UNITED AUTO GROUP INC
Form 10-K
March 01, 2007

Table of Contents

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

Form 10-K

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

For the fiscal year ended December 31, 2006

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

For the transition period from to

Commission file number 1-12297

United Auto Group, Inc.
(Exact name of registrant as specified in its charter)

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

Registrant s telephone number, including area code (248) 648-2500

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

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

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

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

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

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

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the voting common stock held by non-affiliates as of June 30, 2006 was $862,144,726.

As of February 19, 2007, there were 94,471,686 shares of voting common stock outstanding.

Documents Incorporated by Reference

Certain portions, as expressly described in this report, of the registrant s proxy statement for the 2007 Annual Meeting of the Stockholders to be held May 3, 2007 are incorporated by reference into Part III, Items 10-14.

TABLE OF CONTENTS

PART I

Item 1. *Business*

We are the second largest automotive retailer in the United States as measured by total revenues and have the highest concentration of revenues from foreign and premium brands among the publicly-traded automotive retailers. As of February 1, 2007, we owned and operated 169 franchises in the United States and 145 franchises outside of the U.S., primarily in the United Kingdom. We offer a full range of vehicle brands, with 93% of our total revenue in 2006 generated from the sales of foreign brands such as Audi, BMW, Honda, Lexus, Mercedes and Toyota. Sales relating to premium brands, such as Audi, BMW, Cadillac and Porsche, represented 62% of our total revenue. In addition to selling new and used vehicles, we offer a full range of maintenance and repair services, and we facilitate the placement of third-party finance and insurance products, third-party extended service contracts and replacement and aftermarket automotive products.

We benefit from our diversified revenue stream, which we believe helps to mitigate the historical cyclicality found in some other automotive sectors. Revenues from higher margin service and parts sales are typically less cyclical than retail vehicle sales, and generate the largest part of our gross profit. The following graphic shows the percentage of our retail revenues by product area and their respective contribution to our overall gross profit in 2006:

Revenue Mix **Gross Profit Mix**

Business Strategy

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

Offer Outstanding Brands in Premium Facilities

We have the highest concentration of revenues from foreign and premium brands among the publicly-traded automotive retailers. We believe our brand mix has helped us to increase same-store revenue and gross profits, as foreign vehicle brands have gained market share in recent years in the markets where we operate.

Table of Contents

The following chart reflects our percentage of total revenues by brand in 2006:

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

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

Location	Square Feet	Service Bays	2006 Revenue (millions)	Franchises
North Scottsdale, Arizona	450,000	226	$ 585.3	Acura, Audi, BMW, Jaguar, Land Rover, MINI, Porsche, Volkswagen, Volvo
Scottsdale, Arizona	132,000	180	$ 300.5	Aston Martin, Audi, Bentley, Ferrari, Jaguar, Land Rover, Lexus, Maserati, Rolls-Royce
San Diego, California	348,000	232	$ 697.4	Acura, Aston Martin, BMW, Jaguar, Lexus, Maybach, Mercedes-Benz, Scion, Toyota
Fayetteville, Arkansas	122,000	119	$ 258.2	Acura, Chevrolet, Honda, HUMMER, Scion, Toyota
Tyson s Corner, Virginia	191,000	138	$ 270.8	Audi, Aston Martin, Maybach, Mercedes-Benz, Porsche
Inskip, Rhode Island*	319,000	151	$ 383.2	Acura, Audi, Bentley, BMW, Infiniti, Lexus, Mercedes-Benz, Nissan, Porsche, Volvo
Turnersville, New Jersey*	303,000	177	$ 361.0	Acura, BMW, Cadillac, Chevrolet, Honda, HUMMER, Hyundai, Nissan, Scion, Toyota

* Ongoing renovations expected to be complete by the fourth quarter of 2007

Our Scottsdale 101 Auto Mall features nine separate showrooms and franchises with over 450,000 square feet of facilities. Typically, customers may choose from an inventory of over 1,500 new and used vehicles, and have access to approximately 226 service bays with the capacity to service approximately 1,000 vehicles per day. This campus also features an on/off road test course where customers may experience the uniqueness of the brands

2

offered. We will continue to evaluate other opportunities to aggregate our facilities to reap the benefits of a destination location.

Expand Revenues at Existing Locations and Increase Higher-Margin Businesses

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

Increase Same-Store Sales. We believe our emphasis on improving customer service and upgrading our facilities should result in continued increases in same-store sales. We have modernized many of our facilities and added numerous additional service bays in order to better accommodate our customers.

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

Expand Service and Parts and Collision Repair Revenues. In recent years, we have added numerous service bays at our dealerships in an effort to expand this higher-margin element of our business. Many of today s vehicles are complex and require sophisticated equipment and specially trained technicians to perform certain services. Unlike independent service shops, our dealerships are authorized to perform this work and manufacturer warranty work. We believe that our premium brand-mix and the complexity of today s vehicles, together with our focus on customer service and superior facilities, contribute to our service and parts revenue increases. We also operate 26 collision repair centers. As each of these is operated as an integral part of our dealership operations, the repair centers benefit from the dealerships repeat and referral business.

Continue Growth through Targeted Acquisitions

We believe that attractive acquisition opportunities exist in the United States for well-capitalized dealership groups with experience in identifying, acquiring and integrating dealerships. The U.S. automotive retail market provides us with significant growth opportunities as the top ten industry participants represented less than 10% of new vehicle industry sales in 2006. We seek to acquire dealerships with high growth automotive brands in highly concentrated or rapidly growing demographic areas. We focus both on larger dealership operations that will benefit from our management assistance, manufacturer relations and scale of operations, as well as individual dealerships that can be effectively integrated into our existing operations.

One of the unique attributes of our operations versus our peers is our diversification outside the United States. Approximately 32% of our consolidated revenue for 2006 was generated from operations located outside the United States and Puerto Rico, predominately in the United Kingdom. In 2006, we acquired and integrated 40 additional franchises in the United Kingdom. According to industry data, in 2005 the United Kingdom represented the second largest automotive market in Western Europe with approximately 2.5 million new car registrations and revenues exceeding $250 billion in aggregate annual new vehicle, used vehicle and service and parts sales. Although dealerships in the United Kingdom are typically smaller than those in the United States, they offer similar services to customers. Our brand mix in the United Kingdom is largely premium. As of December 31, 2006, we believe we were the largest volume Audi, BMW, Lexus, Mercedes Benz and Toyota dealer in this market. Additionally, we operate a number of dealerships in Germany, some in the form of joint ventures with strong local partners, which sell and service Aston Martin, Audi, BMW, Ferrari, Lexus, MINI, Toyota, Volkswagen and other premium brands. We believe attractive acquisition opportunities exist in the United Kingdom and Germany, similar to those available in the United States.

Table of Contents

Strengthen Customer Loyalty

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

Maintain Diversified Revenue Stream and Variable Cost Structure

We believe that our diversified revenue mix may mitigate the historical cyclicality found in some automotive sectors, and that demand for our higher-margin service and parts business is less affected by economic cycles than demand for new vehicles as consumers are likely to service their vehicles in spite of difficult economic times. Our dealership operations are also diversified both in terms of the brands of vehicles they offer and geographic location, as we operate 169 dealerships in nineteen states in the U.S. and 145 dealerships outside the U.S., predominately in the United Kingdom, which generated approximately 31% of our revenue in 2006. In addition, a significant percentage of our operating expenses are variable, including sales compensation, floor plan interest expense (inventory-secured financing) and advertising, which we believe we can adjust over time to reflect economic trends.

Leverage Scale and Implement Best Practices

As the nation s second largest automotive retailer, we aim to build scale in many of the markets where we have dealership operations. Our desire is to reduce or eliminate redundant operating costs such as accounting, information technology systems and general administrative costs. In addition, we seek to leverage our industry knowledge and experience to foster communication and cooperation between like brand dealerships throughout our organization. Senior management and dealership management meet regularly to review the operating performance of our dealerships, examine industry trends and, where appropriate, implement specific operating improvements. Key financial information is discussed and compared to other dealerships across all markets. This frequent interaction facilitates implementation of successful strategies throughout the organization so that each of our dealerships can benefit from the successes of our other dealerships and the knowledge and experience of our senior management.

smart Distributorship

In 2006, we were named by smart GmbH, an affiliate of Mercedes Benz, as the exclusive distributor of the smart for two vehicles in United States and Puerto Rico. Smart GmbH has sold over 770,000 for two vehicles outside the United States. We expect the first vehicles to be available for U.S. distribution in the first quarter of 2008. As distributor, we are responsible for qualifying and awarding potential dealers and developing and maintaining a smart vehicle dealership network throughout the United States and Puerto Rico.

