

PENSKE AUTOMOTIVE GROUP, INC.

Form 10-Q

November 05, 2008

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**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 September 30, 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:

*(Do not check if a 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 October 22, 2008, there were 91,882,607 shares of voting common stock outstanding.

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

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except per share amounts)</b>	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 27,772	\$ 13,267
Accounts receivable, net of allowance for doubtful accounts of \$2,314 and \$2,917	371,557	447,717
Inventories, net	1,721,833	1,680,062
Other current assets	80,689	65,756
Assets held for sale	7,496	90,987
Total current assets	2,209,347	2,297,789
Property and equipment, net	701,480	617,707
Goodwill	1,444,061	1,430,431
Franchise value	246,941	237,732
Other assets	327,853	84,894
Total assets	\$ 4,929,682	\$ 4,668,553
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Floor plan notes payable	\$ 1,077,639	\$ 1,069,710
Floor plan notes payable non-trade	537,095	476,028
Accounts payable	233,496	266,251
Accrued expenses	239,663	211,588
Current portion of long-term debt	13,444	14,522
Liabilities held for sale	11,419	57,940
Total current liabilities	2,112,756	2,096,039
Long-term debt	1,073,878	830,106
Other long-term liabilities	351,392	320,949
Total liabilities	3,538,026	3,247,094
Commitments and contingent liabilities		
<b>Stockholders Equity</b>		
Preferred Stock, \$0.0001 par value; 100 shares authorized; none issued and outstanding		

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Common Stock, \$0.0001 par value, 240,000 shares authorized; 91,878 shares issued at September 30, 2008; 95,020 shares issued at December 31, 2007	9	10
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	690,711	733,895
Retained earnings	659,942	587,566
Accumulated other comprehensive income	40,994	99,988
Total stockholders' equity	1,391,656	1,421,459
Total liabilities and stockholders' equity	\$ 4,929,682	\$ 4,668,553

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,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Unaudited)			
	(In thousands, except per share amounts)			
Revenue:				
New vehicle	\$ 1,556,198	\$ 1,882,971	\$ 4,922,718	\$ 5,318,796
Used vehicle	721,075	785,598	2,339,925	2,387,664
Finance and insurance, net	68,135	78,400	218,474	221,130
Service and parts	363,067	355,348	1,088,277	1,055,177
Distribution	85,567		247,758	
Fleet and wholesale vehicle	202,401	283,538	735,028	838,918
 Total revenues	 2,996,443	 3,385,855	 9,552,180	 9,821,685
 Cost of sales:				
New vehicle	1,428,921	1,723,615	4,512,354	4,871,488
Used vehicle	668,443	723,137	2,159,328	2,200,786
Service and parts	161,252	157,734	479,678	466,327
Distribution	72,362		208,585	
Fleet and wholesale vehicle	204,352	281,877	738,132	831,021
 Total cost of sales	 2,535,330	 2,886,363	 8,098,077	 8,369,622
 Gross profit	 461,113	 499,492	 1,454,103	 1,452,063
Selling, general and administrative expenses	384,533	390,523	1,179,670	1,143,756
Depreciation and amortization	14,133	12,556	41,125	37,657
 Operating income	 62,447	 96,413	 233,308	 270,650
Floor plan interest expense	(15,557)	(19,235)	(49,378)	(54,206)
Other interest expense	(16,358)	(12,409)	(40,962)	(44,053)
Equity in earnings of affiliates	8,995	1,475	13,322	3,183
Loss on debt redemption				(18,634)
 Income from continuing operations before income taxes and minority interests	 39,527	 66,244	 156,290	 156,940
Income taxes	(14,190)	(22,814)	(55,632)	(55,746)
Minority interests	(189)	(531)	(1,052)	(1,527)
 Income from continuing operations	 25,148	 42,899	 99,606	 99,667
(Loss) income from discontinued operations, net of tax	(932)	501	(1,597)	(1,330)
 Net income	 \$ 24,216	 \$ 43,400	 \$ 98,009	 \$ 98,337

**Basic earnings per share:**

Continuing operations	\$ 0.27	\$ 0.46	\$ 1.06	\$ 1.06
Discontinued operations	(0.01)	0.01	(0.02)	(0.01)
Net income	0.26	0.46	1.04	1.05
Shares used in determining basic earnings per share	92,995	94,244	93,943	94,037

**Diluted earnings per share:**

Continuing operations	\$ 0.27	\$ 0.45	\$ 1.06	\$ 1.05
Discontinued operations	(0.01)	0.01	(0.02)	(0.01)
Net income	0.26	0.46	1.04	1.04
Shares used in determining diluted earnings per share	93,134	94,614	94,215	94,512
Cash dividends per share	\$ 0.09	\$ 0.07	\$ 0.27	\$ 0.21

See Notes to Consolidated Condensed Financial Statements

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<b>Operating Activities:</b>		
Net income	\$ 98,009	\$ 98,337
Adjustments to reconcile net income to net cash from continuing operating activities:		
Depreciation and amortization	41,125	37,657
Undistributed earnings of equity method investments	(13,322)	(3,183)
Loss from discontinued operations, net of tax	1,597	1,330
Deferred income taxes	14,464	11,323
Loss on debt redemption		18,634
Minority interests	1,052	1,527
Changes in operating assets and liabilities:		
Accounts receivable	70,286	(28,201)
Inventories	26,790	(30,856)
Floor plan notes payable	102,257	196,947
Accounts payable and accrued expenses	(28,550)	54,524
Other	44,536	(20,436)
Net cash from continuing operating activities	358,244	337,603
<b>Investing Activities:</b>		
Purchase of equipment and improvements	(165,370)	(114,609)
Proceeds from sale-leaseback transactions	19,740	105,730
Dealership acquisitions net, including repayment of sellers' floor plan notes payable of \$30,711 and \$48,518, respectively	(142,054)	(154,873)
Purchase of Penske Truck Leasing Co., L.P. partnership interest	(219,000)	
Other	(1,500)	15,518
Net cash from continuing investing activities	(508,184)	(148,234)
<b>Financing Activities:</b>		
Proceeds from borrowings under U.S. revolving credit line	493,400	341,400
Repayments under U.S. revolving credit line	(493,400)	(341,400)
Redemption 9 5/8% Senior Subordinated debt		(314,439)
Proceeds from U.S. credit agreement term loan	219,000	
Proceeds from mortgage facility	32,875	
Net repayments of other long-term debt	(13,909)	(78,646)
Net (repayments) borrowings of floor plan notes payable - non-trade	(33,261)	143,468
Payment of deferred financing costs	(661)	
Proceeds from exercises of options, including excess tax benefit	820	2,517
Repurchases of common stock	(50,061)	
Dividends	(25,633)	(19,898)



Net cash from continuing financing activities	129,170	(266,998)
Discontinued operations:		
Net cash from discontinued operating activities	(584)	19,841
Net cash from discontinued investing activities	64,678	34,395
Net cash from discontinued financing activities	(28,819)	34,251
Net cash from discontinued operations	35,275	88,487
Net change in cash and cash equivalents	14,505	10,858
Cash and cash equivalents, beginning of period	13,267	17,045
Cash and cash equivalents, end of period	\$ 27,772	\$ 27,903
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for:		
Interest	\$ 85,085	\$ 97,228
Income taxes	4,574	16,781
Seller financed debt	4,728	4,953

See Notes to Consolidated Condensed Financial Statements

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

	Common Stock Issued Shares	Amount	Additional Paid-In Capital	Retained Earnings (Unaudited)	Accumulated Other Comprehensive Income	Total Stockholders Equity
				(Dollars in thousands)		
Balances, January 1, 2008	95,019,763	\$ 10	\$ 733,895	\$ 587,566	\$ 99,988	\$ 1,421,459
Equity compensation	363,313		6,056			6,056
Dividends				(25,633)		(25,633)
Share repurchase	(3,565,143)	(1)	(50,060)			(50,061)
Exercise of stock options, including tax benefit of \$253	60,336		820			820
Foreign currency translation					(57,187)	(57,187)
Other					(1,807)	(1,807)
Net income				98,009		98,009
Balances, September 30, 2008	91,878,269	\$ 9	\$ 690,711	\$ 659,942	\$ 40,994	\$ 1,391,656

See Notes to Consolidated Condensed Financial Statements

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**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 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, 2008 and December 31, 2007 and for the three and nine month periods ended September 30, 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 September 30, 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.

On June 26, 2008, we acquired a 9% limited partnership interest in Penske Truck Leasing Co., L.P., a leading global transportation services provider, in exchange for \$219 million. PTL operates and maintains more than 200,000 vehicles and serves customers in North America, South America, Europe and Asia. Product lines include full-service leasing, contract maintenance, commercial and consumer truck rental and logistics services, including transportation and distribution center management and supply chain management.

***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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues	\$ 18,113	\$ 139,377	\$ 184,794	\$ 460,056
Pre-tax (loss) income	(845)	764	(4,498)	930
(Loss) Gain on disposal	(560)	5	(794)	(2,808)
			<b>September 30, 2008</b>	<b>December 31, 2007</b>
Inventories			\$ 6,365	\$ 55,726
Other assets			1,131	35,261

Total assets	\$	7,496	\$	90,987
Floor plan notes payable (trade and non-trade)	\$	6,403	\$	44,715
Other liabilities		5,016		13,225
Total Liabilities	\$	11,419	\$	57,940

**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 have 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 by us without substantial cost; and

The Company's history shows that manufacturers have not terminated our franchise agreements. The following is a summary of the changes in the carrying amount of goodwill and franchise value for the nine months ended September 30, 2008:

	<b>Goodwill</b>	<b>Franchise Value</b>
Balances January 1, 2008	\$ 1,430,431	\$ 237,732
Additions during period	56,852	20,164
Deletions during period	(356)	(1,754)
Foreign currency translation	(42,866)	(9,201)
Balances September 30, 2008	\$ 1,444,061	\$ 246,941

As of September 30, 2008, approximately \$789,664 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 were adopted as of January 1, 2008. SFAS 157 thus becomes effective for the Company's non-financial assets and liabilities on January 1, 2009. The Company continues to evaluate the impact of this pronouncement on our non-financial assets and liabilities, including but not limited to, the valuation of our reporting units for the purpose of assessing goodwill impairment, the valuation of our franchise agreements in connection with assessing franchise value impairments, the valuation of property and equipment in connection with assessing long-lived asset impairment, the valuation of liabilities in connection with exit or disposal activities, and the valuation of assets acquired and liabilities assumed in business combinations.

