

SONIC AUTOMOTIVE INC

Form 10-Q

July 25, 2012

Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

Commission files number 1-13395

**SONIC AUTOMOTIVE, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

**56-2010790**  
(I.R.S. Employer  
Identification No.)

**4401 Colwick Road, Charlotte, North Carolina**  
(Address of principal executive offices)

**28211**  
(Zip Code)

**(704) 566-2400**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such file). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one).

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  (Do not check if a smaller reporting company) Smaller Reporting Company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of July 18, 2012, there were 41,129,794 shares of Class A Common Stock and 12,029,375 shares of Class B Common Stock outstanding.

**Table of Contents****INDEX TO FORM 10-Q**

	Page
<b><u>PART I FINANCIAL INFORMATION</u></b>	
ITEM 1. <u>Unaudited Condensed Consolidated Financial Statements</u>	3
<u>Unaudited Condensed Consolidated Statements of Income – Second Quarter and Six-month Periods Ended June 30, 2012 and June 30, 2011</u>	3
<u>Unaudited Condensed Consolidated Statements of Comprehensive Income – Second Quarter and Six-month Periods Ended June 30, 2012 and June 30, 2011</u>	4
<u>Unaudited Condensed Consolidated Balance Sheets – June 30, 2012 and December 31, 2011</u>	5
<u>Unaudited Condensed Consolidated Statement of Stockholders – Equity – Six-month Period Ended June 30, 2012</u>	6
<u>Unaudited Condensed Consolidated Statements of Cash Flows – Six-month Periods Ended June 30, 2012 and June 30, 2011</u>	7
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	8
ITEM 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	37
ITEM 4. <u>Controls and Procedures</u>	38
<b><u>PART II OTHER INFORMATION</u></b>	
ITEM 1. <u>Legal Proceedings</u>	39
ITEM 1A. <u>Risk Factors</u>	40
ITEM 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
ITEM 6. <u>Exhibits</u>	43
<u>SIGNATURES</u>	46
<u>EXHIBIT INDEX</u>	47
EX-10.6	
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	
EX-101	INSTANCE DOCUMENT
EX-101	SCHEMA DOCUMENT
EX-101	CALCULATION LINKBASE DOCUMENT
EX-101	LABELS LINKBASE DOCUMENT
EX-101	PRESENTATION LINKBASE DOCUMENT
EX-101	DEFINITION LINKBASE DOCUMENT

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1: Unaudited Condensed Consolidated Financial Statements.****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(Dollars and shares in thousands, except per share amounts)

	Second Quarter Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues:</b>				
New vehicles	\$ 1,221,297	\$ 1,025,277	\$ 2,285,750	\$ 1,997,770
Used vehicles	550,040	529,107	1,067,092	1,003,662
Wholesale vehicles	43,984	41,136	89,325	76,182
<b>Total vehicles</b>	<b>1,815,321</b>	<b>1,595,520</b>	<b>3,442,167</b>	<b>3,077,614</b>
Parts, service and collision repair	304,570	295,094	606,318	582,195
Finance, insurance and other	65,338	55,369	124,587	104,471
<b>Total revenues</b>	<b>2,185,229</b>	<b>1,945,983</b>	<b>4,173,072</b>	<b>3,764,280</b>
<b>Cost of Sales:</b>				
New vehicles	(1,149,946)	(957,432)	(2,149,579)	(1,870,428)
Used vehicles	(513,313)	(490,072)	(989,836)	(927,054)
Wholesale vehicles	(45,418)	(43,000)	(90,544)	(78,491)
<b>Total vehicles</b>	<b>(1,708,677)</b>	<b>(1,490,504)</b>	<b>(3,229,959)</b>	<b>(2,875,973)</b>
Parts, service and collision repair	(155,780)	(149,545)	(310,472)	(295,134)
<b>Total cost of sales</b>	<b>(1,864,457)</b>	<b>(1,640,049)</b>	<b>(3,540,431)</b>	<b>(3,171,107)</b>
Gross profit	320,772	305,934	632,641	593,173
Selling, general and administrative expenses	(249,525)	(237,092)	(497,005)	(466,109)
Impairment charges	(33)	(41)	(34)	(58)
Depreciation and amortization	(11,390)	(9,699)	(22,461)	(19,595)
<b>Operating income (loss)</b>	<b>59,824</b>	<b>59,102</b>	<b>113,141</b>	<b>107,411</b>
<b>Other income (expense):</b>				
Interest expense, floor plan	(5,053)	(4,914)	(9,527)	(10,280)
Interest expense, other, net	(12,712)	(15,339)	(27,791)	(30,698)
Interest expense, non-cash, convertible debt	(1,413)	(1,715)	(3,043)	(3,409)
Interest income (expense / amortization), non-cash, cash flow swaps	83	(464)	105	(286)
Other income (expense), net	(2,550)	15	(2,530)	88
<b>Total other income (expense)</b>	<b>(21,645)</b>	<b>(22,417)</b>	<b>(42,786)</b>	<b>(44,585)</b>
<b>Income (loss) from continuing operations before taxes</b>	<b>38,179</b>	<b>36,685</b>	<b>70,355</b>	<b>62,826</b>
Provision for income taxes - benefit (expense)	(10,646)	(13,691)	(23,354)	(24,147)
<b>Income (loss) from continuing operations</b>	<b>27,533</b>	<b>22,994</b>	<b>47,001</b>	<b>38,679</b>
<b>Discontinued operations:</b>				
Income (loss) from operations and the sale of dealerships	1,345	(997)	3,049	(2,092)
Income tax benefit (expense)	(699)	(646)	(1,373)	(272)

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Income (loss) from discontinued operations	646	(1,643)	1,676	(2,364)
Net income (loss)	\$ 28,179	\$ 21,351	\$ 48,677	\$ 36,315
Basic earnings (loss) per common share:				
Earnings (loss) per share from continuing operations	\$ 0.52	\$ 0.43	\$ 0.88	\$ 0.73
Earnings (loss) per share from discontinued operations	0.01	(0.03)	0.03	(0.05)
Earnings (loss) per common share	\$ 0.53	\$ 0.40	\$ 0.91	\$ 0.68
Weighted average common shares outstanding	52,593	52,461	52,409	52,438
Diluted earnings (loss) per common share:				
Earnings (loss) per share from continuing operations	\$ 0.46	\$ 0.38	\$ 0.79	\$ 0.65
Earnings (loss) per share from discontinued operations	0.01	(0.03)	0.02	(0.04)
Earnings (loss) per common share	\$ 0.47	\$ 0.35	\$ 0.81	\$ 0.61
Weighted average common shares outstanding	63,506	65,936	63,963	65,943
Dividends declared per common share	\$ 0.025	\$ 0.025	\$ 0.05	\$ 0.05

See notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Dollars in thousands)**

	<b>Second Quarter Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net income (loss)	\$ 28,179	\$ 21,351	\$ 48,677	\$ 36,315
Other comprehensive income (loss) before taxes:				
Change in fair value of interest rate swap agreements	(2,746)	(4,944)	61	(1,663)
Total other comprehensive income (loss) before taxes	(2,746)	(4,944)	61	(1,663)
Provision for income tax benefit (expense) related to components of other comprehensive income (loss)	1,044	1,879	(22)	632
Other comprehensive income (loss)	(1,702)	(3,065)	39	(1,031)
Comprehensive income (loss)	\$ 26,477	\$ 18,286	\$ 48,716	\$ 35,284

See notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

	June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 5,908	\$ 1,913
Receivables, net	264,108	303,279
Inventories	1,033,044	863,133
Other current assets	20,601	12,404
<b>Total current assets</b>	<b>1,323,661</b>	<b>1,180,729</b>
Property and Equipment, net	561,374	552,037
Goodwill	464,136	468,465
Other Intangible Assets, net	75,499	76,276
Other Assets	45,329	62,122
<b>Total Assets</b>	<b>\$ 2,469,999</b>	<b>\$ 2,339,629</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Notes payable - floor plan - trade	\$ 503,153	\$ 469,027
Notes payable - floor plan - non-trade	487,638	399,314
Trade accounts payable	98,389	86,902
Accrued interest	10,672	12,117
Other accrued liabilities	150,003	177,707
Current maturities of long-term debt	12,175	11,608
<b>Total current liabilities</b>	<b>1,262,030</b>	<b>1,156,675</b>
Long-Term Debt	525,395	536,011
Other Long-Term Liabilities	120,728	124,201
Commitments and Contingencies		
Stockholders Equity:		
Class A convertible preferred stock, none issued		
Class A common stock, \$0.01 par value; 100,000,000 shares authorized; 57,011,528 shares issued and 41,127,428 shares outstanding at June 30, 2012; 56,377,778 shares issued and 40,600,031 shares outstanding at December 31, 2011	570	564
Class B common stock; \$0.01 par value; 30,000,000 shares authorized; 12,029,375 shares issued and outstanding at June 30, 2012 and December 31, 2011	121	121
Paid-in capital	662,720	667,839
Retained earnings	170,391	124,383
Accumulated other comprehensive income (loss)	(21,451)	(21,490)
Treasury stock, at cost (15,884,100 Class A shares held at June 30, 2012 and 15,777,747 Class A shares held at December 31, 2011)	(250,505)	(248,675)
<b>Total stockholders equity</b>	<b>561,846</b>	<b>522,742</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 2,469,999</b>	<b>\$ 2,339,629</b>

See notes to Unaudited Condensed Consolidated Financial Statements.





**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

(Dollars and shares in thousands)

	Class A Common Stock		Class B Common Stock		Paid-In Capital	Retained Earnings / (Accumulated Deficit)	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
	Shares	Amount	Shares	Amount					
BALANCE AT DECEMBER 31, 2011	56,378	\$ 564	12,029	\$ 121	\$ 667,839	\$ 124,383	\$ (248,675)	\$ (21,490)	\$ 522,742
Shares awarded under stock compensation plans	342	3			479				482
Purchases of treasury stock							(1,830)		(1,830)
Income tax benefit associated with stock compensation plans					1,573				1,573
Derecognition of equity component of 5.0% Convertible Notes (1), net of tax expense of \$59					(9,755)				(9,755)
Fair value of interest rate swap agreements, net of tax expense of \$22								39	39
Stock-based compensation expense					122				122
Restricted stock amortization					2,465				2,465
Other	292	3			(3)				
Net income (loss)						48,677			48,677
Dividends (\$0.05 per share)						(2,669)			(2,669)
BALANCE AT JUNE 30, 2012	57,012	\$ 570	12,029	\$ 121	\$ 662,720	\$ 170,391	\$ (250,505)	\$ (21,451)	\$ 561,846

- (1) 5.0% Convertible Senior Notes due 2029 which are redeemable by us and which may be put to us by the holders after October 1, 2014 under certain circumstances (the "5.0% Convertible Notes"). See Note 6, "Long-Term Debt," for further discussion. See notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	<b>Six-Month Period Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 48,677	\$ 36,315
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	22,542	19,724
Provision for bad debt expense	301	265
Other amortization	780	831
Debt issuance cost amortization	1,519	1,990
Debt discount amortization, net of premium amortization	2,441	2,575
Stock - based compensation expense	122	217
Amortization of restricted stock, net of forfeitures	2,465	1,405
Deferred income taxes	13,671	(616)
Equity interest in earnings of investees	(227)	(366)
Asset impairment charges	34	58
Loss (gain) on disposal of dealerships and property and equipment	(5,577)	135
Loss on exit of leased dealerships	1,450	4,417
(Gain) loss on retirement of debt	2,578	
Non-cash adjustments - cash flow swaps	(105)	286
Changes in assets and liabilities that relate to operations:		
Receivables	39,245	40,432
Inventories	(180,750)	41,589
Other assets	(7,269)	(5,047)
Notes payable - floor plan - trade	34,126	(40,590)
Trade accounts payable and other liabilities	(23,923)	18,808
Total adjustments	(96,577)	86,113
Net cash provided by (used in) operating activities	(47,900)	122,428
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of land, property and equipment	(34,504)	(112,661)
Proceeds from sales of property and equipment	660	214
Proceeds from sale of dealerships	23,620	129
Distributions from equity investees	700	600
Net cash provided by (used in) investing activities	(9,524)	(111,718)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net (repayments) borrowings on notes payable floor plan - non-trade	88,324	(74,672)
Borrowings on revolving credit facilities	105,246	164,487
Repayments on revolving credit facilities	(105,246)	(164,487)
Proceeds from issuance of long-term debt	10,700	53,950
Principal payments on long-term debt	(5,162)	(4,212)
Repurchase of debt securities	(29,995)	
Purchases of treasury stock	(1,830)	(3,902)
Income tax benefit (expense) associated with stock compensation plans	1,573	663
Issuance of shares under stock compensation plans	482	336

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Dividends paid	(2,673)	(2,644)
Net cash provided by (used in) financing activities	61,419	(30,481)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,995	(19,771)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,913	21,842
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 5,908	\$ 2,071
<b>SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:</b>		
Change in fair value of cash flow hedging instruments (net of tax expense of \$22 and tax benefit of \$632 in the six-month periods ended June 30, 2012 and 2011, respectively)	\$ 39	\$ (1,031)
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid (received) during the year for:		
Interest, including amount capitalized	\$ 40,408	\$ 44,791
Income taxes	\$ 24,755	\$ 6,874

See notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. Summary of Significant Accounting Policies**

**Basis of Presentation** The accompanying Unaudited Condensed Consolidated Financial Statements for the second quarter and six-month periods ended June 30, 2012 and 2011 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and applicable rules and regulations of the Securities and Exchange Commission (the SEC). All material intercompany accounts and transactions have been eliminated. These Unaudited Condensed Consolidated Financial Statements reflect, in the opinion of management, all material normal recurring adjustments necessary to fairly state the financial position and the results of operations for the periods presented. The results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year. These interim financial statements should be read in conjunction with the audited Consolidated Financial Statements of Sonic Automotive, Inc. (Sonic or the Company) for the year ended December 31, 2011, which were included in Sonic's Annual Report on Form 10-K and updated in Sonic's Current Report on Form 8-K furnished to the SEC pursuant to Items 2.02 and 9.01 on June 25, 2012.

**Reclassifications** The Unaudited Condensed Consolidated Statements of Income for the second quarter and six-month periods ended June 30, 2011 reflect the reclassification of balances from continuing operations to discontinued operations from the prior year presentation for additional dealerships sold or terminated subsequent to June 30, 2011.

