PENSKE AUTOMOTIVE GROUP, INC.
Form 10-Q
July 30, 2010

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

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

For the quarterly period ended June 30, 2010

or

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

For the transition period from __________ to __________

Commission file number 1-12297

Penske Automotive Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**22-3086739**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
2555 Telegraph Road, Bloomfield Hills, Michigan	**48302-0954**
(Address of principal executive offices)	*(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 þ No o

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

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

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

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

As of July 26, 2010, there were 92,074,157 shares of voting common stock outstanding.

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PENSKE AUTOMOTIVE GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

	June 30, 2010	December 31, 2009
	(Unaudited) (In thousands, except per share amounts)	
ASSETS		
Cash and cash equivalents	$ 17,664	$ 13,999
Accounts receivable, net of allowance for doubtful accounts of $1,797 and $1,689	351,013	321,226
Inventories	1,364,718	1,302,495
Other current assets	106,479	95,426
Assets held for sale	572	10,625
Total current assets	1,840,446	1,743,771
Property and equipment, net	707,832	726,808
Goodwill	795,366	810,047
Franchise value	199,581	201,756
Equity method investments	280,847	295,473
Other long-term assets	14,591	18,152
Total assets	$ 3,838,663	$ 3,796,007
LIABILITIES AND EQUITY		
Floor plan notes payable	$ 818,339	$ 769,657
Floor plan notes payable non-trade	499,410	423,316
Accounts payable	209,535	189,989
Accrued expenses	218,716	227,294
Current portion of long-term debt	16,551	12,442
Liabilities held for sale	501	7,675
Total current liabilities	1,763,052	1,630,373
Long-term debt	844,292	933,966
Deferred tax liabilities	159,872	157,500
Other long-term liabilities	109,713	128,129
Total liabilities	2,876,929	2,849,968
Commitments and contingent liabilities		
Equity		
Penske Automotive Group stockholders equity:		
Preferred Stock, $0.0001 par value; 100 shares authorized; none issued and outstanding		
	9	9

Common Stock, $0.0001 par value, 240,000 shares authorized; 92,142 shares issued and outstanding at June 30, 2010; 91,618 shares issued and outstanding at December 31, 2009		
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	738,611	737,198
Retained earnings	246,000	196,205
Accumulated other comprehensive income	(26,567)	9,049
Total Penske Automotive Group stockholders equity	958,053	942,461
Non-controlling interest	3,681	3,578
Total equity	961,734	946,039
Total liabilities and equity	$ 3,838,663	$ 3,796,007

See Notes to Consolidated Condensed Financial Statements

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PENSKE AUTOMOTIVE GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(Unaudited) (In thousands, except per share amounts)			
Revenue:				
New vehicle	$ 1,355,813	$ 1,090,127	$ 2,588,136	$ 2,061,323
Used vehicle	749,669	658,787	1,446,337	1,275,286
Finance and insurance, net	63,558	54,674	122,992	103,137
Service and parts	332,160	331,106	666,183	658,009
Distribution	19,933	53,152	27,869	133,265
Fleet and wholesale vehicle	182,555	130,849	337,850	245,975
Total revenues	2,703,688	2,318,695	5,189,367	4,476,995
Cost of sales:				
New vehicle	1,244,630	1,004,151	2,375,452	1,903,990
Used vehicle	689,552	599,526	1,329,500	1,160,009
Service and parts	141,655	148,692	287,275	298,867
Distribution	17,227	45,702	24,949	114,016
Fleet and wholesale	180,280	126,869	331,819	238,319
Total cost of sales	2,273,344	1,924,940	4,348,995	3,715,201
Gross profit	430,344	393,755	840,372	761,794
Selling, general and administrative expenses	355,177	327,389	695,691	640,055
Depreciation	12,054	13,811	24,428	26,692
Operating income	63,113	52,555	120,253	95,047
Floor plan interest expense	(8,321)	(8,969)	(16,842)	(18,431)
Other interest expense	(12,542)	(13,687)	(25,262)	(28,187)
Debt discount amortization	(2,428)	(3,135)	(5,343)	(6,773)
Equity in earnings of affiliates	4,784	3,466	4,355	4,180
Gain on debt repurchase	422		1,027	10,429
Income from continuing operations before income taxes	45,028	30,230	78,188	56,265
Income taxes	(15,625)	(10,329)	(28,060)	(20,074)
Income from continuing operations	29,403	19,901	50,128	36,191
Gain (loss) from discontinued operations, net of tax	281	(5,734)	(112)	(5,822)
Net income	29,684	14,167	50,016	30,369
Less: Income attributable to non-controlling interests	243	88	221	8