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. The Company did not elect the fair value option with respect to any of its current financial assets or financial liabilities when the provisions of this statement became effective on January 1, 2008. As a result, there was no impact upon adoption.

SFAS No. 141(R) *Business Combinations* requires almost all assets acquired and liabilities assumed in business combinations 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 situations in which the fair value of assets and liabilities acquired exceeds the consideration. SFAS 141(R) will be effective for the Company 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 the Company on January 1, 2009 and will require the Company to reclassify its 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 the Company on January 1, 2009. This pronouncement will have no impact on the Company's accounting, and the Company is currently evaluating the pronouncements additional disclosure requirements.

FASB Staff Position ( FSP ) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* requires the issuer of a convertible debt instrument that may be settled in cash upon conversion, including partial cash settlement, to separately account for the debt and equity components of the instrument. The value to be ascribed to the debt portion of the instrument is determined using a fair value methodology, with the residual representing the equity component. The equity component will be recorded as an increase in stockholders equity, with the debt discount being amortized as additional interest expense over the expected life of the instrument. FSP APB 14-1 will be effective for our fiscal year beginning January 1, 2009, and requires retrospective application to all periods presented. The Company will apply this guidance to the accounting for its 3.5% Senior Subordinated Convertible Notes due 2026 (the Notes ), which the Company issued in January 2006. It is expected that the Company will assign approximately \$70 million to the equity component as of the Notes issuance date. In addition, interest expense will be restated for all periods presented, with an increase of approximately \$15 million expected for the year ended December 31, 2009. Due to the prepayment features included within the Notes, the recording of incremental interest expense will be completed in April 2011.



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Inventories consisted of the following:

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
New vehicles	\$ 1,311,223	\$ 1,219,308
Used vehicles	324,384	377,318
Parts, accessories and other	86,226	83,436
Total inventories	\$ 1,721,833	\$ 1,680,062

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 \$20,950 and \$24,162 during the nine months ended September 30, 2008 and 2007, respectively.

**3. Business Combinations**

The Company acquired eight and nine franchises during the nine months ended September 30, 2008 and 2007, respectively. 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 nine months ended September 30, 2008 and 2007 follows:

	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
Accounts receivable	\$ 4,845	\$ 11,908
Inventory	68,561	48,308
Other current assets	1,043	465
Property and equipment	3,918	5,034
Goodwill	56,852	44,895
Franchise value	20,164	47,672
Other non-current assets		3,424
Current liabilities	(13,329)	(6,833)
Cash used in dealership acquisitions	\$ 142,054	\$ 154,873

The following unaudited consolidated pro forma results of operations of the Company for the three and nine months ended September 30, 2008 and 2007 give effect to acquisitions consummated during 2008 and 2007 as if they had occurred on January 1, 2007.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues	\$ 2,996,443	\$ 3,544,340	\$ 9,734,903	\$ 10,426,906
Income from continuing operations	25,148	42,702	100,940	102,525
Net income	24,216	43,203	99,343	101,195
	\$ 0.27	\$ 0.45	\$ 1.07	\$ 1.08



Income from continuing operations per  
diluted common share

Earnings per diluted common share	\$	0.26	\$	0.46	\$	1.05	\$	1.07
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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 used 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 and nine months ended September 30, 2008 and 2007 follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Weighted average shares outstanding	92,995	94,244	93,943	94,037
Effect of stock options	64	156	98	210
Effect of restricted stock	75	214	174	265
Weighted average shares outstanding, including effect of dilutive securities	93,134	94,614	94,215	94,512

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 September 30, 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:

	September 30, 2008	December 31, 2007
U.S. credit agreement revolving credit line	\$	\$
U.S. credit agreement term loan	219,000	
U.K. credit agreement	82,511	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
Mortgage facilities	32,875	

Other	2,936	3,363
Total long-term debt	1,087,322	844,628
Less: current portion	(13,444)	(14,522)
Net long-term debt	\$ 1,073,878	\$ 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 \$479,000 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 in revolving loans for working capital, acquisitions, capital expenditures, investments and for other general corporate purposes, a \$219,000 non-amortizing term loan and for an additional \$10,000 of availability for letters of credit, through September 30, 2010. Pursuant to the evergreen provisions of the credit agreement, the term of the credit agreement was extended on September 10, 2008, by one year through September 30, 2011. The revolving loans bear interest at defined LIBOR plus 1.75%, subject to an incremental 0.50% for uncollateralized borrowings in excess of a defined borrowing base. The term loan, which bears interest at defined LIBOR plus 2.50%, may be prepaid at any time, but then may not be reborrowed. On September 29, 2008, the Company amended the U.S. Credit Agreement to provide greater flexibility to enter into the mortgage facility referenced below under Mortgage Facilities. On October 30, 2008, the Company amended and restated the U.S. Credit Agreement (the Amended U.S. Credit Agreement) to incorporate the prior six amendments, eliminate the ratio of domestic debt to domestic earnings before interest, taxes, depreciation and amortization (EBITDA) covenant and the minimum stockholders' equity covenant, change the financial ratio on the debt to EBITDA covenant from 2.75 to 2.5, provide for additional flexibility for incremental real estate mortgage borrowings, and make other changes designed to provide additional operating flexibility.

The Amended 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 Amended 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 and a ratio of debt to EBITDA. 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 September 30, 2008, the Company was in compliance with all covenants under the U.S. Credit Agreement.

The Amended 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 Amended U.S. Credit Agreement. As of September 30, 2008, \$219,000 of term loans and \$500 of letters of credit were outstanding under this facility. No revolving loans were outstanding as of September 30, 2008.

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

On September 29, 2008, the Company's subsidiaries in the U.K. (the U.K. Subsidiaries) amended their existing £130,000 multi-option credit agreement with the Royal Bank of Scotland plc, as agent for National Westminster Bank plc, to provide greater flexibility within the financial covenants and increase the borrowing rate paid under the facility. This facility consists of a funded term loan, a revolving 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 amended U.K. Credit Agreement provides for (1) up to £80,000 in revolving loans through August 31, 2011, which bears interest between defined LIBOR plus 1.0% and defined LIBOR plus 1.6%, (2) a £30,000 funded term loan which currently bears interest between 6.29% and 6.89% and is payable ratably in quarterly intervals until fully repaid on June 30, 2011, and (3) a seasonally adjusted overdraft line of credit for up to £20,000 that bears interest at the Bank of England Base Rate plus 1.75%, and matures on August 31, 2011.

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

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 September 30, 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 September 30, 2008, outstanding loans under the U.K. Credit Agreement amounted to £46,412 (\$82,511).

***7.75% Senior Subordinated Notes***

On December 7, 2006, the Company issued \$375,000 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 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 September 30, 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, as discussed below. The Convertible Notes are unsecured senior subordinated obligations and are subordinate to all future and existing debt under the Company's credit agreements and floor plan indebtedness. The convertible notes 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 September 30, 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.

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

In the event of a change of control on or before April 6, 2011, the Company will, in certain circumstances, pay a make-whole premium by increasing the conversion rate used in that conversion. In addition, the Company will pay additional cash interest, commencing with six-month periods beginning on April 1, 2011, if the average trading price of a Convertible Note for certain periods in the prior six-month period equals 120% or more of the principal amount of the Convertible Notes.

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.

***Mortgage Facilities***

On September 29, 2008, the Company entered into a \$42,400, seven year mortgage facility with Toyota Motor Credit Corporation with respect to certain of our dealership properties. The facility bears interest at a defined rate, requires monthly principal and interest payments, and includes the option to extend the term for successive periods of five years up to a maximum term of twenty-five years. In the event the Company exercises its option to extend the term, the interest rate will be renegotiated for each renewal period.

The mortgage facility contains typical events of default, including non-payment of obligations, cross-defaults to the Company's other material indebtedness, certain change of control events, and loss or sale of certain franchises operated at the property. Substantially all of the buildings, improvements, fixtures and personal property of the properties under the mortgage facility are subject to security interests granted to the lender. As of September 30, 2008, \$32,900 was outstanding under the mortgage facility. The Company expects to draw the remainder of the facility upon the completion of the dealership facilities and other funding requirements.

***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*****Share Repurchase***

In 2007, the Company's board of directors approved a stock repurchase program for up to \$150,000 of outstanding common stock. During August, 2008, the Company repurchased 3.6 million shares of our outstanding common stock for \$50,061, or \$14.04 per share.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 24,216	\$ 43,400	\$ 98,009	\$ 98,337
Other comprehensive income				
Foreign currency translation	(62,953)	16,673	(57,187)	26,882
Other	(886)	100	(1,807)	567
Comprehensive income	\$ (39,623)	\$ 60,173	\$ 39,015	\$ 125,786

**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 of the then current 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 nine months ended September 30, 2008, the swaps increased the weighted average interest rate on floor plan borrowings by approximately 0.1%. As of September 30, 2008, the Company used Level 2 inputs as described under SFAS 157 to estimate the fair value of these contracts to be a \$2,666 liability, and expects approximately \$1,733 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 which expired in 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.

**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 September 30, 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 was party to a joint venture agreement with respect to one of the Company's franchises pursuant to which the Company was required to repurchase its partner's interest. The Company completed this repurchase on July 23, 2008 with a payment of \$5.1 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.

**Three Months Ended September 30**

	<b>Retail</b>	<b>Distribution</b>	<b>Intersegment Elimination</b>	<b>Total</b>
Revenues -				
2008	\$ 2,910,876	\$ 101,125	\$ (15,558)	\$ 2,996,443
2007	3,385,855			3,385,855
Adjusted segment income -				
2008	\$ 31,794	\$ 7,736	\$ (3)	\$ 39,527
2007	66,244			66,244

**Nine Months Ended September 30**

	<b>Retail</b>	<b>Distribution</b>	<b>Intersegment Elimination</b>	<b>Total</b>
Revenues -				
2008	\$ 9,304,422	\$ 293,486	\$ (45,728)	\$ 9,552,180
2007	9,821,685			9,821,685
Adjusted segment income -				
2008	\$ 134,881	\$ 21,990	\$ (581)	\$ 156,290
2007	175,574			175,574

The following table reconciles total adjusted segment income to consolidated income from continuing operations before income taxes and minority interests for the nine month period ended September 30. There are no reconciling items in the three month period ended September 30.

