

SONIC AUTOMOTIVE INC  
Form 10-Q  
October 30, 2015

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 September 30, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-13395

SONIC AUTOMOTIVE, INC.

(Exact name of registrant as specified in its charter)

Delaware 56-2010790  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

4401 Colwick Road

28211

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Charlotte, North Carolina  
(Address of principal executive offices) (Zip Code)

(704) 566-2400

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 26, 2015, there were 37,781,160 shares of Class A common stock and 12,029,375 shares of Class B common stock outstanding.

SONIC AUTOMOTIVE, INC.

FORM 10-Q

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2015

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## PART I—FINANCIAL INFORMATION

## Item 1. Financial Statements.

## SONIC AUTOMOTIVE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2015	2014	September 30, 2015	2014
	(Dollars and shares in thousands, except per share amounts)			
<b>Revenues:</b>				
New vehicles	\$1,368,029	\$1,327,837	\$3,865,639	\$3,773,234
Used vehicles	652,058	583,570	1,904,594	1,747,254
Wholesale vehicles	37,971	41,433	120,760	127,797
Total vehicles	2,058,058	1,952,840	5,890,993	5,648,285
Parts, service and collision repair	350,520	325,740	1,019,878	973,646
Finance, insurance and other, net	85,830	77,024	242,792	223,340
Total revenues	2,494,408	2,355,604	7,153,663	6,845,271
<b>Cost of Sales:</b>				
New vehicles	(1,302,594)	(1,258,811)	(3,671,919)	(3,563,342)
Used vehicles	(610,328 )	(542,325 )	(1,781,323 )	(1,627,842 )
Wholesale vehicles	(40,452 )	(42,519 )	(126,126 )	(130,290 )
Total vehicles	(1,953,374)	(1,843,655)	(5,579,368)	(5,321,474)
Parts, service and collision repair	(180,783 )	(170,460 )	(523,531 )	(506,361 )
Total cost of sales	(2,134,157)	(2,014,115)	(6,102,899)	(5,827,835)
Gross profit	360,251	341,489	1,050,764	1,017,436
Selling, general and administrative expenses	(280,041 )	(270,144 )	(835,564 )	(803,031 )
Impairment charges	(37 )	(208 )	(16,698 )	(215 )
Depreciation and amortization	(17,250 )	(14,235 )	(50,953 )	(43,047 )
Operating income (loss)	62,923	56,902	147,549	171,143
<b>Other income (expense):</b>				
Interest expense, floor plan	(5,364 )	(4,406 )	(15,488 )	(13,941 )
Interest expense, other, net	(12,361 )	(12,893 )	(38,635 )	(40,576 )
Other income (expense), net	-	(1 )	102	98
Total other income (expense)	(17,725 )	(17,300 )	(54,021 )	(54,419 )
Income (loss) from continuing operations before taxes	45,198	39,602	93,528	116,724
Provision for income taxes for continuing operations - benefit (expense)	(18,095 )	(15,045 )	(36,944 )	(45,122 )
Income (loss) from continuing operations	27,103	24,557	56,584	71,602
<b>Discontinued operations:</b>				
Income (loss) from discontinued operations before taxes	(999 )	254	(2,200 )	(838 )
	401	(99 )	869	327

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Provision for income taxes for discontinued operations - benefit (expense)				
Income (loss) from discontinued operations	(598 )	155	(1,331 )	(511 )
Net income (loss)	\$26,505	\$24,712	\$55,253	\$71,091
Basic earnings (loss) per common share:				
Earnings (loss) per share from continuing operations	\$0.54	\$0.47	\$1.12	\$1.36
Earnings (loss) per share from discontinued operations	(0.01 )	-	(0.03 )	(0.01 )
Earnings (loss) per common share	\$0.53	\$0.47	\$1.09	\$1.35
Weighted average common shares outstanding	50,456	52,070	50,697	52,333
Diluted earnings (loss) per common share:				
Earnings (loss) per share from continuing operations	\$0.53	\$0.47	\$1.11	\$1.35
Earnings (loss) per share from discontinued operations	(0.01 )	-	(0.03 )	(0.01 )
Earnings (loss) per common share	\$0.52	\$0.47	\$1.08	\$1.34
Weighted average common shares outstanding	50,769	52,553	51,086	52,808
Dividends declared per common share	\$0.025	\$0.025	\$0.075	\$0.075

See notes to condensed consolidated financial statements.

SONIC AUTOMOTIVE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2014	2014	2014
	(Dollars in thousands)			
Net income (loss)	\$26,505	\$24,712	\$55,253	\$71,091
Other comprehensive income (loss) before taxes:				
Change in fair value of interest rate swap agreements	(4,221 )	4,037	(4,271 )	5,223
Provision for income tax benefit (expense) related to				
components of other comprehensive income (loss)	1,604	(1,534 )	1,623	(1,985 )
Other comprehensive income (loss)	(2,617 )	2,503	(2,648 )	3,238
Comprehensive income (loss)	\$23,888	\$27,215	\$52,605	\$74,329

See notes to condensed consolidated financial statements.





SONIC AUTOMOTIVE, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$2,493	\$ 4,182
Receivables, net	299,530	371,994
Inventories	1,422,433	1,311,702
Other current assets	99,459	81,081
Total current assets	1,823,915	1,768,959
Property and Equipment, net	859,855	799,319
Goodwill	472,613	475,929
Other Intangible Assets, net	81,937	83,720
Other Assets	54,088	55,208
Total Assets	\$3,292,408	\$ 3,183,135

**LIABILITIES AND STOCKHOLDERS' EQUITY**

## Current Liabilities:

Notes payable - floor plan - trade	\$762,031	\$ 711,618
Notes payable - floor plan - non-trade	521,924	551,118
Trade accounts payable	113,527	132,405
Accrued interest	12,485	12,409
Other accrued liabilities	214,900	208,654
Current maturities of long-term debt	31,711	30,802
Total current liabilities	1,656,578	1,647,006
Long-Term Debt	795,871	742,610
Other Long-Term Liabilities	73,984	69,200
Deferred Income Taxes	72,815	57,601

## Commitments and Contingencies

## Stockholders' Equity:

Class A convertible preferred stock, none issued	-	-
Class A common stock, \$0.01 par value; 100,000,000 shares authorized;		

62,456,603 shares issued and 37,899,038 shares outstanding at

September 30, 2015; 62,046,966 shares issued and 38,890,533 shares

outstanding at December 31, 2014	625	620
Class B common stock; \$0.01 par value; 30,000,000 shares authorized;	121	121

12,029,375 shares issued and outstanding at September 30, 2015

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and December 31, 2014		
Paid-in capital	707,419	697,760
Retained earnings	427,819	376,353
Accumulated other comprehensive income (loss)	(9,072 )	(6,424 )
Treasury stock, at cost; 24,557,565 Class A shares held		
at September 30, 2015 and 23,156,433 Class A shares		
held at December 31, 2014	(433,752 )	(401,712 )
Total Stockholders' Equity	693,160	666,718
Total Liabilities and Stockholders' Equity	\$3,292,408	\$ 3,183,135

See notes to condensed consolidated financial statements.