Net income attributable to Penske Automotive Group common stockholders	$	29,441	$	14,079	$	49,795	$	30,361
Basic earnings per share attributable to Penske Automotive Group common stockholders:								
Continuing operations	$	0.32	$	0.22	$	0.54	$	0.40
Discontinued operations		(0.00)		(0.06)		(0.00)		(0.06)
Net income	$	0.32	$	0.15	$	0.54	$	0.33
Shares used in determining basic earnings per share		92,142		91,531		92,016		91,506
Diluted earnings per share attributable to Penske Automotive Group common stockholders:								
Continuing operations	$	0.32	$	0.22	$	0.54	$	0.40
Discontinued operations		(0.00)		(0.06)		(0.00)		(0.06)
Net income	$	0.32	$	0.15	$	0.54	$	0.33
Shares used in determining diluted earnings per share		92,206		91,592		92,086		91,537
Amounts attributable to Penske Automotive Group common stockholders:								
Income from continuing operations	$	29,403	$	19,901	$	50,128	$	36,191
Less: Income attributable to non-controlling interests		243		88		221		8
Income from continuing operations, net of tax		29,160		19,813		49,907		36,183
Gain (loss) from discontinued operations, net of tax		281		(5,734)		(112)		(5,822)
Net income	$	29,441	$	14,079	$	49,795	$	30,361
Cash dividends per share	$		$		$		$	

See Notes to Consolidated Condensed Financial Statements

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

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
	(Unaudited) (In thousands)	
Operating Activities:		
Net income	$ 50,016	$ 30,369
Adjustments to reconcile net income to net cash from continuing operating activities:		
Depreciation	24,428	26,692
Debt discount amortization	5,343	6,773
Undistributed earnings of equity method investments	(4,355)	(4,180)
Loss from discontinued operations, net of tax	112	5,822
Deferred income taxes	11,398	21,037
Gain on debt repurchase	(1,027)	(10,733)
Changes in operating assets and liabilities:		
Accounts receivable	(25,714)	(26,927)
Inventories	(33,856)	340,656
Floor plan notes payable	27,057	(188,134)
Accounts payable and accrued expenses	12,036	32,906
Other	4,155	6,824
Net cash from continuing operating activities	69,593	241,105
Investing Activities:		
Purchase of equipment and improvements	(37,622)	(43,979)
Dealership acquisitions net, including repayment of sellers floor plan notes payable of $7,231 and $2,940, respectively	(12,277)	(8,610)
Other		12,679
Net cash from continuing investing activities	(49,899)	(39,910)
Financing Activities:		
Proceeds from borrowings under U.S. credit agreement revolving credit line	320,600	276,800
Repayments under U.S. credit agreement revolving credit line	(292,600)	(276,800)
Repayments under U.S. credit agreement term loan		(10,000)
Repurchase of 3.5% senior subordinated convertible notes	(113,604)	(51,425)
Net repayments of other long-term debt	(9,497)	(47,768)
Net borrowings (repayments) of floor plan notes payable non-trade	76,094	(78,608)
Proceeds from exercises of options, including excess tax benefit	211	
Net cash from continuing financing activities	(18,796)	(187,801)
Discontinued operations:		
Net cash from discontinued operating activities	(6,489)	(643)
Net cash from discontinued investing activities	9,463	(2,605)

Net cash from discontinued financing activities		(207)		(7,085)
Net cash from discontinued operations		2,767		(10,333)
Net change in cash and cash equivalents		3,665		3,061
Cash and cash equivalents, beginning of period		13,999		17,108
Cash and cash equivalents, end of period	$	17,664	$	20,169
Supplemental disclosures of cash flow information:				
Cash paid for:				
Interest	$	43,876	$	49,368
Income taxes		14,121		4,655

