. The Company's operations are organized by management by line of business and geography. The Retail segment includes all automotive dealerships, regardless of geography, and includes all departments relevant to the operation of the dealerships. We believe the dealership operations included in the Retail segment are one reportable segment as their operations (A) have similar economic characteristics (all are automotive dealerships having similar margins), (B) offer similar products and services (all sell new and used vehicles, service, parts and third-party finance and insurance products), (C) have similar target markets and customers (generally individuals) and (D) have similar distribution and marketing practices (all distribute products and services through dealership facilities that market to customers in similar fashions.) The accounting policies of both segments are the same and are described in Note 1.

The following table summarizes revenues and income from continuing operations before certain non-recurring items, income taxes and minority interest, which is the measure by which management allocates resources to its segments and which we refer to as adjusted segment income, for each of our reportable segments. Adjusted Segment Income excludes the item discussed below in order to enhance the comparability of segment income from period to period.

	<b>Retail</b>	<b>Distribution</b>	<b>Intersegment Elimination</b>	<b>Total</b>
Revenues				
2008	\$ 3,140,700	\$ 75,480	\$ (11,710)	\$ 3,204,470
2007	3,080,015			3,080,015
Adjusted segment income				
2008	\$ 50,061	\$ 3,947	\$ (587)	\$ 53,421
2007	44,256			44,256

The following table reconciles total adjusted segment income to consolidated income before provision for income taxes.

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>March 31, 2007</b>
Total adjusted segment income	\$ 53,421	\$ 44,256
Loss on debt redemption		(18,634)
Income from continuing operations before income taxes and minority interest	\$ 53,421	\$ 25,622





Table of Contents**PENSKE AUTOMOTIVE GROUP, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)****11. Consolidating Condensed Financial Information**

The following tables include consolidating condensed financial information as of March 31, 2008 and December 31, 2007 and for the three months ended March 31, 2008 and 2007 for Penske Automotive Group, Inc. (as the issuer of the Convertible Notes and the 7.75% Notes), guarantor subsidiaries and non-guarantor subsidiaries (primarily representing foreign entities). The condensed consolidating financial information includes certain allocations of balance sheet, income statement and cash flow items which are not necessarily indicative of the financial position, results of operations or cash flows of these entities on a stand-alone basis. The 2007 condensed consolidating financial statements have been restated for an immaterial error relating to the presentation of long-term debt.

**CONSOLIDATING CONDENSED BALANCE SHEET****March 31, 2008**

	<b>Total Company</b>	<b>Eliminations</b>	<b>Penske Automotive Group, Inc. (In Thousands)</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>
Cash and cash equivalents	\$ 20,394	\$	\$	\$	\$ 20,394
Accounts receivable, net	503,463	(224,831)	224,831	271,198	232,265
Inventories, net	1,818,846			1,011,065	807,781
Other current assets	89,092		4,300	37,865	46,927
Assets held for sale	110,307			87,469	22,838
 Total current assets	 2,542,102	 (224,831)	 229,131	 1,407,597	 1,130,205
Property and equipment, net	650,360		4,391	363,264	282,705
Intangible assets	1,661,243			1,060,262	600,981
Other assets	87,466	(1,964,029)	1,964,029	17,845	69,621
 Total assets	 \$ 4,941,171	 \$ (2,188,860)	 \$ 2,197,551	 \$ 2,848,968	 \$ 2,083,512
 Floor plan notes payable	 \$ 1,198,824	 \$	 \$	 \$ 633,850	 \$ 564,974
Floor plan notes payable non-trade	502,620			290,418	212,202
Accounts payable	291,725		1,733	106,706	183,286
Accrued expenses	257,312	(224,831)	913	103,372	377,858
Current portion of long-term debt	14,437			194	14,243
Liabilities held for sale	68,898			44,614	24,284
 Total current liabilities	 2,333,816	 (224,831)	 2,646	 1,179,154	 1,376,847
Long-term debt	829,982	(239,971)	750,000	2,803	317,150
Other long-term liabilities	328,893			296,878	32,015

Edgar Filing: PENSKE AUTOMOTIVE GROUP, INC. - Form 10-Q

Total liabilities	3,492,691	(464,802)	752,646	1,478,835	1,726,012
Total stockholders' equity	1,448,480	(1,724,058)	1,444,905	1,370,133	357,500
Total liabilities and stockholders' equity	\$ 4,941,171	\$ (2,188,860)	\$ 2,197,551	\$ 2,848,968	\$ 2,083,512

Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED BALANCE SHEET**  
**December 31, 2007**

	<b>Total Company</b>	<b>Eliminations</b>	<b>Penske Automotive Group, Inc. (In Thousands)</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>
Cash and cash equivalents	\$ 11,690	\$	\$	\$	\$ 11,690
Accounts receivable, net	448,985	(210,645)	210,945	289,939	158,746
Inventories, net	1,682,736			924,632	758,104
Other current assets	65,948		3,849	27,958	34,141
Assets held for sale	96,638			75,861	20,777
 Total current assets	 2,305,997	 (210,645)	 214,794	 1,318,390	 983,458
Property and equipment, net	617,874		4,617	345,088	268,169
Intangible assets	1,659,788			1,062,014	597,774
Other assets	84,894	(1,951,050)	1,956,788	12,395	66,761
 Total assets	 \$ 4,668,553	 \$ (2,161,695)	 \$ 2,176,199	 \$ 2,737,887	 \$ 1,916,162
 Floor plan notes payable	 \$ 1,070,882	 \$	 \$	 \$ 569,259	 \$ 501,623
Floor plan notes payable non-trade	476,854			293,269	183,585
Accounts payable	266,726		4,550	96,562	165,614
Accrued expenses	212,310	(210,645)	190	64,037	358,728
Current portion of long-term debt	14,522			496	14,026
Liabilities held for sale	54,745			34,113	20,632
 Total current liabilities	 2,096,039	 (210,645)	 4,740	 1,057,736	 1,244,208
Long-term debt	830,106	(237,616)	750,000	2,548	315,174
Other long-term liabilities	320,949			288,647	32,302
 Total liabilities	 3,247,094	 (448,261)	 754,740	 1,348,931	 1,591,684
Total stockholders' equity	1,421,459	(1,713,434)	1,421,459	1,388,956	324,478
 Total liabilities and stockholders' equity	 \$ 4,668,553	 \$ (2,161,695)	 \$ 2,176,199	 \$ 2,737,887	 \$ 1,916,162



Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF INCOME**  
**Three Months Ended March 31, 2008**

	<b>Total</b>		<b>Penske Automotive Group, Inc. (In Thousands)</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>
	<b>Company</b>	<b>Eliminations</b>			
Revenues	\$ 3,204,470	\$	\$	\$ 1,738,386	\$ 1,466,084
Cost of sales	2,710,412			1,462,756	1,247,656
Gross profit	494,058			275,630	218,428
Selling, general, and administrative expenses	399,173		3,851	232,611	162,711
Depreciation and amortization	13,501		363	7,252	5,886
Operating income (loss)	81,384		(4,214)	35,767	49,831
Floor plan interest expense	(17,312)			(9,556)	(7,756)
Other interest expense	(12,043)		(7,156)		(4,887)
Equity in income of affiliates	1,392				1,392
Loss on debt redemption					
Equity in earnings of subsidiaries		(64,356)	64,356		
Income (loss) from continuing operations before income taxes and minority interests	53,421	(64,356)	52,986	26,211	38,580
Income taxes	(19,147)	23,256	(19,147)	(11,754)	(11,502)
Minority interests	(435)				(435)
Income (loss) from continuing operations	33,839	(41,100)	33,839	14,457	26,643
Income (loss) from discontinued operations, net of tax	91	(91)	91	(185)	276
Net income (loss)	\$ 33,930	\$ (41,191)	\$ 33,930	\$ 14,272	\$ 26,919

Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF INCOME**  
**Three Months Ended March 31, 2007**

	<b>Total</b>		<b>Penske</b>	<b>Guarantor</b>	<b>Non-Guarantor</b>
	<b>Company</b>	<b>Eliminations</b>	<b>Automotive</b>	<b>Subsidiaries</b>	<b>Subsidiaries</b>
			<b>Group,</b>		
			<b>Inc.</b>		
			<b>(In Thousands)</b>		
Revenues	\$ 3,080,015	\$	\$	\$ 1,653,236	\$ 1,426,779
Cost of sales	2,618,248			1,391,226	1,227,022
Gross profit	461,767			262,010	199,757
Selling, general, and administrative expenses	369,711		4,112	212,560	153,039
Depreciation and amortization	12,340		345	6,600	5,395
Operating income (loss)	79,716		(4,457)	42,850	41,323
Floor plan interest expense	(15,816)			(8,636)	(7,180)
Other interest expense	(18,823)		(12,211)	(27)	(6,585)
Equity in income of affiliates	(821)				(821)
Loss on debt redemption	(18,634)		(18,634)		
Equity in earnings of subsidiaries		(60,630)	60,630		
Income (loss) from continuing operations before income taxes and minority interests	25,622	(60,630)	25,328	34,187	26,737
Income taxes	(8,796)	20,614	(8,796)	(12,745)	(7,869)
Minority interests	(294)				(294)
Income (loss) from continuing operations	16,532	(40,016)	16,532	21,442	18,574
Income (loss) from discontinued operations, net of tax	(1,950)	1,469	(1,950)	(1,939)	470
Net income (loss)	\$ 14,582	\$ (38,547)	\$ 14,582	\$ 19,503	\$ 19,044



Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**  
**Three Months Ended March 31, 2008**

	<b>Total</b>	<b>Penske</b>	<b>Guarantor</b>	<b>Non-Guarantor</b>
	<b>Company</b>	<b>Automotive</b>	<b>Subsidiaries</b>	<b>Subsidiaries</b>
		<b>Group,</b>		
		<b>Inc.</b>		
		<b>(In Thousands)</b>		
Net cash from continuing operating activities	\$ 38,043	\$ 137	\$ 38,937	\$ (1,031)
Investing activities:				
Purchase of property and equipment	(49,081)	(137)	(28,463)	(20,481)
Proceeds from sale leaseback transactions	3,676		3,676	
Dealership acquisitions, net				
Other	(1,500)			(1,500)
Net cash from continuing investing activities	(46,905)	(137)	(24,787)	(21,981)
Financing activities:				
Net borrowings (repayments) of long-term debt	(226)	8,550	(12,105)	3,329
Floor plan notes payable non-trade	25,767		(2,850)	28,617
Proceeds from exercises of options including excess tax benefit				
Distributions from (to) parent			1,821	(1,821)
Dividends	(8,550)	(8,550)		
Net cash from continuing financing activities	16,991		(13,134)	30,125
Net cash from discontinued operations	575		(1,016)	1,591
Net change in cash and cash equivalents	8,704			8,704
Cash and cash equivalents, beginning of period	11,690			11,690
Cash and cash equivalents, end of period	\$ 20,394	\$	\$	\$ 20,394



Table of Contents

**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**  
**Three Months Ended March 31, 2007**

	<b>Total Company</b>	<b>Penske Automotive Group, Inc. (In Thousands)</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>
Net cash from continuing operating activities	\$ 108,395	\$ 19,332	\$ 75,462	\$ 13,601
Investing activities:				
Purchase of property and equipment	(37,169)	(99)	(22,184)	(14,886)
Proceeds from sale leaseback transactions	23,600		23,446	154
Dealership acquisitions, net	(7,282)		(8,264)	982
Other	8,764	8,764		
Net cash from continuing investing activities	(12,087)	8,665	(7,002)	(13,750)
Financing activities:				
Net borrowings (repayments) of long-term debt	(3,747)	306,233	(310,978)	998
Floor plan notes payable non-trade	166,143		157,157	8,986
Proceeds from exercises of options including excess tax benefit	333	333		
Redemption 9 5/8% Senior Subordinated Debt	(314,439)	(314,439)		
Distributions from (to) parent			2,520	(2,520)
Dividends	(6,566)	(6,566)		
Net cash from continuing financing activities	(158,276)	(14,439)	(151,301)	7,464
Net cash from discontinued operations	74,056		80,539	(6,483)
Net change in cash and cash equivalents	12,088	13,558	(2,302)	832
Cash and cash equivalents, beginning of period	14,768		2,419	12,349
Cash and cash equivalents, end of period	\$ 26,856	\$ 13,558	\$ 117	\$ 13,181

**Table of Contents**

**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 as a result of various factors, including those discussed in Forward Looking Statements. We have acquired a number of dealerships since inception. Our financial statements include the results of operations of acquired dealerships from the date of acquisition. In addition, this Management's Discussion and Analysis of Financial Condition and Results of Operations has been updated for the effects of revising our financial statements for entities which have been treated as discontinued operations through March 31, 2008 in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets .*

**Overview**

We are the second largest automotive retailer headquartered in the United States as measured by total revenues. As of March 31, 2008, we owned and operated 164 franchises in the United States and 147 franchises outside of the United States, primarily in the United Kingdom. We offer a full range of vehicle brands with 94% of our total revenue in 2008 generated from non-U.S. brands and with sales relating to premium brands, such as Audi, BMW, Cadillac and Porsche, representing 65% of our total revenue. Each of our dealerships offers a wide selection of new and used vehicles for sale. In addition to selling new and used vehicles, we generate higher-margin revenue at each of our dealerships through maintenance and repair services and the sale and placement of higher-margin products, such as third party finance and insurance products, third-party extended service contracts and replacement and aftermarket automotive products.

New and used vehicle revenues include sales to retail customers and to leasing companies providing consumer automobile leasing. We generate finance and insurance revenues from sales of third-party extended service contracts, sales of third-party insurance policies, fees for facilitating the sale of third-party finance and lease contracts and the sale of certain other products. Service and parts revenues include fees paid for repair, maintenance and collision services, the sale of replacement parts and the sale of aftermarket accessories.

We are also, through smart USA Distributor, LLC, a wholly owned subsidiary, the exclusive distributor of the smart fortwo vehicle in United States and Puerto Rico. The smart fortwo is manufactured by Mercedes-Benz Cars and is a Daimler brand. This technologically advanced vehicle achieves 40-plus miles per gallon on the highway and is an ultra-low emissions vehicle. Though launched in the United States in 2008, more than 850,000 fortwo vehicles have previously been sold outside the U.S. smart USA has certified a network of 68 smart dealerships in 31 states, most of which have received the requisite licensing and other required approvals and are actively selling vehicles. Additional dealerships are expected to commence retailing vehicles during 2008 upon completion of their facilities and obtaining licensing approval. Of the 74 dealerships currently planned in the U.S., eight are owned and operated by us. The smart fortwo offers three different versions, the *Pure*, *Passion* and *Cabriolet* with base prices ranging from \$11,600 to \$16,600. We currently expect to distribute at least 20,000 smart fortwo vehicles in 2008.

We and Sirius Satellite Radio Inc. ( Sirius ) have agreed to jointly promote Sirius Satellite Radio service. Pursuant to the terms of our arrangement with Sirius, our dealerships in the United States endeavor to order a significant percentage of eligible vehicles with a factory installed Sirius radio. We and Sirius have also agreed to jointly market the Sirius service under a best efforts arrangement through January 4, 2009. Our costs relating to such marketing initiatives are expensed as incurred. As compensation for our efforts, we received warrants to purchase ten million shares of Sirius common stock at \$2.392 per share in 2004 that are being earned ratably on an annual basis through January 2009. We measure the fair value of the warrants earned ratably on the date they are earned as there are no significant disincentives for non-performance. Since we can reasonably estimate the number of warrants that will be earned pursuant to the ratable schedule, the estimated fair value (based on current fair value) of these warrants is recognized ratably during each annual period. We also had the right to earn additional warrants to purchase Sirius common stock at \$2.392 per share based upon the sale of certain units of specified brands through December 31, 2007. We earned 108,600 of these warrants during the three months ended March 31, 2007. The value of Sirius stock has been and is expected to be subject to significant fluctuations, which may result in variability in the amount we earn under this arrangement. The warrants may be cancelled upon the termination of our arrangement.



## **Table of Contents**

Our gross profit tends to vary with the mix of revenues we derive from the sale of new vehicles, used vehicles, finance and insurance products, and service and parts. Our gross profit generally varies across product lines, with vehicle sales usually resulting in lower gross profit margins and our other revenues resulting in higher gross profit margins. Factors such as customer demand, general economic conditions, seasonality, weather, credit availability, fuel prices and manufacturers' advertising and incentives may impact the mix of our revenues, and therefore influence our gross profit margin.

Our selling expenses consist of advertising and compensation for sales personnel, including commissions and related bonuses. General and administrative expenses include compensation for administration, finance, legal and general management personnel, rent, insurance, utilities and other outside services. We believe a significant portion of our selling expenses are variable, and a significant portion of our general and administrative expenses are subject to our control, allowing us to adjust them over time to reflect economic trends.

Floor plan interest expense relates to financing obligations incurred in connection with the acquisition of new and used vehicle inventories which is secured by those vehicles. Other interest expense consists of interest charges on all of our interest-bearing debt, other than interest relating to floor plan financing.

The future success of our business will likely be dependent on, among other things, our ability to consummate and integrate acquisitions, our ability to increase sales of higher margin products, especially service and parts services, and our ability to realize returns on our significant capital investment in new and upgraded dealerships. See

Forward-Looking Statements.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the application of accounting policies that often involve making estimates and employing judgments. Such judgments influence the assets, liabilities, revenues and expenses recognized in our financial statements. Management, on an ongoing basis, reviews these estimates and assumptions. Management may determine that modifications in assumptions and estimates are required, which may result in a material change in our results of operations or financial position.

The following are the accounting policies applied in the preparation of our financial statements that management believes are most dependent upon the use of estimates and assumptions.

#### ***Revenue Recognition***

##### ***Vehicle, Parts and Service Sales***

We record revenue when vehicles are delivered and title has passed to the customer, when vehicle service or repair work is performed and when parts are delivered to our customers. Sales promotions that we offer to customers are accounted for as a reduction of revenues at the time of sale. Rebates and other incentives offered directly to us by manufacturers are recognized as a reduction of cost of sales. Reimbursement of qualified advertising expenses are treated as a reduction of selling, general and administrative expenses. The amounts received under various manufacturer rebate and incentive programs are based on the attainment of program objectives, and such earnings are recognized either upon the sale of the vehicle for which the award was received, or upon attainment of the particular program goals if not associated with individual vehicles. During the three months ended March 31, 2008 and 2007, we earned \$85.1 million and \$81.2 million, respectively, of rebates, incentives and reimbursements from manufacturers, of which \$83.4 million and \$78.3 million was recorded as a reduction of cost of sales.

