Autonation (AN) Earnings Report: Q2 2015 Conference Call Transcript

The following Autonation conference call took place on July 22, 2015, 11:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Andrew Wamser; AutoNation, Inc.; VP- IR
- Mike Jackson; AutoNation, Inc.; Chairman, CEO
- Cheryl Miller; AutoNation, Inc.; EVP, CFO
- Bill Berman; AutoNation, Inc.; EVP, COO
- Jon Ferrando; AutoNation, Inc.; EVP, General Counsel

Other Participants

- Colin Langan; UBS; Analyst
- John Murphy; BofA Merrill Lynch; Analyst
- Paresh Jain; Morgan Stanley; Analyst
- David Lim; Wells Fargo Securities; Analyst
- Rick Nelson; Stephens Inc.; Analyst
- Brett Hoselton; KeyBanc Capital Markets; Analyst
- Brian Sponheimer; Gabelli and Co.; Analyst
- David Whiston; Morningstar; Analyst
- David Tamberrino; Goldman Sachs; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to AutoNation second-quarter 2015 earnings conference call. (Operator Instructions). Today's conference is being recorded. If you have any objections you, you may disconnect at this time.

Now I will turn the call over to Mr. Andrew Wamser, Director and Vice President of Investor Relations for AutoNation . Sir, you may begin.

Andrew Wamser (VP- IR):

Thank you and good morning and welcome to AutoNation's second-quarter 2015 conference call and webcast. Leading our call today will be Mike Jackson, our Chairman, CEO and President; Cheryl Miller, our Chief Financial Officer; Bill Berman, our Chief Operating Officer; and Jon Ferrando, our EVP responsible for M&A. Following their remarks we will open up the call for questions. Robert Quartaro and I will also be available by phone following the call to address any additional questions that you may have.

Before we begin, let me read our brief statement regarding forward-looking comments. Certain statements and information on this call may constitute forward-looking statements within the meaning of the Federal Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve risks which may cause actual results or performance to differ materially from such forward-looking statements.

Additional discussions of factors that could cause actual results to differ materially are contained in our press release issued earlier today and our SEC filings including our most recent annual report on Form 10-K and subsequent quarterly reports on Form 10-Q and current reports on Form 8-K.

Certain non-GAAP financial measures as defined under SEC rules will be discussed on this call. Reconciliations are provided in our press release and on our Web site located at investors.AutoNation.com.

Now I will turn the call over to AutoNation's Chairman, CEO and President, Mike Jackson. Mike?

Mike Jackson (Chairman, CEO):

Good morning and thank you for joining us. Today we reported record second-quarter earnings per share from continuing operations of $1.00, a 20% increase as compared to EPS from continuing operations of $0.83 for the same period in the prior year. This is the 19th consecutive quarter of double-digit year-over-year growth and EPS from continuing operations.

Second quarter 2015 revenue totaled $5.2 billion compared to $4.8 billion in the year-ago period, an increase of 9% driven by stronger performance in all our business sectors. Total gross profit was an all-time record at $819 million compared to $745 million in the year-ago period, an increase of 10%.

Operating income was a second-quarter record at $220 million compared to $198 million in the year-ago period, an increase of 12%. In the second quarter, AutoNation's retail new vehicle unit sales increased by 6% or 4% on the same-store sales basis.

Last week Honda Financial Services announced a new policy for dealer reserve that does not affect the dealer economics but achieves the CFPB's goal of reducing dealer reserve discretion. We applaud Honda Financial Services for developing an enlightened solution that could become a template for the industry.

Regarding our digital initiatives, we have accelerated the rollout of AutoNation Express. The first phase of the rollout identifying reserving a specific vehicle online has been well received by the marketplace and our associates. AutoNation Express encompasses our continued commitment to delivering a peerless customer experience.

I will now turn the call over to Chief Financial Officer, Cheryl Miller.

Cheryl Miller (EVP, CFO):

Thank you, Mike, and good morning, ladies and gentlemen. For the second quarter, we reported net income from continuing operations of $115 million or $1.00 per share versus net income of $101 million or $0.83 per share during the second quarter of 2014, a 20% improvement on a per share basis. There were no adjustments to net income in either period.

In the second quarter, revenue increased $436 million or 9% compared to the prior year and gross profit improved $74 million or 10%.

SG&A as a percentage of gross profit was 69.4% for the quarter which represents a 100 basis point decrease compared to the year-ago period. Net new vehicle floorplan was a benefit of $16 million, an increase of $2 million from the second quarter of 2014 primarily due to higher floorplan assistance. Floorplan assistance increased due to higher new vehicle sales and an increase in the floorplan assistance rate per unit.

Floorplan debt increased sequentially approximately $319 million during the second quarter to $3.3 billion at quarter end primarily due to increased borrowings on our new and used floorplan facilities which was driven by higher inventory levels supporting current sales trends and newly acquired stores.