## SONIC AUTOMOTIVE, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

	Class A Common Stock		Class A Treasury Stock		Class B Common Stock		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
	(Dollars and shares in thousands)									
Balance at December 31, 2014	62,047	\$ 620	(23,156)	\$(401,712)	12,029	\$ 121	\$697,760	\$376,353	\$(6,424)	\$666,718
Shares awarded under stock compensation plans	389	5	-	-	-	-	1,834	-	-	1,839
Purchases of treasury stock	-	-	(1,402)	(32,040)	-	-	-	-	-	(32,040)
Income tax benefit associated with stock compensation plans	-	-	-	-	-	-	416	-	-	416
Fair value of interest rate swap agreements, net of tax benefit of \$1,623	-	-	-	-	-	-	-	-	(2,648)	(2,648)
Restricted stock amortization	-	-	-	-	-	-	7,409	-	-	7,409
Other	21	-	-	-	-	-	-	-	-	-
Net income (loss)	-	-	-	-	-	-	-	55,253	-	55,253
Dividends (\$0.075 per	-	-	-	-	-	-	-	(3,787)	-	(3,787)

share)

Balance at  
September 30,  
2015

62,457	\$ 625	(24,558)	\$(433,752)	12,029	\$ 121	\$ 707,419	\$ 427,819	\$(9,072 )	\$ 693,160
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See notes to condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
	(Dollars in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$55,253	\$71,091
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of property, plant and equipment	50,948	43,042
Provision for bad debt expense	1,633	331
Other amortization	487	987
Debt issuance cost amortization	1,456	1,654
Debt discount amortization, net of premium amortization	127	43
Stock - based compensation expense	7,409	6,203
Deferred income taxes	16,837	21,273
Equity interest in earnings of investee	(278 )	(221 )
Asset impairment charges	16,698	215
Loss (gain) on disposal of dealerships and property and equipment	(699 )	(11,646 )
Loss (gain) on exit of leased dealerships	1,485	(272 )
Changes in assets and liabilities that relate to operations:		
Receivables	76,888	96,778
Inventories	(110,732)	52,070
Other assets	(20,532 )	(53,589 )
Notes payable - floor plan - trade	50,413	(50,363 )
Trade accounts payable and other liabilities	(15,953 )	(22,054 )
Total adjustments	76,187	84,451
Net cash provided by (used in) operating activities	131,440	155,542
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of businesses, net of cash acquired	-	(15,288 )
Purchases of land, property and equipment	(127,098)	(89,930 )
Proceeds from sales of property and equipment	1,256	6,406
Proceeds from sales of dealerships	1,250	51,391
Distributions from equity investee	225	400
Net cash provided by (used in) investing activities	(124,367)	(47,021 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net (repayments) borrowings on notes payable - floor plan - non-trade	(29,194 )	(101,371)
Borrowings on revolving credit facilities	309,409	97,847
Repayments on revolving credit facilities	(306,163)	(88,068 )
Proceeds from issuance of long-term debt	65,075	40,420
Debt issuance costs	-	(2,956 )
Principal payments on long-term debt	(14,280 )	(15,134 )

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Purchases of treasury stock	(32,040 )	(39,536 )
Income tax benefit (expense) associated with stock compensation plans	416	336
Issuance of shares under stock compensation plans	1,839	2,552
Dividends paid	(3,824 )	(3,963 )
Net cash provided by (used in) financing activities	(8,762 )	(109,873)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,689 )	(1,352 )
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	4,182	3,016
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$2,493	\$1,664

SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:

Change in fair value of cash flow hedging instruments (net of tax benefit of \$1,623 and expense of \$1,985 in the nine months ended September 30, 2015 and 2014, respectively)	\$(2,648 )	\$3,238
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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid (received) during the period for:

Interest, including amount capitalized	\$53,694	\$54,267
Income taxes	\$21,718	\$34,278

See notes to condensed consolidated financial statements.



SONIC AUTOMOTIVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation – The accompanying condensed consolidated financial statements of Sonic Automotive, Inc. and its wholly-owned subsidiaries (“Sonic,” the “Company,” “we,” “us” and “our”) for the three and nine months ended September 30, 2015 and 2014, are unaudited and have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) for interim financial information and applicable rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These unaudited condensed consolidated financial statements reflect, in the opinion of management, all material normal recurring adjustments necessary to fairly state the financial position, results of operations and cash flows for the periods presented. The operating results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year or future interim periods, because the first quarter normally contributes less operating profit than the second, third and fourth quarters. These interim financial statements should be read in conjunction with the audited consolidated financial statements included in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2014.

Recent Accounting Pronouncements – In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-03 to simplify the presentation of debt issuance costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts and premiums. The ASU also requires that the amortization of debt issuance costs be reported as interest expense. For public companies, this ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015 (early adoption is permitted). The adoption of this ASU will impact the presentation of certain items in Sonic’s consolidated financial position and other disclosures.

Also in April 2015, the FASB issued ASU 2015-05 related to customer’s accounting for fees paid in a cloud computing arrangement. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after

December 15, 2015 (early adoption is permitted). Sonic does not expect this ASU to have a significant impact on its consolidated financial position, results of operations or cash flows.

In July 2015, the FASB issued ASU 2015-11 to clarify the subsequent measurement of inventory. This ASU requires an entity to measure inventory within the scope of this update at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The ASU excludes inventory measured using last-in, first-out and the retail inventory method. For public companies, this ASU is effective for fiscal years beginning after December 15, 2016 (early adoption is permitted). Sonic does not expect this ASU to have a significant impact on its consolidated financial position, results of operations or cash flows.

Principles of Consolidation – All of Sonic’s dealership and non-dealership subsidiaries are wholly-owned and consolidated in the accompanying condensed consolidated financial statements, except for one 50% - owned dealership that is accounted for under the equity method. All material intercompany balances and transactions have been eliminated in the accompanying condensed consolidated financial statements.

Lease Exit Accruals – Lease exit accruals relate to facilities Sonic has ceased using in its operations. The accruals represent the present value of the lease payments, net of estimated or actual sublease proceeds, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord. These situations could include the relocation of an existing facility or the sale of a dealership whereby the buyer will not be subleasing the property for either the remaining term of the lease or for an amount of rent equal to Sonic’s obligation under the lease. See Note 12, “Commitments and Contingencies,” of the notes to the consolidated financial statements in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2014 for further discussion.

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

	(In thousands)
Balance at December 31, 2014	\$ 18,962
Lease exit expense (1)	1,485
Payments (2)	(4,671 )
Balance at September 30, 2015	\$ 15,776

SONIC AUTOMOTIVE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

- (1) Expense of approximately \$0.1 million is recorded in interest expense, other, net, expense of approximately \$0.2 million is recorded in selling, general and administrative expenses and expense of approximately \$1.2 million is recorded in income (loss) from discontinued operations before taxes, in the accompanying condensed consolidated statements of income.
- (2) Amount is recorded as an offset to rent expense, with approximately \$0.5 million in selling, general and administrative expenses, and \$4.2 million in income (loss) from discontinued operations before taxes, in the accompanying condensed consolidated statements of income.

**Income Tax Expense** – The overall effective tax rate from continuing operations was 40.0% and 39.5% for the three and nine months ended September 30, 2015, respectively, and was 38.0% and 38.7% for the three and nine months ended September 30, 2014, respectively. The effective tax rate in the three and nine months ended September 30, 2015 was higher than the prior year periods primarily due to a discrete tax benefit in the three months ended September 30, 2014. Sonic’s effective tax rate varies from year to year based on the distribution of taxable income between states in which Sonic operates and other tax adjustments. Sonic expects the effective tax rate in future periods to fall within a range of 38.0% to 40.0% before the impact, if any, of changes in valuation allowances related to deferred income tax assets or unusual discrete tax adjustments.

