

Selected Consolidated Financial Data

We acquired the founding groups on November 3, 1997. For financial statement presentation purposes, however, the Howard Group, one of the founding groups, has been identified as the accounting acquiror. As such, the financial data as of December 31, 1996, 1995 and 1994, and for each of the three years in the period ended December 31, 1996 represent the historical financial data of the Howard Group on a stand-alone basis. The financial data as of and for the year ended December 31, 1997, includes the operations of Group 1 Automotive, Inc., the parent company, and the founding groups, excluding the Howard Group, beginning October 31, 1997, the effective closing date of the acquisitions for accounting purposes. The Howard Group is included for the entire year ended December 31, 1997. The financial data as of and for the year ended December 31, 1998, includes the operations of Group 1 and the founding groups from January 1, 1998 and the dealerships acquired during 1998, from the effective dates of the acquisitions. The following selected historical financial data as of December 31, 1998, 1997, 1996 and 1995, and for each of the five years in the period ended December 31, 1998, have been derived from audited financial statements. The following selected historical financial data as of December 31, 1994, has been derived from unaudited financial statements, which have been prepared on the same basis as the audited financial statements, and in our opinion, reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of such data.

YEAR ENDED DECEMBER 31,	1998	1997	1996	1995	1994
<i>(dollars in thousands, except per share amounts)</i>					
INCOME STATEMENT DATA:					
Revenues	\$ 1,630,057	\$ 403,967	\$ 281,492	\$ 254,003	\$ 227,259
Cost of sales	1,393,547	349,366	241,898	219,907	197,642
Gross profit	236,510	54,601	39,594	34,096	29,617
Selling, general and administrative expenses	178,038	43,360	30,027	25,628	23,823
Depreciation and amortization	6,426	1,020	741	538	430
Income from operations	52,046	10,221	8,826	7,930	5,364
Other income (expense):					
Floorplan interest expense	(12,837)	(3,810)	(3,112)	(3,410)	(2,408)
Other interest expense, net	(4,027)	(176)	(56)	(61)	(44)
Other income (expense), net	39	156	(69)	(80)	9
Income before income taxes	35,221	6,391	5,589	4,379	2,921
Provision for income taxes	14,502	573	382	744	768
Net income	\$ 20,719	\$ 5,818	\$ 5,207	\$ 3,635	\$ 2,153
Earnings per share:					
Basic	\$ 1.20	-	-	-	-
Diluted	\$ 1.16	-	-	-	-
Weighted average shares outstanding:					
Basic	17,281,165	-	-	-	-
Diluted	17,904,878	-	-	-	-

YEAR ENDED DECEMBER 31,	1998	1997	1996	1995	1994
<i>(in thousands)</i>					
BALANCE SHEET DATA:					
Working capital	\$ 48,251	\$ 55,475	\$ 9,327	\$ 7,538	\$ 4,891
Inventories	219,176	105,421	47,674	39,573	34,699
Total assets	477,710	213,149	72,874	61,641	51,124
Total debt, including current portion	239,192	67,857	42,887	37,320	31,601
Stockholders' equity	136,184	89,372	12,210	8,620	5,346

Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

We are a leading operator and consolidator in the highly fragmented automotive retailing industry. We own automobile dealership franchises located in Texas, Oklahoma, Florida, New Mexico, Georgia and Colorado. We sell new and used cars and light trucks, provide maintenance and repair services at all of our dealerships, and operate 12 collision service centers. We expect a significant portion of our future growth to come from acquisitions of additional dealerships.

We have diverse sources of revenues, including: new car sales, new truck sales, used car sales, used truck sales, manufacturer remarketed vehicle sales, parts sales, service sales, collision repair services, finance fees, insurance commissions, vehicle service contract commissions, documentary fees and after-market product sales. Sales revenues from new and used vehicle sales and parts and service sales include sales to retail customers, other dealerships and wholesalers. Other dealership revenue includes revenue from arranging financing, insurance and vehicle service contracts, net of a provision for anticipated chargebacks, and documentary fees.

Our gross profit varies as our merchandise mix (the mix between new vehicle sales, used vehicle sales, parts and service sales, collision repair services and other dealership revenues) changes. Our gross margin on the sale of products and services generally varies between approximately 8.0% and 85.0%, with new vehicle sales generally resulting in the lowest gross margin and other dealership revenue sales generally resulting in the highest gross margin. When our new vehicle sales increase or decrease at a rate greater than our other revenue sources, our gross margin responds inversely. Factors such as seasonality, weather, cyclicalities and manufacturers' advertising and incentives may impact our merchandise mix, and therefore influence our gross margin.

Selling, general and administrative expenses consist primarily of compensation for sales, administrative, finance and general management personnel, rent, marketing, insurance and utilities. Interest expense consists of interest charges on interest-bearing debt, including floorplan inventory financing, net of interest income earned. Until we acquired them, all of the dealerships had been managed as independent private companies and their results of operations reflect different tax structures (S Corporations and C Corporations) which influenced, among other things, their historical levels of owners' compensation. Certain of these owners and key employees agreed to reductions in their compensation and benefits in connection with their acquisition by us.

We are integrating certain functions and installing practices that have been successful at other franchises and in other retail segments ("best practices"). This integration of functions and installation of best practices may present opportunities to increase revenues and reduce costs but may also necessitate additional costs and expenditures for corporate administration, including expenses necessary to implement our acquisition strategy. These various costs and possible cost-savings and revenue enhancements may make historical operating results difficult to compare to and not indicative of, future performance.

PRO FORMA COMBINED FOUNDING GROUPS' DATA

The pro forma combined founding groups' data presented below for 1997 and 1996 do not purport to present the combined founding groups in accordance with generally accepted accounting principles, but represent a summation of certain data of the individual founding groups on a historical basis, including the effects of the pro forma adjustments. Such information does not give effect to any other acquisitions that were made by us other than the founding groups. This data will not be comparable to and may not be indicative of our post-combination results of operations because (i) the founding groups were not under common control of management and had different tax structures during the periods presented and (ii) we used the purchase method to establish a new basis of accounting to record the acquisitions.

The financial information presented below for the year ended December 31, 1998 reflects the historical results of our operations and includes acquisitions made during such period, from the effective dates, for accounting purposes, of the acquisitions.