See Notes to Consolidated Condensed Financial Statements

PENSKE AUTOMOTIVE GROUP, INC.
CONSOLIDATED CONDENSED STATEMENT OF EQUITY

	Common Stock Issued Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity Attributable to Penske Automotive Group	Non-controlling Interest	Total Equity
	(Unaudited) (Dollars in thousands)							
Balance, January 1, 2010	91,617,746	$ 9	$ 737,198	$ 196,205	$ 9,049	$ 942,461	$ 3,578	$ 946,039
Equity compensation	499,751		5,837			5,837		5,837
Exercise of options, including tax benefit of $108	25,000		211			211		211
Repurchase of 3.5% senior subordinated convertible notes			(4,635)			(4,635)		(4,635)
Distributions to non-controlling interests							(118)	(118)
Foreign currency translation					(42,831)	(42,831)		(42,831)
Other					7,215	7,215		7,215
Net income				49,795		49,795	221	50,016
Balance, June 30, 2010	92,142,497	$ 9	$ 738,611	$ 246,000	$ (26,567)	$ 958,053	$ 3,681	$ 961,734

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

Business Overview

Penske Automotive Group, Inc. (the Company) is the second largest automotive retailer headquartered in the U.S. as measured by total revenues. As of June 30, 2010, the Company owned and operated 171 franchises in the U.S. and 152 franchises outside of the U.S., primarily in the U.K. During the six months ended June 30, 2010, we acquired 6 franchises, including Volkswagen and Audi franchises in Santa Ana, California and a group of BMW franchises in Augsburg, Germany through the dissolution of a joint venture. We were awarded 9 franchises, including Audi and Mercedes franchises in Chantilly, Virginia, two Mini franchises in the western U.S. and four Mercedes Sprinter commercial van franchises in the U.S. We also disposed of 5 franchises, including our Toyota/Scion business in Warren, Michigan and our Ford business in Goodyear, Arizona.

Each of the Company s dealerships offers a wide selection of new and used vehicles for sale. In addition to selling new and used vehicles, the Company generates higher-margin revenue at each of its 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. In 2007, the Company established a wholly-owned subsidiary, smart USA Distributor, LLC (smart USA), which is the exclusive distributor of the smart fortwo vehicle in the U.S. and Puerto Rico. The Company also holds a 9.0% limited partnership interest in Penske Truck Leasing Co., L.P. (PTL), a leading global transportation services provider.

Basis of Presentation

The following unaudited consolidated condensed financial statements of 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 June 30, 2010 and December 31, 2009 and for the three and six month periods ended June 30, 2010 and 2009 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 June 30, 2010, and the results for interim periods are not necessarily indicative of results to be expected for the year. These consolidated condensed financial statements should be read in conjunction with the Company s audited financial statements for the year ended December 31, 2009, which are included as part of the Company s Annual Report on Form 10-K.

Results for three and six months ended June 30, 2010 include a $422 and $1,027 pre-tax gain relating to the repurchase of $41,548 and $112,658 aggregate principal amount of the Company s 3.5% senior subordinated convertible notes (Convertible Notes), respectively. Results for the six months ended June 30, 2009 include a $10,429 pre-tax gain relating to the repurchase of $68,740 aggregate principal amount of the Convertible Notes.

Discontinued Operations

The Company accounts for dispositions as discontinued operations when the operations and cash flows of the business being disposed of will be eliminated from on-going operations and that the Company will not have any significant continuing involvement in its operations.

In evaluating whether the cash flows of a dealership in its Retail reportable segment 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 owned dealerships, the Company does not treat the disposition as a discontinued operation if the Company believes that the cash flows previously generated by the disposed franchise will be replaced by expanded operations of the remaining franchises. The results of operations during the three and six months ended June 30, 2010 and 2009 and the net assets as of June 30, 2010 and December 31, 2009 of dealerships accounted for as discontinued operations were immaterial.

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PENSKE AUTOMOTIVE GROUP, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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.

Estimated Useful Lives of Assets

The Company changed the useful lives of certain fixed assets during the first quarter of 2010 as part of a review of assumptions related to the expected utilization of those assets by the Company. The Company accounted for the change in useful lives as a change in estimate prospectively effective January 1, 2010, which resulted in a reduction of depreciation expense of $1,410 and $2,820 for the three and six month periods ended June 30, 2010, respectively.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt, floor plan notes payable, and interest rate swaps used to hedge future cash flows. Other than our subordinated notes, the carrying amount of all significant financial instruments approximates fair value due either to length of maturity, the existence of variable interest rates that approximate prevailing market rates, or as a result of mark to market accounting. A summary of the fair value of the subordinated notes as of June 30, 2010, based on level one market data follows:

	Carrying Value	Fair Value
7.75% senior subordinated notes due 2016	$ 375,000	$ 350,625
3.5% senior subordinated convertible notes due 2026	187,157	194,570

2. Inventories

Inventories consisted of the following:

	June 30, 2010	December 31, 2009
New vehicles	$ 956,879	$ 898,110
Used vehicles	330,895	325,707
Parts, accessories and other	76,944	78,678
Total inventories	$ 1,364,718	$ 1,302,495

The Company receives non-refundable floor plan interest and advertising assistance credits from certain vehicle manufacturers that reduce cost of sales when the vehicles are sold. These floor plan interest and advertising assistance credits amounted to $13,176 and $8,975 during the six months ended June 30, 2010 and 2009, respectively.