## 2. Business Acquisitions and Dispositions

**Acquisitions** – Sonic did not acquire any franchises during the nine months ended September 30, 2015. Sonic acquired one mid-line import franchise during the three months ended September 30, 2014 and one luxury franchise during the nine months ended September 30, 2014 for a combined aggregate purchase price of approximately \$15.3 million.

**Dispositions** – As discussed in Note 1, “Description of Business and Summary of Significant Accounting Policies,” of the notes to the consolidated financial statements in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2014, the FASB issued ASU 2014-08 which amended the definition of and reporting requirements for discontinued operations. Sonic elected to adopt and apply this guidance beginning with its Quarterly Report on Form 10-Q for the period ended June 30, 2014. The results of operations for those dealerships that were classified as discontinued operations as of March 31, 2014 are included in income (loss) from discontinued operations in the accompanying condensed consolidated statements of income and will continue to be reported within discontinued operations in the future. Revenues and other activities associated with dealerships classified as discontinued operations were as follows:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
	2015	2014	2015	2014
	(In thousands)			
Income (loss) from operations	\$ (383)	\$ (900)	\$ (1,029)	\$ (1,670)
Gain (loss) on disposal	-	148	-	201
Lease exit accrual adjustments and charges	(616)	1,006	(1,171)	631
Pre-tax income (loss)	\$ (999)	\$ 254	\$ (2,200)	\$ (838)

Total revenues	\$-	\$-	\$42	\$-
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SONIC AUTOMOTIVE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Beginning with disposals occurring after March 31, 2014, only the operating results of disposals that represent a strategic shift that has (or will have) a major impact on Sonic's results of operations and financial position will be included in the income (loss) from discontinued operations in the accompanying condensed consolidated statements of income. Sonic disposed of one franchise during the nine months ended September 30, 2015 that generated net cash of approximately \$1.3 million. Sonic disposed of two franchises during the three months ended September 30, 2014 and disposed of five franchises during the nine months ended September 30, 2014. These disposals generated net cash from disposition in those periods of approximately \$14.9 million and \$30.1 million, respectively.

Revenues and other activities associated with disposed dealerships that remain in continuing operations were as follows:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
	2015	2014	2015	2014
	(In thousands)			
Income (loss) from operations	\$(707 )	\$(441 )	\$(2,166 )	\$(344 )
Gain (loss) on disposal	(542 )	3,111	414	10,734
Property impairment charges	-	-	(10,096)	-
Pre-tax income (loss)	\$(1,249)	\$2,670	\$(11,848)	\$10,390
Total revenues	\$36	\$39,778	\$11,602	\$195,558

## 3. Inventories

Inventories consists of the following:

	September 30, 2015	December 31, 2014
	(In thousands)	
New vehicles	\$998,481	\$924,818
Used vehicles	247,260	214,015
Service loaners	115,517	112,520
Parts, accessories and other	61,175	60,349
Net inventories	\$1,422,433	\$1,311,702

## 4. Property and Equipment

Property and equipment, net consists of the following:

	September 30 2015	December 31, 2014
	(In thousands)	
Land	\$252,939	\$224,124
Building and improvements	637,356	582,261
Office equipment and fixtures	177,450	151,165
Parts and service equipment	75,763	68,248
Company vehicles	9,228	8,958
Construction in progress	72,832	81,180
Total, at cost	1,225,568	1,115,936
Less accumulated depreciation	(365,713 )	(316,617 )
Property and equipment, net	\$859,855	\$799,319

In the three and nine months ended September 30, 2015, capital expenditures were approximately \$44.2 million and \$127.1 million, respectively, and in the three and nine months ended September 30, 2014, capital expenditures were approximately \$41.3 million and \$89.9 million, respectively. Capital expenditures for the three and nine months ended September 30, 2015 and 2014 were primarily related to real estate acquisitions, construction of new dealerships and EchoPark® stores, building improvements and equipment purchased for use in Sonic's dealerships and EchoPark® stores.

Impairment charges for the three months ended September 30, 2015 were immaterial and for the nine months ended September 30, 2015 were approximately \$16.7 million. Impairment charges for the three and nine months ended September 30, 2015 include the

SONIC AUTOMOTIVE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

write-off of goodwill, intangible assets, property and equipment as part of the disposal of a franchise, the write-off of certain costs associated with website and software development projects as well as abandonment of certain construction projects.

## 5. Goodwill and Intangible Assets

The change in the carrying amount of franchise assets and goodwill for the nine months ended September 30, 2015 is as follows:

	Franchise Net	
	Assets	Goodwill
	(In thousands)	
Balance at December 31, 2014	\$77,100	\$475,929 (1)
Prior year acquisition allocations	1,100	(870 )
Reductions from dispositions	(2,400 )	(2,446 )
Balance at September 30, 2015	\$75,800	\$472,613 (1)

(1) Net of accumulated impairment losses of \$796,725.

At December 31, 2014, Sonic had approximately \$6.6 million of definite life intangibles related to favorable lease agreements. After the effect of amortization of the definite life intangibles, the balance recorded at September 30, 2015 was approximately \$6.1 million and is included in other intangible assets, net, in the accompanying condensed consolidated balance sheets.

## 6. Long-Term Debt

Long-term debt consists of the following:

	September 30, 2015	December 31, 2014
	(In thousands)	
2014 Revolving Credit Facility (1)	\$3,246	\$ -

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7.0% Senior Subordinated Notes due 2022 (the "7.0% Notes")	200,000	200,000
5.0% Senior Subordinated Notes due 2023 (the "5.0% Notes")	300,000	300,000
Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19%)	1,689	4,367
Mortgage notes to finance companies-fixed rate, bearing interest from 3.51% to 7.03%	170,621	147,554
Mortgage notes to finance companies-variable rate, bearing interest at 1.25 to 3.50 percentage points above one-month LIBOR	148,954	118,368
Net debt discount and premium (2)	(1,633 )	(1,761 )
Other	4,705	4,884
Total debt	\$827,582	\$ 773,412
Less current maturities	(31,711 )	(30,802 )
Long-term debt	\$795,871	\$ 742,610

- (1) The interest on the 2014 Revolving Credit Facility was 2.25% above LIBOR at September 30, 2015 and December 31, 2014.
- (2) September 30, 2015 includes a \$1.3 million discount associated with the 7.0% Notes and a \$0.3 million discount associated with mortgage notes payable. December 31, 2014 includes a \$1.5 million discount associated with the 7.0% Notes, a \$0.1 million premium associated with notes payable to a finance company and a \$0.4 million discount associated with mortgage notes payable.

#### 2014 Credit Facilities

On July 23, 2014, Sonic entered into agreements to amend and restate its syndicated revolving credit agreement and syndicated new and used vehicle floor plan credit facilities. The amended and restated syndicated revolving credit agreement (the "2014 Revolving Credit Facility") and the amended and restated syndicated new and used vehicle floor plan credit facilities (the "2014 Floor Plan Facilities" and, together with the 2014 Revolving Credit Facility, the "2014 Credit Facilities") are scheduled to mature on August 15, 2019.



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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Availability under the 2014 Revolving Credit Facility is calculated as the lesser of \$225.0 million or a borrowing base calculated based on certain eligible assets, less the aggregate face amount of any outstanding letters of credit under the 2014 Revolving Credit Facility (the "Revolving Borrowing Base"). The 2014 Revolving Credit Facility may be increased at Sonic's option up to \$275.0 million upon satisfaction of certain conditions. Based on balances as of September 30, 2015, the Revolving Borrowing Base was approximately \$179.5 million. As of September 30, 2015, Sonic had approximately \$3.2 million of outstanding borrowings and \$23.7 million in outstanding letters of credit under the 2014 Revolving Credit Facility, resulting in total borrowing availability of \$152.6 million under the 2014 Revolving Credit Facility. See Note 6, "Long-Term Debt," of the notes to the consolidated financial statements in Sonic's Annual Report on Form 10-K for the year ended December 31, 2014 for further discussion.