OPERATIONS DATA

	YEAR ENDED DECEMBER 31,					
	1998		1997		1996	
	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCENT
	<i>(dollars in thousands)</i>					
Revenues						
New vehicle sales	\$ 931,205	57.1%	\$ 513,864	56.9%	\$ 469,318	57.1%
Used vehicle sales	510,192	31.3	288,010	31.9	258,027	31.4
Parts and service sales	139,144	8.5	77,215	8.6	73,451	8.9
Other dealership revenues, net	49,516	3.1	23,206	2.6	21,117	2.6
Total revenues	1,630,057	100.0	902,295	100.0	821,913	100.0
Cost of sales	1,393,547	85.5	775,164	85.9	705,783	85.9
Gross profit	\$ 236,510	14.5%	\$ 127,131	14.1%	\$ 116,130	14.1%

NEW VEHICLE DATA

YEAR ENDED DECEMBER 31,	1998	1997	1996
<i>(dollars in thousands, except gross profit per unit)</i>			
Retail unit sales	39,822	23,201	21,378
Retail sales revenue	\$ 931,205	\$ 513,864	\$ 469,318
Gross profit	\$ 74,096	\$ 42,199	\$ 37,677
Gross margin	8.0%	8.2%	8.0%
Gross profit per retail unit sold	\$ 1,861	\$ 1,819	\$ 1,762

USED VEHICLE DATA

YEAR ENDED DECEMBER 31,	1998	1997	1996
<i>(dollars in thousands, except gross profit per unit)</i>			
Retail unit sales	31,248	18,130	17,220
Retail sales revenue ⁽¹⁾	\$ 411,065	\$ 235,353	\$ 219,183
Gross profit	\$ 38,282	\$ 21,035	\$ 21,358
Gross margin	9.3%	8.9%	9.7%
Gross profit per retail unit sold	\$ 1,225	\$ 1,160	\$ 1,240

(1) Excludes wholesale revenues.

PARTS AND SERVICE DATA

YEAR ENDED DECEMBER 31,	1998	1997	1996
<i>(dollars in thousands)</i>			
Sales revenue	\$ 139,144	\$ 77,215	\$ 73,451
Gross profit	\$ 74,616	\$ 40,691	\$ 35,978
Gross margin	53.6%	52.7%	49.0%

OTHER DEALERSHIP REVENUES, NET

YEAR ENDED DECEMBER 31,	1998	1997	1996
<i>(dollars in thousands, except revenues per unit)</i>			
Retail new and used unit sales	71,070	41,331	38,598
Retail sales revenue	\$ 49,516	\$ 23,206	\$ 21,117
Net revenues per retail unit sold	\$ 697	\$ 561	\$ 547

HISTORICAL YEAR ENDED DECEMBER 31, 1998

COMPARED WITH PRO FORMA COMBINED FOUNDING GROUPS YEAR ENDED DECEMBER 31, 1997

REVENUES. Revenues increased \$727.8 million, or 80.7%, from \$902.3 million for the year ended December 31, 1997 to \$1,630.1 million for the year ended December 31, 1998. New vehicle revenues increased \$417.3 million, or 81.2%, from \$513.9 million for the year ended December 31, 1997 to \$931.2 million for the year ended December 31, 1998. This increase in revenue was primarily attributable to strong customer acceptance of our products, particularly Toyota, Lexus, Honda and Acura, and the acquisition of additional dealership operations during 1998. The increase was partially offset by reduced sales at our Nissan franchises, which declined due to reduced manufacturer sales incentives as compared to the prior year. Used vehicle revenues increased \$222.2 million, or 77.2%, from \$288.0 million for the year ended December 31, 1997 to \$510.2 million for the year ended December 31, 1998. The increase was primarily attributable to an emphasis on used vehicle sales in the Oklahoma and Houston, Texas markets and the additional dealership operations acquired. Parts and service sales increased \$61.9 million, or 80.2%, from \$77.2 million for the year ended December 31, 1997 to \$139.1 million for the year ended December 31, 1998. The increase was primarily attributable to the additional dealership operations acquired. Other dealership revenues increased \$26.3 million or 113.4% from \$23.2 million for the year ended December 31, 1997 to \$49.5 million for the year ended December 31, 1998. The increase was due primarily to the implementation of our vehicle service contract and insurance programs, which resulted in improved revenues per unit, and an increase in the number of retail new and used vehicles sold.

GROSS PROFIT. Gross profit increased \$109.4 million, or 86.1%, from \$127.1 million for the year ended December 31, 1997 to \$236.5 million for the year ended December 31, 1998. The increase was attributable to increased revenues and an increase in gross margin from 14.1% for the year ended December 31, 1997 to 14.5% for the year ended December 31, 1998. This increase was caused by improvements in the gross margin earned on used vehicle sales and parts and service sales, and a change in the merchandising mix, as higher margin other dealership revenues increased as a percentage of total revenues. Partially offsetting the gross margin increases, the gross margin on new retail vehicle sales declined from 8.2% for the year ended December 31, 1997 to 8.0% for the year ended December 31, 1998. The decline is attributable primarily to reduced margins in the Nissan product line due to reduced manufacturer sales incentives in 1998. The gross margin on used retail vehicle sales increased from 8.9% for the year ended December 31, 1997 to 9.3% for the year ended December 31, 1998. The increase was primarily attributable to an emphasis on used vehicle operations in the Oklahoma platform.

PRO FORMA COMBINED FOUNDING GROUPS YEAR ENDED DECEMBER 31, 1997

COMPARED WITH PRO FORMA COMBINED FOUNDING GROUPS YEAR ENDED DECEMBER 31, 1996

REVENUES. Revenues increased \$80.4 million, or 9.8%, from \$821.9 million for the year ended December 31, 1996 to \$902.3 million for the year ended December 31, 1997. New vehicle revenues increased \$44.6 million, or 9.5% from \$469.3 million for the year ended December 31, 1996 to \$513.9 million for the year ended December 31, 1997. The increase in revenue was primarily attributable to significant revenue growth from maturing Round Rock Nissan and Bob Howard Dodge franchise operations, successful marketing efforts and strong customer acceptance of the founding groups' products, particularly Lexus. Used vehicle revenues increased \$30.0 million, or 11.6%, from \$258.0 million for the year ended December 31, 1996 to \$288.0 million for the year ended December 31, 1997. The increase was primarily attributable to the maturing franchise operations, successful marketing efforts and an emphasis on used vehicle sales in the Oklahoma market to mitigate the impact of lower than expected new vehicle demand. Parts and service sales increased \$3.7 million, or 5.0%, from \$73.5 million for the year ended December 31, 1996 to \$77.2 million for the year ended December 31, 1997. The increase was primarily attributable to the maturing dealership operations and increased vehicle sales. Other dealership revenues increased \$2.1 million or 10.0% from \$21.1 million for the year ended December 31, 1996 to \$23.2 million for the year ended December 31, 1997. The increase was due primarily to an increase in the number of retail new and used vehicle sales.

