ASBURY AUTOMOTIVE GROUP INC
Form 10-Q
August 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006

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: 001-31262

ASBURY AUTOMOTIVE GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**01-0609375**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
622 Third Avenue, 37th Floor **New York, New York**	**10017**
(Address of principal executive offices)	(Zip Code)

(212) 885-2500

(Registrant s telephone number, including area code)

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

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

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o

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

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: The number of shares of common stock outstanding as of August 4, 2006, was 33,197,382 (net of 1,586,587 treasury shares).

ASBURY AUTOMOTIVE GROUP, INC.
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PART I. FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements

ASBURY AUTOMOTIVE GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 89,097	$ 57,194
Contracts-in-transit	102,696	122,250
Accounts receivable (net of allowance of $811 and $1,216, respectively)	162,468	167,203
Inventories	779,817	709,791
Deferred income taxes	19,825	19,825
Prepaid and other current assets	57,390	57,419
Assets held for sale	19,677	51,498
Total current assets	1,230,970	1,185,180
PROPERTY AND EQUIPMENT, net	198,825	193,457
GOODWILL	450,362	457,405
OTHER LONG-TERM ASSETS	94,130	94,758
Total assets	$ 1,974,287	$ 1,930,800
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Floor plan notes payable manufacturer affiliated	$ 331,025	$ 204,044
Floor plan notes payable non-manufacturer affiliated	326,303	410,338
Current maturities of long-term debt	26,257	24,522
Accounts payable	65,620	72,432
Accrued liabilities	86,228	100,043
Liabilities associated with assets held for sale	5,659	26,847
Total current liabilities	841,092	838,226
LONG-TERM DEBT	470,743	472,427
DEFERRED INCOME TAXES	44,403	44,287
OTHER LONG-TERM LIABILITIES	30,419	28,094
COMMITMENTS AND CONTINGENCIES (Note 14)		
SHAREHOLDERS EQUITY:		
Preferred stock, $.01 par value per share, 10,000,000 shares authorized		
Common stock, $.01 par value per share, 90,000,000 shares authorized, 34,709,443 and 34,435,252 shares issued, including shares held in treasury, respectively	347	344
Additional paid-in capital	423,795	417,055
Retained earnings	180,543	148,986
Treasury stock, at cost; 1,586,587 shares held	(15,032)	(15,032)
Accumulated other comprehensive loss	(2,023)	(3,587)
Total shareholders equity	587,630	547,766
Total liabilities and shareholders equity	$ 1,974,287	$ 1,930,800

See Notes to Condensed Consolidated Financial Statements.

ASBURY AUTOMOTIVE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	For the Three Months Ended June 30, 2006	2005	For the Six Months Ended June 30, 2006	2005
REVENUES:				
New vehicle	$ 918,116	$ 872,308	$ 1,739,153	$ 1,643,577
Used vehicle	384,561	348,416	742,667	668,872
Parts, service and collision repair	172,036	157,999	341,924	309,672
Finance and insurance, net	43,224	39,064	78,844	74,554
Total revenues	1,517,937	1,417,787	2,902,588	2,696,675
COST OF SALES:				
New vehicle	854,390	812,339	1,617,630	1,530,845
Used vehicle	349,923	318,479	675,102	610,233
Parts, service and collision repair	84,842	77,510	169,744	151,641
Total cost of sales	1,289,155	1,208,328	2,462,476	2,292,719
GROSS PROFIT	228,782	209,459	440,112	403,956
OPERATING EXPENSES:				
Selling, general and administrative	171,715	160,185	337,364	318,552
Depreciation and amortization	5,113	4,768	10,088	9,460
Income from operations	51,954	44,506	92,660	75,944
OTHER INCOME (EXPENSE):				
Floor plan interest expense	(11,239)	(7,458)	(20,401)	(13,988)
Other interest expense	(11,139)	(10,269)	(22,043)	(19,869)
Interest income	1,021	171	1,748	435
Other income, net	481	332	825	441
Total other expense, net	(20,876)	(17,224)	(39,871)	(32,981)
Income before income taxes	31,078	27,282	52,789	42,963
INCOME TAX EXPENSE	11,654	10,231	19,796	16,111
INCOME FROM CONTINUING OPERATIONS	19,424	17,051	32,993	26,852
DISCONTINUED OPERATIONS, net of tax	(420)	(1,065)	(1,436)	(1,225)
NET INCOME	$ 19,004	$ 15,986	$ 31,557	$ 25,627
EARNINGS PER COMMON SHARE:				
Basic				
Continuing operations	$ 0.59	$ 0.52	$ 1.00	$ 0.82
Discontinued operations	(0.02)	(0.03)	(0.04)	(0.03)
Net income	$ 0.57	$ 0.49	$ 0.96	$ 0.79
Diluted				
Continuing operations	$ 0.58	$ 0.52	$ 0.98	$ 0.82
Discontinued operations	(0.02)	(0.03)	(0.04)	(0.04)
Net income	$ 0.56	$ 0.49	$ 0.94	$ 0.78
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	33,077	32,604	33,000	32,596
Diluted	33,709	32,725	33,680	32,753

