

SONIC AUTOMOTIVE INC  
Form 10-Q  
July 29, 2008  
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, 2008

OR

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

Commission file 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.)

**6415 Idlewild Road, Suite 109, Charlotte, North Carolina**  
(Address of principal executive offices)

**28212**  
(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 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  Smaller Reporting Company   
(Do not check if a 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 24 2008, there were 28,053,002 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**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	<b>3</b>
ITEM 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Statements of Income – Quarter and Six-month period ended June 30, 2007 and June 30, 2008</u>	3
<u>Condensed Consolidated Balance Sheets – December 31, 2007 and June 30, 2008</u>	4
<u>Condensed Consolidated Statement of Stockholders – Equity – Six-month period ended June 30, 2008</u>	5
<u>Condensed Consolidated Statements of Cash Flows – Six-month periods ended June 30, 2007 and June 30, 2008</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
ITEM 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	19
ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
ITEM 4. <u>Controls and Procedures</u>	31
<b><u>PART II OTHER INFORMATION</u></b>	<b>32</b>
ITEM 1. <u>Legal Proceedings</u>	32
ITEM 1A. <u>Risk Factors</u>	33
ITEM 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	46
ITEM 4. <u>Submission of Matters to a Vote of Security Holders</u>	47
ITEM 6. <u>Exhibits</u>	48
<b><u>SIGNATURES</u></b>	<b>50</b>

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1: Condensed Consolidated Financial Statements.****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Dollars and shares in thousands except per share amounts)****(Unaudited)**

	<b>Quarter Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2008</b>	<b>2007</b>	<b>2008</b>
<b>Revenues:</b>				
New vehicles	\$ 1,229,365	\$ 1,169,979	\$ 2,346,340	\$ 2,257,298
Used vehicles	351,333	379,522	670,590	749,310
Wholesale vehicles	98,260	82,467	203,972	166,802
<b>Total vehicles</b>	<b>1,678,958</b>	<b>1,631,968</b>	<b>3,220,902</b>	<b>3,173,410</b>
Parts, service and collision repair	283,478	294,608	561,606	587,581
Finance, insurance and other	52,352	52,943	99,129	103,636
<b>Total revenues</b>	<b>2,014,788</b>	<b>1,979,519</b>	<b>3,881,637</b>	<b>3,864,627</b>
<b>Cost of Sales:</b>				
New vehicles	(1,143,423)	(1,090,020)	(2,181,706)	(2,103,041)
Used vehicles	(318,690)	(347,258)	(607,138)	(684,059)
Wholesale vehicles	(99,496)	(84,269)	(205,287)	(169,706)
<b>Total vehicles</b>	<b>(1,561,609)</b>	<b>(1,521,547)</b>	<b>(2,994,131)</b>	<b>(2,956,806)</b>
Parts, service and collision repair	(139,482)	(147,217)	(278,142)	(294,309)
<b>Total cost of sales</b>	<b>(1,701,091)</b>	<b>(1,668,764)</b>	<b>(3,272,273)</b>	<b>(3,251,115)</b>
<b>Gross profit</b>	<b>313,697</b>	<b>310,755</b>	<b>609,364</b>	<b>613,512</b>
Selling, general and administrative expenses	(232,366)	(242,042)	(461,378)	(481,690)
Depreciation and amortization	(8,327)	(8,879)	(13,825)	(16,744)
<b>Operating income</b>	<b>73,004</b>	<b>59,834</b>	<b>134,161</b>	<b>115,078</b>
<b>Other income / (expense):</b>				
Interest expense, floor plan	(16,645)	(11,502)	(32,342)	(24,723)
Interest expense, other, net	(8,871)	(14,794)	(17,548)	(26,778)
Other income / (expense), net	74	26	90	97
<b>Total other expense</b>	<b>(25,442)</b>	<b>(26,270)</b>	<b>(49,800)</b>	<b>(51,404)</b>
<b>Income from continuing operations before taxes</b>	<b>47,562</b>	<b>33,564</b>	<b>84,361</b>	<b>63,674</b>
Provision for income taxes	(18,722)	(13,431)	(33,256)	(25,470)
<b>Income from continuing operations</b>	<b>28,840</b>	<b>20,133</b>	<b>51,105</b>	<b>38,204</b>
<b>Discontinued operations:</b>				
Loss from operations and the sale of discontinued franchises	(3,532)	(13,319)	(6,781)	(18,836)
Income tax benefit	1,060	3,997	2,035	5,651

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Loss from discontinued operations	(2,472)	(9,322)	(4,746)	(13,185)
Net income	\$ 26,368	\$ 10,811	\$ 46,359	\$ 25,019
Basic earnings (loss) per share:				
Earnings per share from continuing operations	\$ 0.67	\$ 0.50	\$ 1.19	\$ 0.94
Loss per share from discontinued operations	(0.06)	(0.23)	(0.11)	(0.32)
Earnings per share	\$ 0.61	\$ 0.27	\$ 1.08	\$ 0.62
Weighted average common shares outstanding	42,902	40,432	42,886	40,603
Diluted earnings (loss) per share:				
Earnings per share from continuing operations	\$ 0.62	\$ 0.49	\$ 1.11	\$ 0.92
Loss per share from discontinued operations	(0.05)	(0.22)	(0.10)	(0.30)
Earnings per share	\$ 0.57	\$ 0.27	\$ 1.01	\$ 0.62
Weighted average common shares outstanding	47,987	43,421	47,963	43,633
Dividends declared per common share	\$ 0.12	\$ 0.12	\$ 0.24	\$ 0.24

See notes to unaudited condensed consolidated financial statements.

**Table of Contents**

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

(Dollars in thousands)

	December 31, 2007	June 30, 2008 (Unaudited)
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 16,514	\$ 11,381
Receivables, net	347,309	279,740
Inventories	1,093,017	1,156,208
Assets held for sale	87,342	114,263
Other current assets	35,879	36,477
Total current assets	1,580,061	1,598,069
Property and Equipment, net	286,591	396,841
Goodwill	1,276,074	1,250,363
Other Intangible Assets, net	111,342	108,684
Other Assets	28,676	28,565
<b>Total Assets</b>	<b>\$ 3,282,744</b>	<b>\$ 3,382,522</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Notes payable - floor plan - trade	\$ 298,376	\$ 336,837
Notes payable - floor plan - non-trade	827,294	823,116
Trade accounts payable	66,026	61,636
Accrued interest	19,202	16,290
Other accrued liabilities	162,430	152,495
Liabilities associated with assets held for sale - trade	25,057	12,124
Liabilities associated with assets held for sale - non-trade	23,535	38,805
Current maturities of long-term debt	4,197	134,983
<b>Total current liabilities</b>	<b>1,426,117</b>	<b>1,576,286</b>
Long-Term Debt	697,800	647,652
Other Long-Term Liabilities	83,829	81,977
Deferred Income Taxes	144,170	142,290
Commitments and Contingencies		
Stockholders' Equity:		
Class A convertible preferred stock, none issued		
Class A common stock, \$.01 par value; 100,000,000 shares authorized; 42,413,646 shares issued and 29,298,482 shares outstanding at December 31, 2007; 42,861,966 shares issued and 28,430,687 shares outstanding at June 30, 2008	424	428
Class B common stock; \$.01 par value; 30,000,000 shares authorized; 12,029,375 shares issued and outstanding at December 31, 2007 and June 30, 2008	121	121
Paid-in capital	488,983	500,528
Retained earnings	664,280	680,040
Accumulated other comprehensive income	(15,114)	(14,881)
Treasury stock, at cost (13,115,164 Class A shares held at December 31, 2007 and 14,431,279 Class A shares held at June 30, 2008)	(207,866)	(231,919)
<b>Total stockholders' equity</b>	<b>930,828</b>	<b>934,317</b>

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Total Liabilities and Stockholders	Equity	\$ 3,282,744	\$ 3,382,522
------------------------------------	--------	--------------	--------------

See notes to unaudited condensed consolidated financial statements.

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

(Dollars and shares in thousands)

(Unaudited)

	Class A		Class B		Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other	Total	Comprehensive Income
	Common Stock Shares	Common Stock Amount	Common Stock Shares	Common Stock Amount				Comprehensive (Loss)/Income	Stockholders Equity	
BALANCE AT DECEMBER 31, 2007	42,414	\$ 424	12,029	\$ 121	\$ 488,983	\$ 664,280	\$ (207,866)	\$ (15,114)	\$ 930,828	
Shares awarded under stock compensation plans	448	4			5,143				5,147	
Purchases of treasury stock							(24,053)		(24,053)	
Income tax benefit associated with stock compensation plans					1,195				1,195	
Income tax benefit associated with convertible note hedge					1,062				1,062	
Fair value of interest rate swap agreements, net of tax benefit of \$77								(82)	(82)	(82)
Unrealized loss on available-for-sale securities, net of tax benefit of \$66								315	315	315
Stock-based compensation expense					1,779				1,779	
Restricted stock amortization, net of forfeitures					2,366				2,366	
Net income						25,019			25,019	25,019
Dividends (\$.24 per share)						(9,259)			(9,259)	
BALANCE AT JUNE 30, 2008	42,862	\$ 428	12,029	\$ 121	\$ 500,528	\$ 680,040	\$ (231,919)	\$ (14,881)	\$ 934,317	\$ 25,252

See notes to unaudited condensed consolidated financial statements.



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

(Dollars in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2007	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 46,359	\$ 25,019
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	14,659	17,369
Provision for bad debt expense	1,885	1,260
Other amortization	537	655
Debt issuance cost amortization	567	583
Debt discount amortization, net of premium amortization	377	483
Stock based compensation expense	2,578	1,779
Amortization of restricted stock	1,911	2,448
Restricted stock forfeiture	(1,544)	(82)
Deferred income taxes	(1,119)	(1,575)
Equity interest in earnings of investees	(314)	(220)
Impairment of favorable lease asset		1,903
Impairment of franchise agreements	1,250	2,300
Impairment of property and equipment and other assets	512	4,388
(Gain)/Loss on disposal of franchises and property and equipment	(39)	2,645
Loss on exit of leased dealerships	542	1,647
Changes in assets and liabilities that relate to operations:		
Receivables	32,822	66,309
Inventories	(68,578)	(77,514)
Other assets	(1,416)	(9,147)
Notes payable floor plan trade	(126,069)	23,190
Trade accounts payable and other liabilities	12,680	(13,276)
<b>Total adjustments</b>	<b>(128,759)</b>	<b>25,145</b>
<b>Net cash (used in) / provided by operating activities</b>	<b>(82,400)</b>	<b>50,164</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of businesses, net of cash acquired	(160,109)	(22,728)
Purchases of property and equipment	(39,817)	(103,382)
Proceeds from sales of property and equipment	16,383	623
Proceeds from sale of franchises	5,374	24,004
Distributions from equity investees	900	600
<b>Net cash used in investing activities</b>	<b>(177,269)</b>	<b>(100,883)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net borrowings on notes payable floor plan non-trade	183,579	11,093
Borrowings on revolving credit facilities	541,899	540,229
Repayments on revolving credit facilities	(482,354)	(495,561)
Proceeds from long-term debt	17,335	17,763

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Payments on long-term debt	(907)	(1,801)
Purchases of treasury stock	(6,374)	(24,053)
Income tax benefit associated with stock compensation plans	3,097	1,195
Income tax benefit associated with convertible hedge	929	1,062
Issuance of shares under stock compensation plans	12,363	5,147
Dividends paid	(10,437)	(9,488)
<b>Net cash provided by financing activities</b>	<b>259,130</b>	<b>45,586</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(539)</b>	<b>(5,133)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>12,696</b>	<b>16,514</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 12,157</b>	<b>\$ 11,381</b>
<b>SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING ACTIVITIES:</b>		
Adoption of FIN 48	\$ (8,582)	\$
<b>SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:</b>		
Change in fair value of cash flow hedging instruments (net of tax expense / (benefit) of \$2,062 and \$(77) for six month period ended June 30, 2007 and 2008, respectively)	\$ 3,364	\$ (82)
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for:		
Interest, net of amount capitalized	\$ 58,980	\$ 58,058
Income taxes	\$ 19,072	\$ 11,917

See notes to unaudited condensed consolidated financial statements.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation** The accompanying unaudited condensed consolidated financial information for the second quarter and six month period ended June 30, 2008 has been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). All significant intercompany accounts and transactions have been eliminated. These unaudited condensed consolidated financial statements reflect, in the opinion of management, all material adjustments (which include only 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 for the year ended December 31, 2007, which were included in Sonic's Annual Report on Form 10-K.

**Reclassifications** The statement of income for the second quarter and six month period ended June 30, 2007 reflects the reclassification of balances from continuing operations to discontinued operations from the prior year presentation for additional franchises sold and terminated or identified for sale subsequent to June 30, 2007. The statement of income for the second quarter and six month period ended June 30, 2007 also reflects the reclassification of balances from discontinued operations to continuing operations for franchises identified for sale as of June 30, 2007 but which Sonic has decided to retain and operate as of June 30, 2008.

**Recent Accounting Pronouncements** In March 2008, the Financial Accounting Standards Board (FASB) concluded its re-deliberations on FSP APB 14-a Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-a) deciding to retain its original proposal related to this matter. FSP APB 14-A applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). FSP APB 14-a will require that the issuer of a convertible debt instrument within its scope separately account for the liability and equity components in a manner that will reflect the issuer's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The excess of the principal amount of the liability component over its initial fair value shall be amortized to interest cost using the effective interest method. The provisions of FSP APB 14-a apply to Sonic's 4.25% Convertible Senior Subordinated Notes. FSP APB 14-a is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods thereafter. Early adoption is not permitted. FSP APB 14-a shall be applied retrospectively to all periods presented. Sonic is currently reviewing the provisions of FSP APB 14-a and has not yet determined the impact of this FSP on its consolidated operating results, financial position and cash flows.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133, and how derivative instruments and related hedged items affect an entity's operating results, financial position and cash flows. SFAS 161 is effective for fiscal years beginning after November 15, 2008. Early adoption is permitted. Sonic is currently reviewing the provisions of SFAS 161 and has not yet adopted the statement. However, as the provisions of SFAS 161 are only related to disclosure of derivative and hedging activities, Sonic does not believe the adoption of SFAS 161 will have a material impact on its consolidated operating results, financial position or cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), Business Combinations (SFAS 141(R)). SFAS 141(R) provides guidance regarding the allocation of purchase price in business combinations, measurement of assets acquired and liabilities assumed as well as other intangible assets acquired. Also in December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 160 provides accounting and reporting standards for a noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary if certain conditions exist. SFAS 141(R) and SFAS 160 are effective for fiscal years beginning on or after December 15, 2008. Early adoption is prohibited. Sonic is currently reviewing the provisions of SFAS 141(R) and SFAS 160 and has not yet determined the impact of these statements on its consolidated operating results, financial position and cash flows.

Sonic adopted the provisions of Statements of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Sonic has elected not to apply the fair value option to any eligible items as defined by SFAS 159.