GROSS PROFIT. Gross profit increased \$11.0 million, or 9.5%, from \$116.1 million for the year ended December 31, 1996 to \$127.1 million for the year ended December 31, 1997. The increase was attributable to increased revenues and a stable overall gross margin. The gross margin on new retail vehicle sales increased from 8.0% for the year ended December 31,

1996 to 8.2% for the year ended December 31, 1997 primarily due to stronger margins in the Lexus and Nissan product lines, partially offset by reduced margins in the Oklahoma market. The gross margin for retail used vehicle sales declined from 9.7% for the year ended December 31, 1996 to 8.9% for the year ended December 31, 1997. The decline was primarily attributable to efforts to increase market share in the Oklahoma market while customer demand for new vehicles was not as strong as in prior years.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of liquidity are cash on hand, cash from operations, our credit facility (which includes the floorplan facility and the acquisition facility) and equity and debt offerings.

The following table sets forth historical selected information from our statements of cash flows:

YEAR ENDED DECEMBER 31, <i>(in thousands)</i>	1998	1997	1996
Net cash provided by operating activities	\$ 24,277	\$ 6,922	\$ 7,332
Net cash provided by (used in) investing activities	(58,225)	10,661	(4,615)
Net cash provided by (used in) financing activities	65,299	5,830	(1,558)
Net increase in cash and cash equivalents	\$ 31,351	\$ 23,413	\$ 1,159

CASH FLOWS

Total cash and cash equivalents at December 31, 1998, were \$66.4 million.

OPERATING ACTIVITIES. For the three-year period ended December 31, 1998, we generated \$38.5 million in net cash from operating activities, primarily driven by net income plus depreciation and amortization. Cash flow provided by operating activities increased \$17.4 million from \$6.9 million for the year-ended December 31, 1997 to \$24.3 million for the year-ended December 31, 1998. This increase is primarily attributable to the inclusion of the dealership operations acquired since October 31, 1997.

INVESTING ACTIVITIES. We obtained approximately \$10.7 million from investing activities in 1997, primarily from the cash balances obtained in the acquisitions of the founding groups. The \$58.2 million of cash used for investing activities during 1998 was primarily attributable to cash paid in completing acquisitions, net of cash balances obtained in the acquisitions, and purchases of property and equipment, partially offset by sales of property and equipment. Of the \$9.7 million used in purchasing property and equipment, approximately \$5.6 million related to the purchase of land and construction of facilities for new or expanded operations, including a new Lexus companion dealership located in south Houston, which we expect to be opened by the third quarter of 1999. During December 1998, we completed the sale and leaseback of six dealership properties and received \$20.0 million in gross proceeds from the sale.

FINANCING ACTIVITIES. We obtained approximately \$5.8 million and \$65.3 million from financing activities in 1997 and 1998, respectively. The net cash provided by financing activities for 1997 was primarily attributable to the net proceeds of our initial public offering of approximately \$51.8 million offset primarily by the pay down of floorplan debt in the amount of \$33.5 million. The net cash provided during 1998 was generated primarily from drawings on our credit facility and was utilized in completing acquisitions and supporting increased sales volumes. Partially offsetting the \$75.5 million in borrowings was \$10.0 million in principal payments on long-term debt, of which \$6.6 million was related to the payoff of mortgages in connection with the sale and leaseback transaction completed in December 1998.

WORKING CAPITAL. At December 31, 1998, we had working capital of \$48.3 million. Historically, we have funded our operations with internally generated cash flow and borrowings. While we cannot guarantee it, based on current facts and circumstances, management believes we have adequate cash flow coupled with borrowings under our credit facility to fund our current operations.

ACQUISITION FINANCING

We anticipate that our primary use of cash will be for the completion of acquisitions. We expect the cash needed to complete our acquisitions will come from the operating cash flows of our existing dealerships, borrowings under our current credit facilities, other borrowings or equity or debt offerings. Although we believe that we will be able to obtain sufficient capital to fund acquisitions, we cannot guarantee that such capital will be available to us at the time it is required or on terms acceptable to us.

RECENT OFFERINGS. In March 1999, we completed offerings, in which we sold two million shares of common stock and \$100 million of 10-year senior subordinated notes with an interest rate of 10^{7/8}%. We received proceeds, before our expenses, of \$138.9 million. All of the proceeds were used to temporarily repay borrowings under our credit facility. These proceeds are expected to be used in the future to complete acquisitions, resulting in increased borrowings under the credit facility.

CREDIT FACILITY

In November 1998, we amended our credit facility to increase the commitment from \$345 million to \$425 million (which was reduced to \$405 million upon consummation of the offerings) and to extend the term of the credit facility from December 2000 to December 2001. The credit facility provides a floorplan facility of \$295 million for financing vehicle inventories and an acquisition facility of \$130 million (which was reduced to \$110 million upon consummation of the offerings), for financing acquisitions, general corporate purposes and capital expenditures. Currently, \$110 million is available to be drawn under the acquisition facility, subject to a cash flow calculation and the maintenance of certain financial ratios. Additionally, the credit facility contains various covenants, including financial ratios and other requirements, which must be maintained by us. The credit facility also limits the amount we may pay as cash dividends.

In January 1998, we entered into a three-year interest rate swap agreement to hedge our exposure to changes in interest rates. This swap converts the interest rate on \$75 million of debt to a fixed rate of approximately 7.16%.

FLOORPLAN FINANCING

We currently obtain floorplan financing for vehicle inventory through our credit facility. This debt bears interest at the rate of LIBOR plus 150 basis points.

SALE OF DEALERSHIP PROPERTIES TO A REIT

On December 21, 1998, we entered into an agreement with a REIT to sell nine of our dealership properties for approximately \$32.3 million in cash. In connection with the sale of the properties, we have agreed to leaseback the properties under leases with terms of 30 years, with tenant termination options after 15, 20 and 25 years. As of December 31, 1998, we had closed the sale of six properties to the REIT, pursuant to the terms of the agreement, for approximately \$20.0 million.

We generally seek to avoid the ownership of real property. Accordingly we intend to continue to enter into sale and leaseback transactions in order to minimize our investment in acquired and constructed facilities.

LEASES

We lease various real estate, facilities and equipment under long-term operating lease agreements, including leases with related parties. Substantially all related-party leases have terms of 30 years and are cancelable at our option ten years from execution of the lease and at the end of each subsequent five-year period.