	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Total adjusted segment income	\$ 156,290	\$ 175,574
Loss on debt redemption		(18,634)
	\$ 156,290	\$ 156,940

Income from continuing operations before income taxes and minority interests

**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 September 30, 2008 and December 31, 2007 and for the three and nine month periods ended September 30, 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 consolidating condensed financial statements have been restated for an immaterial error relating to the presentation of long-term debt.

**CONSOLIDATING CONDENSED BALANCE SHEET**  
**September 30, 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	\$ 27,772	\$	\$	\$ 18,406	\$ 9,366
Accounts receivable, net	371,557	(197,270)	197,270	188,095	183,462
Inventories, net	1,721,833			964,242	757,591
Other current assets	80,689		6,868	33,440	40,381
Assets held for sale	7,496			278	7,218
Total current assets	2,209,347	(197,270)	204,138	1,204,461	998,018
Property and equipment, net	701,480		6,993	414,120	280,367
Intangible assets	1,691,002			1,183,334	507,668
Other assets	327,853	(1,918,612)	2,154,302	19,519	72,644
Total assets	\$ 4,929,682	\$ (2,115,882)	\$ 2,365,433	\$ 2,821,434	\$ 1,858,697
Floor plan notes payable	\$ 1,077,639	\$	\$	\$ 542,367	\$ 535,272
Floor plan notes payable non-trade	537,095			317,670	219,425
Accounts payable	233,496		2,534	88,656	142,306
Accrued expenses	239,663	(197,270)	2,243	113,531	321,159
Current portion of long-term debt	13,444			868	12,576
Liabilities held for sale	11,419			858	10,561
Total current liabilities	2,112,756	(197,270)	4,777	1,063,950	1,241,299
Long-term debt	1,073,878	(155,355)	969,000	34,883	225,350
Other long-term liabilities	351,392			332,867	18,525

Total liabilities	3,538,026	(352,625)	973,777	1,431,700	1,485,174
Total stockholders equity	1,391,656	(1,763,257)	1,391,656	1,389,734	373,523
 Total liabilities and stockholders equity	 \$ 4,929,682	 \$ (2,115,882)	 \$ 2,365,433	 \$ 2,821,434	 \$ 1,858,697

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**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	\$ 13,267	\$	\$	\$	\$ 13,267
Accounts receivable, net	447,717	(210,645)	210,945	289,939	157,478
Inventories, net	1,680,062			924,632	755,430
Other current assets	65,756		3,849	27,959	33,948
Assets held for sale	90,987			61,265	29,722
<b>Total current assets</b>	<b>2,297,789</b>	<b>(210,645)</b>	<b>214,794</b>	<b>1,303,795</b>	<b>989,845</b>
Property and equipment, net	617,707		4,617	345,087	268,003
Intangible assets	1,668,163			1,076,611	591,552
Other assets	84,894	(1,951,050)	1,956,788	12,395	66,761
<b>Total assets</b>	<b>\$ 4,668,553</b>	<b>\$ (2,161,695)</b>	<b>\$ 2,176,199</b>	<b>\$ 2,737,888</b>	<b>\$ 1,916,161</b>
Floor plan notes payable	\$ 1,069,710	\$	\$	\$ 569,259	\$ 500,451
Floor plan notes payable non-trade	476,028			293,270	182,758
Accounts payable	266,251		4,550	96,563	165,138
Accrued expenses	211,588	(210,645)	190	64,036	358,007
Current portion of long-term debt	14,522			496	14,026
Liabilities held for sale	57,940			34,113	23,827
<b>Total current liabilities</b>	<b>2,096,039</b>	<b>(210,645)</b>	<b>4,740</b>	<b>1,057,737</b>	<b>1,244,207</b>
Long-term debt	830,106	(237,616)	750,000	2,548	315,174
Other long-term liabilities	320,949			288,647	32,302
<b>Total liabilities</b>	<b>3,247,094</b>	<b>(448,261)</b>	<b>754,740</b>	<b>1,348,932</b>	<b>1,591,683</b>
Total stockholders' equity	1,421,459	(1,713,434)	1,421,459	1,388,956	324,478
<b>Total liabilities and stockholders' equity</b>	<b>\$ 4,668,553</b>	<b>\$ (2,161,695)</b>	<b>\$ 2,176,199</b>	<b>\$ 2,737,888</b>	<b>\$ 1,916,161</b>



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**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF INCOME**  
**Three Months Ended September 30, 2008**

	<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	\$ 2,996,443	\$	\$	\$ 1,795,138	\$ 1,201,305
Cost of sales	2,535,330			1,504,276	1,031,054
Gross profit	461,113			290,862	170,251
Selling, general, and administrative expenses	384,533		12,503	229,134	142,896
Depreciation and amortization	14,133		290	8,418	5,425
Operating income (loss)	62,447		(12,793)	53,310	21,930
Floor plan interest expense	(15,557)			(8,875)	(6,682)
Other interest expense	(16,358)		(11,959)	(35)	(4,364)
Equity in income of affiliates	8,995		7,853		1,142
Equity in earnings of subsidiaries		(56,237)	56,237		
Income from continuing operations before income taxes and minority interests	39,527	(56,237)	39,338	44,400	12,026
Income taxes	(14,190)	20,286	(14,190)	(16,666)	(3,620)
Minority interests	(189)				(189)
Income from continuing operations	25,148	(35,951)	25,148	27,734	8,217
(Loss) from discontinued operations, net of tax	(932)	932	(932)	(694)	(238)
Net income	\$ 24,216	\$ (35,019)	\$ 24,216	\$ 27,040	\$ 7,979

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**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF INCOME**  
**Three Months Ended September 30, 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	\$ 3,385,855	\$	\$	\$ 1,905,593	\$ 1,480,262
Cost of sales	2,886,363			1,615,373	1,270,990
Gross profit	499,492			290,220	209,272
Selling, general, and administrative expenses	390,523		4,269	228,475	157,779
Depreciation and amortization	12,556		40	6,896	5,620
Operating income (loss)	96,413		(4,309)	54,849	45,873
Floor plan interest expense	(19,235)			(11,590)	(7,645)
Other interest expense	(12,409)		(6,293)	(49)	(6,067)
Equity in income of affiliates	1,475				1,475
Equity in earnings of subsidiaries		(76,315)	76,315		
Income from continuing operations before income taxes and minority interests	66,244	(76,315)	65,713	43,210	33,636
Income taxes	(22,814)	25,947	(22,814)	(15,570)	(10,377)
Minority interests	(531)				(531)
Income from continuing operations	42,899	(50,368)	42,899	27,640	22,728
Income from discontinued operations, net of tax	501	(501)	501	244	257
Net income	\$ 43,400	\$ (50,869)	\$ 43,400	\$ 27,884	\$ 22,985



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**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF INCOME**  
**Nine Months Ended September 30, 2008**

	<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	\$ 9,552,180	\$	\$	\$ 5,512,491	\$ 4,039,689
Cost of sales	8,098,077			4,635,514	3,462,563
Gross profit	1,454,103			876,977	577,126
Selling, general, and administrative expenses	1,179,670		19,276	708,042	452,352
Depreciation and amortization	41,125		943	23,292	16,890
Operating income (loss)	233,308		(20,219)	145,643	107,884
Floor plan interest expense	(49,378)			(28,023)	(21,355)
Other interest expense	(40,962)		(27,507)	(180)	(13,275)
Equity in income of affiliates	13,322		7,853		5,469
Equity in earnings of subsidiaries		(195,111)	195,111		
Income from continuing operations before income taxes and minority interests	156,290	(195,111)	155,238	117,440	78,723
Income taxes	(55,632)	69,921	(55,632)	(46,404)	(23,517)
Minority interests	(1,052)				(1,052)
Income from continuing operations	99,606	(125,190)	99,606	71,036	54,154
(Loss) income from discontinued operations, net of tax	(1,597)	1,597	(1,597)	(1,829)	232
Net income	\$ 98,009	\$ (123,593)	\$ 98,009	\$ 69,207	\$ 54,386

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**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF INCOME**  
**Nine Months Ended September 30, 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	\$ 9,821,685	\$	\$	\$ 5,470,704	\$ 4,350,981
Cost of sales	8,369,622			4,627,148	3,742,474
Gross profit	1,452,063			843,556	608,507
Selling, general, and administrative expenses	1,143,756		12,341	668,884	462,531
Depreciation and amortization	37,657		774	20,336	16,547
Operating income (loss)	270,650		(13,115)	154,336	129,429
Floor plan interest expense	(54,206)			(31,915)	(22,291)
Other interest expense	(44,053)		(25,086)	(60)	(18,907)
Equity in income of affiliates	3,183				3,183
Loss on debt redemption	(18,634)		(18,634)		
Equity in earnings of subsidiaries		(211,796)	211,796		
Income from continuing operations before income taxes and minority interests	156,940	(211,796)	154,961	122,361	91,414
Income taxes	(55,746)	72,011	(55,294)	(43,755)	(28,708)
Minority interests	(1,527)				(1,527)
Income from continuing operations	99,667	(139,785)	99,667	78,606	61,179
(Loss) income from discontinued operations, net of tax	(1,330)	1,330	(1,330)	(2,372)	1,042
Net income	\$ 98,337	\$ (138,455)	\$ 98,337	\$ 76,234	\$ 62,221



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**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**  
**Nine Months Ended September 30, 2008**

	<b>Total Company</b>	<b>Penske Automotive Group, Inc.</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>
	<b>(In thousands)</b>			
Net cash from continuing operating activities	\$ 358,244	\$ 3,319	\$ 196,821	\$ 158,104
Investing activities:				
Purchase of property and equipment	(165,370)	(3,319)	(87,352)	(74,699)
Proceeds from sale leaseback transactions	19,740		5,964	13,776
Dealership acquisitions, net	(142,054)		(94,759)	(47,295)
Purchase of Penske Truck Leasing Co., L.P. partnership interest	(219,000)	(219,000)		
Other	(1,500)			(1,500)
Net cash from continuing investing activities	(508,184)	(222,319)	(176,147)	(109,718)
Financing activities:				
Proceeds from U.S. credit agreement term loan	219,000	219,000		
Proceeds from mortgage facility	32,875		32,875	
Net (repayments) borrowings of long-term debt	(13,909)	75,395	(38,801)	(50,503)
Floor plan notes payable non-trade	(33,261)		(18,962)	(14,299)
Payment of deferred financing costs	(661)	(521)		(140)
Proceeds from exercises of options including excess tax benefit	820	820		
Distributions (to) from parent			(306)	306
Repurchases of common stock	(50,061)	(50,061)		
Dividends	(25,633)	(25,633)		
Net cash from continuing financing activities	129,170	219,000	(25,194)	(64,636)
Net cash from discontinued operations	35,275		22,926	12,349
Net change in cash and cash equivalents	14,505		18,406	(3,901)
Cash and cash equivalents, beginning of period	13,267			13,267
Cash and cash equivalents, end of period	\$ 27,772	\$	\$ 18,406	\$ 9,366