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

Sonic adopted the provisions of Statement of Financial Accounting Standards No. 157, Fair Value Measures ( SFAS 157 ) as of January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. In February 2008, the FASB issued FASB Staff Position (FSP) Financial Accounting Standard (FAS) 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Its Related Interpretive Accounting Pronouncements That Address Leasing Transactions, and FSP FAS 157-2, Effective Date of FASB Statement No. 157. FSP FAS 157-1 removes leases from the scope of SFAS No. 157, Fair Value Measurements. FSP FAS 157-2 delays the effective date of SFAS No. 157 from 2008 to 2009 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Required disclosures are included in Note 10.

**Operating Lease Accruals** Operating lease accruals relate to facilities Sonic has ceased using in its operations. The accruals represent the present value of the lease payments, net of estimated sublease rentals, 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 operating lease accruals consists of the following:

	(dollars in thousands)	
Balance, December 31, 2007	\$	8,164
Lease exit expense		1,647
Lease exit expense recovery		(221)
Payments		(5,754)
<b>Balance, June 30, 2008</b>	<b>\$</b>	<b>3,836</b>

**2. BUSINESS ACQUISITIONS AND DISPOSITIONS**

**Acquisitions** The aggregate purchase price for franchises acquired during the six month period ended June 30, 2008 totaled approximately \$22.2 million in cash, net of cash acquired. These cash outflows were funded by cash from operations, borrowings under our revolving credit facility and borrowings under our floor plan facilities. The balance sheet as of June 30, 2008 includes preliminary allocations of the purchase price of these acquisitions to the assets and liabilities acquired based on their estimated fair market values at the date of acquisition and are subject to final adjustment. As a result of these allocations, Sonic has recorded the following related to 2008 acquisitions:

\$13.0 million of net assets relating to dealership operations;

\$3.2 million of intangible assets representing rights acquired under franchise agreements, all of which is expected to be tax deductible; and

\$6.0 million of goodwill, all of which is expected to be tax deductible.

**Dispositions** In the six month period ended June 30, 2008, Sonic identified an additional 14 franchises to be held for sale and Sonic decided to retain and operate 4 franchises which were held for sale as of December 31, 2007. These 14 additional franchises have been identified as held for sale because of unprofitable operations or various strategic considerations. All franchises held for sale are expected to be sold within one year from June 30, 2008. The operating results of these franchises are included in the loss from discontinued operations in Sonic's statements of income. Assets to be disposed of in connection with franchises not yet sold have been classified in assets held for sale in Sonic's balance sheets along with other assets held for sale. The major components of assets held for sale consist of the following:

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

	<b>(dollars in thousands)</b>	
	<b>December 31, 2007</b>	<b>June 30, 2008</b>
Inventories	\$ 54,028	\$ 56,701
Property and equipment, net	22,137	20,494
Goodwill	8,777	35,068
Franchise assets	2,400	2,000
Assets held for sale	\$ 87,342	\$ 114,263

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

Liabilities to be disposed in connection with these dispositions are comprised primarily of notes payable floor plan and are classified as liabilities associated with assets held for sale on Sonic's balance sheets. Revenues and other activities associated with franchises classified as discontinued operations were as follows:

	(dollars in thousands)		(dollars in thousands)	
	Quarter Ended June 30,		Six Months Ended June 30,	
	2007	2008	2007	2008
Revenues	\$ 215,539	\$ 101,613	\$ 431,527	\$ 237,697
Franchise agreement and other asset impairments		(4,300)	(1,250)	(4,300)
Lease exit charges	(414)	(756)	(598)	(1,518)
Property impairment charges	(238)	(1,651)	(439)	(2,117)
Favorable lease asset impairment charges				(1,903)
Gain / (Loss) on disposal of franchises	(251)	(3,448)	(251)	(2,944)
Pre-tax losses	(3,532)	(13,319)	(6,781)	(18,836)

Franchise asset and other asset impairment charges recorded relate to revising the estimated fair value of franchises and other assets held for sale. Lease exit charges recorded for the second quarter and six month period ended June 30, 2007 and 2008 relate to the revision of estimates and establishment of lease exit accruals. The lease exit accruals are calculated by discounting the remaining lease payments, net of estimated sublease proceeds. For a discussion of property impairment charges, see footnote 4 and for a discussion of favorable lease asset impairment charges see footnote 5.

Sonic allocates corporate level interest expense to discontinued operations based on the net assets of the discontinued operations group. Interest allocated to discontinued operations for the second quarter ended June 30, 2007 and 2008 was \$0.9 million and \$0.6 million, respectively. Interest allocated to discontinued operations for the six month period ended June 30, 2007 and 2008 was \$1.8 million and \$1.3 million, respectively.

**3. INVENTORIES**

Inventories consist of the following:

	(dollars in thousands)	
	December 31,	June 30,
	2007	2008
New vehicles	\$ 836,252	\$ 932,549
Used vehicles	168,851	141,516
Parts and accessories	61,153	60,310
Other	80,789	78,534
	\$ 1,147,045	\$ 1,212,909
Less inventories classified as assets held for sale	(54,028)	(56,701)
<b>Inventories</b>	<b>\$ 1,093,017</b>	<b>\$ 1,156,208</b>

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****4. PROPERTY AND EQUIPMENT**

Property and equipment consists of the following:

	(dollars in thousands)	
	December 31, 2007	June 30, 2008
Land	\$ 30,644	\$ 67,898
Building and improvements	218,383	296,097
Office equipment and fixtures	66,906	68,959
Parts and service equipment	53,091	54,400
Company vehicles	10,187	10,377
Construction in progress	34,265	30,497
<b>Total, at cost</b>	<b>413,476</b>	<b>528,228</b>
Less accumulated depreciation	(98,327)	(110,893)
<b>Subtotal</b>	<b>315,149</b>	<b>417,335</b>
Less assets held for sale	(22,137)	(20,494)
Less construction in progress and land expected to be sold	(6,421)	
<b>Property and equipment, net</b>	<b>\$ 286,591</b>	<b>\$ 396,841</b>

Construction in progress and land expected to be sold represent dealership facilities that are or were expected to be completed and sold within one year in sale-leaseback transactions. These assets have been classified as other current assets in Sonic's balance sheet. Subsequent to December 31, 2007, Sonic made the decision to retain the construction in progress and land expected to be sold and reclassified the December 31, 2007 balances into land and construction in progress for the second quarter and six month period ended June 30, 2008.

Property and equipment impairment charges of \$1.8 and \$2.4 million were recorded in the second quarter and six month period ended June 30, 2008, respectively. In the quarter ended June 30, 2008, \$1.7 million was included in discontinued operations and \$0.1 million was included within selling, general and administrative expenses in the accompanying Condensed Consolidated Statements of Income. Of the \$2.4 million recorded in the six month period ended June 30, 2008, \$2.1 million was included in discontinued operations and \$0.3 million was included within selling, general and administrative expenses in the accompanying Condensed Consolidated Statements of Income. Property and equipment impairment charges of \$0.2 and \$0.5 million were recorded in the quarter and six month period ended June 30, 2007, respectively. In the quarter ended June 30, 2007, \$0.2 million was included in discontinued operations. Of the \$0.5 million recorded in the six month period ended June 30, 2007, \$0.4 million was included in discontinued operations and \$0.1 million was included within selling, general and administrative expenses in the accompanying Condensed Consolidated Statements of Income. The impairment charges recorded in discontinued operations in all periods were recorded based on the estimated fair value of the property and equipment to be sold in connection with the disposal of associated franchises and recorded values. The impairment charges recorded in continuing operations in all periods were recorded based on Sonic's decision to abandon certain facility construction projects.



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

## 5. GOODWILL AND INTANGIBLE ASSETS

	<b>Franchise Agreements</b>	<b>Goodwill</b>
Balance, December 31, 2007	\$ 89,900	\$ 1,276,074
Additions through current year acquisitions	3,200	5,954
Prior year acquisition allocations		510
Reductions from sales of franchises	(3,700)	(5,885)
Reclassification to assets held for sale, net	400	(26,290)
Balance, June 30, 2008	\$ 89,800	\$ 1,250,363

At December 31, 2007, Sonic had \$21.4 million of definite life intangibles recorded relating to favorable lease agreements. In the six month period ended June 30, 2008, Sonic recorded an impairment charge of \$1.9 million within discontinued operations related to its definite life intangibles. The impairment charge was recorded based on management's estimate that sublease income from certain properties would not allow Sonic to recover the recorded value of favorable lease assets related to the properties. After the effect of the six month period charge and amortization of the definite life intangibles, the balance recorded at June 30, 2008 was \$18.9 million and was included in Other Intangible Assets, net, in the accompanying Condensed Consolidated Balance Sheets.

Pursuant to applicable accounting pronouncements, Sonic tests goodwill for impairment annually or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of goodwill below its carrying amount. If Sonic determines that the amount of recorded goodwill is impaired at any point in time, goodwill will be reduced on the balance sheet. If goodwill is impaired, Sonic will record a significant non-cash impairment charge that would likely have a materially adverse effect on earnings and the consolidated balance sheet for the period in which the impairment of goodwill occurred.

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

## 6. LONG-TERM DEBT

Long-term debt consists of the following:

	(dollars in thousands)	
	December 31, 2007	June 30, 2008
2006 Revolving Credit Sub-Facility(1) collateralized by all assets of Sonic	\$ 70,000	\$ 114,667
Senior Subordinated Notes bearing interest at 8.625% maturing August 15, 2013, net of net discount of \$2,202 and \$2,043, respectively	272,798	272,957
Convertible Senior Subordinated Notes bearing interest at 5.25%, maturing May 7, 2009, net of discount of \$879 and \$564, respectively	129,221	129,536
Convertible Senior Subordinated Notes bearing interest at 4.25%, maturing November 30, 2015, redeemable on or after October 31, 2010, net of discount of \$2,442 and \$2,049, respectively	157,558	157,951
Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19%), with combined monthly principal and interest payments of \$325, maturing November 1, 2015 through September 1, 2016, and collateralized by letters of credit, including premium of \$4,010 and \$3,609, respectively	25,490	24,235
Mortgage notes to finance companies-fixed rate, bearing interest from 6.10% to 7.03% with combined monthly principal and interest payments of \$328, maturing August 2014 through May 2028	28,988	42,326
Mortgage notes to finance companies-variable rate, bearing interest at 1.25 to 2.65 percentage points above one-month LIBOR with combined monthly principal and interest payments currently of \$179, maturing June 2013 through January 2018	17,427	34,106
Fair value of Variable Swaps	724	445
Other	(209)	6,412
	\$ 701,997	\$ 782,635
Less current maturities(2)	(4,197)	(134,983)
Long-term debt	\$ 697,800	\$ 647,652

(1) Interest rate on the revolving credit sub-facility is based on a performance based grid that ranges from 1.75% to 2.75% above LIBOR. The rate at December 31, 2007 was 2.00% above LIBOR and at June 30, 2008 was 2.25% above LIBOR.

(2) Current maturities include Sonic's 5.25% Convertible Senior Subordinated Notes maturing May 7, 2009.

During the second quarter ended June 30, 2008, Sonic exercised an accordion feature related to its four-year syndicated credit facility (the 2006 Credit Facility) increasing the availability of new vehicle floor plan financing from \$700.0 million to \$775.6 million, increasing the availability of used vehicle inventory floor plan financing from \$150.0 million to \$193.9 million, and increasing the availability of revolving credit borrowings (the 2006 Revolving Credit Sub-Facility) from \$350.0 million to \$415.5 million. Availability under the 2006 Revolving Credit Sub-Facility is subject to a borrowing base calculation and is reduced on a dollar for dollar basis by any outstanding letters of credit.

Neither of the conversion features on the 5.25% or 4.25% convertible senior subordinated notes was satisfied during the six months ended June 30, 2008. Sonic was in compliance with all financial covenants under the above long-term debt and credit facilities as of June 30, 2008.

## 7. STOCK-BASED COMPENSATION

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

Sonic currently has two active stock compensation plans, the Sonic Automotive, Inc. 2004 Stock Incentive Plan (the 2004 Plan ) and the 2005 Formula Restricted Stock Plan for Non-Employee Directors (the 2005 Formula Plan ) and three inactive stock compensation plans which only have grants outstanding, the Sonic Automotive, Inc. Formula Stock Option Plan for Independent Directors, the Sonic Automotive, Inc. 1997 Stock Option Plan and the First America Automotive, Inc. 1997 Stock Option Plan (collectively, the Stock Plans ). See Sonic s Annual Report on Form 10-K for the year ended December 31, 2007 for a more detailed description of the Stock Plans.

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

A summary of the status of the options related to the Stock Plans is presented below:

	Options Outstanding (in thousands)	Exercise Price Per Share	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance - December 31, 2007	3,938	\$ 7.80 - \$37.50	\$ 21.05	5.3	\$ 9,707
Exercised	(432)	\$ 9.19 - \$19.23	11.92		
Forfeited	(74)	\$ 7.94 - \$37.50	28.07		
Balance - June 30, 2008	3,432	\$ 7.80 - \$37.50	\$ 22.05	5.2	\$ 1,305
Exercisable	3,301	\$ 7.80 - \$37.50	\$ 21.87	5.0	\$ 1,305

(amounts in thousands, except per option data)

	Six Months Ended June 30, 2008
Intrinsic Value of Options Exercised	\$ 3,146
Fair Value of Shares Vested	5,385

Sonic recognized compensation expense related to previously issued stock options within selling, general and administrative expenses of \$1.5 million and \$0.4 million in the second quarter ended June 30, 2007 and 2008, respectively. Sonic recognized stock option expense of \$2.6 million and \$1.8 million in the six month period ended June 30, 2007 and 2008, respectively. Tax benefits recognized related to the compensation expenses were \$0.6 million and \$0.1 million for the second quarter ended June 30, 2007 and 2008, respectively. Tax benefits recognized related to the compensation expenses were \$1.0 million and \$0.7 million for the six month period ended June 30, 2007 and 2008, respectively. The total compensation cost related to unvested options not yet recognized at June 30, 2008 was \$0.7 million and is expected to be recognized over a weighted average period of 1.5 years. Sonic received \$5.1 million in cash from the exercise of stock options during the six month period ended June 30, 2008, and recognized a tax benefit of \$1.2 million associated with these option exercises.

A summary of the status of restricted stock and restricted stock unit grants related to the Stock Plans is presented below:

	Unvested Restricted Stock and Restricted Stock Units (in thousands)	Weighted Average Grant Date Fair Value
Balance - December 31, 2007	411	\$ 23.76
Granted	311	23.50
Forfeited	(14)	14.91
Vested	(17)	29.14
Balance - June 30, 2008	691	\$ 23.62

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

In the first half of 2008, 310,841 restricted shares of Class A common stock and restricted stock units were awarded to Sonic's Board of Directors, executive officers and certain other employees under the 2004 Plan and the 2005 Formula Plan. Awards to the Board of Directors cliff-vest one year from the date of grant and all other awards made during the six month period ended June 30, 2008 cliff-vest three years from the date of grant. The shares and units granted in conjunction with 2008 incentive compensation for executive officers and certain other employees are subject to forfeiture, in whole or in part,

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

based upon specified measures of Sonic's earnings per share performance for the 2008 fiscal year, continuation of employment and compliance with any restrictive covenants contained in any agreement between Sonic and the respective employee. These awards are generally subject to the same restrictions and rights as the awards granted in prior years to certain executive officers. Sonic recognized expense of \$1.2 million and \$1.3 million in the second quarter ended June 30, 2007 and 2008, respectively. Sonic recognized expense of \$0.4 million and \$2.4 million in the six month period ended June 30, 2007 and 2008, respectively. Sonic recognized \$0.5 million and \$0.5 million of tax benefit related to the compensation expenses for the second quarter ended June 30, 2007 and 2008, respectively. Sonic recognized \$0.1 million and \$0.9 million of tax benefit for the six month period ended June 30, 2007 and 2008, respectively. Total compensation cost related to unvested restricted stock not yet recognized at June 30, 2008 was \$10.8 million, and is expected to be recognized over a weighted average period of 2.2 years.