Non-vehicle interest expense increased slightly to $21.6 million compared to $21.3 million in the second quarter of 2014 due to higher debt balances. At the end of June, we had $2.1 billion of non-vehicle debt, an increase of $73 million compared to March 31, 2015. In addition to our fixed-rate debt, this balance includes $800 million of outstanding borrowings under the revolving credit facility and $299 million of commercial paper.

The provision for income tax in the quarter was $71.6 million or 38.3%. During the second quarter 2015, we repurchased 796,000 shares for $50 million at an average price of $62.78 per share. AutoNation has approximately $217 million of remaining Board authorization for share repurchase. As of July 20, there were approximately 113 million shares outstanding and again this does not include the dilutive impact of stock options.

Our leverage ratio remained at 2.2 times at the end of Q2 as compared to Q1. The leverage ratio was 2.0 times on a net debt basis including used floorplan availability and our covenant limit is 3.75 times. Capital expenditures were $65.2 million for the quarter. Capital expenditures are on an accrual basis excluding operating lease buyouts and related asset sales.

Our quarter end cash balance was $65 million which combined with our additional borrowing capacity resulted in total liquidity of $1.1 billion at the end of June. We plan to use the revolving credit facility as a liquidity backstop for borrowings under our commercial paper programs.

At quarter end, we had $299 million of commercial paper notes outstanding which in effect reduces our available liquidity to $806 million. We remain committed to driving Company value and shareholder returns through disciplined capital allocation as we continue to invest in strategic digital initiatives, acquisitions and opportunistic share repurchase.

Now let me turn you over to our Chief Operating Officer, Bill Berman.

Bill Berman (EVP, COO):

Thank you, Cheryl, and good morning. AutoNation posted record second-quarter results with growth across all business sectors. We reported all-time records in total gross profit, used vehicle revenue, customer care revenue and customer care gross profit. In the second quarter we set records in operating income, net income from continuing operations and this marked our 19th consecutive quarter of double-digit EPS growth.

Going forward, my comments will be on a same-store basis and compared to the period a year ago unless noted otherwise.

Total gross profit for variable operations was $459 million, up 6%. Total variable gross was $3307 on a per vehicle retail basis, an increase of $30 or 1%.

New and used same-store sales unit volume was up 5%.

New vehicle revenue for the quarter was $2.9 billion, an increase of $144 million or 5%. We retailed 83,000 units, an increase of 4%. New vehicle gross profit was $1905 on a per vehicle retail basis, a decrease of $106 or 5%.

We continue to experience new car PVR price from the import segment, increased stair-step incentives as well as growth in entry level premium luxury models. However, our focus remains on the total variable operation.

For the quarter, used vehicle retail revenue was $1.1 billion, an increase of $86 million or 9% compared to the period a year ago. Used vehicle retail were 55,800, up 7%. Used vehicle gross profit was $1590 on a per vehicle retail basis, a decrease of $95 or 6%.

Customer financial services gross profit was $1528 on a per vehicle retail basis, an increase of $133 or 10%. Approximately two-thirds of our gross profit per vehicle retail was related to customer financial services products and one-third was related to finance.

Total gross profit per customer financial services of $212 million was up $28 million or 15% compared with the period a year ago.

During the quarter, we rolled out the first AutoNation branded products, the AutoNation vehicle protection plan or VPP in our central region. The initial launch of VPP has been well received by our associates in the marketplace. By the end of the third quarter, the program will be rolled out nationwide to our remaining domestic and import stores.

Over the remainder of the year, we will also pilot additional AutoNation branded products. We continue to see opportunity in customer financial services as we drive store level execution and offer product that deliver customer value and drive loyalty.

As Mike mentioned earlier, we do not expect a financial impact to our business from Honda Financial Services new dealer reserve policy. The new policy provides compensation in addition to the dealer reserves which is 100 to 125 basis points based on the term of the loan. We believe Honda's new policy could become an attractive template for the industry.

In the quarter, customer care revenue was at an all-time record of $751 million, an increase of $51 million or 7%. We set another all-time record in customer care gross profit of $324 million, an increase of $26 million or 9%. Customer pay gross was $129 million, up 8%, our 20th consecutive quarterly increase in customer pay gross.

Warranty gross was $62 million up 11%; collision gross was $30 million, up 12%.

Turning to digital. Though we are still in the early phases of the rollout, we are pleased with the growth of traffic to our Web site. AutoNation Web sites generated over 20% of sales for the first half of the year. We completed the first phase of AutoNation Express six months ahead of schedule. We remain committed to providing transparency and delivering a peerless customer experience with initiatives such as AutoNation Express.

Thanks to the efforts of our 25,000 associates, we achieved an unprecedented milestone in automotive history with the sale of our 10 millionth vehicle. We will continue to build on this momentum in the second half of the year by selling and servicing one car at a time to our next milestone.

I will now turn the call back to Mike Jackson.

Mike Jackson (Chairman, CEO):

Thanks, Bill. We believe the auto industry remains healthy and we are reconfirming our 2015 sales forecast of 17 million units.

With that we will be happy to take your questions. I'm calling in from New York so I will direct the traffic on the questions to the team in Fort Lauderdale. But let's begin.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions).

