

PENSKE AUTOMOTIVE GROUP, INC.

Form 10-K/A

February 26, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K/A

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

For the fiscal year ended December 31, 2007

**○ 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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Voting Common Stock, par value \$0.0001 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ○

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ○ No ☐

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. (Check one):

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

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

The aggregate market value of the voting common stock held by non-affiliates as of June 30, 2007 was \$894,529,752. As of February 15, 2008, there were 95,022,292 shares of voting common stock outstanding.

Documents Incorporated by Reference

Certain portions, as expressly described in this report, of the registrant's proxy statement for the 2008 Annual Meeting of the Stockholders to be held May 1, 2008 are incorporated by reference into Part III, Items 10-14.

Explanatory Note

We are filing this Form 10-K/A to correct a typographical error in the opinion of our principal auditor. All other information remains unchanged.

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PART I

Item 1. *Business*

We are the second largest automotive retailer headquartered in the U.S. as measured by total revenues. As of February 1, 2008, we owned and operated 170 franchises in the U.S. and 145 franchises outside of the U.S., primarily in the United Kingdom. We offer a full range of vehicle brands, with 94% of our total revenue in 2007 generated from the sales of brands such as Audi, BMW, Honda, Lexus, Mercedes-Benz and Toyota (non-U.S. brands). Sales relating to premium brands, such as Audi, BMW, Cadillac and Porsche, represented 65% of our total revenue. As a result, we have the highest concentration of revenues from non-U.S. and premium brands among the U.S. publicly-traded automotive retailers.

Each of our dealerships offers a wide selection of new and used vehicles for sale. In addition to selling new and used vehicles, we offer a full range of maintenance and repair services, and we facilitate the placement of third-party finance and insurance products, third-party extended service contracts and replacement and aftermarket automotive products. We are also diversified geographically, with 62% of our revenues generated from U.S. operations and 38% generated from our operations outside the U.S. (predominately in the U.K.).

Beginning in 2007, our wholly-owned subsidiary, smart USA Distributor LLC, became the exclusive distributor of the smart fortwo vehicle in the U.S. and Puerto Rico.

We believe our diversified revenue streams help to mitigate the historical cyclicity found in some elements of the automotive sector. Revenues from higher margin service and parts sales are typically less cyclical than retail vehicle sales, and generate the largest part of our gross profit. The following graphic shows the percentage of our retail revenues by product area and their respective contribution to our overall gross profit in 2007:

Revenue Mix

Gross Profit Mix

Business Strategy

Our strategy is to sell and service outstanding vehicle brands in premium facilities. We believe offering our customers superior customer service in a premium location fosters a long-term relationship, which helps generate repeat and referral business, particularly in our higher-margin service and parts business. We believe our focus on developing a loyal customer base has helped to increase our profitability and generate incremental service and parts sales. In addition, our large number of dealerships, geographically concentrated by region, allows us the opportunity to achieve cost savings and implement best practices, while also providing access to a broad base of potential acquisitions.

Offer Outstanding Brands in Premium Facilities

We have the highest concentration of revenues from non-U.S. brands among the U.S. publicly-traded automotive retailers. We believe the market performance of the brands we represent contributed to our same-

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store revenue and gross profit growth, as non-U.S. vehicle brands have gained market share in recent years. The following chart reflects our revenue mix:

The following chart reflects our percentage of total revenues by brand in 2007:

Over time, we are making substantial investments in our retail dealerships in an effort to create an outstanding retail experience for our customers. We believe the experience we offer customers in our facilities drives repeat and referral business, particularly in our higher margin service and parts operations. Where advantageous, we attempt to aggregate our dealerships in a campus or group setting in order to build a destination location for our customers, which we believe helps to drive increased customer traffic to each of the brands at the location. This strategy also creates an opportunity to reduce personnel expenses and administrative expenses, and leverage operating expenses over a larger base of dealerships. We believe this strategy has enabled us to consistently achieve new unit vehicle sales per dealership that are significantly higher than industry averages for most of the brands we sell.