PENSKE AUTOMOTIVE GROUP, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

3. Business Combinations

The Company s retail operations acquired three and five franchises during the six months ended June 30, 2010 and 2009, respectively. The Company s financial statements include the results of operations of the acquired dealerships from the date of acquisition. The fair value of the assets acquired and liabilities assumed have been recorded in the Company s consolidated condensed financial statements, and may be subject to adjustment pending completion of final valuation. A summary of the aggregate consideration paid and the aggregate amounts of the assets acquired and liabilities assumed in the six months ended June 30, 2010 and 2009 follows:

	June 30, 2010	June 30, 2009
Inventory	$ 8,595	$ 2,935
Other current assets	17	129
Property and equipment	187	3,250
Goodwill	3,510	1,746
Franchise value		749
Current liabilities	(32)	(199)
Cash used in dealership acquisitions	$ 12,277	$ 8,610

In the first quarter of 2010, the Company exited one of its German joint ventures by exchanging its 50% interest in the joint venture for 100% ownership in three BMW franchises previously held by the joint venture. The Company recorded $13,331 of intangible assets in connection with this transaction.

4. Intangible Assets

The following is a summary of the changes in the carrying amount of goodwill and franchise value during the six months ended June 30, 2010:

	Goodwill	Franchise Value
Balance January 1, 2010	$ 810,047	$ 201,756
Additions	13,051	3,703
Foreign currency translation	(27,732)	(5,878)
Balance June 30, 2010	$ 795,366	$ 199,581

5. Floor Plan Notes Payable Trade and Non-trade

The Company finances substantially all of its new and a portion of its used vehicle inventories under revolving floor plan arrangements with various lenders, primarily through captive finance companies associated with automotive manufacturers. In the U.S., the floor plan arrangements are due on demand; however, the Company has not historically been 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.

The floor plan agreements typically 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 the prime rate, defined London Interbank Offered Rate (LIBOR), Finance House Base Rate, or Euro Interbank Offered Rate. The Company classifies floor plan notes payable to a party other than the manufacturer of a particular new vehicle, and all floor plan notes payable relating to pre-owned vehicles, as floor plan notes payable non-trade on its consolidated condensed balance sheets, and classifies related cash flows as a financing activity on its consolidated condensed statements of cash flows.

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PENSKE AUTOMOTIVE GROUP, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

6. Earnings Per Share

Basic earnings per share is computed using net income attributable to Penske Automotive Group common stockholders and the number of weighted average shares of voting common stock outstanding, including outstanding unvested restricted stock awards which contain rights to non-forfeitable dividends. Diluted earnings per share is computed using net income attributable to Penske Automotive Group common stockholders and the number of weighted average shares of voting common stock outstanding, adjusted for the dilutive effect of non-participatory equity compensation. A reconciliation of the number of shares used in the calculation of basic and diluted earnings per share for the three and six months ended June 30, 2010 and 2009 follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Weighted average number of common shares outstanding	92,142	91,531	92,016	91,506
Effect of non-participatory equity compensation	64	61	70	31
Weighted average number of common shares outstanding, including effect of dilutive securities	92,206	91,592	92,086	91,537

There were no anti-dilutive stock options outstanding during the three and six months ended June 30, 2010 which were excluded from the calculation of diluted earnings per share. During the three and six months ended June 30, 2009, 3 and 222 stock options, respectively, were excluded from the calculation of diluted earnings per share because the effect of such securities was anti-dilutive. In addition, the Company has senior subordinated convertible notes outstanding which, under certain circumstances discussed in Note 7, may be converted to voting common stock. As of June 30, 2010 and 2009, 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 anti-dilutive.