**8. PER SHARE DATA AND STOCKHOLDERS' EQUITY**

The calculation of diluted earnings per share considers the potential dilutive effect of Sonic's contingently convertible debt issuances and stock options to purchase shares of Class A common stock under the Stock Plans. The following table illustrates the dilutive effect of such items:

	For the Second Quarter Ended June 30, 2007						
	Shares	Income		Loss		Net Income	
		From Continuing Operations		From Discontinued Operations		Per Share	
		Amount	Per Share	Amount	Per Share	Amount	Per Share
	(amounts in thousands except per share amounts)						
Basic Earnings Per Share	42,902	\$ 28,840	\$ 0.67	\$(2,472)	\$ (0.06)	\$ 26,368	\$ 0.61
Effect of Dilutive Securities:							
Contingently Convertible Debt (2002 Convertibles)	2,776	1,042		85		1,127	
Contingently Convertible Debt (2005 Convertibles)	1,227						
Stock Plans	1,082						
Diluted Earnings (Loss) Per Share	47,987	\$ 29,882	\$ 0.62	\$(2,387)	\$ (0.05)	\$ 27,495	\$ 0.57

	For the Second Quarter Ended June 30, 2008						
	Shares	Income		Loss		Net Income	
		From Continuing Operations		From Discontinued Operations		Per Share	
		Amount	Per Share	Amount	Per Share	Amount	Per Share
	(amounts in thousands except per share amounts)						
Basic Earnings Per Share	40,432	\$ 20,133	\$ 0.50	\$(9,322)	\$ (0.23)	\$ 10,811	\$ 0.27
Effect of Dilutive Securities:							
Contingently Convertible Debt (2002 Convertibles)	2,776	936		32		968	
Stock Plans	213						
Diluted Earnings (Loss) Per Share	43,421	\$ 21,069	\$ 0.49	\$(9,290)	\$ (0.22)	\$ 11,779	\$ 0.27



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

	For Six Months Ended June 30, 2007						
	Shares	Income		Loss		Net Income	
		From Continuing Operations		From Discontinued Operations		Per Share	
		Amount	Per Share	Amount	Per Share	Amount	Per Share
(amounts in thousands except per share amounts)							
Basic Earnings Per Share	42,886	\$ 51,105	\$ 1.19	\$ (4,746)	\$ (0.11)	\$ 46,359	\$ 1.08
Effect of Dilutive Securities:							
Contingently Convertible Debt (2002 Convertibles)	2,776	2,078		167		2,245	
Contingently Convertible Debt (2005 Convertibles)	1,267						
Stock Plans	1,034						
Diluted Earnings (Loss) Per Share	47,963	\$ 53,183	\$ 1.11	\$ (4,579)	\$ (0.10)	\$ 48,604	\$ 1.01

	For Six Months Ended June 30, 2008						
	Shares	Income		Loss		Net Income	
		From Continuing Operations		From Discontinued Operations		Per Share	
		Amount	Per Share	Amount	Per Share	Amount	Per Share
(amounts in thousands except per share amounts)							
Basic Earnings Per Share	40,603	\$ 38,204	\$ 0.94	\$ (13,185)	\$ (0.32)	\$ 25,019	\$ 0.62
Effect of Dilutive Securities:							
Contingently Convertible Debt (2002 Convertibles)	2,776	2,014		90		2,104	
Stock Plans	254						
Diluted Earnings (Loss) Per Share	43,633	\$ 40,218	\$ 0.92	\$ (13,095)	\$ (0.30)	\$ 27,123	\$ 0.62

In addition to the stock options included in the table above, options to purchase 0.8 million shares and 2.3 million shares of Class A common stock were outstanding at June 30, 2007 and 2008, respectively, but were not included in the computation of diluted earnings per share because the options were antidilutive.

## 9. CONTINGENCIES

**Legal Proceedings:**

Sonic is a defendant in the matter of Galura, et al. v. Sonic Automotive, Inc., a private civil action filed in the Circuit Court of Hillsborough County, Florida. In this action, originally filed on December 30, 2002, the plaintiffs allege that Sonic and Sonic's Florida dealerships sold an anti-theft protection product in a deceptive or otherwise illegal manner, and further sought representation on behalf of any customer of any of Sonic's Florida dealerships who purchased the anti-theft protection product since December 30, 1998. The plaintiffs are seeking monetary damages and injunctive relief on behalf of this class of customers. In June 2005, the court granted the plaintiffs' motion for certification of the requested class of customers, but the court has made no finding to date regarding actual liability in this lawsuit. Sonic subsequently filed a notice of appeal of the court's class certification ruling with the Florida Court of Appeals. In April 2007, the Florida Court of Appeals affirmed a portion of the trial court's class certification, and overruled a portion of the trial court's class certification. Sonic intends to continue its vigorous appeal and defense of this lawsuit and to assert available defenses. However, an adverse resolution of this lawsuit could result in the payment of significant costs and damages, which could have a material adverse effect on Sonic's future results of operations, financial condition and cash flows. Currently, Sonic is unable to estimate a range of potential loss related to this matter.





**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Sonic is involved, and expects to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of Sonic's 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 December 31, 2007 and June 30, 2008 were \$1.9 million and \$1.8 million, respectively, in reserves that Sonic has provided for pending proceedings.

**Guarantees and Indemnifications:**

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 franchise dispositions, certain of Sonic's dealership subsidiaries have assigned or sublet to the buyer their 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 sublessee does not perform. There are situations where Sonic has assigned a lease to the buyer and Sonic was not able to obtain a release from the landlord. In these situations, although Sonic is no longer the primary obligor, Sonic is contingently liable if the buyer does not perform under the lease terms. The total estimated minimum lease payments remaining related to these leases totaled \$1.6 million at June 30, 2008. However, in accordance with the terms of the assignment and sublease agreements, the assignees and sublessees have generally agreed to indemnify Sonic and its subsidiaries in the event of non-performance. Additionally, in connection with certain dispositions, Sonic has obtained indemnifications and / or guarantees from the parent company, affiliates and / or owners of these assignees and sublessees in the event of non-performance.

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 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 estimates that the maximum exposure associated with these general indemnifications if the counterparties failed to perform under their contractual obligations was approximately \$14.8 million and \$19.8 million at December 31, 2007 and June 30, 2008, respectively. These indemnifications generally expire within a period of one to three years following the date of sale. The estimated fair value of these indemnifications was not material.

**10. FAIR VALUE MEASUREMENTS**

In determining fair value, Sonic uses various valuation approaches including market, income and/or cost approaches. SFAS 157 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 fair value and cash flow swap instruments.

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

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

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

fair value of non-financial assets and non-financial liabilities in purchase acquisitions, those used in assessing impairment under Financial Accounting Standards No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* and those used in the reporting unit valuation in the first step of 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 instruments 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 1 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.

Assets or liabilities recorded at fair value in the accompanying balance sheet as of June 30, 2008 are as follows:

	(amounts in millions)	Fair Value at Reporting Date Using:		
		Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Trading Securities (1)		\$ 8.1	\$ 8.1	\$
Fair Value Swaps (2)		0.2		0.2
Cash Flow Swaps (3)		(24.0)		(24.0)
Total		\$ (15.7)	\$ 8.1	\$ (23.8)

(1) - Included within other current assets in the accompanying balance sheet

(2) - Included within other assets in the accompanying balance sheet

(3) - Included net of taxes of \$9.1 million in accumulated other comprehensive income in the accompanying balance sheet

During the second quarter and six month period ended June 30, 2008, Sonic recorded an unrealized loss related to trading securities in the amount of \$1.3 million. The loss is included within selling, general and administrative expenses in the accompanying Condensed Consolidated Statements of Income.

Furthermore, during the quarter ended June 30, 2008, Sonic settled four of its fair value swaps with notional values totaling \$125.0 million. The swaps were settled with a net settlement payment to Sonic of \$0.4 million. This settlement gain was deferred and will be amortized over the remaining term of the initial swaps underlying, Sonic's 8.625% Senior Subordinated Notes maturing August 15, 2013.



**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, 2007.

**Overview**

We are one of the largest automotive retailers in the United States. As of June 30, 2008, we operated 166 dealership franchises, representing 33 different brands of cars and light trucks, at 139 locations and 31 collision repair centers in 15 states. Our dealerships provide comprehensive services including sales of both new and used cars and light trucks, sales of replacement parts, performance of vehicle maintenance, manufacturer warranty repairs, paint and collision repair services, and arrangement of extended service contracts, financing, insurance and other aftermarket products for our customers. Although vehicle sales are cyclical and are affected by many factors, including general economic conditions, consumer confidence, levels of discretionary personal income, interest rates and available credit, our parts service and collision repair services are not closely tied to vehicle sales and are not as dependent upon near-term sales volume. As a result, we believe the diversity of these products and services reduces the risk of periodic economic downturns.

**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 period ended June 30, 2007 and 2008:

Brand (1)	Percentage of New Vehicle Revenue Quarter Ended June 30,		Percentage of New Vehicle Revenue Six Months Ended June 30,	
	2007	2008	2007	2008
BMW	15.6%	17.9%	15.4%	17.1%
Honda	14.9%	16.0%	15.1%	15.1%
Toyota	12.0%	11.0%	11.5%	11.2%
Mercedes	9.0%	10.5%	9.6%	10.5%
Ford	8.3%	8.7%	8.0%	9.1%
General Motors (2)	8.8%	7.4%	8.6%	7.7%
Cadillac	8.0%	6.2%	8.3%	6.9%
Lexus	6.9%	5.4%	7.0%	5.7%
Audi	1.6%	2.0%	1.6%	1.9%
Volkswagen	1.4%	1.7%	1.3%	1.6%
Porsche	1.5%	1.4%	1.4%	1.4%
Volvo	1.7%	1.0%	1.8%	1.3%
Land Rover	1.5%	1.2%	1.5%	1.3%
Hyundai	1.6%	1.4%	1.5%	1.3%
Infiniti	1.1%	1.0%	1.3%	1.1%
Nissan	1.3%	1.0%	1.4%	1.1%
Acura	1.2%	1.0%	1.3%	1.1%
Chrysler (3)	0.4%	0.5%	0.4%	0.5%
Other Luxury (4)	1.1%	1.2%	1.2%	1.2%
Other (5)	2.1%	3.5%	1.8%	2.9%
Total	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

- (1) In accordance with the provisions of SFAS No. 144, prior years' income statement data reflect reclassifications to exclude franchises sold, identified for sale, or terminated subsequent to June 30, 2007 which had not been previously included in discontinued operations. See Notes 1 and 2 to our accompanying unaudited Consolidated Financial Statements which discusses these and other factors that affect the comparability of the information for the periods presented.
- (2) Includes Buick, Chevrolet, GMC, Pontiac and Saturn
- (3) Includes Chrysler, Dodge and Jeep
- (4) Includes Hummer, Jaguar, and Saab
- (5) Includes Isuzu, KIA, Mini, Scion and Subaru

**Results of Operations**

Except where otherwise noted, the following discussions are on a same store basis.





**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

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

**Revenues***New Vehicles:*

	Quarter Ended		Units or \$ Change	%	Six Months Ended		Units or \$ Change	%
	6/30/2007	6/30/2008			6/30/2007	6/30/2008		
<b>Total New Vehicle Units</b>								
Same Store	38,365	34,884	(3,481)	(9.1)%	72,247	66,638	(5,609)	(7.8)%
Acquisitions and Other	92	1,861	1,769	1922.8%	187	3,303	3,116	1666.3%
<b>Total as Reported</b>	<b>38,457</b>	<b>36,745</b>	<b>(1,712)</b>	<b>(4.5)%</b>	<b>72,434</b>	<b>69,941</b>	<b>(2,493)</b>	<b>(3.4)%</b>
<b>Total New Vehicle Revenues (in thousands)</b>								
Same Store	\$ 1,225,397	\$ 1,081,784	\$ (143,613)	(11.7)%	\$ 2,336,485	\$ 2,100,433	\$ (236,052)	(10.1)%
Acquisitions and Other	3,968	88,195	84,227	2122.7%	9,855	156,865	147,010	1491.7%
<b>Total as Reported</b>	<b>\$ 1,229,365</b>	<b>\$ 1,169,979</b>	<b>\$ (59,386)</b>	<b>(4.8)%</b>	<b>\$ 2,346,340</b>	<b>\$ 2,257,298</b>	<b>\$ (89,042)</b>	<b>(3.8)%</b>
<b>Total New Vehicle Unit Price</b>								
Same Store	\$ 31,940	\$ 31,011	\$ (929)	(2.9)%	\$ 32,340	\$ 31,520	\$ (820)	(2.5)%
<b>Total Dealerships as Reported</b>	<b>\$ 31,967</b>	<b>\$ 31,840</b>	<b>\$ (127)</b>	<b>(0.4)%</b>	<b>\$ 32,393</b>	<b>\$ 32,274</b>	<b>\$ (119)</b>	<b>(0.4)%</b>

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.

<b>SAAR (in millions of vehicles)</b>	<b>2007</b>	<b>2008</b>	<b>% Change</b>
Second Quarter Ended June 30	16.1	14.1	(12.4)%
Six Months Ended June 30	16.3	14.7	(9.8)%

Our overall same store unit retail declines tracked closely to the industry declines. We anticipate the second half of 2008 to be consistent with the new vehicle unit volumes experienced in the first half of 2008.

New unit sales at our import dealerships decreased 6.8% and 8.1%, for the second quarter and six month period ended June 30, 2008, respectively, as compared to the same periods last year. Our import stores underperformed the import brand market, which declined only 1.7% and 3.0% for the second quarter and six month period ended June 30, 2008. The declines in import new vehicle unit sales were led by our Lexus and Mercedes brands, which posted declines of 24.6% and 16.3% for the second quarter ended June 30, 2008 and declines of 21.0% and 17.3% for the six month period ended June 30, 2008.

Domestic dealerships posted unit volume decreases of 14.6% and 6.8% for the second quarter and six month period ended June 30, 2008, outperformed the industry's domestic brand new unit sales decreases of 22.0% and 17.1% for the second quarter and six month period ended June 30, 2008, respectively. All of our domestic brands experienced declines in new vehicle unit sales volume for both the second quarter and six month period ended June 30, 2008 with the exception of Ford. Our Ford stores experienced a decrease of 3.5% and an increase of 6.7% for the second quarter and six month period ended June 30, 2008, respectively. Our Ford stores outperformed the Ford brand market mainly due to fleet sales, which increased 8.3% and 20.5% for the second quarter and six month period ended June 30, 2008, respectively.