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The following is a list of our larger dealership campuses or groups:

Location	Square Feet	Service Bays	2007 Revenue (millions)	Franchises
North Scottsdale, Arizona	450,000	226	\$ 584.4	Acura, Audi, BMW, Jaguar, Land Rover, MINI, Porsche, Volkswagen, Volvo
Scottsdale, Arizona	136,000	76	\$ 299.2	Aston Martin, Bentley, Ferrari, Jaguar, Land Rover, Lexus, Maserati, Rolls-Royce
San Diego, California	348,000	232	\$ 683.9	Acura, Aston Martin, BMW, Jaguar, Lexus, Mercedes-Benz, Scion, smart, Toyota
Fayetteville, Arkansas	122,000	59	\$ 270.0	Acura, Chevrolet, Honda, HUMMER, Scion, Toyota
Tyson s Corner, Virginia	191,000	138	\$ 274.4	Audi, Aston Martin, Mercedes-Benz, Porsche, smart
Inskip, Rhode Island	319,000	176	\$ 402.5	Acura, Audi, Bentley, BMW, Infiniti, Lexus, Mercedes-Benz, MINI, Nissan, Porsche, smart, Volvo
Turnersville, New Jersey	303,000	177	\$ 389.7	Acura, BMW, Cadillac, Chevrolet, Honda, HUMMER, Hyundai, Nissan, Scion, Toyota

By way of example, our Scottsdale 101 Auto Mall features nine separate showrooms and franchises with over 450,000 square feet of facilities. Typically, customers may choose from an inventory of over 1,500 new and used vehicles, and have access to approximately 226 service bays with the capacity to service approximately 1,000 vehicles per day. This campus also features an on/off road test course where customers may experience the uniqueness of the brands offered. We will continue to evaluate other opportunities to aggregate our facilities to reap the benefits of a destination location.

Expand Revenues at Existing Locations and Increase Higher-Margin Businesses

We aim to increase our existing business by generating additional revenue at existing dealerships, with a particular focus on developing our higher-margin businesses such as finance, insurance and other products and service, parts and collision repair services.

Increase Same-Store Sales. We believe our emphasis on improving customer service and upgrading our facilities should result in continued increases in same-store sales. As part of the investment program noted above, we added numerous incremental service bays in order to better accommodate our customers.

Grow Finance, Insurance and Other Aftermarket Revenues. Each sale of a vehicle provides us the opportunity to assist in financing the sale, selling the customer a third party extended service contract or insurance product, or selling other aftermarket products, such as entertainment systems, security systems, satellite radios and protective coatings. In order to improve our finance and insurance business, we focus on enhancing and standardizing our salesperson

training programs, strengthening our product offerings and standardizing our selling process.

Expand Service and Parts and Collision Repair Revenues. In recent years, we have added a significant number of service bays at our dealerships in an effort to expand this higher-margin element of our business. Many of today's vehicles are complex and require sophisticated equipment and specially trained technicians to perform certain services. Unlike independent service shops, our dealerships are authorized to perform this work as well as warranty work for the manufacturers. We believe that our brand-mix and the complexity of today's vehicles, combined with our focus on customer service and superior facilities, contribute to our service and parts revenue increases. We also operate 27 collision repair centers which are operated as an integral part of our dealership operations. As a result, the repair centers benefit from the dealerships' repeat and referral business.

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Continue Growth through Targeted Acquisitions

We believe that attractive acquisition opportunities exist for well-capitalized dealership groups with experience in identifying, acquiring and integrating dealerships. The automotive retail market provides us with significant growth opportunities in each of the markets in which we operate. In the U.S., the ten largest industry participants generated less than 10% of new vehicle industry sales in 2007. Generally, we seek to acquire dealerships with high growth automotive brands in highly concentrated or rapidly growing demographic areas. We focus on larger dealership operations that will benefit from our management assistance, manufacturer relations and scale of operations, as well as individual dealerships that can be effectively integrated into our existing operations.

Diversification Outside the U.S.