Colin Langan, UBS.

Colin Langan (Analyst - UBS):

Thanks for taking my question. Can you give color on the -- when you mentioned Honda's Finance has no impact on your profit but you also made a comment that there is additional income in addition to the cap. How does that mechanism work?

Mike Jackson (Chairman, CEO):

This is Mike Jackson. I think the Honda agreement is very enlightened, it is something that while in principle everyone agreed that discrimination or unintentional disparate impact is not something that should exist in auto retail, how to get there was quite a contentious dilemma.

I think the Honda solution is quite enlightened in that by putting caps in place that are dramatically reduced, the amount of discretion that exists on the individual transaction at the store level is dramatically reduced and in principle AutoNation moved in that direction a decade ago.

But with a cap of only 100 to 125 basis points, the economics would change and that is not acceptable as a solution and everyone agreed, CFPB lenders and certainly retailers, that the added value that dealers have on indirect lending is significant and that the compensation we were receiving was fair and justified and this was not about changing that.

So there is additional compensation system that comes to the dealers for having originated the loan that is built into the base rate from Honda. So we have looked at it. We say this gets us whole back to where we are and it addresses CFPB issues and I think it is workable for the lenders.

So AutoNation is publicly supporting this direction. We will work with Honda closely on working out any bugs in the system to make sure we achieve this goal and we will urge other lenders to take a close look at this as a template for, a solution and pledge to those lenders if they go in this direction, they will have AutoNation's full support.

Colin Langan (Analyst - UBS):

As a follow-up, I believe industry data says that there is about 100 basis point markup on new but about 200 on used. So do you think there will be separate rules for used or an adjustment made or is that a risk to the used F&I profit?

Mike Jackson (Chairman, CEO):

So Honda is in the midst of having a series of meetings across the country where there is rolling this out. I think there are detailed questions that are still unanswered and there could be some changes.

So I don't want to get too deep into the weeds on exactly how it all is going to work but I can tell you I have looked at it, I've spoken to Honda, I have spoken to CFPB. I believe this is a very workable concept and a structure and with a little movement here and there on some details, it is going to work.

Colin Langan (Analyst - UBS):

Thank you very much. One last question. Just any color on the decline in what was driving the decline in margins on new? That is it. Thank you very much.

Mike Jackson (Chairman, CEO):

This is Mike Jackson again. I think again gas prices are significantly different from what everyone thought they would be a couple of years ago so this has led to a tremendous shift in consumer demand. If you look at the year-to-date industry sales figures up 4.4%, that is 10% in trucks, 9% in luxury vehicles, and car sales are actually down.

There is a mishmash between install capacity and what the marketplace is demanding. So there is quite a bit of pressure around midsize sedans which is a traditional strength of Japanese manufacturers.

So that is a challenge. These things happen from time to time we will work through it but that is what is going on. Bill, would you like to read any more color to that?

Bill Berman (EVP, COO):

The only other thing I would add is there is some additional pressure coming from stairsteps, coming from certain manufacturers as well as entry level premium luxury vehicles are having an adverse effect on PVR. But like I said earlier, we are looking at total variable PVR and for the seventh consecutive quarter, we have been able to grow that and the last quarter was an additional $30.

Colin Langan (Analyst - UBS):

All right. Thank you very much.

Operator:

John Murphy, Bank of America Merrill Lynch.

John Murphy (Analyst - BofA Merrill Lynch):

A first question, it sounds like the AutoNation Express in your online efforts have been really pulled forward and accelerated here. I am just curious how that correlates to your spending, your investment that you have highlighted on that and what kind of benefits we might be able to see more quickly in the second half of this year and going into 2016?

Mike Jackson (Chairman, CEO):

I think that is a correct assumption and in our plan for this you will always have contingencies for challenges and difficulties that you can't foresee. In this case though, we saw the opportunity to move faster and so we did. And I'm not going to quantify how much money that is but we made an additional investments in the second quarter.

Also as I laid out years ago that we would reduce our dependency on third parties and there would be a vetting process to determine who we could partner with in the long-term on third parties but that we expect to ultimately be in the high single digits.

We came to a fork in the road with TrueCar which was 3% of our business in the second quarter and that money will be reinvested in the AutoNation brand and AutoNation Express going forward.

So it is strategically all good news. I think we are on the right path for our Company. I am absolutely convinced of it but we need the flexibility and freedom depending on circumstances to either speed up or slow down depending what we are confronted with. But we are very pleased and I have to congratulate Bill and his team for fully implementing AutoNation Express first phase six months ahead of time, quite an effort.

John Murphy (Analyst - BofA Merrill Lynch):

Okay, and does that mean that the bulk of the $100 million has been spent or that is still over the next couple of years that there is still a big chunk to come in the next couple of years?

Mike Jackson (Chairman, CEO):

There is still far to go, John. So phase one, the next phase that we will take out nationally is we will buy your car. That is already through pilot, that will roll out in the rest of this year and then we will be in pilot phase toward the end of the year for financing and customer care and then move that out in 2016.