7.0% Senior Subordinated Notes

On July 2, 2012, Sonic issued \$200.0 million in aggregate principal amount of unsecured senior subordinated 7.0% Notes which mature on July 15, 2022. The 7.0% Notes were issued at a price of 99.11% of the principal amount thereof, resulting in a yield to maturity of 7.125%. Interest on the 7.0% Notes is payable semi-annually in arrears on January 15 and July 15 of each year. See Note 6, "Long-Term Debt," of the notes to the consolidated financial statements in Sonic's Annual Report on Form 10-K for the year ended December 31, 2014 for further discussion.

5.0% Senior Subordinated Notes

On May 9, 2013, Sonic issued \$300.0 million in aggregate principal amount of unsecured senior subordinated 5.0% Notes which mature on May 15, 2023. The 5.0% Notes were issued at a price of 100.0% of the principal amount thereof. Interest on the 5.0% Notes is payable semi-annually in arrears on May 15 and November 15 of each year. See Note 6, "Long-Term Debt," of the notes to the consolidated financial statements in Sonic's Annual Report on Form 10-K for the year ended December 31, 2014 for further discussion.

Notes Payable to a Finance Company

Three notes payable (due October 2015 and August 2016) were assumed in connection with an acquisition in 2004 (the "Assumed Notes"). At September 30, 2015, the outstanding principal balance on the Assumed Notes was approximately \$1.7 million.

Mortgage Notes

At September 30, 2015, Sonic had mortgage financing totaling approximately \$319.6 million related to approximately 30% of its operating properties. These mortgage notes require monthly payments of principal and interest through their respective maturities and are secured by the underlying properties. Maturity dates range between 2015 and 2033. The weighted average interest rate was 3.66% at September 30, 2015.

Covenants

Sonic was in compliance with the covenants under the 2014 Credit Facilities as of September 30, 2015. Financial covenants include required specified ratios (as each is defined in the 2014 Credit Facilities) of:

Covenant	Minimum		Maximum
	Consolidated	Consolidated	
Minimum			
Fixed Charge			Total Lease
Consolidated			Adjusted
Liquidity Coverage			Leverage
	Ratio	Ratio	Ratio
Required ratio	1.05	1.20	5.50
September 30, 2015 actual	1.20	1.78	4.13

The 2014 Credit Facilities contain events of default, including cross-defaults to other material indebtedness, change of control events and events of default customary for syndicated commercial credit facilities. Upon the future occurrence of an event of default, Sonic could be required to immediately repay all outstanding amounts under the 2014 Credit Facilities.

In addition, many of Sonic's facility leases are governed by a guarantee agreement between the landlord and Sonic that contains financial and operating covenants. The financial covenants are identical to those under the 2014 Credit Facilities with the exception of

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

one financial covenant related to the ratio of EBT DAR to Rent (as defined in the lease agreements) with a required ratio of no less than 1.50 to 1.00. As of September 30, 2015, the ratio was 3.76 to 1.00.

Derivative Instruments and Hedging Activities

Sonic has interest rate cash flow swap agreements to effectively convert a portion of its LIBOR-based variable rate debt to a fixed rate. The fair value of these swap positions at September 30, 2015 was a liability of approximately \$15.0 million, with \$5.6 million included in other accrued liabilities and \$9.4 million included in other long-term liabilities in the accompanying condensed consolidated balance sheets. The fair value of these swap positions at December 31, 2014 was a net liability of approximately \$11.1 million, with \$8.2 million included in other accrued liabilities and \$3.5 million included in other long-term liabilities, offset partially by an asset of approximately \$0.6 million included in other assets in the accompanying condensed consolidated balance sheets.

## SONIC AUTOMOTIVE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Under the terms of these cash flow swaps, Sonic will receive and pay interest based on the following:

Notional Amount (In millions)	Pay Rate	Receive Rate (1)	Maturing Date
\$ 2.6	7.100%	one-month LIBOR + 1.50%	July 10, 2017
\$ 8.1	4.655%	one-month LIBOR	December 10, 2017
\$ 7.1	(2) 6.860%	one-month LIBOR + 1.25%	August 1, 2017
\$ 6.2	(2) 6.410%	one-month LIBOR + 1.25%	September 12, 2017
\$ 100.0	2.065%	one-month LIBOR	June 30, 2017
\$ 100.0	2.015%	one-month LIBOR	June 30, 2017
\$ 200.0	0.788%	one-month LIBOR	July 1, 2016
\$ 50.0	(3) 1.320%	one-month LIBOR	July 1, 2017
\$ 250.0	(4) 1.887%	one-month LIBOR	June 30, 2018
\$ 25.0	(3) 2.080%	one-month LIBOR	July 1, 2017
\$ 100.0	1.560%	one-month LIBOR	July 1, 2017
\$ 125.0	(3) 1.303%	one-month LIBOR	July 1, 2017
\$ 125.0	(5) 1.900%	one-month LIBOR	July 1, 2018
\$ 50.0	(6) 2.320%	one-month LIBOR	July 1, 2019
\$ 200.0	(6) 2.313%	one-month LIBOR	July 1, 2019

(1) The one-month LIBOR rate was approximately 0.193% at September 30, 2015.

(2) Changes in fair value are recorded through earnings.

(3) The effective date of these forward-starting swaps is July 1, 2016.

(4) The effective date of this forward-starting swap is July 3, 2017.

(5) The effective date of this forward-starting swap is July 1, 2017.

(6) The effective date of these forward-starting swaps is July 2, 2018.

During the nine months ended September 30, 2015, Sonic entered into four forward-starting interest rate cash flow swap agreements with notional amounts of \$125.0 million, \$125.0 million, \$50.0 million and \$200.0 million. These interest rate swaps have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of these swaps are recorded in other comprehensive income (loss), net of related income taxes, in the accompanying condensed consolidated statements of comprehensive income.

For the interest rate swaps not designated as cash flow hedges, the changes in the fair value of these swaps are recognized through earnings and are included in interest expense, other, net, in the accompanying condensed consolidated statements of income. For the three and nine months ended September 30, 2015, these items were a

benefit of approximately \$0.1 million and \$0.4 million, respectively, and for the three and nine months ended September 30, 2014, these items were a benefit of approximately \$0.2 million and \$0.4 million, respectively.

For the cash flow swaps that qualify as cash flow hedges, the changes in the fair value of these swaps have been recorded in other comprehensive income (loss), net of related income taxes, in the accompanying condensed consolidated statements of comprehensive income and are disclosed in the supplemental schedule of non-cash financing activities in the accompanying condensed consolidated statements of cash flows. The incremental interest expense (the difference between interest paid and interest received) related to these cash flow swaps was approximately \$1.6 million and \$6.2 million for the three and nine months ended September 30, 2015, respectively, and \$2.4 million and \$8.3 million for the three and nine months ended September 30, 2014, respectively, and is included in interest expense, other, net, in the accompanying condensed consolidated statements of income and the interest paid amount disclosed in the supplemental disclosures of cash flow information in the accompanying condensed consolidated statements of cash flows. The estimated net expense expected to be reclassified out of accumulated other comprehensive income (loss) into results of operations during the next twelve months is approximately \$3.5 million.