See Notes to Condensed Consolidated Financial Statements.

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ASBURY AUTOMOTIVE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	For the Six Months Ended June 30, 2006	2005
CASH FLOW FROM OPERATING ACTIVITIES:		
Net income	$ 31,557	$ 25,627
Adjustments to reconcile net income to net cash provided by (used in) operating activities-		
Depreciation and amortization	10,088	9,460
Depreciation and amortization from discontinued operations	175	1,129
Stock-based compensation	2,296	
Amortization of deferred financing fees	1,158	1,013
Change in allowance for doubtful accounts	(405)	151
Gain on sale of discontinued operations, net	(2,617)	(10)
Deferred income taxes	(860)	
Other adjustments	4,222	2,993
Changes in operating assets and liabilities, net of acquisitions and divestitures-		
Contracts-in-transit	19,554	(7,072)
Accounts receivable	(5,221)	(10,375)
Proceeds from the sale of accounts receivable	9,318	8,126
Inventories	(65,565)	31,705
Prepaid and other current assets	(9,156)	(13,190)
Floor plan notes payable manufacturer affiliated	126,981	(141,120)
Accounts payable and accrued liabilities	(19,371)	13,097
Excess tax benefits from share-based payment arrangements	(519)	
Other long-term assets and liabilities	4,050	770
Net cash provided by (used in) operating activities	105,685	(77,696)
CASH FLOW FROM INVESTING ACTIVITIES:		
Capital expenditures internally financed	(16,184)	(16,942)
Capital expenditures externally financed	(7,115)	(18,236)
Construction reimbursements associated with sale-leaseback agreements	3,118	2,595
Acquisitions		(11,562)
Proceeds from the sale of assets	42,122	7,989
Other investing activities	(746)	(878)
Net cash provided by (used in) investing activities	21,195	(37,034)
CASH FLOW FROM FINANCING ACTIVITIES:		
Floor plan borrowings non-manufacturer affiliated	1,273,177	1,753,115
Floor plan repayments non-manufacturer affiliated	(1,371,358)	(1,629,643)
Proceeds from borrowings	987	20,734
Repayments of debt	(2,226)	(41,989)
Payments of debt issuance costs		(4,927)
Proceeds from the exercise of stock options	3,924	396
Excess tax benefits from share-based payment arrangements	519	
Net cash (used in) provided by financing activities	(94,977)	97,686
Net increase (decrease) in cash and cash equivalents	31,903	(17,044)
CASH AND CASH EQUIVALENTS, beginning of period	57,194	28,093
CASH AND CASH EQUIVALENTS, end of period	$ 89,097	$ 11,049

See Note 13 for supplemental cash flow information

See Notes to Condensed Consolidated Financial Statements

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ASBURY AUTOMOTIVE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. DESCRIPTION OF BUSINESS

Asbury Automotive Group, Inc. is a national automotive retailer, operating 119 franchises (86 dealership locations) in 21 metropolitan markets within 10 states as of June 30, 2006. We offer an extensive range of automotive products and services, including new and used vehicles, vehicle maintenance, replacement parts, collision repair services, and financing, insurance and service contracts. We offer 33 domestic and foreign brands of new vehicles, including four heavy truck brands. We also operate 24 collision repair centers that serve our markets.