We intend to fully make our site transactional for every phase of the business and we think combined with our brand positioning to attract consumers to our sites, give them a good experience, the most important thing is on-sites. They want to be able to do something. The sites need to be transactional.

This combination of a strong brand with consumer empowered transactional sites that is seamlessly integrated into the dealerships, it is something no one else in the industry is doing and we are convinced it will be a significant competitive advantage for us in the long-term. How we have to make those investments from quarter and quarter will speed up and slow down depending upon the challenges and opportunities that we have.

John Murphy (Analyst - BofA Merrill Lynch):

Okay, thank you. Then just a follow-up to Colin's question on the new vehicle gross pressure, is this really something where you think it is just a mix shift because there is a lot of concern in the market that it portends some pressure on demand in general. And just curious on what you are seeing there and if you think demand is fundamentally showing up and not being incented by these cuts in gross?

Mike Jackson (Chairman, CEO):

The way we think about it, John, and I was very clear with the team several years ago, that total variable gross is our final report card and then we have a lot of different ways to get there but I want to see and the Company wants to see a steady increase in total variable gross. And then how the various pieces move within that is interesting and we will talk about. But at the end of the day we have to put the whole pie together and we have shown we are very successful in doing that.

Front end grosses will move around new cars depending like we just already talked about, the gas situation. Used cars this year we are pushing for volume. But if you then take those opportunities and are able to package it with your financial services and products and come out ahead, I think it is a good business plan. And so we have consistently demonstrated the ability to do that.

And so that is the big picture for me that I am saying. I think our total front-end gross is stable to I observe the fact that seven quarters in a row we've improved it so there is something going on there and there it is.

John Murphy (Analyst - BofA Merrill Lynch):

And then just lastly, Cheryl, you alluded to floorplan assistance being increased and rates being increased. Just curious why that is happening with inventory levels largely balanced and demand coming through. I am just not sure why there would be an increase of floorplan assistance coming from the automakers, curious why that happens?

Cheryl Miller (EVP, CFO):

Some of that is mix shift. So I would say that varies depending on what products are out there that we have out there. Our focus within floorplan certainly is to make sure we are running the inventories in a disciplined way to take advantage of the assistance per unit but also to keep down the interest expense costs.

So we are very focused on our partnerships with the captives and bank lenders on the interest expense side as well as making sure we manage the inventory there as well.

But as you know, the OEMs have an ability to look at that assistance per unit and that is something that as interest rates move up which at some point they will, so whether that is September, December or into next year, that is another variable that the OEMs have that they can continue to look at.

John Murphy (Analyst - BofA Merrill Lynch):

So it was more of mix than an actual rate change at this point but there could be a rate change going forward is what you are saying?

Cheryl Miller (EVP, CFO):

I would say it is a combination, some of them have moved it per unit, some of it is mix and then I think going forward, it is something that we will continue to see how the OEMs evaluate that, particularly in a rising rate environment in the future.

John Murphy (Analyst - BofA Merrill Lynch):

Great, thank you very much.

Operator:

Paresh Jain, Morgan Stanley .

Paresh Jain (Analyst - Morgan Stanley):

Good morning, everyone. A follow-up on the CFPB impact now, Mike, AutoNation has certainly welcoming the Honda solution. But there seems to be still a lot of resistance in the broader dealer community.

So if I'm looking at it from a different angle, any potential negative impact here perhaps could be far worse for smaller dealer groups that on average have one or two stores and don't have the same levers to pull as AutoNation and other big dealer groups to offset that impact. So do you think this could hurt their multiple and create some acquisition opportunities since a lot of times valuation is what holds up deals from getting done?

Mike Jackson (Chairman, CEO):

I think in principle you have a point and while this is still very controversial within the total dealer organization and you saw both NADA and AIADA come out with strong statements opposing this, I think for smaller dealers the ever-increasing regulatory burden in principle -- and by the way you can look at that for all business whether we are talking about how you keep track of overtime, how you deal with healthcare, the regulatory environment now here around CFPB. The regulatory burden for smaller companies in principle in America is getting more and more difficult.

And also there is a large number of dealers who have not narrowed their bandwidth on their financing reserves, have not installed disciplined caps and so they have much further to go to get to a solution like Honda.

Now I can't begin to tell you whether that is going to change the acquisition environment. I will tell you though that this regulatory burden and difficulty of doing business and the complexity of the demands from the OEMs, you need a PhD to keep track of these incentive programs.

It is making the world much more difficult and you need a certain size and a certain structure and a certain discipline to be able to manage it all. So I think the willing sellers are going to be standing there for quite some time.

Paresh Jain (Analyst - Morgan Stanley):

No, that makes sense. On AutoNation Express, and I apologize if I missed this earlier, I understand you may not be able to share specific numbers on the performance impact but can you highlight certain metrics that you are internally tracking? Is it about conversion, is it about transaction time, market share? Just wanted to understand how you prioritize and rank your goals with Express initiative?