##### ***Finance and Insurance Sales***

Subsequent to the sale of a vehicle to a customer, we sell our installment sale contracts to various financial institutions on a non-recourse basis to mitigate the risk of default. We receive a commission from the lender equal to either the difference between the interest rate charged to the customer and the interest rate set by the financing institution or a flat fee. We also receive commissions for facilitating the sale of various third-party insurance products to customers, including credit and life insurance policies and extended service contracts. These commissions are recorded as revenue at the time the customer enters into the contract. In the case of finance contracts, a customer may prepay or fail to pay their contract, thereby terminating the contract. Customers may also terminate extended service contracts and other insurance products, which are fully paid at purchase, and become eligible for refunds of unused premiums. In these circumstances, a portion of the commissions we received may be charged back to us based on the terms of the

contracts. The revenue we record relating to these transactions is net of an estimate of the amount of chargebacks we will be required to pay. Our estimate is based upon our historical experience with similar contracts, including the impact of refinance and default rates on retail finance contracts and cancellation rates on extended service contracts and other insurance products. Aggregate reserves relating to chargeback activity were \$19.4 million as of March 31, 2008 and December 31, 2007.

## **Table of Contents**

### ***Intangible Assets***

Our principal intangible assets relate to our franchise agreements with vehicle manufacturers, which represent the estimated value of franchises acquired in business combinations, and goodwill, which represents the excess of cost over the fair value of tangible and identified intangible assets acquired in business combinations. We believe the franchise value of our dealerships has an indefinite useful life based on the following facts:

Automotive retailing is a mature industry and is based on franchise agreements with the vehicle manufacturers;

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

Certain franchise agreement terms are indefinite;

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

Our history shows that manufacturers have not terminated our franchise agreements.

### ***Impairment Testing***

Franchise value impairment is assessed as of October 1 every year through a comparison of the carrying amounts of our franchises with their estimated fair values. An indicator of impairment exists if the carrying value of a franchise exceeds its estimated fair value and an impairment loss may be recognized equal to that excess. We also evaluate our franchises in connection with the annual impairment testing to determine whether events and circumstances continue to support our assessment that the franchise has an indefinite life.

Goodwill impairment is assessed at the reporting unit level as of October 1 every year and upon the occurrence of an indicator of impairment. An indicator of impairment exists if the carrying amount of the reporting unit including goodwill is determined to exceed its estimated fair value. If an indication of impairment exists, the impairment is measured by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill and an impairment loss may be recognized equal to that excess.

The fair values of franchise value and goodwill are determined using a discounted cash flow approach, which includes assumptions that include revenue and profitability growth, franchise profit margins, residual values and our cost of capital. If future events and circumstances cause significant changes in the assumptions underlying our analysis and result in a reduction of our estimates of fair value, we may incur an impairment charge.

### ***Investments***

Investments include marketable securities and investments in businesses accounted for under the equity method. A majority of our investments are in joint venture relationships that are more fully described in Joint Venture Relationships below. Such joint venture relationships are accounted for under the equity method, pursuant to which we record our proportionate share of the joint venture's income each period.

The net book value of our investments was \$67.4 million and \$64.4 million as of March 31, 2008 and December 31, 2007, respectively. Investments for which there is not a liquid, actively traded market are reviewed periodically by management for indicators of impairment. If an indicator of impairment was identified, management would estimate the fair value of the investment using a discounted cash flow approach, which would include assumptions relating to revenue and profitability growth, profit margins, residual values and our cost of capital. Declines in investment values that are deemed to be other than temporary may result in an impairment charge reducing the investments' carrying value to fair value. During 2007, we recorded an adjustment to the carrying value of our investment in Internet Brands to recognize an other than temporary impairment of \$3.4 million which became apparent upon their initial public offering.

Investments in marketable securities held by us are typically classified as available for sale and are stated at fair value on our balance sheet with unrealized gains and losses included in other comprehensive income, a separate component of stockholders' equity. Declines in investment values that are deemed to be other than temporary would be an indicator of impairment and may result in an impairment charge reducing the investments' carrying value to fair value.



## **Table of Contents**

### ***Self-Insurance***

We retain risk relating to certain of our general liability insurance, workers' compensation insurance, auto physical damage insurance, property insurance, employment practices liability insurance, directors' and officers' insurance and employee medical benefits in the U.S. As a result, we are likely to be responsible for a majority of the claims and losses incurred under these programs. The amount of risk we retain varies by program, and, for certain exposures, we have pre-determined maximum loss limits for certain individual claims and/or insurance periods. Losses, if any, above the pre-determined loss limits are paid by third-party insurance carriers. Our estimate of future losses is prepared by management using our historical loss experience and industry-based development factors. Aggregate reserves relating to retained risk were \$16.2 million and \$12.8 million as of March 31, 2008 and December 31, 2007. Changes in the reserve estimate during 2008 relate primarily to the conversion of participants from fully insured health plans to those where the Company has retained risk.

### ***Income Taxes***

Tax regulations may require items to be included in our tax return at different times than the items are reflected in our financial statements. Some of these differences are permanent, such as expenses that are not deductible on our tax return, and some are timing differences, such as the timing of depreciation expense. Timing differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that will be used as a tax deduction or credit in our tax return in future years which we have already recorded in our financial statements. Deferred tax liabilities generally represent deductions taken on our tax return that have not yet been recognized as expense in our financial statements. We establish valuation allowances for our deferred tax assets if the amount of expected future taxable income is not likely to allow for the use of the deduction or credit. A valuation allowance of \$2.3 million has been recorded relating to state net operating loss and credit carryforwards in the U.S. based on our determination that it is more likely than not that they will not be utilized.

### ***Classification of Franchises in Continuing and Discontinued Operations***

We classify the results of our operations in our consolidated financial statements based on the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, which requires judgment in determining whether a franchise will be reported within continuing or discontinued operations. Such judgments include whether a franchise will be divested, the period required to complete the divestiture, and the likelihood of changes to the divestiture plans. If we determine that a franchise should be either reclassified from continuing operations to discontinued operations or from discontinued operations to continuing operations, our consolidated financial statements for prior periods are revised to reflect such reclassification.

### ***New Accounting Pronouncements***

SFAS No. 157, "Fair Value Measurements" defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure requirements relating to fair value measurements. The FASB provided a one year deferral of the provisions of this pronouncement for non-financial assets and liabilities, however, the relevant provisions of SFAS 157 required by SFAS 159 was adopted as of January 1, 2008. SFAS 157 thus becomes effective for our non-financial assets and liabilities on January 1, 2009. We continue to evaluate the impact of those elements of this pronouncement.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115" permits entities to choose to measure many financial instruments and certain other items at fair value and consequently report unrealized gains and losses on such items in earnings. We did not elect the fair value option with respect to any of our current financial assets or financial liabilities on January 1, 2008 when the provisions of this statement became effective. As a result, there was no impact upon adoption.

SFAS No. 141(R) "Business Combinations" requires almost all assets acquired and liabilities assumed to be recorded at fair value as of the acquisition date, liabilities related to contingent consideration to be remeasured at fair value in each subsequent reporting period and all acquisition related costs to be expensed as incurred. The pronouncement also clarifies the accounting under various scenarios such as step purchases or where the fair value of assets and liabilities acquired exceeds the consideration. SFAS 141(R) will be effective for us on January 1, 2009.

SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51" clarifies that a noncontrolling interest in a subsidiary must be measured at fair value and classified as a separate component of



equity. This pronouncement also outlines the accounting for changes in a parent's ownership in a subsidiary. SFAS 160 will be effective for us on January 1, 2009 and will require us to reclassify our minority interest liabilities to shareholders equity for the Company's non-wholly owned consolidated subsidiaries.

SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities amends and expands the disclosure requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities to explain why and how an entity uses derivative instruments, how the hedged items are accounted for under the relevant literature and how the derivative instruments affect an entity's financial position, financial performance and cash flows. SFAS 161 will be effective for us on January 1, 2009. While the pronouncement will have no impact on the Company's accounting, we are currently evaluating the additional disclosure requirements.

**Table of Contents****Results of Operations**

The following tables present comparative financial data relating to our operating performance in the aggregate and on a same store basis. Dealership results are only included in same store comparisons when we have consolidated the acquired entity during the entirety of both periods being compared. As an example, if a dealership was acquired on January 15, 2006, the results of the acquired entity would be included in annual same store comparisons beginning with the year ended December 31, 2008 and in quarterly same store comparisons beginning with the quarter ended June 30, 2007.

***Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2007 (dollars in millions, except per unit amounts)***

Our results for the quarter ended March 31, 2007 include charges of \$18.6 million (\$12.3 million after tax) relating to the redemption of \$300.0 million aggregate principal amount of 9.625% Senior Subordinated Notes.