**Recent Accounting Pronouncements** In May 2011, the Financial Accounting Standards Board (the FASB) issued an accounting standard update that amends the accounting standard on fair value measurements. The accounting standard update provides for a consistent definition and measurement of fair value, as well as similar disclosure requirements between U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards. The accounting standard update changes certain fair value measurement principles, clarifies the application of existing fair value measurement, and expands the fair value measurement disclosure requirements, particularly for Level 3 fair value measurements. The amendments in this accounting standard update are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. The adoption of this accounting standard did not have a material effect on Sonic's consolidated financial statements or disclosures.

**Lease Exit Accruals** Lease exit accruals relate to facilities Sonic has ceased using in its operations. The accruals represent the present value of the lease payments, net of estimated or actual sublease proceeds, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord.

A summary of the activity of these lease exit accruals consists of the following:

	(In thousands)
Balance, December 31, 2011	\$ 39,118
Lease exit expense (1)	1,450
Payments (2)	(4,331)
Lease buyout (3)	(1,657)
Balance, June 30, 2012	\$ 34,580

- Approximately \$0.2 million is recorded in interest expense, other, net, approximately \$0.1 million is recorded in selling, general and administrative expenses and approximately \$1.2 million is recorded in income (loss) from operations and the sale of dealerships in the accompanying Unaudited Condensed Consolidated Statements of Income.
- Amount is recorded as reduction of rent expense in selling, general and administrative expenses, with approximately \$0.8 million in continuing operations and \$3.5 million as a reduction to income (loss) from operations and the sale of dealerships in the accompanying Unaudited Condensed Consolidated Statements of Income.
- Amount represents write-off of accrual related to an early lease buyout agreement which was completed and paid, relieving Sonic of any future lease obligation.

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

**Income Tax Expense** The overall effective tax rate from continuing operations was 27.9% and 33.2% for the second quarter and six-month periods ended June 30, 2012, respectively, and 37.3% and 38.4% for the second quarter and six-month periods ended June 30, 2011, respectively. The effective rates for the second quarter and six-month periods ended June 30, 2012 were lower than the same prior year periods primarily due to a \$3.6 million tax benefit for the second quarter ended June 30, 2012 related to the settlement of a state tax examination.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****2. Discontinued Operations**

**Dispositions** The operating results of disposed dealerships are included in the income (loss) from discontinued operations in Sonic's Unaudited Condensed Consolidated Statements of Income. During the six-month period ended June 30, 2012, Sonic disposed of five dealerships, which generated cash from disposition of approximately \$23.6 million on the disposal of approximately \$8.0 million of net assets. At June 30, 2012, there were no dealerships held for sale.

Revenues and other activities associated with franchises classified as discontinued operations were as follows:

(In thousands)	Second Quarter Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Income (loss) from operations	\$ (189)	\$ 260	\$ (1,000)	\$ 852
Gain (loss) on disposal	(367)	(180)	5,292	(222)
Lease exit accrual adjustments and charges	1,901	(1,077)	(1,243)	(2,722)
Pre-tax income (loss)	\$ 1,345	\$ (997)	\$ 3,049	\$ (2,092)
<hr/>				
Total revenues	\$	\$ 22,227	\$ 10,267	\$ 43,287

Lease exit charges recorded for the second quarter and six-month periods ended June 30, 2012 and 2011 relate to interest charges, the revision of estimates on previously established lease exit accruals and the reversal of a lease exit accrual related to a property which was returned to operating use. The lease exit accruals represent the present value of the lease payments, net of estimated or actual sublease proceeds, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord.

**3. Inventories**

Inventories consist of the following:

(In thousands)	June 30, 2012	December 31, 2011
New vehicles	\$ 708,689	\$ 569,573
Used vehicles	203,177	178,568
Parts and accessories	53,397	54,042
Other	67,781	60,950
Inventories	\$ 1,033,044	\$ 863,133

**4. Property and Equipment**

Property and equipment consists of the following:

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

(In thousands)	June 30, 2012	December 31, 2011
Land	\$ 134,407	\$ 131,865
Building and improvements	455,973	455,650
Office equipment and fixtures	108,044	92,920
Parts and service equipment	62,136	61,561
Company vehicles	8,183	8,391
Construction in progress	25,026	16,191
<b>Total, at cost</b>	<b>793,769</b>	<b>766,578</b>
Less accumulated depreciation	(232,395)	(214,541)
<b>Property and equipment, net</b>	<b>\$ 561,374</b>	<b>\$ 552,037</b>

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

In the second quarter and six-month periods ended June 30, 2012, capital expenditures were approximately \$22.5 million and \$34.5 million, respectively, and were primarily related to construction of new dealerships, building improvements and equipment purchased for use in Sonic's dealerships.

**5. Goodwill and Intangible Assets**

(In thousands)	Franchise Agreements	Gross Goodwill	Accumulated Impairment	Net Goodwill
Balance, December 31, 2011	\$ 64,835	\$ 1,265,190	\$ (796,725)	\$ 468,465
Reductions from dispositions		(6,107)	1,778	(4,329)
Balance, June 30, 2012	\$ 64,835	\$ 1,259,083	\$ (794,947)	\$ 464,136

At December 31, 2011, Sonic had approximately \$11.4 million of definite life intangibles recorded related to favorable lease agreements. After the effect of amortization of the definite life intangibles, the balance recorded at June 30, 2012 was approximately \$10.7 million and was included in other intangible assets, net, in the accompanying Unaudited Condensed Consolidated Balance Sheets.

**6. Long-Term Debt**

Long-term debt consists of the following:

(In thousands)	June 30, 2012	December 31, 2011
2011 Revolving Credit Facility (1)	\$	\$
9.0% Senior Subordinated Notes due 2018 (the 9.0% Notes )	210,000	210,000
5.0% Convertible Senior Notes due 2029, redeemable in 2014 (the 5.0% Convertible Notes ) (2)	134,905	155,055
Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19%)	11,932	13,223
Mortgage notes to finance companies-fixed rate, bearing interest from 4.29% to 7.03%	125,228	116,584
Mortgage notes to finance companies-variable rate, bearing interest at 1.25 to 3.50 percentage points above one-month LIBOR	63,930	65,640
Net debt discount and premium (3)	(14,015)	(18,635)
Other	5,590	5,752
Total debt	\$ 537,570	\$ 547,619
Less current maturities	(12,175)	(11,608)
Long-term debt	\$ 525,395	\$ 536,011



## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

- (1) The interest rate on the revolving credit facility was 2.0% above LIBOR at June 30, 2012 and 2.25% above LIBOR at December 31, 2011.
- (2) See the heading "5.0% Senior Convertible Notes" below for discussion of the terms under which these notes may be redeemed in 2014.
- (3) June 30, 2012 includes \$1.2 million discount associated with the 9.0% Notes, \$13.0 million discount associated with the 5.0% Convertible Notes, \$1.0 million premium associated with notes payable to a finance company and \$0.8 million discount associated with mortgage notes payable. December 31, 2011 includes \$1.2 million discount associated with the 9.0% Notes, \$17.7 million discount associated with the 5.0% Convertible Notes, \$1.2 million premium associated with notes payable to a finance company and \$0.9 million discount associated with mortgage notes payable.

### **2011 Credit Facilities**

Sonic has a syndicated revolving credit agreement (the "2011 Revolving Credit Facility") and a syndicated floor plan credit facility (the "2011 Floor Plan Facility"). The 2011 Revolving Credit Facility and 2011 Floor Plan Facility (collectively the "2011 Credit Facilities") are scheduled to mature on August 15, 2016.

Availability under the 2011 Revolving Credit Facility is calculated as the lesser of \$175.0 million or a borrowing base calculated based on certain eligible assets plus 50% of the fair market value of 5,000,000 shares of common stock of Speedway Motorsports, Inc. ("SMI") that are pledged as collateral, less the aggregate face amount of any outstanding letters of credit under the 2011 Revolving Credit Facility (the "2011 Revolving Borrowing Base"). The 2011 Revolving Credit Facility may be increased at Sonic's option to \$225.0 million upon satisfaction of certain conditions. A withdrawal of the pledge of SMI common stock by Sonic Financial Corporation ("SFC"), which holds the 5,000,000 shares of common stock of SMI, or a decline in the value of SMI common stock, could reduce the amount Sonic can borrow under the 2011 Revolving Credit Facility.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Based on balances as of June 30, 2012, the 2011 Revolving Borrowing Base was approximately \$175.0 million and Sonic had approximately \$39.2 million in outstanding letters of credit resulting in total borrowing availability of approximately \$135.8 million under the 2011 Revolving Credit Facility.

**Covenants**

Sonic was in compliance with the covenants under the 2011 Credit Facilities as of June 30, 2012. Financial covenants include required specified ratios (as each is defined in the 2011 Credit Facilities) of:

	Consolidated Liquidity Ratio	Covenant Consolidated Fixed Charge Coverage Ratio	Consolidated Total Lease Adjusted Leverage Ratio
Required ratio	<sup>3</sup> 1.05	<sup>3</sup> 1.20	£ 5.50
June 30, 2012 actual	1.16	1.56	3.88

The 2011 Credit Facilities contain events of default, including cross-defaults to other material indebtedness, change of control events and events of default customary for syndicated commercial credit facilities. Upon the future occurrence of an event of default, Sonic could be required to immediately repay all outstanding amounts under the 2011 Credit Facilities.

In addition, many of Sonic's facility leases are governed by a guarantee agreement between the landlord and Sonic that contains financial and operating covenants. The financial covenants are identical to those under the 2011 Credit Facilities with the exception of one financial covenant related to the ratio of EBTDAR to Rent (as defined in the lease agreements) with a required ratio of no less than 1.50 to 1.00. At June 30, 2012, the ratio was 2.94 to 1.00.

**9.0% Senior Subordinated Notes**

The 9.0% Notes are unsecured senior subordinated obligations of Sonic that mature on March 15, 2018 and are guaranteed by Sonic's domestic operating subsidiaries. Interest is payable semi-annually on March 15 and September 15 each year. Sonic may redeem the 9.0% Notes in whole or in part at any time after March 15, 2014 at the following redemption prices, which are expressed as percentages of the principal amount:

	Redemption Price
Beginning on March 15, 2014	104.50%
Beginning on March 15, 2015	102.25%
Beginning on March 15, 2016 and thereafter	100.00%

In addition, on or before March 15, 2013, Sonic may redeem up to 35% of the aggregate principal amount of the 9.0% Notes at par value plus accrued interest with proceeds from certain equity offerings. The Indenture also provides that holders of 9.0% Notes may require Sonic to repurchase the 9.0% Notes at 101% of the par value of the 9.0% Notes, plus accrued interest if Sonic undergoes a change of control as defined in the Indenture.

The Indenture governing the 9.0% Notes contains certain specified restrictive covenants. Sonic has agreed not to pledge any assets to any third party lender of senior subordinated debt except under certain limited circumstances. Sonic also has agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, capital stock, guarantees, asset sales, investments, cash dividends to stockholders,

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

distributions and redemptions. Specifically, the indenture governing Sonic's 9.0% Notes limits Sonic's ability to pay quarterly cash dividends on Sonic's Class A and B common stock in excess of \$0.10 per share. Sonic may only pay quarterly cash dividends on Sonic's Class A and B common stock if Sonic complies with the terms of the indenture governing the 9.0% Notes. Sonic was in compliance with all restrictive covenants as of June 30, 2012.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

***5.0% Convertible Senior Notes***

During the second quarter ended June 30, 2012, Sonic repurchased approximately \$20.2 million in aggregate principal amount of its 5.0% Convertible Notes, which resulted in a loss of approximately \$2.6 million recorded in other income (expense), net, in the accompanying Unaudited Condensed Consolidated Statements of Income.

The 5.0% Convertible Notes bear interest at a rate of 5.0% per year, payable semiannually on April 1 and October 1 of each year. The 5.0% Convertible Notes mature on October 1, 2029. Sonic may redeem some or all of the 5.0% Convertible Notes for cash at any time subsequent to October 1, 2014 at a repurchase price equal to 100% of the outstanding principal amount of the notes. Upon the issuance of a redemption notice by Sonic, the holders may convert the 5.0% Convertible Notes prior to the redemption date at their option. Holders have the right to require Sonic to purchase the 5.0% Convertible Notes on each of October 1, 2014, October 1, 2019 and October 1, 2024 or in the event of a change in control for cash at a purchase price equal to 100% of the outstanding principal amount of the notes.

Holders of the 5.0% Convertible Notes may convert their notes at their option prior to the close of business on the business day immediately preceding July 1, 2029 only under the following circumstances: (1) during any fiscal quarter commencing after December 31, 2009, if the last reported sale price of the Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the Measurement Period) in which the trading price (as defined below) per \$1,000 principal amount of notes for each day of that Measurement Period was less than 98% of the product of the last reported sale price of Sonic's Class A common stock and the applicable conversion rate on each such day; (3) if Sonic calls any or all of the notes for redemption, at any time prior to the close of business on the third scheduled trading day prior to the redemption date; or (4) upon the occurrence of specified corporate events. On and after July 1, 2029, to (and including) the close of business on the third scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of the foregoing circumstances. As of June 30, 2012, the conversion rate was 75.3017 shares of Class A common stock per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$13.28 per share of Class A common stock. The conversion rate may be adjusted in the future as a result of any future declaration of dividends on Sonic's Class A common stock. The 5% Convertible Notes were convertible at the option of the holder during the second quarter ended June 30, 2012, however, none of the 5% Convertible Notes were presented by the holder for conversion. As of the June 30, 2012 measurement date, the 5% Convertible Notes did not meet any of the criteria for conversion.

To recognize the equity component of a convertible borrowing instrument, upon issuance of the 5.0% Convertible Notes in September 2009, Sonic recorded a debt discount of approximately \$31.0 million and a corresponding amount (net of taxes of approximately \$12.8 million) to equity, based on an estimated non-convertible borrowing rate of 10.5%. The debt discount is being amortized to interest expense through October 2014, the earliest redemption date. The unamortized debt discount was approximately \$13.0 million and \$17.7 million at June 30, 2012 and December 31, 2011, respectively.

Sonic incurred interest expense related to the 5.0% Convertible Notes of approximately \$1.7 million and \$3.7 million for the second quarter and six-month periods ended June 30, 2012, respectively, and \$2.1 million and \$4.3 million for the second quarter and six-month periods ended June 30, 2011, respectively, recorded to interest expense, other, net, in the accompanying Unaudited Condensed Consolidated Statements of Income. In addition, Sonic recorded interest expense associated with the amortization of debt discount and deferred loan costs on the 5.0% Convertible Notes of approximately \$1.4 million and \$3.0 million for the second quarter and six-month periods ended June 30, 2012, respectively, and \$1.7 million and \$3.4 million for the second quarter and six-month periods ended June 30, 2011, respectively, recorded to interest expense, non-cash, convertible debt in the accompanying Unaudited Condensed Consolidated Statements of Income.