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

Our import dealerships' average price per new unit decreased \$1,248, or 3.8%, and \$906, or 2.7%, for the second quarter and six month period ended June 30, 2008. Our import stores' new vehicle price per unit decreased primarily due to a change in sales mix to lower value, more gas efficient vehicles. Our BMW and Mercedes dealerships experienced the most significant declines in the average price per unit.

Our domestic dealerships' average price per new unit decreased \$317, or 1.1%, and \$581, or 1.9%, for the second quarter and six month period ended June 30, 2008, respectively. Fleet unit prices at our domestic stores improved over both periods when compared to the same periods in 2007. Excluding fleet sales, our domestic stores' average price per unit decreased \$1,769, or 5.2%, and \$890, or 2.6%, for the second quarter and six month period ended June 30, 2008, respectively. The decrease in average price per unit at our domestic stores can be attributed to a shift from truck and sports utility vehicle sales to car sales during 2008.

We believe customers will continue to migrate to smaller, more fuel efficient vehicles from larger trucks and sport utility vehicles. We expect the average sales price of our vehicles to fall due to this trend.

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

	Quarter Ended		Units or \$ Change	%	Six Months Ended		Units or \$ Change	%
	6/30/2007	6/30/2008			6/30/2007	6/30/2008		
<b>Total Used Vehicle Units</b>								
Same Store	17,428	18,171	743	4.3%	33,603	35,921	2,318	6.9%
Acquisitions and Other	15	700	685	4566.7%	99	1,345	1,246	1258.6%
<b>Total as Reported</b>	<b>17,443</b>	<b>18,871</b>	<b>1,428</b>	<b>8.2%</b>	<b>33,702</b>	<b>37,266</b>	<b>3,564</b>	<b>10.6%</b>
<b>Total Used Vehicle Revenues (in thousands)</b>								
Same Store	\$ 350,830	\$ 360,448	\$ 9,618	2.7%	\$ 667,404	\$ 711,510	\$ 44,106	6.6%
Acquisitions and Other	503	19,074	18,571	3692.0%	3,186	37,800	34,614	1086.4%
<b>Total as Reported</b>	<b>\$ 351,333</b>	<b>\$ 379,522</b>	<b>\$ 28,189</b>	<b>8.0%</b>	<b>\$ 670,590</b>	<b>\$ 749,310</b>	<b>\$ 78,720</b>	<b>11.7%</b>
<b>Total Used Vehicle Unit Price</b>								
Same Store	\$ 20,130	\$ 19,836	\$ (294)	(1.5)%	\$ 19,861	\$ 19,808	\$ (53)	(0.3)%
<b>Total Dealerships as Reported</b>	<b>\$ 20,142</b>	<b>\$ 20,111</b>	<b>\$ (31)</b>	<b>(0.2)%</b>	<b>\$ 19,898</b>	<b>\$ 20,107</b>	<b>\$ 209</b>	<b>1.1%</b>

Increases in used vehicle unit sales are primarily attributable to the recently implemented standardized used vehicle merchandising process at our dealerships. The process allowed us to retail many used vehicles we historically would have disposed of through the wholesale market. In addition, during the second quarter and six month period ended June 30, 2008, we continued the implementation of the second generation of our standardized used vehicle merchandising process. The second generation process includes enhanced visibility to vehicle market pricing and other inventory data, allowing us to price our used vehicles more competitively and physically move certain used vehicles to specific dealerships within a particular region that have shown success in retailing the specific type of used vehicle. Our used vehicle unit volume increases were driven primarily by our luxury stores, which posted increases of 7.3% and 11.1%, compared to the second quarter and six month period ended June 30, 2007, respectively. We continue to see improvements in our certified pre-owned (CPO) unit volume. On a same store basis, CPO units sold increased 23.9% for the second quarter ended June 30, 2008 and 22.3% for the six month period ended June 30, 2008 compared to the comparable period in the prior year.

*Wholesale Vehicles:*

	Quarter Ended		Units or \$ Change	%	Six Months Ended		Units or \$ Change	%
	6/30/2007	6/30/2008			6/30/2007	6/30/2008		
<b>Total Wholesale Vehicle Units</b>								
Same Store	10,808	10,258	(550)	(5.1)%	22,585	20,247	(2,338)	(10.4)%
Acquisitions and Other	6	247	241	4016.7%	54	567	513	950.0%
<b>Total as Reported</b>	<b>10,814</b>	<b>10,505</b>	<b>(309)</b>	<b>(2.9)%</b>	<b>22,639</b>	<b>20,814</b>	<b>(1,825)</b>	<b>(8.1)%</b>

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

Total Wholesale Vehicle Revenues (in thousands)								
Same Store	\$ 98,158	\$ 79,660	\$ (18,498)	(18.8)%	\$ 202,812	\$ 159,801	\$ (43,011)	(21.2)%
Acquisitions and Other	102	2,807	2,705	2652.0%	1,160	7,001	5,841	503.5%
Total as Reported	\$ 98,260	\$ 82,467	\$ (15,793)	(16.1)%	\$ 203,972	\$ 166,802	\$ (37,170)	(18.2)%

Total Wholesale Unit Price								
Same Store	\$ 9,082	\$ 7,766	\$ (1,316)	(14.5)%	\$ 8,980	\$ 7,893	\$ (1,087)	(12.1)%
Total Dealerships as Reported	\$ 9,086	\$ 7,850	\$ (1,236)	(13.6)%	\$ 9,010	\$ 8,014	\$ (996)	(11.1)%

Lower wholesale vehicle revenues during the second quarter and six month period ended June 30, 2008 resulted from a decline in wholesale unit sales coupled with a decrease in average wholesale price per unit. The decrease in unit volume can be primarily attributed to our increased focus on retail used vehicles (see Used Vehicles above).

**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 ):*

	Quarter Ended		\$ Change	% Change	Six Months Ended		\$ Change	% Change
	6/30/2007	6/30/2008			6/30/2007	6/30/2008		
Total Fixed Operations (in thousands)								
Same Store	\$ 282,118	\$ 279,897	\$ (2,221)	(0.8)%	\$ 558,408	\$ 558,104	\$ (304)	(0.1)%
Acquisitions and Other	1,360	14,711	13,351	981.7%	3,198	29,477	26,279	821.7%
Total as Reported	\$ 283,478	\$ 294,608	\$ 11,130	3.9%	\$ 561,606	\$ 587,581	\$ 25,975	4.6%

	Quarter Ended		\$ Change	% Change	Six Months Ended		\$ Change	% Change
	6/30/2007	6/30/2008			6/30/2007	6/30/2008		
Total Same Store Fixed Operations (in thousands)								
Parts	\$ 148,819	\$ 148,737	\$ (82)	(0.1)%	\$ 295,458	\$ 297,195	\$ 1,737	0.6%
Service	118,034	115,616	(2,418)	(2.0)%	232,563	\$ 229,516	(3,047)	(1.3)%
Collision repair	15,265	15,544	279	1.8%	30,387	\$ 31,393	1,006	3.3%
	\$ 282,118	\$ 279,897	\$ (2,221)	(0.8)%	\$ 558,408	\$ 558,104	\$ (304)	(0.1)%

For the second quarter ended June 30, 2008, customer pay revenue was relatively flat, but for the six month period ended June 30, 2008, customer pay increased \$1.2 million, or 0.5%. Our luxury and import stores showed an increase in customer pay, with our Toyota stores showing a significant revenue increase of \$1.3 million, or 7.1%, for the six month period ended June 30, 2008. Warranty revenue decreased \$2.0 million, or 4.0%, and \$2.6 million, or 2.6%, for the second quarter and six month period ended June 30, 2008, respectively, when compared to the same periods in the prior year. Our Mercedes dealerships experienced significant decreases in warranty revenue, decreasing by \$1.4 million, or 19.4%, and \$3.7 million, or 22.6% for the second quarter and six month period ended June 30, 2008, compared to the same period last year. Our domestic stores posted an increase in warranty revenue, with an increase in revenue of \$0.3 million, or 2.8%, and \$1.6 million, or 7.7%, for the second quarter and six month period ended June 30, 2008, when compared to the same period in the prior year.

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

	Quarter Ended		\$ Change	% Change	Six Months Ended		\$ Change	% Change
	6/30/2007	6/30/2008			6/30/2007	6/30/2008		
Total Finance, Insurance and Other Revenue (in thousands)								
Same Store	\$ 51,287	\$ 50,229	\$ (1,058)	(2.1)%	\$ 96,889	\$ 98,229	\$ 1,340	1.4%
Acquisitions and Other	1,065	2,714	1,649	154.8%	2,240	5,407	3,167	141.4%
Total as Reported	\$ 52,352	\$ 52,943	\$ 591	1.1%	\$ 99,129	\$ 103,636	\$ 4,507	4.5%
Total F&I per Unit (excluding fleet)								

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

Same Store	\$ 1,003	\$ 1,030	\$ 27	2.7%	\$ 994	\$ 1,045	\$ 51	5.1%
Total Dealerships as Reported	\$ 1,022	\$ 1,037	\$ 15	1.5%	\$ 1,014	\$ 1,054	\$ 40	3.9%

F&I revenue decreased in the second quarter ended June 30, 2008 primarily due to a 4.6% decrease in total retail (excluding fleet) unit sales. Despite the unit decrease, F&I revenue per unit increased 2.7% during the second quarter of 2008. The increase in F&I revenue per unit during the second quarter is primarily attributed to an increase in revenue per maintenance contract of 13.7% compared to the same prior year period. An increase in F&I revenue for the six month period ended June 30, 2008 primarily resulted from an increase in used units retailed of 6.9% coupled with an increase in F&I revenue per unit of 5.1%.

### *Gross Profit and Gross Margins*

	Quarter Ended		\$ Change	% Change	Six Months Ended		\$ Change	% Change
	6/30/2007	6/30/2008			6/30/2007	6/30/2008		
Total Gross Profit (in thousands)								
Same Store	\$ 311,770	\$ 294,241	\$ (17,529)	(5.6)%	\$ 605,417	\$ 580,371	\$ (25,046)	(4.1)%
Acquisitions and Other	1,927	16,514	14,587	757.0%	3,947	33,141	29,194	739.7%
Total as Reported	\$ 313,697	\$ 310,755	\$ (2,942)	(0.9)%	\$ 609,364	\$ 613,512	\$ 4,148	0.7%

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

Decreases in same store gross profit for the second quarter and six month period ended June 30, 2008 compared to the same periods in the prior year were primarily due to lower new vehicle unit volume, which declined 9.1% and 7.8%, respectively. Despite an increase in used vehicle unit volume of 4.3% and 6.9% for the second quarter and six month period ended June 30 2008, respectively, gross profit from used vehicles declined 6.4% and 2.8% for the same periods due to economic softness and a shift toward smaller more fuel efficient vehicles. Gross profit from Fixed Operations and F&I activities remained relatively flat compared to the same prior year periods.

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

Our overall same store gross margin percentage increased slightly for the second quarter and six month period ended June 30, 2008, as compared to the same period last year. The increase of 40 basis points and 30 basis points, respectively, is largely attributed to a higher percentage of our revenues being generated by higher margin revenue categories such as Fixed Operations and F&I.

Quarter Ended				Six Months Ended							
6/30/2007		6/30/2008		Basis Point Change		6/30/2007		6/30/2008		Basis Point Change	
Revenues as a Percentage of Total Revenues	Gross Profit as a Percentage of Total Gross Profit	Revenues as a Percentage of Total Revenues	Gross Profit as a Percentage of Total Gross Profit	Revenues as a Percentage of Total Revenues	Gross Profit as a Percentage of Total Gross Profit	Revenues as a Percentage of Total Revenues	Gross Profit as a Percentage of Total Gross Profit	Revenues as a Percentage of Total Revenues	Gross Profit as a Percentage of Total Gross Profit	Revenues as a Percentage of Total Revenues	Gross Profit as a Percentage of Total Gross Profit
61.0%	27.4%	58.4%	25.4%	(260)	(200)	60.5%	27.2%	57.9%	24.9%	(260)	(200)
17.5%	10.6%	19.5%	10.5%	200	(10)	17.3%	10.5%	19.6%	10.7%	230	(10)
4.9%	(0.4)%	4.3%	(0.6)%	(60)	(20)	5.2%	(0.2)%	4.4%	(0.5)%	(80)	(20)
14.1%	45.9%	15.1%	47.6%	100	170	14.5%	46.5%	15.4%	48.0%	90	100
2.5%	16.5%	2.7%	17.1%	20	60	2.5%	16.0%	2.7%	16.9%	20	60
100.0%	100.0%	100.0%	100.0%			100.0%	100.0%	100.0%	100.0%		

The same store gross margin rates on our various revenue lines were as follows:

	Quarter Ended		Basis Point Change	Six Months Ended		Basis Point Change
	6/30/2007	6/30/2008		6/30/2007	6/30/2008	
New vehicles	7.0%	6.9%	(10)	7.0%	6.9%	(10)
Used vehicles	9.4%	8.6%	(80)	9.6%	8.7%	(90)
Wholesale vehicles	(1.3)%	(2.3)%	(100)	(0.6)%	(1.8)%	(120)
Parts, service and collision repair	50.8%	50.0%	(80)	50.4%	49.9%	(50)
Finance and insurance	100.0%	100.0%		100.0%	100.0%	
Total same store gross margin	15.5%	15.9%	40	15.7%	16.0%	30

Gross margin rates for used vehicles declined in both the second quarter and six month period ended June 30, 2008 compared to the prior year periods primarily due to a shift in demand to more Certified Pre-Owned vehicles and smaller cars, which typically generate lower margin rates. Gross margin rates for parts, service and collision repair in both the second quarter and six month period ended June 30, 2008 declined over the comparative prior year periods primarily due to a higher proportion of the sales being comprised of lower margin activities such as standard oil changes and tire sales and a proportionately lower amount of sales being comprised of higher margin business such as significant repair and maintenance work. We believe customers are choosing to forgo or delay significant repair and maintenance work due to the current economic environment.

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



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

For the second quarter and six month period ended June 30, 2008, continuing operations SG&A expenses increased \$9.7 million, or 4.2%, and \$20.3 million, or 4.4%, respectively, as compared to the second quarter and six month period ended June 30, 2007. Total SG&A expenses as a percentage of gross profit were 77.9% and 78.5% for the second quarter and six month period ended June 30, 2008, respectively, compared to 74.1% and 75.7% for the second quarter and six month period ended June 30, 2007, respectively. These increases are primarily related to employee compensation expenses, training costs, and fuel-related expenses.

In the second quarter and six month period ended June 30, 2008, total reported employee compensation expense increased by \$1.9 million, or 1.4%, and \$7.7 million, or 2.9%, respectively, as compared to the second quarter and six month period ended June 30, 2007. The increase in the six month period comparison is partly due to a \$1.5 million benefit recorded in the prior year period related to restricted stock forfeitures. Advertising expense increased \$1.2 million, or 7.4%, and \$2.4 million, or 7.7%, during the second quarter and six month period ended June 30, 2008, respectively, as compared to the second quarter and six month period ended June 30, 2007. Advertising costs are unfavorable versus prior year mainly due to

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

higher internet advertising expenses. Rent and rent related expenses decreased during the second quarter and six month period ended June 30, 2008 by \$2.5 million, or 7.1%, and \$2.6 million, or 3.5% compared to the second quarter and six month period ended June 30, 2007. Other SG&A expenses increased \$9.2 million, or 20.1%, and \$12.8 million, or 13.7%, as compared to the second quarter and six month period ended June 30, 2007, respectively. These increases are primarily related to increases in fuel-related expenses, service loaner and outside services expense. In addition, hail damage incurred at several of our stores in the mid-west during the second quarter ended June 30, 2008 resulted in a charge of approximately \$2.1 million.