7. Long-Term Debt

Long-term debt consisted of the following:

	June 30, 2010	**December 31, 2009**
U.S. credit agreement revolving credit line	$ 28,000	$
U.S. credit agreement term loan	149,000	149,000
U.K. credit agreement revolving credit line	44,817	59,803
U.K. credit agreement term loan	10,545	17,115
U.K. credit agreement overdraft line of credit	12,259	12,048
7.75% senior subordinated notes due 2016	375,000	375,000
3.5% senior subordinated convertible notes due 2026, net of debt discount	187,157	289,344
Mortgage facilities	46,608	41,358
Other	7,457	2,740
Total long-term debt	860,843	946,408
Less: current portion	(16,551)	(12,442)
Net long-term debt	$ 844,292	$ 933,966

U.S. Credit Agreement

The Company is party to a credit agreement with DCFS USA LLC and Toyota Motor Credit Corporation, as amended (the U.S. Credit Agreement), which, as of June 30, 2010, provided for up to $250,000 in revolving loans for working capital, acquisitions, capital expenditures, investments and other general corporate purposes, a non-amortizing term loan with a remaining balance of $149,000, and for an additional $10,000 of availability for letters of credit, through September 30, 2012. As of June 30, 2010, the revolving loans bore interest at a defined LIBOR plus 2.50%, 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.

The U.S. Credit Agreement is fully and unconditionally guaranteed on a joint and several basis by the Company s domestic subsidiaries and contains a number of significant covenants that, among other things, restrict the Company s ability to dispose of assets, incur additional indebtedness, repay other indebtedness, pay dividends, create liens on assets, make investments or acquisitions and engage in mergers or consolidations. The Company is also required to comply with specified financial and other tests and ratios, each as defined in the U.S. Credit Agreement, including: a ratio of current assets to current liabilities, a fixed charge coverage ratio, a ratio of debt to stockholders equity 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 June 30, 2010, the Company was in compliance with all covenants under the U.S. Credit Agreement.

PENSKE AUTOMOTIVE GROUP, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

The U.S. Credit Agreement also contains typical events of default, including change of control, non-payment of obligations and cross-defaults to the Company s other material indebtedness. Substantially all of the Company s domestic assets are subject to security interests granted to lenders under the U.S. Credit Agreement. As of June 30, 2010, $149,000 of term loans, $1,250 of letters of credit, and $28,000 of revolver borrowings were outstanding under the U.S. Credit Agreement.

In July 2010, the Company amended the U.S. Credit Agreement to (1) increase the borrowing capacity under the revolving credit line by $50.0 million, (2) increase the interest rate on secured revolving borrowings by 25 basis points, and (3) increase the rate on unsecured revolving borrowings by 50 basis points.

U.K. Credit Agreement

The Company s subsidiaries in the U.K. (the U.K. Subsidiaries) are party to an agreement with the Royal Bank of Scotland plc, as agent for National Westminster Bank plc, which provides for a funded term loan, a revolving credit agreement and a seasonally adjusted overdraft line of credit (collectively, the U.K. Credit Agreement) to be used for working capital, acquisitions, capital expenditures, investments and general corporate purposes. The U.K. Credit Agreement provides for (1) up to £100,000 in revolving loans through August 31, 2013, which bears interest between a defined LIBOR plus 1.1% and defined LIBOR plus 3.0%, (2) a term loan which bears interest between 6.39% and 8.29% and is payable ratably in quarterly intervals until fully repaid on June 30, 2011, and (3) a demand seasonally adjusted overdraft line of credit for up to £20,000 that bears interest at the Bank of England Base Rate plus 1.75%.

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 EBITDAR 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 June 30, 2010, 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 June 30, 2010, outstanding loans under the U.K. Credit Agreement amounted to £45,265 ($67,621), including £7,059 ($10,545) under the term loan. In July 2010, the Company amended the U.K. Credit Agreement in connection with a reorganization of our European operations.

7.75% Senior Subordinated Notes

In December 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, mortgages and floor plan indebtedness. The 7.75% Notes are guaranteed by substantially all of the Company s 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. 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 June 30, 2010, 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), of which $193,602 were outstanding at June 30, 2010. 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 senior debt, including debt under the Company s credit agreements, mortgages 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 June 30, 2010, the Company was in compliance with all negative covenants and there were no events of default.

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Holders of the Convertible Notes may convert them based on a conversion rate of 42.7796 shares of common stock per $1,000 principal amount of the Convertible Notes (which is equal to a conversion price of approximately $23.38 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 $28.05 (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, equal to the lesser of (i) $1,000 or (ii) the conversion value, determined in the manner set forth in the related indenture covering the Convertible Notes, of the number of shares of common stock equal to the conversion rate. If the conversion value exceeds $1,000, the Company will also deliver, at its election, cash, common stock or a combination of cash and common stock with respect to the remaining value deliverable upon conversion.