Industry Overview

With revenues of approximately $1 trillion per year, the automotive retail industry is the largest retail trade sector in the United States. The majority of automotive retail sales in 2005 were generated by the approximately 21,500 U.S. franchised dealerships, producing revenues of approximately $700 billion. The industry is highly fragmented and largely privately held, with the publicly held automotive retail groups accounting for less than 10% of the total industry revenue.

Of the close to $700 billion in U.S. franchised dealer aggregate annual sales in 2005, new vehicle sales represent approximately 60% and used vehicle sales represent approximately 28%. In addition to new and used vehicles, dealerships offer a wide range of higher-margin products and services, including service and repair work,

Table of Contents

replacement parts, extended service contracts, and financing and credit insurance, which collectively represent the remaining 12% of total industry revenues.

According to industry data, the number of U.S. franchised dealerships has declined from approximately 24,000 in 1990 to approximately 21,500 today. Although significant consolidation has already taken place, the industry today remains highly fragmented, with more than 90% of the U.S. industry s market share remaining in the hands of smaller regional and independent players. We believe that further consolidation in the industry is likely due to increased capital requirements of dealerships, the limited number of viable alternative exit strategies for dealership owners, and the desire of certain manufacturers to strengthen their brand identity by consolidating their franchised dealerships. According to industry data, in 2005 the United Kingdom represented the second largest automotive market in Western Europe with approximately 2.5 million new car registrations and revenues exceeding $250 billion in aggregate annual new vehicle, used vehicle and service and parts sales.

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

Acquisitions

We have completed a number of dealership acquisitions since January 2004. Our financial statements include the results of operations of acquired dealerships from the date of acquisition. The following table sets forth information with respect to our current dealerships acquired or opened since January 2004:

Dealership	Date Opened or Acquired	Location	Franchises
U.S.			
Penske Cadillac South Bay	1/04	Torrance, CA	Cadillac
Penske HUMMER South Bay	4/04	Torrance, CA	HUMMER
Ferrari Maserati of Central New Jersey	7/04	Edison, NJ	Ferrari, Maserati
Mercedes-Benz of Chandler	7/04	Chandler, AZ	Mercedes-Benz
Capitol Honda	8/04	San Jose, CA	Honda
Honda North	8/04	Clovis, CA	Honda
Marin Honda	8/04	Corte Madera, CA	Honda
Los Gatos Acura	8/04	Los Gatos, CA	Acura
Maserati of Cleveland	8/04	Bedford, OH	Maserati
Honda Mall of Georgia	1/05	Buford, GA	Honda
Jaguar of Tulsa	1/05	Tulsa, OK	Jaguar
United Ford North	1/05	Tulsa, OK	Ford
United Ford South	1/05	Tulsa, OK	Ford
HUMMER of Turnersville	5/05	Turnersville, NJ	HUMMER
Inskip Nissan	7/05	Warwick, RI	Nissan

Stevens Creek Porsche Audi	10/05	San Jose, CA	Audi Porsche
Acura of Escondido	1/06	Escondido, CA	Acura
Aston Martin San Diego	1/06	San Diego, CA	Aston Martin
Audi of Escondido	1/06	Escondido, CA	Audi
Honda Mission Valley	1/06	San Diego, CA	Honda
Honda of Escondido	1/06	Escondido, CA	Honda

Table of Contents

Dealership	Date Opened or Acquired	Location	Franchises
Jaguar Kearny Mesa	1/06	San Diego, CA	Jaguar
Kearny Mesa Acura	1/06	San Diego, CA	Acura
Mazda of Escondido	1/06	Escondido, CA	Mazda
United HUMMER of Tulsa	1/06	Tulsa, OK	HUMMER
Motorwerks BMW/MINI	5/06	Minneapolis, MN	BMW/MINI
West Palm Subaru	7/06	West Palm Beach, FL	Subaru
Triangle Nissan del Oeste	7/06	Puerto Rico	Nissan
Cadillac of Turnersville	11/06	Turnersville, NJ	Cadillac
Outside the U.S.			
Kings Cheltenham & Gloucester	5/04	Gloucester, England	Chrysler Jeep
Bentley Edinburgh	7/04	Lothian, Scotland	Bentley
Graypaul Edinburgh	7/04	Lothian, Scotland	Ferrari, Maserati
Guildford Audi	7/04	Surrey, England	Audi
Porsche Centre Edinburgh	7/04	Lothian, Scotland	Porsche
Porsche Centre Glasgow	7/04	Strathclyde, Scotland	Porsche
Reading Audi	7/04	Berkshire, England	Audi
Slough Audi	7/04	Berkshire, England	Audi
Tamsen GmbH (Bremen)	7/04	Bremen/Hamburg, Germany	Aston Martin, Bentley, Ferrari, Lamborghini, Maserati, Rolls Royce
West London Audi	7/04	Middlesex, England	Audi
Harrogate Audi	10/04	Harrogate, England	Audi
Toyota World Tamworth	10/04	Staffordshire, England	Toyota
Kings Swindon	4/05	Swindon, England	Chrysler, Jeep, Dodge
Lexus of Milton Keynes	11/05	Milton Keynes, England	Lexus
BMW/ Mini Sunningdale	1/06	Berkshire, England	BMW, MINI
Guy Salmon Jaguar Ascot	1/06	Berks, England	Jaguar
Guy Salmon Jaguar Gatwick	1/06	West Sussex, England	Jaguar
Guy Salmon Jaguar Medway	1/06	Kent, England	Jaguar
Guy Salmon Land Rover Ascot	1/06	Berks, England	Land Rover
Guy Salmon Land Rover Gatwick	1/06	West Sussex, England	Land Rover
Guy Salmon Land Rover Medway	1/06	Kent, England	Land Rover
Guy Salmon Land Rover Wessex	1/06	Portsmouth, England	Land Rover
Honda Redhill	1/06	Surrey, England	Honda
Kings Bristol Chrysler Jeep Dodge	1/06	Bristol, England	Chrysler, Jeep, Dodge
Rolls Royce Sunningdale	1/06	Berkshire, England	Rolls Royce
Sytner Coventry	1/06	West Midlands, England	BMW, MINI
Lamborghini Birmingham	6/06	Birmingham, England	Lamborghini
Lamborghini Edinburgh	6/06	Edinburgh, Scotland	Lamborghini
Autohaus Augsburg	8/06	Augsburg, Germany	BMW(4), MINI
Kings Chrysler Jeep Dodge Newcastle	8/06	Cleveland, England	Chrysler, Jeep, Dodge
Kings Chrysler Jeep Dodge Stockton	8/06	Stockton-on-Tees, England	Chrysler, Jeep, Dodge

Mercedes-Benz of Carlisle	8/06	Cumbria, England	Mercedes-Benz
Mercedes-Benz of Newcastle	8/06	Cleveland, England	Mercedes-Benz
Mercedes-Benz of Stockton	8/06	Stockton-on-Tees, England	Mercedes-Benz
Mercedes-Benz of Sunderland	8/06	Sunderland, England	Mercedes-Benz
Rydale BMW/MINI Cardiff	8/06	South Glamorgan, Wales	BMW/MINI

Table of Contents

Dealership	Date Opened or Acquired	Location	Franchises
Rydale BMW/MINI Central	8/06	West Midlands, England	BMW/MINI
Rydale BMW/MINI Newport	8/06	Newport, South Wales	BMW/MINI
Rydale BMW/MINI Sutton	8/06	West Midlands, England	BMW/MINI
Rydale BMW/MINI Warley	8/06	West Midlands, England	BMW/MINI

In 2005 and 2006, we disposed of 22 and 23 dealerships, respectively, that we believe were not integral to our strategy or operations. We expect to continue to pursue acquisitions, selected dispositions and related transactions in the future.