Our retail network is organized into principally four regions and includes ten dealership groups, each marketed under different local brands: (i) Florida (comprising our Coggin dealerships, operating primarily in Jacksonville and Orlando, and our Courtesy dealerships operating in Tampa), (ii) West (comprising our McDavid dealerships operating throughout Texas and our Spirit dealership operating in Los Angeles, California), (iii) Mid-Atlantic (comprising our Crown dealerships operating in North Carolina, South Carolina and Southern Virginia) and (iv) South (comprising our Nalley dealerships operating in Atlanta, Georgia, and our North Point dealerships operating in Little Rock, Arkansas). Our Plaza dealerships operating in St. Louis, Missouri, our Gray Daniels dealerships operating in Jackson, Mississippi and our Northern California Dealerships operating in Sacramento and Fresno, California remain standalone operations.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), and reflect the condensed consolidated accounts of Asbury Automotive Group, Inc. and our wholly owned subsidiaries.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Accordingly, actual results could differ from these estimates. Estimates and assumptions are reviewed quarterly and the effects of revisions are reflected in the condensed consolidated financial statements in the period they are determined to be necessary. Refer to Critical Accounting Estimates in Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations for more information on our critical estimates. All intercompany transactions have been eliminated in consolidation.

In the opinion of management, all adjustments (consisting only of normal, recurring adjustments) considered necessary for a fair presentation of the unaudited interim condensed consolidated financial statements as of June 30, 2006, and for the three and six months ended June 30, 2006 and 2005 have been included. The results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the full year. Our interim unaudited condensed consolidated financial statements should be read together with our consolidated financial statements and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2005.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, certain amounts reflected in the accompanying Condensed Consolidated Balance Sheets as of June 30, 2006 and December 31, 2005, have been classified as Assets Held for Sale and Liabilities Associated with Assets Held for Sale for operations held for sale at each balance sheet date. In addition, the accompanying Condensed Consolidated Statements of Income for the three and six months ended June 30, 2005, have been reclassified to reflect the status of our discontinued operations as of June 30, 2006.

Revenue Recognition

Revenue from the sale of new and used vehicles is recognized upon delivery, passage of title, signing of the sales contract and approval of financing. Revenue from the sale of parts, service and collision repair is recognized upon delivery of parts to the customer or at the time vehicle service or repair work is completed. Manufacturer incentives and rebates, including manufacturer holdbacks, floor plan interest assistance and certain advertising assistance, are recognized as a reduction of new vehicle cost of sales when earned, generally at the time the related vehicles are sold.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairme

We receive commissions for arranging customer financing and for the sale of vehicle service contracts, credit life insurance and disability insurance to customers (collectively F&I). We may be charged back (chargebacks) for F&I commissions in the event a contract is terminated. F&I commissions are recorded at the time the vehicles are sold and a reserve for future chargebacks is established based on historical operating results and the termination provisions of the applicable contracts. F&I commissions, net of estimated chargebacks, are included in Finance and insurance, net in the accompanying Condensed Consolidated Statements of Income.

Goodwill and Other Intangible Assets

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairme

Goodwill represents the excess cost of the businesses acquired over the fair market value of the identifiable net assets. We have determined that based on how we operate our business, allocate resources, and regularly review our financial data and operating results that we qualify as a single reporting unit for purposes of testing goodwill for impairment. We evaluate our operations and financial results in the aggregate by dealership. The dealership general managers implement the strategy as determined by the corporate office in conjunction with our regional management team, and have the independence and flexibility to respond effectively to local market conditions.

The fair market value of our manufacturer franchise rights is determined at the acquisition date through discounting the projected cash flows specific to each franchise. We have determined that manufacturer franchise rights have an indefinite life as there are no legal, contractual, economic or other factors that limit their useful lives and they are expected to generate cash flows indefinitely due to the historically long lives of the manufacturers brand names. Due to the fact that manufacturer franchise rights are specific to the location in which we acquire a dealership, we have determined that the dealership is the reporting unit for purposes of testing for impairment.