Mike Jackson (Chairman, CEO):

It is a one-two punch and that cannot be missed. First, we are building the brand, AutoNation , and the metric I can give you there is that the awareness and consideration for doing business with AutoNation in a relatively short period of time just over two years, has already exceeded all of the legacy brands. It is just a tremendous launch and embraced by the marketplace.

The next metric we look at and we have changed our marketing to drive much more traffic to AutoNation sites is what is the yield or what has the business generated from AutoNation sites by raising the visibility of our brand in all the ways you do in the digital marketplace and then how do you approve the experience that you have ever higher customer satisfaction, higher closing rates?

And again I will just give you there a very broad metric from before we started this effort, AutoNation's digital sites generated less than 10% of the business and now we are over 20% of the business. So that is a doubling since the brand launch and the investments to improve the experience on the AutoNation site. So you look at that report card and you say yes, this is working.

Paresh Jain (Analyst - Morgan Stanley):

Got it. And lastly, just a housekeeping one, depreciation kind of saw an uptick this quarter. What was the driver for that and how sustainable is it?

Mike Jackson (Chairman, CEO):

That would be Cheryl's specialty, Cheryl?

Cheryl Miller (EVP, CFO):

Welcome to the call. The majority of the increase is actually driven by recent renovations and acquisitions as well as accelerated depreciation on a corporate asset. But going forward we expect depreciation will be more in line with Q1 of 2015. Keep in mind that on digital, the majority of digital is actually expensed so we were pleased with our ability to keep SG&A as a percentage of growth improving versus last year and below that 70% metric despite the increased digital investment.

Paresh Jain (Analyst - Morgan Stanley):

Very helpful. Thank you.

Operator:

David Lim, Wells Fargo .

David Lim (Analyst - Wells Fargo Securities):

Good morning. I wanted to again follow up on the gross margin question. But on a yearly basis, we have seen declines since 2012. I guess the question is what are the factors that could possibly turn that around where we could see some incremental gains coming into the future? You have talked about mix and some stairstep programs but what would actually turn the industry around for you guys?

Mike Jackson (Chairman, CEO):

You can get cadence launches from manufacturers, particularly in premium luxury where certain products when they arrive for the first year or two could actually impact the entire margin of the company.

So they are nice to have but it is incidental and you can't say that is a strategic shift. I would say in principle the pressure on front-end margins I expect to remain. It is a competitive marketplace. You have stairsteps are being embraced by additional marketing companies and that is a downward pressure. And you have pressure from third-party -- from certain third-party sites that put pressure on front-end margins.

So it is a very competitive marketplace so I am not calling a turn in the front-end gross margin. If it happens, we will certainly point (technical difficulty) when it does but I am not sitting here looking forward at an environment where I say I see how we can do that, not that we aren't trying but I am not predicting it.

That is why a couple of years ago we said we have really got to have a strategy that we look at the total front-end variable gross on a transaction and we have implemented that strategy and we are executing it successfully.

David Lim (Analyst - Wells Fargo Securities):

Got you. The follow-up question I have there is are you seeing additional OEMs, I think you alluded to this, additional OEMs offering stairsteps?

And also on -- is a larger percentage of sales for you as well as the industry really relying upon the leases? And if so, are you seeing OEMs playing with the residual values when they come to these calculations?

Mike Jackson (Chairman, CEO):

So as far as stairsteps, I have come to terms that there is now three certainties, death, taxes and stairsteps. I have railed against them and all of their sins but they are not going away. You have some practitioners who have gotten highly skilled at.

Even though I don't like the practice they actually run it in a very professional way and you have others where it is absolutely a loose cannon rolling back and forth across the deck. And you have a couple of newcomers to the party.

So there it is, I don't think they are going away.

Leasing, we like leasing. I have no issues with leasing. I think auto financing whether it is longer-terms leasing is in fantastic shape. People pay for their cars. The record is clear and leasing does set up a recurring buying cycle which is very worthwhile.

Bill, do have anything to add?

Bill Berman (EVP, COO):

Yes, I would add our leasing penetration has gone up slightly about 200 basis points on a year-over-year basis. Like Mike said, I am a big fan of leasing and there doesn't appear to be any really incentivization of the residuals and they are pretty on-base to the industry standards. Most of the incentives have come in on the finance of leasing so we don't see any real impact when it comes to any kind of overhead on residual values.

David Lim (Analyst - Wells Fargo Securities):

Just two more questions quickly. We noticed that your inventories had a little uptick on a quarter-over-quarter basis. I think some of that was explained but I was wondering if you could give additional color?

Finally, when you talk about the Honda settlement, I think you are alluding to the fact that Honda would give some sort of fee or it is baked into the original cost of the loan. But if we stripped all of that out, would it go back to let's say 150 or 200 basis points above when it comes to dealer reserve? Thank you.

Mike Jackson (Chairman, CEO):

On Honda, I don't understand the question. So there is compensation in the base buy rate that is going to come to the retailer and then we have a range of markup of 100 to 125 basis points depending on term. And we will put both that compensation into dealer reserve as you refer to it and when you combine both, we come out to the same place that we are today. That is the easiest way I can explain it.