See Note 10, Subsequent Events, for discussion of Sonic's pending offer to repurchase all of its 5.0% Convertible Notes.

***Mortgage Notes***

Sonic has mortgage financing totaling approximately \$189.2 million in aggregate, related to 20 of its dealership properties. These mortgage notes require monthly payments of principal and interest through maturity and are secured by the underlying properties. Maturity dates range between June 2013 and March 2031. The weighted average interest rate was 4.67% at June 30, 2012.



**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS*****Derivative Instruments and Hedging Activities***

Sonic has interest rate cash flow swap agreements to effectively convert a portion of its LIBOR-based variable rate debt to a fixed rate. The fair value of these swap positions at June 30, 2012 was a liability of approximately \$37.5 million, with \$25.0 million included in other accrued liabilities and \$12.5 million included in other long-term liabilities in the accompanying Unaudited Condensed Consolidated Balance Sheets. Under the terms of these cash flow swaps, Sonic will receive and pay interest based on the following:

<b>Notional Amount (In millions)</b>	<b>Pay Rate</b>	<b>Receive Rate (1)</b>	<b>Maturing Date</b>
\$ 3.3	7.100%	one-month LIBOR + 1.50%	July 10, 2017
\$ 25.0 (2)	5.160%	one-month LIBOR	September 1, 2012
\$ 15.0 (2)	4.965%	one-month LIBOR	September 1, 2012
\$ 25.0 (2)	4.885%	one-month LIBOR	October 1, 2012
\$ 10.3	4.655%	one-month LIBOR	December 10, 2017
\$ 8.2 (2)	6.860%	one-month LIBOR + 1.25%	August 1, 2017
\$ 6.3	4.330%	one-month LIBOR	July 1, 2013
\$ 100.0 (3)	3.280%	one-month LIBOR	July 1, 2015
\$ 100.0 (3)	3.300%	one-month LIBOR	July 1, 2015
\$ 6.9 (2)	6.410%	one-month LIBOR + 1.25%	September 12, 2017
\$ 50.0 (3)	2.767%	one-month LIBOR	July 1, 2014
\$ 50.0 (3)	3.240%	one-month LIBOR	July 1, 2015
\$ 50.0 (3)	2.610%	one-month LIBOR	July 1, 2014
\$ 50.0 (3)	3.070%	one-month LIBOR	July 1, 2015
\$ 100.0 (4)	2.065%	one-month LIBOR	June 30, 2017
\$ 100.0 (4)	2.015%	one-month LIBOR	June 30, 2017

- (1) The one-month LIBOR rate was 0.243% at June 30, 2012.
- (2) Changes in fair value are recorded through earnings.
- (3) The effective date of these forward-starting swaps is July 2, 2012.
- (4) The effective date of these forward-starting swaps is July 1, 2015.

During the six-month period ended June 30, 2012, Sonic entered into two \$100.0 million notional forward-starting interest rate cash flow swap agreements that become effective in July 2015 and terminate in June 2017. These interest rate swaps have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of these swaps are recorded in other comprehensive income (loss), net of related income taxes, in the accompanying Unaudited Condensed Consolidated Statements of Comprehensive Income.

For the cash flow swaps not designated as hedges (changes in the fair value are recognized through earnings) and amortization of amounts in accumulated other comprehensive income (loss) related to terminated cash flow swaps, certain benefits and charges were included in interest income (expense/amortization), non-cash, cash flow swaps, in the accompanying Unaudited Condensed Consolidated Statements of Income.

For the cash flow swaps that qualify as cash flow hedges, the changes in the fair value of these swaps have been recorded in other comprehensive income (loss), net of related income taxes, in the accompanying Unaudited Condensed Consolidated Statements of Comprehensive Income. The incremental interest expense (the difference between interest paid and interest received) related to these cash flow swaps was approximately \$2.5 million and \$6.9 million for the second quarter and six-month periods ended June 30, 2012, respectively and \$4.4 million and \$8.8 million for the second quarter and six-month periods ended June 30, 2011, respectively, and is included in interest expense, other, net, in the accompanying Unaudited Condensed Consolidated Statements of Income. The estimated net expense expected to be reclassified out of accumulated other comprehensive income (loss) into results of operations during the next twelve months is approximately

\$7.7 million.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****7. Per Share Data and Stockholders' Equity**

The calculation of diluted earnings per share considers the potential dilutive effect of options and shares under Sonic's stock compensation plans, Class A common stock purchase warrants and the 5.0% Convertible Notes. Sonic's non-vested restricted stock and restricted stock units contain rights to receive non-forfeitable dividends, and thus, are considered participating securities and are included in the two-class method of computing earnings per share. The following table illustrates the dilutive effect of such items on earnings per share for the second quarter and six-month periods ended June 30, 2012 and 2011:

	Second Quarter Ended June 30, 2012						
	Weighted Average Shares	Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
		Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
Earnings (loss) and shares	52,593	\$ 27,533		\$ 646		\$ 28,179	
Effect of participating securities:							
Non-vested restricted stock and stock units		(429)				(429)	
Basic earnings (loss) and shares	52,593	\$ 27,104	\$ 0.52	\$ 646	\$ 0.01	\$ 27,750	\$ 0.53
Effect of dilutive securities:							
Contingently convertible debt (5.0% Convertible Notes)	10,535	1,889				1,889	
Stock compensation plans	378						
Diluted earnings (loss) and shares	63,506	\$ 28,993	\$ 0.46	\$ 646	\$ 0.01	\$ 29,639	\$ 0.47

	Second Quarter Ended June 30, 2011						
	Weighted Average Shares	Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
		Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
Earnings (loss) and shares	52,461	\$ 22,994		\$ (1,643)		\$ 21,351	
Effect of participating securities:							
Non-vested restricted stock and stock units		(302)				(302)	



Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Basic earnings (loss) and shares	52,461	\$	22,692	\$	0.43	\$	(1,643)	\$	(0.03)	\$	21,049	\$	0.40
Effect of dilutive securities:													
Contingently convertible debt (5.0% Convertible Notes)	12,890		2,280				14				2,294		
Stock compensation plans	585												
Diluted earnings (loss) and shares	65,936	\$	24,972	\$	0.38	\$	(1,629)	\$	(0.03)	\$	23,343	\$	0.35

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

	Six Months Ended June 30, 2012						
	Weighted Average Shares	Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
		Amount	Per Share Amount (In thousands, except per share amounts)	Amount	Per Share Amount	Amount	Per Share Amount
Earnings (loss) and shares	52,409	\$ 47,001		\$ 1,676		\$ 48,677	
Effect of participating securities:							
Non-vested restricted stock and stock units		(729)				(729)	
Basic earnings (loss) and shares	52,409	\$ 46,272	\$ 0.88	\$ 1,676	\$ 0.03	\$ 47,948	\$ 0.91
Effect of dilutive securities:							
Contingently convertible debt (5.0% Convertible Notes)	11,106	4,056		5		4,061	
Stock compensation plans	448						
Diluted earnings (loss) and shares	63,963	\$ 50,328	\$ 0.79	\$ 1,681	\$ 0.02	\$ 52,009	\$ 0.81

	Six Months Ended June 30, 2011						
	Weighted Average Shares	Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
		Amount	Per Share Amount (In thousands, except per share amounts)	Amount	Per Share Amount	Amount	Per Share Amount
Earnings (loss) and shares	52,438	\$ 38,679		\$ (2,364)		\$ 36,315	
Effect of participating securities:							
Non-vested restricted stock and stock units		(508)				(508)	
Basic earnings (loss) and shares	52,438	\$ 38,171	\$ 0.73	\$ (2,364)	\$ (0.05)	\$ 35,807	\$ 0.68
Effect of dilutive securities:							
Contingently convertible debt (5.0% Convertible Notes)	12,890	4,576		28		4,604	
Stock compensation plans	615						
Diluted earnings (loss) and shares	65,943	\$ 42,747	\$ 0.65	\$ (2,336)	\$ (0.04)	\$ 40,411	\$ 0.61

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

In addition to the stock options included in the table above, options to purchase approximately 1.6 million shares and 2.2 million shares of Class A common stock were outstanding at June 30, 2012 and June 30, 2011, respectively, but were not included in the computation of diluted earnings per share because the options were not dilutive.

### **8. Contingencies**

#### ***Legal and Other Proceedings***

Several private civil actions have been filed against Sonic Automotive, Inc. and several of its dealership subsidiaries that purport to represent classes of customers as potential plaintiffs and make allegations that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. One of these private civil actions was filed on November 15, 2004 in South Carolina state court, York County Court of Common Pleas, against Sonic Automotive, Inc. and some of Sonic's South Carolina subsidiaries. The plaintiffs in that lawsuit were Misty J. Owens, James B. Wright, Vincent J. Astey and Joseph Lee Williams, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The group of plaintiffs' attorneys representing the plaintiffs in the South Carolina lawsuit also filed another private civil class action lawsuit against Sonic Automotive, Inc. and certain of its subsidiaries on February 14, 2005 in state court in North Carolina, Lincoln County Superior Court, which similarly sought certification of a multi-state class of plaintiffs and alleged that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. The plaintiffs in this North Carolina lawsuit were Robert Price, Carolyn Price, Marcus Cappelletti and Kelly Cappelletti, on behalf of themselves and all

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The South Carolina state court action and the North Carolina state court action were subsequently consolidated into a single proceeding in private arbitration before the American Arbitration Association (the Arbitrator). On November 12, 2008, claimants in the consolidated arbitration filed a Motion for Class Certification as a national class action including all of the states in which Sonic operates dealerships except Florida. Claimants are seeking monetary damages and injunctive relief on behalf of this class of customers. The parties have briefed and argued the issue of class certification.

On July 19, 2010, the Arbitrator issued a Partial Final Award on Class Certification, certifying a class which includes all customers who, on or after November 15, 2000, purchased or leased from a Sonic dealership a vehicle with the Etch product as part of the transaction, but not including customers who purchased or leased such vehicles from a Sonic dealership in Florida. The Partial Final Award on Class Certification is not a final decision on the merits of the action. The merits of Claimants' assertions and potential damages would still have to be proven through the remainder of the arbitration. The Arbitrator stayed the Arbitration for thirty days to allow either party to petition a court of competent jurisdiction to confirm or vacate the award. On July 22, 2010, the plaintiffs in this consolidated arbitration filed a Motion to Confirm the Arbitrator's Partial Final Award on Class Certification in state court in North Carolina, Lincoln County Superior Court. On August 17, 2010, Sonic removed this North Carolina state court action to federal court, and simultaneously filed a Petition to Vacate the Arbitrator's Partial Final Award on Class Certification, with both filings made in the United States District Court for the Western District of North Carolina.

On August 12, 2011, the United States District Court for the Western District of North Carolina issued an Order granting Sonic's Petition to Vacate Arbitration Award on Class Certification and denied Claimant's Motion to Dismiss the same. Claimants filed a Notice of Appeal to the United States Fourth Circuit Court of Appeals on September 12, 2011. The federal court's stay of the arbitration proceeding remains in force. At a mediation held January 16, 2012, Sonic reached an agreement with the Claimants to settle this ongoing dispute in its entirety. Sonic and the Claimants subsequently entered into a definitive settlement agreement, the terms of which received preliminary approval by a North Carolina state court in May 2012. This settlement remains subject to final court approval. In the event that final court approval is received, this settlement would not have a material adverse effect on Sonic's future results of operations, financial condition and cash flows.

Sonic is involved, and expects to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of its business, including regulatory investigations and private civil actions brought by plaintiffs purporting to represent a potential class or for which a class has been certified. Although Sonic vigorously defends itself in all legal and administrative proceedings, the outcomes of pending and future proceedings arising out of the conduct of Sonic's business, including litigation with customers, employment related lawsuits, contractual disputes, class actions, purported class actions and actions brought by governmental authorities, cannot be predicted with certainty. An unfavorable resolution of one or more of these matters could have a material adverse effect on Sonic's business, financial condition, results of operations, cash flows or prospects. Included in other accrued liabilities at both June 30, 2012 and December 31, 2011 was approximately \$7.3 million in reserves that Sonic has provided for pending proceedings. Except as reflected in such reserves, Sonic is currently unable to estimate a range of reasonably possible loss, or a range of reasonably possible loss in excess of the amount accrued, for pending proceedings.

***Guarantees and Indemnification Obligations***

In accordance with the terms of Sonic's operating lease agreements, Sonic's dealership subsidiaries, acting as lessees, generally agree to indemnify the lessor from certain exposure arising as a result of the use of the leased premises, including environmental exposure and repairs to leased property upon termination of the lease. In addition, Sonic has generally agreed to indemnify the lessor in the event of a breach of the lease by the lessee.

In connection with dealership dispositions, certain of Sonic's dealership subsidiaries have assigned or sublet to the buyer its interests in real property leases associated with such dealerships. In general, the subsidiaries retain responsibility for the performance of certain obligations under such leases, including rent payments, and repairs to leased property upon termination of the lease, to the extent that the assignee or sub-lessee does not perform. In the event the sub-lessees do not perform under their obligations Sonic remains liable for the lease payments. The total amount relating to this risk was approximately \$106.0 million as of December 31, 2011.

In accordance with the terms of agreements entered into for the sale of Sonic's franchises, Sonic generally agrees to indemnify the buyer from certain exposure and costs arising subsequent to the date of sale, including environmental exposure and exposure resulting from the breach of

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

representations or warranties made in accordance with the agreement. While Sonic's exposure with respect to environmental remediation and repairs is difficult to quantify, Sonic's maximum exposure

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

associated with these general indemnifications was approximately \$9.8 million and \$3.1 million at June 30, 2012 and December 31, 2011, respectively. These indemnifications expire within a period of 12 to 24 months following the date of sale. The estimated fair value of these indemnifications was not material and the amount recorded for this contingency was not significant at June 30, 2012. Sonic also guarantees the floor plan commitments of its 50% owned joint venture, the amount of which was \$4.5 million at both June 30, 2012 and December 31, 2011.