Consolidated Balance Sheets

DECEMBER 31, <i>(in thousands)</i>	1998	1997
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 66,443	\$ 35,092
Accounts and notes receivable, net	21,373	10,611
Inventories	219,176	105,421
Deferred income taxes	11,212	8,693
Other assets	8,718	1,865
Total current assets	326,922	161,682
PROPERTY AND EQUIPMENT, net	21,960	21,586
GOODWILL, net	123,587	27,078
OTHER ASSETS	5,241	2,803
Total assets	\$ 477,710	\$ 213,149
 LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Floorplan notes payable	\$ 193,405	\$ 58,488
Current maturities of long-term debt	2,966	2,316
Accounts payable and accrued expenses	82,300	45,403
Total current liabilities	278,671	106,207
DEBT, net of current maturities	42,821	7,053
DEFERRED INCOME TAXES	-	3,699
OTHER LIABILITIES	20,034	6,818
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, 1,000,000 shares authorized, none issued or outstanding	-	-
Common stock, \$.01 par value, 50,000,000 shares authorized, 18,267,515 and 14,673,051 issued	183	147
Additional paid-in capital	118,469	91,846
Retained earnings (deficit)	18,190	(2,529)
Treasury stock, at cost, 37,366 and 10,000 shares	(658)	(92)
Total stockholders' equity	136,184	89,372
Total liabilities and stockholders' equity	\$ 477,710	\$ 213,149

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Operations

YEAR ENDED DECEMBER 31,	1998	1997	1996
<i>(dollars in thousands, except per share amounts)</i>			
REVENUES:			
New vehicle sales	\$ 931,205	\$ 228,044	\$ 164,979
Used vehicle sales	510,192	135,507	88,477
Parts and service sales	139,144	30,006	20,649
Other dealership revenues, net	49,516	10,410	7,387
Total revenues	1,630,057	403,967	281,492
COST OF SALES:			
New vehicle sales	857,109	212,349	152,709
Used vehicle sales	471,910	123,932	78,912
Parts and service sales	64,528	13,085	10,277
Total cost of sales	1,393,547	349,366	241,898
GROSS PROFIT	236,510	54,601	39,594
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	178,038	43,360	30,027
DEPRECIATION AND AMORTIZATION	6,426	1,020	741
Income from operations	52,046	10,221	8,826
OTHER INCOME AND EXPENSES:			
Floorplan interest expense	(12,837)	(3,810)	(3,112)
Other interest expense, net	(4,027)	(176)	(56)
Other income (expense), net	39	156	(69)
INCOME BEFORE INCOME TAXES	35,221	6,391	5,589
PROVISION FOR INCOME TAXES	14,502	573	382
NET INCOME	\$ 20,719	\$ 5,818	\$ 5,207
S Corporation pro forma income taxes (unaudited)		1,465	1,831
Pro forma net income (unaudited)		\$ 4,353	\$ 3,376
Earnings per share:			
Basic	\$ 1.20		
Diluted	\$ 1.16		
Weighted average shares outstanding:			
Basic	17,281,165		
Diluted	17,904,878		

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Stockholders' Equity

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	TREASURY STOCK	TOTAL
	SHARES	AMOUNT				
<i>(dollars in thousands)</i>						
BALANCE, December 31, 1995	3,353,461	\$ 34	\$ 4,772	\$ 3,815	\$ -	\$ 8,621
Net income	-	-	-	5,207	-	5,207
Issuance of common stock	216,841	2	1,498	-	-	1,500
Dividends, prior to the initial public offering	-	-	-	(3,118)	-	(3,118)
BALANCE, December 31, 1996	3,570,302	36	6,270	5,904	-	12,210
Net income	-	-	-	5,818	-	5,818
Acquisition of founding companies	5,954,613	60	33,294	-	-	33,354
Initial public offering, net	5,148,136	51	51,707	-	-	51,758
Purchase of treasury stock	-	-	-	-	(92)	(92)
Stock transfer by shareholder, net of tax	-	-	575	-	-	575
Dividends, prior to the initial public offering	-	-	-	(14,251)	-	(14,251)
BALANCE, December 31, 1997	14,673,051	147	91,846	(2,529)	(92)	89,372
Net Income	-	-	-	20,719	-	20,719
Issuance of common stock in acquisitions	3,516,805	35	26,770	-	-	26,805
Proceeds from sales of common stock under employee benefit plans	234,650	1	2,063	-	-	2,064
Issuance of treasury stock to employee benefit plan	(156,991)	-	(2,210)	-	2,210	-
Purchase of treasury stock	-	-	-	-	(2,776)	(2,776)
BALANCE, December 31, 1998	18,267,515	\$ 183	\$ 118,469	\$ 18,190	\$ (658)	\$ 136,184

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

YEAR ENDED DECEMBER 31, <i>(dollars in thousands)</i>	1998	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 20,719	\$ 5,818	\$ 5,207
Adjustments to reconcile net income to net cash provided by operating activities -			
Depreciation and amortization	6,426	1,020	741
Non-cash compensation, net of tax	-	575	-
Deferred income taxes	(4,201)	(1,015)	(316)
Provision for doubtful accounts and uncollectible notes	356	270	108
Loss (gain) on sale of assets	(115)	(112)	18
Changes in assets and liabilities -			
Accounts receivable	(4,544)	1,564	295
Inventories	44	5,686	(6,107)
Prepaid expenses and other assets	(2,661)	3,609	(514)
Due from affiliates, net	-	491	-
Floorplan notes payable	(1,730)	(5,374)	5,508
Accounts payable and accrued expenses	9,983	(5,610)	2,392
Total adjustments	3,558	1,104	2,125
Net cash provided by operating activities	24,277	6,922	7,332
CASH FLOWS FROM INVESTING ACTIVITIES:			
Increase in notes receivable	(2,276)	(362)	(235)
Collections on notes receivable	1,630	88	192
Purchases of property and equipment	(9,695)	(2,164)	(1,977)
Proceeds from sale of property and equipment	20,238	1,935	-
Cash paid in acquisitions, net of cash received	(68,122)	11,164	(2,595)
Net cash provided by (used in) investing activities	(58,225)	10,661	(4,615)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowings under floorplan facility for acquisition financing	33,523	(33,523)	-
Net borrowings on revolving credit facility	42,000	-	-
Principal payments of long-term debt	(10,001)	(471)	(153)
Borrowings of long-term debt	490	109	213
Issuance of common stock to benefit plans	2,063	-	1,500
Initial public offering, net	-	51,759	-
Purchase of treasury stock	(2,776)	(92)	-
Dividends paid in cash, prior to the initial public offering	-	(11,952)	(3,118)
Net cash provided by (used in) financing activities	65,299	5,830	(1,558)
NET INCREASE IN CASH AND CASH EQUIVALENTS	31,351	23,413	1,159
CASH AND CASH EQUIVALENTS, beginning of period	35,092	11,679	10,520
CASH AND CASH EQUIVALENTS, end of period	\$ 66,443	\$ 35,092	\$ 11,679
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid for -			
Interest	\$ 15,218	\$ 4,200	\$ 3,118
Taxes	\$ 17,832	\$ 131	\$ 924