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**PENSKE AUTOMOTIVE GROUP, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**  
**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**  
**Nine Months Ended September 30, 2007**

	<b>Total Company</b>	<b>Penske Automotive Group, Inc.</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>
		<b>(In thousands)</b>		
Net cash from continuing operating activities	\$ 337,603	\$ (7,017)	\$ 207,832	\$ 136,788
Investing activities:				
Purchase of property and equipment	(114,609)	(1,747)	(74,652)	(38,210)
Proceeds from sale leaseback transactions	105,730		62,432	43,298
Dealership acquisitions, net	(154,873)		(119,618)	(35,255)
Other	15,518	8,764	(6,048)	12,802
Net cash from continuing investing activities	(148,234)	7,017	(137,886)	(17,365)
Financing activities:				
Net (repayments) borrowings of long-term debt	(78,646)	331,820	(345,665)	(64,801)
Floor plan notes payable non-trade	143,468		171,729	(28,261)
Proceeds from exercises of options including excess tax benefit	2,517	2,517		
Redemption 9 5/8% Senior Subordinated Debt	(314,439)	(314,439)		
Distributions from (to) parent			14,923	(14,923)
Dividends	(19,898)	(19,898)		
Net cash from continuing financing activities	(266,998)		(159,013)	(107,985)
Net cash from discontinued operations	88,487		86,376	2,111
Net change in cash and cash equivalents	10,858		(2,691)	13,549
Cash and cash equivalents, beginning of period	17,045		2,691	14,354
Cash and cash equivalents, end of period	\$ 27,903	\$	\$	\$ 27,903

**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 September 30, 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 September 30, 2008, we owned and operated 160 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 95% 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 64% 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, and the sale of replacement parts and the sale of aftermarket accessories.

We are, through smart USA Distributor, LLC ( smart USA ), 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 as certified by the California Air Resources Board. Though launched in the United States in 2008, more than 1,000,000 fortwo vehicles have previously been sold outside the U.S. smart USA has certified a network of 73 smart dealerships in 35 states, of which eight are owned and operated by us. The smart fortwo currently offers three different versions, the *pure*, *passion coupe* and *passion cabriolet* with base prices ranging from \$11,600 to \$16,600. For the 2009 model year, we will add two additional versions, the *BRABUS coupe* and *BRABUS cabriolet* with expected base prices ranging from \$17,990 to \$21,000. We currently expect to distribute approximately 27,000 smart fortwo vehicles in 2008.

On June 26, 2008, we acquired a 9% limited partnership interest in Penske Truck Leasing Co., L.P. ( PTL ), a leading global transportation services provider, from subsidiaries of General Electric Capital Corporation (collectively, GE Capital ) in exchange for \$219.0 million. PTL operates and maintains more than 200,000 vehicles and serves customers in North America, South America, Europe and Asia. Product lines include full-service leasing, contract maintenance, commercial and consumer truck rental and logistics services, including, transportation and distribution center management and supply chain management. The general partner is Penske Truck Leasing Corporation, a wholly-owned subsidiary of Penske Corporation, which together with other wholly-owned subsidiaries of Penske Corporation, owns 40% of PTL. The remaining 51% of PTL is owned by GE Capital.

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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 166,400 of these warrants during the nine months ended September 30, 2007. The value of Sirius stock was \$0.57 per share on September 30, 2008 and 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 and our rights to exercise any vested warrants expire July 5, 2009. Our gross profit varies 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 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.

Equity in earnings of affiliates represents our share of the earnings from investments in various joint ventures and other non-consolidated investments, notably PTL.

The future success of our business will likely be dependent on, among other things, general economic and industry conditions, our ability to consummate and integrate acquisitions, our ability to increase sales of higher margin products, especially service and parts services, our ability to realize returns on our significant capital investment in new and upgraded dealerships, the success of our distribution of the smart fortwo, and the return realized from our investments in various joint ventures and other non-consolidated investments, notably PTL. 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.





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***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 nine months ended September 30, 2008 and 2007, we earned \$260.4 million and \$261.5 million, respectively, of rebates, incentives and reimbursements from manufacturers, of which \$254.4 million and \$256.4 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 (with specified exceptions) 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 \$19.2 million and \$19.4 million as of September 30, 2008 and December 31, 2007, respectively. Changes in reserve estimates relate primarily to a decrease in the amount of revenues subject to chargeback.

***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 have 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 by us 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.

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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. On June 26, 2008, we acquired the 9% limited partnership interest in PTL for \$219 million.

The net book value of our investments was \$297.6 million and \$64.4 million as of September 30, 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.

***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. 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 \$20.7 million and \$12.8 million as of September 30, 2008 and December 31, 2007. Changes in the reserve estimate during 2008 relate primarily to reserves for current year activity and changes in loss experience in our historical employee medical, general liability and workers compensation programs.

***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 \$2.5 million has been recorded as of September 30, 2008 relating to net operating losses and credit carryforwards in the U.S. based on

our determination that it is more likely than not that they will not be utilized.

**Table of Contents*****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 were 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 this pronouncement on our non-financial assets and liabilities, including but not limited to, the valuation of our reporting units for the purpose of assessing goodwill impairment, the valuation of our franchise agreements in connection with assessing franchise value impairments, the valuation of property and equipment in connection with assessing long-lived asset impairment, the valuation of liabilities in connection with exit or disposal activities, and the valuation of assets acquired and liabilities assumed in business combinations.

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 when the provisions of this statement became effective on January 1, 2008. As a result, there was no impact upon adoption.

SFAS No. 141(R) *Business Combinations* requires almost all assets acquired and liabilities assumed in business combinations 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 situations in which 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. This pronouncement will have no impact on our accounting, and we are currently evaluating the pronouncement's additional disclosure requirements.

FASB Staff Position ( FSP ) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* requires the issuer of a convertible debt instrument that may be settled in cash upon conversion, including partial cash settlement, to separately account for the debt and equity components of the instrument. The value to be ascribed to the debt portion of the instrument is determined using a fair value methodology, with the residual representing the equity component. The equity component will be recorded as an increase in stockholders equity, with the debt discount being amortized as additional interest expense over the expected life of the instrument. FSP APB 14-1 will be effective for our fiscal year beginning January 1, 2009, and requires retrospective application to all periods presented. We will apply this guidance to the accounting for our 3.5%

Senior Subordinated Convertible Notes due 2026 (the Notes ), which we issued in January 2006. We expect to assign approximately \$70 million to the equity component as of the Notes issuance date. In addition, interest expense will be restated for all periods presented, with an increase of approximately \$15 million expected for the year ended December 31, 2009. Due to the prepayment features included within the Notes, the recording of incremental interest expense will be completed in April 2011.

**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 September 30, 2008 Compared to Three Months Ended September 30, 2007 (dollars in millions, except per unit amounts)**

Our results for the three months ended September 30, 2008 include charges of \$4.3 million (\$2.7 million after-tax), or \$0.03 per share, relating to severance costs, costs associated with the termination of an acquisition agreement and insurance deductibles relating to damage sustained in the Houston market during Hurricane Ike.

Our results in the third quarter of 2008 were significantly impacted by a difficult operating environment for the automotive retail industry. We believe declining consumer confidence in the wake of an unstable financial market has resulted in a significant reduction in consumer traffic at our retail locations, particularly in the month of September.

**Total Retail Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
Total retail unit sales	71,827	78,816	(6,989)	(8.9%)
Total same store retail unit sales	68,123	78,438	(10,315)	(13.2%)
Total retail sales revenue	\$ 2,708.5	\$ 3,102.3	\$ (393.8)	(12.7%)
Total same store retail sales revenue	\$ 2,562.7	\$ 3,088.7	\$ (526.0)	(17.0%)
Total retail gross profit	\$ 449.8	\$ 497.9	\$ (48.1)	(9.7%)
Total same store retail gross profit	\$ 427.9	\$ 495.6	\$ (67.7)	(13.7%)
Total retail gross margin	16.6%	16.0%	0.6%	3.8%
Total same store retail gross margin	16.7%	16.0%	0.7%	4.4%

**Units**

Retail data includes retail new vehicle, retail used vehicle, finance and insurance and service and parts transactions. Retail unit sales of vehicles decreased by 6,989 or 8.9%, from 2007 to 2008. The decrease is due to a 10,315, or 13.2%, decrease in same store retail unit sales, offset by 3,326 unit increase from net dealership acquisitions during the period. The decrease in same store retail unit sales was driven primarily by decreases in new retail units sales at our premium brand stores in the U.S. and U.K., volume foreign and domestic brand stores in the U.S. and used retail unit sales at our premium brand stores in the U.K. and volume foreign brand stores in the U.S., which was somewhat offset by increases in used retail unit sales at our premium brand stores in the U.S. We believe these decreases were largely due to reduced consumer traffic resulting from declining consumer confidence brought about by instability in the financial markets in the markets we serve.

**Revenues**

Retail sales revenue decreased \$393.8 million, or 12.7%, from 2007 to 2008. The decrease is due to a \$526.0 million, or 17.0%, decrease in same store revenues, offset by a \$132.2 million increase from net dealership acquisitions. The same store retail revenue decrease is due to (1) the 13.2% decrease in retail unit sales, which decreased revenue by \$375.1 million, (2) a \$3,852, or 12.6%, decrease in average used vehicle revenue per unit, which decreased revenue by \$97.8 million, (3) a \$953, or 2.7%, decrease in average new vehicle revenue per unit, which decreased revenue by \$40.7 million, (4) a \$10.1 million, or 2.9%, decrease in service and parts revenues, and (5) the \$34, or 3.4%, decrease in the average finance and insurance revenue per unit, which decreased revenue by \$2.3 million.