**Total Retail Data**

	2008 vs. 2007			
	2008	2007	Change	% Change
Total retail unit sales	72,461	70,655	1,806	2.6%
Total same store retail unit sales	67,500	69,239	(1,739)	(2.5)%
Total retail sales revenue	\$ 2,877.5	\$ 2,820.9	\$ 56.6	2.0%
Total same store retail sales revenue	\$ 2,703.6	\$ 2,768.5	\$ (64.9)	(2.3)%
Total retail gross profit	\$ 484.2	\$ 458.7	\$ 25.5	5.6%
Total same store retail gross profit	\$ 457.7	\$ 452.4	\$ 5.3	1.2%
Total retail gross margin	16.8%	16.3%	0.5%	3.1%
Total same store retail gross margin	16.9%	16.3%	0.6%	3.7%

**Units**

Retail data includes retail new vehicle, retail used vehicle, finance and insurance and service and parts transactions. Retail unit sales of vehicles increased by 1,806 units, or 2.6%, from 2007 to 2008. The increase is due to a 3,545 unit increase from net dealership acquisitions during the period, offset by a 1,739, or 2.5%, decrease in same store retail unit sales. The decrease in same store retail unit sales was driven primarily by decreases in new retail units sales of our premium and volume foreign brand stores in the U.S., which was somewhat offset by increases in used retail unit sales at our premium and volume foreign brand stores in the U.S.

**Revenues**

Retail sales revenue increased \$56.6 million, or 2.0%, from 2007 to 2008. The increase is due to a \$121.5 million increase from net dealership acquisitions, offset by a \$64.9 million, or 2.3%, decrease in same store revenues. The same store retail revenue decrease is due to (1) the 2.5% decrease in retail unit sales, which decreased revenue by \$72.2 million and (2) an \$836, or 2.7%, decrease in average used vehicle revenue per unit, which decreased revenue by \$20.5 million. These were somewhat offset by (1) an \$80, or 8.2%, increase in average finance and insurance revenue per unit, which increased revenue by \$5.4 million, (2) a \$3.8 million, or 1.1%, increase in service and parts revenues, and (3) the \$445, or 1.2%, increase in average new vehicle revenue per unit, which increased revenue by \$18.6 million.

**Gross Profit**

Retail gross profit increased \$25.5 million, or 5.6%, from 2007 to 2008. The increase is due to a \$5.3 million, or 1.2%, increase in same store retail gross profit, coupled with a \$20.2 million increase from net dealership acquisitions. The same store retail gross profit increase is due to (1) a \$39, or 1.3%, increase in average gross profit per new vehicle retailed, which increased retail gross profit by \$1.6 million, (2) an \$86, or 3.5%, increase in average gross profit per used vehicle retailed, which increased retail gross profit by \$2.1 million, (3) the \$80, or 8.2%, increase in average finance and insurance revenue per unit, which increased retail gross profit by \$5.4 million, and (4) a \$3.8 million, or 2.0%, increase in service and parts gross profit. These increases were somewhat offset by the 2.5% decrease in retail unit sales, which decreased retail gross profit by \$7.6 million.



**Table of Contents****New Vehicle Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
New retail unit sales	45,550	45,105	445	1.0%
Same store new retail unit sales	41,668	44,659	(2,991)	(6.7)%
New retail sales revenue	\$ 1,635.6	\$ 1,624.8	\$ 10.8	0.7%
Same store new retail sales revenue	\$ 1,518.8	\$ 1,607.9	\$ (89.1)	(5.5)%
New retail sales revenue per unit	\$ 35,908	\$ 36,022	\$ (114)	(0.3)%
Same store new retail sales revenue per unit	\$ 36,450	\$ 36,005	\$ 445	1.2%
Gross profit new	\$ 138.0	\$ 136.6	\$ 1.4	1.0%
Same store gross profit new	\$ 127.6	\$ 135.0	\$ (7.4)	(5.5)%
Average gross profit per new vehicle retailed	\$ 3,029	\$ 3,028	\$ 1	0.0%
Same store average gross profit per new vehicle retailed	\$ 3,062	\$ 3,023	\$ 39	1.3%
Gross margin % new	8.4%	8.4%	0.0%	0.0%
Same store gross margin % new	8.4%	8.4%	0.0%	0.0%

***Units***

Retail unit sales of new vehicles increased 445 units, or 1.0%, from 2007 to 2008. The increase is due a 3,436 unit increase from net dealership acquisitions, offset by a 2,991 unit or 6.7% decrease in same store retail unit sales during the period. The same store decrease was due primarily to unit sales decreases in our premium and volume foreign brand stores in the U.S.

***Revenues***

New vehicle retail sales revenue increased \$10.8 million, or 0.7%, from 2007 to 2008. The increase is due to a \$99.9 million increase from net dealership acquisitions, offset by an \$89.1 million, or 5.5%, decrease in same store revenues. The same store revenue decrease is due primarily to the 6.7% decrease in retail unit sales, which reduced revenue by \$107.7 million, offset somewhat by the \$445, or 1.2%, increase in average selling prices per unit, which increased revenue by \$18.6 million.

***Gross Profit***

Retail gross profit from new vehicle sales increased \$1.4 million, or 1.0%, from 2007 to 2008. The increase is due to an \$8.8 million increase from net dealership acquisitions, offset by a \$7.4 million, or 5.5%, decrease in same store gross profit. The same store decrease is due primarily to the 6.7% decrease in retail unit sales, which reduced gross profit by \$9.0 million, somewhat offset by a \$39, or 1.3%, increase in the average gross profit per new vehicle retailed, which increased gross profit by \$1.6 million.

**Table of Contents****Used Vehicle Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
Used retail unit sales	26,911	25,550	1,361	5.3%
Same store used retail unit sales	25,832	24,580	1,252	5.1%
Used retail sales revenue	\$ 803.4	\$ 780.3	\$ 23.1	3.0%
Same store used retail sales revenue	\$ 768.4	\$ 751.7	\$ 16.7	2.2%
Used retail sales revenue per unit	\$ 29,854	\$ 30,542	\$ (688)	(2.3)%
Same store used retail sales revenue per unit	\$ 29,747	\$ 30,583	\$ (836)	(2.7)%
Gross profit used	\$ 67.6	\$ 61.1	\$ 6.5	10.6%
Same store gross profit used	\$ 65.1	\$ 59.8	\$ 5.3	8.9%
Average gross profit per used vehicle retailed	\$ 2,512	\$ 2,392	\$ 120	5.0%
Same store average gross profit per used vehicle retailed	\$ 2,520	\$ 2,434	\$ 86	3.5%
Gross margin % used	8.4%	7.8%	0.6%	7.7%
Same store gross margin % used	8.5%	8.0%	0.5%	6.3%

***Units***

Retail unit sales of used vehicles increased 1,361 units, or 5.3%, from 2007 to 2008. The increase is due to a 1,252 unit, or 5.1%, increase in same store retail unit sales, coupled with a 109 unit increase from net dealership acquisitions. The same store increase was due primarily to unit sales increases in our premium brand stores in the U.S. and in our volume foreign brand stores worldwide.

***Revenues***

Used vehicle retail sales revenue increased \$23.1 million, or 3.0%, from 2007 to 2008. The increase is due to a \$16.7 million, or 2.2%, increase in same store revenues, coupled with a \$6.4 million increase from net dealership acquisitions. The same store revenue increase is due primarily to the 5.1% increase in retail unit sales, which increased revenue by \$37.2 million, somewhat offset by a decrease in comparative average selling prices per vehicle of \$836, or 2.7%, which decreased revenue by \$20.5 million,.

***Gross Profit***

Retail gross profit from used vehicle sales increased \$6.5 million, or 10.6%, from 2007 to 2008. The increase is due to a \$5.3 million, or 8.9%, increase in same store gross profit, coupled with a \$1.2 million increase from net dealership acquisitions. The increase in same store gross profit is due primarily to the 5.1% increase in used retail unit sales, which increased gross profit by \$3.2 million, coupled with an \$86, or 3.5%, increase in average gross profit per used vehicle retailed which increased retail gross profit by \$2.1 million.

**Finance and Insurance Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
Finance and insurance revenue	\$ 75.1	\$ 67.8	\$ 7.3	10.8%
Same store finance and insurance revenue	\$ 71.2	\$ 67.5	\$ 3.7	5.5%
Finance and insurance revenue per unit	\$ 1,036	\$ 960	\$ 76	7.9%
Same store finance and insurance revenue per unit	\$ 1,054	\$ 974	\$ 80	8.2%

Finance and insurance revenue increased \$7.3 million, or 10.8%, from 2007 to 2008. The increase is due to a \$3.7 million, or 5.5%, increase in same store revenues, coupled with a \$3.6 million increase from net dealership acquisitions during the period. The same store revenue increase is due primarily to the \$80, or 8.2%, increase in comparative average finance and insurance revenue per unit, which increased revenue by \$5.4 million, somewhat offset by the 2.5% decrease in retail unit sales which decreased revenue by \$1.7 million.



**Table of Contents****Service and Parts Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
Service and parts revenue	\$ 363.4	\$ 348.0	\$ 15.4	4.4%
Same store service and parts revenue	\$ 345.2	\$ 341.4	\$ 3.8	1.1%
Gross profit	\$ 203.6	\$ 193.2	\$ 10.4	5.4%
Same store gross profit	\$ 193.9	\$ 190.1	\$ 3.8	2.0%
Gross margin	56.0%	55.5%	0.5%	0.9%
Same store gross margin	56.2%	55.7%	0.5%	0.9%

**Revenues**

Service and parts revenue increased \$15.4 million, or 4.4%, from 2007 to 2008. The increase is due to a \$3.8 million, or 1.1%, increase in same store revenues, coupled with an \$11.6 million increase from net dealership acquisitions during the period. We believe that our service and parts business is being positively impacted by the growth in total retail unit sales at our dealerships in recent years and capacity increases in our service and parts operations resulting from our ongoing facility improvement and expansion programs.