In the event of a conversion due to 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. Because the Company expects to be required to redeem the Convertible Notes in April 2011, it is reviewing alternatives to refinance or repay the Convertible Notes, which may include the issuance of additional securities. In the absence of a refinancing of the Convertible Notes, the Company expects to utilize cash flow from operations, working capital and availability under the U.S. Credit Agreement to repay the Convertible Notes. Based on the ability and intent to refinance any redemption or repayment of the Convertible Notes, the Company has classified them as long-term in the Consolidated Condensed Balance Sheet as of June 30, 2010. In the event the outstanding balance of the Convertible Notes exceeds or was expected to exceed the revolving capacity under the U.S. Credit Agreement, any such excess would have been classified as current.

In the second quarter of 2010, the Company repurchased $41,548 principal amount of its outstanding Convertible Notes, which had a book value, net of debt discount, of $40,013 for $41,859. The Company allocated $2,438 of the total consideration to the reacquisition of the equity component of the Convertible Notes. In connection with the transactions, the Company wrote off $170 of unamortized deferred financing costs. As a result, the Company recorded a $422 pre-tax gain in connection with the repurchases. In total during the first six months of 2010, the Company repurchased $112,658 principal amount of its outstanding Convertible Notes, which had a book value, net of debt discount, of $107,530 for $113,603. The Company allocated $7,667 of the total consideration to the reacquisition of the equity component of the Convertible Notes. In connection with the transactions, the Company wrote off $567 of unamortized deferred financing costs. As a result, the Company has recorded an aggregate $1,027 pre-tax gain in connection with the repurchases during 2010.

In the first quarter of 2009, the Company repurchased $68,740 principal amount of its outstanding Convertible Notes, which had a book value, net of debt discount, of $62,831 for $51,425. In connection with the transaction, the Company wrote off $672 of unamortized deferred financing costs and incurred $305 of transaction costs. No element of the consideration was allocated to the reacquisition of the equity component because the consideration paid was less than the fair value of the liability component prior to extinguishment. As a result, the Company recorded a

$10,429 pre-tax gain in connection with the repurchase.

The liability and equity components related to the Convertible Notes consist of the following:

	June 30, 2010	December 31, 2009
Carrying amount of the equity component	$ 38,458	$ 43,093
Principal amount of the liability component	$ 193,602	$ 306,260
Unamortized debt discount	6,445	16,916
Net carrying amount of the liability component	$ 187,157	$ 289,344

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The unamortized debt discount will be amortized as additional interest expense through April 1, 2011, the date the Company expects to be required to redeem the Convertible Notes. The annual effective interest rate on the liability component is 8.25%.

In July 2010, the Company repurchased an additional $43,000 principal amount of the Convertible Notes for $43,215. As a result, there is an aggregate of $150,602 principal amount of the Convertible Notes currently outstanding.

Mortgage Facilities

The Company is party to several mortgages, including a $42,400 mortgage facility with respect to certain of its dealership properties that matures on October 1, 2015. This 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 options to extend the term, the interest rate will be renegotiated at each renewal period. This mortgage facility also 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 the 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 June 30, 2010, $46,608 was outstanding under these facilities.

8. Interest Rate Swaps

The Company uses interest rate swaps to manage interest rate risk associated with the Company s variable rate floor plan debt. The Company is party to interest rate swap agreements through January 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 Company designated $290,000 of the swap agreements as cash flow hedges of future interest payments of LIBOR based U.S. floor plan borrowings and the effective portion of the gain or loss on that $290,000 of the swap agreements is reported as a component of other comprehensive income and reclassified into earnings when the hedged transaction affects earnings. Settlements and changes in the fair value related to the undesignated $10,000 of the swap agreements will be recorded as realized and unrealized gains/losses within interest expense.

The Company used Level 2 inputs to estimate the fair value of the interest rate swap agreements. As of June 30, 2010, the fair value of the swaps designated as hedging instruments was estimated to be a liability of $5,729, which is recorded in accrued expenses. As of December 31, 2009, the fair value of the swaps designated as hedging instruments was estimated to be a liability of $9,963, of which $9,250 and $713 were recorded in accrued expenses and other long-term liabilities, respectively. As of June 30, 2010, the fair value of the swaps not designated as hedging instruments was estimated to be a liability of $198, which is recorded in accrued expenses. As of December 31, 2009, the fair value of the swaps not designated as hedging instruments was estimated to be a liability of $344, of which $319 and $25 were recorded in accrued expenses and other long-term liabilities, respectively.