**Table of Contents****Gross Profit**

Retail gross profit decreased \$48.1 million, or 9.7%, from 2007 to 2008. The decrease is due to a \$67.7 million, or 13.7%, decrease in same store retail gross profit, offset by a \$19.6 million increase from net dealership acquisitions. The same store retail gross profit decrease is due to (1) the 13.2% decrease in retail unit sales, which decreased retail gross profit by \$41.2 million, (2) a \$454, or 18.6%, decrease in average gross profit per used vehicle retailed, which decreased retail gross profit by \$11.6 million, (3) a \$204, or 6.8%, decrease in average gross profit per new vehicle retailed, which decreased retail gross profit by \$8.7 million, (4) a \$3.9 million, or 2.0%, decrease in service and parts gross profit, and (5) a \$34, or 3.4%, decrease in average finance and insurance revenue per unit, which decreased retail gross profit by \$2.3 million.

**New Vehicle Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
New retail unit sales	45,416	53,168	(7,752)	(14.6%)
Same store new retail unit sales	42,733	52,923	(10,190)	(19.3%)
New retail sales revenue	\$ 1,556.2	\$ 1,883.0	\$ (326.8)	(17.4%)
Same store new retail sales revenue	\$ 1,473.3	\$ 1,875.0	\$ (401.7)	(21.4%)
New retail sales revenue per unit	\$ 34,265	\$ 35,415	\$ (1,150)	(3.2%)
Same store new retail sales revenue per unit	\$ 34,476	\$ 35,429	\$ (953)	(2.7%)
Gross profit new	\$ 127.3	\$ 159.4	\$ (32.1)	(20.1%)
Same store gross profit new	\$ 119.6	\$ 159.0	\$ (39.4)	(24.8%)
Average gross profit per new vehicle retailed	\$ 2,802	\$ 2,997	\$ (195)	(6.5%)
Same store average gross profit per new vehicle retailed	\$ 2,800	\$ 3,004	\$ (204)	(6.8%)
Gross margin % new	8.2%	8.5%	(0.3%)	(3.5%)
Same store gross margin % new	8.1%	8.5%	(0.4%)	(4.7%)

**Units**

Retail unit sales of new vehicles decreased 7,752 units, or 14.6%, from 2007 to 2008. The decrease is due a 10,190 unit, or 19.3%, decrease in same store retail unit sales during the period, somewhat offset by a 2,438 unit increase from net dealership acquisitions. The same store decrease was due primarily to unit sales decreases in our premium brand stores in the U.S. and U.K. and volume foreign and domestic brand stores in the U.S. We believe these decreases were largely due to reduced consumer traffic resulting from declining consumer confidence brought about by instability in the financial markets in the markets we serve.

**Revenues**

New vehicle retail sales revenue decreased \$326.8 million, or 17.4%, from 2007 to 2008. The decrease is due to a \$401.7 million, or 21.4%, decrease in same store revenues, somewhat offset by a \$74.9 million increase from net dealership acquisitions. The same store revenue decrease is due primarily to the 19.3% decrease in retail unit sales, which reduced revenue by \$361.0 million, coupled with the \$953, or 2.7%, decrease in average selling prices per unit, which decreased revenue by \$40.7 million.

**Gross Profit**

Retail gross profit from new vehicle sales decreased \$32.1 million, or 20.1%, from 2007 to 2008. The decrease is due to a \$39.4 million, or 24.8%, decrease in same store gross profit, somewhat offset by a \$7.3 million increase from net dealership acquisitions. The same store decrease is due primarily to the 19.3% decrease in retail unit sales, which reduced gross profit by \$30.7 million, coupled with the \$204, or 6.8%, decrease in the average gross profit per new vehicle retailed, which decreased gross profit by \$8.7 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	26,411	25,648	763	3.0%
Same store used retail unit sales	25,390	25,515	(125)	(0.5%)
Used retail sales revenue	\$ 721.1	\$ 785.6	\$ (64.5)	(8.2%)
Same store used retail sales revenue	\$ 681.0	\$ 782.7	\$ (101.7)	(13.0%)
Used retail sales revenue per unit	\$ 27,302	\$ 30,630	\$ (3,328)	(10.9%)
Same store used retail sales revenue per unit	\$ 26,823	\$ 30,675	\$ (3,852)	(12.6%)
Gross profit used	\$ 52.6	\$ 62.5	\$ (9.9)	(15.8%)
Same store gross profit used	\$ 50.4	\$ 62.3	\$ (11.9)	(19.1%)
Average gross profit per used vehicle retailed	\$ 1,993	\$ 2,435	\$ (442)	(18.2%)
Same store average gross profit per used vehicle retailed	\$ 1,986	\$ 2,440	\$ (454)	(18.6%)
Gross margin % used	7.3%	8.0%	(0.7%)	(8.8%)
Same store gross margin % used	7.4%	8.0%	(0.6%)	(7.5%)

**Units**

Retail unit sales of used vehicles increased 763 units, or 3.0%, from 2007 to 2008. The increase is due to an 888 unit increase from net dealership acquisitions, somewhat offset by a 125 unit, or 0.5%, decrease in same store retail unit sales. The same store decrease was due primarily to unit sales decreases in our premium brand stores in the U.K. and volume foreign brand stores in the U.S., somewhat offset by increases in unit sales at our premium brand stores in the U.S. We believe these decreases were largely due to reduced consumer traffic resulting from declining consumer confidence brought about by instability in the financial markets in the markets we serve.

**Revenues**

Used vehicle retail sales revenue decreased \$64.5 million, or 8.2%, from 2007 to 2008. The decrease is due to a \$101.7 million, or 13.0%, decrease in same store revenues, somewhat offset by a \$37.2 million increase from net dealership acquisitions. The same store revenue decrease is due to the \$3,852, or 12.6% decrease in comparative average selling prices per vehicle, which decreased revenue by \$97.8 million, coupled with the 0.5% decrease in same store retail unit sales which decreased revenue by \$3.9 million.

**Gross Profit**

Retail gross profit from used vehicle sales decreased \$9.9 million, or 15.8%, from 2007 to 2008. The decrease is due to a \$11.9 million, or 19.1%, decrease in same store gross profit, somewhat offset by a \$2.0 million increase from net dealership acquisitions. The decrease in same store gross profit is due to the \$454, or 18.6%, decrease in average gross profit per used vehicle retailed which decreased retail gross profit by \$11.6 million, coupled with the 0.5% decrease in used retail unit sales, which decreased gross profit by \$0.3 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	\$ 68.1	\$ 78.4	\$ (10.3)	(13.1%)
Same store finance and insurance revenue	\$ 65.6	\$ 78.1	\$ (12.5)	(16.0%)
Finance and insurance revenue per unit	\$ 949	\$ 995	\$ (46)	(4.6%)
Same store finance and insurance revenue per unit	\$ 962	\$ 996	\$ (34)	(3.4%)

Finance and insurance revenue decreased \$10.3 million, or 13.1%, from 2007 to 2008. The decrease is due to a \$12.5 million, or 16.0%, decrease in same store revenues during the period, somewhat offset by a \$2.2 million increase from net dealership acquisitions. The same store revenue decrease is due to the 13.2% decrease in retail unit sales which decreased revenue by \$10.2 million, coupled with a \$34, or 3.4%, decrease in comparative average finance and insurance revenue per unit which decreased revenue by \$2.3 million. We believe these decreases were

largely due to reduced consumer traffic resulting from declining consumer confidence brought about by instability in the financial markets in the markets we serve.

**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	\$ 363.1	\$ 355.3	\$ 7.8	2.2%
Same store service and parts revenue	\$ 342.8	\$ 352.9	\$ (10.1)	(2.9%)
Gross profit	\$ 201.8	\$ 197.6	\$ 4.2	2.1%
Same store gross profit	\$ 192.3	\$ 196.2	\$ (3.9)	(2.0%)
Gross margin	55.6%	55.6%	0.0%	0.0%
Same store gross margin	56.1%	55.6%	0.5%	0.9%

**Revenues**

Service and parts revenue increased \$7.8 million, or 2.2%, from 2007 to 2008. The increase is due to a \$17.9 million increase from net dealership acquisitions during the period, somewhat offset by a \$10.1, or 2.9%, decrease in same store revenues. 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, but are being affected in the short term due to the economic uncertainty in the markets in which we operate.

**Gross Profit**

Service and parts gross profit increased \$4.2 million, or 2.1%, from 2007 to 2008. The increase is due to an \$8.1 million increase from net dealership acquisitions during the period, somewhat offset by a \$3.9, or 2.0%, decrease in same store gross profit. The same store gross profit decrease is due to the \$10.1 million, or 2.9%, decrease in same store revenues, which decreased gross profit by \$5.6 million, somewhat offset by a 50 basis point increase in gross margin, which increased gross profit by \$1.7 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 three months ended September 30, 2008 aggregated to \$101.1 million. Segment gross profit totaled \$13.2 million, which includes gross profit on vehicle and parts sales.

**Selling, General and Administrative**

Selling, general and administrative expenses ( SG&A ) decreased \$6.0 million, or 1.5%, from \$390.5 million to \$384.5 million. The aggregate decrease is primarily due to a \$26.5 million, or 6.8%, decrease in same store SG&A, somewhat offset by a \$20.5 million increase from net dealership acquisition SG&A. The decrease in same store SG&A is due to a net decrease in variable selling expenses, including decreases in variable compensation as a result of the 13.7% decrease in same store retail gross profit versus the prior year, somewhat offset by additional costs associated with the smart distribution business, increased rent and other costs relating to our ongoing facility improvement and expansion programs, and charges totaling \$4.3 million related to severance, termination of an acquisition agreement, and hurricane damage in the Houston market during Hurricane Ike. The severance charges relate to a 4.3% reduction in worldwide staffing levels. SG&A expenses increased as a percentage of gross profit from 78.2% to 83.4%.

**Depreciation and Amortization**

Depreciation and amortization increased \$1.5 million, or 12.6%, from \$12.6 million to \$14.1 million. The increase is due to a \$0.7 million, or 5.9%, increase in same store depreciation and amortization, coupled with an \$0.8 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 decreased \$3.6 million, or 19.1%, from \$19.2 million to \$15.6 million. The decrease is due to a \$4.5 million, or 23.4%, decrease in same store floor plan interest expense, somewhat offset by a \$0.9 million increase from net dealership acquisitions. The same store decrease is due in large part to decreases in the underlying variable rates of our revolving floor plan arrangements, somewhat offset by increases in our average amounts

outstanding.

