PENSKE AUTOMOTIVE GROUP, INC.
Form 10-Q
November 02, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from to

Commission file number 1-12297

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

As of October 24, 2012, there were 90,264,514 shares of voting common stock outstanding.

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PENSKE AUTOMOTIVE GROUP, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

	September 30, 2012	December 31, 2011
	(Unaudited) (In thousands, except per share amounts)	
ASSETS		
Cash and cash equivalents	$ 25,935	$ 28,676
Accounts receivable, net of allowance for doubtful accounts of $2,672 and $2,159	505,770	438,769
Inventories	1,864,773	1,572,568
Other current assets	91,204	80,179
Assets held for sale	38,005	81,122
Total current assets	2,525,687	2,201,314
Property and equipment, net	961,488	856,674
Goodwill	952,848	903,721
Franchise value	258,111	228,460
Equity method investments	304,101	298,640
Other long-term assets	21,945	13,490
Total assets	$ 5,024,180	$ 4,502,299
LIABILITIES AND EQUITY		
Floor plan notes payable	$ 1,254,895	$ 977,548
Floor plan notes payable non-trade	704,280	691,888
Accounts payable	275,032	220,538
Accrued expenses	259,146	201,179
Current portion of long-term debt	14,929	3,414
Liabilities held for sale	34,124	55,820
Total current liabilities	2,542,406	2,150,387
Long-term debt	815,918	846,777
Deferred tax liabilities	231,999	217,902
Other long-term liabilities	165,466	146,820
Total liabilities	3,755,789	3,361,886
Commitments and contingent liabilities		
Equity		
Penske Automotive Group stockholders equity:		
Preferred Stock, $0.0001 par value; 100 shares authorized; none issued and outstanding		
Common Stock, $0.0001 par value, 240,000 shares authorized; 90,265 shares issued and outstanding at September 30, 2012; 90,277 shares issued and outstanding at December 31, 2011	9	9
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	698,489	702,335
Retained earnings	566,556	459,375
Accumulated other comprehensive loss	(8,200)	(25,734)

Total Penske Automotive Group stockholders equity		1,256,854		1,135,985
Non-controlling interest		11,537		4,428
Total equity		1,268,391		1,140,413
Total liabilities and equity	$	5,024,180	$	4,502,299

See Notes to Consolidated Condensed Financial Statements

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PENSKE AUTOMOTIVE GROUP, INC.

CONSOLIDATED CONDENSED STATEMENTS OF INCOME

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(Unaudited) (In thousands, except per share amounts)			
Revenue:				
New vehicle	$ 1,763,050	$ 1,451,177	$ 5,066,417	$ 4,229,192
Used vehicle	995,376	867,969	2,926,523	2,511,573
Finance and insurance, net	85,420	73,191	247,906	208,540
Service and parts	372,032	347,432	1,109,122	1,027,120
Fleet and wholesale	185,531	158,672	656,663	490,135
Total revenues	3,401,409	2,898,441	10,006,631	8,466,560
Cost of sales:				
New vehicle	1,626,759	1,327,968	4,659,490	3,877,615
Used vehicle	922,703	802,542	2,701,645	2,310,147
Service and parts	156,942	149,429	465,620	440,392
Fleet and wholesale	184,009	157,739	650,302	484,222
Total cost of sales	2,890,413	2,437,678	8,477,057	7,112,376
Gross profit	510,996	460,763	1,529,574	1,354,184
Selling, general and administrative expenses	409,432	369,783	1,216,231	1,098,132
Depreciation	14,037	12,427	41,013	36,132
Operating income	87,527	78,553	272,330	219,920
Floor plan interest expense	(10,055)	(6,837)	(29,675)	(20,617)
Other interest expense	(11,689)	(11,153)	(35,474)	(32,889)
Debt discount amortization				(1,718)
Equity in earnings of affiliates	8,814	9,623	21,392	17,527
Debt redemption costs	(17,753)		(17,753)	
Income from continuing operations before income taxes	56,844	70,186	210,820	182,223
Income taxes	(15,308)	(13,246)	(69,052)	(49,289)
Income from continuing operations	41,536	56,940	141,768	132,934
Loss from discontinued operations, net of tax	(223)	(895)	(3,837)	(2,833)
Net income	41,313	56,045	137,931	130,101
Less: Income attributable to non-controlling interests	282	338	990	907
Net income attributable to Penske Automotive Group common stockholders	$ 41,031	$ 55,707	$ 136,941	$ 129,194
Basic earnings per share attributable to Penske Automotive Group common stockholders:				
Continuing operations	$ 0.46	$ 0.62	$ 1.56	$ 1.43
Discontinued operations		(0.01)	(0.04)	(0.03)
Net income attributable to Penske Automotive Group common stockholders	$ 0.45	$ 0.61	$ 1.52	$ 1.40
Shares used in determining basic earnings per share	90,264	91,390	90,330	92,106
Diluted earnings per share attributable to Penske Automotive Group common stockholders:				
Continuing operations	$ 0.46	$ 0.62	$ 1.56	$ 1.43