Dealership Operations

Franchises. The following charts reflect our franchises by location and our dealership mix by franchise as of February 1, 2007:

Location	Franchises
Arizona	20
Arkansas	14
California	26
Connecticut	4
Florida	10
Georgia	4
Indiana	2
Michigan	8
Minnesota	2
Mississippi	2
Nevada	2
New Jersey	19
New York	4
Ohio	7
Oklahoma	9
Puerto Rico	15
Rhode Island	10
Tennessee	3
Texas	3
Virginia	5
Total Domestic	169
United Kingdom	130
Germany	15
Total Foreign	145

Franchises	U.S.	Non-U.S.	Total
Daimler Chrysler	22	39	61
Toyota/Lexus	34	13	47
Ford/PAG	21	24	45
BMW/MINI	10	35	45
General Motors	18		18
Honda/Acura	26	1	27
Nissan/Infiniti	9		9
Audi	7	8	15
Porsche	5	4	9
Others	17	21	38
Total	169	145	314

Total Worldwide	314

Management. Each dealership or group of dealerships has independent operational and financial management responsible for day-to-day operations. We believe experienced local managers are better qualified to make day-to-day decisions concerning the successful operation of a dealership and can be more responsive to our customers needs. We seek local dealership management that not only has experience in the automotive industry, but also is familiar with the local dealership s market. We also have regional management that oversees operations at the individual dealerships and supports the dealerships operationally and administratively.

Table of Contents

New Vehicle Retail Sales. In 2006, we sold 183,370 new vehicles which generated 60.8% of our retail revenue and 32.3% of our retail gross profit. We sell over forty brands of domestic and import family, sports and premium cars, light trucks and sport utility vehicles through 314 franchises in nineteen U.S. states, Puerto Rico, the U.K. and Germany. As of February 1, 2007, we sold the following brands: Acura, Alpina, Aston Martin, Audi, BMW, Buick, Cadillac, Chevrolet, Chrysler, Dodge, Ferrari, Ford, GMC Truck, Honda, HUMMER, Hyundai, Infiniti, Jaguar, Jeep, Lamborghini, Land Rover, Lexus, Lincoln-Mercury, Lotus, Maybach, Mazda, Maserati, Mercedes Benz, MINI, Nissan, Pontiac, Porsche, Rolls Royce, Bentley, SAAB, Scion, smart, Subaru, Suzuki, Toyota, Volvo and Volkswagen.

Our customers finance their purchases of new and used vehicles through both traditional financing sources and consumer automobile leasing companies. Lease transactions are typically provided to consumers by short term financing sources. We believe leases also provide the opportunity to obtain repeat business from customers on a more regular basis than traditional purchase transactions because leases are typically of a short duration.

Our new vehicles are typically acquired by our dealerships directly from the manufacturer. We strive to maintain good relations with the automotive manufacturers, which we believe is supported by our long-term presence in the automotive retail market, the reputation of our management team and our consistent high sales volume from our dealerships. Our dealerships finance the purchase of new vehicles from the manufacturers through floor plan financing provided by various manufacturers captive finance companies.

Used Vehicle Retail Sales. In 2006, we sold 88,723 used vehicles, which generated 24.7% of our retail revenue and 12.7% of our retail gross profit. We generally acquire used vehicles from various sources including, auctions open only to authorized new vehicle dealers, public auctions, trade-ins in connection with new purchases and lease expirations or terminations. Leased vehicles returned at the end of the lease provide us with low mileage, late model vehicles for our used vehicle sales operations. We clean, repair and recondition, as necessary, all used vehicles we acquire for resale generally at our own service facilities.

We believe growth opportunities relating to used vehicle sales exist in part because of the availability of high-quality, low-mileage, late model used vehicles, along with the proliferation of manufacturer certification processes for these vehicles. To improve customer confidence in our used vehicle inventory, each of our dealerships participates in all available manufacturer certification processes for used vehicles. If certification is obtained, the used vehicle owner is typically provided benefits and warranties similar to those offered to new vehicle owners by the applicable manufacturer. Since warranty work can only be performed at franchised dealerships, we believe we may benefit from the opportunity to retain these customers as service and parts customers. In addition, we offer for sale third-party extended service contracts on all of our used vehicles.

Some vehicles acquired through trade-ins or originally intended for sale in our used vehicle operations are instead sold via auction. Through our scale in many markets, we have implemented closed-bid auctions that allow us to bring a large number of vehicles from different franchises to a central market for other dealers or wholesalers to purchase. We believe this strategy has resulted in greater operating efficiency and helped to reduce costs associated with maintaining optimal inventories.

Vehicle Finance, Extended Service and Insurance Sales. Finance and insurance sales represented 2.4% of our retail revenue and 14.7% of our retail gross profit in 2006. At our customers option, our dealerships can arrange third-party financing for our customers vehicle purchases. As compensation we receive a portion of the cost of financing paid by the customer for each financed sale. While these services are generally non-recourse to us, we are subject to chargebacks in certain circumstances such as default under a financing arrangement or other circumstances. We provide training to our finance and insurance personnel to help assure compliance with internal policies and procedures, as well as applicable state regulations. We also impose limits on the amount of revenue per transaction we may receive from certain finance products as part of our compliance efforts. We also offer for sale other aftermarket products, such as Sirius Satellite Radio, cellular phones, security systems and protective coatings.

We offer our customers various vehicle warranty and extended protection products, including extended warranties, maintenance programs, guaranteed auto protection (known as GAP, this protection covers the shortfall between a customer s loan balance and insurance payoff in the event of a casualty), lease wear and tear insurance and theft protection products at competitive prices. The vehicle warranty and extended protection products that our dealerships currently offer to customers are underwritten by independent third parties, including the vehicle manufacturers captive finance subsidiaries. We also are subject to chargebacks in connection with the sale of certain of these products.

Service and Parts Sales. Service and parts sales represented 12.1% of our retail revenue and 40.3% of our retail gross profit in 2006. We generate service and parts sales for warranty and non-warranty work at each of our dealerships, primarily relating to the vehicle models sold at that dealership. Our service and parts revenues have increased each year, we believe in large part due to our increased service capacity, coupled with the increasingly complex technology used in vehicles, which makes it difficult for independent repair facilities to maintain and repair today s automobiles. As part of our agreements with our manufacturers, we obtain all the necessary equipment required by the manufacturer to service and maintain each make of vehicle sold at each of our dealerships.

A goal of each of our dealerships is to make each vehicle purchaser a customer of our service and parts department. Our dealerships keep detailed records of our customers maintenance and service histories, and many dealerships send reminders to customers when vehicles are due for periodic maintenance or service. Many of our dealerships have extended evening and weekend service hours for the convenience for our customers. We also operate 26 collision repair centers, each of which is operated as an integral part of our dealership operations.

Internet Presence. According to industry analysts, the majority of car buyers nationwide will consult the Internet for new and pre-owned automotive information. In order to attract customers and enhance our customer service, each of our dealerships maintains its own website. Our corporate website, www.unitedauto.com, provides a link to each of our dealership websites allowing consumers to source information and communicate directly with our dealerships locally.

In the U.S., all of our dealership websites are presented in common formats (except where otherwise required by manufacturers) which helps to minimize costs and provide a consistent image across dealerships. In addition, many automotive manufacturers websites provide links to our dealership websites.

The Internet is generating better-informed consumers and improving the efficiency of the sales process. Using our dealership websites, consumers can review our inventory for vehicles that meet their model and feature requirements and price range. Our websites provide detailed information for the purchase process, including photos, prices, promotions, specifications, reviews, tools to schedule service appointments and financial applications. We believe these features make it easier for consumers to meet all of their automotive research needs. Customers can contact dedicated Internet sales consultants on line via www.unitedauto.com or the dealership websites.

We have also partnered with CarsDirect.com, a leading online car buying service that provides consumers with a full menu of research features. Consumers can also use CarsDirect.com to either buy a vehicle online or be sent to a network of dealerships in their market, including most of our dealerships. Research features include detailed safety ratings and reviews, financing, extended warranties, insurance quotes, anti-theft products and trade-in appraisals.