***Depreciation and Amortization***

Reported depreciation and amortization expense increased \$0.6 million, or 6.6%, and \$2.9 million, or 21.1%, respectively in the second quarter and six month period ended June 30, 2008 as compared to the same periods last year. This increase was due to capital improvements and our strategic shift to continue to own and hold more dealership properties rather than finance our investment in these properties through sale-leaseback transactions.

***Interest Expense, Floor Plan***

Interest expense, floor plan for new vehicles decreased \$4.6 million, or 30.6%, and \$7.0 million, or 23.8%, respectively in the second quarter and six month period ended June 30, 2008 as compared to the second quarter and six month period ended June 30, 2007. The weighted average new vehicle floor plan interest rate incurred by continuing dealerships was 4.0% and 4.4% for the second quarter and six month period ended June 30, 2008, compared to 6.3% and 6.2% for the second quarter and six month period ended June 30, 2007, which decreased interest expense by approximately \$5.6 million and \$8.3 million for the second quarter and six month period ended June 30, 2008. The average new vehicle floor plan notes payable balance from continuing dealerships increased \$100.6 million and \$60.3 million compared to the second quarter and six month period ended June 30, 2007 resulting in an increase in new vehicle floor plan interest expense of approximately \$1.0 million and \$1.3 million for the second quarter and six month period ended June 30, 2008.

Interest expense, floor plan for used vehicles decreased \$0.5 million, or 34.4%, and \$0.6 million, or 21.2%, in the second quarter and six month period ended June 30, 2008 compared to the second quarter and six month period ended June 30, 2007. Before considering used floor plan interest expense allocated to discontinued operations for the second quarter and six month period ended June 30, 2008 of \$0.5 million and \$1.1 million, respectively, and for the second quarter and six month period ended June 30, 2007 of \$0.7 million and \$1.4 million, respectively, the weighted average used vehicle floor plan interest rate incurred by both continuing and discontinued operations was 3.9% and 4.5% for the second quarter and six month period ended June 30, 2008, compared to 6.4% and 6.5% for the second quarter and six month period ended June 30, 2007, which decreased interest expense by approximately \$0.6 million and \$1.0 million for the second quarter and six month period ended June 30, 2008. The average used vehicle floor plan notes payable balance from continuing and discontinued dealerships increased to \$106.5 million and \$108.4 million during the second quarter and six month period ended June 30, 2008, from \$103.1 million and \$99.0 during the second quarter and six month period ended June 30, 2007, resulting in an increase in used vehicle floor plan interest expense of approximately \$0.2 million for the six month period ended June 30, 2008.

Our floor plan interest expenses related to new vehicles are partially offset by amounts received from manufacturers in the form of floor plan assistance. These payments are credited against our cost of sales upon the sale of the vehicle. For franchises classified as continuing operations, our floor plan interest expense exceeded the amounts we recognized in our Consolidated Income Statements from floor plan assistance by approximately \$3.8 million and \$9.4 million for the second quarter and six month period ended June 30, 2008, respectively, and \$7.9 million and \$15.3 million for the second quarter and six month period ended June 30, 2007, respectively.

***Interest Expense, Other***

Interest expense, other, for the second quarter and six month period ended June 30, 2008 compared to the second quarter and six month period ended June 30, 2007 is summarized in the table below:



**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

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

(in millions)	Increase/(Decrease) in Interest Expense, Other	
	Second Quarter Ended June 30, 2008	Six Month Period Ended June 30, 2008
Debt balances		
Increase in debt balances	2.4	4.4
Other factors		
Decrease in capitalized interest	0.4	0.6
Incremental interest expense related to variable to fixed rate swaps	3.2	4.3
Incremental interest savings related to fixed to variable rate swaps	(0.8)	(1.4)
Lower interest allocation to discontinued operations	0.2	0.3
Other	0.5	1.0
	\$ 5.9	\$ 9.2

**Income Taxes**

The overall effective tax rates from continuing operations were 40.0% and 39.4% for the second quarter and six month period ended June 30, 2008 and 2007. The effective rate for the second quarter and six month period ended June 30, 2008 was higher than the second quarter and six month period ended June 30, 2007 due primarily to the shift in the distribution of taxable income between states in which we operate. We expect the effective tax rate from continuing operations in future periods to fall within a range of 39% to 42%.

**Discontinued Operations**

Pretax loss from operations and the sale of discontinued operations increased \$9.8 million, or 277.1%, and \$12.1 million, or 177.8%, for the second quarter and six month period ended June 30, 2008 as compared to the second quarter and six month period ended June 30, 2007, respectively. The increase in loss on discontinued operations for the second quarter and six month period ended June 30, 2008 is primarily related to an increase in loss on disposal and impairment of \$8.9 million and \$9.3 million, respectively. Loss on disposal and impairment for the six month period ended June 30, 2008 includes a loss on disposition of approximately \$2.9 million, a favorable lease impairment charge of \$1.9 million, a property impairment charge of \$2.1 million and a franchise agreement and other asset impairment charge of \$4.3 million. Loss on disposal and impairment for the six month period ended June 30, 2007 was \$1.9 million primarily comprised of a \$1.3 million franchise agreement impairment charge.

**Liquidity and Capital Resources**

We require cash to finance acquisitions and fund debt service and working capital requirements. We rely on cash flows from operations, borrowings under our various credit facilities and offerings of debt and equity securities to meet these requirements.

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 depend to a substantial degree on the results of operations of our subsidiaries and their ability to provide us with cash. Uncertainties in the economic environment may affect our overall liquidity.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

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

***Floor Plan Facilities***

The weighted average interest rate for all of our new vehicle floor plan facilities (both continuing and discontinued operations) was 4.0% and 4.4% for the second quarter and six month period ended June 30, 2008 and 6.3% and 6.2% for the second quarter and six month period ended June 30, 2007, respectively. Interest payments under each of our floor plan facilities are due monthly, and we are generally not required to make principal repayments prior to the sale of the particular vehicles. We were in compliance with all restrictive covenants under our floor plan facilities as of June 30, 2008.

The weighted average interest rate for our used vehicle floor plan facility (which interest expense is allocated to discontinued and continuing operations) was 3.9% and 4.5% for the second quarter and six month period ended June 30, 2008 and 6.4% and 6.5% for the second quarter and six month period ended June 30, 2007, respectively.

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

See Note 6 to our annual financial statements in our Annual Report on Form 10-K for the year ended December 31, 2007 which defines our 2006 Credit Facility and our 2006 Revolving Credit Sub-Facility.

During the second quarter ended June 30, 2008, we exercised an accordion feature related to our 2006 Credit Facility and increased its overall capacity by \$185.0 million to \$1.4 billion. This accordion feature increased the availability of new vehicle floor plan financing from \$700.0 million to \$775.6 million, increased the availability of used vehicle inventory floor plan financing from \$150.0 million to \$193.9 million, and increased the availability of revolving credit borrowings (the 2006 Revolving Credit Sub-Facility) from \$350.0 million to \$415.5 million. Availability under the 2006 Revolving Credit Sub-Facility is subject to a borrowing base calculation and is reduced on a dollar for dollar basis by any outstanding letters of credit.

*2006 Revolving Credit Sub-Facility:* At June 30, 2008, our 2006 Revolving Credit Sub-Facility had a borrowing limit of \$415.5 million, subject to a borrowing base calculated on the basis of our receivables, inventory and equipment and a pledge of certain additional collateral by one of our affiliates (the borrowing base was approximately \$305.7 million at June 30, 2008). The amount available to be borrowed under the 2006 Revolving Credit Sub-Facility is reduced on a dollar-for-dollar basis by the cumulative face amount of outstanding letters of credit. At June 30, 2008, we had \$80.6 million in letters of credit outstanding, \$114.7 million in outstanding borrowings under the 2006 Revolving Credit Sub-Facility, and \$110.4 million of borrowing availability. We expect this availability to increase in the third quarter of 2008 as we obtain mortgage funding on various properties and use those proceeds to reduce the outstanding borrowings on the 2006 Revolving Credit Sub-Facility.

See Note 6 of the accompanying financial statements for a summary of outstanding balances on our long-term debt and credit facilities as of June 30, 2008.

We were in compliance with all of the restrictive and financial covenants under all our long-term debt and credit facilities as of June 30, 2008.

In March 2008, the Financial Accounting Standards Board ( FASB ) concluded its re-deliberations on FSP APB 14-a Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB 14-a ) deciding to retain its original proposal related to this matter. FSP APB 14-A applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ). FSP APB 14-a will require that the issuer of a convertible debt instrument within its scope separately account for the liability and equity components in a manner that will reflect the issuer's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The excess of the principal amount of the liability component over its initial fair value shall be amortized to interest cost using the effective interest method. The provisions of FSP APB 14-a apply to our 4.25% Convertible Senior Subordinated Notes. FSP APB 14-a is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods thereafter. Early adoption is not permitted. FSP APB 14-a shall be applied retrospectively to all periods presented. We are currently reviewing the provisions of FSP APB

14-a and have not yet determined the impact of this FSP on our consolidated operating results, financial position and cash flows.

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

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

***Dealership Acquisitions and Dispositions***

During the six month period ended June 30, 2008, we acquired five franchises for an aggregate purchase price, net of cash acquired, of \$22.2 million. These acquisitions were funded using cash from operations, borrowings under the 2006 Revolving Credit Sub-Facility and borrowings under our floor plan facilities. During the six month period ended June 30, 2008, we disposed of 8 franchises. These disposals generated cash of \$24.0 million.

***Capital Expenditures***

Our capital expenditures include purchases of land, the construction of new dealerships and collision repair centers, building improvements and equipment purchased for use in our dealerships. Capital expenditures in the six month period ended June 30, 2008 were approximately \$103.4 million. Our capital expenditures were higher than historical amounts due to our strategic decision to own more of our dealership properties. Of the \$103.4 million used for capital expenditures in the six month period ended June 30, 2008, approximately \$69.3 million relates to the purchase of land and buildings either previously leased by us or expected to be developed and used as a dealership property. As of June 30, 2008, contractual commitments to contractors for facilities construction projects totaled approximately \$31.2 million.

As we continue to buy, develop and own our dealership properties, we expect to finance those investments primarily by utilizing our availability under our 2006 Revolving Credit Sub-Facility or by obtaining mortgage financing. In the six month period ended June 30, 2008, we entered into new mortgages totaling \$30.8 million and expect to enter into new mortgages totaling \$43.5 million during the second half of the year. Proceeds from these mortgages are expected to be used to repay amounts outstanding under our 2006 Revolving Credit Sub-Facility.

***Stock Repurchase Program***

As of June 30, 2008, pursuant to previous authorizations from our Board of Directors, we had approximately \$49.3 million available to repurchase shares of our Class A common stock or redeem securities convertible into Class A common stock. In first six months of 2008, we repurchased 1,316,115 shares of our Class A common stock for approximately \$24.1 million, which was partially offset by proceeds received from the exercise of stock options under stock compensation plans of \$5.1 million.

***Dividends***

During the second quarter and six month period ended June 30, 2008, a dividend of \$0.12 per share was paid to shareholders of record as of March 15, 2008 and our Board of Directors approved a dividend of \$0.12 per share for shareholders of record on June 15, 2008 that was paid on July 15, 2008. Subsequent to the second quarter ended June 30, 2008, our Board of Directors approved a dividend of \$0.12 per share for shareholders of record on September 15, 2008 to be paid on October 15, 2008.

***Cash Flows***

For the six month period ended June 30, 2008, net cash provided by operating activities was approximately \$50.2 million. This provision of cash was comprised primarily of cash inflows related to a reduction in receivables, an increase in notes payable floor plan trade, and net income, partially offset by an increase in inventories and a decrease in trade accounts payable and other liabilities. Net cash used in investing activities during the six month period ended June 30, 2008 was approximately \$100.9 million. This use of cash was primarily comprised of cash outflows used for dealership acquisitions and property and equipment purchases, partially offset by proceeds from sales of franchises. Net cash provided by financing activities for the six month period ended June 30, 2008 was approximately \$45.6 million, comprised mainly of net borrowings under the 2006 Credit Facility.

We arrange our inventory floor plan financing through both manufacturer captive finance companies and a syndicate consisting of banks and manufacturer captive finance companies. Generally, our floor plan financed with manufacturer captives is recorded as trade floor plan liabilities

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

(with the resulting change being reflected as an operating cash flow). Our dealerships that obtain floor plan financing from the syndicate record their obligation as non-trade floor plan liabilities (with the resulting change being reflected as a financing cash flow).



**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

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

Due to the presentation differences for changes in trade floor plan and non-trade floor plan in the statement 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. Accordingly, if all changes in floor plan notes payable were classified as an operating activity for the six month period ended June 30, 2008 and 2007, the adjusted net cash provided by operating activities would be \$61.3 million and \$101.2 million, respectively.

***Guarantees and Indemnifications***

In connection with the operation and disposition of dealership franchises, we have entered into various guarantees and indemnifications. See Note 9 of the accompanying financial statements.

***Future Liquidity Outlook***

Our 5.25% Convertible Senior Subordinated Notes mature in May 2009. Accordingly, we have classified those notes as current in the accompanying Condensed Consolidated Balance Sheet as of June 30, 2008. We believe we will have the ability to repay these notes either through availability under our 2006 Credit Facility or through the public or private debt markets.

We believe our best source of liquidity for future growth remains cash flows from operations combined with the availability of borrowings under our new and used floor plan financing and our revolving credit facility. Though uncertainties in the economic environment may affect our ability to generate cash from operations, we expect to generate more than sufficient cash flow to fund our debt service, quarterly cash dividends and working capital requirements and any seasonal operating requirements, including our currently anticipated internal growth for our existing businesses, for the foreseeable future. Once these needs are met, we may use remaining cash flow to support our acquisition strategy or repurchase shares of our Class A common stock or publicly-traded debt securities, based on market conditions.

***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, 2007 for a description of our off-balance sheet arrangements.

***Seasonality***

Our business is subject to seasonal variations in revenues. In our experience, demand for automobiles is generally lower during the first and fourth quarters of each year. We therefore receive a disproportionate amount of revenues generally in the second and third quarters, and expect our revenues and operating results to be generally lower in the first and fourth quarters. Consequently, if conditions surface during the second and third quarters that impair vehicle sales, such as higher fuel costs, depressed economic conditions or similar adverse conditions, our revenues for the year could be adversely affected.

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

Our variable rate notes payable floor plan, 2006 Credit Facility (as defined in our Annual Report on Form 10-K for the year ended December 31, 2007) borrowings and other variable rate notes expose us to risks caused by fluctuations in the underlying interest rates. The total outstanding balance of such instruments was approximately \$1,514.8 million at June 30, 2008. A change of 100 basis points in the underlying interest rate would have caused a change in interest expense of approximately \$4.4 million in the six month period ended June 30, 2008. Of the total change in interest expense, approximately \$3.2 million would have resulted from notes payable floor plan.