Discontinued operations				(0.01)		(0.04)		(0.03)
Net income attributable to Penske Automotive Group common stockholders	$	0.45	$	0.61	$	1.52	$	1.40
Shares used in determining diluted earnings per share		90,296		91,431		90,362		92,169
Amounts attributable to Penske Automotive Group common stockholders:								
Income from continuing operations	$	41,536	$	56,940	$	141,768	$	132,934
Less: Income attributable to non-controlling interests		282		338		990		907
Income from continuing operations, net of tax		41,254		56,602		140,778		132,027
Loss from discontinued operations, net of tax		(223)		(895)		(3,837)		(2,833)
Net income attributable to Penske Automotive Group common stockholders	$	41,031	$	55,707	$	136,941	$	129,194

See Notes to Consolidated Condensed Financial Statements

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PENSKE AUTOMOTIVE GROUP, INC.

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(Unaudited) (In thousands, except per share amounts)			
Net Income	$ 41,313	$ 56,045	$ 137,931	$ 130,101
Other Comprehensive Income:				
Foreign currency translation adjustment	16,707	(20,904)	15,224	(1,170)
Unrealized gain (loss) on interest rate swaps:				
Unrealized gain(loss) arising during the period, net of tax benefit of $590, $3,519, $2,114, and $5,995, respectively	(903)	(5,379)	(3,232)	(9,163)
Reclassification adjustment for loss included in floor plan interest expense, net of tax provision of $705, $0, $2,066, and $46, respectively	1,078		3,158	70
Unrealized gain (loss) on interest rate swaps, net of tax	175	(5,379)	(74)	(9,093)
Other adjustments to Comprehensive Income, net	1,066	456	2,608	(519)
Other Comprehensive Income (Loss), Net of Taxes	17,948	(25,827)	17,758	(10,782)
Comprehensive Income	59,261	30,218	155,689	119,319
Less: Comprehensive income attributable to non-controlling interest	489	338	1,197	907
Comprehensive income attributable to Penske Automotive Group common stockholders	$ 58,772	$ 29,880	$ 154,492	$ 118,412

See Notes to Consolidated Condensed Financial Statements

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PENSKE AUTOMOTIVE GROUP, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(Unaudited) (In thousands)	
Operating Activities:		
Net income	$ 137,931	$ 130,101
Adjustments to reconcile net income to net cash from continuing operating activities:		
Depreciation	41,013	36,132
Debt discount amortization		1,718
Earnings of equity method investments	(16,796)	(17,527)
Loss from discontinued operations, net of tax	3,837	2,833
Debt redemption costs	17,753	
Deferred income taxes	14,867	14,801
Changes in operating assets and liabilities:		
Accounts receivable	(36,412)	918
Inventories	(193,658)	34,757
Floor plan notes payable	258,337	(14,774)
Accounts payable and accrued expenses	45,986	15,193
Other	(8,246)	(24,042)
Net cash from continuing operating activities	264,612	180,110
Investing Activities:		
Purchase of equipment and improvements	(96,447)	(79,770)
Proceeds from sale-leaseback transactions	1,584	
Dealership acquisitions net, including repayment of sellers floor plan notes payable of $49,467 and $54,453, respectively	(137,805)	(232,106)
Other	3,496	2,865
Net cash from continuing investing activities	(229,172)	(309,011)
Financing Activities:		
Proceeds from borrowings under U.S. credit agreement revolving credit line	525,800	494,500
Repayments under U.S. credit agreement revolving credit line	(657,800)	(374,500)
Issuance of 5.75% senior subordinated notes	550,000	
Repurchase of 7.75% senior subordinated notes	(390,755)	
Repurchase of 3.5% senior subordinated convertible notes	(62,687)	(87,278)
Net borrowings (repayments) of other long-term debt	(1,913)	31,807
Net borrowings of floor plan notes payable non-trade	29,681	98,131
Repurchases of common stock	(9,829)	(44,263)
Dividends	(29,760)	(13,866)
Payment of deferred financing fees	(8,502)	
Proceeds from exercises of options, including excess tax benefit		3,018
Net cash from continuing financing activities	(55,765)	107,549
Discontinued operations:		
Net cash from discontinued operating activities	(6,852)	(39,383)
Net cash from discontinued investing activities	34,620	47,549
Net cash from discontinued financing activities	(10,184)	3,181
Net cash from discontinued operations	17,584	11,347
Net change in cash and cash equivalents	(2,741)	(10,005)
Cash and cash equivalents, beginning of period	28,676	19,904
Cash and cash equivalents, end of period	$ 25,935	$ 9,899