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

1. BUSINESS AND ORGANIZATION:

Group 1 Automotive, Inc. and Subsidiaries (Group 1 or the Company) was founded in December 1995 to become a leading consolidator in the highly fragmented automobile retailing industry. In October 1997, Group 1 acquired four separate dealership groups (the Founding Groups), consisting of 30 dealership franchises and related businesses, in exchange for consideration consisting of a combination of cash and common stock. Concurrent with the acquisition of the Founding Groups, Group 1 completed an initial public offering of 5,520,000 shares of common stock. The Company is engaged in the retail sale of new and used vehicles and the arranging of vehicle finance, insurance and service contracts. In addition, the Company sells automotive parts and provides vehicle servicing and collision repair.

During 1998, the Company acquired an additional 33 automobile dealership franchises in exchange for a combination of restricted common stock and cash.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

BASIS OF PRESENTATION

For financial statement presentation purposes, Howard Group, one of the Founding Groups, has been identified as the accounting acquiror. The acquisition of the remaining Founding Groups and the subsequent acquisitions were accounted for using the purchase method of accounting. The results of operations of the Howard Group are included for all periods presented. The operations of Group 1 Automotive, Inc., the parent company, and the Founding Groups, excluding the Howard Group, are included in the results of operations beginning October 31, 1997, the effective closing date of the acquisitions for accounting purposes. The results of operations of all acquisitions subsequent to October 31, 1997 are included from the effective dates of the closings of the acquisitions. The allocation of purchase price to the assets acquired and liabilities assumed has been initially assigned and recorded based on preliminary estimates of fair value and may be revised as additional information concerning the valuation of such assets and liabilities becomes available. All significant intercompany balances and transactions have been eliminated in consolidation.

REVENUE RECOGNITION

Revenue from vehicle sales, parts sales and vehicle service is recognized upon delivery to the customer.

FINANCE, INSURANCE AND SERVICE CONTRACT INCOME RECOGNITION

The Company arranges financing for customers through various institutions and receives financing fees equal to the difference between the loan rates charged to customers over predetermined financing rates set by the financing institution. In addition, the Company receives commissions from the sale of credit life and disability insurance and vehicle service contracts to customers.

The Company may be charged back (chargebacks) for unearned financing fees, insurance or vehicle service contract commissions in the event of early termination of the contracts by customers. The revenues from financing fees and commissions are recorded at the time of the sale of the vehicles and a reserve for future chargebacks is established based on historical operating results and the termination provisions of the applicable contracts. Finance, insurance and vehicle service contract revenues, net of estimated chargebacks, are included in other dealership revenue in the accompanying consolidated financial statements.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include highly liquid investments that have an original maturity of three months or less at the date of purchase, as well as contracts in transit. Contracts in transit represent contracts on vehicles sold, for which the proceeds are in transit from financing institutions.

INVENTORIES

New, used and demonstrator vehicles are stated at the lower of cost or market, determined on a specific-unit basis. Parts and accessories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are capitalized and amortized over the lesser of the life of the lease or the estimated useful life of the asset.

Expenditures for major additions or improvements, which extend the useful lives of assets, are capitalized. Minor replacements, maintenance and repairs, which do not improve or extend the lives of such assets, are charged to operations as incurred. Disposals are removed at cost less accumulated depreciation, and any resulting gain or loss is reflected in current operations.

GOODWILL

Goodwill represents the excess of the purchase price of dealerships acquired over the fair value of tangible assets acquired at the date of acquisition. Goodwill is amortized on a straight-line basis over 40 years. Amortization expense charged to operations totaled approximately \$2.2 million, \$170,000 and \$37,000 for the years ended December 31, 1998, 1997 and 1996, respectively. Accumulated amortization totaled approximately \$2.5 million and \$299,000 as of December 31, 1998 and 1997, respectively.

INCOME TAXES

The Company follows the liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109. Under this method, deferred income taxes are recorded based upon differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the underlying assets are realized or liabilities are settled. A valuation allowance reduces deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized.

Prior to acquisition of the Founding Groups, certain entities of the Howard Group elected S Corporation status, as defined by the Internal Revenue Code, whereby the companies were not subject to taxation for federal purposes. Under S Corporation status, the stockholders report their share of these companies' taxable earnings or losses in their personal tax returns. All S Corporation elections were terminated in conjunction with the acquisitions.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist primarily of floorplan notes payable and long-term debt. The carrying amount of these financial instruments approximates fair value due either to length of maturity or existence of variable interest rates that approximate market rates.

In January 1998, the Company entered into a three-year interest rate swap agreement to hedge its exposure to changes in interest rates. The effect of this swap is to convert the interest rate on \$75 million of debt to a fixed rate of approximately 7.16%.

ADVERTISING

The Company expenses production and other costs of advertising as incurred. Advertising expense for the years ended December 31, 1998, 1997 and 1996 totaled \$16.8, \$5.9 and \$3.2 million, respectively.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The significant estimates made by management in the accompanying financial statements relate to reserves for vehicle valuations, retail loan guarantees and future chargebacks on finance, insurance and service contract income. Actual results could differ from those estimates.

STATEMENTS OF CASH FLOWS

For purposes of the statements of cash flows, cash and cash equivalents include contracts in transit which are typically collected within one month. Additionally, the net change in floorplan financing of inventory, which is a customary financing technique in the industry, is reflected as an operating activity in the statements of cash flows.

EARNINGS PER SHARE

SFAS No. 128 requires the presentation of basic earnings per share and diluted earnings per share in financial statements of public enterprises. Under the provisions of this statement, basic earnings per share is computed based on weighted average shares outstanding and excludes dilutive securities. Diluted earnings per share is computed including the impacts of all potentially dilutive securities. As the Company was not a public enterprise until October 1997, and the companies included in the statements of operations were under different tax structures (S Corporations and C Corporations), no earnings per share data has been presented for the historical results of operations for the years ended December 31, 1997 and 1996. The following table sets forth the shares outstanding for the earnings per share calculations for the year ended December 31, 1998:

YEAR ENDED DECEMBER 31,	1998
Common stock outstanding, beginning of period	14,673,051
Weighted average common stock issued in acquisitions	2,591,834
Weighted average common stock issued to employee stock purchase plan	90,123
Weighted average common stock issued in stock option exercise	15,953
Less: Weighted average treasury shares repurchased	(89,796)
Shares used in computing basic earnings per share	17,281,165
Dilutive effect of stock options, net of assumed repurchase of treasury stock	623,713
Shares used in computing diluted earnings per share	17,904,878

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1997, SFAS No. 130, "Reporting Comprehensive Income" was issued. SFAS No.130 requires the reporting of comprehensive income and its components to be displayed with the same prominence as other financial statements. This statement requires a company to classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the statement of financial position. The Company adopted this statement for its fiscal year ended December 31, 1998.