David Lim (Analyst - Wells Fargo Securities):

Got you. So what I was trying to understand is that same place, is that like 200 basis points in the old methodology or how should (multiple speakers) ?

Mike Jackson (Chairman, CEO):

I see what you are saying. Our old caps were 250 basis points, the old system that we were operating under and our average dealer reserve is 90 basis points.

David Lim (Analyst - Wells Fargo Securities):

Got you. Can you talk about --?

Mike Jackson (Chairman, CEO):

Bill, you talk about the inventory, please?

Bill Berman (EVP, COO):

The inventory being ramped up two things. First and foremost, it is driven by acquisitions from last year so obviously intrinsically that brings up the inventory as well as increased inventory going into these selling season. We have no issues on a day supply or by any particular brand.

David Lim (Analyst - Wells Fargo Securities):

Okay, great. Thank you so much.

Operator:

Rick Nelson, Stephens.

Rick Nelson (Analyst - Stephens Inc.):

Mike, can you address the TrueCar situation and what you think that means for your business?

Mike Jackson (Chairman, CEO):

So TrueCar, the leads generated 3% of our business. We are operating under a contract that had acceptable terms. That contract expired end of February, beginning of March.

TrueCar demanded in the new contract that we give them all our customer information. In our old contract, we gave TrueCar no customer information, we gave them anonymous data but we gave them no customer information.

This is an unprecedented demand. They weren't asking for the 3%, they were asking for 100% and we have never given -- I don't know what company gives away 100% of their customer information.

I think also if we had that yes definitely would have created privacy issues that would have been cumbersome for us to implement and that we would have had to have gotten permission from our customers to give this information to TrueCar and we really didn't want to intrude into a sales transaction by saying Mr. Smith, you have never heard of TrueCar but do you mind if we send them all of the information on this transaction? That is something we really wanted to protect the privacy of our customers.

And TrueCar was making this demand saying this is how they operate with all their dealerships. And why I certainly didn't investigate that other than to say I don't think that is true. I think they operate quite differently with other companies. I think this is a new demand that we cannot agree to.

So I think it was a demand that we could not agree to that was based on a false premise and if you arrive at that point with a company, you should really just go your separate ways. That is what we have done. We think our brand is strong enough, our digital capabilities are strong enough that we will be fine and TrueCar is now in our rearview mirror.

Rick Nelson (Analyst - Stephens Inc.):

So you think you can offset that volume by reallocating spend to drive volume elsewhere?

Mike Jackson (Chairman, CEO):

Rick, you know I thought I would be at this point years ago that at some point a third-party would make a demand that was unacceptable, was an overreach. And we better have a way to go when that day comes or else you are really in trouble. So I believe our brand and our digital effort is strong enough that we will be able to go forward and put TrueCar in the rearview mirror.

Rick Nelson (Analyst - Stephens Inc.):

Great. Thanks for that color. I would also like to ask Bill about regional performance, strengths, weaknesses and particularly Texas, Florida, California if there is any outliers there?

Bill Berman (EVP, COO):

Actually we had strong performance out of all three states that you just called out, Texas, Florida and California. We have had no negative impact in Texas with declining oil prices. If anything it has put more disposable income into our consumers' hands and we had very solid growth out of all three of those markets. Across the country all three of our regions are performing at a very high level pretty much across the board.

Rick Nelson (Analyst - Stephens Inc.):

Great. Thanks a lot and good luck.

Operator:

Brett Hoselton, KeyBanc.

Brett Hoselton (Analyst - KeyBanc Capital Markets):

Good morning. A few quick questions. First of all M&A outlook, have you seen any notable or material changes maybe in terms of the volume of deals and/or valuations?

Mike Jackson (Chairman, CEO):

Jon, could you please take care of that?

Jon Ferrando (EVP, General Counsel):

Brett, it is Jon Ferrando. We have been pretty consistent the last couple of years in calling out that we are expecting a good pipeline of potential opportunities in the next few years. We have been able to execute on that with over $2 billion of annualized revenue acquired since late 2012.

Through the first six months of this year, we have closed five acquisitions with $320 million in revenue with a good brand mix including premium luxury. So we feel like we have been able to execute on opportunities in the marketplace.

I would say currently we continue to a see solid strong pipeline of potential deals out there and we are well positioned for a number of reasons to continue to execute on acquisitions that will provide a strong return on capital. So we will continue to be prudent to see good opportunities and we are well-positioned to execute.

Brett Hoselton (Analyst - KeyBanc Capital Markets):

Thank you, Jon. Switching gears, as we look out over the next year or two, interest rates are likely to rise. And my question is simply how do we think about the impact of interest rates on your earnings? In other words, what are some of the more significant impacts, areas of impact on your earnings?

Mike Jackson (Chairman, CEO):

This is Mike Jackson. We fully expect interest rates to begin rising later this year. It will be different than most interest rate increase cycles in that it will go slower and stop sooner. That is what we expect.