Supplemental disclosures of cash flow information:				
Cash paid for:				
Interest	$	64,340	$	47,004
Income taxes		35,232		38,664
Seller financed/assumed debt				4,865

See Notes to Consolidated Condensed Financial Statements

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PENSKE AUTOMOTIVE GROUP, INC.

CONSOLIDATED CONDENSED STATEMENT OF EQUITY

	Common Stock Issued Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Penske Automotive Group Stockholders Equity	Non-controlling Interest	Total Equity
	(Unaudited) (Dollars in thousands)							
Balance, January 1, 2012	90,277,356	$ 9	$ 702,335	$ 459,375	$ (25,734)	$ 1,135,985	$ 4,428	$ 1,140,413
Equity compensation	392,789		5,102			5,102		5,102
Distributions to non-controlling interests							(1,319)	(1,319)
Sale of subsidiary shares to non-controlling interest			317			317	7,231	7,548
Foreign currency translation					15,017	15,017	207	15,224
Repurchase of common stock	(405,631)		(9,829)			(9,829)		(9,829)
Dividends				(29,760)		(29,760)		(29,760)
Convertible debt redemption			564			564		564
Other					2,517	2,517		2,517
Net income				136,941		136,941	990	137,931
Balance, September 30, 2012	90,264,514	$ 9	$ 698,489	$ 566,556	$ (8,200)	$ 1,256,854	$ 11,537	$ 1,268,391

See Notes to Consolidated Condensed Financial Statements

PENSKE AUTOMOTIVE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except per share amounts)

1. Interim Financial Statements

Business Overview

Unless the context otherwise requires, the use of the terms PAG, we, us, and our in these Notes to the Consolidated Condensed Financial Statements refers to Penske Automotive Group, Inc. and its consolidated subsidiaries.

We are the second largest automotive retailer headquartered in the U.S. as measured by total revenue. As of September 30, 2012, we operated 342 retail franchises, of which 169 franchises are located in the U.S. and 173 franchises are located outside of the U.S. The franchises outside the U.S. are located primarily in the U.K. 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. We also hold a 9.0% limited partnership interest in Penske Truck Leasing Co., L.P. (PTL), a leading provider of transportation services and supply chain management.

During the nine months ended September 30, 2012, we acquired the Agnew Group in the United Kingdom, representing fourteen franchises, and seven other franchises. We also were awarded seven franchises representing seven different brands, including Mini of Marin (California) and Nissan and Infiniti San Francisco. We disposed of seven franchises representing seven different brands, including Jaguar and Land Rover in Gatwick (U.K.), and Scottsdale Lexus.

In the third quarter of 2012, we signed an agreement with Hertz System, Inc. to join Hertz s franchise network in the Memphis, Tennessee market. In October 2012, we purchased the assets of Hertz s Memphis market, which provides us the opportunity to operate airport and off-airport rental locations in that area.

Basis of Presentation

The accompanying unaudited consolidated condensed financial statements of PAG have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and disclosures normally included in our annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the SEC rules and regulations. The information presented as of September 30, 2012 and December 31, 2011 and for the three and nine month periods ended September 30, 2012 and 2011 is unaudited, but includes all adjustments which our management 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 September 30, 2012, and the results for 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 our audited financial statements for the year ended December 31, 2011, which are included as part of our Annual Report on Form 10-K.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued ASU No. 2011-04, Fair Value Measurements and Disclosures (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU No. 2011-04 clarifies the application of existing fair value measurement and disclosure requirements, changes certain principles related to measuring fair value, and requires additional disclosures about fair value measurements. ASU No. 2011-04 is effective for periods beginning after December 15, 2011. We adopted the standard on January 1, 2012. Adoption of ASU No. 2011-04 did not affect our consolidated financial position, results of operations, or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income , which requires the presentation of components of other comprehensive income with the components of net income. We adopted the standard on January 1, 2012. Adoption of ASU No. 2011-05 did not affect our consolidated financial position, results of operations, or cash flows.