**Gross Profit**

Service and parts gross profit increased \$10.4 million, or 5.4%, from 2007 to 2008. The increase is due to a \$3.8 million, or 2.0%, increase in same store gross profit, coupled with a \$6.6 million increase from net dealership acquisitions during the period. The same store gross profit increase is due to the \$3.8 million, or 1.1%, increase in same store revenues, which increased gross profit by \$2.2 million, and a 50 basis point increase in gross margin, which increased gross profit by \$1.6 million.

**Distribution**

The Company's wholly-owned subsidiary, smart USA Distributor LLC ( smart USA ), began distributing the smart fortwo vehicle in the U.S. during 2008. Total distribution segment revenue during the first three months of 2008 aggregated to \$75.5 million. Segment gross profit totaled \$10.7 million, which includes gross profit on vehicle and parts sales.

**Selling, General and Administrative**

Selling, general and administrative expenses ( SG&A ) increased \$29.5 million, or 8.0%, from \$369.7 million to \$399.2 million. The aggregate increase is primarily due to a \$7.1 million, or 2.0%, increase in same store SG&A, coupled with a \$22.4 million increase from net dealership acquisitions. The increase in same store SG&A is due to costs associated with the smart distribution business, a net increase in variable selling expenses, including increases in variable compensation as a result of the 1.2% increase in same store retail gross profit over the prior year, and increased rent and other costs relating to our ongoing facility improvement and expansion programs. SG&A expenses increased as a percentage of total revenue from 12.0% to 12.4% and increased as a percentage of gross profit from 80.1% to 80.8%.

**Depreciation and Amortization**

Depreciation and amortization increased \$1.2 million, or 9.4%, from \$12.3 million to \$13.5 million. The increase is due to an \$0.8 million, or 7.2%, increase in same store depreciation and amortization, coupled with a \$0.4 million increase from net dealership acquisitions. The same store increase is due in large part to our ongoing facility improvement and expansion program.

**Floor Plan Interest Expense**

Floor plan interest expense increased \$1.5 million, or 9.5%, from \$15.8 million to \$17.3 million. The increase is due to a \$0.6 million, or 4.0%, increase in same store floor plan interest expense, coupled with a \$0.9 million increase from net dealership acquisitions. The same store increase is due in large part to increases in our average amounts outstanding, somewhat offset by decreases in the underlying variable rates of our revolving floor plan arrangements.





## **Table of Contents**

### **Other Interest Expense**

Other interest expense decreased \$6.8 million, or 36.0%, from \$18.8 million to \$12.0 million. The decrease is due primarily to a decrease in our average total outstanding indebtedness in 2008 versus 2007, coupled with a decrease in our weighted average interest rate.

### **Income Taxes**

Income taxes increased \$10.3 million, or 117.7%, from \$8.8 million to \$19.1 million. The increase from 2007 to 2008 is due to the increase in our pre-tax income versus the prior year, coupled with an increase in our overall effective income tax rate.

### **Liquidity and Capital Resources**

Our cash requirements are primarily for working capital, inventory financing, the acquisition of new dealerships, the improvement and expansion of existing facilities, the construction of new facilities, dividends and potentially repurchases of common stock under the program discussed below. Historically, these cash requirements have been met through cash flow from operations, borrowings under our credit agreements and floor plan arrangements, the issuance of debt securities, sale-leaseback transactions or the issuance of equity securities. As of March 31, 2008, we had working capital of \$208.3 million, including \$20.4 million of cash available to fund our operations and capital commitments. In addition, we had \$250.0 million and £67 million (\$133.3 million) available for borrowing under our U.S. credit agreement and our U.K. credit agreement, respectively, each of which is discussed below.

We paid dividends of seven cents per share on March 1, 2007, June 1, 2007 and September 4, 2007 and dividends of nine cents per share on December 3, 2007 and March 3, 2008. We have also declared a dividend of nine cents per share payable on June 2, 2008 to shareholders of record on May 12, 2008. Future quarterly or other cash dividends will depend upon our earnings, capital requirements, financial condition, restrictions on any then existing indebtedness and other factors considered relevant by our Board of Directors.

We have historically expanded our automotive retail operations through organic growth and the acquisition of retail automotive dealerships. In addition, one of our subsidiaries is the exclusive distributor of smart fortwo vehicles in the United States and Puerto Rico. We believe that cash flow from operations and our existing capital resources, including the liquidity provided by our credit agreements and floor plan financing arrangements, will be sufficient to fund our operations and commitments for at least the next twelve months. To the extent we pursue additional significant acquisitions, other expansion opportunities, or refinance existing debt, we may need to raise additional capital either through the public or private issuance of equity or debt securities or through additional borrowings which sources of funds may not necessarily be available on terms acceptable to us, if at all.

Our board of directors has approved a stock repurchase program for up to \$150 million of our outstanding common stock. We may, from time to time as market conditions warrant, purchase our outstanding common stock on the open market and in privately negotiated transactions and, potentially, via a tender offer. We currently intend to fund any repurchases through cash flow from operations and borrowings under our U.S. credit facility. The decision to make stock repurchases will be based on such factors as the market price of our common stock versus our view of its intrinsic value, the potential impact on our capital structure and the expected return on competing uses of capital such as strategic store acquisitions and capital investments in our current businesses, as well as any then-existing limits imposed by our finance agreements. We have not made any repurchases under this program to date.

### ***Inventory Financing***

We finance substantially all of our new and a portion of our used vehicle inventories under revolving floor plan arrangements with various lenders. In the U.S., the floor plan arrangements are due on demand; however, we are generally not required to make loan principal repayments prior to the sale of the vehicles financed. We typically make monthly interest payments on the amount financed. In the U.K., substantially all of our floor plan arrangements are payable on demand or have an original maturity of 90 days or less and we are generally required to repay floor plan advances at the earlier of the sale of the vehicles financed or the stated maturity. The floor plan agreements grant a security interest in substantially all of the assets of our dealership subsidiaries and in the United States are guaranteed by the Company. Interest rates under the floor plan arrangements are variable and increase or decrease based on changes in various benchmarks. We receive non-refundable credits from certain of our vehicle manufacturers, which are treated as a reduction of cost of sales as vehicles are sold.



## **Table of Contents**

### ***U.S. Credit Agreement***

We are party to a credit agreement with DCFS USA LLC and Toyota Motor Credit Corporation, as amended, which provides for up to \$250.0 million of borrowing capacity for working capital, acquisitions, capital expenditures, investments and for other general corporate purposes, including \$10.0 million of availability for letters of credit, through September 30, 2010. The revolving loans bear interest at defined London Interbank Offered Rate ( LIBOR ) plus 1.75%.

The U.S. credit agreement is fully and unconditionally guaranteed on a joint and several basis by our domestic subsidiaries and contains a number of significant covenants that, among other things, restrict our ability to dispose of assets, incur additional indebtedness, repay other indebtedness, pay dividends, create liens on assets, make investments or acquisitions and engage in mergers or consolidations. We are also required to comply with specified financial and other tests and ratios, each as defined in the U.S. credit agreement, including: a ratio of current assets to current liabilities, a fixed charge coverage ratio, a ratio of debt to stockholders' equity, a ratio of debt to earnings before interest, taxes, depreciation and amortization ( EBITDA ), a ratio of domestic debt to domestic EBITDA, and a measurement of stockholders' equity. A breach of these requirements would give rise to certain remedies under the agreement, the most severe of which is the termination of the agreement and acceleration of the amounts owed. As of March 31, 2008, we were in compliance with all covenants under the U.S. credit agreement, and we believe we will remain in compliance with such covenants for the foreseeable future. In making such determination, we have considered the current margin of compliance with the covenants and our expected future results of operations, working capital requirements, acquisitions, capital expenditures and investments in the U.S. See Forward Looking Statements .

The U.S. credit agreement also contains typical events of default, including change of control, non-payment of obligations and cross-defaults to our other material indebtedness. Substantially all of our domestic assets not pledged as security under floor plan arrangements are subject to security interests granted to lenders under the U.S. credit agreement. Other than \$0.5 million of letters of credit, no amounts were outstanding under the U.S. credit agreement as of March 31, 2008.