In June 1997, SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" was issued. SFAS No. 131 requires that segment reporting for public reporting purposes be conformed to the segment reporting used by management for internal purposes. Additionally, it adds a requirement for the presentation of certain segment data on a quarterly basis starting in 1999. The Company currently operates in only one segment.

In June 1998, SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" was issued. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity

recognizes all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security or a foreign currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative (that is, gains or losses) depends on the intended use of the derivative and the resulting designation. SFAS No. 133 is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. Management does not believe that the adoption of this statement will have a material impact on the financial position or results of operations of the Company.

RECLASSIFICATIONS

Certain reclassifications have been made to prior year financial statements to conform them to the current year presentation.

3. BUSINESS COMBINATIONS:

During 1998, the Company acquired 33 automobile dealership franchises. These acquisitions were accounted for as purchases. The consideration paid in completing these acquisitions, including real estate acquired, included approximately \$68.1 million in cash, net of cash received, approximately 3.5 million shares of restricted common stock and the assumption of an estimated \$103.1 million in inventory financing and \$2.9 million of mortgage financing. Additional consideration may be paid based on the financial performance of certain dealerships, over specified periods. Additional consideration, if any, will be payable in cash and common stock and will result in an increase in goodwill on the balance sheet of the Company. The accompanying consolidated balance sheet includes preliminary allocations of the purchase price of the acquisitions, which are subject to final adjustment. The preliminary allocations resulted in recording approximately \$98.7 million of goodwill, which is being amortized over 40 years.

The following pro forma financial information consists of income statement data from continuing operations as presented in the consolidated financial statements plus (1) the acquisition of the Founding Groups and the subsequent acquisitions assuming the acquisitions occurred on January 1, 1998 and 1997, respectively, (2) the completion of the IPO as of January 1, 1997 and (3) certain pro forma adjustments discussed below.

	1998	1997
<i>(in thousands, except per share amounts) (unaudited)</i>		
Revenues	\$ 1,853,693	\$ 1,578,141
Gross profit	271,578	232,549
Income from operations	60,599	51,817
Net income	23,195	18,617
Basic earnings per share	1.28	1.03
Diluted earnings per share	1.23	1.00

Pro forma adjustments included in the amounts above primarily relate to: (a) increases in revenues and decreases in cost of sales related to commission arrangements on certain third-party products sold by the dealerships, which previously directly benefited the stockholders, and which were terminated in conjunction with the acquisitions allowing the dealerships to realize the benefits thereafter; (b) pro forma goodwill amortization expense over an estimated useful life of 40 years; (c) reductions in compensation expense and management fees to the level that certain management employees and owners of the acquired companies will contractually receive; (d) incremental corporate overhead costs related to personnel costs, rents, professional service fees and directors and officers liability insurance premiums; (e) net increases in interest expense resulting from net cash borrowings utilized to complete acquisitions, partially offset by interest rate reductions received; and (f) incremental provisions for federal and state income taxes relating to the compensation differential, S Corporation income and other pro forma adjustments.

4. DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS:

Accounts and notes receivable consist of the following:

DECEMBER 31,	1998	1997
<i>(in thousands)</i>		
Amounts due from manufacturers	\$ 9,522	\$ 3,889
Due from finance companies	4,452	3,217
Parts and service receivables	3,733	2,273
Other	4,405	1,752
Total accounts and notes receivable	22,112	11,131
Less - Allowance for doubtful accounts	(739)	(520)
Accounts and notes receivable, net	\$ 21,373	\$ 10,611

Inventories, net of valuation reserves, consist of the following:

DECEMBER 31,	1998	1997
<i>(in thousands)</i>		
New vehicles	\$ 155,088	\$ 70,574
Used vehicles	44,384	25,690
Rental vehicles	7,228	2,495
Parts, accessories and other	12,476	6,662
Total inventories	\$ 219,176	\$ 105,421

Accounts payable and accrued expenses consist of the following:

DECEMBER 31,	1998	1997
<i>(in thousands)</i>		
Accounts payable, trade	\$ 31,362	\$ 18,511
Accrued expenses	50,938	26,892
Total accounts payable and accrued expenses	\$ 82,300	\$ 45,403

5. PROPERTY AND EQUIPMENT:

Property and equipment consist of the following:

DECEMBER 31,	ESTIMATED USEFUL LIVES IN YEARS	1998	1997
<i>(in thousands)</i>			
Land	-	\$ 2,130	\$ 7,665
Buildings	30 to 40	1,086	5,403
Leasehold improvements	7 to 15	6,940	3,808
Machinery and equipment	3 to 7	8,186	2,995
Furniture and fixtures	5 to 7	8,104	4,590
Company vehicles	5	1,556	528
Total		28,002	24,989
Less - Accumulated depreciation		(6,042)	(3,403)
Property and equipment, net		\$ 21,960	\$ 21,586

6. FLOORPLAN NOTES PAYABLE:

Floorplan notes payable reflect amounts payable for the purchase of specific vehicle inventory and consist of the following:

DECEMBER 31, <i>(in thousands)</i>	1998	1997
New vehicles	\$ 166,650	\$ 42,918
Used vehicles	19,452	13,174
Rental vehicles	7,303	2,396
Total floorplan notes payable	\$ 193,405	\$ 58,488

During 1998, the Company consolidated its floorplan notes payable under its Revolving Credit Agreement with a bank group, maturing December 31, 2001 (the "Credit Facility"). These notes payable bear interest at the London Interbank Offered Rate ("LIBOR") plus 150 basis points.

As of December 31, 1998 and 1997 the weighted average interest rate on floorplan notes payable outstanding was 7.12% and 7.93%, respectively. The floorplan arrangement permits the Company to borrow up to \$295.0 million, dependent upon new and used vehicle inventory levels. As of December 31, 1998, total available borrowings under floorplan agreements were approximately \$101.6 million.

Vehicle payments on the notes are due when the related vehicles are sold. The notes are collateralized by substantially all of the inventories of the Company.