One of the unique attributes of our operations versus our peers is our diversification outside the U.S. Approximately 38% of our consolidated revenue during 2007 was generated from operations located outside the U.S. and Puerto Rico, predominately in the United Kingdom. According to industry data, the United Kingdom represented the third largest retail automotive market in Western Europe in 2007 with approximately 2.4 million new vehicle registrations. Our brand mix in the United Kingdom is predominantly premium. As of December 31, 2007, we believe we were the largest or second largest volume Audi, Bentley, BMW, Land Rover, Lexus, Mercedes-Benz, Porsche and Toyota dealer in this market. Additionally, we operate a number of dealerships in Germany, some in the form of joint ventures with experienced local partners, which sell and service Audi, BMW, Lexus, MINI, Toyota, Volkswagen and other premium brands.

Strengthen Customer Loyalty

Our ability to generate and maintain repeat and referral business depends on our ability to deliver superior customer service. We believe that customer loyalty contributes directly to increases in same-store sales. By offering outstanding brands in premium facilities, one-stop shopping convenience, competitive pricing and a well-trained and knowledgeable sales staff, we aim to establish lasting relationships with our customers, enhance our reputation in the community, and create the opportunity for significant repeat and referral business. We believe our low and steadily decreasing employee turnover has been critical to furthering our customer relationships. Additionally, we monitor customer satisfaction data accumulated by manufacturers to track the performance of dealership operations and use it as a factor in determining the compensation of general managers and sales and service personnel in our dealerships.

Maintain Diversified Revenue Stream and Variable Cost Structure

We believe that our diversified revenue mix may mitigate the historical cyclicity found in some elements of the automotive sector, and that demand for our higher-margin service and parts business is less affected by economic cycles than demand for new vehicles. We are further diversified due to our brand mix and the geographical dispersion of our dealership operations. In addition, a significant percentage of our operating expenses are variable, including sales compensation, floor plan interest expense (inventory-secured financing) and advertising, which we believe we can adjust over time to reflect economic trends.

Leverage Scale and Implement Best Practices

We seek to build scale in many of the markets where we have dealership operations. Our desire is to reduce or eliminate redundant operating costs such as accounting, information technology systems and general administrative costs. In addition, we seek to leverage our industry knowledge and experience to foster communication and cooperation between like brand dealerships throughout our organization. Senior management and dealership management meet regularly to review the operating performance of our dealerships, examine industry trends and,

where appropriate, implement specific operating improvements. Key financial information is discussed and compared to other dealerships across all markets. This frequent interaction facilitates implementation of successful strategies throughout the organization so that each of our dealerships can benefit from the successes of our other dealerships and the knowledge and experience of our senior management.

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smart Distributorship

smart USA Distributor, LLC, a wholly owned subsidiary, is the exclusive distributor of the smart fortwo vehicle in U.S. 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 State of California Air Resources Board. Though launched in the U.S. in 2008, more than 850,000 fortwo vehicles have previously been sold outside the U.S. As distributor, smart USA is responsible for developing and maintaining a smart vehicle dealership network throughout the U.S. and Puerto Rico.

smart USA has certified a network of 68 smart dealerships in 31 states, most of which have received the requisite licensing and other required approvals and are actively selling vehicles. Additional dealerships are expected to commence retailing vehicles during 2008 upon completion of their facilities and obtaining licensing approval. Of the 74 dealerships currently planned in the U.S., eight are owned and operated by us (see below Acquisitions for a listing of those dealerships). The smart fortwo offers three different versions, the *Pure*, *Passion* and *Cabriolet* with base prices ranging from \$11,600 to \$16,600. We currently expect to distribute at least 20,000 smart fortwo vehicles in 2008.

Industry Overview

The automotive retail industry is among the largest retail trade sectors in each of the markets in which we operate. In the U.S., the majority of automotive retail sales are generated by approximately 21,800 U.S. franchised dealerships, producing revenues of approximately \$675 billion. Of these \$675 billion in U.S. franchised dealer revenues, new vehicle sales represent approximately 59%, used vehicle sales represent approximately 29% and service and parts sales represent 12%. Dealerships also offer a wide range of higher-margin products and services, including extended service contracts, financing arrangements and credit insurance. The National Automobile Dealers Association figures noted above include finance and insurance revenues within either new or used vehicle sales as sales of these products are usually incremental with the sale of a vehicle.