### ***U.K. Credit Agreement***

Our subsidiaries in the U.K. are party to an agreement with the Royal Bank of Scotland plc, as agent for National Westminster Bank plc, which provides for a multi-option credit agreement, a fixed rate credit agreement and a seasonally adjusted overdraft line of credit to be used to finance acquisitions, working capital, and general corporate purposes. The U.K. credit agreement provides for (1) up to £70.0 million in revolving loans through August 31, 2011, which have an original maturity of 90 days or less and bear interest between defined LIBOR plus 0.65% and defined LIBOR plus 1.25%, (2) a £30.0 million funded term loan which bears interest between 5.94% and 6.54% and is payable ratably in quarterly intervals through June 30, 2011, and (3) a seasonally adjusted overdraft line of credit for up to £30.0 million that bears interest at the Bank of England Base Rate plus 1.00% and matures on August 31, 2011. The U.K. credit agreement is fully and unconditionally guaranteed on a joint and several basis by our U.K. subsidiaries, and contains a number of significant covenants that, among other things, restrict the ability of our U.K. subsidiaries to pay dividends, dispose of assets, incur additional indebtedness, repay other indebtedness, create liens on assets, make investments or acquisitions and engage in mergers or consolidations. In addition, our U.K. subsidiaries are required to comply with specified ratios and tests, each as defined in the U.K. credit agreement, including: a ratio of earnings before interest and taxes plus rental payments to interest plus rental payments (as defined), a measurement of maximum capital expenditures, and a debt to EBITDA ratio (as defined). A breach of these requirements would give rise to certain remedies under the agreement, the most severe of which is the termination of the agreement and acceleration of the amounts owed. As of March 31, 2008, our U.K. subsidiaries were in compliance with all covenants under the U.K. credit agreement, and we believe we will remain in compliance with such covenants for the foreseeable future. In making such determination, we have considered the current margin of compliance with the covenants and our expected future results of operations, working capital requirements, acquisitions, capital expenditures and investments in the U.K. See Forward Looking Statements .

The U.K. credit agreement also contains typical events of default, including change of control and non-payment of obligations and cross-defaults to other material indebtedness of our U.K. subsidiaries. Substantially all of our U.K.

subsidiaries' assets not pledged as security under floor plan arrangements are subject to security interests granted to lenders under the U.K. credit agreement. As of March 31, 2008, outstanding loans under the U.K. credit agreement amounted to £45.9 million (\$91.2 million).

**Table of Contents**

***7.75% Senior Subordinated Notes***

On December 7, 2006 we issued \$375.0 million aggregate principal amount of 7.75% Senior Subordinated Notes due 2016 (the 7.75% Notes ). The 7.75% Notes are unsecured senior subordinated notes and are subordinate to all existing and future senior debt, including debt under our credit agreements and floor plan indebtedness. The 7.75% Notes are guaranteed by substantially all wholly-owned domestic subsidiaries on an unsecured senior subordinated basis. We can redeem all or some of the 7.75% Notes at our option beginning in December 2011 at specified redemption prices, or prior to December 2011 at 100% of the principal amount of the notes plus an applicable make-whole premium, as defined. In addition, we may redeem up to 40% of the 7.75% Notes at specified redemption prices using the proceeds of certain equity offerings before December 15, 2009. Upon certain sales of assets or specific kinds of changes of control we are required to make an offer to purchase the 7.75% Notes. The 7.75% Notes also contain customary negative covenants and events of default. As of March 31, 2008, we were in compliance with all negative covenants and there were no events of default.

***Senior Subordinated Convertible Notes***

On January 31, 2006, we issued \$375.0 million aggregate principal amount of 3.50% senior subordinated convertible notes due 2026 (the Convertible Notes ). The Convertible Notes mature on April 1, 2026, unless earlier converted, redeemed or purchased by us. The Convertible Notes are unsecured senior subordinated obligations and are guaranteed on an unsecured senior subordinated basis by substantially all of our wholly owned domestic subsidiaries. The guarantees are full and unconditional and joint and several. The Convertible Notes also contain customary negative covenants and events of default. As of March 31, 2008, we were in compliance with all negative covenants and there were no events of default.

Holders of the convertible notes may convert them based on a conversion rate of 42.2052 shares of our common stock per \$1,000 principal amount of the Convertible Notes (which is equal to a conversion price of approximately \$23.69 per share), subject to adjustment, only under the following circumstances: (1) in any quarterly period, if the closing price of our common stock for twenty of the last thirty trading days in the prior quarter exceeds \$28.43 (subject to adjustment), (2) for specified periods, if the trading price of the Convertible Notes falls below specific thresholds, (3) if the Convertible Notes are called for redemption, (4) if specified distributions to holders of our common stock are made or specified corporate transactions occur, (5) if a fundamental change (as defined) occurs, or (6) during the ten trading days prior to, but excluding, the maturity date.

Upon conversion of the Convertible Notes, for each \$1,000 principal amount of the Convertible Notes, a holder will receive an amount in cash, in lieu of shares of our common stock, equal to the lesser of (i) \$1,000 or (ii) the conversion value, determined in the manner set forth in the related indenture covering the Convertible Notes, of the number of shares of common stock equal to the conversion rate. If the conversion value exceeds \$1,000, we will also deliver, at our election, cash, common stock or a combination of cash and common stock with respect to the remaining value deliverable upon conversion.

In the event of a conversion due to a change of control on or before April 6, 2011, we will pay, to the extent described in the indenture, a make-whole premium by increasing the conversion rate applicable to such Convertible Notes. In addition, we will pay contingent interest in cash, commencing with any six-month period from April 1 to September 30 and from October 1 to March 31, beginning on April 1, 2011, if the average trading price of a Convertible Note for the five trading days ending on the third trading day immediately preceding the first day of that six-month period equals 120% or more of the principal amount of the Convertible Note.

On or after April 6, 2011, we may redeem the Convertible Notes, in whole at any time or in part from time to time, for cash at a redemption price of 100% of the principal amount of the Convertible Notes to be redeemed, plus any accrued and unpaid interest to the applicable redemption date. Holders of the Convertible Notes may require us to purchase all or a portion of their Convertible Notes for cash on each of April 1, 2011, April 1, 2016 or April 1, 2021 at a purchase price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus accrued and unpaid interest, if any, to the applicable purchase date.

***9.625% Senior Subordinated Notes***

In March 2007, we redeemed our outstanding \$300.0 million aggregate principal amount of 9.625% senior subordinated notes due 2012 (the 9.625% Notes ). The 9.625% Notes were unsecured senior subordinated notes and

were subordinate to all existing senior debt, including debt under our credit agreements and floor plan indebtedness. We incurred an \$18.6 million pre-tax charge in connection with the redemption, consisting of a \$14.4 million redemption premium and the write-off of \$4.2 million of unamortized deferred financing costs.

## **Table of Contents**

### ***Interest Rate Swaps***

The Company is party to interest rate swap agreements through January 7, 2011 pursuant to which the LIBOR portion of \$300,000 of the Company's floating rate floor plan debt was fixed at 3.67%. We may terminate this arrangement at any time subject to the settlement at that time of the fair value of the swap arrangement. The swaps are designated as cash flow hedges of future interest payments of LIBOR based U.S. floor plan borrowings. During the three months ended March 31, 2008, the swaps had an immaterial impact on the weighted average interest rate on floor plan borrowings. As of March 31, 2008, the Company expects approximately \$3.8 million associated with the swaps to be recognized as an increase of interest expense over the next twelve months.

The Company was party to an interest rate swap agreement through January 2008, pursuant to which a notional \$200,000 of its U.S. floating rate debt was exchanged for fixed rate debt. The swap was designated as a cash flow hedge of future interest payments of the LIBOR based U.S. floor plan borrowings.

### ***Other Financing Arrangements***

We have in the past and expect in the future to enter into significant sale-leaseback transactions to finance certain property acquisitions and capital expenditures, pursuant to which we sell property and/or leasehold improvements to third-parties and agree to lease those assets back for a certain period of time. Such sales generate proceeds which vary from period to period.

### ***Off-Balance Sheet Arrangements 3.5% Convertible Senior Subordinated Notes due 2026***

The Convertible Notes are convertible into shares of our common stock, at the option of the holder, based on certain conditions described above. Certain of these conditions are linked to the market value of our common stock. This type of financing arrangement was selected by us in order to achieve a more favorable interest rate (as opposed to other forms of available financing). Since we or the holders of the Convertible Notes can redeem these notes on April 2011, a conversion or a redemption of these notes is likely to occur in 2011. Such redemption conversion will include cash for the principal amount of the Convertible Notes then outstanding plus an amount payable in either cash or stock, at our option, depending on the trading price of our common stock.

### ***Cash Flows***

Cash and cash equivalents increased by \$8.7 million and \$12.1 million during the three months ended March 31, 2008 and 2007, respectively. The major components of these changes are discussed below.

### ***Cash Flows from Continuing Operating Activities***

Cash provided by continuing operating activities was \$38.0 million and \$108.4 million during the three months ended March 31, 2008 and 2007, respectively. Cash flows from operating activities include net income, as adjusted for non-cash items, and the effects of changes in working capital.

We finance substantially all of our new and a portion of our used vehicle inventories under revolving floor plan notes payable with various lenders. In accordance with SFAS No. 95, Statement of Cash Flows, we report all cash flows arising in connection with floor plan notes payable with the manufacturer of a particular new vehicle as an operating activity in our statement of cash flows and all cash flows arising in connection with floor plan notes payable to a party other than the manufacturer of a particular new vehicle and all floor plan notes payable relating to pre-owned vehicles as a financing activity in our statement of cash flows.