**Table of Contents****Other Interest Expense**

Other interest expense increased \$4.0 million, or 31.8%, from \$12.4 million to \$16.4 million. The increase is due primarily to an increase in our average total outstanding indebtedness in 2008 versus 2007, somewhat offset by decreases in our weighted average interest rate. The increase in our outstanding indebtedness is due primarily to our investment in PTL in June 2008.

**Equity in Income of Affiliates**

Equity in income of affiliates increased \$7.5 million, from \$1.5 million to \$9.0 million. The increase from 2007 to 2008 is largely due to our investment in PTL.

**Income Taxes**

Income taxes decreased \$8.6 million, or 37.8%, from \$22.8 million to \$14.2 million. The decrease from 2007 to 2008 is due to the decrease in our pre-tax income versus the prior year, somewhat offset by an increase in our overall effective income tax rate.

***Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007 (dollars in millions, except per unit amounts)***

Our results for the nine months ended September 30, 2008 include charges of \$4.3 million (\$2.7 million after-tax), or \$0.03 per share relating to severance costs, costs associated with the termination of an acquisition agreement and insurance deductibles relating to damage sustained in the Houston market during Hurricane Ike. Our results for the nine months ended September 30, 2007 include a charge of \$18.6 million (\$12.3 million after-tax), or \$0.13 per share, relating to the redemption of our \$300.0 million aggregate principal amount of 9.625% Senior Subordinated Notes at a price of 104.813% in March of 2007.

Our results in the third quarter of 2008, and to a lesser extent the year to date results in the nine months ended September 2008, were significantly impacted by a difficult operating environment for the automotive retail industry. We believe declining consumer confidence in the wake of an unstable financial market has resulted in a significant reduction in consumer traffic at our retail locations, particularly in the month of September.

**Total Retail Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>Change</b>
				<b>%</b>
Total retail unit sales	222,523	227,307	(4,784)	(2.1%)
Total same store retail unit sales	203,408	217,717	(14,309)	(6.6%)
Total retail sales revenue	\$ 8,569.4	\$ 8,982.8	\$ (413.4)	(4.6%)
Total same store retail sales revenue	\$ 7,908.3	\$ 8,664.9	\$ (756.6)	(8.7%)
Total retail gross profit	\$ 1,418.1	\$ 1,444.1	\$ (26.0)	(1.8%)
Total same store retail gross profit	\$ 1,318.7	\$ 1,401.8	\$ (83.1)	(5.9%)
Total retail gross margin	16.5%	16.1%	0.4%	2.5%
Total same store retail gross margin	16.7%	16.2%	0.5%	3.1%

**Units**

Retail data includes retail new vehicle, retail used vehicle, finance and insurance and service and parts transactions. Retail unit sales of vehicles decreased by 4,784 units, or 2.1%, from 2007 to 2008. The decrease is due to a 14,309 unit, or 6.6%, decrease in same store retail unit sales, somewhat offset by a 9,525 increase from net dealership acquisitions during the period. The decrease in same store retail unit sales was driven primarily by decreases in new retail units sales at our premium brand stores in the U.S. and U.K. and volume foreign and domestic brand stores in the U.S, which was somewhat offset by increases in used retail unit sales at our premium and domestic brand stores in the U.S. We believe these decreases were largely due to reduced consumer traffic resulting from declining consumer confidence brought about by instability in the financial markets in the markets we serve.





**Table of Contents****Revenues**

Retail sales revenue decreased \$413.4 million, or 4.6%, from 2007 to 2008. The decrease is due to a \$756.6 million, or 8.7%, decrease in same store revenues, offset by a \$343.2 million increase from net dealership acquisitions during the period. The same store revenue decrease is due to (1) the 6.6% decrease in retail unit sales, which decreased revenue by \$542.6 million, (2) a \$2,310, or 7.5%, decrease in average used vehicle revenue per unit, which decreased revenue by \$172.6 million, (3) a \$304, or 0.8%, decrease in average new vehicle revenue per unit, which decreased revenue by \$38.4 million, and (4) a \$5.2 million, or 0.5%, decrease in service and parts revenues. These decreases were somewhat offset by (1) an \$11, or 1.1%, increase in average finance and insurance revenue per unit, which increased revenue by \$2.2 million.

**Gross Profit**

Retail gross profit decreased \$26.0 million, or 1.8%, from 2007 to 2008. The decrease is due to an \$83.1 million, or 5.9%, decrease in same store retail gross profit, offset by a \$57.1 million increase from net dealership acquisitions during the period. The same store retail gross profit decrease is due to (1) the 6.6% decrease in retail unit sales, which decreased retail gross profit by \$58.9 million, (2) a \$215, or 8.8%, decrease in average gross profit per used vehicle retailed, which decreased retail gross profit by \$16.1 million, (3) a \$73, or 2.4%, decrease in average gross profit per new vehicle retailed, which decreased retail gross profit by \$9.2 million, and (4) a \$1.1 million, or 0.2%, decrease in service and parts gross profit. These decreases were offset by an \$11, or 1.1%, increase in average finance and insurance revenue per unit, which increased retail gross profit by \$2.2 million.

**New Vehicle Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
New retail unit sales	141,164	149,362	(8,198)	(5.5%)
Same store new retail unit sales	126,512	142,993	(16,481)	(11.5%)
New retail sales revenue	\$ 4,922.7	\$ 5,318.8	\$ (396.1)	(7.4%)
Same store new retail sales revenue	\$ 4,493.3	\$ 5,122.1	\$ (628.8)	(12.3%)
New retail sales revenue per unit	\$ 34,872	\$ 35,610	\$ (738)	(2.1%)
Same store new retail sales revenue per unit	\$ 35,517	\$ 35,821	\$ (304)	(0.8%)
Gross profit new	\$ 410.4	\$ 447.3	\$ (36.9)	(8.2%)
Same store gross profit new	\$ 372.1	\$ 430.9	\$ (58.8)	(13.6%)
Average gross profit per new vehicle retailed	\$ 2,907	\$ 2,995	\$ (88)	(2.9%)
Same store average gross profit per new vehicle retailed	\$ 2,941	\$ 3,014	\$ (73)	(2.4%)
Gross margin % new	8.3%	8.4%	(0.1%)	(1.2%)
Same store gross margin % new	8.3%	8.4%	(0.1%)	(1.2%)

**Units**

Retail unit sales of new vehicles decreased 8,198 units, or 5.5%, from 2007 to 2008. The decrease is due to a 16,481 unit, or 11.5%, decrease in same store retail unit sales, offset by an 8,283 unit increase from net dealership acquisitions during the period. The same store decrease was due primarily to decreases in our premium brands in the U.S. and U.K. and volume foreign and domestic brands in the U.S. We believe these decreases were largely due to reduced consumer traffic resulting from declining consumer confidence brought about by instability in the financial markets in the markets we serve.

**Revenues**

New vehicle retail sales revenue decreased \$396.1 million, or 7.4%, from 2007 to 2008. The decrease is due to a \$628.8 million, or 12.3%, decrease in same store revenues, offset by a \$232.7 million increase from net dealership acquisitions during the period. The same store revenue decrease is due primarily to the 11.5% decrease in retail unit sales, which reduced revenue by \$590.4 million, coupled with a \$304, or 0.8%, decrease in average selling prices per unit, which decreased revenue by \$38.4 million.



**Table of Contents****Gross Profit**

Retail gross profit from new vehicle sales decreased \$36.9 million, or 8.2%, from 2007 to 2008. The decrease is due to a \$58.8 million, or 13.6%, decrease in same store gross profit, offset by a \$21.9 million increase from net dealership acquisitions during the period. The same store decrease is due to the 11.5% decrease in new retail unit sales, which decreased gross profit by \$49.6 million, coupled with a \$73, or 2.4%, decrease in average gross profit per new vehicle retailed, which decreased gross profit by \$9.2 million.

**Used Vehicle Data**

	<b>2008 vs. 2007</b>			
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>% Change</b>
Used retail unit sales	81,359	77,945	3,414	4.4%
Same store used retail unit sales	76,896	74,724	2,172	2.9%
Used retail sales revenue	\$ 2,339.9	\$ 2,387.7	\$ (47.8)	(2.0%)
Same store used retail sales revenue	\$ 2,192.6	\$ 2,303.3	\$ (110.7)	(4.8%)
Used retail sales revenue per unit	\$ 28,760	\$ 30,633	\$ (1,873)	(6.1%)
Same store used retail sales revenue per unit	\$ 28,514	\$ 30,824	\$ (2,310)	(7.5%)
Gross profit used	\$ 180.6	\$ 186.9	\$ (6.3)	(3.4%)
Same store gross profit used	\$ 171.3	\$ 182.6	\$ (11.3)	(6.2%)
Average gross profit per used vehicle retailed	\$ 2,220	\$ 2,398	\$ (178)	(7.4%)
Same store average gross profit per used vehicle retailed	\$ 2,228	\$ 2,443	\$ (215)	(8.8%)
Gross margin % used	7.7%	7.8%	(0.1%)	(1.3%)
Same store gross margin % used	7.8%	7.9%	(0.1%)	(1.3%)

**Units**

Retail unit sales of used vehicles increased 3,414 units, or 4.4%, from 2007 to 2008. The increase is due to a 2,172 unit, or 2.9%, increase in same store retail unit sales, coupled with a 1,242 unit increase from net dealership acquisitions during the period. The same store increase was due primarily to increases in premium and domestic brands in the U.S.

**Revenues**

Used vehicle retail sales revenue decreased \$47.8 million, or 2.0%, from 2007 to 2008. The decrease is due to a \$110.7 million, or 4.8%, decrease in same store revenues, somewhat offset by a \$62.9 million increase from net dealership acquisitions during the period. The same store revenue decrease is due primarily to a \$2,310, or 7.5%, decrease in comparative average selling prices per vehicle, which decreased revenue by \$172.6 million, offset by the 2.9% increase in retail unit sales, which increased revenue by \$61.9 million.