Stock-Based Compensation

Effective January 2006, we adopted SFAS No. 123R Share-Based Payment under the modified prospective transition method and therefore we record stock-based compensation expense under the fair value method on a straight-line basis over the vesting period. Accordingly, prior periods have not been restated. Prior to January 2006, including the three and six months ended June 30, 2005, we recorded stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. APB Opinion No. 25 required the use of the intrinsic value method, which measures compensation cost as the excess, if any, of the quoted market price of the stock at the measurement date over the amount an employee must pay to acquire the stock.

Derivative Instruments and Hedging Activities

We utilize derivative financial instruments to manage our capital structure. The types of risks hedged are those relating to the variability of cash flows and changes in the fair value of our financial instruments caused by movements in interest rates. We document our risk management strategy and assess hedge effectiveness at the inception and during the term of each hedge. Derivatives are reported at fair value on the accompanying Condensed Consolidated Balance Sheets.

The changes in fair value of the effective portion of cash flow hedges are reported as a component of accumulated other comprehensive income (loss). Amounts in accumulated other comprehensive income (loss) are reclassified to interest expense to the extent the hedge becomes ineffective. The change in fair value of fair value hedges are recorded as a component of interest expense. Changes in the fair value of the associated hedged exposures are also recorded as a component of interest expense.

Measurements of hedge effectiveness are based on comparisons between the gains or losses of the actual interest rate swaps and the gains or losses of hypothetical interest rate swaps which are designed to reflect the critical terms of the defined hedged exposures. Ineffective portions of these interest rate swaps are reported as a component of interest expense in the accompanying Condensed Consolidated Statements of Income. We recognized no ineffectiveness during the six months ended June 30, 2006 and minor ineffectiveness during the six months ended June 30, 2005.

Statements of Cash Flows

Borrowings and repayments of floor plan notes payable to a party unaffiliated with the manufacturer of a particular new vehicle, and all floor plan notes payable relating to pre-owned vehicles, are classified as financing activities on the accompanying Condensed Consolidated Statements of Cash Flows with borrowings reflected separately from repayments. The net change in floor plan notes payable to a party affiliated with the manufacturer of a particular new vehicle is classified as an operating activity on the accompanying Condensed Consolidated Statements of Cash Flows.

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The net change in service loaner vehicle obligations is reflected as an operating activity in the accompanying Condensed Consolidated Statements of Cash Flows, as these borrowings and repayments are with lenders affiliated with the vehicle manufacturer from which we purchase the related vehicles.

Construction reimbursements in connection with sale-leaseback agreements for the construction of new dealership facilities or leasehold improvements to our existing dealership facilities are included in investing activities in the accompanying Condensed Consolidated Statements of Cash Flows.

Externally financed capital expenditures include all expenditures that we have financed during the reporting period or intend to finance in future reporting periods through sale-leaseback transactions or mortgage financing. Internally financed capital expenditures include all capital expenditures which were paid using available cash and for which we do not intend to seek external financing.

Tax benefits related to stock-based awards that are fully vested prior to the adoption of SFAS No. 123R are included as cash inflows from financing activities and cash outflows from operating activities on the accompanying Condensed Consolidated Statements of Cash Flows. Excess tax benefits related to stock-based awards that are partially vested upon or granted after the adoption of SFAS No. 123R are included as cash inflows from financing activities and cash outflows from operating activities on the accompanying Condensed Consolidated Statements of Cash Flows.

Recent Accounting Pronouncements

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairme

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48 Accounting for Uncertainty in Income Taxes. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109 Accounting for Income Taxes. FIN No. 48 prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Earlier application is encouraged if the enterprise has not yet issued financial statements, including interim financial statements, in the period of adoption. We are currently evaluating the impact of FIN No. 48 on our condensed consolidated financial statements and disclosures.