We think that is entirely manageable and you can't expect these extremely low interest rates forever. And it could actually be a very healthy sign for the economy that you are telling everyone this crisis is over. And I think we will go on selling high 16 million, 17 million vehicles in a more normal interest rate environment.

Inflation appears to be far away, so above average rates are something over the horizon from this point of view. As far as to quantify exactly what the cost is of 100 basis points, do you have that, Cheryl?

Cheryl Miller (EVP, CFO):

Yes, I would note there is a couple of places this impacts us. If you think about from a customer perspective for instance, if you have a 1% increase in interest rates, that is less than $15 a month on the average $30,000, 60-month loan. So we always think first about impact on customer. And as Mike said, in a slow steady rise that is going to be very manageable.

We have got $2.1 billion of corporate debt that is roughly 56 (inaudible) and then we've got $3.3 billion of floorplan which flows. But to John's point earlier in the discussion that we had, you have assistance on that so you can manage inventory levels, you can see where the OEMs go with that fixed-rate assistance on a per vehicle basis to help offset that.

The underlying theme though -- and this is a cyclical business, we have been through interest rate cycles and rises before. We think it is manageable, we think usually the customer tends to be better positioned which is part of why the rates are rising and overall for the economy, we think it is a healthy thing. We are prepared for it.

An example of the things that we do in light of it is commercial paper program. So we were able to secure $300 million of financing at market rates which are substantially lower than our revolver.

So we are looking for ways to continue to reduce spreads and look at alternative instruments where possible to help lower our blended rate where we can and I think that is the great thing about a strong balance sheet is the ability to make sure that we are hitting pockets of the market. There is a lot of capital out there so we are going to hit pockets of the market where we can be flexible and opportunistic at lower cost rates.

Brett Hoselton (Analyst - KeyBanc Capital Markets):

Thank you, Cheryl. Thank you, Mike.

Operator:

Brian Sponheimer, Gabelli.

Brian Sponheimer (Analyst - Gabelli and Co.):

Mike, you have been ahead of a lot of industry trends over the course of the last decade and I guess I just want to potentially peel back the onion on why you think we have another two to three years of 16.7 million to 17 million SAAR and I guess we will just take it from there.

Mike Jackson (Chairman, CEO):

I have seen the argument for 18 million, 19 million. I've seen the argument for 14 million, 15 million. I don't believe either of those. I think it is high 16 million, 17 million is trend. I think the average age is still pushed out to 11.5, 11.6 years. Interest rates are still going to be very reasonable for consumers.

I have seen the product portfolio from the manufacturers, it is extraordinary, the best ever. And it looks like gas prices are going to be low for an extended period of time. So it is hard to say anything past three years but I think we still have several years ago of high 16, 17 and it is too far over the horizon to say how many.

When will it end? When inflation rears its head and the Federal Reserve begins increasing interest rates above normal aggressively to tamp down inflation, there will be a downturn in housing and there will be a downturn in auto sales.

I am absolutely convinced -- Cheryl said it earlier -- we remain in a cyclical business and that is not going to change. We will be prepared for it, we will outperform in it. If our stock falls out of significant favor during that period, we will view it as a buying opportunity. So we really think we can create shareholder value anywhere in the cycle, anytime in the cycle.

But I think it is high 16, 17. So we all can manage 18, 19 so let's not even talk about that. Those who argue for 14, let's say two things that car sharing is going to have a significant impact on the marketplace. I think car sharing has its place in the marketplace. I think it is wonderful.

I think Uber is a great company but somebody just add up, there is three trillion miles driven a year in the

United States. How many miles are driven on car sharing? It is an infinitesimal part of the marketplace. It will have its place but it not going to structurally change the selling volume.

And we millenniums who are not going to buy cars, that is the other argument. They are not going to get drivers license, they are not going to drive cars. We talk to that generation every day, they have a student debt problem that they need to work off, it is a four- to five-year delay in what they normally would be doing in their lives. They want their own home, they want to get married, they want to have kids and they want to have a car.

So that is going to become the biggest generation buying new vehicles and so I am right smack there in the middle high 16 million to 17 million and I think that is sustainable over the next several years.

Brian Sponheimer (Analyst - Gabelli and Co.):

Okay, I appreciate the color. Just one more, the impact of Berkshire buying Van Tuyl on potentially your ability to buy in some larger acquisitions and the multiples that you have to pay.

Mike Jackson (Chairman, CEO):

We have seen no impact. Have you, Jon? Anything to add on that?

Jon Ferrando (EVP, General Counsel):

No, no impact. Haven't run into them on acquisitions and we see very good pipeline with a lot of activity out there. If anything it may have increased sellers that are interested in exploring the marketplace.

Mike Jackson (Chairman, CEO):

I said it at the time. I have met Warren a few times, I've talked to him about the car business a few times. I admire him as an investor. He is a value, he is a value investor so he is certainly a credible buyer in the marketplace absolutely. But is he going to rush in and overpay for stuff? I don't think so and we see no sign of that yet.

Brian Sponheimer (Analyst - Gabelli and Co.):

All right, thank you very much.

Operator:

David Whiston, Morningstar .