## SONIC AUTOMOTIVE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## 7. Per Share Data and Stockholders' Equity

The calculation of diluted earnings per share considers the potential dilutive effect of options and shares under Sonic's stock compensation plans. Certain of Sonic's non-vested restricted stock and restricted stock units contain rights to receive non-forfeitable dividends and thus, are considered participating securities and are included in the two-class method of computing earnings per share. The following table illustrates the dilutive effect of such items on earnings per share for the three and nine months ended September 30, 2015 and 2014:

	Three Months Ended September 30, 2015						
	Income (Loss)		Income (Loss)		Net		
	From Continuing		From Discontinued		Income (Loss)		
	Weighted	Per	Per	Per	Per	Per	Per
Average	Share	Share	Share	Share	Share	Share	
Shares	Amount	Amount	Amount	Amount	Amount	Amount	Amount
(In thousands, except per share amounts)							
Earnings (loss) and shares	50,456	\$27,103		\$(598)		\$26,505	
Effect of participating securities:							
Non-vested restricted stock							
and restricted stock units		(13 )		-		(13 )	
Basic earnings (loss) and shares	50,456	\$27,090	\$ 0.54	\$(598)	\$(0.01 )	\$26,492	\$ 0.53
Effect of dilutive securities:							
Stock compensation plans	313						
Diluted earnings (loss) and shares	50,769	\$27,090	\$ 0.53	\$(598)	\$(0.01 )	\$26,492	\$ 0.52

	Three Months Ended September 30, 2014						
	Income (Loss)		Income (Loss)		Net		
	From Continuing		From Discontinued		Income (Loss)		
	Weighted	Per	Per	Per	Per	Per	Per
Average	Share	Share	Share	Share	Share	Share	
Shares	Amount	Amount	Amount	Amount	Amount	Amount	Amount
(In thousands, except per share amounts)							
Earnings (loss) and shares	52,070	\$24,557		\$ 155		\$24,712	
Effect of participating securities:							
Non-vested restricted stock		(79 )		-		(79 )	

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and restricted stock units							
Basic earnings (loss) and shares	52,070	\$24,478	\$ 0.47	\$ 155	\$ -	\$24,633	\$ 0.47
Effect of dilutive securities:							
Stock compensation plans	483						
Diluted earnings (loss) and shares	52,553	\$24,478	\$ 0.47	\$ 155	\$ -	\$24,633	\$ 0.47

Nine Months Ended September 30, 2015

		Income (Loss)		Income (Loss)		Net Income (Loss)	
		From Continuing		From Discontinued			
		Operations		Operations			
Weighted	Per	Per	Per	Per	Per	Per	Per
Average	Share	Share	Share	Share	Share	Share	Share
Shares	Amount	Amount	Amount	Amount	Amount	Amount	Amount
(In thousands, except per share amounts)							

Earnings (loss) and shares	50,697	\$56,584		\$(1,331)		\$55,253	
Effect of participating securities:							
Non-vested restricted stock							
and restricted stock units							
		(27 )		-		(27 )	
Basic earnings (loss) and shares	50,697	\$56,557	\$ 1.12	\$(1,331)	\$(0.03 )	\$55,226	\$ 1.09
Effect of dilutive securities:							
Stock compensation plans	389						
Diluted earnings (loss) and shares	51,086	\$56,557	\$ 1.11	\$(1,331)	\$(0.03 )	\$55,226	\$ 1.08

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SONIC AUTOMOTIVE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Nine Months Ended September 30, 2014							
	Income (Loss)				Income (Loss)			
	From Continuing				From			
	Operations		Operations		Operations		Net Income (Loss)	
Weighted	Per	Per	Per	Per	Per	Per	Per	
Average	Share	Share	Share	Share	Share	Share	Share	
Shares	Amount	Amount	Amount	Amount	Amount	Amount	Amount	
(In thousands, except per share amounts)								
Earnings (loss) and shares	52,333	\$71,602			\$(511)		\$71,091	
Effect of participating securities:								
Non-vested restricted stock								
and restricted stock units		(229 )			-		(229 )	
Basic earnings (loss) and shares	52,333	\$71,373	\$ 1.36		\$(511)	\$(0.01 )	\$70,862 \$ 1.35	
Effect of dilutive securities:								
Stock compensation plans	475							
Diluted earnings (loss) and shares	52,808	\$71,373	\$ 1.35		\$(511)	\$(0.01 )	\$70,862 \$ 1.34	

In addition to the stock options included in the table above, options to purchase approximately 0.5 million shares and 0.4 million shares of Class A common stock were outstanding at September 30, 2015 and 2014, respectively, but were not included in the computation of diluted earnings per share because the options were not dilutive.

## 8. Contingencies

## Legal and Other Proceedings

Sonic is involved, and expects to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of its business, including regulatory investigations and private civil actions brought by plaintiffs purporting to represent a potential class or for which a class has been certified. Although Sonic vigorously defends itself in all legal and administrative proceedings, the outcomes of pending and future proceedings arising out of the conduct of Sonic's business, including litigation with customers, employment related lawsuits, contractual disputes, class actions, purported class actions and actions brought by governmental authorities, cannot be predicted with certainty. An unfavorable resolution of one or more of these matters could have a material adverse effect on Sonic's results of operations, financial position or cash flows.

Included in other accrued liabilities and other long-term liabilities in the accompanying condensed consolidated balance sheets was approximately \$0.6 million and \$0.3 million, respectively, at September 30, 2015, and approximately \$2.0 million and \$0.3 million, respectively, at December 31, 2014, in reserves that Sonic was holding for pending proceedings. Except as reflected in such reserves, Sonic is currently unable to estimate a range of reasonably possible loss, or a range of reasonably possible loss in excess of the amount accrued, for pending



proceedings.

#### Guarantees and Indemnification Obligations

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

In connection with dealership dispositions, certain of Sonic's dealership subsidiaries have assigned or sublet to the buyer 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 sub-lessee does not perform. In the event the sub-lessees do not perform their obligations under such leases, Sonic remains liable for the lease payments. See Note 12, "Commitments and Contingencies," of the notes to the consolidated financial statements in Sonic's Annual Report on Form 10-K for the year ended December 31, 2014 for further discussion.

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, but that existed prior 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's maximum exposure associated with these general indemnifications was approximately \$6.8 million and \$16.8 million at September 30, 2015 and December 31, 2014,

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

respectively. These indemnifications expire within a period of one to three years following the date of sale. The estimated fair value of these indemnifications was not material and the amount recorded for this contingency was not significant at September 30, 2015. Sonic also guarantees the floor plan commitments of its 50% -owned joint venture, the amount of which was approximately \$2.8 million at both September 30, 2015 and December 31, 2014.

### 9. Fair Value Measurements

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

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

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

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

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

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



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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Assets and liabilities recorded at fair value in the accompanying condensed consolidated balance sheets as of September 30, 2015 and December 31, 2014 are as follows:

	Fair Value Based on	
	Significant Other	
	Observable	
	Inputs (Level 2)	
	September 30,	December 31,
	2015	2014
	(In thousands)	
<b>Assets:</b>		
Cash surrender value of life insurance policies (1)	\$28,683	\$ 27,552
Cash flow swaps designated as hedges (1)	-	618
<b>Total assets</b>	<b>\$28,683</b>	<b>\$ 28,170</b>
<b>Liabilities:</b>		
Cash flow swaps designated as hedges (2)	\$13,905	\$ 10,251
Cash flow swaps not designated as hedges (3)	1,125	1,469
Deferred compensation plan (4)	15,553	15,863
<b>Total liabilities</b>	<b>\$30,583</b>	<b>\$ 27,583</b>

(1) Included in other assets in the accompanying condensed consolidated balance sheets.