In addition to our variable rate debt, approximately 25.1% of our dealership facility lease agreements monthly lease payments fluctuate based on LIBOR interest rates. Many of our lease agreements have interest rate floors whereby our lease expense would not fluctuate significantly in periods when LIBOR is relatively low.

During the second quarter ended June 30, 2008, we settled four of our fair value swaps with notional values totaling \$125.0 million. The swaps were settled with a net settlement payment to us of \$0.4 million. This settlement gain will be deferred and amortized over the remaining term of the initial swaps underlying, our 8.625% Senior Subordinated Notes maturing August 15, 2013.

At the end of the second quarter ended June 30, 2008, the following interest rate swaps were outstanding:

Notional (in millions)	Pay Rate (1)	Receive Rate (1)	Maturing Date
\$25.0	six-month LIBOR plus 3.85%	8.625%	August 15, 2013
\$200.0	4.935%	one-month LIBOR	May 1, 2012
\$100.0	5.002%	one-month LIBOR	June 1, 2012
\$100.0	5.265%	one-month LIBOR	June 1, 2012
\$100.0	5.319%	one-month LIBOR	July 1, 2010
\$4.1	7.100%	one-month LIBOR	July 10, 2017
\$25.0	5.160%	one-month LIBOR	September 1, 2012
\$15.0	4.965%	one-month LIBOR	September 1, 2012
\$25.0	4.885%	one-month LIBOR	October 1, 2012
\$12.9	4.655%	one-month LIBOR	December 10, 2017
\$9.2	6.860%	one-month LIBOR	August 1, 2017
\$7.9	4.330%	one-month LIBOR	July 1, 2013

(1) One-month LIBOR and six-month LIBOR rates were 2.463% and 3.109%, respectively, at June 30, 2008.

All cash flow swaps (fixed pay rate and variable receive rate), with the exception of the swap with a notional amount of \$9.2 million, have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of the swaps are recorded in other comprehensive (loss)/income, net of related income taxes in the Consolidated Statements of Stockholders' Equity. The cash flow swap with a notional amount of \$9.2 was not designated as a hedging instrument and therefore changes in the fair value of this swap are recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Income. The gain / (loss) recognized for the quarter ended June 30, 2008 was not significant.

***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 this volatility negatively impacts consumer demand through higher retail prices for our products, it could adversely affect our future operations 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 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.**

We are a defendant in the matter of Galura, et al. v. Sonic Automotive, Inc., a private civil action filed in the Circuit Court of Hillsborough County, Florida. In this action, originally filed on December 30, 2002, the plaintiffs allege that we and our Florida dealerships sold an antitheft protection product in a deceptive or otherwise illegal manner, and further sought representation on behalf of any customer of any of our Florida dealerships who purchased the antitheft protection product since December 30, 1998. The plaintiffs are seeking monetary damages and injunctive relief on behalf of this class of customers. In June 2005, the court granted the plaintiffs' motion for certification of the requested class of customers, but the court has made no finding to date regarding actual liability in this lawsuit. Sonic subsequently filed a notice of appeal of the court's class certification ruling with the Florida Court of Appeals. In April 2007, the Florida Court of Appeals affirmed a portion of the trial court's class certification, and overruled a portion of the trial court's class certification. We intend to continue our vigorous appeal and defense of this lawsuit and to assert available defenses. However, an adverse resolution of this lawsuit could result in the payment of significant costs and damages, which could 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. 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**

*Risks Related to Our Indebtedness*

**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, 2008, our total outstanding indebtedness was \$1,993.5 million, including the following:

\$114.7 million under the 2006 Revolving Credit Sub-Facility (as defined below);

\$1,210.9 million under the secured new and used inventory floor plan facilities, including \$50.9 million classified as liabilities associated with assets held for sale;

\$129.5 million in 5.25% convertible senior subordinated notes due 2009 (the 5.25% Convertibles ) representing \$130.1 million in aggregate principal amount outstanding less unamortized discount of approximately \$0.6 million;

\$158.0 million in 4.25% convertible senior subordinated notes due 2015, redeemable on or after November 30, 2010, (the 4.25% Convertibles ) representing \$160.0 million in aggregate principal amount outstanding less unamortized discount of approximately \$2.0 million;

\$273.0 million in 8.625% senior subordinated notes due 2013 (the 8.625% Notes ) representing \$275.0 million in aggregate principal amount outstanding less unamortized net discount of approximately \$2.0 million;

\$76.4 million of mortgage notes due from June 2013 to May 2028 with a weighted average interest rate of 5.64%; and

\$31.0 million of other secured debt, representing \$26.9 million in aggregate principal amount plus unamortized premium of approximately \$3.6 million and plus \$0.5 million for the fair value of fixed to variable interest rate swaps.

As of June 30, 2008, we had \$110.4 million available for additional borrowings under the 2006 Revolving Credit Sub-Facility. We also have significant additional capacity under new and used floor plan facilities. In addition, the indentures relating to our 8.625% Notes, 5.25% Convertibles, 4.25% Convertibles and our other debt instruments allow us to incur additional indebtedness, including secured indebtedness. We refer to the \$415.5 million of commitments under a revolving credit facility ( 2006 Revolving Credit Sub-Facility ), up to \$775.6 million in commitments for new vehicle inventory floor plan financing and up to \$193.9 million in commitments for used vehicle inventory floor plan financing collectively as our 2006 Credit Facility .

In addition, the majority of our dealership properties are leased under long-term operating lease arrangements that generally have initial terms of fifteen to twenty years with one or two five-year renewal options. These operating leases require 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 the notes to our financial statements under the heading Commitments and Contingencies in our Annual Report on Form 10-K for the year ended December 31, 2007.

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

The degree to which we are leveraged could have important consequences to the holders of our securities, including the following:

our ability to obtain additional financing for acquisitions, capital expenditures, working capital or general corporate purposes may be impaired in the future;

a substantial portion of our current cash flow from operations must be dedicated to the payment of principal and interest on our indebtedness, thereby reducing the funds available to us for our operations and other purposes;

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

some of our borrowings and facility leases are and will continue to be at variable rates of interest, which exposes us to the risk of increasing interest rates;

the indebtedness outstanding under our 2006 Credit Facility and other floor plan facilities are secured by a pledge of substantially all the assets of our dealerships; and

we may be substantially more leveraged than some of our competitors, which may place us at a relative competitive disadvantage and make us more vulnerable to changing market conditions and regulations.

In addition, our debt agreements contain numerous covenants that limit our discretion with respect to business matters, including mergers or acquisitions, paying dividends, incurring additional debt, making capital expenditures or disposing of assets.

**An acceleration of our obligation to repay all or a substantial portion of our outstanding indebtedness or lease obligations would have a material adverse effect on our business, financial condition or results of operations.**

Our 2006 Credit Facility, the indenture governing our 8.625% Notes and many of our facility operating leases contain numerous financial and operating covenants. A breach of any of these covenants could result in a default under the applicable agreement or indenture. If a default were to occur, we may be unable to adequately finance our operations and the value of our common stock would be materially adversely affected. In addition, a default under one agreement or indenture could result in a default and acceleration of our repayment obligations under the other agreements or indentures, including the indentures governing our outstanding 5.25% Convertibles, 4.25% Convertibles and the 8.625% Notes, under the cross default provisions in those agreements or indentures. If a cross default were to occur, we may not be able to pay our debts or borrow sufficient funds to refinance them. Even if new financing were available, it may not be on terms acceptable to us. As a result of this risk, we could be forced to take actions that we otherwise would not take, or not take actions that we otherwise might take, in order to comply with the covenants in these agreements and indentures.

**Our ability to make interest and principal payments when due to holders of our debt securities depends upon the receipt of sufficient funds from our subsidiaries.**

Substantially all of our consolidated assets are held by our subsidiaries and substantially all of our consolidated cash flow and net income are generated by our subsidiaries. Accordingly, our cash flow and ability to service debt depends to a substantial degree on the results of operations of our subsidiaries and upon the ability of our subsidiaries to provide us with cash. We may receive cash from our subsidiaries in the form of dividends, loans or otherwise. We may use this cash to service our debt obligations or for working capital. Our subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to distribute cash to us or to make funds available to service debt. In addition, the ability of our subsidiaries to pay dividends or make loans to us are subject to contractual limitations under the floor plan facilities, minimum net capital requirements under manufacturer franchise agreements and laws of the state in which a subsidiary is organized and depend to a significant degree on the results of operations of our subsidiaries and other business considerations.

**We depend on the performance of sublessees to offset costs related to certain of our lease agreements.**

In most cases when we sell a dealership franchise, the buyer of the franchise will sublease the dealership property from us, but we are not released from the underlying lease obligation to the primary landlord. We rely on the sublease income from the buyer to offset the expense incurred related to our obligation to pay the primary landlord. We also rely on the buyer to maintain the property in accordance with the terms of the sublease (which in most cases mirror the terms of the lease we have with the primary landlord). Although we assess the financial condition of a buyer at the time we sell the franchise, and seek to obtain guarantees of the buyer's sublease obligation from the stockholders or affiliates of the buyer, the financial condition of the buyer and/or the sublease guarantors may deteriorate over time. In the event the buyer does not perform under the terms of the sublease agreement (due to the buyer's financial condition or other factors), we may not be able to recover amounts owed to us under the terms of the sublease agreement or the related guarantees. Our operating results, financial condition and cash flows may be materially adversely affected if sublessees do not perform their obligations under the terms of the sublease agreements.





**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

*Risks Related to Our Relationships with Vehicle Manufacturers*

**Our operations may be adversely affected if one or more of our manufacturer franchise agreements is terminated or not renewed.**

Each of our dealerships operates under a franchise agreement with the applicable automobile manufacturer or distributor. Without a franchise agreement, we cannot obtain new vehicles from a manufacturer. As a result, we are significantly dependent on our relationships with these manufacturers.

Manufacturers exercise a great degree of control over the operations of our dealerships through the franchise agreements. The franchise agreements govern, among other things, our ability to purchase vehicles from the manufacturer and to sell vehicles to customers. Each of our franchise agreements provides for termination or non-renewal for a variety of causes, including any unapproved change of ownership or management. Manufacturers may also have a right of first refusal if we seek to sell dealerships.

Actions taken by manufacturers to exploit their superior bargaining position in negotiating the terms of franchise agreements or renewals of these agreements or otherwise could also have a material adverse effect on our results of operations, financial condition and cash flows. We cannot guarantee you that any of our existing franchise agreements will be renewed or that the terms and conditions of such renewals will be favorable to us.

**Our sales volume and profit margin on each sale may be materially adversely affected if manufacturers discontinue or change their incentive programs.**

Our dealerships depend on the manufacturers for certain sales incentives, warranties and other programs that are intended to promote and support dealership new vehicle sales. Manufacturers routinely modify their incentive programs in response to changing market conditions. Some of the key incentive programs include:

customer rebates or below market financing on new vehicles;

employee pricing;

dealer incentives on new vehicles;

manufacturer floor plan interest and advertising assistance;

warranties on new and used vehicles; and

sponsorship of used vehicle sales by authorized new vehicle dealers.

Manufacturers frequently offer incentives to potential customers. A reduction or discontinuation of a manufacturer's incentive programs may materially adversely impact vehicle demand and affect our profitability.

**We depend on manufacturers to supply us with sufficient numbers of popular and profitable new models.**

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

Manufacturers typically allocate their vehicles among dealerships based on the sales history of each dealership. Supplies of popular new vehicles may be limited by the applicable manufacturer's production capabilities. Popular new vehicles that are in limited supply typically produce the highest profit margins. We depend on manufacturers to provide us with a desirable mix of popular new vehicles. Our operating results may be materially adversely affected if we do not obtain a sufficient supply of these vehicles.

### **Adverse conditions affecting one or more key manufacturers may negatively impact our profitability.**

During the six months ended June 30, 2008, approximately 88.7% of our new vehicle revenue was derived from the sale of new vehicles manufactured by BMW, Honda (including Acura), Toyota (including Lexus), Mercedes, General Motors (including Cadillac) and Ford (including Volvo). Our success depends to a great extent on these manufacturers :

financial condition;

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

marketing;

vehicle design;

publicity concerning a particular manufacturer or vehicle model;

production capabilities;

management;

reputation; and

labor relations.

Events such as labor strikes that may adversely affect a manufacturer may also adversely affect us. In particular, labor strikes at a manufacturer that continue for a substantial period of time could have a material adverse effect on our business. Similarly, the delivery of vehicles from manufacturers at a time later than scheduled, which may occur particularly during periods of new product introductions, could limit sales of those vehicles during those periods. This has been experienced at some of our dealerships from time to time. Adverse conditions affecting these and other important aspects of manufacturers' operations and public relations may adversely affect our ability to sell their automobiles and, as a result, significantly and detrimentally affect our profitability.

In recent years, the financial condition and operating results of Ford, General Motors and Chrysler have deteriorated significantly. As of June 30, 2008, we owned 14 Ford franchises (including Volvo), 37 General Motors franchises (including Cadillac, Saab, Saturn, Chevrolet, Buick, GMC, Hummer and Pontiac) and 9 Chrysler franchises (including Jeep, Dodge and Chrysler). Should the financial condition and operating results of Ford, General Motors or Chrysler continue to significantly deteriorate, it is possible that the particular manufacturer could file for bankruptcy protection. Such a bankruptcy filing by Ford, General Motors or Chrysler could have a material adverse effect on our future results of operations, financial condition or cash flows.

**Manufacturer stock ownership restrictions may impair our ability to maintain or renew franchise agreements or issue additional equity.**

Some of our franchise agreements prohibit transfers of any ownership interests of a dealership and, in some cases, its parent, without prior approval of the applicable manufacturer. A number of manufacturers impose restrictions on the transferability of our Class A common stock and our ability to maintain franchises if a person acquires a significant percentage of the voting power of our common stock. Our existing franchise agreements could be terminated if a person or entity acquires a substantial ownership interest in us or acquires voting power above certain levels without the applicable manufacturer's approval. Violations of these levels by an investor are generally outside of our control and may result in the termination or non-renewal of existing franchise agreements or impair our ability to negotiate new franchise agreements for dealerships we acquire. In addition, if we cannot obtain any requisite approvals on a timely basis, we may not be able to issue additional equity or otherwise raise capital on terms acceptable to us. These restrictions may also prevent or deter a prospective acquirer from acquiring control of us. This could adversely affect the market price of our Class A common stock.

The current holders of our Class B common stock maintain voting control over us. However, we are unable to prevent our stockholders from transferring shares of our common stock, including transfers by holders of the Class B common stock. If such transfer results in a change in control, it could result in the termination or non-renewal of one or more of our existing franchise agreements, the triggering of provisions in our

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

agreements with certain manufacturers requiring us to sell our dealerships franchised with such manufacturers and/or a default under our credit arrangements.

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

**Our dealers depend upon vehicle sales and, therefore, their success depends in large part upon customer demand for the particular vehicles they carry.**

The success of our dealerships depends in large part on the overall success of the vehicle lines they carry. New vehicle sales generate the majority of our total revenue and lead to sales of higher-margin products and services such as finance, insurance, vehicle protection products and other aftermarket products, and parts and service operations. Although we have sought to limit our dependence on any one vehicle brand and our parts and service operations and used vehicle sales may serve to offset some of this risk, we have focused our new vehicle sales operations in mid-line import and luxury brands.