7. LONG-TERM DEBT:

DECEMBER 31, <i>(in thousands)</i>	1998	1997
Credit Facility (described below)	\$ 42,000	\$ -
Note payable to a bank with monthly principal payments of \$41,892, due through March 2004, bearing interest at 7.5%, payable monthly	2,592	3,138
Note payable to a bank, with monthly principal payments of \$13,740 due through August 2006, bearing interest at prime rate (8.50% at December 31, 1997)	-	2,083
Mortgage loan to a bank, with monthly principal payments of \$15,000, due through May 2005, bearing interest at prime plus 25 basis points (8.75% at December 31, 1997), payable monthly	-	1,314
Revolving line of credit with a bank, due on demand, bearing interest at prime plus 100 basis points (9.5% at December 31, 1997)	-	985
Note payable to a bank, with monthly principal and interest payments of \$5,831 due through February 2006, bearing interest at 8.20%	-	568
Other notes payable, maturing in varying amounts through October 2004 with a weighted average interest rate of 7.93%	1,195	1,281
Total long-term debt	45,787	9,369
Less - Current portion	(2,966)	(2,316)
Long-term portion	\$ 42,821	\$ 7,053

The notes payable are secured by the land, buildings or other assets for which the debt was incurred. In addition to floorplan notes payable, the Credit Facility provides an acquisition line of credit of up to \$130 million, for the financing of acquisitions, general corporate purposes or capital expenditures. The amount of funds available under the acquisition line is dependent upon a calculation based on the Company's cash flow and maintaining certain financial ratios. At the Company's option the acquisition line of credit of the Credit Facility may bear interest based on the LIBOR plus a margin varying from 150 to 275 basis points, dependent upon certain financial ratios. Additionally, the loan agreement contains various covenants including financial ratios and other requirements, which must be maintained by the Company. The agreement also limits the amount the Company may pay as cash dividends. At December 31, 1998, the interest rate on borrowings under the acquisition line of credit of the Credit Facility was 7.37%.

Total interest expense on long-term debt was approximately \$4.5 million, \$176,000 and \$56,000 for the years ended December 31, 1998, 1997 and 1996, respectively.

The aggregate maturities of long-term debt as of December 31, 1998 are as follows:

<i>(in thousands)</i>	
1999	\$ 2,966
2000	693
2001	42,078
2002	18
2003	17
Thereafter	15
Total long-term debt	\$ 45,787

8. CAPITAL STOCK AND STOCK OPTIONS:

In 1996, Group 1 adopted the 1996 Stock Incentive Plan (the Plan), which provides for the granting or awarding of stock options, stock appreciation rights and restricted stock to officers and other key employees and directors. The number of shares authorized and reserved for issuance under the Plan is 2,000,000 shares, of which 71,348 are available for future issuance as of December 31, 1998. In general, the terms of the option awards (including vesting schedules) are established by the Compensation Committee of the Company's Board of Directors. As of December 31, 1998, the Company has granted options to employees and directors covering an aggregate of 1,928,652 shares of common stock. All outstanding options are exercisable over a period not to exceed 10 years and vest over three to six-year periods.

The following table summarizes the Company's outstanding stock options:

	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE
Options outstanding, December 31, 1996	205,000	\$ 2.90
Grants:		
First quarter 1997 (all at \$2.90 per share)	360,000	2.90
Fourth quarter 1997 (all at \$12.00 per share)	682,450	12.00
Options outstanding, December 31, 1997	1,247,450	7.88
Grants (exercise prices between \$12.00 and \$17.88 per share)	780,850	16.16
Exercised	(49,973)	3.13
Forfeited	(99,648)	13.27
Options outstanding, December 31, 1998	1,878,679	\$ 11.15

At December 31, 1998, 208,460 options were exercisable at a weighted average exercise price of \$7.35. The weighted average exercise price of options granted during the year ended December 31, 1997 was \$8.86. The weighted average remaining contractual life of options outstanding at December 31, 1998 is 9.0 years. The weighted average fair value per share of options granted during the years ended December 31, 1998, 1997 and 1996 is \$9.18, \$5.94 and \$0.45, respectively. The fair value of the options granted prior to the initial public offering were estimated on the date of the grant using the minimum value method as the Company was not a public entity and not able to use the Black-Scholes model because estimating the expected volatility was not feasible. The fair value of options granted at or subsequent to the initial public offering is estimated on the date of grant using the Black-Scholes option pricing model.

The following table summarizes the weighted average information used in determining the fair value of the options granted during the years ended December 31, 1998, 1997 and 1996:

	1998	1997	1996
Weighted average risk-free interest rate	5.5%	5.9%	5.0%
Weighted average expected life of options	10 years	10 years	6 years
Weighted average expected volatility	42.8%	58.1%	N/A
Weighted average expected dividends	-	-	-

In September 1997, Group 1 adopted the Group 1 Automotive, Inc. 1998 Employee Stock Purchase Plan (the Purchase Plan). The Purchase Plan authorizes the issuance of up to 200,000 shares of Common Stock and provides that no options may be granted under the Purchase Plan after June 30, 2007. Effective as of October 1, 1998, the Purchase Plan was amended to increase the number of shares that may be issued under the Purchase Plan, subject to stockholder approval, from 200,000 to 1,000,000. The Purchase Plan is available to all employees of the Company and its participating subsidiaries and is a qualified plan as defined by Section 423 of the Internal Revenue Code. At the end of each fiscal quarter (Option Period) during the term of the Purchase Plan, the employee contributions are used to acquire shares of Common Stock at 85% of the fair market value of the Common Stock on the first or the last day of the Option Period, whichever is lower. During 1998, the Company issued 184,677 shares of Common Stock to employees participating in the Purchase Plan.

In October 1995, the Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation," which, if fully adopted, requires the Company to record stock-based compensation at fair value. The Company has adopted the disclosure requirements of SFAS No. 123 and has elected to record employee compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25. Accordingly, compensation expense is recorded for stock options based on the excess of the fair market value of the common stock on the date the options were granted over the aggregate exercise price of the options. As the exercise price of options granted under the Plan has been equal to or greater than the market price of the Company's stock on the date of grant, no compensation expense related to the Plan has been recorded. Additionally, no compensation expense is recorded for shares issued pursuant to the Purchase Plan as it is a qualified plan.

Had compensation expense for the Plan been determined based on the provisions of SFAS No. 123, the impact on the Company's net income would have been as follows:

FOR THE YEAR ENDED DECEMBER 31, <i>(in thousands, except per share amounts)</i>	1998	1997
Net income as reported	\$ 20,719	\$ 5,818
Pro forma net income under SFAS 123	19,519	5,451
Pro forma basic earnings per share	1.13	-
Pro forma diluted earnings per share	1.09	-

9. OPERATING LEASES:

The Company leases various facilities and equipment under long-term operating lease agreements, including leases with related parties. The related-party leases expire on various dates through May 2028 and are cancelable, at the Company's option, at various times during the lease term. In general, the third-party leases are cancelable at the Company's option, at various times during the lease term, and expire on various dates through January 2029.