(2) As of September 30, 2015, approximately \$5.1 million and \$8.8 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying condensed consolidated balance sheets. As of December 31, 2014, approximately \$7.5 million and \$2.8 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying condensed consolidated balance sheets.

(3) As of September 30, 2015, approximately \$0.5 million and \$0.6 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying condensed consolidated balance sheets. As of December 31, 2014, approximately \$0.7 million and \$0.8 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying condensed consolidated balance sheets.

(4) Included in other long-term liabilities in the accompanying condensed consolidated balance sheets.

There were no instances in the three and nine months ended September 30, 2015 which required a fair value measurement of assets ordinarily measured at fair value on a non-recurring basis. Therefore, the carrying value of assets measured at fair value on a non-recurring basis in the accompanying condensed consolidated balance sheets as

of September 30, 2015 have not changed since December 31, 2014. These assets will be evaluated as of the annual valuation assessment date of October 1.

As of September 30, 2015 and December 31, 2014, the fair values of Sonic's financial instruments, including receivables, notes receivable from finance contracts, notes payable – floor plan, trade accounts payable, borrowings under the 2014 Credit Facilities and certain mortgage notes, approximate their carrying values due either to length of maturity or existence of variable interest rates that approximate prevailing market rates.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At September 30, 2015 and December 31, 2014, the fair value and carrying value of Sonic's fixed rate long-term debt were as follows:

	September 30, 2015		December 31, 2014	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(In thousands)			
7.0% Notes (1)	\$211,500	\$198,669	\$216,000	\$198,556
5.0% Notes (1)	\$290,250	\$300,000	\$294,000	\$300,000
Mortgage Notes (2)	\$177,363	\$170,621	\$152,240	\$147,554
Assumed Notes (2)	\$1,687	\$1,696	\$4,365	\$4,474
Other (2)	\$4,425	\$4,705	\$4,588	\$4,884

(1) As determined by market quotations as of September 30, 2015 and December 31, 2014, respectively (Level 1).

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

## 10. Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss) for the nine months ended September 30, 2015 are as follows:

Changes in Accumulated Other Comprehensive		
Income (Loss) by Component		
for the Nine Months Ended September 30, 2015		
Gains and		Total
Losses on	Defined Benefit	Accumulated Other
Cash Flow	Pension	Comprehensive
Hedges	Plan	Income (Loss)
(In thousands)		

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Balance at December 31, 2014	\$ (5,973)	\$ (451 )	\$ (6,424 )
Other comprehensive income (loss) before reclassifications (1)	(6,683)	-	(6,683 )
Amounts reclassified out of accumulated			
other comprehensive income (loss) (2)	4,035	-	4,035
Net current-period other comprehensive income (loss)	(2,648)	-	(2,648 )
Balance at September 30, 2015	\$ (8,621)	\$ (451 )	\$ (9,072 )

(1) Net of tax benefit of \$4,096.

(2) Net of tax expense of \$2,473.

See the heading “Derivative Instruments and Hedging Activities” in Note 6, “Long-Term Debt,” for further discussion of Sonic’s cash flow hedges. For further discussion of Sonic’s defined benefit pension plan, see Note 10, “Employee Benefit Plans,” of the notes to the consolidated financial statements in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2014.

## 11. Segment Information

As of September 30, 2015, Sonic had two operating segments: Franchised Dealerships and EchoPark®. The Franchised Dealerships segment is comprised of retail automotive franchises that sell new and buy and sell used vehicles, replacement parts and vehicle repair and maintenance services, and finance and insurance products. The EchoPark® segment is comprised of stand-alone pre-owned specialty retail locations that provide customers an opportunity to search, buy, service, finance and sell pre-owned vehicles.

The operating segments identified above are the business activities of Sonic for which discrete financial information is available and for which operating results are regularly reviewed by Sonic’s chief operating decision maker to assess operating performance and allocate resources. Sonic’s chief operating decision maker is a group consisting of the Company’s Executive Chairman, Chief Executive Officer and President and Chief Financial Officer. The Company has determined that its operating segments also represent its reportable segments.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Reportable segment revenue and segment income are as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
	(In thousands)			
<b>Revenues:</b>				
Franchised Dealerships	\$2,472,357	\$2,355,604	\$7,094,951	\$6,845,271
EchoPark®	22,051	-	58,712	-
Total consolidated revenues	\$2,494,408	\$2,355,604	\$7,153,663	\$6,845,271

	Three Months		Nine Months Ended	
	Ended		September 30,	
	September 30,	September 30,	2015	2014
	(In thousands)			
<b>Segment income (loss) (1):</b>				
Franchised Dealerships	\$61,104	\$56,349	\$145,888	\$166,040
EchoPark®	(3,545 )	(3,853 )	(13,827 )	(8,838 )
Total segment income	57,559	52,496	132,061	157,202
Interest expense, other, net	(12,361)	(12,893)	(38,635 )	(40,576 )
Other income (expense), net	-	(1 )	102	98
Income (loss) from continuing operations before taxes	\$45,198	\$39,602	\$93,528	\$116,724

(1) Segment income (loss) for each segment is defined as operating income less floor plan interest expense.



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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 our financial condition and results of operations should be read in conjunction with the Sonic Automotive, Inc. condensed consolidated financial statements and related notes thereto appearing elsewhere in this report, as well as the audited financial statements and related notes thereto, "Item 1A: Risk Factors" and "Item 7: 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, 2014.

Except to the extent that differences among operating segments are material to an understanding of our business taken as a whole, we present the discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations on a consolidated basis.

As a result of the way we manage our business, as of September 30, 2015, we had two operating segments: Franchised Dealerships and EchoPark®. The Franchised Dealerships segment is comprised of retail automotive franchises that sell new and buy and sell used vehicles, replacement parts and vehicle repair and maintenance services, and finance and insurance products. The EchoPark® segment is comprised of stand-alone pre-owned specialty retail locations that provide customers an opportunity to search, buy, service, finance and sell pre-owned vehicles.

Overview

We are one of the largest automotive retailers in the United States. As of September 30, 2015, we operated 117 franchises in 13 states (representing 25 different brands of cars and light trucks) and 18 collision repair centers. For management and operational reporting purposes, we group certain franchises together that share management and inventory (principally used vehicles) into "stores." As of September 30, 2015, we operated 99 franchised dealership stores and three EchoPark® stores.

Our dealerships provide comprehensive services including (1) sales and purchases of both new and used cars and light trucks; (2) sales of replacement parts, performance of vehicle maintenance, manufacturer warranty repairs, paint and collision repair services (collectively, "Fixed Operations"); and (3) arrangement of extended warranties, service contracts, financing, insurance and other aftermarket products (collectively, "F&I") for our customers.