**Table of Contents**

We believe that changes in aggregate floor plan liabilities are typically linked to changes in vehicle inventory and, therefore, are an integral part of understanding changes in our working capital and operating cash flow. As a result, we have presented the following reconciliation of cash flow from operating activities as reported in our condensed consolidated statement of cash flows as if all changes in vehicle floor plan were classified as an operating activity for informational purposes:

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Net cash from operating activities as reported	\$ 38,043	\$ 108,395
Floor plan notes payable non-trade as reported	25,767	166,143
Net cash from operating activities including all floor plan notes payable	\$ 63,810	\$ 274,538

***Cash Flows from Continuing Investing Activities***

Cash used in continuing investing activities was \$46.9 million and \$12.1 million during the three months ended March 31, 2008 and 2007, respectively. Cash flows from investing activities consist primarily of cash used for capital expenditures, proceeds from sale-leaseback transactions and net expenditures for dealership acquisitions. Capital expenditures were \$49.1 million and \$37.2 million during the three months ended March 31, 2008 and 2007, respectively. Capital expenditures relate primarily to improvements to our existing dealership facilities and the construction of new facilities. Proceeds from sale-leaseback transactions were \$3.7 million and \$23.6 million during the three months ended March 31, 2008 and 2007, respectively. Cash used in business acquisitions, net of cash acquired, was \$1.5 million and \$7.3 million during the three months ended March 31, 2008 and 2007, respectively, and included cash used to repay sellers floor plan liabilities in such business acquisitions of \$5.6 million during the three months ended March 31, 2007. We used \$1.5 million for other investing activities during the three months ended March 31, 2008. The three months ended March 31, 2007 included \$8.8 million of proceeds of other investing activities.

***Cash Flows from Continuing Financing Activities***

Cash provided by continuing financing activities was \$17.0 million during the three months ended March 31, 2008 and cash used by continuing financing activities was \$158.3 million during the three months ended March 31, 2007. Cash flows from financing activities include net borrowings or repayments of long-term debt, net borrowings or repayments of floor plan notes payable non-trade, payments of deferred financing costs, proceeds from the issuance of common stock, including proceeds from the exercise of stock options, repurchases of common stock and dividends. We had net repayments of long-term debt of \$0.2 million and \$318.2 million during the three months ended March 31, 2008 and 2007, respectively. The repayments in the three months ended March 31, 2007 included \$14.4 million of premium paid on the redemption of our 9.625% Senior Subordinated Notes. We had net borrowings of floor plan notes payable non-trade of \$25.8 million and \$166.1 million during the three months ended March 31, 2008 and 2007, respectively. During the three months ended March 31, 2007 we received proceeds of \$0.3 million from the issuance of common stock. During the three months ended March 31, 2008 and 2007, we paid \$8.6 million and \$6.6 million, respectively, of cash dividends to our stockholders.

***Cash Flows from Discontinued Operations***

Cash flows relating to discontinued operations are not currently considered, nor are they expected to become material to our liquidity or our capital resources. Management does not believe that there is any significant past, present or future cash transactions relating to discontinued operations.

***Commitments***

We are party to a joint venture with respect to our Honda of Mentor dealership in Ohio. We are required to repurchase our partner's interest in this joint venture in July 2008. We expect this payment to be approximately \$4.7 million.





**Table of Contents**

**Related Party Transactions**

***Stockholders Agreement***

Several of our directors and officers are affiliated with Penske Corporation or related entities. Roger S. Penske, our Chairman of the Board and Chief Executive Officer, is also Chairman of the Board and Chief Executive Officer of Penske Corporation, and through entities affiliated with Penske Corporation, our largest stockholder owning approximately 40% of our outstanding common stock. Mitsui & Co., Ltd. and Mitsui & Co. (USA), Inc. (collectively, Mitsui ) own approximately 16% of our outstanding common stock. Mitsui, Penske Corporation and certain other affiliates of Penske Corporation are parties to a stockholders agreement pursuant to which the Penske affiliated companies agreed to vote their shares for one director who is a representative of Mitsui. In turn, Mitsui agreed to vote their shares for up to fourteen directors voted for by the Penske affiliated companies. This agreement terminates in March 2014, upon the mutual consent of the parties or when either party no longer owns any of our common stock.

***Other Related Party Interests and Transactions***

Roger S. Penske is also a managing member of Penske Capital Partners and Transportation Resource Partners, each organizations that undertake investments in transportation-related industries. Richard J. Peters, one of our directors, is a managing director of Transportation Resource Partners and is a director of Penske Corporation. Eustace W. Mita and Lucio A. Noto (two of our directors) are investors in Transportation Resource Partners. One of our directors, Hiroshi Ishikawa, serves as our Executive Vice President International Business Development and serves in a similar capacity for Penske Corporation. Robert H. Kurnick, Jr., our President and a director, is also the President and a director of Penske Corporation.

We are currently a tenant under a number of non-cancelable lease agreements with Automotive Group Realty, LLC and its subsidiaries (together AGR ), which are subsidiaries of Penske Corporation. From time to time, we may sell AGR real property and improvements that are subsequently leased by AGR to us. In addition, we may purchase real property or improvements from AGR. Each of these transactions is valued at a price that is independently confirmed. We sometimes pay to and/or receive fees from Penske Corporation and its affiliates for services rendered in the normal course of business, or to reimburse payments made to third parties on each others behalf. These transactions and those relating to AGR mentioned above, are reviewed periodically by our Audit Committee and reflect the provider s cost or an amount mutually agreed upon by both parties.

We and Penske Corporation have entered into a joint insurance agreement which provides that, with respect to our joint insurance policies (which includes our property policy), available coverage with respect to a loss shall be paid to each party as stipulated in the policies. In the event of losses by us and Penske Corporation that exceed the limit of liability for any policy or policy period, the total policy proceeds shall be allocated based on the ratio of premiums paid.

We have entered into joint ventures with certain related parties as more fully discussed below.

**Table of Contents****Joint Venture Relationships**

From time to time, we enter into joint venture relationships in the ordinary course of business, through which we acquire automotive dealerships together with other investors. We may provide these dealerships with working capital and other debt financing at costs that are based on our incremental borrowing rate. As of March 31, 2008, our automotive joint venture relationships were as follows:

<b>Location</b>	<b>Dealerships</b>	<b>Ownership Interest</b>
Fairfield, Connecticut	Audi, Mercedes-Benz, Porsche, smart	90.00 %(A)(B)
Edison, New Jersey	Ferrari, Maserati	70.00 %(B)
Tysons Corner, Virginia	Aston Martin, Audi, Mercedes-Benz, Porsche, smart	90.00 %(B)(C)
Las Vegas, Nevada	Ferrari, Maserati	50.00 %(D)
Mentor, Ohio	Honda	75.00 %(B)
Munich, Germany	BMW, MINI	50.00 %(D)
Frankfurt, Germany	Lexus, Toyota	50.00 %(D)
Aachen, Germany	Audi, Lexus, Toyota, Volkswagen	50.00 %(D)
Mexico	Toyota	48.70 %(D)
Mexico	Toyota	45.00 %(D)

(A) An entity controlled by one of our directors, Lucio A. Noto (the Investor ), owns a 10% interest in this joint venture, which entitles the Investor to 20% of the joint venture s operating profits. In addition, the Investor has an option to purchase up to a 20% interest in the joint venture for specified amounts

(B) Entity is consolidated in our financial statements

(C)

Roger S.  
Penske, Jr.  
owned a 10%  
interest in this  
joint venture  
through his  
departure from  
the company on  
March 31, 2008.  
The Company  
purchased this  
interest from  
Mr. Penske on  
April 28, 2008.  
See Item 5:  
Other  
Information.

- (D) Entity is  
accounted for  
using the equity  
method of  
accounting

**Cyclicality**

Unit sales of motor vehicles, particularly new vehicles, historically have been cyclical, fluctuating with general economic cycles. During economic downturns, the automotive retailing industry tends to experience periods of decline and recession similar to those experienced by the general economy. We believe that the industry is influenced by general economic conditions and particularly by consumer confidence, the level of personal discretionary spending, fuel prices, interest rates and credit availability.

**Seasonality**

Our business is modestly seasonal overall. Our U.S. operations generally experience higher volumes of vehicle sales in the second and third quarters of each year due in part to consumer buying trends and the introduction of new vehicle models. Also, vehicle demand, and to a lesser extent demand for service and parts, is generally lower during the winter months than in other seasons, particularly in regions of the United States where dealerships may be subject to severe winters. Our U.K. operations generally experience higher volumes of vehicle sales in the first and third quarters of each year, due primarily to vehicle registration practices in the U.K.

**Effects of Inflation**

We believe that inflation rates over the last few years have not had a significant impact on revenues or profitability. We do not expect inflation to have any near-term material effects on the sale of our products and services, however, we cannot be sure there will be no such effect in the future. We finance substantially all of our inventory through various revolving floor plan arrangements with interest rates that vary based on various benchmarks. Such rates have historically increased during periods of increasing inflation.

**Table of Contents**

**Forward Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements which generally can be identified by the use of terms such as may, will, should, expect, anticipate, believe, intend, plan, estimate, predict, continue or variations of such terms, or the use of these terms in the negative. Forward-looking statements include statements regarding our current plans, forecasts, estimates, beliefs or expectations, including, without limitation, statements with respect to:

our future financial performance;

future acquisitions;

future capital expenditures and share repurchases;

our ability to obtain cost savings and synergies;

our ability to respond to economic cycles;

trends in the automotive retail industry and in the general economy in the various countries in which we operate dealerships;

our ability to access the remaining availability under our credit agreements;

our liquidity;

interest rates;

trends affecting our future financial condition or results of operations; and

our business strategy.