Germany and the U.K. represented the first and third largest European automotive retail markets in 2007, with new car registrations of 3.1 million and 2.4 million vehicles, respectively. In 2006, U.K. and German automotive sales exceeded \$260 billion and \$330 billion, respectively. Combined, the UK and German markets make up approximately 35% of the European market, based on new vehicle sales.

The automotive retail industry is highly fragmented and largely privately held in the U.S and Europe, with the U.S. publicly held automotive retail groups accounting for less than 10% of total industry revenue. According to industry data, the number of U.S. franchised dealerships has declined from approximately 24,000 in 1990 to approximately 21,800 as of January 1, 2007. Although significant consolidation has already taken place, the industry remains highly fragmented, with more than 90% of the U.S. industry's market share remaining in the hands of smaller regional and independent players. We believe that further consolidation in the industry is probable due to the significant capital requirements of maintaining manufacturer facility standards and the limited number of viable alternative exit strategies for dealership owners.

Generally, new vehicle unit sales are cyclical and, historically, fluctuations have been influenced by factors such as manufacturer incentives, interest rates, fuel prices, unemployment, inflation, weather, the level of personal discretionary spending, credit availability, consumer confidence and other general economic factors. However, from a profitability perspective, automotive retailers have historically been less vulnerable than automobile manufacturers to declines in new vehicle sales. We believe this may be due to the retailers' more flexible expense structure (a significant portion of the automotive retail industry's costs are variable, relating to sales personnel, advertising and inventory finance cost) and diversified revenue stream. In addition, automobile manufacturers may increase dealer incentives

when sales are slow, which further increases the volatility in profitability for automobile manufacturers and may help to decrease volatility for automotive retailers.

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We have completed a number of dealership acquisitions since January 2005. Our financial statements include the results of operations of acquired dealerships from the date of acquisition. The following table sets forth information with respect to our current dealerships acquired or opened since January 2005:

Dealership	Date Opened or Acquired	Location	Franchises
<i>U.S.</i>			
Honda Mall of Georgia	1/05	Buford, GA	Honda
Jaguar of Tulsa	1/05	Tulsa, OK	Jaguar
United Ford North	1/05	Tulsa, OK	Ford
United Ford South	1/05	Tulsa, OK	Ford
HUMMER of Turnersville	5/05	Turnersville, NJ	HUMMER
Inskip Nissan	7/05	Warwick, RI	Nissan
Stevens Creek Porsche Audi	10/05	San Jose, CA	Audi Porsche
Acura of Escondido	1/06	Escondido, CA	Acura
Aston Martin San Diego	1/06	San Diego, CA	Aston Martin
Audi of Escondido	1/06	Escondido, CA	Audi
Honda Mission Valley	1/06	San Diego, CA	Honda
Honda of Escondido	1/06	Escondido, CA	Honda
Jaguar Kearny Mesa	1/06	San Diego, CA	Jaguar
Kearny Mesa Acura	1/06	San Diego, CA	Acura
Mazda of Escondido	1/06	Escondido, CA	Mazda
United HUMMER of Tulsa	1/06	Tulsa, OK	HUMMER
Motorwerks BMW/MINI	5/06	Minneapolis, MN	BMW/MINI
West Palm Subaru	7/06	West Palm Beach, FL	Subaru
Triangle Nissan del Oeste	7/06	Puerto Rico	Nissan
Cadillac of Turnersville	11/06	Turnersville, NJ	Cadillac
Landers Ford Lincoln Mercury	1/07	Benton, Arkansas	Ford, Lincoln, Mercury
Lexus of Edison	3/07	Edison, NJ	Lexus
Round Rock Toyota-Scion	4/07	Round Rock, TX	Toyota, Scion
Round Rock Hyundai	4/07	Round Rock, TX	Hyundai
Round Rock Honda	4/07	Round Rock, TX	Honda
Inskip MINI	5/07	Warwick, RI	MINI
Royal Palm Toyota-Scion	1/08	Royal Palm, FL	Toyota, Scion
smart center Bedford	1/08	Bedford, OH	smart
smart center Bloomfield	1/08	Bloomfield Hills, MI	smart
smart center Chandler	1/08	Chandler, AZ	smart
smart center Fairfield	1/08	Fairfield, CT	smart
smart center Round Rock	1/08	Round Rock, TX	smart
smart center San Diego	1/08	San Diego, CA	smart
smart center Tysons Corner	1/08	Vienna, VA	smart
smart center Warwick	1/08	Warwick, RI	smart

Outside the U.S.