In December 2011, the FASB issued ASU No. 2011-11, Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. ASU No. 2011-11 will require disclosure of the effect or potential effect of offsetting arrangements on our financial position as well as enhanced disclosure of the rights of setoff associated with our recognized assets and recognized liabilities. ASU No. 2011-11 is effective for periods beginning on or after January 1, 2013. Since these amended principles

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require only additional disclosures concerning offsetting and related arrangements, adoption will not affect our consolidated financial position, results of operations, or cash flows.

In July 2012, the FASB issued ASU No. 2012-02, Intangibles Goodwill and Other (Topic 350) Testing Indefinite-Lived Intangible Assets for Impairment. In accordance with the amendments in ASU No. 2012-02, we have the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, we conclude that it is not more likely than not that the indefinite-lived intangible asset is impaired, we are not required to take further action. We will adopt ASU No. 2012-02 during the fourth quarter of 2012 when our annual indefinite-lived intangible asset impairment assessment is performed. We do not expect adoption of ASU No. 2012-02 to affect our consolidated financial position, results of operations, or cash flows.

Discontinued Operations

We account for dispositions in our retail operations as discontinued operations when it is evident that the operations and cash flows of a franchise being disposed will be eliminated from on-going operations and that we will not have any significant continuing involvement in its operations.

In evaluating whether the cash flows of a dealership in our Retail reportable segment will be eliminated from ongoing operations, we consider whether it is likely that customers will migrate to similar franchises that we own in the same geographic market. Our consideration includes an evaluation of the brands sold at other dealerships we operate in the market and their proximity to the disposed dealership. When we dispose of franchises, we typically do not have continuing brand representation in that market. If the franchise being disposed of is located in a complex of PAG owned dealerships, we do not treat the disposition as a discontinued operation if we believe that the cash flows previously generated by the disposed franchise will be replaced by expanded operations of the remaining or replacement franchises.

Combined financial information regarding entities accounted for as discontinued operations follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Revenues	$ 42,002	$ 114,129	$ 141,031	$ 388,871
Pre-tax loss	(393)	(1,411)	(12,581)	(6,207)
Gain on disposal	285	250	10,445	2,016

	September 30, 2012	December 31, 2011
Inventories	$ 28,436	$ 48,203
Other assets	9,569	32,919
Total assets	$ 38,005	$ 81,122
Floor plan notes payable (including non-trade)	$ 27,898	$ 44,869
Other liabilities	6,226	10,951

Total liabilities	$	34,124	$	55,820

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.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt, floor plan notes payable, and interest rate swaps used to hedge future cash flows. Other than our subordinated notes, the carrying amount of all significant financial instruments approximates fair value due either to length of maturity, the existence of variable interest rates that approximate prevailing market rates, or as a result of mark to market accounting.

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PENSKE AUTOMOTIVE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

2. Inventories

Inventories consisted of the following:

	September 30, 2012	December 31, 2011
New vehicles	$ 1,299,364	$ 1,051,120
Used vehicles	479,460	441,655
Parts, accessories and other	85,949	79,793
Total inventories	$ 1,864,773	$ 1,572,568

We receive credits from certain vehicle manufacturers that reduce cost of sales when the vehicles are sold. Such credits amounted to $23,190 and $20,967 during the nine months ended September 30, 2012 and 2011, respectively.

3. Business Combinations

We acquired twenty-one and three franchises during the nine months ended September 30, 2012 and 2011, respectively, in our retail operations. Our financial statements include the results of operations of the acquired dealerships from the date of acquisition. The fair value of the assets acquired and liabilities assumed have been recorded in our consolidated condensed financial statements, and may be subject to adjustment pending completion of final valuation. A summary of the aggregate consideration paid and the aggregate amounts of the assets acquired and liabilities assumed for the nine months ended September 30, 2012 and 2011 follows:

	September 30,	
	2012	2011
Accounts receivable	$ 28,907	$ 953
Inventory	94,627	61,247
Other current assets	411	
Property and equipment	34,261	40,190
Goodwill	35,343	107,498
Franchise Value	26,343	29,491
Other non-current assets	745	