Forward-looking statements involve known and unknown risks and uncertainties and are not assurances of future performance. Actual results may differ materially from anticipated results due to a variety of factors, including the factors identified in our 2007 annual report on Form 10-K filed February 26, 2008. Important factors that could cause actual results to differ materially from our expectations include the following:

the ability of automobile manufacturers to exercise significant control over our operations, since we depend on them in order to operate our business;

because we depend on the success and popularity of the brands we sell, adverse conditions affecting one or more automobile manufacturers may negatively impact our revenues and profitability;

we may not be able to satisfy our capital requirements for acquisitions, dealership renovation projects or financing the purchase of our inventory;

our failure to meet a manufacturer's consumer satisfaction requirements may adversely affect our ability to acquire new dealerships, our ability to obtain incentive payments from manufacturers and our profitability;

our business and the automotive retail industry in general are susceptible to adverse economic conditions, including changes in interest rates, consumer confidence, fuel prices and credit availability;

substantial competition in automotive sales and services may adversely affect our profitability;



**Table of Contents**

if we lose key personnel, especially our Chief Executive Officer, or are unable to attract additional qualified personnel, our business could be adversely affected;

because most customers finance the cost of purchasing a vehicle, increased interest rates in the U.S. or the U.K. may adversely affect our vehicle sales;

our business may be adversely affected by import product restrictions and foreign trade risks that may impair our ability to sell foreign vehicles profitably;

our automobile dealerships are subject to substantial regulation which may adversely affect our profitability;

if state dealer laws in the United States are repealed or weakened, our automotive dealerships may be subject to increased competition and may be more susceptible to termination, non-renewal or renegotiation of their franchise agreements;

our U.K. dealerships are not afforded the same legal franchise protections as those in the U.S. so we could be subject to addition competition from other local dealerships in the U.K.;

our smart distribution operations represents a new line of business for us whose profitability is unproven;

our automotive dealerships are subject to environmental regulations that may result in claims and liabilities;

our dealership operations may be affected by severe weather or other periodic business interruptions;

our principal stockholders have substantial influence over us and may make decisions with which other stockholders may disagree;

some of our directors and officers may have conflicts of interest with respect to certain related party transactions and other business interests;

our level of indebtedness may limit our ability to obtain financing for acquisitions and may require that a significant portion of our cash flow be used for debt service;

we may be involved in legal proceedings that could have a material adverse effect on our business;

our operations outside of the United States subject our profitability to fluctuations relating to changes in foreign currency valuations; and

we are a holding company and, as a result, must rely on the receipt of payments from our subsidiaries, which are subject to limitations, in order to meet our cash needs and service our indebtedness.

In addition:

the price of our common stock is subject to substantial fluctuation, which may be unrelated to our performance; and

shares eligible for future sale, or issuable under the terms of our convertible notes, may cause the market price of our common stock to drop significantly, even if our business is doing well.

We urge you to carefully consider these risk factors in evaluating all forward-looking statements regarding our business. Readers of this report are cautioned not to place undue reliance on the forward-looking statements contained in this report. All forward-looking statements attributable to us are qualified in their entirety by this cautionary

statement. Except to the extent required by the federal securities laws and Securities and Exchange Commission rules and regulations, we have no intention or obligation to update publicly any forward-looking statements whether as a result of new information, future events or otherwise.



**Table of Contents**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest Rates.* We are exposed to market risk from changes in the interest rates on a significant portion of our outstanding debt. Outstanding revolving balances under our credit agreements bear interest at variable rates based on a margin over defined benchmarks. Based on the amount outstanding as of March 31, 2008, a 100 basis point change in interest rates would result in an approximate \$0.5 million change to our annual interest expense. Similarly, amounts outstanding under floor plan financing arrangements bear interest at a variable rate based on a margin over defined benchmarks. Based on an average of the aggregate amounts outstanding under our floor plan financing arrangements subject to variable interest payments during the trailing twelve months ended March 31, 2008, a 100 basis point change in interest rates would result in an approximate \$12.9 million change to our annual interest expense.

We continually evaluate our exposure to interest rate fluctuations and follow established policies and procedures to implement strategies designed to manage the amount of variable rate indebtedness outstanding at any point in time in an effort to mitigate the effect of interest rate fluctuations on our earnings and cash flows. We are currently party to swap agreements pursuant to which a notional \$300.0 million of our floating rate floor plan debt was exchanged for fixed rate debt through January 2011.

Interest rate fluctuations affect the fair market value of our swaps and fixed rate debt, including the 7.75% Notes, the Convertible Notes and certain seller financed promissory notes, but, with respect to such fixed rate debt instruments, do not impact our earnings or cash flows.

*Foreign Currency Exchange Rates.* As of March 31, 2008, we have dealership operations in the U.K. and Germany. In each of these markets, the local currency is the functional currency. Due to our intent to remain permanently invested in these foreign markets, we do not hedge against foreign currency fluctuations. In the event we change our intent with respect to the investment in any of our international operations, we would expect to implement strategies designed to manage those risks in an effort to mitigate the effect of foreign currency fluctuations on our earnings and cash flows. A ten percent change in average exchange rates versus the U.S. Dollar would have resulted in an approximate \$126.7 million change to our revenues for the three months ended March 31, 2008.

In common with other automotive retailers, we purchase certain of our new vehicle and parts inventories from foreign manufacturers. Although we purchase the majority of our inventories in the local functional currency, our business is subject to certain risks, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions and foreign exchange rate volatility which may influence such manufacturers' ability to provide their products at competitive prices in the local jurisdictions. Our future results could be materially and adversely impacted by changes in these or other factors.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of our management, including the principal executive and financial officers, we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this report. Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our principal executive and financial officers, to allow timely discussions regarding required disclosure.

Based upon this evaluation, the Company's principal executive and financial officers concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report. In addition, we maintain internal controls designed to provide us with the information required for accounting and financial reporting purposes. There were no changes in our internal control over financial reporting that occurred during our first quarter of 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1. *Legal Proceedings***

From time to time, we are involved in litigation relating to claims arising in the normal course of business. Such claims may relate to litigation with customers, employment related lawsuits, class action lawsuits, purported class action lawsuits and actions brought by governmental authorities. As of March 31, 2008, we are not a 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 our 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 our results of operations, financial condition or cash flows.

**Item 5. *Other Information***

We have entered into a new license agreement with an affiliate of Penske Corporation for a license of the Penske Automotive name, which agreement replaces our prior license to use the Penske name at certain of our dealerships. The license agreement is filed as exhibit 10.1 to this quarterly report on Form 10-Q, and incorporated into this Item 5. This agreement provides us with a perpetual license of Penske Automotive and related trade names so long as Penske Corporation and its affiliates own in excess of 20% of our outstanding stock and we adhere to the other terms of the license agreement. On April 28, 2008, we purchased the remaining 10% of the HBL, LLC that was previously owned by Roger S. Penske, Jr., our former President. HBL, LLC is the corporate entity which owns our Audi, Aston Martin, Mercedes-Benz, Porsche and smart franchises in Tysons Corner, Virginia. Each of these transactions was approved by the disinterested members of our Board of Directors, which, in the case of the HBL purchase, included review by an independent committee of our Board of Directors.

**Table of Contents**

**Item 6. Exhibits**

- 4.1 Amended and Restated Supplemental Indenture regarding our 3.5% senior subordinated convertible notes due 2026 dated as of May 6, 2008, among us, as Issuer, and certain of our domestic subsidiaries, as Guarantors, and The Bank of New York Trust Company, N.A., as trustee.
- 4.2 Amended and Restated Supplemental Indenture regarding 7.75% Senior Subordinated Notes due 2016 dated May 6, 2008, among us, as Issuer, and certain of our domestic subsidiaries, as Guarantors, and Bank of New York Trust Company, N.A., as trustee.
- 10 Trade Name and Trademark Agreement dated May 6, 2008 between us and Penske System, Inc.
- 12 Computation of Ratio of Earnings to Fixed Charges
- 31 Rule 13a-14(a)/15(d)-14(a) Certifications
- 32 Section 1350 Certifications

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PENSKE AUTOMOTIVE GROUP, INC.

Date: May 8, 2008

By: /s/ Roger S. Penske  
Roger S. Penske  
*Chief Executive Officer*

Date: May 8, 2008

By: /s/ Robert T. O Shaughnessy  
Robert T. O Shaughnessy  
*Chief Financial Officer*

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
4.1	Amended and Restated Supplemental Indenture regarding our 3.5% senior subordinated convertible notes due 2026 dated as of May 6, 2008, among us, as Issuer, and certain of our domestic subsidiaries, as Guarantors, and The Bank of New York Trust Company, N.A., as trustee.
4.2	Amended and Restated Supplemental Indenture regarding 7.75% Senior Subordinated Notes due 2016 dated May 6, 2008, among us, as Issuer, and certain of our domestic subsidiaries, as Guarantors, and Bank of New York Trust Company, N.A., as trustee.
10	Trade Name and Trademark Agreement dated May 6, 2008 between us and Penske System, Inc.
12	Computation of Ratio of Earnings to Fixed Charges
31	Rule 13a-14(a)/15(d)-14(a) Certifications
32	Section 1350 Certifications