In October 2005, the FASB issued Staff Position (FSP) No. FAS 13-1, Accounting for Rental Costs Incurred during a Construction Period, which requires rental costs associated with ground or building operating leases that are incurred during a construction period to be recognized as rental expense. FSP No. FAS 13-1 is effective for reporting periods beginning after December 15, 2005. Accordingly, we adopted the provisions of FSP No. FAS 13-1 in January 2006 and currently expense all rent obligations incurred during the construction period.

3. STOCK-BASED COMPENSATION

We have established two stock-based compensation plans (the Plans) under which we may grant non-qualified stock options and restricted stock units to our directors, officers and employees at fair market value on the date of the grant. Stock options generally vest ratably over three years from the date of grant and expire ten years from the date of grant. Restricted stock units generally vest after two to three years from the date of grant and also expire ten years from the date of grant. We have granted a total of 4,310,954 non-qualified stock options and in January 2006, we granted 175,500 restricted stock units to certain of our key employees and officers. As of June 30, 2006, there were 2,636,362 non-qualified stock options and 175,500 restricted stock units outstanding. In addition, there were approximately 2,213,000 stock-based awards available for grant under our stock-based compensation plans as of June 30, 2006. We expect to continue to issue restricted stock units in lieu of non-qualified stock options.

Effective January 2006, we adopted SFAS No. 123R under the modified prospective transition method. As a result we have recorded stock-based compensation expense for the three and six months ended June 30, 2006, under the fair value method. Prior to January 2006, including the three and six months ended June 30, 2005, we accounted for stock-based awards under the intrinsic value method in accordance with APB Opinion No. 25. During the six months ended June 30, 2006, the adoption of SFAS No. 123R resulted in incremental stock-based compensation expense of $1.5 million (excluding $0.8 million associated with our decision to issue restricted stock units). The incremental stock-based compensation expense decreased income before income taxes by $1.5 million, net income by $0.9 million and basic and diluted earnings per common share by $0.03 per share. Net cash provided by operating activities decreased and net cash used in financing activities decreased by $0.5 million related to excess tax benefits from stock-based payment arrangements.

The fair value of each option award is estimated on the date of grant using the Black Scholes option valuation model. The fair value of each restricted stock unit is estimated using the market price of our common stock on the date of grant. Expected volatilities are based on the historical volatility of our common stock. We use historical data to estimate the rate of option exercises and employee turnover within the valuation model. The expected term of options granted represents the period of time that the related options are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

We recorded $0.9 million in compensation expense and an associated tax benefit of $0.3 million for the three months ended June 30, 2006; and $2.3 million in compensation expense and an associated tax benefit of $0.9 million for the six months ended June 30, 2006. We did not recognize any material stock-based compensation expense during the six months ended June 30, 2005. As of June 30, 2006, there was $4.6 million of total unrecognized stock-based compensation expense related to non-vested stock-based awards granted under the Plans. That cost is expected to be recognized over a weighted average period of 0.8 years. The following table illustrates the effect on net income and net income per share had our stock-based awards been recorded using the fair value method of SFAS No. 123R for the three and six months ended June 30, 2005:

(In thousands, except per share data)	**For the Three Months Ended June 30, 2005**	**For the Six Months Ended June 30, 2005**
Net income	$ 15,986	$ 25,627
Adjustments to net income:		
Stock-based compensation expense included in net income, net of tax		1
Pro forma stock-based compensation expense, net of tax	(674)	(1,340)
Pro forma net income	$ 15,312	$ 24,288
Net income per common share basic (as reported)	$ 0.49	$ 0.79
Net income per common share diluted (as reported)	$ 0.49	$ 0.78
Pro forma net income per common share basic	$ 0.47	$ 0.75
Pro forma net income per common share diluted	$ 0.47	$ 0.74

A summary of options outstanding and exercisable under the Plans as of June 30, 2006, and changes during the six months then ended is presented below:

	Stock Options	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term**	**Aggregate Intrinsic Value***
Options outstanding - December 31, 2005	2,941,262	$ 15.35		
Granted				
Exercised	(274,191)	$ 14.31		
Expired / Forfeited	(30,709)	$ 15.09		
Options outstanding June 30, 2006	2,636,362	$ 15.46	5.1	$ 14,447,263