Outside the U.S. Sytner Group, our U.K. subsidiary, is one of the leading retailers of premium vehicles in the U.K. As of February 1, 2007, Sytner operated 130 franchises, including: Alpina, Audi, Bentley, BMW, Chrysler, Dodge, Ferrari, Honda, Jaguar, Jeep, Lamborghini, Land Rover, Lexus, Maserati, Mercedes-Benz, MINI, Porsche, Rolls Royce, Saab, smart, Toyota, and Volvo. Revenues attributable to Sytner Group for the years ended December 31, 2006, 2005 and 2004 were $3.4 billion, $2.8 billion and $2.4 billion, respectively. Our other operations outside the U.S. consist of fifteen wholly-owned franchises in Germany, as well as joint venture investments in Germany and Mexico which operate 25 franchises representing Audi, BMW, Lexus, MINI, Toyota, and Volkswagen.

Table of Contents

The following is a list of all of our dealerships as of February 1, 2007:

U.S. DEALERSHIPS

ARIZONA
Acura North Scottsdale
Audi North Scottsdale
BMW North Scottsdale
Jaguar North Scottsdale
Jaguar Scottsdale
Land Rover North Scottsdale
Land Rover Scottsdale
Lexus of Chandler
Mercedes-Benz of Chandler
MINI North Scottsdale
Porsche North Scottsdale
Rolls-Royce Scottsdale
Scottsdale Aston Martin
Scottsdale Audi
Scottsdale Bentley
Scottsdale Ferrari Maserati
Scottsdale Lexus
Tempe Honda
Volkswagen North Scottsdale
Volvo North Scottsdale

ARKANSAS
Acura of Fayetteville
Chevrolet/HUMMER of Fayetteville
Honda of Fayetteville
Landers Chevrolet HUMMER
Landers Chrysler Jeep Dodge
Landers Ford Lincoln Mercury
Toyota-Scion of Fayetteville

CALIFORNIA
Acura of Escondido
Aston Martin of San Diego
Audi Escondido
Audi Stevens Creek
BMW of San Diego
Capitol Honda
Cerritos Buick Pontiac HUMMER GMC
Honda Mission Valley
Honda North
Honda of Escondido

CONNECTICUT
Audi of Fairfield
Honda of Danbury
Mercedes-Benz of Fairfield
Porsche of Fairfield

FLORIDA
Central Florida Toyota-Scion
Citrus Chrysler Jeep Dodge
Palm Beach Mazda
Palm Beach Subaru
Palm Beach Toyota-Scion
West Palm Nissan

GEORGIA
Atlanta Toyota-Scion
Honda Mall of Georgia
United BMW of Gwinnett
United BMW of Roswell

INDIANA
Penske Chevrolet
Penske Honda

MICHIGAN
Honda Bloomfield
Rinke Cadillac
Rinke Pontiac GMC Truck
Rinke Toyota-Scion
Toyota-Scion of Waterford

MINNESOTA
Motorwerks BMW/MINI

MISSISSIPPI
Landers Dodge
Landers Nissan

NEW JERSEY
Acura of Turnersville
BMW of Turnersville
Chevrolet HUMMER Cadillac of Turnersville

NEW YORK
Honda of Nanuet
Mercedes-Benz of Nanuet
Westbury Toyota-Scion

NEVADA
Penske Wynn Ferrari Maserati

OHIO
Honda of Mentor
Infiniti of Bedford
Maserati of Cleveland
Mercedes-Benz of Bedford
Nissan of North Olmsted
Toyota-Scion of Bedford

OKLAHOMA
Jaguar of Tulsa
Lincoln Mercury of Tulsa (4111 S Memorial)
Lincoln Mercury of Tulsa (9607 S Memorial)
United Ford North
United Ford South
United HUMMER of Tulsa
Volvo of Tulsa

RHODE ISLAND
Inskip Acura
Inskip Audi
Inskip Autocenter (Mercedes-Benz)
Inskip Bentley Providence
Inskip BMW
Inskip Infiniti
Inskip Lexus
Inskip Nissan
Inskip Porsche
Inskip Volvo

TENNESSEE
Landers Ford of Memphis
Wolfchase Toyota-Scion

Jaguar Kearny Mesa
Kearny Mesa Acura
Kearny Mesa Toyota-Scion
Lexus Kearny Mesa
Los Gatos Acura
Marin Honda
Mazda of Escondido
Mercedes-Benz of San Diego (& Maybach)
Penske Cadillac HUMMER South Bay
Porsche of Stevens Creek

DiFeo BMW
Ferrari Maserati of Central New Jersey
Gateway Toyota-Scion
Honda of Turnersville
Hudson Nissan
Hudson Toyota-Scion
Hyundai of Turnersville
Lexus of Bridgewater
Nissan of Turnersville
Toyota-Scion of Turnersville

TEXAS

BMW of Austin
Goodson Honda North
Goodson Honda West

VIRGINIA

Aston Martin of Tysons Corner
Audi of Tysons Corner
Mercedes-Benz of Tysons Corner (& Maybach)
Porsche of Tysons Corner

Table of Contents

NON-U.S. DEALERSHIPS

UNITED KINGDOM
Bentley Lamborghini Birmingham
Bentley Lamborghini Edinburgh
Bentley Manchester
Bradford Audi
Graypaul Edinburgh (Ferrari/Maserati)
Graypaul Nottingham (Ferrari/Maserati)
Guildford Audi
Guy Salmon Jaguar Ascot
Guy Salmon Jaguar Coventry
Guy Salmon Jaguar Gatwick
Guy Salmon Jaguar Maidstone
Guy Salmon Jaguar Northampton
Guy Salmon Jaguar Oxford
Guy Salmon Jaguar Stratford (After Sales)
Guy Salmon Jaguar Thames Ditton
Guy Salmon Land Rover Ascot
Guy Salmon Land Rover Coventry
Guy Salmon Land Rover Gatwick
Guy Salmon Land Rover Knutsford
Guy Salmon Land Rover Leeds
Guy Salmon Land Rover Maidstone
Guy Salmon Land Rover Portsmouth
Guy Salmon Land Rover Sheffield
Guy Salmon Land Rover Stockport
Guy Salmon Land Rover Stratford-upon-Avon
Guy Salmon Land Rover Thames Ditton
Guy Salmon Land Rover Wakefield
Harrogate Audi
Kings Bristol Chrysler Jeep Dodge
Kings Cheltenham & Gloucester (Chrysler, Jeep, Dodge)
Kings Manchester (Chrysler, Jeep, Dodge)
Kings Swindon (Chrysler, Jeep, Dodge)
Leeds Audi
Lexus Birmingham
Lexus Bristol
Lexus Cardiff
Lexus Leicester
Lexus Milton Keynes
Lexus Oxford
Mayfair Audi
Mercedes-Benz of Bath
Mercedes-Benz of Bedford
Mercedes-Benz of Carlisle
Mercedes-Benz of Cheltenham and Gloucester
Mercedes-Benz of Cribbs Causeway
Mercedes-Benz of Kettering
Mercedes-Benz of Milton Keynes
Mercedes-Benz of Newbury
Mercedes-Benz of Northampton
Mercedes-Benz of Sunderland
Mercedes-Benz of Teesside
Mercedes-Benz of Weston-Super-Mare
Mercedes-Benz/smart of Bristol
Mercedes-Benz/smart of New Castle
Mercedes-Benz/smart of Swindon
Oxford Saab
Porsche Centre Edinburgh
Porsche Centre Glasgow
Porsche Centre Mid-Sussex
Porsche Centre Silverstone
Reading Audi
Redhill Honda
Rolls-Royce Motor Cars Sunningdale
Rydale BMW/MINI Cardiff
Rydale BMW/MINI Central
Rydale BMW/MINI Newport
Rydale BMW/MINI Sutton
Rydale BMW/MINI Warley
Ryfield Chrysler Jeep Dodge New Castle
Ryfield Chrysler Jeep Dodge Stockton
Slough Audi
smart North East Stockton
smart of Milton Keynes
Sytner Canary Wharf (BMW/MINI)
Sytner Chigwell (BMW/MINI)
Sytner Coventry (BMW/MINI)
Sytner Harold Wood (BMW/MINI)
Sytner High Wycombe (BMW)
Sytner Leicester (BMW/MINI)
Sytner Nottingham (BMW/MINI, Alpina)
Sytner Rolls-Royce Motor Cars
Sytner Sheffield (BMW/MINI)
Sytner Solihull (BMW/MINI)
Sytner Sunningdale (BMW/MINI)
Tollbar Coventry (Volvo)
Tollbar Twickenham (Volvo)
Tollbar Warwick (Volvo)
Toyota World Birmingham
Toyota World (Bridgend)
Toyota World (Bristol North)
Toyota World (Bristol South)
Toyota World (Cardiff)
Toyota World (Newport)
Toyota World (Tamworth)
Victoria Audi (After Sales)
Wakefield Audi
West London Audi