During the six months ended June 30, 2010, the Company recognized a net gain of $1,328 related to the effective portion of the interest rate swap agreements designated as hedging instruments in accumulated other comprehensive income, and reclassified $2,207 of the existing derivative losses from accumulated other comprehensive income into floor plan interest expense. During the six months ended June 30, 2009, the Company recognized a net gain of $1,464 related to the effective portion of the interest rate swap agreements designated as hedging instruments in accumulated other comprehensive income, and reclassified $4,894 of existing derivative losses from accumulated other comprehensive income into floor plan interest expense. The Company expects approximately $4,248 associated with the swaps to be recognized as an increase of interest expense as the hedged interest payments become due through the swap agreement s maturity in January 2011. During the six months ended June 30, 2010 and 2009, the swaps increased the weighted average interest rate on the Company s floor plan borrowings by approximately 0.8% and 0.6%, respectively.

9. Commitments and Contingent Liabilities

The Company is involved in litigation which may relate to claims brought by governmental authorities, issues with customers and employment related matters, including class action claims and purported class action claims. As of

June 30, 2010, 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.

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The Company has historically structured its operations so as to minimize ownership of real property. As a result, the Company leases or subleases substantially all of its facilities. These leases are generally for a period between five and 20 years, and are typically structured to include renewal options at the Company s election. Pursuant to the leases for some of the Company s larger facilities, the Company is required to comply with specified financial ratios, including a rent coverage ratio and a debt to EBITDA ratio, each as defined. For these leases, non-compliance with the ratios may require the Company to post collateral in the form of a letter of credit. A breach of the other lease covenants give rise to certain remedies by the landlord, the most severe of which include the termination of the applicable lease and acceleration of the total rent payments due under the lease. As of June 30, 2010, the Company was in compliance with all covenants under these leases.

The Company has sold a number of dealerships to third parties and, as a condition to certain of those sales, remains liable for the lease payments relating to the properties on which those businesses operate in the event of non-payment by the buyer. The Company is also party to lease agreements on properties that it no longer uses in its retail operations that it has sublet to third parties. The Company relies on subtenants to pay the associated rent and maintain the property at these locations. In the event the subtenant does not perform as expected, the Company may not be able to recover amounts owed to it and the Company could be required to fulfill these obligations.

The Company is potentially subject to additional purchase commitments pursuant to its smart distribution agreement, smart franchise agreement and state franchise laws in the event of franchise terminations, none of which have historically had a material adverse effect on its results of operations, financial condition or cash flows. The Company does not anticipate that the purchase commitments will have a material adverse effect on its future results of operations, financial condition or cash flows, although such an outcome is possible.

The Company has $20,891 of letters of credit outstanding as of June 30, 2010, which are required by certain of our lenders and insurance providers. In addition, the Company has $14,382 of surety bonds posted by dealerships in the ordinary course of business.

10. Equity

Comprehensive income (loss)

Other comprehensive income (loss) includes foreign currency translation gains and losses, as well as changes relating to other immaterial items, including certain defined benefit plans in the U.K. and changes in the fair value of interest rate swap agreements, each of which has been excluded from net income and reflected in equity. Total comprehensive income (loss) is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Attributable to Penske Automotive Group:				
Net income	$ 29,441	$ 14,079	$ 49,795	$ 30,361
Other comprehensive income (loss):				
Foreign currency translation	(15,123)	52,357	(42,831)	54,565
Other	4,029	1,472	7,215	1,635
Total attributable to Penske Automotive Group	18,347	67,908	14,179	86,561
Attributable to the non-controlling interest:				
Net income	243	88	221	8
Total comprehensive income (loss)	$ 18,590	$ 67,996	$ 14,400	$ 86,569

In July 2010, the Company repurchased 68 shares at an average price of $10.97 for a total of $751.

11. Segment Information

The Company s operations are organized by management into operating segments by line of business and geography. The Company has determined it has three reportable segments as defined in general accounting principles for segment reporting, including: (i) Retail, consisting of our automotive retail operations, (ii) Distribution, consisting of our distribution of the smart fortwo vehicle, parts and accessories in the U.S. and Puerto Rico and (iii) PAG Investments, consisting of our investments in non-automotive retail operations. The Retail reportable segment includes all automotive dealerships and all departments relevant to the operation of the dealerships. The individual dealership operations included in the Retail reportable segment have been grouped into five geographic operating segments, which have been aggregated into 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).