## SONIC AUTOMOTIVE, INC.

## 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 three and nine months ended September 30, 2015 and 2014:

Brand	Percentage of New Vehicle Revenue Three Months Ended September 30, 2015		Percentage of New Vehicle Revenue Three Months Ended September 30, 2014		Percentage of New Vehicle Revenue Nine Months Ended September 30, 2015		Percentage of New Vehicle Revenue Nine Months Ended September 30, 2014	
<b>Luxury:</b>								
BMW	20.3	%	20.8	%	21.1	%	20.8	%
Mercedes	9.1	%	8.7	%	9.4	%	9.0	%
Lexus	5.5	%	5.6	%	5.4	%	5.1	%
Audi	4.9	%	5.0	%	4.9	%	4.9	%
Cadillac	3.3	%	4.1	%	3.2	%	4.4	%
Land Rover	3.1	%	2.5	%	3.8	%	2.7	%
Porsche	2.6	%	2.5	%	2.5	%	2.4	%
Mini	1.7	%	2.1	%	2.0	%	2.2	%
Volvo	1.0	%	0.8	%	0.8	%	0.8	%
Acura	0.9	%	0.8	%	0.9	%	0.9	%
Infiniti	0.8	%	0.7	%	0.8	%	0.7	%
Jaguar	0.6	%	0.7	%	0.7	%	0.7	%
Smart	0.3	%	0.0	%	0.1	%	0.0	%
Total Luxury	54.1	%	54.3	%	55.6	%	54.6	%
<b>Mid-line Import:</b>								
Honda	16.5	%	16.0	%	15.9	%	15.4	%
Toyota	11.5	%	11.3	%	11.2	%	10.6	%
Volkswagen	1.8	%	2.3	%	1.8	%	2.0	%
Hyundai	1.6	%	1.6	%	1.5	%	1.7	%
Other (1)	0.8	%	1.2	%	0.9	%	1.6	%
Nissan	0.6	%	0.8	%	0.6	%	1.0	%
Total Mid-line Import	32.8	%	33.2	%	31.9	%	32.3	%
<b>Domestic:</b>								
Ford	7.3	%	7.1	%	7.0	%	7.6	%
General Motors (2)	5.8	%	5.4	%	5.5	%	5.5	%
Total Domestic	13.1	%	12.5	%	12.5	%	13.1	%
Total	100.0	%	100.0	%	100.0	%	100.0	%

- (1) Includes Kia, Scion and Subaru.
- (2) Includes Buick, Chevrolet and GMC.

## Results of Operations

Unless otherwise noted, all discussion of increases or decreases for the three and nine months ended September 30, 2015 are compared to the three and nine months ended September 30, 2014, as applicable. The following discussion of new vehicles, used vehicles, wholesale vehicles, Fixed Operations and F&I are on a same store basis, except where otherwise noted. All currently operating continuing operations stores are included within the same store group in the first full month following the first anniversary of the store's opening or acquisition.

## SONIC AUTOMOTIVE, INC.

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

## New Vehicles

The automobile retail industry uses the Seasonally Adjusted Annual Rate ("SAAR") to measure the annual amount of expected new vehicle unit sales activity (both retail and fleet sales) within the United States. The SAAR below reflects all brands marketed or sold in the United States. The SAAR includes brands we do not sell and markets in which we do not operate, therefore, our new vehicle sales may not trend directly with the SAAR.

(in millions of vehicles)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2015	2014	% Change	2015	2014	% Change
SAAR	17.8	16.7	6.6 %	17.2	16.3	5.5 %

New vehicle revenues include the sale of new vehicles to retail customers, as well as the sale of fleet vehicles. New vehicle revenues can be influenced by manufacturer incentives for consumers, which vary from cash-back incentives to low interest rate financing. New vehicle revenues are also dependent on manufacturers providing adequate vehicle allocations to our dealerships to meet customer demands and the availability of consumer credit.

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

	Three Months Ended September 30,		Better / (Worse) %	
	2015	2014	Change	Change
(In thousands, except units and per unit data)				
<b>Reported:</b>				
Revenue	\$1,368,029	\$1,327,837	\$40,192	3.0 %
Gross profit	\$65,435	\$69,026	\$(3,591)	(5.2 %)
Unit sales	37,493	36,774	719	2.0 %
Revenue per unit	\$36,488	\$36,108	\$380	1.1 %
Gross profit per unit	\$1,745	\$1,877	\$(132)	(7.0 %)
Gross profit as a % of revenue	4.8 %	5.2 %	(40)	bps

	Nine Months Ended September 30,		Better / (Worse) %	
	2015	2014	Change	Change
(In thousands, except units and per unit data)				
<b>Reported:</b>				

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Revenue	\$3,865,639	\$3,773,234	\$92,405	2.4	%
Gross profit	\$193,720	\$209,892	\$(16,172)	(7.7	%)
Unit sales	104,145	103,310	835	0.8	%
Revenue per unit	\$37,118	\$36,523	\$595	1.6	%
Gross profit per unit	\$1,860	\$2,032	\$(172 )	(8.5	%)
Gross profit as a % of revenue	5.0	% 5.6	% (60	)	bps

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

	Three Months Ended September 30,		Better / (Worse)		
	2015	2014	Change	Change	
(In thousands, except units and per unit data)					
<b>Same Store:</b>					
Revenue	\$1,357,281	\$1,307,800	\$49,481	3.8 %	
Gross profit	\$64,860	\$67,826	\$(2,966 )	(4.4 %)	
Unit sales	37,147	36,143	1,004	2.8 %	
Revenue per unit	\$36,538	\$36,184	\$354	1.0 %	
Gross profit per unit	\$1,746	\$1,877	\$(131 )	(7.0 %)	
Gross profit as a % of revenue	4.8	% 5.2	% (40	)	bps

## SONIC AUTOMOTIVE, INC.

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

	Nine Months Ended September 30,		Better / (Worse)	
	2015	2014	Change	% Change
(In thousands, except units and per unit data)				
<b>Same Store:</b>				
Revenue	\$3,830,202	\$3,670,736	\$159,466	4.3 %
Gross profit	\$192,086	\$204,223	\$(12,137)	(5.9 %)
Unit sales	103,058	100,350	2,708	2.7 %
Revenue per unit	\$37,165	\$36,579	\$586	1.6 %
Gross profit per unit	\$1,864	\$2,035	\$(171)	(8.4 %)
Gross profit as a % of revenue	5.0 %	5.6 %	(60)	bps

During 2015, we continued to test our new car pricing model. Once the pricing models prove to be efficient and effective, we believe we will become more aggressive in pricing as well as gain market share as customers benefit from the entire complement of our shopping experience.

The increase in new vehicle revenue during the three and nine months ended September 30, 2015 was primarily driven by an increase in new vehicle unit sales volume of 2.8% and 2.7%, respectively. During the three and nine months ended September 30, 2015, excluding fleet sales (which we began to scale back in 2014), our retail new vehicle revenue increased 3.8% and 5.2%, respectively, and our retail new unit sales volume increased 2.5% and 3.7%, respectively. Our Honda, Mercedes and Toyota/Scion dealerships led our retail new vehicle unit sales volume growth with increases of 4.0%, 10.8% and 3.9%, respectively, in the three months ended September 30, 2015. Our Honda, Toyota/Scion and Mercedes dealerships led our retail new vehicle unit sales volume growth with increases of 5.3%, 8.2% and 13.4%, respectively, in the nine months ended September 30, 2015.

Total new vehicle gross profit dollars decreased \$3.0 million, or 4.4%, during the three months ended September 30, 2015 and decreased \$12.1 million, or 5.9%, during the nine months ended September 30, 2015. Our gross profit per new unit decreased in the three and nine months ended September 30, 2015 by \$131 and \$171 per unit, respectively, primarily driven by our Toyota/Scion, BMW and Audi dealerships. New fleet vehicle gross profit dollars decreased \$0.2 million during the three months ended September 30, 2015, primarily driven by the 18.3% decrease in new fleet vehicle revenue per unit. New fleet vehicle gross profit dollars decreased \$1.5 million during the nine months ended September 30, 2015, primarily driven by the 41.7% decrease in new fleet vehicle unit sales volume.