GERMANY
Autohaus Augsburg (BMW(4)/MINI)
Tamsen, Bremen (Aston Martin, Bentley, Ferrari, Maserati, Rolls-Royce)
Tamsen, Hamburg (Aston Martin, Ferrari, Lamborghini, Maserati, Rolls-Royce)

PUERTO RICO
Lexus de San Juan
Triangle Chrysler, Dodge, Jeep, Honda del Oeste
Triangle Chrysler, Dodge, Jeep de Ponce
Triangle Honda 65 de Infanteria
Triangle Honda-Suzuki de Ponce
Triangle Mazda de Ponce
Triangle Nissan del Oeste
Triangle Toyota-Scion de San Juan

We also own approximately 50% of the following dealerships:

GERMANY

Aix Automobile (Toyota, Lexus)
Audi Zentrum Aachen
Autohaus Krings (Volkswagon)
Autohaus Nix (Frankfurt) (Toyota, Lexus)
Autohaus Nix (Offenbach) (Toyota, Lexus)
Autohaus Nix (Wachtersbach) (Toyota, Lexus)
Autohaus Piper (Volkswagen)
Autohaus Reisacher (Krunback) (BMW)
Autohaus Reisacher (Memmingen) (BMW, MINI)
Autohaus Reisacher (Ulm) (BMW, MINI)
Autohaus Reisacher (Vöhringen) (BMW)
J-S Auto Park Stolberg (Volkswagen)
TCD (Toyota)
Volkswagen Zentrum Aachen
Wolff & Meir (Volkswagen)

MEXICO

Toyota de Aguascalientes
Toyota de Lindavista
Toyota de Monterrey

Table of Contents

Management Information Systems

We consolidate financial, accounting and operational data received from our U.S. dealers through an exclusive private communications network. Dealership data is gathered and processed through individual dealer systems utilizing The Reynolds and Reynolds Company dealer management systems. Each dealership is allowed to tailor the operational capabilities of that system locally, but we require that they follow our standardized accounting procedures. Our U.S. network allows us to extract and aggregate information from the system in a consistent format to generate consolidating financial and operational data. The system also allows us to access detailed information for each dealership in the U.S. individually, as a group, or on a consolidated basis. Information we can access includes, among other things, inventory, cash, unit sales, the mix of new and used vehicle sales and sales of aftermarket products and services. Our ability to access this data allows us to continually analyze these dealerships operating results and financial position so as to identify areas for improvement. Our technology also enables us to quickly integrate dealerships or dealership groups we acquire in the U.S.

Our foreign dealership financial, accounting and operational data is processed through dealer management systems provided by a number of local software providers. Financial and operational information is aggregated following U.S. policies and accounting requirements, and is reported in our U.S. reporting format to ensure consistency of results among our worldwide operations.

Marketing

We believe that our marketing programs have contributed to our sales growth. Our advertising and marketing efforts are focused at the local market level, with the aim of building our retail vehicle business, as well as repeat sales and service business. We utilize many different media for our marketing activities, including newspapers, direct mail, magazines, television, radio and the Internet. We also assist our local management in running special marketing events to generate sales such as tent sales or local product placement. Automobile manufacturers supplement our local and regional advertising efforts by producing large advertising campaigns to support their brands, promote attractive financing packages and draw traffic to local area dealerships. We believe that our scale has enabled us to obtain favorable terms from suppliers and advertising media, and should enable us to realize continued cost savings in marketing. In an effort to realize increased efficiencies, we are focusing on common marketing metrics and business practices across our dealerships, as well as negotiating enterprise arrangements for many marketing resources.

Agreements with Vehicle Manufacturers

Each of our dealerships operates under separate franchise agreements with the manufacturers of each brand of vehicle sold at that dealership. These agreements contain provisions and standards governing almost every aspect of the dealership, including ownership, management, personnel, training, maintenance of minimum working capital and in some cases net worth, maintenance of minimum lines of credit, advertising and marketing, facilities, signs, products and services, acquisitions of other dealerships (including restrictions on how many dealerships can be acquired or operated in any given market), maintenance of minimum amounts of insurance, achievement of minimum customer service standards and monthly financial reporting. Typically, the dealership principal and/or the owner of a dealership may not be changed without the manufacturer s consent.

In exchange for complying with these provisions and standards, we are granted the non-exclusive right to sell the manufacturer s brand of vehicles and related parts and services at our dealerships. The agreements also grant us a non-exclusive license to use each manufacturer s trademarks, service marks and designs in connection with our sales and service of its brands at our dealerships. Some of our franchise agreements expire after a specified period of time, ranging from one to five years. The agreements also permit the manufacturer to terminate or not renew the agreement for a variety of causes, including failure to adequately operate the dealership, insolvency or bankruptcy, impairment of the dealer s reputation or financial standing, changes in the dealership s management, owners or location without consent, sales of the dealership s assets without consent, failure to maintain adequate working capital or floor plan financing, changes in the dealership s financial or other condition, failure to submit required information to the manufacturer on a timely basis, failure to have any permit or license necessary to operate the dealership, and material breaches of other provisions of the agreement. These termination rights are subject to applicable state franchise laws that limit a manufacturer s right to terminate a franchise. Many agreements grant the manufacturer a security interest in the vehicles and/or parts sold by the manufacturer to the dealership.

Our agreements with manufacturers usually give the manufacturers the right, in some circumstances (including upon a merger, sale, or change of control of the company, or in some cases a material change in our business or capital structure), to acquire from us, at fair market value, the dealerships that sell the manufacturers brands. In particular, our agreement with General Motors Corporation provides that, upon a proposed sale of 20% or more of our voting stock to any other person or entity (other than for passive investment) or another manufacturer, an extraordinary corporate transaction (such as a merger, reorganization or sale of a material amount of assets) or a change of control of our board of directors, General Motors has the right to acquire at fair market value, all assets, properties and business of any General Motors dealership owned by us. In addition, General Motors has a right of first refusal if we propose to sell any of our General Motors dealerships to a third party. Some of our agreements with other major manufacturers contain provisions similar to the General Motors provisions. Some of the agreements also prohibit us from pledging, or impose significant limitations on our ability to pledge, the capital stock of some of our subsidiaries to lenders.

Competition

For new vehicle sales, we compete primarily with other franchised dealers in each of our marketing areas. We do not have any cost advantage in purchasing new vehicles from manufacturers, and typically we rely on our world-class facilities, advertising and merchandising, management experience, sales expertise, service reputation and the location of our dealerships to sell new vehicles. Each of our markets may include a number of well-capitalized competitors that also have extensive automobile dealership managerial experience and strong retail locations and facilities.

We compete with dealers that sell the same brands of new vehicles that we sell and with dealers that sell other brands of new vehicles that we do not represent in a particular market. Our new vehicle dealership competitors have franchise agreements with the various vehicle manufacturers and, as such, generally have access to new vehicles on the same terms as us. In recent years, automotive dealers have also faced increased competition in the sale of new vehicles from on-line purchasing services and warehouse clubs. Due to lower overhead and sales costs, these companies may be willing to offer products at lower prices than franchised dealers.

For used vehicle sales, we compete with other franchised dealers, independent used vehicle dealers, automobile rental agencies, on-line purchasing services, private parties and used vehicle superstores for the procurement and resale of used vehicles.