**Our failure to meet a manufacturer's customer satisfaction, financial and sales performance and facility requirements may adversely affect our ability to acquire new dealerships and our profitability.**

Many manufacturers attempt to measure customers' satisfaction with their sales and warranty service experiences through manufacturer-determined CSI scores. The components of CSI vary from manufacturer to manufacturer and are modified periodically. Franchise agreements also may impose financial and sales performance standards. Under our agreements with certain manufacturers, a dealership's CSI scores, sales and financial performance may be considered a factor in evaluating applications for additional dealership acquisitions. From time to time, some of our dealerships have had difficulty meeting various manufacturers' CSI requirements or performance standards. We cannot assure you that our dealerships will be able to comply with these requirements in the future. A manufacturer may refuse to consent to an acquisition of one of its franchises if it determines our dealerships do not comply with its CSI requirements or performance standards, which could impair the execution of our acquisition strategy. In addition, we receive incentive payments from the manufacturers based, in part, on CSI scores, which could be materially adversely affected if our CSI scores decline.

In addition, a manufacturer may condition its allotment of vehicles, participation in bonus programs, or acquisition of additional franchises upon our compliance with its facility standards. This may put us in a competitive disadvantage with other competing dealerships and may ultimately result in our decision to sell a franchise when we believe it may be difficult to recover the cost of the required investment to reach the manufacturer's facility standards.

**If state dealer laws are repealed or weakened, our dealerships will be more susceptible to termination, non-renewal or renegotiation of their franchise agreements.**

State dealer laws generally provide that a manufacturer may not terminate or refuse to renew a franchise agreement unless it has first provided the dealer with written notice setting forth good cause and stating the grounds for termination or nonrenewal. Some state dealer laws allow dealers to file protests or petitions or attempt to comply with the manufacturer's criteria within the notice period to avoid the termination or nonrenewal. Though unsuccessful to date, manufacturers' lobbying efforts may lead to the repeal or revision of state dealer laws. If dealer laws are repealed in the states in which we operate, manufacturers may be able to terminate our franchises without providing advance notice, an opportunity to cure or a showing of good cause. Without the protection of state dealer laws, it may also be more difficult for our dealers to renew their franchise agreements upon expiration.

In addition, these laws restrict the ability of automobile manufacturers to directly enter the retail market in the future. However, the ability of a manufacturer to grant additional franchises is based on several factors which are not within our control. If manufacturers grant new franchises in areas near or within our existing markets, this could significantly impact our revenues and/or profitability. Further, if manufacturers obtain the ability to directly retail vehicles and do so in our markets, such competition could have a material adverse effect on us.

*Risks Related to Our Acquisition Strategy*

**Manufacturers' restrictions on acquisitions could limit our future growth.**

We are required to obtain the approval of the applicable manufacturer before we can acquire an additional dealership franchise of that manufacturer. In determining whether to approve an acquisition, manufacturers may consider many factors such as our financial condition, CSI scores and adherence to the particular manufacturer's facility requirements. Obtaining manufacturer approval of acquisitions also takes a

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

significant amount of time, typically three to five months. We cannot assure you that manufacturers will approve future acquisitions or do so on a timely basis, which could impair the execution of our acquisition strategy.

Certain manufacturers also limit the number of its dealerships that we may own, our national market share of that manufacturer's products or the number of dealerships we may own in a particular geographic area. In addition, under an applicable franchise agreement or under state law, a manufacturer may have a right of first refusal to acquire a dealership that we seek to acquire.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

A manufacturer may condition approval of an acquisition on the implementation of material changes in our operations or extraordinary corporate transactions, facilities improvements or other capital expenditures. If we are unable or unwilling to comply with these conditions, we may be required to forego a proposed dealership acquisition, sell the assets of that manufacturer's dealerships or terminate our franchise agreement.

**Failure to effectively integrate acquired dealerships with our existing operations could adversely affect our future operating results.**

Our future operating results depend on our ability to integrate the operations of recently acquired dealerships, as well as dealerships we acquire in the future, with our existing operations. In particular, we need to integrate our management information systems, procedures and organizational structures, which can be difficult. Our growth strategy has focused on the pursuit of strategic acquisitions that either expand or complement our business.

We cannot assure you that we will effectively and profitably integrate the operations of these dealerships without substantial costs, delays or operational or financial problems, due to:

the difficulties of managing operations located in geographic areas where we have not previously operated;

the management time and attention required to integrate and manage newly acquired dealerships;

the difficulties of assimilating and retaining employees;

the challenges of keeping customers; and

the challenge of retaining or attracting appropriate dealership management personnel.

These factors could have a material adverse effect on our financial condition and results of operations.

**We may not adequately anticipate all of the demands that growth through acquisitions will impose.**

The automobile retailing industry is considered a mature industry in which minimal growth is expected in total unit sales. Accordingly, our ability to generate higher revenue and earnings in future periods depends in large part on our ability to acquire additional dealerships, manage geographic expansion, control costs in our operations and consolidate both past and future dealership acquisitions into our existing operations. In pursuing a strategy of acquiring other dealerships, we face risks commonly encountered with growth through acquisitions. These risks include, but are not limited to:

incurring significantly higher capital expenditures and operating expenses;

failing to assimilate the operations and personnel of acquired dealerships;



entering new markets with which we are unfamiliar;

potential undiscovered liabilities and operational difficulties at acquired dealerships;

disrupting our ongoing business;

diverting our management resources;

failing to maintain uniform standards, controls and policies;

impairing relationships with employees, manufacturers and customers as a result of changes in management;

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

increased expenses for accounting and computer systems, as well as integration difficulties;

failure to obtain a manufacturer's consent to the acquisition of one or more of its dealership franchises or renew the franchise agreement on terms acceptable to us; and

incorrectly valuing entities to be acquired.

We may not adequately anticipate all of the demands that growth will impose on our systems, procedures and structures.

**We may not be able to capitalize on acquisition opportunities because our financial resources available for acquisitions are limited.**

We intend to finance our acquisitions with cash generated from operations, through issuances of our stock or debt securities and through borrowings under credit arrangements. We may not be able to obtain additional financing by issuing stock or debt securities due to the market price of our Class A common stock, overall market conditions or the need for manufacturer consent to the issuance of equity securities. Using cash to complete acquisitions could substantially limit our operating or financial flexibility. If we are unable to obtain financing on acceptable terms, we may be required to reduce the scope of our presently anticipated expansion, which could materially adversely affect our overall growth strategy.

In addition, we are dependent to a significant extent on our ability to finance our new vehicle inventory with floor plan financing. Floor plan financing arrangements allow us to borrow money to buy a particular vehicle from the manufacturer and pay off the loan when we sell that particular vehicle. We must obtain new floor plan financing or obtain consents to assume existing floor plan financing in connection with our acquisition of dealerships.

Substantially all the assets of our dealerships are pledged to secure the indebtedness under the 2006 Credit Facility and our separate floor plan indebtedness with the respective captive finance subsidiaries of BMW, Chrysler, Ford, General Motors and Mercedes. Five of the lenders under the 2006 Credit Facility are the respective captive finance subsidiaries of BMW, Mercedes, Nissan, VW and Toyota. These pledges may impede our ability to borrow from other sources. Moreover, because the identified manufacturer captive finance subsidiaries are either owned or affiliated with BMW, Mercedes, Chrysler, Ford, General Motors, Nissan, VW and Toyota, respectively, any deterioration of our relationship with the particular captive finance subsidiary could adversely affect our relationship with the affiliated manufacturer, and vice-versa.

**We may not be able to continue executing our acquisition strategy without the costs of future acquisitions escalating.**

We have grown our business primarily through acquisitions. We may not be able to consummate any future acquisitions at acceptable prices and terms or identify suitable candidates. In addition, increased competition for acquisition candidates could result in fewer acquisition opportunities for us and higher acquisition prices. The magnitude, timing, pricing and nature of future acquisitions will depend upon various factors, including:

the availability of suitable acquisition candidates;

competition with other dealer groups for suitable acquisitions;

the negotiation of acceptable terms with the seller and with the manufacturer;

facilities requirements imposed by the particular manufacturer;

our financial capabilities;

our stock price; and

the availability of skilled employees to manage the acquired companies.

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

**We may not be able to determine the actual financial condition of dealerships we acquire until after we complete the acquisition and take control of the dealerships.**

The operating and financial condition of acquired businesses cannot be determined accurately until we assume control. Although we conduct what we believe to be a prudent level of investigation regarding the operating and financial condition of the businesses we purchase, in light of the circumstances of each transaction, an unavoidable level of risk remains regarding the actual operating condition of these businesses. Similarly, many of the dealerships we acquire, including our largest acquisitions, do not have financial statements audited or prepared in accordance with generally accepted accounting principles. We may not have an accurate understanding of the historical financial condition and performance of our acquired entities. Until we actually assume control of business assets and their operations, we may not be able to ascertain the actual value or understand the potential liabilities of the acquired entities and their operations.

**Although O. Bruton Smith, our chairman and chief executive officer, and his affiliates have previously assisted us with obtaining financing, we cannot assure you that he or they will be willing or able to do so in the future.**

Our obligations under the 2006 Credit Facility are secured with a pledge of shares of common stock of Speedway Motorsports, Inc., a publicly traded owner and operator of automobile racing facilities. These shares of Speedway Motorsports common stock are beneficially owned by Sonic Financial Corporation ( SFC ), an entity controlled by Mr. Smith. Presently, the \$415.5 million borrowing limit of our 2006 Revolving Credit Sub-Facility is subject to a borrowing base calculation that is based, in part, on the value of the Speedway Motorsports shares pledged by SFC. Consequently, a withdrawal of this pledge by SFC or a significant decrease in the value of Speedway Motorsports common stock could reduce the amount we can borrow under the 2006 Revolving Credit Sub-Facility.

In the past, Mr. Smith has also guaranteed additional indebtedness incurred to complete certain dealership acquisitions. Mr. Smith may not be willing or able to provide similar guarantees or credit support in the future. This could impair our ability to obtain acquisition financing on favorable terms.

***Risks Related to the Automotive Retail Industry***

**Increasing competition among automotive retailers reduces our profit margins on vehicle sales and related businesses. Further, the use of the Internet in the car purchasing process could materially adversely affect us.**

Automobile retailing is a highly competitive business. Our competitors include publicly and privately owned dealerships, some of which are larger and have greater financial and marketing resources than we do. Many of our competitors sell the same or similar makes of new and used vehicles that we offer in our markets at competitive prices. We do not have any cost advantage in purchasing new vehicles from manufacturers due to economies of scale or otherwise. In addition, the popularity of short-term vehicle leasing in the past few years has resulted, as these leases expire, in a large increase in the number of late model used vehicles available in the market, which puts added pressure on new and used vehicle margins. We typically rely on advertising, merchandising, sales expertise, service reputation and dealership location to sell new vehicles. Our revenues and profitability could be materially adversely affected if manufacturers decide to enter the retail market directly.

Our F&I business and other related businesses, which have higher margins than sales of new and used vehicles, are subject to strong competition from various financial institutions and other third parties.

The Internet has become a significant part of the sales process in our industry. Customers are using the Internet to compare pricing for cars and related F&I services, which may further reduce margins for new and used cars and profits for related F&I services. If Internet new vehicle sales are allowed to be conducted without the involvement of franchised dealers, our business could be materially adversely affected. In addition, other franchise groups have aligned themselves with services offered on the Internet or are investing heavily in the development of their own Internet capabilities, which could materially adversely affect our business.

Our franchise agreements do not grant us the exclusive right to sell a manufacturer's product within a given geographic area. Our revenues or profitability could be materially adversely affected if any of our manufacturers award franchises to others in the same markets where we operate or if existing franchised dealers increase their market share in our markets.



**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

As we seek to acquire dealerships in new markets, we may face increasingly significant competition as we strive to gain market share through acquisitions or otherwise. Our operating margins may decline over time as we expand into markets where we do not have a leading position.

**Our business will be harmed if overall consumer demand suffers from a severe or sustained downturn.**

Our business is heavily dependent on consumer demand and preferences. Our revenues will be materially and adversely affected if there is a severe or sustained downturn in overall levels of consumer spending. Retail vehicle sales are cyclical and historically have experienced periodic downturns characterized by oversupply and weak demand. These cycles are often dependent on general economic conditions and consumer confidence, as well as the level of discretionary personal income and credit availability. Economic recessions may have a material adverse effect on our retail business, particularly sales of new and used vehicles.

In addition, severe or sustained increases in gasoline prices may lead to a reduction in vehicle purchases or a shift in buying patterns from luxury and sport utility vehicle models (which typically provide high margins to retailers) to smaller, more economical vehicles (which typically have lower margins).

**A decline of available financing in the sub-prime lending market may adversely affect our sales of new and used vehicles.**

A significant portion of vehicle buyers, particularly in the used car market, finance their purchases of automobiles. Sub-prime lenders have historically provided financing for consumers who, for a variety of reasons including poor credit histories and lack of down payment, do not have access to more traditional finance sources. In the event sub-prime lenders tighten their credit standards or there is a decline in the availability of credit in the sub-prime lending market, the ability of these consumers to purchase vehicles could be limited, which could have a material adverse effect on our business, revenues and profitability.

**Our business may be adversely affected by import product restrictions and foreign trade risks that may impair our ability to sell foreign vehicles profitably.**

A significant portion of our new vehicle business involves the sale of vehicles, parts or vehicles composed of parts that are manufactured outside the United States. As a result, our operations are subject to customary risks of importing merchandise, including fluctuations in the relative values of currencies, import duties, exchange controls, trade restrictions, work stoppages and general political and socio-economic conditions in other countries. The United States or the countries from which our products are imported may, from time to time, impose new quotas, duties, tariffs or other restrictions, or adjust presently prevailing quotas, duties or tariffs, which may affect our operations and our ability to purchase imported vehicles and/or parts at reasonable prices.

**The seasonality of our business magnifies the importance of second and third quarter operating results.**

Our business is subject to seasonal variations in revenues. In our experience, demand for automobiles is generally lower during the first and fourth quarters of each year. We therefore receive a disproportionate amount of revenues generally in the second and third quarters and expect our revenues and operating results to be generally lower in the first and fourth quarters. Consequently, if conditions surface during the second and third quarters that impair vehicle sales, such as higher fuel costs, depressed economic conditions or similar adverse conditions, our revenues for the year could be adversely affected.

*General Risks Related to Investing in Our Securities*

**Concentration of voting power and anti-takeover provisions of our charter, bylaws, Delaware law and our dealer agreements may reduce the likelihood of any potential change of control.**

Our common stock is divided into two classes with different voting rights. This dual class stock ownership allows the present holders of the Class B common stock to control us. Holders of Class A common stock have one vote per share on all matters. Holders of Class B common stock have 10 votes per share on all matters, except that they have only one vote per share on any transaction proposed or approved by the Board

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

of Directors or a Class B common stockholder or otherwise benefiting the Class B common stockholders constituting a:

going private transaction;

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

disposition of substantially all of our assets;

transfer resulting in a change in the nature of our business; or

merger or consolidation in which current holders of common stock would own less than 50% of the common stock following such transaction.