David Whiston (Analyst - Morningstar):

Good morning. Mike, you actually gave some very helpful commentary on one of my questions on car sharing. Longer-term though, are you open to that possibly being a threat that could bring the SAAR well below 14 million or do you think that is still just way too far out to even think about at this point?

Mike Jackson (Chairman, CEO):

I think that is way too far away. Again, I am not in denial and I think there is a role for car sharing especially in certain urban settings and I think everyone is open. I mean everyone has embraced Uber, it is not a generational thing. It is a great way of doing things.

But to say that it is going to take 3 million out of the annual selling rate of new vehicles, I just can't get there at all. So that is my point of view and we will see. So far my batting average on these things is pretty good. So we will see.

David Whiston (Analyst - Morningstar):

Okay, thanks. Moving on, you guys have had a lot of success in the AutoNation 40 under 40 polls, the dealers to work. How do you retain rising mid-level talent like that once you identify them?

Mike Jackson (Chairman, CEO):

We offer something quite unique in the industry, not only a professional career opportunity but fully supported by a talent development process that is centered on AutoNation University that is a big investment on our part by the Company in the talent within the Company.

John Ferrando led the effort, created it and the courses are taught by ourselves. Bill Berman did a session this morning, I did one yesterday. Jon, why don't you talk about it a little bit?

Jon Ferrando (EVP, General Counsel):

We launched the AutoNation University years ago. We are putting our GM talent and potential talent through it for a number of years it has been very stressful. It is our flagship development program.

We think it helps us attract great talent into the Company. When we go out and acquire businesses, that is a great selling point for sellers that we offer tremendous careers and we back it up for great talent by making major investments in people and AN University is one example of it.

It is a large investment, it is five weeks of their time throughout a year along with mentorship along the way. So we are able to attract, retain, develop great talent through the investment.

And in fact, Bill and I have been working on a number of ways to expand that to other positions within the Company as well as with Cheryl on the finance side. So we continue to expand our university development offerings to talented people that want to go further with their career.

Bill Berman (EVP, COO):

David, this is Bill. I'm actually one of those that came up through the Company. I'm hired on 17 years ago, in my early 30s through an acquisition and nearly I would say 90%, 95% of our senior leadership in the field has come up through that program from our RPs to our market presidents all the way down to our store level GMs.

So to Jon's point, we identify talent early in the pipeline and then with different training courses, grow and mentor them throughout the process.

David Whiston (Analyst - Morningstar):

And I'm sorry, what was that percentage you gave?

Bill Berman (EVP, COO):

90% of our market presidents and our regional presidents all came through GMU.

David Whiston (Analyst - Morningstar):

Okay. That is very helpful, thank you. My last question is what are your plans for the commercial paper proceeds or is that just done because of the lower cost of capital that Cheryl talked about earlier?

Cheryl Miller (EVP, CFO):

Really lower cost of capital. So its general corporate uses. It could be anything from repo to acquisition, CapEx, etc. so it was opportunistic from a pricing standpoint relative to the rates that we were paying under our broader revolving credit facility.

David Whiston (Analyst - Morningstar):

Okay. Thanks for all the detail.

Operator:

David Tamberrino, Goldman Sachs .

David Tamberrino (Analyst - Goldman Sachs):

Great. Thanks for squeezing me in here. On the parts and service, looks like it was still a pretty solid comp but it was decelerating from the fourth quarter 10% and then 8% in the first quarter.

Do you expect that to continue to decelerate in the back half of this year? And then just on the back of that, can you explain the gross profit margin expansion in P&S that you saw year-over-year and what the mix impact was as a result? Thanks.

Bill Berman (EVP, COO):

Absolutely. So no, we do not see a continued decline. Some of that is just seasonality. We will sit here and be able to grow in the mid to high single digits on a go forward basis and as far as the margin of growth a couple of different factors that are driving that. RO count, mix of work, increase in CP drivers and also increase in our parts gross and our parts dollars per RO.

David Tamberrino (Analyst - Goldman Sachs):

That is helpful. And then just one last one. On the used margin, we saw it down I think about 70 basis points year-over-year and you would expect at least we would have with off-lease supply growing that you might see lower wholesale pricing as a result. Is that not coming to fruition and what is really driving that compression in used margins?

Bill Berman (EVP, COO):

I can take that. I think it is a little bit of a blip. Last year we had a much lower inventory level so it gave us the ability to go after margin more. Currently we are focused more on driving volume and we had a little bit of a blip last quarter. I do not see that continuing.

The nice thing about used cars to your point as we get more off-lease vehicles coming in, it will lower our buy -- or what we can buy the vehicle for and should be able to maintain or even help grow our margin slightly. There is always a 30-, 60-day where you ebb and flow with the marketplace. But going forward, we see good growth in used car volume and PVRs.

David Whiston (Analyst - Morningstar):

Thank you. That is very helpful.

Mike Jackson (Chairman, CEO):

Thank you everyone for joining us today. We really appreciate all your questions. Thank you very much.

Operator:

This concludes today's conference.