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Kings Swindon	4/05	Swindon, England	Chrysler, Jeep, Dodge
Lexus of Milton Keynes	11/05	Milton Keynes, England	Lexus
BMW/ Mini Sunningdale	1/06	Berkshire, England	BMW, MINI
Guy Salmon Jaguar Ascot	1/06	Berks, England	Jaguar
Guy Salmon Jaguar Gatwick	1/06	West Sussex, England	Jaguar

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Dealership	Date Opened or Acquired	Location	Franchises
Guy Salmon Jaguar Maidstone	1/06	Kent, England	Jaguar
Guy Salmon Land Rover Ascot	1/06	Berks, England	Land Rover
Guy Salmon Land Rover Gatwick	1/06	West Sussex, England	Land Rover
Guy Salmon Land Rover Maidstone	1/06	Kent, England	Land Rover
Guy Salmon Land Rover Portsmouth	1/06	Portsmouth, England	Land Rover
Honda Redhill	1/06	Surrey, England	Honda
Kings Bristol Chrysler Jeep Dodge	1/06	Bristol, England	Chrysler, Jeep, Dodge
Rolls Royce Sunningdale	1/06	Berkshire, England	Rolls Royce
Sytner Coventry	1/06	West Midlands, England	BMW, MINI
Lamborghini Birmingham	6/06	Birmingham, England	Lamborghini
Lamborghini Edinburgh	6/06	Edinburgh, Scotland	Lamborghini
Kings Chrysler Jeep Dodge Newcastle	8/06	Cleveland, England	Chrysler, Jeep, Dodge
Kings Chrysler Jeep Dodge Stockton	8/06	Stockton-on-Tees, England	Chrysler, Jeep, Dodge
Mercedes-Benz of Carlisle	8/06	Cumbria, England	Mercedes-Benz
Mercedes-Benz of Newcastle	8/06	Cleveland, England	Mercedes-Benz
Mercedes-Benz of Stockton	8/06	Stockton-on-Tees, England	Mercedes-Benz
Mercedes-Benz of Sunderland	8/06	Sunderland, England	Mercedes-Benz
Sytner BMW/MINI Cardiff	8/06	South Glamorgan, Wales	BMW/MINI
Sytner BMW/MINI Central	8/06	West Midlands, England	BMW/MINI
Sytner BMW/MINI Newport	8/06	Newport, South Wales	BMW/MINI
Sytner BMW/MINI Sutton	8/06	West Midlands, England	BMW/MINI
Sytner BMW/MINI Warley	8/06	West Midlands, England	BMW/MINI
Audi Leicester	6/07	Leicester, England	Audi
Audi Nottingham	6/07	Nottingham, England	Audi
Toyota Solihull	9/07	West Midlands, England	Toyota
Maranello Ferrari/Maserati	10/07	Surrey, England	Ferrari, Maserati

In 2006 and 2007, we disposed of 23 and 21 dealerships, respectively, that we believe were not integral to our strategy or operations. We expect to continue to pursue acquisitions, selected dispositions and related transactions in the future.

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Franchises. The following charts reflect our franchises by location and our dealership mix by franchise as of February 1, 2008:

Location	Franchises	Franchises	U.S.	Non-U.S.	Total
Arizona	21	Toyota/Lexus	38	14	52
Arkansas	14	BMW/MINI	11	30	41
California	26	Ford/PAG	18	22	40
Connecticut	5	Daimler	15	21	36
Florida	9	Honda/Acura	27	1	28
Georgia	4	Chrysler	9	18	27
Indiana	2	Audi	7	10	17
Michigan	7	General Motors	16		16
Minnesota	2	Porsche	5	4	9
Nevada	2	Nissan/Infiniti	7		7
New Jersey	19	Others	17	25	42
New York	4	Total	170	145	315
Ohio	6				
Oklahoma	7				
Puerto Rico	15				
Rhode Island	12				