**9. Fair Value Measurements**

In determining fair value, Sonic uses various valuation approaches including market, income and/or cost approaches. Fair Value Measurements and Disclosures in the Accounting Standards Codification (the ASC) establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of Sonic. Unobservable inputs are inputs that reflect Sonic's assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that Sonic has the ability to access. Assets utilizing Level 1 inputs include marketable securities that are actively traded.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. Assets and liabilities utilizing Level 2 inputs include cash flow swap instruments.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement. Asset and liability measurements utilizing Level 3 inputs include those used in estimating fair value of non-financial assets and non-financial liabilities in purchase acquisitions, those used in assessing impairment of property, plant and equipment and other intangibles and those used in the reporting unit valuation in the annual goodwill impairment evaluation.

The availability of observable inputs can vary and is affected by a wide variety of factors. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment required by Sonic in determining fair value is greatest for assets and liabilities categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement is disclosed is determined based on the lowest level input (Level 3 being the lowest level) that is significant to the fair value measurement.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, Sonic's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. Sonic uses inputs that are current as of the measurement date, including during periods when the market may be abnormally high or abnormally low. Accordingly, fair value measurements can be volatile based on various factors that may or may not be within Sonic's control.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Assets or liabilities recorded at fair value in the accompanying Unaudited Condensed Consolidated Balance Sheets as of June 30, 2012 are as follows:

(In millions)	Total	Fair Value at June 30, 2012		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash flow swaps designated as hedges (1)	\$ 33.8	\$	\$ 33.8	\$
Cash flow swaps not designated as hedges (2)	3.7		3.7	
Deferred compensation plan (3)	13.0		13.0	
Total	\$ 50.5	\$	\$ 50.5	\$

- (1) Approximately \$22.4 million and \$11.4 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying Unaudited Condensed Consolidated Balance Sheets.
- (2) Approximately \$2.6 million and \$1.1 million are included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying Unaudited Condensed Consolidated Balance Sheets.
- (3) Included in other long-term liabilities in the accompanying Unaudited Condensed Consolidated Balance Sheets.

Assets or liabilities measured at fair value on a non-recurring basis in the accompanying Unaudited Condensed Consolidated Balance Sheets as of June 30, 2012 are as follows:

(In millions)	Balance as of June 30, 2012	Significant Unobservable Inputs (Level 3) as of June 30, 2012		Total Gains / (Losses) for the Six Months Ended June 30, 2012
Long-lived assets held and used	\$ 561.4	\$	\$ 561.4	\$
Goodwill	464.1		464.1	
Franchise assets	64.8		64.8	

As of June 30, 2012 and December 31, 2011, the fair values of Sonic's financial instruments including receivables, notes receivable from finance contracts, notes payable floor plan, trade accounts payable, borrowings under the revolving credit facilities and certain mortgage notes approximate their carrying values due either to length of maturity or existence of variable interest rates that approximate prevailing market rates.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The fair value and carrying value of Sonic's fixed rate long-term debt was as follows:

(In thousands)	June 30, 2012		December 31, 2011	
	Fair Value	Carrying Value	Fair Value	Carrying Value
9.0% Notes (1)	\$ 226,800	\$ 208,844	\$ 221,025	\$ 208,769
5.0% Convertible Notes (1)	\$ 171,869	\$ 121,906	\$ 205,448	\$ 137,333
Mortgage Notes (2)	\$ 112,204	\$ 125,228	\$ 119,310	\$ 116,584
Assumed Notes (2)	\$ 11,960	\$ 12,885	\$ 13,260	\$ 14,438
Other (2)	\$ 5,063	\$ 5,450	\$ 5,150	\$ 5,555

(1) As determined by market quotations as of June 30, 2012 and December 31, 2011, respectively (Level 1).

(2) As determined by discounted cash flows (Level 3).

**10. Subsequent Events****Issuance of 7.0% Senior Subordinated Notes due 2022**

On July 2, 2012, Sonic issued \$200.0 million in aggregate principal amount of 7.0% Senior Subordinated Notes which mature on July 15, 2022 (the 7.0% Notes). The 7.0% Notes were issued at a price of 99.11% of the principal amount thereof (the Issue Price), resulting in a yield to maturity of 7.125%. Sonic will use the net proceeds from the 7.0% Notes to repurchase some or all of its outstanding 5.0% Convertible Notes pursuant to an exchange offer (see the heading Exchange Offer for 5.0% Convertible Notes below for further discussion) for shares of its Class A common stock plus cash, including any associated tender premium, and to pay related fees and expenses. Any remaining amount will be used for general corporate purposes, including repurchases of shares of Sonic's Class A common stock. The 7.0% Notes are unsecured senior subordinated obligations of Sonic and are guaranteed by Sonic's domestic operating subsidiaries. Interest is payable semi-annually in arrears on January 15 and July 15 of each year, beginning on January 15, 2013.

The net proceeds from the issuance of the 7.0% Notes were deposited into an escrow account where they will remain until Sonic has accepted for exchange at least \$80.0 million aggregate principal amount of the 5.0% Convertible Notes pursuant to the exchange offer for the 5.0% Convertible Notes or until the earlier of the termination of the exchange offer or October 23, 2012. In the event that at least \$80.0 million aggregate principal amount of the 5.0% Convertible Notes are not accepted for exchange in the exchange offer by October 23, 2012, the 7.0% Notes will be subject to a special mandatory redemption. The terms of the special mandatory redemption require that Sonic redeem the 7.0% Notes in full at 100% of the Issue Price plus accrued but unpaid interest from the issue date up to, but excluding, the date of special mandatory redemption.

Sonic may redeem the 7.0% Notes in whole or in part at any time after July 15, 2017 at the following redemption prices, which are expressed as percentages of the principal amount:

	Redemption Price
Beginning on July 15, 2017	103.500%
Beginning on July 15, 2018	102.333%
Beginning on July 15, 2019	101.167%



## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Beginning on July 15, 2020 and thereafter

100.000%

In addition, on or before July 15, 2015, Sonic may redeem up to 35% of the aggregate principal amount of the 7.0% Notes at 107% of the par value of the 7.0% Notes plus accrued and unpaid interest with proceeds from certain equity offerings. The indenture also provides that holders of the 7.0% Notes may require Sonic to repurchase the 7.0% Notes at 101% of the par value of the 7.0% Notes, plus accrued and unpaid interest if Sonic undergoes a change of control as defined in the indenture.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The indenture governing the 7.0% Notes contains certain specified restrictive covenants. Sonic has agreed not to pledge any assets to any third party lender of senior subordinated debt except under certain limited circumstances. Sonic also has agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, guarantees, liens, certain types of investments, certain transactions with affiliates, mergers, consolidations, issuance of preferred stock, cash dividends to stockholders, distributions, redemptions and the sale, assignment, lease, conveyance or disposal of certain assets. Specifically, the indenture governing Sonic's 7.0% Notes limits Sonic's ability to pay quarterly cash dividends on Sonic's Class A and B common stock in excess of \$0.10 per share. Sonic may only pay quarterly cash dividends on Sonic's Class A and B common stock if Sonic complies with the terms of the indenture governing the 7.0% Notes.

Balances outstanding under Sonic's 7.0% Notes are guaranteed by all of Sonic's operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor.

Sonic's obligations under the 7.0% Notes may be accelerated by the holders of 25% of the outstanding principal amount of the 7.0% Notes then outstanding if certain events of default occur, including: (1) defaults in the payment of principal or interest when due; (2) defaults in the performance, or breach, of Sonic's covenants under the 7.0% Notes; and (3) certain defaults under other agreements under which Sonic or its subsidiaries have outstanding indebtedness in excess of \$35.0 million.

***Exchange Offer for 5.0% Convertible Notes***

On June 25, 2012, Sonic commenced an offer to exchange newly issued shares of Class A common stock and cash for all of its outstanding 5.0% Convertible Notes as described in Sonic's Registration Statement on Form S-4 (Reg. No. 333-182307). The offer consideration for the exchange of the 5.0% Convertible Notes will consist of a fixed cash payment of \$1,000 per \$1,000 principal amount of the 5.0% Convertible Notes accepted by Sonic for exchange in the exchange offer plus a number of shares of Sonic's Class A common stock to be determined based on a volume weighted average pricing (VWAP) formula described in Sonic's Registration Statement on Form S-4 (Reg. No. 333-182307). Holders of the 5.0% Convertible Notes whose notes are accepted for exchange will be entitled to a cash payment for accrued and unpaid interest up to, but excluding, the settlement date. In no event will the total value of the offer consideration be less than \$1,000 or more than \$1,631 per \$1,000 principal amount of the 5.0% Convertible Notes accepted for exchange in the exchange offer, plus accrued and unpaid interest. Cash will be paid in lieu of fractional shares based on the VWAP. The exchange offer expires at 12:00 midnight New York City time at the end of July 27, 2012, unless Sonic chooses to extend or terminate the exchange offer, subject to certain conditions.

***Additional Stock Repurchase Authorization***

Subsequent to June 30, 2012, Sonic's Board of Directors authorized an additional \$100.0 million to be used in the repurchase program to acquire shares of Sonic's Class A common stock.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF  
OPERATIONS**

**Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion and analysis of the results of operations and financial condition should be read in conjunction with the Sonic Automotive, Inc. and Subsidiaries Unaudited Condensed Consolidated Financial Statements and the related notes thereto appearing elsewhere in this report, as well as the audited financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in our Annual Report on Form 10-K for the year ended December 31, 2011 and updated in Sonic's Current Report on Form 8-K furnished to the SEC pursuant to Items 2.02 and 9.01 on June 25, 2012.

**Overview**

We are one of the largest automotive retailers in the United States. As of June 30, 2012, we operated 116 dealerships in 15 states (representing 25 different brands of cars and light trucks) and 24 collision repair centers. For management and operational reporting purposes, we group certain dealerships together that share management and inventory (principally used vehicles) into stores. As of June 30, 2012, we operated 106 stores. Our dealerships provide comprehensive services including (1) sales of both new and used cars and light trucks; (2) sales of replacement parts, performance of vehicle maintenance, manufacturer warranty repairs, paint and collision repair services (collectively, Fixed Operations); and (3) arrangement of extended service contracts, financing, insurance and other aftermarket products (collectively, F&I) for our customers.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is a detail of our new vehicle revenues by brand for the second quarter and six-month periods ended June 30, 2012 and 2011:

Brand	Percentage of New Vehicle Revenue			
	Second Quarter Ended June 30, 2012	2011	Six Months Ended June 30, 2012	2011
Luxury				
BMW	17.0%	18.7%	16.7%	17.7%
Mercedes	8.2%	8.0%	8.2%	8.1%
Lexus	4.7%	3.4%	4.5%	4.3%
Cadillac	4.1%	4.5%	4.4%	5.0%
Audi	3.8%	3.4%	3.9%	3.3%
Mini	2.9%	3.6%	2.8%	3.4%
Land Rover	2.0%	2.1%	2.2%	2.1%
Porsche	1.8%	1.7%	1.7%	1.7%
Volvo	1.2%	1.3%	1.1%	1.3%
Infiniti	1.1%	1.1%	1.0%	1.2%
Acura	0.9%	0.9%	0.8%	0.9%
Jaguar	0.7%	0.9%	0.8%	0.9%
Other Luxury (2)	0.0%	0.1%	0.0%	0.0%
Total Luxury	48.4%	49.7%	48.1%	49.9%
Mid-line Import				
Honda	16.7%	14.3%	16.4%	14.5%
Toyota	11.5%	9.3%	11.2%	10.0%
Volkswagen	3.1%	3.2%	3.1%	2.9%
Hyundai	2.2%	2.7%	2.3%	2.4%
Other (3)	1.8%	1.7%	2.1%	1.5%
Nissan	0.8%	1.3%	0.8%	1.2%
Total Mid-line Import	36.1%	32.5%	35.9%	32.5%
Domestic				
General Motors (4)	7.8%	8.8%	8.0%	8.4%
Ford	7.4%	8.7%	7.6%	8.9%
Chrysler (5)	0.3%	0.3%	0.4%	0.3%
Total Domestic	15.5%	17.8%	16.0%	17.6%
Total	100.0%	100.0%	100.0%	100.0%

- (1) In accordance with the provisions of Presentation of Financial Statements in the Accounting Standards Codification (the ASC), prior period income statement data reflects reclassifications to (i) exclude franchises sold, identified for sale, or terminated subsequent to June 30, 2011 that had not been previously included in discontinued operations or (ii) include franchises previously held for sale that subsequently were reclassified to held and used. See Note 1 and Note 2 to our accompanying Unaudited Condensed Consolidated

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Financial Statements for a discussion of these and other factors that affect the comparability of the information for the periods presented.

- (2) Includes Smart and Saab.
- (3) Includes Kia, Scion and Subaru.
- (4) Includes Buick, Chevrolet and GMC.
- (5) Includes Chrysler, Dodge and Jeep.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Results of Operations**

The following discussions are based on reported figures. Same store amounts do not vary significantly from reported totals since we have not made any significant dealership acquisitions since March 31, 2008.

**New Vehicles**

The automobile retail industry uses the Seasonally Adjusted Annual Rate ( SAAR ) to measure the amount of new vehicle unit sales activity within the United States market. The SAAR averages below reflect a blended average of all brands marketed or sold in the United States market. The SAAR includes brands we do not sell and markets in which we do not operate.

(in millions of vehicles)	Second Quarter Ended June 30,			Six Months Ended June 30,		
	2012	2011	% Change	2012	2011	% Change
SAAR	14.1	12.1	16.5%	14.3	12.5	14.4%

Source: Bloomberg Financial Markets, via Stephens Inc.

Our reported new vehicle (including fleet) results are as follows:

	Second Quarter Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
	(In thousands, except units and per unit data)			
Revenue	\$ 1,221,297	\$ 1,025,277	\$ 196,020	19.1%
Gross profit	\$ 71,351	\$ 67,845	\$ 3,506	5.2%
Unit sales	36,026	30,276	5,750	19.0%
Revenue per unit	\$ 33,900	\$ 33,864	\$ 36	0.1%
Gross profit per unit	\$ 1,981	\$ 2,241	\$ (260)	(11.6%)
Gross profit as a % of revenue	5.8%	6.6%	(80) bps	

	Six Months Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
	(In thousands, except units and per unit data)			
Revenue	\$ 2,285,750	\$ 1,997,770	\$ 287,980	14.4%
Gross profit	\$ 136,171	\$ 127,342	\$ 8,829	6.9%
Unit sales	67,416	59,467	7,949	13.4%
Revenue per unit	\$ 33,905	\$ 33,595	\$ 310	0.9%
Gross profit per unit	\$ 2,020	\$ 2,141	\$ (121)	(5.7%)
Gross profit as a % of revenue	6.0%	6.4%	(40) bps	

The increase in new vehicle revenues for the second quarter and six-month periods ended June 30, 2012 was primarily driven by an increase of 19.0% and 13.4%, respectively, in our new unit sales volume compared to the prior year periods. The industry new unit sales volume increased 16.5% and 14.4% during the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. Excluding fleet volume, our retail new vehicle volume growth increased 22.3% and 16.9% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. Our new unit volume increase for the second quarter and six-month periods

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

ended June 30, 2012 was led by our Honda, Toyota, Lexus and Mercedes dealerships, which combined accounted for 86.1% and 78.4%, respectively, of the year-over-year increase. For the second quarter ended June 30, 2012, the majority of our brands outperformed their local market peer group for their respective brand compared to the prior year period. Total gross profit dollars were up 5.2% and 6.9% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Our luxury dealerships (which include Cadillac) experienced a 15.9% and 10.8% increase in new vehicle revenue for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods, primarily due to a 14.0% and 8.4% increase in our new unit volume for the second quarter and six-month periods ending June 30, 2012, respectively, and a 1.7% and 2.2% increase in average new vehicle selling price for the second quarter and six-month periods ended June 30, 2012, respectively. The increase in new unit sales volume was primarily driven by our Lexus and Mercedes dealerships. Total luxury gross profit dollars were up 8.5% and 7.7% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods.