We believe that the principal competitive factors in vehicle sales are the marketing campaigns conducted by manufacturers, the ability of dealerships to offer a wide selection of the most popular vehicles, the location of dealerships and the quality of customer service. Other competitive factors include customer preference for particular brands of automobiles, pricing (including manufacturer rebates and other special offers) and warranties. We believe that our dealerships are competitive in all of these areas.

We compete with other franchised dealers to perform warranty repairs and with other automotive dealers, franchised and non-franchised service center chains, and independent garages for non-warranty repair and routine maintenance business. We compete with other automotive dealers, service stores and auto parts retailers in our parts operations. We believe that the principal competitive factors in parts and service sales are price, the use of factory-approved replacement parts, facility location, the familiarity with a manufacturer s brands and models and the quality of customer service. A number of regional or national chains offer selected parts and services at prices that may be lower than our prices.

According to various industry sources, the automotive retail industry is currently served by approximately 21,500 franchised automotive dealerships, over 50,000 independent used vehicle dealerships and individual consumers who sell used vehicles in private transactions. Several other companies have established national or regional automotive retail chains. Additionally, vehicle manufacturers have historically engaged in the retail sale and service of vehicles, either independently or in conjunction with their franchised dealerships, and may do so on an expanded basis in the future, subject to various state laws that restrict or prohibit manufacturer ownership of dealerships.

We believe that a growing number of consumers are utilizing the Internet, to differing degrees, in connection with the purchase of vehicles. Accordingly, we may face increased pressure from on-line automotive websites, including those developed by automobile manufacturers and other dealership groups. Consumers use the Internet to compare prices for vehicles and related services, which may result in reduced margins for new vehicles, used vehicles and related services.

Employees and Labor Relations

As of December 31, 2006, we employed approximately 15,800 people, approximately 465 of whom were covered by collective bargaining agreements with labor unions. We consider our relations with our employees to be satisfactory. Our policy is to motivate our key managers through, among other things, variable compensation programs tied principally to dealership profitability and our equity incentive compensation plans. Due to our reliance on vehicle manufacturers, we may be adversely affected by labor strikes or work stoppages at the manufacturers facilities.

Regulation

We operate in a highly regulated industry. A number of regulations affect our business of marketing, selling, financing and servicing automobiles. We actively make efforts to assure compliance with these regulations. Under the laws of the jurisdictions in which we currently operate or into which we may expand, we typically must obtain a license in order to establish, operate or relocate a dealership or operate an automotive repair service, including dealer, sales, finance and insurance-related licenses issued by relevant authorities. These laws also regulate our conduct of business, including our advertising, operating, financing, employment and sales practices. Other laws and regulations include franchise laws and regulations, extensive laws and regulations applicable to new and used motor vehicle dealers, as well as wage-hour, anti-discrimination and other employment practices laws.

Our operations may also be subject to consumer protection laws known in the U.S. as Lemon Laws . These laws typically require a manufacturer or dealer to replace a new vehicle or accept it for a full refund within a period of time after initial purchase if the vehicle does not conform to the manufacturer s express warranties and the dealer or manufacturer, after a reasonable number of attempts, is unable to correct or repair the defect. Various laws require various written disclosures to be provided on new vehicles, including mileage and pricing information. Imported automobiles may be subject to customs duties and, in the ordinary course of our business, we may, from time to time, be subject to claims for duties, penalties, liquidated damages, or other charges.

Our financing activities with customers are subject to federal truth-in-lending, consumer leasing equal credit opportunity and similar regulations as well as motor vehicle finance laws, installment finance laws, insurance laws, usury laws and other installment sales laws. Some jurisdictions regulate finance fees that may be paid as a result of vehicle sales. In recent years, private plaintiffs and state attorneys general in the U.S. have increased their scrutiny of advertising, sales, and finance and insurance activities in the sale and leasing of motor vehicles.

In the U.S., we also benefit from the protection of numerous state dealer laws that generally provide that a manufacturer may not terminate or refuse to renew a franchise agreement unless it has first provided the dealer with written notice setting forth good cause and stating the grounds for termination or non-renewal. Some state dealer laws allow dealers to file protests or petitions or to attempt to comply with the manufacturer s criteria within the notice period to avoid the termination or non-renewal. Europe generally does not have these laws and, as a result, our European dealerships operate without these protections.

Environmental Matters

We are subject to a wide range of environmental laws and regulations, including those governing discharges into the air and water, the operation and removal of aboveground and underground storage tanks, the use, handling, storage and disposal of hazardous substances and other materials and the investigation and remediation of contamination. As with automotive dealerships generally, and service, parts and body shop operations in particular, our business involves the generation, use, handling and contracting for recycling or disposal of hazardous or toxic substances or wastes, including environmentally sensitive materials such as motor oil, waste motor oil and filters, transmission fluid, antifreeze, refrigerant, waste paint and lacquer thinner, batteries, solvents, lubricants, degreasing agents, gasoline and diesel fuels. Similar to many of our competitors, we have incurred and will continue to incur, capital and operating expenditures and other costs in complying with such laws and regulations.

Our operations involving the management of hazardous and other environmentally sensitive materials are subject to numerous requirements. Our business also involves the operation of storage tanks containing such materials. Storage tanks are subject to periodic testing, containment, upgrading and removal under applicable law. Furthermore, investigation or remediation may be necessary in the event of leaks or other discharges from current or former underground or aboveground storage tanks. In addition, water quality protection programs govern certain discharges from some of our operations. Similarly, certain air emissions from our operations, such as auto body painting, may be subject to relevant laws. Various health and safety standards also apply to our operations.

We may also have liability in connection with materials that were sent to third-party recycling, treatment, and/or disposal facilities under the U.S. Comprehensive Environmental Response, Compensation and Liability Act, or CERCLA, and comparable statutes. These statutes impose liability for investigation and remediation of contamination without regard to fault or the legality of the conduct that contributed to the contamination. Responsible parties under these statutes may include the owner or operator of the site where the contamination occurred and companies that disposed or arranged for the disposal of the hazardous substances released at these sites.

We believe that we do not have any material environmental liabilities and that compliance with environmental laws and regulations will not, individually or in the aggregate, have a material adverse effect on our results of operations, financial condition or cash flows. However, soil and groundwater contamination is known to exist at certain of our current or former properties. Further, environmental laws and regulations are complex and subject to change. In addition, in connection with our acquisitions, it is possible that we will assume or become subject to new or unforeseen environmental costs or liabilities, some of which may be material. Compliance with current, amended, new or more stringent laws or regulations, stricter interpretations of existing laws or the future discovery of environmental conditions could require additional expenditures by us, and such expenditures could be material.

Insurance

Due to the nature of the automotive retail industry, automotive retail dealerships generally require significant levels of insurance covering a broad variety of risks. The business is subject to substantial risk of property loss due to the significant concentration of property values at dealership locations, including vehicles and parts. Other potential liabilities arising out of our operations involve claims by employees, customers or third parties for personal injury or property damage and potential fines and penalties in connection with alleged violations of regulatory requirements.

As a result, we purchase insurance subject to specified deductibles and significant loss retentions, including umbrella and excess insurance policies. The level of risk we retain may change in the future as insurance market conditions or other factors affecting the economics of purchasing insurance change. Based on the coverage of our existing policies, we could be exposed to uninsured or underinsured losses, including as a result of our deductibles and significant loss retentions, that could have a material adverse effect on our results of operations, financial condition or cash flows. We and Penske Corporation, which is our largest stockholder, have entered into a joint insurance agreement which provides that, with respect to our joint insurance policies (which includes our property policy), available coverage with respect to a loss shall be paid to each party as stipulated in the policies. In the event of losses by us and Penske Corporation in excess of the limit of any policy during a policy period, the total policy proceeds will be allocated based on the ratio of premiums paid. For information regarding our relationship with Penske Corporation, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations-Related Party

Transactions.