The holders of Class B common stock currently hold less than a majority of our outstanding common stock, but a majority of our voting power. This may prevent or discourage a change of control of us even if the action was favored by holders of Class A common stock.

Our charter and bylaws make it more difficult for our stockholders to take corporate actions at stockholders' meetings. In addition, stock options, restricted stock and restricted stock units granted under our 1997 Stock Option Plan and 2004 Stock Incentive Plan become immediately exercisable or automatically vest upon a change in control. Delaware law also makes it difficult for stockholders who have recently acquired a large interest in a company to consummate a business combination transaction with the company against its directors' wishes. Finally, restrictions imposed by our dealer agreements may impede or prevent any potential takeover bid. Generally, our franchise agreements allow the manufacturers the right to terminate the agreements upon a change of control of our company and impose restrictions upon the transferability of any significant percentage of our stock to any one person or entity who may be unqualified, as defined by the manufacturer, to own one of its dealerships. The inability of a person or entity to qualify with one or more of our manufacturers may prevent or seriously impede a potential takeover bid. In addition, provisions of our lending arrangements create an event of default on a change in control. These agreements, corporate governance documents and laws may have the effect of delaying or preventing a change in control or preventing stockholders from realizing a premium on the sale of their shares if we were acquired.

**The outcome of legal and administrative proceedings we are or may become involved in could have an adverse effect on our business, results of operations and profitability.**

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, such as the following.

Several private civil actions have been filed against Sonic Automotive, Inc. 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 has been filed in South Carolina state court against Sonic Automotive, Inc. and 10 of our South Carolina subsidiaries. We have been advised that the plaintiffs' attorneys in this South Carolina private civil action intend to file private civil class actions against Sonic Automotive, Inc. and certain of its subsidiaries in other states. This group of plaintiffs' attorneys has filed another one of these private civil class action lawsuits in state court in North Carolina seeking certification of a multi-state class of plaintiffs. The South Carolina state court action and the North Carolina state court action have since been consolidated into a single proceeding in private arbitration.

The outcomes of the civil actions brought by plaintiffs purporting to represent a class of customers, as well as other pending and future legal 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.

Our company is a defendant in the matter of *Galura, et al. v. Sonic Automotive, Inc.*, a private civil action filed in the Circuit Court of Hillsborough County, Florida. In this action, originally filed on December 30, 2002, the plaintiffs allege that we and our Florida dealerships sold an anti-theft protection product in a deceptive or otherwise illegal manner, and further sought representation on behalf of any customer of any of our Florida dealerships who purchased the anti-theft protection product since December 30, 1998. The plaintiffs are seeking monetary damages and injunctive relief on behalf of this class of customers. In June 2005, the court granted the plaintiffs' motion for certification of the requested



class of customers, but the

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

court has made no finding to date regarding actual liability in this lawsuit. We have subsequently filed a notice of appeal of the court's class certification ruling with the Florida Court of Appeals. In April 2007, the Florida Court of Appeals affirmed a portion of the trial court's class certification, and overruled a portion of the trial court's class certification. We intend to continue our vigorous defense of this lawsuit, including the aforementioned appeal of the trial court's class certification order, and to assert available defenses. However, an adverse resolution of this lawsuit could result in the payment of significant costs and damages, which could have a material adverse effect on our future results of operations, financial condition and cash flows.

**Our business may be adversely affected by claims alleging violations of laws and regulations in our advertising, sales and finance and insurance activities.**

Our business is highly regulated. In the past several years, private plaintiffs and state attorney generals have increased their scrutiny of advertising, sales, and finance and insurance activities in the sale and leasing of motor vehicles. The conduct of our business is subject to numerous federal, state and local laws and regulations regarding unfair, deceptive and/or fraudulent trade practices (including advertising, marketing, sales, insurance, repair and promotion practices), truth-in-lending, consumer leasing, fair credit practices, equal credit opportunity, privacy, insurance, motor vehicle finance, installment finance, closed-end credit, usury and other installment sales. Claims arising out of actual or alleged violations of law may be asserted against us or any of our dealers by individuals, either individually or through class actions, or by governmental entities in civil or criminal investigations and proceedings. Such actions may expose us to substantial monetary damages and legal defense costs, injunctive relief and criminal and civil fines and penalties, including suspension or revocation of our licenses and franchises to conduct dealership operations.

**Our business may be adversely affected by unfavorable conditions in our local markets, even if those conditions are not prominent nationally.**

Our performance is subject to local economic, competitive, weather and other conditions prevailing in geographic areas where we operate. For example, our current results of operations depend substantially on general economic conditions and consumer spending habits in our Northern California and Houston markets. Revenues in our Northern California and Houston markets represented approximately 30.6% of our total revenues for the six months ended June 30, 2008. We may not be able to expand geographically and any geographic expansion may not adequately insulate us from the adverse effects of local or regional economic conditions. In addition, due to the provisions and terms contained in our operating lease agreements, we may not be able to relocate a dealership operation to a more favorable location without incurring significant costs or penalties.

**The loss of key personnel and limited management and personnel resources could adversely affect our operations and growth.**

Our success depends to a significant degree upon the continued contributions of our management team, particularly our senior management, and service and sales personnel. Additionally, manufacturer franchise agreements may require the prior approval of the applicable manufacturer before any change is made in franchise general managers. We do not have employment agreements with certain members of our senior management team, our dealership managers and other key dealership personnel. Consequently, the loss of the services of one or more of these key employees could have a material adverse effect on our results of operations.

In addition, as we expand we may need to hire additional managers. The market for qualified employees in the industry and in the regions in which we operate, particularly for general managers and sales and service personnel, is highly competitive and may subject us to increased labor costs during periods of low unemployment. The loss of the services of key employees or the inability to attract additional qualified managers could have a material adverse effect on our results of operations. In addition, the lack of qualified management or employees employed by potential acquisition candidates may limit our ability to consummate future acquisitions.

**Governmental regulation and environmental regulation compliance costs may adversely affect our profitability.**

We are subject to a wide range of federal, state and local laws and regulations, such as local licensing requirements, retail financing and consumer protection laws and regulations, and wage-hour, anti-discrimination and other employment practices laws and regulations. Our facilities and operations are also subject to federal, state and local laws and regulations relating to environmental protection and human health

Edgar Filing: SONIC AUTOMOTIVE INC - Form 10-Q

and safety, including those governing wastewater discharges, air emissions, the operation and removal of underground and aboveground storage tanks, the use, storage, treatment,

---

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

transportation, release, recycling and disposal of solid and hazardous materials and wastes and the cleanup of contaminated property or water. The violation of these laws and regulations can result in administrative, civil or criminal penalties against us or in a cease and desist order against our operations that are not in compliance. Our future acquisitions may also be subject to regulation, including antitrust reviews. We believe that we comply in all material respects with all laws and regulations applicable to our business, but future regulations may be more stringent and require us to incur significant additional compliance costs.

Our past and present business operations are subject to environmental laws and regulations. We may be required by these laws to pay the full amount of the costs of investigation and/or remediation of contaminated properties, even if we are not at fault for disposal of the materials or if such disposal was legal at the time. Like many of our competitors, we have incurred, and will continue to incur, capital and operating expenditures and other costs in complying with these laws and regulations. In addition, soil and groundwater contamination exists at certain of our properties. We cannot assure you that our other properties have not been or will not become similarly contaminated. In addition, we could become subject to potentially material new or unforeseen environmental costs or liabilities because of our acquisitions.

**Potential conflicts of interest between us and our officers or directors could adversely affect our future performance.**

O. Bruton Smith serves as the chairman and chief executive officer of Speedway Motorsports. Accordingly, we compete with Speedway Motorsports for the management time of Mr. Smith.

We have in the past and will likely in the future enter into transactions with Mr. Smith, entities controlled by Mr. Smith or our other affiliates. We believe that all of our existing arrangements with affiliates are as favorable to us as if the arrangements were negotiated between unaffiliated parties, although the majority of these transactions have neither been verified by third parties in that regard nor are likely to be so verified in the future.

Potential conflicts of interest could arise in the future between us and our officers or directors in the enforcement, amendment or termination of arrangements existing between them.

**We may be subject to substantial withdrawal liability assessments in the future related to a multi-employer pension plan to which certain of our dealerships make contributions pursuant to collective bargaining agreements.**

Seven of our dealership subsidiaries in Northern California currently make fixed-dollar contributions to the Automotive Industries Pension Plan pursuant to collective bargaining agreements between our subsidiaries and the International Association of Machinists. The AI Pension Plan is a multi-employer pension plan as defined under the Employee Retirement Income Security Act of 1974, as amended, and our seven dealership subsidiaries are among approximately 120 automobile dealerships that make contributions to the AI Pension Plan pursuant to collective bargaining agreements with the IAM. In June 2006, we received information that the AI Pension Plan was substantially underfunded as of December 31, 2005. In July 2007, we received updated information that the AI Pension Plan continued to be substantially underfunded as of December 31, 2006, with the amount of such underfunding increasing versus the year ended December 31, 2005. In March 2008, the Board of Trustees of the AI Pension Plan notified participants, participating employers and local unions that the Plan's actuary, in accordance with the requirements of the federal Pension Protection Act of 2006, had issued a certification that the AI Pension Plan is in Critical Status effective with the plan year commencing January 1, 2008. In conjunction with this finding, the Board of Trustees of the AI Pension Plan adopted a Rehabilitation Plan that implements reductions or eliminations of certain adjustable benefits that were previously available under the Plan (including some forms of early retirement benefits, and disability and death benefits), and also implements a requirement on all participating employers to increase employer contributions to the Plan for a seven year period commencing in 2013.

Under applicable federal law, any employer contributing to a multi-employer pension plan that completely ceases participating in the plan while the plan is underfunded is subject to payment of such employer's assessed share of the aggregate unfunded vested benefits of the plan. In certain circumstances, an employer can be assessed withdrawal liability for a partial withdrawal from a multi-employer pension plan. In addition, if the financial condition of the AI Pension Plan were to continue to deteriorate to the point that the Plan is forced to terminate and be assumed by the Pension Benefit Guaranty Corporation, the participating employers could be subject to assessments by the PBGC to cover the participating employers' assessed share of the unfunded vested benefits. If any of these adverse events were to occur in the future, it could result in a substantial withdrawal liability assessment that could have a material adverse effect on our business, financial condition, results of operations or

cash flows.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**RISK FACTORS**

**A change in historical experience and/or assumptions used to estimate reserves could have a material impact on our earnings.**

As described in Item 7 under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations - Use of Estimates and Critical Accounting Policies" in our Annual Report on Form 10-K for the year ended December 31, 2007, our estimates for finance, insurance and service contracts and insurance reserves are based on historical experience. Differences for the year ended December 31, 2007 between actual results and our historical experiences and/or our assumptions could have a material impact on our earnings in the period of the change and in periods subsequent to the change.

**An impairment of our goodwill could have a material adverse impact on our earnings.**

Pursuant to applicable accounting pronouncements, we test goodwill for impairment annually or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. We describe the process for testing goodwill more thoroughly in our Annual Report on Form 10-K in Item 7 under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2007 - Use of Estimates and Critical Accounting Policies." If we determine that the amount of our goodwill is impaired at any point in time, we will be required to reduce goodwill on our balance sheet. As of June 30, 2008, our balance sheet reflected a carrying amount of approximately \$1,285.4 million in goodwill (including goodwill classified as assets held for sale). If goodwill is impaired, we will record a significant non-cash impairment charge that would likely have a material adverse effect on our earnings for the period in which the impairment of goodwill occurred.

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

The following table sets forth information about the shares of Class A Common Stock we repurchased during the quarter ended June 30, 2008:

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

	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
April 2008	75,500	\$ 19.84	75,500	\$ 51,706
May 2008	80,900	\$ 18.79	80,900	\$ 50,186
June 2008	64,234	\$ 14.11	64,234	\$ 49,280
<b>Total</b>	<b>220,634</b>	<b>\$ 17.79</b>	<b>220,634</b>	<b>\$ 49,280</b>

- (1) All shares repurchased were part of publicly announced share repurchase programs  
(2) Our publicly announced Class A Common Stock repurchase authorizations occurred 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
<b>Total</b>	<b>\$ 295,000</b>

See Note 6 to our annual financial statements in our Annual Report on Form 10-K for the year ended December 31, 2007 for a description of restrictions on the payment of dividends.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****Item 4: Submission of Matters to a Vote of Security Holders**

At the annual meeting of stockholders held April 24, 2008, Mr. O. Bruton Smith, Mr. B. Scott Smith, Mr. William I. Belk, Mr. William P. Benton, Mr. William R. Brooks, Mr. Victor H. Doolan, Mr. H. Robert Heller, Mr. Jeffrey C. Rachor, Mr. Robert L. Rewey and Mr. David C. Vorhoff were voted on by Sonic's stockholders for the position of Director.

	Votes For	Votes Withheld
Election of O. Bruton Smith	145,496,912	572,278
Election of B. Scott Smith	145,499,606	569,584
Election of William I. Belk	145,942,909	126,281
Election of William P. Benton	145,885,867	183,323
Election of William R. Brooks	145,490,535	578,655
Election of Victor H. Doolan	145,942,437	126,753
Election of H. Robert Heller	145,943,539	125,651
Election of Jeffrey C. Rachor	145,499,996	569,194
Election of Robert L. Rewey	145,941,807	127,383
Election of David C. Vorhoff	145,942,387	126,803

In addition to the election of the ten directors, the stockholders approved:

the appointment of Deloitte & Touche as Sonic's independent registered public accounting firm for the fiscal year ending December 31, 2008.

	Votes For	Votes Against	Votes Abstained	Broker Non-Votes
Ratification of Deloitte & Touche as the independent registered public accounting firm	145,921,026	142,699	5,465	

On June, 9, 2008 Sonic filed a Current Report on Form 8-K announcing the dismissal of Deloitte & Touche LLP ( Deloitte & Touche ), as its independent registered public accountants. In accordance with its charter, the Audit Committee of Sonic's board of directors approved the dismissal of Deloitte & Touche. Sonic has engaged Ernst & Young LLP ( E&Y ) as its new independent registered public accountants to audit the consolidated financial statements of Sonic for the fiscal year ending December 31, 2008. The Audit Committee of Sonic's board of directors approved the engagement of E&Y.



**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**Item 6: Exhibits.**

**(a) Exhibits:**

<b>Exhibit No.</b>	<b>Description</b>
<b>31.1</b>	Certification of Mr. David P. Cosper 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. Cosper 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>99.1</b>	Amendment No. 3 to Credit Agreement dated February 17, 2006

**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:

future acquisitions or dispositions;

industry trends;

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

vehicle sales rates and same store sales growth;

our financing plans; and

our business and growth strategies.

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 1A of this Form 10-Q and elsewhere in this report, as well as:

our ability to generate sufficient cash flows or obtain additional financing to support 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 they offer and their ability to design, manufacture, deliver and market their vehicles successfully;

our relationships with manufacturers, which may affect our ability to complete additional acquisitions;

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;

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

the timing of and our ability to successfully integrate recent and potential future acquisitions.

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**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 29, 2008

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

Date: July 29, 2008

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

**Table of Contents**

**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
<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>99.1</b>	Amendment No. 3 to Credit Agreement dated February 17, 2006