Our mid-line import dealerships experienced a 33.0% and 25.4% increase in new vehicle revenue for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. Our mid-line import new unit volume increased 33.1% and 23.5% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. New vehicle inventory availability for our major Japanese brands (Honda, Toyota and Lexus) has recovered from the effects of inventory supply reductions caused by the impact of the earthquake, tsunami and severe flooding that occurred in Asia during 2011, which was a primary contributor to the sales volume increases in 2012 discussed above. Overall mid-line import new vehicle gross profit increased 2.9% and 11.3% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods.

Our domestic dealerships experienced a 2.8% and 4.1% increase in new vehicle revenue for the second quarter and six-month periods ended June 30, 2012, respectively, primarily due to increases in average new vehicle selling price compared to the prior year periods. New unit sales volume at our General Motors (excluding Cadillac) dealerships increased 0.6% and 5.3% for the second quarter and six-month periods ended June 30, 2012, respectively, while our Ford dealerships experienced a 7.1% and 7.8% decline in new unit sales volume for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. Overall domestic new vehicle gross profit increased 3.2% and 2.1% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods.

**Used Vehicles**

Our reported used vehicle results are as follows:

	Second Quarter Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
(In thousands, except units and per unit data)				
Revenue	\$ 550,040	\$ 529,107	\$ 20,933	4.0%
Gross profit	\$ 36,727	\$ 39,035	\$ (2,308)	(5.9%)
Unit sales	27,528	26,799	729	2.7%
Revenue per unit	\$ 19,981	\$ 19,744	\$ 237	1.2%
Gross profit per unit	\$ 1,334	\$ 1,457	\$ (123)	(8.4%)
Gross profit as a % of revenue	6.7%	7.4%	(70) bps	

  

	Six Months Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
(In thousands, except units and per unit data)				
Revenue	\$ 1,067,092	\$ 1,003,662	\$ 63,430	6.3%
Gross profit	\$ 77,256	\$ 76,608	\$ 648	0.8%
Unit sales	54,075	51,694	2,381	4.6%
Revenue per unit	\$ 19,734	\$ 19,415	\$ 319	1.6%
Gross profit per unit	\$ 1,429	\$ 1,482	\$ (53)	(3.6%)



## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Gross profit as a % of revenue

7.2%

7.6%

(40) bps

For the second quarter and six-month periods ended June 30, 2012, our used vehicle unit volume increased 2.7% and 4.6%, respectively, compared to the prior year periods, primarily due to the continued implementation of our standardized used vehicle merchandising process. We believe this process allows us to purchase and price our used vehicles more competitively and market them more effectively than our competition, resulting in higher unit sales volume, overall revenue

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

and overall gross profit levels. Although we experienced declines in our gross profit per unit in the second quarter and six-month periods ended June 30, 2012, the incremental unit sales volume contributed to higher gross profit experienced in our F&I and Fixed Operations areas.

**Wholesale Vehicles**

Our reported wholesale results are as follows:

	<b>Second Quarter Ended June 30,</b>		<b>Better / (Worse)</b>	
	<b>2012</b>	<b>2011</b>	<b>Change</b>	<b>% Change</b>
	<b>(In thousands, except units and per unit data)</b>			
Revenue	\$ 43,984	\$ 41,136	\$ 2,848	6.9%
Gross profit (loss)	\$ (1,434)	\$ (1,864)	\$ 430	23.1%
Unit sales	7,939	6,310	1,629	25.8%
Revenue per unit	\$ 5,540	\$ 6,519	\$ (979)	(15.0%)
Gross profit (loss) per unit	\$ (181)	\$ (295)	\$ 114	38.6%
Gross profit (loss) as a % of revenue	(3.3%)	(4.5%)	120 bps	

  

	<b>Six Months Ended June 30,</b>		<b>Better / (Worse)</b>	
	<b>2012</b>	<b>2011</b>	<b>Change</b>	<b>% Change</b>
	<b>(In thousands, except units and per unit data)</b>			
Revenue	\$ 89,325	\$ 76,182	\$ 13,143	17.3%
Gross profit (loss)	\$ (1,219)	\$ (2,309)	\$ 1,090	47.2%
Unit sales	15,465	11,893	3,572	30.0%
Revenue per unit	\$ 5,776	\$ 6,406	\$ (630)	(9.8%)
Gross profit (loss) per unit	\$ (79)	\$ (194)	\$ 115	59.3%
Gross profit (loss) as a % of revenue	(1.4%)	(3.0%)	160 bps	

During the second quarter and six-month periods ended June 30, 2012, we experienced increases in wholesale revenue and wholesale unit sales, compared to the prior year periods. Wholesale gross loss improved significantly as a result

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**  
**OPERATIONS**

of the increased unit sales and a decrease in gross loss per unit during the second quarter and six-month periods ended June 30, 2012. The improvements in gross profit and gross loss per unit occurred despite decreases in revenue per unit, primarily due to the mix of wholesale vehicles sold.

Table of Contents

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Parts, Service and Collision Repair ( Fixed Operations )*

Our reported Fixed Operations results are as follows:

	Second Quarter Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
(In thousands)				
<b>Revenue</b>				
Parts	\$ 160,690	\$ 154,982	\$ 5,708	3.7%
Service	130,758	126,850	3,908	3.1%
Collision repair	13,122	13,262	(140)	(1.1%)
<b>Total</b>	<b>\$ 304,570</b>	<b>\$ 295,094</b>	<b>\$ 9,476</b>	<b>3.2%</b>
<b>Gross profit</b>				
Parts	\$ 51,665	\$ 51,555	\$ 110	0.2%
Service	89,897	87,063	2,834	3.3%
Collision repair	7,228	6,931	297	4.3%
<b>Total</b>	<b>\$ 148,790</b>	<b>\$ 145,549</b>	<b>\$ 3,241</b>	<b>2.2%</b>
<b>Gross profit as a % of revenue</b>				
Parts	32.2%	33.3%	(110) bps	
Service	68.8%	68.6%	20 bps	
Collision repair	55.1%	52.3%	280 bps	
<b>Total</b>	<b>48.9%</b>	<b>49.3%</b>	<b>(40) bps</b>	
	Six Months Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
(In thousands)				
<b>Revenue</b>				
Parts	\$ 320,860	\$ 307,175	\$ 13,685	4.5%
Service	259,665	250,382	9,283	3.7%
Collision repair	25,793	24,638	1,155	4.7%
<b>Total</b>	<b>\$ 606,318</b>	<b>\$ 582,195</b>	<b>\$ 24,123</b>	<b>4.1%</b>
<b>Gross profit</b>				
Parts	\$ 102,521	\$ 101,183	\$ 1,338	1.3%
Service	179,083	172,592	6,491	3.8%
Collision repair	14,242	13,286	956	7.2%
<b>Total</b>	<b>\$ 295,846</b>	<b>\$ 287,061</b>	<b>\$ 8,785</b>	<b>3.1%</b>

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Gross profit as a % of revenue			
Parts	32.0%	32.9%	(90) bps
Service	69.0%	68.9%	10 bps
Collision repair	55.2%	53.9%	130 bps
<b>Total</b>	<b>48.8%</b>	<b>49.3%</b>	<b>(50) bps</b>

Overall Fixed Operations customer pay revenue increased 3.9% and 6.0% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. Wholesale parts revenue increased 8.1% and 10.4% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. Overall used vehicle reconditioning revenue increased 7.7% and 6.4% for the second quarter and six-month periods ended June 30, 2012, compared to the prior year periods. Warranty revenue decreased 7.9% and 10.3% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods, primarily due to higher levels of recall activity in the prior year periods. Fixed Operations customer pay revenue at our domestic, mid-line import and luxury branded dealerships decreased 3.8%, increased 0.2% and increased 6.3%, respectively, for the second quarter ended June 30, 2012, compared to the prior year period. Fixed Operations customer pay revenue remained flat at our domestic branded dealerships and increased at our mid-line import and luxury branded dealerships 2.8% and 8.5%, respectively, for the six-month period ended June 30, 2012, compared to the prior year period.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

For the second quarter and six-month periods ended June 30, 2012, the increase in Fixed Operations revenue contributed approximately \$4.6 million and \$11.8 million, respectively, in gross profit increase. Higher gross profit as a result of higher revenue was partially offset by a \$1.4 million and \$3.0 million decrease in gross profit due to a 40 basis point and 50 basis point decline in the gross margin rate for the second quarter and six-month periods ended June 30, 2012, respectively, caused primarily by a shift in the sales mix compared to the prior year periods.

As of June 30, 2012, we operated 24 collision repair centers. Collision repair revenues decreased 1.1% and increased 4.7% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. Collision repair gross profit improved 4.3% and 7.2% for the second quarter and six-month periods ended June 30, 2012, respectively, due to improvements in the gross margin rate as a result of a mix shift away from lower margin sublet work.

**Finance, Insurance and Other ( F&I )**

Our reported F&I results are as follows:

	Second Quarter Ended June 30,		Better / (Worse)		
	2012	2011	Change	% Change	
(In thousands, except per unit data)					
Revenue	\$ 65,338	\$ 55,369	\$ 9,969	18.0%	
Gross profit per retail unit (excludes fleet)	\$ 1,055	\$ 1,008	\$ 47	4.7%	
		Six Months Ended June 30,		Better / (Worse)	
		2012	2011	Change	% Change
(In thousands, except per unit data)					
Revenue	\$ 124,587	\$ 104,471	\$ 20,116	19.3%	
Gross profit per retail unit (excludes fleet)	\$ 1,054	\$ 981	\$ 73	7.4%	

F&I revenue increased during the second quarter and six-month periods ended June 30, 2012, compared to the prior year periods, primarily due to increases in total new and used retail (excluding fleet) unit volume of 7,000 units, or 12.7%, and 11,634 units, or 10.9%, respectively. F&I gross profit per retail unit improved 4.7% and 7.4% in the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods, primarily due to improved penetration and pricing. Finance contract gross revenue improved 14.6% and 16.8% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods, primarily due to a 15.2% and a 14.1% increase in unit volume and an increase in the finance contract penetration rate of 150 and 190 basis points for the second quarter and six-month periods ending June 30, 2012, respectively. Compared to the second quarter and six-month periods ended June 30, 2011, combined service and aftermarket contract revenue increased 21.3% and 21.4% in the second quarter and six-month periods ended June 30, 2012, respectively, and total service and aftermarket contract volume increased 22.9% and 22.1% for the second quarter and six-month periods ended June 30, 2012, respectively.

**Selling, General and Administrative ( SG&A ) Expenses**

SG&A expenses are comprised of four major groups: compensation expense, advertising expense, rent and rent related expense and other expense. Compensation expense primarily relates to dealership personnel who are paid a commission or a modest salary plus commission and support personnel who are paid a fixed salary. Due to the salary component for certain dealership and corporate personnel, gross profits and compensation expense do not change in direct proportion to one another. Advertising expense and other expenses vary based on the level of actual or anticipated business activity. Rent and rent related expense typically varies with the number of dealership properties owned by us, investments made for facility improvements and interest rates. Although not completely correlated, we believe the best way to measure SG&A

expenses is as a percentage of gross profit.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Following is information related to our SG&A expenses:

	Second Quarter Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
(In thousands)				
Compensation	\$ 148,569	\$ 137,888	\$ (10,681)	(7.7%)
Advertising	13,684	13,425	(259)	(1.9%)
Rent and rent related	28,516	32,664	4,148	12.7%
Other	58,756	53,115	(5,641)	(10.6%)
<b>Total</b>	<b>\$ 249,525</b>	<b>\$ 237,092</b>	<b>\$ (12,433)</b>	<b>(5.2%)</b>
SG&A as a % of gross profit				
Compensation	46.3%	45.1%	(120) bps	
Advertising	4.3%	4.4%	10 bps	
Rent and rent related	8.9%	10.7%	180 bps	
Other	18.3%	17.3%	(100) bps	
<b>Total</b>	<b>77.8%</b>	<b>77.5%</b>	<b>(30) bps</b>	
	Six Months Ended June 30,		Better / (Worse)	
	2012	2011	Change	% Change
(In thousands)				
Compensation	\$ 296,102	\$ 272,689	\$ (23,413)	(8.6%)
Advertising	26,727	26,865	138	0.5%
Rent and rent related	57,209	62,455	5,246	8.4%
Other	116,967	104,100	(12,867)	(12.4%)
<b>Total</b>	<b>\$ 497,005</b>	<b>\$ 466,109</b>	<b>\$ (30,896)</b>	<b>(6.6%)</b>
SG&A as a % of gross profit				
Compensation	46.8%	46.0%	(80) bps	
Advertising	4.2%	4.5%	30 bps	
Rent and rent related	9.0%	10.5%	150 bps	
Other	18.6%	17.6%	(100) bps	
<b>Total</b>	<b>78.6%</b>	<b>78.6%</b>	<b>0 bps</b>	

Overall SG&A expense dollars increased in the second quarter and six-month periods ended June 30, 2012, compared to the prior year periods, due to increases in revenue and gross profit driving higher compensation costs and other SG&A expenses. These increases also resulted in an increase of 30 basis points in overall SG&A expense as a percentage of gross profit during the second quarter ended June 30, 2012 compared to the prior year period. During the six-month period ended June 30, 2012, overall SG&A expense as a percentage of gross profit remained flat.