Seasonality

Our business is modestly seasonal overall. Our U.S. operations generally experience higher volumes of vehicle sales in the second and third quarters of each year due in part to consumer buying trends and the introduction of new vehicle models. Also, demand for cars and light trucks is generally lower during the winter months than in other seasons, particularly in regions of the United States where dealerships may be subject to severe winters. The greatest U.S. seasonality exists at the dealerships we operate in northeastern and upper mid-western states, for which the second and third quarters are the strongest with respect to vehicle-related sales. Our U.K. operations generally experience higher volumes of vehicle sales in the first and third quarters of each year, due primarily to vehicle registration practices in the U.K. The service and parts business at all dealerships experience relatively modest seasonal fluctuations.

Available Information

For selected financial information concerning our U.S. and non-U.S. sales and assets, see the notes to our consolidated financial statements included in Item 8 of this report. Our Internet website address is www.unitedauto.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are available free of charge through our website under the tab Investor Relations as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission. We also make available on our website copies of materials regarding our corporate governance policies and practices, including our Corporate Governance Guidelines; our Code of Business Ethics; and the charters relating to the committees of our Board of Directors. You also may obtain a printed copy of the foregoing materials by sending a written request to: Investor Relations, United Auto Group, Inc., 2555 Telegraph Road, Bloomfield Hills, MI 48302. The information on or linked to our website is not part of this document. We plan to disclose waivers, if any, for our executive officers or directors from our code of conduct on our website, www.unitedauto.com. We are incorporated in the state of Delaware and began dealership operations in October 1992. We submitted to the New York Stock Exchange its required annual CEO certification in 2006 without qualification and have filed all required certifications under section 302 of the Sarbanes-Oxley Act as exhibits to this annual report on Form 10-K relating to 2006.

Item 1A. *Risk Factors*

Risks Relating to Automotive Manufacturers

Automotive manufacturers exercise significant control over our operations and we depend on them in order to operate our business.

Each of our dealerships operates under franchise agreements with automotive manufacturers or related distributors. We are dependent on automotive manufacturers because, without a franchise agreement, we cannot operate a new vehicle franchise or perform manufacturer authorized service.

Manufacturers exercise a great degree of control over the operations of our dealerships. For example, manufacturers can require our dealerships to meet specified standards of appearance, require individual dealerships to meet specified financial criteria such as maintenance of minimum net working capital and, in some cases, minimum net worth, impose minimum customer service and satisfaction standards, set standards regarding the maintenance of vehicle and parts inventories, restrict the use of manufacturers names and trademarks and, in many cases, must consent to the replacement of the dealership principal.

Our franchise agreements may be terminated or not renewed by automotive manufacturers for a variety of reasons, including unapproved changes of ownership or management and other material breaches of the franchise agreements. We have, from time to time, not been compliant with various provisions of some of our franchise agreements. Although we believe that we will be able to renew at expiration all of our existing franchise agreements, if any of our significant existing franchise agreements or a large number of franchise agreements are not renewed or the terms of any such renewal are materially unfavorable to us, our results of operations, financial condition or cash flows could be materially adversely affected. In addition, actions taken by manufacturers to exploit their bargaining position in negotiating the terms of renewals of franchise agreements or otherwise could also materially adversely affect our results of operations, financial condition or cash flows.

Table of Contents

While U.S. franchise laws give us limited protection in selling a manufacturer s product within a given geographic area, our franchise agreements do not give us the exclusive right to sell vehicles within a given area and the location of a significant number of new dealerships near our existing dealerships could materially adversely affect our results of operations, financial condition or cash flows.

We depend on manufacturers to provide us with a desirable mix of popular new vehicles, which tends to produce the highest profit margins. Manufacturers generally allocate their vehicles among dealerships based on the sales history of each dealership. Our inability to obtain sufficient quantities of the most popular models, whether due to sales declines at our dealerships or otherwise, could materially adversely affect our results of operations, financial condition or cash flows.

Our volumes and profitability may be adversely affected if automotive manufacturers reduce or discontinue their incentive programs.

Our dealerships depend on the manufacturers for sales incentives, warranties and other programs that promote and support vehicle sales at our dealerships. Some of these programs include customer rebates, dealer incentives, special financing or leasing terms and warranties. Manufacturers frequently change their incentive programs. If manufacturers reduce or discontinue incentive programs, our results of operations, financial condition or cash flows could be materially adversely affected.

Adverse conditions affecting one or more automotive manufacturers may negatively impact our revenues and profitability.

Our success depends on the overall success of the line of vehicles that each of our dealerships sells. As a result, our success depends to a great extent on the automotive manufacturers financial condition, marketing, vehicle design, production and distribution capabilities, reputation, management and labor relations. For 2006, Toyota/Lexus brands, BMW/MINI, Honda/Acura, DaimlerChrysler brands and Ford/Premier Auto Group accounted for 21%, 18%, 16%, 11% and 10%, respectively, of our total revenues. A significant decline in the sale of new vehicles manufactured by these manufacturers, or the loss or deterioration of our relationships with one or more of these manufacturers, could materially adversely affect our results of operations, financial condition or cash flows. No other manufacturer accounted for more than 10% of our total revenues for 2006.

Events such as labor strikes that may adversely affect a manufacturer may also materially adversely affect us, especially if these events were to interrupt the supply of vehicles or parts to us. Similarly, the delivery of vehicles from manufacturers at a time later than scheduled, which may occur particularly during periods of new product introductions, has led, and in the future could lead, to reduced sales during those periods. In addition, any event that causes adverse publicity involving one or more automotive manufacturers or their vehicles may materially adversely affect our results of operations, financial condition or cash flows.

Our failure to meet manufacturers consumer satisfaction requirements may adversely affect us.

Many manufacturers measure customers satisfaction with their sales and warranty service experiences through systems that are generally known as customer satisfaction indices, or CSI. Manufacturers sometimes use a dealership s CSI scores as a factor in evaluating applications for additional dealership acquisitions. Certain of our dealerships have had difficulty from time to time in meeting their manufacturers CSI standards. We may be unable to meet these standards in the future. A manufacturer may refuse to consent to a franchise acquisition by us if our dealerships do not meet their CSI standards. This could materially adversely affect our acquisition strategy. In addition, because we receive payments from the manufacturers based in part on CSI scores, future payments could be materially reduced or eliminated if our CSI scores decline.

Automotive manufacturers impose limits on our ability to issue additional equity and on the ownership of our common stock by third parties, which may hamper our ability to meet our financing needs.

A number of manufacturers impose restrictions on the sale and transfer of our common stock. The most prohibitive restrictions provide that, under specified circumstances, we may be forced to sell or surrender franchises (1) if a competing automotive manufacturer acquires a 5% or greater ownership interest in us or (2) if an individual

Table of Contents

or entity that has a criminal record in connection with business dealings with any automotive manufacturer, distributor or dealer or who has been convicted of a felony acquires a 5% or greater ownership interest in us. Further, several manufacturers have the right to approve the acquisition by a third party of 20% or more of our common stock, and a number of manufacturers continue to prohibit changes in ownership that may affect control of our company.

Actions by our stockholders or prospective stockholders that would violate any of the above restrictions are generally outside our control. If we are unable to obtain a waiver or relief from these restrictions, we may be forced to terminate or sell one or more franchises, which could materially adversely affect our results of operations, financial condition or cash flows. These restrictions also may prevent or deter prospective acquirers from acquiring control of us and, therefore, may adversely impact the value of our common stock. These restrictions also may impede our ability to raise required capital or our ability to acquire dealership groups using our common stock may also be inhibited.

Risks Relating to our Acquisition Strategy

Growth in our revenues and earnings depends substantially on our ability to acquire and successfully operate new dealerships.

While we expect to acquire new dealerships, we cannot guarantee that we will be able to identify and acquire additional dealerships in the future. Moreover, acquisitions involve a number of risks, including:

- integrating the operations and personnel of the acquired dealerships;
- operating in new markets with which we are not familiar;
- incurring unforeseen liabilities at acquired dealerships;
- disruption to our existing businesses;
- failure to retain key personnel of the acquired dealerships;
- impairment of relationships with employees, manufacturers and customers; and
- incorrectly valuing acquired entities.

In addition, integrating acquired dealerships into our existing mix of dealerships may result in substantial costs, diversion of our management resources or other operational or financial problems. Unforeseen expenses, difficulties and delays frequently encountered in connection with the integration of acquired entities and the rapid expansion of operations could inhibit our growth, result in our failure to achieve acquisition synergies and require us to focus resources on integration rather than other more profitable areas.