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The following table summarizes revenues and income from continuing operations before certain non-recurring items and income taxes, 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 in the table below in order to enhance the comparability of segment income from period to period.

Three Months Ended June 30

	Retail	Distribution	PAG Investments	Intersegment Elimination	Total
Revenues					
2010	$ 2,684,068	$ 32,063	$	$ (12,443)	$ 2,703,688
2009	2,265,625	58,878		(5,808)	2,318,695
Adjusted segment income					
2010	44,294	(3,610)	4,103	(181)	44,606
2009	26,802	967	2,520	(59)	30,230

Six Months Ended June 30

	Retail	Distribution	PAG Investments	Intersegment Elimination	Total
Revenues					
2010	$ 5,162,123	$ 47,187	$	$ (19,943)	$ 5,189,367
2009	4,343,812	147,509		(14,326)	4,476,995
Adjusted segment income					
2010	83,030	(9,202)	3,597	(264)	77,161
2009	35,660	7,272	3,126	(222)	45,836

The following table reconciles total adjusted segment income to consolidated income from continuing operations before income taxes for the three and six month periods ended June 30, 2010 and 2009.

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Adjusted segment income	$ 44,606	$ 30,230	$ 77,161	$ 45,836
Gain on debt repurchase	422		1,027	10,429
Income from continuing operations before income taxes	$ 45,028	$ 30,230	$ 78,188	$ 56,265

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12. Consolidating Condensed Financial Information

The following tables include consolidating condensed financial information as of June 30, 2010 and December 31, 2009 and for the three and six month periods ended June 30, 2010 and 2009 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.

CONSOLIDATING CONDENSED BALANCE SHEET
June 30, 2010

	Total Company	Eliminations	Penske Automotive Group, Inc. (In thousands)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries
Cash and cash equivalents	$ 17,664	$	$	$ 13,540	$ 4,124
Accounts receivable, net	351,013	(250,655)	250,655	206,509	144,504
Inventories	1,364,718			850,026	514,692
Other current assets	106,479		863	66,670	38,946
Assets held for sale	572			572	
Total current assets	1,840,446	(250,655)	251,518	1,137,317	702,266
Property and equipment, net	707,832		5,024	449,485	253,323
Intangible assets	994,947			572,940	422,007
Equity method investments	280,847		232,015		48,832
Other long-term assets	14,591	(1,241,648)	1,245,377	9,252	1,610
Total assets	$ 3,838,663	$ (1,492,303)	$ 1,733,934	$ 2,168,994	$ 1,428,038
Floor plan notes payable	$ 818,339	$	$	$ 501,158	$ 317,181
Floor plan notes payable non-trade	499,410		29,900	300,139	169,371
Accounts payable	209,535		1,994	82,788	124,753
Accrued expenses	218,716	(250,655)	1,149	125,777	342,445
Current portion of long-term debt	16,551			1,239	15,312
Liabilities held for sale	501			501	
Total current liabilities	1,763,052	(250,655)	33,043	1,011,602	969,062
Long-term debt	844,292	(59,194)	739,157	50,087	114,242
Deferred tax liabilities	159,872			148,563	11,309
Other long-term liabilities	109,713			92,416	17,297

Total liabilities	2,876,929	(309,849)	772,200	1,302,668	1,111,910
Total equity	961,734	(1,182,454)	961,734	866,326	316,128
Total liabilities and equity	$ 3,838,663	$ (1,492,303)	$ 1,733,934	$ 2,168,994	$ 1,428,038

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CONSOLIDATING CONDENSED BALANCE SHEET
December 31, 2009

	Total Company	Eliminations	Penske Automotive Group, Inc. (In thousands)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries
Cash and cash equivalents	$ 13,999	$	$	$ 12,344	$ 1,655
Accounts receivable, net	321,226	(230,299)	230,299	195,748	125,478
Inventories	1,302,495			776,887	525,608
Other current assets	95,426		1,725	61,640	32,061
Assets held for sale	10,625			10,625	
Total current assets	1,743,771	(230,299)	232,024	1,057,244	684,802
Property and equipment, net	726,808		6,007	450,116	270,685
Intangible assets	1,011,803			570,282	441,521
Equity method investments	295,473		231,897		63,576
Other long-term assets	18,152	(1,287,938)	1,293,067	10,848	2,175
Total assets	$ 3,796,007	$ (1,518,237)	$ 1,762,995	$ 2,088,490	$ 1,462,759