Compensation costs as a percentage of gross profit increased 120 and 80 basis points for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods, primarily due to increases in sales compensation expense and payroll taxes,



## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

driven by higher gross profit levels in the second quarter and six-month periods ended June 30, 2012.

Compared to the second quarter and six-month periods ended June 30, 2011, total advertising expense in the second quarter and six-month periods ended June 30, 2012 decreased as a percentage of gross profit as a result of changes in manufacturer advertising programs and higher gross profit levels in the second quarter and six-month periods ended June 30, 2012.

For the second quarter and six-month periods ended June 30, 2012, rent and rent related expenses decreased as a percentage of gross profit compared to the prior year periods, primarily due to the higher gross profit levels and the purchase of certain properties that were previously leased.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Other SG&A expenses increased in the second quarter and six-month periods ended June 30, 2012, compared to the prior year periods, primarily due to customer related costs as a result of the higher sales activity, IT spending, legal expenses and training costs.

**Depreciation and Amortization**

Depreciation and amortization expense increased approximately \$1.7 million, or 17.4%, and \$2.9 million, or 14.6%, for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. These increases are primarily related to completed construction projects that were placed in service subsequent to June 30, 2011.

**Interest Expense, Floor Plan**

Total continuing operations interest expense, floor plan, for new and used vehicles increased approximately \$0.1 million, or 2.8%, and decreased approximately \$0.8 million, or 7.3%, for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods.

Interest expense, floor plan, for new vehicles incurred by continuing operations was flat for the second quarter ended June 30, 2012, and decreased approximately \$0.9 million, or 9.7%, for the six-month period ended June 30, 2012, compared to the prior year periods. The average new vehicle floor plan interest rate incurred by these dealerships was 2.04% and 2.24% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to 2.44% and 2.51% for the second quarter and six-month periods ended June 30, 2011, respectively.

Interest expense, floor plan, for used vehicles incurred by continuing operations increased approximately \$0.1 million, or 21.3%, and \$0.1 million, or 12.1%, for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the prior year periods. The average used vehicle floor plan interest rate incurred by these dealerships was 2.64% and 2.63% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to 2.49% and 2.94% for the second quarter and six-month periods ended June 30, 2011, respectively.

**Interest Expense, Other, Net**

Interest expense, other, net, was approximately \$12.7 million and \$27.8 million in the second quarter and six-month periods ended June 30, 2012, respectively, compared to \$15.3 million and \$30.7 million in the second quarter and six-month periods ended June 30, 2011, respectively. Changes in interest expense, other, net, are summarized in the schedule below:

(In millions)	Increase (Decrease) in Interest Expense for the Second Quarter Ended June 30, 2012	Increase (Decrease) in Interest Expense for the Six Months Ended June 30, 2012
<b>Debt balances</b>		
Change in debt balances	\$ (1.4)	\$ (2.3)
<b>Other factors</b>		
Change in capitalized interest	0.7	1.3
Change in cash flow swap interest	(1.9)	(1.9)
	0.1	0.2

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Change in interest allocated to discontinued operations		
Change in deferred loan cost amortization	(0.1)	(0.3)
Change in other interest expense, net		0.1
<b>Total</b>	<b>\$ (2.6)</b>	<b>\$ (2.9)</b>

We have entered into various cash flow swaps to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate in order to reduce our exposure to market risks from fluctuations in interest rates. The incremental interest expense (the difference between interest paid and interest received) related to these cash flow swaps was approximately \$2.5 million and \$6.9 million for the second quarter and six-month periods ended June 30, 2012, respectively and \$4.4 million and \$8.8 million for the second quarter and six-month periods ended June 30, 2011, respectively, and is included in interest expense, other, net, in the accompanying Unaudited Condensed Consolidated Statements of Income.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Other Income (Expense), Net**

Other income (expense) net, increased approximately \$2.6 million for each of the second quarter and six-month periods ended June 30, 2012 due to a loss on extinguishment of debt of approximately \$2.6 million related to the retirement of approximately \$20.2 million in aggregate principal amount of the 5.0% Convertible Notes in the second quarter ended June 30, 2012.

**Income Taxes**

The overall effective tax rate from continuing operations was 27.9% and 33.2% for the second quarter and six-month periods ended June 30, 2012, respectively, and 37.3% and 38.4% for the second quarter and six-month periods ended June 30, 2011, respectively. The effective rates for the second quarter and six-month periods ended June 30, 2012 were lower than the same prior year periods primarily due to a \$3.6 million tax benefit for the second quarter ended June 30, 2012 related to the settlement of a state tax examination. We expect the effective tax rate for continuing operations in future periods to fall within a range of 38.0% to 40.0%.

**Discontinued Operations**

Significant components of results from discontinued operations were as follows:

(In thousands)	Second Quarter Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Income (loss) from operations	\$ (189)	\$ 260	\$ (1,000)	\$ 852
Gain (loss) on disposal	(367)	(180)	5,292	(222)
Lease exit accrual adjustments and charges	1,901	(1,077)	(1,243)	(2,722)
Pre-tax income (loss)	\$ 1,345	\$ (997)	\$ 3,049	\$ (2,092)
Total revenues	\$	\$ 22,227	\$ 10,267	\$ 43,287

Pre-tax income (loss) from discontinued operations improved for the second quarter and six-month periods ended June 30, 2012 compared to the prior year periods as a result of the disposition of five dealerships during the six-month period ended June 30, 2012, resulting in a gain on disposition of approximately \$5.3 million. Lease exit charges recorded for the second quarters and six-month periods ended June 30, 2012 and 2011 relate to interest charges, the revision of estimates on previously established lease exit accruals and the reversal of a lease exit accrual related to a property which was returned to operating use. The lease exit accruals represent the present value of the lease payments, net of estimated or actual sublease proceeds, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord.

**Liquidity and Capital Resources**

We require cash to fund debt service, operating lease obligations, working capital requirements, facility improvements and other capital improvements, dividends on our common stock and to finance acquisitions and otherwise invest in our business. We rely on cash flows from operations, borrowings under our revolving credit and floor plan borrowing arrangements, real estate mortgage financing, asset sales and offerings of debt and equity securities to meet these requirements. We closely monitor our available liquidity and projected future operating

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

results in order to remain in compliance with our restrictive covenants and other obligations. However, our liquidity could be negatively affected if we fail to comply with the financial covenants in our existing debt or lease arrangements. Cash flows provided by our dealerships are derived from various sources. The primary sources include individual consumers, automobile manufacturers, automobile manufacturers' captive finance subsidiaries and finance companies. Disruptions in these cash flows can have a material and adverse impact on our operations and overall liquidity.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Because the majority of our consolidated assets are held by our dealership subsidiaries, the majority of our cash flows from operations are generated by these subsidiaries. As a result, our cash flows and ability to service our obligations depends to a substantial degree on the cash generated from the operations of these dealership subsidiaries.

***Floor Plan Facilities***

The weighted average interest rate for all of our new vehicle floor plan facilities (both continuing and discontinued operations) decreased to 2.03% and 2.23% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to the second quarter and six-month periods ended June 30, 2011, which had a weighted average rate of 2.44% and 2.50%, respectively. The weighted average interest rate for all of our used vehicle floor plan facilities (both continuing and discontinued operations) was 2.64% and 2.61% for the second quarter and six-month periods ended June 30, 2012, respectively, compared to 2.48% and 2.94% for the second quarter and six-month periods ended June 30, 2011.

Interest payments under each of our floor plan facilities are due monthly and, unless an event of default occurs, we are not required to make principal repayments prior to the sale of the floor plan financed vehicles. We were in compliance with all restrictive covenants under our floor plan facilities as of June 30, 2012 and expect to be in compliance with the covenants for the foreseeable future.

***Long-Term Debt and Credit Facilities***

On July 2, 2012, we issued \$200.0 million in aggregate principal amount of 7.0% Senior Subordinated Notes which mature on July 15, 2022 (the 7.0% Notes). The 7.0% Notes were issued at a price of 99.11% of the principal amount thereof (the Issue Price), resulting in a yield to maturity of 7.125%. We will use the net proceeds from the 7.0% Notes to repurchase some or all of our outstanding 5.0% Convertible Notes pursuant to an exchange offer (see below for further discussion) for shares of our Class A common stock plus cash, including any associated tender premium, and to pay related fees and expenses. Any remaining amount will be used for general corporate purposes, including repurchases of shares of our Class A common stock. The 7.0% Notes are unsecured senior subordinated obligations of ours and are guaranteed by our domestic operating subsidiaries. Interest is payable semi-annually in arrears on January 15 and July 15 of each year, beginning on January 15, 2013.

The net proceeds from the issuance of the 7.0% Notes were deposited into an escrow account where they will remain until we have accepted for exchange at least \$80.0 million aggregate principal amount of the 5.0% Convertible Notes pursuant to the exchange offer for the 5.0% Convertible Notes or until the earlier of the termination of the exchange offer or October 23, 2012. In the event that at least \$80.0 million aggregate principal amount of the 5.0% Convertible Notes are not accepted for exchange in the exchange offer by October 23, 2012, the 7.0% Notes will be subject to a special mandatory redemption. The terms of the special mandatory redemption require that we redeem the 7.0% Notes in full at 100% of the Issue Price plus accrued but unpaid interest from the issue date up to, but excluding, the date of special mandatory redemption.

We may redeem the 7.0% Notes in whole or in part at any time after July 15, 2017 at the following redemption prices, which are expressed as percentages of the principal amount:

	<b>Redemption Price</b>
Beginning on July 15, 2017	103.500%
Beginning on July 15, 2018	102.333%
Beginning on July 15, 2019	101.167%
Beginning on July 15, 2020 and thereafter	100.000%

In addition, on or before July 15, 2015, we may redeem up to 35% of the aggregate principal amount of the 7.0% Notes at 107% of the par value of the 7.0% Notes plus accrued and unpaid interest with proceeds from certain equity offerings. The indenture also provides that holders of the

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

7.0% Notes may require us to repurchase the 7.0% Notes at 101% of the par value of the 7.0% Notes, plus accrued and unpaid interest if we undergo a change of control as defined in the indenture.

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF  
OPERATIONS**

The indenture governing the 7.0% Notes contains certain specified restrictive covenants. We have agreed not to pledge any assets to any third party lender of senior subordinated debt except under certain limited circumstances. We also have agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, guarantees, liens, certain types of investments, certain transactions with affiliates, mergers, consolidations, issuance of preferred stock, cash dividends to stockholders, distributions, redemptions and the sale, assignment, lease, conveyance or disposal of certain assets. Specifically, the indenture governing our 7.0% Notes limits our ability to pay quarterly cash dividends on our Class A and B common stock in excess of \$0.10 per share. We may only pay quarterly cash dividends on our Class A and B common stock if we comply with the terms of the indenture governing the 7.0% Notes.

Balances outstanding under our 7.0% Notes are guaranteed by all of our operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor.

Our obligations under the 7.0% Notes may be accelerated by the holders of 25% of the outstanding principal amount of the 7.0% Notes then outstanding if certain events of default occur, including: (1) defaults in the payment of principal or interest when due; (2) defaults in the performance, or breach, of our covenants under the 7.0% Notes; and (3) certain defaults under other agreements under which we or our subsidiaries have outstanding indebtedness in excess of \$35.0 million.

On June 25, 2012, we commenced an offer to exchange newly issued shares of Class A common stock and cash for all of our outstanding 5.0% Convertible Notes as described in our Registration Statement on Form S-4 (Reg. No. 333-182307). The offer consideration for the exchange of the 5.0% Convertible Notes will consist of a fixed cash payment of \$1,000 per \$1,000 principal amount of the 5.0% Convertible Notes we accept for exchange in the exchange offer plus a number of shares of our Class A common stock to be determined based on a volume weighted average pricing ( VWAP ) formula described in our Registration Statement on Form S-4 (Reg. No. 333-182307). Holders of the 5.0% Convertible Notes whose notes are accepted for exchange will be entitled to a cash payment for accrued and unpaid interest up to, but excluding, the settlement date. In no event will the total value of the offer consideration be less than \$1,000 or more than \$1,631 per \$1,000 principal amount of the 5.0% Convertible Notes accepted for exchange in the exchange offer, plus accrued and unpaid interest. Cash will be paid in lieu of fractional shares based on the VWAP. The exchange offer expires at 12:00 midnight New York City time at the end of July 27, 2012, unless we choose to extend or terminate the exchange offer, subject to certain conditions.

See Note 6, Long-Term Debt, to the accompanying Unaudited Condensed Consolidated Financial Statements for further discussion of our long-term debt and credit facilities and compliance with debt covenants.

***Dealership Dispositions***

During the six-month period ended June 30, 2012, we disposed of five dealerships. These dispositions generated cash of approximately \$23.6 million.

***Capital Expenditures***

Our capital expenditures include the purchase of land and buildings, construction of new dealerships and collision repair centers, building improvements and equipment purchased for use in our dealerships. We selectively construct or improve new dealership facilities to maintain compliance with manufacturers' image requirements. We typically finance these projects through new mortgages or, alternatively, through our credit facilities. We also fund these improvements through cash flows from operations.

Capital expenditures for the second quarter and six-month periods ended June 30, 2012 were approximately \$22.5 million and \$34.5 million (\$23.8 million, net of mortgage funding of \$10.7 million), respectively. As of June 30, 2012, contractual commitments to contractors for facility construction projects totaled approximately \$39.1 million.



***Stock Repurchase Program***

Our Board of Directors has authorized us to repurchase shares of our Class A common stock. Historically, we have used our share repurchase authorization to offset dilution caused by the exercise of stock options or the vesting of restricted stock awards and to maintain our desired capital structure. During the second quarter and six-month periods ended June 30, 2012, we repurchased approximately 3,000 shares of our Class A common stock in connection with tax withholdings on the

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF  
OPERATIONS**

vesting of restricted stock awards. As of June 30, 2012, our remaining repurchase authorization was approximately \$30.7 million. Subsequent to June 30, 2012, our Board of Directors authorized an additional \$100.0 million to repurchase shares of our Class A common stock for a total of \$130.7 million currently available for this purpose. Under our 2011 Credit Facilities, share repurchases are permitted to the extent that no event of default exists and we have the pro forma liquidity amount required by the repurchase test (as defined in the 2011 Credit Facilities) and the result of such test has been accepted by the administrative agent.

Our share repurchase activity is subject to the business judgment of management and our Board of Directors, taking into consideration our historical and projected results of operations, financial condition, cash flows, capital requirements, covenant compliance and economic and other factors considered relevant. These factors are considered each quarter and will be scrutinized as management and our Board of Directors determines our share repurchase policy in the future.