**Gross Profit**

Retail gross profit from used vehicle sales decreased \$6.3 million, or 3.4%, from 2007 to 2008. The decrease is due to an \$11.3 million, or 6.2%, decrease in same store gross profit, somewhat offset by a \$5.0 million increase from net dealership acquisitions during the period. The decrease in same store gross profit is due primarily to a \$215, or 8.8%, decrease in average gross profit per used vehicle retailed, which decreased retail gross profit by \$16.1 million, offset by the 2.9% increase in used retail unit sales, which increased gross profit by \$4.8 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	\$ 218.5	\$ 221.1	\$ (2.6)	(1.2%)
Same store finance and insurance revenue	\$ 204.1	\$ 216.0	\$ (11.9)	(5.5%)
Finance and insurance revenue per unit	\$ 982	\$ 973	\$ 9	0.9%
Same store finance and insurance revenue per unit	\$ 1,003	\$ 992	\$ 11	1.1%



**Table of Contents**

Finance and insurance revenue decreased \$2.6 million, or 1.2%, from 2007 to 2008. The decrease is due to an \$11.9 million, or 5.5%, decrease in same store revenues, somewhat offset by the \$9.3 million increase from net dealership acquisitions during the period. The same store revenue decrease is due primarily to the 6.6% decrease in retail unit sales, which decreased revenue by \$14.1 million, somewhat offset by the \$11, or 1.1%, increase in average finance and insurance revenue per unit, which increased revenue by \$2.2 million. We believe these decreases were largely due to reduced consumer traffic resulting from declining consumer confidence brought about by instability in the financial markets in the markets we serve.

**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	\$ 1,088.3	\$ 1,055.2	\$ 33.1	3.1%
Same store service and parts revenue	\$ 1,018.3	\$ 1,023.5	\$ (5.2)	(0.5%)
Gross profit	\$ 608.6	\$ 588.8	\$ 19.8	3.4%
Same store gross profit	\$ 571.2	\$ 572.3	\$ (1.1)	(0.2%)
Gross margin	55.9%	55.8%	0.1%	0.2%
Same store gross margin	56.1%	55.9%	0.2%	0.4%

**Revenues**

Service and parts revenue increased \$33.1 million, or 3.1%, from 2007 to 2008. The increase is due to a \$38.3 million increase from net dealership acquisitions during the period, somewhat offset by the \$5.2 million, or 0.5%, decrease in same store revenues. 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, but are being affected in the short term due to the economic uncertainty in the markets in which we operate.

**Gross Profit**

Service and parts gross profit increased \$19.8 million, or 3.4%, from 2007 to 2008. The increase is due a \$20.9 million increase from net dealership acquisitions during the period, somewhat offset by the \$1.1 million, or 0.2%, decrease in same store gross profit. The same store gross profit decrease is due to the \$5.2 million, or 0.5%, decrease in same store revenues, which decreased gross profit by \$3.0 million, somewhat offset by a 20 basis point increase in gross margin, which increased gross profit by \$1.9 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 nine months of 2008 aggregated to \$293.5 million. Segment gross profit totaled \$39.8 million, which includes gross profit on vehicle and parts sales.

**Selling, General and Administrative**

Selling, general and administrative expenses ( SG&A ) increased \$35.9 million, or 3.1%, from \$1,143.8 million to \$1,179.7 million. The aggregate increase is primarily due to a \$62.1 million increase from net dealership acquisitions during the period, somewhat offset by the \$26.2 million, or 2.4%, decrease in same store SG&A. The decrease in same store SG&A is due to a net decrease in variable selling expenses, including decreases in variable compensation as a result of the 5.9% decrease in same store retail gross profit versus the prior year, somewhat offset by additional costs associated with the smart distribution business and increased rent and other costs relating to our ongoing facility improvement and expansion programs, and charges totaling \$4.3 million related to severance, termination of an acquisition agreement, and hurricane damage in the Houston market during Hurricane Ike. The severance charges relate to a 4.3% reduction in worldwide staffing levels. SG&A expenses increased as a percentage of gross profit from 78.8% to 81.1%.

**Depreciation and Amortization**

Depreciation and amortization increased \$3.4 million, or 9.2%, from \$37.7 million to \$41.1 million. The increase is due to a \$2.0 million, or 5.3%, increase in same store depreciation and amortization, coupled with a \$1.4 million increase from net dealership acquisitions during the period. The same store increase is due in large part to our ongoing facility improvement and expansion program.

**Table of Contents****Floor Plan Interest Expense**

Floor plan interest expense decreased \$4.8 million, or 8.9%, from \$54.2 million to \$49.4 million. The decrease is due to a \$6.8 million, or 13.0%, decrease in same store floor plan interest expense, somewhat offset by a \$2.0 million increase from net dealership acquisitions during the period. The same store decrease is due in large part to decreases in the underlying variable rates of our revolving floor plan arrangements, somewhat offset by increases in our average amounts outstanding.

**Other Interest Expense**

Other interest expense decreased \$3.1 million, or 7.0%, from \$44.1 million to \$41.0 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.

In March 2007, we redeemed our outstanding \$300.0 million 9.625% Senior Subordinated Notes due 2012 at a price of 104.813%. We incurred an \$18.6 million pretax charge in connection with the redemption, consisting of the \$14.4 million redemption premium and the write-off of \$4.2 million of unamortized deferred financing costs.

**Equity in Income of Affiliates**

Equity in income of affiliates increased \$10.1 million, from \$3.2 million to \$13.3 million. The increase from 2007 to 2008 is primarily due to our investment in PTL.

**Income Taxes**

Income taxes decreased \$0.1 million, or 0.2%, from \$55.7 million to \$55.6 million. The decrease from 2007 to 2008 is due to our decrease in pre-tax income versus the prior year, somewhat offset by 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, debt service, 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 and mortgages, or the issuance of equity securities. As of September 30, 2008, we had working capital of \$96.6 million, including \$27.8 million of cash available to fund our operations and capital commitments. In addition, we had \$250.0 million and £73.0 million (\$129.8 million) available for borrowing under our U.S. credit agreement and our U.K. credit agreement, respectively, each of which is discussed below.

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, significant repurchases of our common stock, 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.

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, March 3, 2008, June 2, 2008 and September 1, 2008. We have also declared a dividend of nine cents per share payable on December 1, 2008 to shareholders of record on November 10, 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.

**Table of Contents*****Share Repurchases and Dividends***

Our board of directors has approved a stock repurchase program for our outstanding common stock with a remaining authority of \$99.9 million. 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 or a pre-arranged trading plan. 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 factors such as the market price of our common stock versus our view of its intrinsic value, the potential impact of such repurchases on our capital structure, and alternative uses of capital, such as for strategic store acquisitions and capital investments in our current businesses, as well as any then-existing limits imposed by our finance agreements and securities trading policy. During the third quarter of 2008, we repurchased 3.6 million shares for \$50.1 million, or \$14.04 per share, under this program.

***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.

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

We are party to a \$479.0 million credit agreement with DCFS USA LLC and Toyota Motor Credit Corporation, as amended (the "U.S. credit agreement"), which provides for up to \$250.0 million in revolving loans for working capital, acquisitions, capital expenditures, investments and for other general corporate purposes, a \$219.0 million non-amortizing term loan, and for an additional \$10.0 million of availability for letters of credit, through September 30, 2010. Pursuant to the "evergreen" provisions of the credit agreement, the term of the credit agreement was extended on September 10, 2008, by one year through September 30, 2011. The revolving loans bear interest at defined LIBOR plus 1.75%, subject to an incremental 0.50% for uncollateralized borrowings in excess of a defined borrowing base. The term loan, which bears interest at defined LIBOR plus 2.50%, may be prepaid at any time, but then may not be re-borrowed.

On September 29, 2008, we amended the U.S. credit agreement to provide us greater flexibility to enter into the mortgage facility referenced below under "Mortgage Facilities." On October 30, 2008, we amended and restated the U.S. credit agreement (the "amended U.S. credit agreement") to incorporate our prior six amendments, eliminate the ratio of domestic debt to domestic earnings before interest, taxes, depreciation and amortization ("EBITDA") covenant and the minimum stockholders' equity covenant, change the financial ratio on the debt to EBITDA covenant from 2.75 to 2.5, provide for additional flexibility for incremental real estate mortgage borrowings, and make other changes designed to provide us with additional operating flexibility.

The amended 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 amended 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 and a ratio of debt to EBITDA. 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 September 30, 2008, the Company was 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. However, in the event of continued weakness in the economy and the automotive sector in particular, we may need to seek covenant relief. See Forward Looking Statements .

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The amended 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 are subject to security interests granted to lenders under the amended U.S. credit agreement. As of September 30, 2008, \$219.0 million of term loans and \$0.5 million of letters of credit were outstanding under this facility. No revolving loans were outstanding as of September 30, 2008.

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

On September 29, 2008, our subsidiaries in the U.K. (the U.K. subsidiaries) amended their existing £130.0 million multi-option credit agreement with the Royal Bank of Scotland plc, as agent for National Westminster Bank plc, to provide greater flexibility within the financial covenants and increase the borrowing rate paid under the facility. This facility consists of a funded term loan, a revolving 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 amended U.K. credit agreement provides for (1) up to £80.0 million in revolving loans through August 31, 2011, which bears interest between defined LIBOR plus 1.0% and defined LIBOR plus 1.6%, (2) a £30.0 million funded term loan which currently bears interest between 6.29% and 6.89% and is payable ratably in quarterly intervals until fully repaid on June 30, 2011, and (3) a seasonally adjusted overdraft line of credit for up to £20.0 million that bears interest at the Bank of England Base Rate plus 1.75%, 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 September 30, 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. However, in the event of continued weakness in the economy and the automotive sector in particular, we may need to seek covenant relief. 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 are subject to security interests granted to lenders under the U.K. credit agreement. As of September 30, 2008, outstanding loans under the U.K. credit agreement amounted to £46.4 million (\$82.5 million).

***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 September 30, 2008, we were in compliance with all negative covenants and there were no events of default.



**Table of Contents*****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, as discussed below. The Convertible Notes are unsecured senior subordinated obligations and are subordinate to all future and existing debt under our credit agreement and floor plan indebtedness. The convertible notes 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 September 30, 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, in certain circumstances, pay a make-whole premium by increasing the conversion rate used in that conversion. In addition, we will pay additional cash interest commencing with six-month periods beginning on April 1, 2011, if the average trading price of a Convertible Note for certain periods in the prior 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.