Acquired entities may subject us to unforeseen liabilities that we are unable to detect prior to completing the acquisition, or liabilities that turn out to be greater than those we had expected. These liabilities may include liabilities that arise from non-compliance with environmental laws by prior owners for which we, as a successor owner, will be responsible. Until we assume operating control of acquired entities, we may not be able to ascertain the actual value of the acquired entity.

We may be unable to identify acquisition candidates that would result in the most successful combinations, or complete acquisitions on acceptable terms on a timely basis. The magnitude, timing, pricing and nature of future acquisitions will depend upon various factors, including the availability of suitable acquisition candidates, the negotiation of acceptable terms, our financial capabilities, the availability of skilled employees to manage the acquired companies and general economic and business conditions. Further, covenants contained in our debt instruments impose limitations on our ability to acquire additional dealerships and future debt instruments may impose additional restrictions. Furthermore, we have sold and may in the future sell dealerships based on numerous factors, which may impact our future revenues and earnings, particularly if we do not make acquisitions to replace such revenues and earnings.

Table of Contents

Manufacturers restrictions on acquisitions may limit our future growth.

Our future growth via acquisition of automotive dealerships will depend on our ability to obtain the requisite manufacturer approvals. The relevant manufacturer must consent to any franchise acquisition and it may not consent in a timely fashion or at all. In addition, under many franchise agreements or under local law, a manufacturer may have a right of first refusal to acquire a dealership that we seek to acquire.

Certain manufacturers limit the total number of their dealerships that we may own in a particular geographic area and, in some cases, the total number of their vehicles that we may sell as a percentage of that manufacturer s overall sales. Manufacturers may also limit the ownership of stores in contiguous markets and the dueling of a franchise with another brand. To date, we have only reached these ceilings with two manufacturers. If additional manufacturers impose or expand these types of restrictions, our acquisition strategy and results of operations, financial condition or cash flows could be materially adversely affected.

Other Business Risks

Our business is susceptible to adverse economic conditions, including changes in consumer confidence, fuel prices and credit availability.

We believe that the automotive retail industry is influenced by general economic conditions and particularly by consumer confidence, the level of personal discretionary spending, interest rates, fuel prices, weather conditions, unemployment rates and credit availability. Historically, unit sales of motor vehicles, particularly new vehicles, have been cyclical, fluctuating with general economic cycles. During economic downturns, new vehicle retail sales tend to experience periods of decline characterized by oversupply and weak demand. The automotive retail industry may experience sustained periods of decline in vehicle sales in the future. Any decline or change of this type could materially adversely affect our results of operations, financial condition or cash flows.

Some of our operations are regionally concentrated such as those in Arizona, California, the Northeastern United States and the United Kingdom. Adverse regional economic and competitive conditions in these areas could materially adversely affect our results of operations, financial condition or cash flows.

Substantial competition in automotive sales and services may adversely affect our profitability.

The automotive retail industry is highly competitive. Depending on the geographic market, we compete with:

- franchised automotive dealerships in our markets that sell the same or similar makes of new and used vehicles that we offer;
- private market buyers and sellers of used vehicles;
- Internet-based vehicle brokers that sell vehicles obtained from franchised dealers directly to consumers;
- vehicle rental companies that sell their used rental vehicles;
- service center chain stores; and
- independent service and repair shops.

In addition, automotive manufacturers may directly enter the retail market in the future, which could materially adversely affect our results of operations, financial condition or cash flows. Some of our competitors may have greater financial, marketing and personnel resources and lower overhead and sales costs than us. We do not have any cost advantage over other franchised automotive dealerships in purchasing new vehicles from the automotive manufacturers.

In addition to competition for vehicle sales, our dealerships compete with franchised dealerships to perform warranty repairs and with other automotive dealers, independent service center chains, independent garages and others, for non-warranty repair, routine maintenance and parts business. A number of regional or national chains offer selected parts and services at prices that may be lower than our dealerships prices. We also compete with a broad range of financial institutions in arranging financing for our customers vehicle purchases.

Table of Contents

The Internet is a significant part of the sales process in our industry. We believe that customers are using the Internet as part of the sales process to compare pricing for cars and related finance and insurance services, which may reduce gross profit margins for new and used cars and profits generated from the sale of finance and insurance products. Some websites offer vehicles for sale over the Internet without the benefit of having a dealership franchise, although they must currently source their vehicles from a franchised dealer. If Internet new vehicle sales are allowed to be conducted without the involvement of franchised dealers, or if dealerships are able to effectively use the Internet to sell outside of their markets, our business could be materially adversely affected. We could also be materially adversely affected to the extent that Internet companies acquire dealerships or ally themselves with our competitors dealerships.

Our capital costs and our results of operations may be adversely affected by a rising interest rate environment.

We finance our purchases of new and, to a lesser extent, used vehicle inventory using floor plan financing arrangements under which we are charged interest at floating rates. In addition, we obtain capital for general corporate purposes, dealership acquisitions and real estate purchases and improvements under predominantly floating interest rate credit facilities. Therefore, excluding the potential mitigating effects from interest rate hedging techniques, our interest expenses will rise with increases in interest rates. Rising interest rates may also have the affect of depressing demand in the interest rate sensitive aspects of our business, particularly new and used vehicles sales, because many of our customers finance their vehicle purchases. As a result, rising interest rates may have the affect of simultaneously increasing our costs and reducing our revenues, which could materially adversely affect our results of operations, financial condition or cash flows.

Our substantial indebtedness may limit our ability to obtain financing for acquisitions and may require that a significant portion of our cash flow be used for debt service.

We have a substantial amount of indebtedness. As of December 31, 2006, we had approximately $1.2 billion of total non-floor plan debt outstanding and $1.2 billion of floor plan notes payable outstanding. In addition, we have additional debt capacity under our credit facilities.

Our substantial debt could have important consequences. For example, it could:

- make it more difficult for us to obtain additional financing in the future for our acquisitions and operations, working capital requirements, capital expenditures, debt service or other general corporate requirements;

- require us to dedicate a substantial portion of our cash flows from operations to repay debt and related interest rather than other areas of our business;

- limit our operating flexibility due to financial and other restrictive covenants, including restrictions on incurring additional debt, creating liens on our properties, making acquisitions or paying dividends;

- place us at a competitive disadvantage compared to our competitors that have less debt; and

- make us more vulnerable in the event of adverse economic or industry conditions or a downturn in our business.

Our ability to meet our debt service obligations depends on our future performance, which will be impacted by general economic conditions and by financial, business and other competitive factors, many of which are beyond our control. These factors could include operating difficulties, increased operating costs, the actions of competitors, regulatory developments and delays in implementing our growth strategies. Our ability to meet our debt service and other obligations may depend on our success in implementing our business strategy. We may not be able to implement our business strategies and the anticipated results of our strategies may not be realized.

If our business does not generate sufficient cash flow from operations or future sufficient borrowings are not available to us, we might not be able to service our debt or to fund our other liquidity needs. If we are unable to service our debt, we may have to delay or cancel acquisitions, sell equity securities, sell assets or restructure or refinance our debt. If we are unable to service our debt, we may not be able to pursue these options on a timely basis

Table of Contents

or on satisfactory terms or at all. In addition, the terms of our existing or future franchise agreements, agreements with manufacturers or debt agreements may prohibit us from adopting any of these alternatives.

Our inability to raise capital, if needed, could adversely affect us.

We require substantial capital in order to acquire and renovate automotive dealerships. This capital might be raised through public or private financing, including through the issuance of debt or equity securities, sale-leaseback transactions and other sources. Availability under our credit agreements may be limited by the covenants and conditions of those facilities. We may not be able to raise additional funds. If we raise additional funds by issuing equity securities, dilution to then existing stockholders may result.

If adequate funds are not available, we may be required to significantly curtail our acquisition and renovation programs, which could materially and adversely affect our growth strategy.

We depend to a significant extent on our ability to finance the purchase of inventory in the form of floor plan financing. Floor plan financing is financing from a vehicle manufacturer secure