***Dividends***

During the second quarter ended June 30, 2012, our Board of Directors approved a cash dividend of \$0.025 per share on all outstanding shares of Class A and Class B common stock as of June 15, 2012 to be paid on July 15, 2012. Subsequent to June 30, 2012, our Board of Directors approved a cash dividend on all outstanding shares of common stock of \$0.025 per share for stockholders of record on September 14, 2012 to be paid on October 15, 2012. Under our 2011 Credit Facilities, dividends are permitted to the extent that no event of default exists and we are in compliance with the financial covenants, including pro forma liquidity requirements, contained therein. The indentures governing our outstanding 9.0% Notes and 7.0% Notes contain restrictions on our ability to pay dividends. The payment of any future dividend is subject to the business judgment of our Board of Directors, taking into consideration our historic and projected results of operations, financial condition, cash flows, capital requirements, covenant compliance, share repurchases, current economic environment and other factors considered relevant. These factors are considered each quarter and will be scrutinized as our Board of Directors determines our future dividend policy. There is no guarantee that additional dividends will be declared and paid at any time in the future. See Note 6, Long-Term Debt, to the accompanying Unaudited Condensed Consolidated Financial Statements for a description of restrictions on the payment of dividends.

***Cash Flows***

For the six-month period ended June 30, 2012, net cash used in operating activities was approximately \$47.9 million. This use of cash was comprised primarily of purchases of inventories, partially offset by cash inflows related to operating profits, decreases in receivables and an increase in notes payable floor plan trade. Net cash used in investing activities for the six-month period ended June 30, 2012 was approximately \$9.5 million. This use of cash was primarily comprised of purchases of land, property and equipment partially offset by proceeds from the sale of dealerships. Net cash provided by financing activities for the six-month period ended June 30, 2012 was approximately \$61.4 million. This provision of cash was primarily related to an increase in notes payable floor plan non-trade and mortgage loan proceeds partially offset by repurchases of debt securities.

We arrange our inventory floor plan financing through both manufacturer captive finance companies and a syndicate of manufacturer captive finance companies and commercial banks. Our floor plan financed with manufacturer captives is recorded as trade floor plan liabilities (with the resulting change being reflected as operating cash flows). Our dealerships that obtain floor plan financing from a syndicate of manufacturer captives and commercial banks record their obligation as non-trade floor plan liabilities (with the resulting change being reflected as financing cash flows).

Due to the presentation differences for changes in trade floor plan and non-trade floor plan in the Unaudited Condensed Consolidated Statements of Cash Flows, decisions made by us to move dealership floor plan financing arrangements from one finance source to another may cause significant variations in operating and financing cash flows without affecting our overall liquidity, working capital or cash flow. Net cash provided by combined trade and non-trade floor plan financing was approximately \$122.5 million for the six-month period ended June 30, 2012, and net cash used was approximately \$115.3 million for the six-month period ended June 30, 2011. Accordingly, if all changes in floor plan notes payable were classified as an operating activity, the result would have been net cash provided by operating activities of approximately \$40.4 million and \$47.8 million for the six-month periods ended June 30, 2012 and 2011, respectively.



**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF**  
**OPERATIONS**

***Guarantees and Indemnification Obligations***

In connection with the operation and disposition of dealership franchises, we have entered into various guarantees and indemnification obligations. See Note 8, Contingencies, to the accompanying Unaudited Condensed Consolidated Financial Statements. See also Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 12, Commitments and Contingencies, to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2011 and updated in our Current Report on Form 8-K furnished to the SEC pursuant to Items 2.02 and 9.01 on June 25, 2012.

***Future Liquidity Outlook***

We believe our best source of liquidity for operations and debt service remains cash flows generated from operations combined with our availability of borrowings under our floor plan facilities (or any replacements thereof), our 2011 Credit Facilities, real estate mortgage financing, selected dealership and other asset sales and our ability to raise funds in the capital markets through offerings of debt or equity securities. Because the majority of our consolidated assets are held by our dealership subsidiaries, the majority of our cash flows from operations are generated by these subsidiaries. As a result, our cash flows and ability to service debt depends to a substantial degree on the results of operations of these subsidiaries and their ability to provide us with cash.

***Off-Balance Sheet Arrangements***

See Management's Discussion and Analysis of Financial Condition and Results of Operations Off-Balance Sheet Arrangements in our Annual Report on Form 10-K for the year ended December 31, 2011 and updated in our Current Report on Form 8-K furnished to the SEC pursuant to Items 2.02 and 9.01 on June 25, 2012.

***Seasonality***

Our operations are subject to seasonal variations. The first quarter normally contributes less operating profit than the second, third and fourth quarters. Weather conditions, the timing of manufacturer incentive programs and model changeovers cause seasonality and may adversely affect vehicle demand, and consequently, our profitability. Comparatively, parts and service demand remains more stable throughout the year.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****Item 3: Quantitative and Qualitative Disclosures About Market Risk.****Interest Rate Risk**

Our variable rate floor plan facilities, 2011 Revolving Credit Facility borrowings and other variable rate notes expose us to risks caused by fluctuations in the applicable interest rates. The total outstanding balance of such variable instruments after considering the effect of our interest rate swaps (see below) was approximately \$939.3 million at June 30, 2012. After considering the effect of our interest rate swaps, a change of 100 basis points in the underlying interest rate would have caused a total change in interest expense of approximately \$0.8 million in the six-month period ended June 30, 2012. Of the total change in interest expense, approximately \$0.7 million would have resulted from the floor plan facilities.

In addition to our variable rate debt, as of June 30, 2012, approximately 20% of our dealership lease facilities have monthly lease payments that fluctuate based on LIBOR interest rates. An increase in interest rates of 100 basis points would not have had a significant impact on rent expense in the second quarter and six-month periods ended June 30, 2012 due to the leases containing LIBOR floors that were above the applicable LIBOR rate during the second quarter and six-month periods ended June 30, 2012.

We also have various cash flow swaps to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate. Under the terms of these cash flow swaps, interest rates reset monthly. The fair value of these swap positions at June 30, 2012 was a liability of approximately \$37.5 million, with \$25.0 million included in other accrued liabilities and \$12.5 million recorded to other long-term liabilities in the accompanying Unaudited Condensed Consolidated Balance Sheets. During the second quarter ended June 30, 2012, \$300.0 million of notional amount of cash flow hedges reached maturity. See the previous discussion of our cash flow swaps in Note 6, Long-Term Debt, to the accompanying Unaudited Condensed Consolidated Financial Statements. We will receive and pay interest based on the following:

Notional Amount (In millions)	Pay Rate	Receive Rate (1)	Maturing Date
\$ 3.3	7.100%	one-month LIBOR + 1.50%	July 10, 2017
\$ 25.0 (2)	5.160%	one-month LIBOR	September 1, 2012
\$ 15.0 (2)	4.965%	one-month LIBOR	September 1, 2012
\$ 25.0 (2)	4.885%	one-month LIBOR	October 1, 2012
\$ 10.3	4.655%	one-month LIBOR	December 10, 2017
\$ 8.2 (2)	6.860%	one-month LIBOR + 1.25%	August 1, 2017
\$ 6.3	4.330%	one-month LIBOR	July 1, 2013
\$ 100.0 (3)	3.280%	one-month LIBOR	July 1, 2015
\$ 100.0 (3)	3.300%	one-month LIBOR	July 1, 2015
\$ 6.9 (2)	6.410%	one-month LIBOR + 1.25%	September 12, 2017
\$ 50.0 (3)	2.767%	one-month LIBOR	July 1, 2014
\$ 50.0 (3)	3.240%	one-month LIBOR	July 1, 2015
\$ 50.0 (3)	2.610%	one-month LIBOR	July 1, 2014
\$ 50.0 (3)	3.070%	one-month LIBOR	July 1, 2015
\$ 100.0 (4)	2.065%	one-month LIBOR	June 30, 2017
\$ 100.0 (4)	2.015%	one-month LIBOR	June 30, 2017

- (1) The one-month LIBOR rate was 0.243% at June 30, 2012.
- (2) Changes in fair value are recorded through earnings.
- (3) The effective date of these forward-starting swaps is July 2, 2012.
- (4) The effective date of these forward-starting swaps is July 1, 2015.

**Foreign Currency Risk**

We purchase certain of our new vehicle and parts inventories from foreign manufacturers. Although we purchase our inventories in U.S. dollars, our business is subject to foreign exchange rate risk, which may influence automobile manufacturers' ability to provide their products at

competitive prices in the United States. To the extent that we cannot recapture this volatility in prices charged to customers or if this volatility negatively impacts consumer demand for our products, this volatility could adversely affect our future operating results.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**Item 4: Controls and Procedures.**

Our management, under the supervision and with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer have concluded that the design and operation of our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q. During our last fiscal quarter, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**PART II OTHER INFORMATION**

**Item 1: Legal Proceedings.**

Several private civil actions have been filed against us and several of our dealership subsidiaries that purport to represent classes of customers as potential plaintiffs and make allegations that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. One of these private civil actions was filed on November 15, 2004 in South Carolina state court, York County Court of Common Pleas, against us and some of our South Carolina subsidiaries. The plaintiffs in that lawsuit were Misty J. Owens, James B. Wright, Vincent J. Astey and Joseph Lee Williams, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The group of plaintiffs' attorneys representing the plaintiffs in the South Carolina lawsuit also filed another private civil class action lawsuit against us and certain of our subsidiaries on February 14, 2005 in state court in North Carolina, Lincoln County Superior Court, which similarly sought certification of a multi-state class of plaintiffs and alleged that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. The plaintiffs in this North Carolina lawsuit were Robert Price, Carolyn Price, Marcus Cappelletti and Kelly Cappelletti, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The South Carolina state court action and the North Carolina state court action were subsequently consolidated into a single proceeding in private arbitration before the American Arbitration Association (the Arbitrator). On November 12, 2008, claimants in the consolidated arbitration filed a Motion for Class Certification as a national class action including all of the states in which we operate dealerships except Florida. Claimants are seeking monetary damages and injunctive relief on behalf of this class of customers. The parties have briefed and argued the issue of class certification.

On July 19, 2010, the Arbitrator issued a Partial Final Award on Class Certification, certifying a class which includes all customers who, on or after November 15, 2000, purchased or leased from one of our dealerships a vehicle with the Etch product as part of the transaction, but not including customers who purchased or leased such vehicles from one of our dealerships in Florida. The Partial Final Award on Class Certification is not a final decision on the merits of the action. The merits of Claimants' assertions and potential damages would still have to be proven through the remainder of the arbitration. The Arbitrator stayed the Arbitration for thirty days to allow either party to petition a court of competent jurisdiction to confirm or vacate the award. On July 22, 2010, the plaintiffs in this consolidated arbitration filed a Motion to Confirm the Arbitrator's Partial Final Award on Class Certification in state court in North Carolina, Lincoln County Superior Court. On August 17, 2010, we removed this North Carolina state court action to federal court, and simultaneously filed a Petition to Vacate the Arbitrator's Partial Final Award on Class Certification, with both filings made in the United States District Court for the Western District of North Carolina.

On August 12, 2011, the United States District Court for the Western District of North Carolina issued an Order granting our Petition to Vacate Arbitration Award on Class Certification and denied Claimants' Motion to Dismiss the same. Claimants filed a Notice of Appeal to the United States Fourth Circuit Court of Appeals on September 12, 2011. The federal court's stay of the arbitration proceeding remains in force. At a mediation held January 16, 2012, our company reached an agreement with the Claimants to settle this ongoing dispute in its entirety. Our company and the Claimants subsequently entered into a definitive settlement agreement, the terms of which received preliminary approval by a North Carolina state court in May 2012. This settlement remains subject to final court approval. In the event that final court approval is received, this settlement would not have a material adverse effect on our future results of operations, financial condition and cash flows.

We are involved, and expect to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of our business, including regulatory investigations and private civil actions brought by plaintiffs purporting to represent a potential class or for which a class has been certified. Although we vigorously defend ourselves in all legal and administrative proceedings, the outcomes of pending and future proceedings arising out of the conduct of our business, including litigation with customers, employment related lawsuits, contractual disputes, class actions, purported class actions and actions brought by governmental authorities, cannot be predicted with certainty. Similarly, except as reflected in reserves we have provided for in other accrued liabilities in the accompanying Unaudited Condensed Consolidated Balance Sheets, we are currently unable to estimate a range of reasonably possible loss, or a range of reasonably possible loss in excess of the amount accrued, for pending proceedings. An unfavorable resolution of one or more of these matters could have a material adverse effect on our business, financial condition, results of operations, cash flows or prospects.



**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

**Item 1A: Risk Factors**

In addition to the information below and other information set forth in this Form 10-Q, you should carefully consider the risk factors discussed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results.

*Our significant indebtedness could materially adversely affect our financial health, limit our ability to finance future acquisitions and capital expenditures and prevent us from fulfilling our financial obligations.*

As of June 30, 2012, our total outstanding indebtedness was approximately \$1.5 billion, which includes floor plan notes payable, long-term debt and short-term debt.

We have \$175.0 million of maximum borrowing availability under a syndicated revolving credit facility (the 2011 Revolving Credit Facility ), up to \$500.0 million in maximum borrowing availability for new vehicle inventory floor plan financing and up to \$80.0 million in maximum borrowing availability for used vehicle inventory floor plan financing (the 2011 Floor Plan Facility ). We refer to the 2011 Revolving Credit Facility and 2011 Floor Plan Facility collectively as our 2011 Credit Facilities. Based on balances as of June 30, 2012, we had approximately \$135.8 million available for additional borrowings under the 2011 Revolving Credit Facility based on the borrowing base calculation, which is affected by numerous factors including eligible asset balances and the market value of certain additional collateral. We are able to borrow under our 2011 Revolving Credit Facility only if, at the time of the borrowing, we have met all representations and warranties and are in compliance with all financial and other covenants contained therein. We also have capacity to finance new and used vehicle inventory purchases under bilateral floor plan agreements with various manufacturer captive finance companies and other lending institutions (the Silo Floor Plan Facilities ) as well as our 2011 Floor Plan Facility. In addition, the indentures relating to our 9.0% Senior Subordinated Notes due 2018 (the 9.0% Notes ), 7.0% Senior Subordinated Notes due 2022 (the 7.0% Notes ), 5.0% Convertible Senior Notes due 2029 which are redeemable by us and which may be put to us by the holders after October 1, 2014 under certain circumstances (the 5.0% Convertible Notes ) and our other debt instruments allow us to incur additional indebtedness, including secured indebtedness, as long as we comply with the terms thereunder.