***Mortgage Facilities***

On September 29, 2008, we entered into a \$42.4 million seven year mortgage facility with Toyota Motor Credit Corporation with respect to certain of our dealership properties. The facility bears interest at a defined rate, requires monthly principal and interest payments, and includes the option to extend the term for successive periods of five years up to a maximum term of twenty-five years. In the event we exercise our option to extend the term, the interest rate will be renegotiated for each renewal period.

The mortgage facility contains typical events of default, including non-payment of obligations, cross-defaults to the Company's other material indebtedness, certain change of control events, and loss or sale of certain franchises operated at the property. Substantially all of the buildings, improvements, fixtures and personal property of the properties under the mortgage facility are subject to security interests granted to the lender. As of September 30, 2008, \$32.9 million was outstanding under the mortgage facility. We expect to draw the remainder of the facility upon the completion of the dealership facilities and other funding requirements.

***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.

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***Interest Rate Swaps***

We are party to interest rate swap agreements through January 7, 2011 pursuant to which the LIBOR portion of \$300.0 million of our floating rate floor plan debt was fixed at 3.67%. We may terminate this arrangement at any time subject to the settlement of the then current 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 nine months ended September 30, 2008, the swaps increased the weighted average interest rate on floor plan borrowings by approximately 0.1%. As of September 30, 2008, we used Level 2 inputs as described under SFAS 157 to estimate the fair value of these contracts to be a \$2.7 million liability, and expect approximately \$1.7 million associated with the swaps to be recognized as an increase of interest expense over the next twelve months.

We were party to an interest rate swap agreement which expired in January 2008, pursuant to which a notional \$200.0 million of our 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***

In the past, we have entered into significant sale-leaseback transactions to finance certain property acquisitions and capital expenditures, pursuant to which we sold property and/or leasehold improvements to third parties and agreed to lease those assets back for a certain period of time. Such sales generated proceeds which varied from period to period. In light of current market conditions, this financing option has become more expensive and thus we may utilize these arrangements less in the near term.

***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 or 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 \$14.5 million and \$10.9 million during the nine months ended September 30, 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 \$358.2 million and \$337.6 million during the nine months ended September 30, 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.

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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>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Net cash from operating activities as reported	\$ 358,244	\$ 337,603
Floor plan notes payable non-trade as reported	(33,261)	143,468
Net cash from operating activities including all floor plan notes payable	\$ 324,983	\$ 481,071

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

Cash used in continuing investing activities was \$508.2 million and \$148.2 million during the nine months ended September 30, 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 \$165.4 million and \$114.6 million during the nine months ended September 30, 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 \$19.7 million and \$105.7 million during the nine months ended September 30, 2008 and 2007, respectively. Cash used in business acquisitions and other investments, net of cash acquired, was \$142.1 million and \$154.9 million during the nine months ended September 30, 2008 and 2007, respectively, and included cash used to repay sellers floor plan liabilities in such business acquisitions of \$30.7 million and \$48.5 million during the nine months ended September 30, 2008 and 2007, respectively. We used \$220.5 million for other investing activities during the nine months ended September 30, 2008, including \$219.0 million for the acquisition of a 9% partnership interest in Penske Truck Leasing Co., L.P. ( PTL ).

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

Cash provided by continuing financing activities was \$129.2 million during the nine months ended September 30, 2008 and cash used by continuing financing activities was \$267.0 million during the nine months ended September 30, 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 borrowings of long-term debt of \$238.0 million during the nine months ended September 30, 2008 and net repayments of \$393.1 million during the nine months ended September 30, 2007. The borrowings in the nine months ended September 30, 2008 included the \$219.0 million loan to finance the purchase of the PTL limited partnership interest and the \$32.9 million mortgage facility. The repayments in the nine months ended September 30, 2007 included \$14.4 million of premium paid on the redemption of our 9.625% Senior Subordinated Notes. We had net repayments of floor plan notes payable non-trade of \$33.3 million during the nine months ended September 30, 2008 and net borrowings of floor plan notes payable non-trade of \$143.5 million during the nine months ended September 30, 2007. During the nine months ended September 30, 2008 and 2007 we received proceeds of \$0.8 million and \$2.5 million, respectively, from the issuance of common stock. We used \$50.1 million to repurchase 3.6 million shares of common stock during the nine months ended September 30, 2008. During the nine months ended September 30, 2008 and 2007, we paid \$25.6 million and \$19.9 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. We do not believe that there is any significant past, present or future cash

transactions relating to discontinued operations.

***Commitments***

We were party to a joint venture agreement with respect to our Honda of Mentor dealership in Ohio. We were required to repurchase our partner's interest in this joint venture in July 2008 and completed the repurchase on July 23, 2008 with a payment of \$5.1 million.



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**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 41% of our outstanding common stock. Mitsui & Co., Ltd. and Mitsui & Co. (USA), Inc. (collectively, Mitsui ) own approximately 17% 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 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 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 are a 9% limited partner of PTL, a leading global transportation services provider. PTL operates and maintains more than 200,000 vehicles and serves customers in North America, South America, Europe and Asia. Product lines include full-service leasing, contract maintenance, commercial and consumer truck rental and logistics services, including, transportation and distribution center management and supply chain management. The general partner is Penske Truck Leasing Corporation, a wholly-owned subsidiary of Penske Corporation, which together with other wholly-owned subsidiaries of Penske Corporation, owns 40% of PTL. The remaining 51% of PTL is owned by GE Capital. We are party to a partnership agreement among the other partners which, among other things, provides us with specified partner distribution and governance rights and restricts our ability to transfer our interests.

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

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

From time to time, we enter into other 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 September 30, 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	88.53%(A)(B)
Edison, New Jersey	Ferrari, Maserati	70.00%(B)
Las Vegas, Nevada	Ferrari, Maserati	50.00%(C)
Munich, Germany	BMW, MINI	50.00%(C)
Frankfurt, Germany	Lexus, Toyota	50.00%(C)
Aachen, Germany	Audi, Lexus, Toyota, Volkswagen	50.00%(C)
Mexico	Toyota	48.70%(C)
Mexico	Toyota	45.00%(C)

(A) An entity controlled by one of our directors, Lucio A. Noto (the Investor ), owns an 11.47% 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) 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.

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**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;

with respect to PTL, changes in tax, financial or regulatory rules on requirements, changes in the financial health of PTL's customers, labor strikes or work stoppages, asset utilization rates and industry competition;

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

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;

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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 September 30, 2008, a 100 basis point change in interest rates would result in an approximate \$2.7 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 September 30, 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 fixed rate debt, including our swaps, 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 September 30, 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 \$367.1 million change to our revenues for the nine months ended September 30, 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 the most recent quarter 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 September 30, 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 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The table below sets forth information with respect to shares of common stock we repurchased during the third fiscal quarter of 2008.

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Avg. Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Programs</b>	<b>Approximate Dollar Value of Shares That May Yet Be Purchased Under The Programs (in millions)(1)(2)</b>
August 1, 2008 to August 31, 2008	3,565,143	\$ 14.04	3,565,143	\$ 99.9
	3,565,143		3,565,143	

(1) On February 19, 2008, we announced that our Board of Directors approved a stock repurchase program for up to \$150 million in shares of our common stock, \$50.1 million of which has been repurchased by us as of September 30, 2008 in the open market and in privately negotiated

transactions.

This program does not have an expiration date.

- (2) Future share repurchases are subject to limitations contained in our 7.75% senior subordinated notes indenture.

As of September 30, 2008, we had availability to repurchase the full amount remaining under the program.

For a further discussion of factors we will consider in deciding whether to repurchase shares in the future, please refer to

Management's Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources, Share Repurchases and Dividends.

**Item 5. Other Information**

On October 30, 2008, we amended and restated our \$479 million credit agreement with DCFS USA LLC and Toyota Motor Credit Corporation (the amended U.S. credit agreement) to incorporate our prior six amendments, eliminate the ratio of domestic debt to domestic EBITDA covenant and the minimum stockholders' equity covenant, change the financial ratio on the debt to EBITDA covenant from 2.75 to 2.5, provide for additional flexibility for incremental real estate mortgage borrowings, and make other changes designed to provide us with additional operating flexibility.

These changes are further described in the third amended and restated U.S. credit agreement, which is filed as exhibit 4.4 to this Form 10-Q. We purchase motor vehicles from Daimler AG and Toyota Motor Corporation, affiliates of the lenders under the U.S. credit agreement, for sale at certain of our dealerships. The lenders also provide certain of our dealerships with floor-plan financing and consumer financing.

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**Item 6. Exhibits**

- 4.1 Amended and Restated Supplemental Indenture regarding our 3.5% senior subordinated convertible notes due 2026 dated as of October 30, 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 October 30, 2008, among us, as Issuer, and certain of our domestic subsidiaries, as Guarantors, and Bank of New York Trust Company, N.A., as trustee.
- 4.3 Sixth Amendment dated September 29, 2008 to the Second Amended and Restated Credit Agreement dated September 8, 2004 by and among us, DCFS USA LLC and Toyota Motor Credit Corporation (incorporated by reference to Exhibit 4.1 of our October 1, 2008 Form 8-K).
- 4.4 Third Amended and Restated Credit Agreement dated October 30, 2008 by and among us, DCFS USA LLC and Toyota Motor Credit Corporation.
- 4.5 Amendment dated September 29, 2008 to Multi-Option Credit Agreement dated as of August 31, 2006 between Sytner Group Limited and RBS (incorporated by reference to Exhibit 4.2 of our October 1, 2008 Form 8-K).
- 4.6 Amendment dated September 29, 2008 to Fixed Rate Credit Agreement dated as of August 31, 2006 between Sytner Group Limited and RBS (incorporated by reference to Exhibit 4.3 of our October 1, 2008 Form 8-K).
- 4.7 Amendment dated September 29, 2008 to Seasonally Adjusted Overdraft Agreement dated as of August 31, 2006 between Sytner Group Limited and RBS (incorporated by reference to Exhibit 4.4 of our October 1, 2008 Form 8-K).
- 10.1 Second Amended and Restated Limited Partnership Agreement of Penske Truck Leasing Co., L.P. dated as of September 19, 2008 (substantially identical to the form of agreement we filed as exhibit 10.2 to our July 2, 2008 Form 8-K)
- 12 Computation of Ratio of Earnings to Fixed Charges
- 31 Rule 13a-14(a)/15(d)-14(a) Certifications
- 32 Section 1350 Certifications

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**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.

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

Date: November 5, 2008

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

Date: November 5, 2008

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