During 1998 the Company entered into a sale and leaseback transaction related to nine of its owned dealerships properties. As of December 31, 1998, the transaction had been completed with respect to six of the nine properties.

Future minimum lease payments for operating leases are as follows:

YEAR ENDED DECEMBER 31,	RELATED PARTIES	THIRD PARTIES	TOTAL
<i>(in thousands)</i>			
1999	\$ 7,055	\$ 7,643	\$ 14,698
2000	6,826	7,492	14,318
2001	6,818	6,896	13,714
2002	6,820	6,589	13,409
2003	6,980	6,280	13,260
Thereafter	38,340	52,994	91,334
Total	\$ 72,839	\$ 87,894	\$ 160,733

Total rent expense under all operating leases, including operating leases with related parties, was approximately \$11.1, \$3.3 and \$2.3 million for the years ended December 31, 1998, 1997 and 1996, respectively. Rental expense on related-party leases, which is included in the above amounts, totaled approximately \$8.3, \$2.6 and \$1.9 million for the years ended December 31, 1998, 1997 and 1996, respectively.

10. INCOME TAXES:

Federal and state income taxes are as follows:

DECEMBER 31,	1998	1997	1996
<i>(in thousands)</i>			
Federal -			
Current	\$ 15,478	\$ 1,291	\$ 587
Deferred	(3,465)	(762)	(262)
State -			
Current	3,225	297	111
Deferred	(736)	(253)	(54)
Provision for income taxes	\$ 14,502	\$ 573	\$ 382

Actual income tax expense differs from income tax expense computed by applying the U.S. federal statutory corporate tax rate of 35% in 1998 and 34% in 1996 and 1997 to income before income taxes as follows:

DECEMBER 31,	1998	1997	1996
<i>(in thousands)</i>			
Provision at the statutory rate	\$ 12,327	\$ 2,173	\$ 1,900
Increase (decrease) resulting from -			
Income of S Corporations	-	(1,269)	(1,585)
State income tax, net of benefit for federal deduction	1,618	29	38
Deferred tax assets realized on			
conversion of S Corporations to C Corporations	-	(403)	-
Non-deductible portion of goodwill amortization	339	-	-
Other	218	43	29
Provision for income taxes	\$ 14,502	\$ 573	\$ 382

Deferred income tax provisions result from temporary differences in the recognition of income and expenses for financial reporting purposes and for tax purposes. The tax effects of these temporary differences representing deferred tax assets (liabilities) result principally from the following:

DECEMBER 31, <i>(in thousands)</i>	1998	1997
Inventory (LIFO conversion)	\$ (2,981)	\$ (3,166)
Reserves and accruals not deductible until paid	17,828	8,639
Depreciation	(1,082)	(645)
Goodwill	(584)	-
Other	(186)	166
Net deferred tax asset	\$ 12,995	\$ 4,994

The net deferred tax assets (liabilities) are comprised of the following:

DECEMBER 31, <i>(in thousands)</i>	1998	1997
Deferred tax assets -		
Current	\$ 11,238	\$ 10,220
Long-term	7,154	-
Deferred tax liabilities -		
Current	(26)	(1,527)
Long-term	(5,371)	(3,699)
Net deferred tax asset	\$ 12,995	\$ 4,994

11. COMMITMENTS AND CONTINGENCIES:

LITIGATION

The Company is a defendant in several lawsuits arising from normal business activities. Management has reviewed pending litigation with legal counsel and believes that the ultimate liability, if any, resulting from such actions will not have a material adverse effect on the Company's financial position or results of operations.

INSURANCE

Because of their vehicle inventory and nature of business, automobile dealerships generally require significant levels of insurance covering a broad variety of risks. The Company's insurance includes an umbrella policy with a \$50 million per occurrence limit as well as insurance on its real property, comprehensive coverage for its vehicle inventory, general liability insurance, employee dishonesty coverage and errors and omissions insurance in connection with its vehicle sales and financing activities.

LOAN GUARANTEES

One of the Company's dealerships provides financing for certain customers through a third-party lender. Under the terms of this financing contract, customers execute installment contracts, which are guaranteed with full recourse to the dealership. The dealership transfers the rights to the future economic benefits related to the receivables; however, in the event that the customer defaults on the note, the lender requires repayment of the principal amount of the note plus earned interest through the date of default, with collection efforts to be performed by the dealership. As of December 31, 1998, total customer notes outstanding under this program were approximately \$12.3 million. Under the terms of the agreement with the lender, the total customer notes outstanding may not exceed \$12.5 million. The Company has provided reserves for estimated future loan losses based on historical loss trends, current economic conditions and total guarantees outstanding. This financing arrangement represents approximately 1.0% of the Company's total financing arranged.

12. SUBSEQUENT EVENTS (UNAUDITED):

RECENT ACQUISITIONS.

During 1999, the Company signed definitive purchase agreements related to 28 dealership franchise acquisitions with revenues of approximately \$700 million. Two of these acquisitions are new platforms representing 14 dealership franchises in west Texas and north Florida. The remaining acquisitions are tuck-ins, which will complement platform operations in Texas, Oklahoma, New Mexico and Georgia. Two of the tuck-in acquisitions were closed during January 1999. These acquisitions will bring the total number of dealership franchises to 83 and the number of brands represented to 24. The closing of each of these acquisitions is subject to customary closing conditions, including manufacturer approval and the completion of due diligence. The aggregate consideration paid, or to be paid, in completing these acquisitions, excluding the assumption of an estimated \$63.3 million of inventory financing, is approximately \$91.0 million in cash and 1.3 million shares of restricted common stock.

RECENT OFFERINGS.

In March 1999, the Company completed offerings of two million shares of common stock and \$100 million of 10-year senior subordinated notes carrying an interest rate of 10 7/8%. Proceeds to the Company, before expenses, totaled \$138.9 million and were used to temporarily repay borrowings under the Credit Facility. These proceeds are expected to be used in the future to complete acquisitions, resulting in increased borrowings under the credit facility.

Report of Independent Public Accountants

To Group 1 Automotive, Inc. and Subsidiaries:

We have audited the accompanying consolidated balance sheets of Group 1 Automotive, Inc. and Subsidiaries (a Delaware corporation) (the Company) as of December 31, 1998 and 1997 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.



Arthur Andersen LLP
Houston, Texas
February 3, 1999