In addition, the majority of our dealership properties are leased under long-term operating lease arrangements that commonly have initial terms of fifteen to twenty years with renewal options ranging from five to ten years. These operating leases require compliance with financial and operating covenants similar to those under our 2011 Credit Facilities, and monthly payments of rent that may fluctuate based on interest rates and local consumer price indices. The total future minimum lease payments related to these operating leases and certain equipment leases are significant and are disclosed in Note 12, Commitments and Contingencies, to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2011 as updated by Sonic's Current Report on Form 8-K furnished to the SEC pursuant to Items 2.02 and 9.01 on June 25, 2012.

*The outcome of legal and administrative proceedings we are or may become involved in could have a material adverse effect on our future business, results of operations, financial condition and cash flows.*

We are involved, and expect to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of our business, including regulatory investigations and private civil actions brought by plaintiffs purporting to represent a potential class or for which a class has been certified.

Several private civil actions have been filed against us and several of our dealership subsidiaries that purport to represent classes of customers as potential plaintiffs and make allegations that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. One of these private civil actions was filed on November 15, 2004 in South Carolina state court, York County Court of Common Pleas, against us and some of our South Carolina subsidiaries. The plaintiffs in that lawsuit were Misty J. Owens, James B. Wright, Vincent J. Astey and Joseph Lee Williams, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The group of plaintiffs' attorneys representing the plaintiffs in the South Carolina lawsuit also filed another private civil class action lawsuit against us and certain of our subsidiaries on February 14, 2005 in state court in North Carolina, Lincoln County Superior Court, which similarly sought certification of a multi-state class of plaintiffs and alleged that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. The plaintiffs in this North Carolina lawsuit were Robert Price, Carolyn Price, Marcus Cappelletti and Kelly Cappelletti, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The South Carolina state court action

and the North

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

Carolina state court action were subsequently consolidated into a single proceeding in private arbitration before the American Arbitration Association (the Arbitrator ). On November 12, 2008, claimants in the consolidated arbitration filed a Motion for Class Certification as a national class action including all of the states in which we operate dealerships except Florida. Claimants are seeking monetary damages and injunctive relief on behalf of this class of customers. The parties have briefed and argued the issue of class certification.

On July 19, 2010, the Arbitrator issued a Partial Final Award on Class Certification, certifying a class which includes all customers who, on or after November 15, 2000, purchased or leased from one of our dealerships a vehicle with the Etch product as part of the transaction, but not including customers who purchased or leased such vehicles from one of our dealerships in Florida. The Partial Final Award on Class Certification is not a final decision on the merits of the action. The merits of Claimants' assertions and potential damages would still have to be proven through the remainder of the arbitration. The Arbitrator stayed the Arbitration for thirty days to allow either party to petition a court of competent jurisdiction to confirm or vacate the award. On July 22, 2010, the plaintiffs in this consolidated arbitration filed a Motion to Confirm the Arbitrator's Partial Final Award on Class Certification in state court in North Carolina, Lincoln County Superior Court. On August 17, 2010, we removed this North Carolina state court action to federal court, and simultaneously filed a Petition to Vacate the Arbitrator's Partial Final Award on Class Certification, with both filings made in the United States District Court for the Western District of North Carolina.

On August 12, 2011, the United States District Court for the Western District of North Carolina issued an Order granting our Petition to Vacate Arbitration Award on Class Certification and denied Claimant's Motion to Dismiss the same. Claimants filed a Notice of Appeal to the United States Fourth Circuit Court of Appeals on September 12, 2011. The federal court's stay of the arbitration proceeding remains in force. At a mediation held January 16, 2012, our company reached an agreement with the Claimants to settle this ongoing dispute in its entirety. Our company and the Claimants subsequently entered into a definitive settlement agreement, the terms of which received preliminary approval by a North Carolina state court in May 2012. This settlement remains subject to final court approval. In the event that final court approval is received, this settlement would not have a material adverse effect on our future results of operations, financial condition and cash flows.

Although we vigorously defend ourself in all legal and administrative proceedings, the outcomes of pending and future proceedings arising out of the conduct of our business, including litigation with customers, employment related lawsuits, contractual disputes, class actions, purported class actions and actions brought by governmental authorities, cannot be predicted with certainty. An unfavorable resolution of one or more of these matters could have a material adverse effect on our business, financial condition, results of operations, cash flows or prospects.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****Item 2: Unregistered Sales of Equity Securities and Use of Proceeds**

(In thousands, except per share data)

	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (3)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
April 2012		\$		\$ 30,725
May 2012	3	16.47	3	30,694
June 2012				30,694
Total	3	\$ 16.47	3	\$ 30,694 (2)

- (1) All shares repurchased were part of publicly announced share repurchase programs.
- (2) Subsequent to June 30, 2012, our Board of Directors authorized an additional \$100.0 million to repurchase shares of our Class A common stock for a total of \$130.7 million currently available for this purpose.
- (3) Our publicly announced Class A common stock repurchase authorization and current availability is as follows:

	(amounts in thousands)
November 1999	\$ 25,000
February 2000	25,000
December 2000	25,000
May 2001	25,000
August 2002	25,000
February 2003	20,000
December 2003	20,000
July 2004	20,000
July 2007	30,000
October 2007	40,000
April 2008	40,000
July 2012	100,000
Total authorization	395,000
Total repurchases through June 30, 2012	(264,306)
Currently available	\$ 130,694

See Note 6, Long-term Debt, to the accompanying Unaudited Condensed Consolidated Financial Statements and Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations for additional discussion of restrictions on share repurchases and payment of dividends.



**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****Item 6: Exhibits.****(a) Exhibits:**

Exhibit No.	Description
<b>10.1*</b>	Amendment No. 1, dated as of April 19, 2012, to Second Amended and Restated Credit Agreement dated July 8, 2011 with Bank of America, N.A., as administrative agent, swing line lender and a lender and Mercedes-Benz Financial Services USA LLC, BMW Financial Services NA, LLC, Toyota Motor Credit Corporation, JPMorgan Chase Bank, N.A., Wells Fargo Bank, National Association, Comerica Bank, US Bank, National Association, Capital One, N.A., VW Credit, Inc. and World Omni Financial Corp., as lenders and Bank of America, N.A., and Wells Fargo Bank, National Association, as letter of credit issuer (incorporated by reference to Exhibit 10.1 to Sonic's Current Report on Form 8-K filed April 23, 2012).
<b>10.2*</b>	Amendment No. 1, dated as of April 19, 2012, to Amended and Restated Syndicated New and Used Vehicle Floorplan Credit Agreement with Bank of America, N.A., as administrative agent, a lender, new vehicle swingline lender and used vehicle swingline lender, and JPMorgan Chase Bank, N.A., Wells Fargo Bank, National Association, US Bank, National Association, Capital One, N.A., Mercedes-Benz Financial Services USA LLC and Comerica Bank, as lenders, and Wells Fargo Bank, National Association as letter of credit issuer (incorporated by reference to Exhibit 10.2 to Sonic's Current Report on Form 8-K filed April 23, 2012).
<b>10.3*</b>	Sonic Automotive, Inc. 2012 Stock Incentive Plan (incorporated by reference to Exhibit 4.5 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-180814)).(1)
<b>10.4*</b>	Sonic Automotive, Inc. 2012 Formula Restricted Stock Plan for Non-Employee Directors (incorporated by reference to Exhibit 4.5 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-180815)).(1)
<b>10.5*</b>	Dealer Manager Agreement dated as of June 25, 2012 by and among Sonic Automotive, Inc. and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Wells Fargo Securities, LLC (incorporated by reference to Exhibit 1.1 to Sonic's Registration Statement on Form S-4 (Reg. No. 333-182307)).
<b>10.6</b>	Purchase Agreement dated as of June 25, 2012 by and among Sonic Automotive, Inc., the guarantors party thereto and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Representative of the Initial Purchasers.
<b>31.1</b>	Certification of Mr. David P. Cospers pursuant to rule 13a-14(a)
<b>31.2</b>	Certification of Mr. O. Bruton Smith pursuant to rule 13a-14(a)
<b>32.1</b>	Certification of Mr. David P. Cospers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<b>32.2</b>	Certification of Mr. O. Bruton Smith pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<b>101.INS**</b>	XBRL Instance Document
<b>101.SCH**</b>	XBRL Taxonomy Extension Schema Document
<b>101.CAL**</b>	XBRL Taxonomy Extension Calculation Linkbase Document
<b>101.DEF**</b>	XBRL Taxonomy Definition Linkbase Document
<b>101.LAB**</b>	XBRL Taxonomy Extension Label Linkbase Document
<b>101.PRE**</b>	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed previously

## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

- \*\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under those sections.
- (1) Indicates a management contract or compensatory plan or arrangement.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**Forward Looking Statements**

This Quarterly Report on Form 10-Q contains numerous forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address our future objectives, plans and goals, as well as our intent, beliefs and current expectations regarding future operating performance, and can generally be identified by words such as may, will, should, believe, expect, anticipate, intend, plan, foresee and other similar words or phrases. Specific events addressed by these forward-looking statements include, but are not limited to:

vehicle sales rates and same store sales growth;

future liquidity trends or needs;

our business and growth strategies;

future covenant compliance;

our financing plans and our ability to repay or refinance existing debt when due, including our pending offer to repurchase all of our 5.0% Convertible Senior Notes due 2029;

future acquisitions or dispositions;

level of fuel prices;

industry trends; and

general economic trends, including employment rates and consumer confidence levels.

These forward-looking statements are based on our current estimates and assumptions and involve various risks and uncertainties. As a result, you are cautioned that these forward-looking statements are not guarantees of future performance and that actual results could differ materially from those projected in these forward-looking statements. Factors which may cause actual results to differ materially from our projections include those risks described in Item 1 and Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011, as updated by our Current Report on Form 8-K furnished to the SEC pursuant to Items 2.02 and 9.01 on June 25, 2012 and Item 1A of this Form 10-Q and elsewhere in this report, as well as:

the number of new and used cars sold in the United States as compared to our expectations and the expectations of the market;



## Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

our ability to generate sufficient cash flows or obtain additional financing to fund acquisitions, capital expenditures, our share repurchase program, dividends on our Common Stock and general operating activities;

the reputation and financial condition of vehicle manufacturers whose brands we represent, the financial incentives vehicle manufacturers offer and their ability to design, manufacture, deliver and market their vehicles successfully;

our relationships with manufacturers, which may affect our ability to obtain desirable new vehicle models in inventory or complete additional acquisitions;

adverse resolutions of one or more significant legal proceedings against us or our dealerships;

changes in laws and regulations governing the operation of automobile franchises, accounting standards, taxation requirements and environmental laws;

general economic conditions in the markets in which we operate, including fluctuations in interest rates, employment levels, the level of consumer spending and consumer credit availability;

the terms of any refinancing of our existing indebtedness;

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

high competition in the automotive retailing industry, which not only creates pricing pressures on the products and services we offer, but also on businesses we may seek to acquire;

our ability to successfully integrate potential future acquisitions; and

the rate and timing of overall economic recovery or decline.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**SONIC AUTOMOTIVE, INC.**

Date: July 25, 2012

By: */s/ O. BRUTON SMITH*  
O. Bruton Smith  
*Chairman and Chief Executive Officer*

Date: July 25, 2012

By: */s/ DAVID P. COSPER*  
David P. Cosper  
*Vice Chairman and Chief Financial Officer*  
  
*(Principal Financial Officer)*

**Table of Contents**

## EXHIBIT INDEX

Exhibit	
No.	Description
<b>10.1*</b>	Amendment No. 1, dated as of April 19, 2012, to Second Amended and Restated Credit Agreement dated July 8, 2011 with Bank of America, N.A., as administrative agent, swing line lender and a lender and Mercedes-Benz Financial Services USA LLC, BMW Financial Services NA, LLC, Toyota Motor Credit Corporation, JPMorgan Chase Bank, N.A., Wells Fargo Bank, National Association, Comerica Bank, US Bank, National Association, Capital One, N.A., VW Credit, Inc. and World Omni Financial Corp., as lenders and Bank of America, N.A., and Wells Fargo Bank, National Association, as letter of credit issuer (incorporated by reference to Exhibit 10.1 to Sonic's Current Report on Form 8-K filed April 23, 2012).
<b>10.2*</b>	Amendment No. 1, dated as of April 19, 2012, to Amended and Restated Syndicated New and Used Vehicle Floorplan Credit Agreement with Bank of America, N.A., as administrative agent, a lender, new vehicle swingline lender and used vehicle swingline lender, and JPMorgan Chase Bank, N.A., Wells Fargo Bank, National Association, US Bank, National Association, Capital One, N.A., Mercedes-Benz Financial Services USA LLC and Comerica Bank, as lenders, and Wells Fargo Bank, National Association as letter of credit issuer (incorporated by reference to Exhibit 10.2 to Sonic's Current Report on Form 8-K filed April 23, 2012).
<b>10.3*</b>	Sonic Automotive, Inc. 2012 Stock Incentive Plan (incorporated by reference to Exhibit 4.5 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-180814)).(1)
<b>10.4*</b>	Sonic Automotive, Inc. 2012 Formula Restricted Stock Plan for Non-Employee Directors (incorporated by reference to Exhibit 4.5 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-180815)).(1)
<b>10.5*</b>	Dealer Manager Agreement dated as of June 25, 2012 by and among Sonic Automotive, Inc. and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Wells Fargo Securities, LLC (incorporated by reference to Exhibit 1.1 to Sonic's Registration Statement on Form S-4 (Reg. No. 333-182307)).
<b>10.6</b>	Purchase Agreement dated as of June 25, 2012 by and among Sonic Automotive, Inc., the guarantors party thereto and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Representative of the Initial Purchasers.
<b>31.1</b>	Certification of Mr. David P. Cospers pursuant to rule 13a-14(a)
<b>31.2</b>	Certification of Mr. O. Bruton Smith pursuant to rule 13a-14(a)
<b>32.1</b>	Certification of Mr. David P. Cospers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<b>32.2</b>	Certification of Mr. O. Bruton Smith pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<b>101.INS**</b>	XBRL Instance Document
<b>101.SCH**</b>	XBRL Taxonomy Extension Schema Document
<b>101.CAL**</b>	XBRL Taxonomy Extension Calculation Linkbase Document
<b>101.DEF**</b>	XBRL Taxonomy Definition Linkbase Document
<b>101.LAB**</b>	XBRL Taxonomy Extension Label Linkbase Document
<b>101.PRE**</b>	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed previously

\*\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under those sections.

(1) Indicates a management contract or compensatory plan or arrangement.