Our luxury dealerships (which include Cadillac) experienced an increase in retail new vehicle revenue of 2.4% and 5.9% during the three and nine months ended September 30, 2015, respectively, primarily due to a retail new unit sales volume increase of 1.5% and 3.9%, respectively. Luxury dealership retail new vehicle gross profit decreased 3.4% and 0.8% during the three and nine months ended September 30, 2015, respectively, primarily driven by gross profit decreases at our BMW, Audi and Cadillac dealerships, offset partially by increases at our Land Rover and Mercedes dealerships. Luxury dealership retail new vehicle gross profit per unit decreased 4.8% and 4.5% during the three and nine months ended September 30, 2015, respectively, primarily driven by our BMW and Audi dealerships. These declines in retail new vehicle gross profit per unit are the result of the transparency of new vehicle pricing and our strategy to maintain and gain market share in these brands to support used inventory acquisition and fixed

operations.

Our mid-line import dealerships experienced an increase in retail new vehicle revenue of 2.9% and 4.3% during the three and nine months ended September 30, 2015, respectively, primarily due to a retail new unit sales volume increase of 2.0% and 4.2%, respectively. Mid-line import dealership retail new vehicle gross profit decreased 16.4% and 20.8% during the three and nine months ended September 30, 2015, respectively, primarily driven by gross profit decreases at our Toyota/Scion, Honda and Hyundai dealerships. Mid-line import dealership retail new vehicle gross profit per unit decreased 18.1% and 24.0% during the three and nine months ended September 30, 2015, respectively, primarily driven by our Toyota/Scion, Honda and Hyundai dealerships. These declines in retail new vehicle gross profit per unit are the result of the transparency of new vehicle pricing and our strategy to maintain and gain market share in these brands to support used inventory acquisition and fixed operations.

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## SONIC AUTOMOTIVE, INC.

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

Our domestic dealership retail new vehicle revenue increased 12.5% and 4.3% during the three and nine months ended September 30, 2015, respectively, primarily due to a retail new unit sales volume increase of 7.3% and 0.9%, respectively. Domestic dealership retail new vehicle gross profit increased 14.7% during the three months ended September 30, 2015, driven primarily by our Ford dealerships, and decreased 0.7% during the nine months ended September 30, 2015, driven primarily by our General Motors dealerships. Domestic dealership retail new vehicle gross profit per unit increased 7.0% during the three months ended September 30, 2015, driven by our Ford dealerships and decreased 1.6% during the nine months ended September 30, 2015, driven by our General Motors dealerships. Domestic dealership retail new vehicle gross profit per unit increased during the three months ended September 30, 2015, primarily driven by an increase in higher margin retail truck sales. Domestic dealership retail new vehicle gross profit per unit decreased during the nine months ended September 30, 2015, as a result of the transparency of new vehicle pricing and our strategy to maintain and gain market share in these brands to support used inventory acquisition and fixed operations, partially offset by an increase in higher margin retail truck sales.

## Used Vehicles

Used vehicle revenues are directly affected by a number of factors, including the level of manufacturer incentives on new vehicles, the number and quality of trade-ins and lease turn-ins, the availability and pricing of used vehicles acquired at auction and the availability of consumer credit.

Our reported used vehicle results are as follows:

	Three Months Ended September 30,		Better / (Worse) %		
	2015	2014	Change	Change	
	(In thousands, except units and per unit data)				
<b>Reported:</b>					
Revenue	\$652,058	\$583,570	\$68,488	11.7	%
Gross profit	\$41,730	\$41,245	\$485	1.2	%
Unit sales	30,467	27,536	2,931	10.6	%
Revenue per unit	\$21,402	\$21,193	\$209	1.0	%
Gross profit per unit	\$1,370	\$1,498	\$(128 )	(8.5)	%
Gross profit as a % of revenue	6.4	% 7.1	% (70 )		bps

	Nine Months Ended September 30,		Better / (Worse) %		
	2015	2014	Change	Change	
	(In thousands, except units and per unit data)				
<b>Reported:</b>					



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Revenue	\$1,904,594	\$1,747,254	\$157,340	9.0	%
Gross profit	\$123,271	\$119,412	\$3,859	3.2	%
Unit sales	88,903	83,707	5,196	6.2	%
Revenue per unit	\$21,423	\$20,873	\$550	2.6	%
Gross profit per unit	\$1,387	\$1,427	\$(40 )	(2.8	%)
Gross profit as a % of revenue	6.5	% 6.8	% (30 )		bps

Our same store used vehicle results are as follows:

	Three Months Ended		Better / (Worse)		
	September 30,		%		
	2015	2014	Change	Change	
(In thousands, except units and per unit data)					
<b>Same Store:</b>					
Revenue	\$625,760	\$571,295	\$54,465	9.5	%
Gross profit	\$40,288	\$40,816	\$(528 )	(1.3	%)
Unit sales	29,173	26,902	2,271	8.4	%
Revenue per unit	\$21,450	\$21,236	\$214	1.0	%
Gross profit per unit	\$1,381	\$1,517	\$(136 )	(9.0	%)
Gross profit as a % of revenue	6.4	% 7.1	% (70 )		bps

## SONIC AUTOMOTIVE, INC.

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

	Nine Months Ended September 30,		Better / (Worse) %		
	2015	2014	Change	Change	
(In thousands, except units and per unit data)					
<b>Same Store:</b>					
Revenue	\$1,831,379	\$1,689,958	\$141,421	8.4	%
Gross profit	\$119,184	\$116,749	\$2,435	2.1	%
Unit sales	85,225	80,900	4,325	5.3	%
Revenue per unit	\$21,489	\$20,889	\$600	2.9	%
Gross profit per unit	\$1,398	\$1,443	\$(45 )	(3.1)	%
Gross profit as a % of revenue	6.5	% 6.9	% (40 )		bps

In the three months ended September 30, 2015, our used vehicle unit volume increased 8.4%, driven primarily by our BMW, Honda and Toyota stores. Used vehicle unit volume increased 5.3% in the nine months ended September 30, 2015, driven primarily by our BMW, Honda and Audi stores. Used vehicle gross profit for the three months ended September 30, 2015 decreased 1.3%, driven primarily by a 9.0% decrease in gross profit per unit, partially offset by an increase in used vehicle unit volume. Used vehicle gross profit for the nine months ended September 30, 2015 increased 2.1%, primarily driven by an increase in used vehicle unit volume, offset partially by a 3.1% decrease in gross profit per unit. As we expand the One Sonic-One Experience initiative to additional stores, we believe we will have the opportunity to experience gains in our used vehicle unit volume and gross profit.

## Wholesale Vehicles

Wholesale vehicle revenues are highly correlated with new and used vehicle retail sales and the associated trade-in volume and are also significantly affected by our corporate inventory management policies, which are designed to optimize our total used vehicle inventory.

Our reported wholesale vehicle results are as follows:

	Three Months Ended September 30,		Better / (Worse) %		
	2015	2014	Change	Change	
(In thousands, except units and per unit data)					
<b>Reported:</b>					
Revenue	\$37,971	\$41,433	\$(3,462)	(8.4)	%
Gross profit (loss)	\$(2,481 )	\$(1,086 )	\$(1,395)	(128.5)	%
Unit sales	7,787	7,916	(129 )	(1.6)	%
Revenue per unit	\$4,876	\$5,234	\$(358 )	(6.8)	%
Gross profit (loss) per unit	\$(319 )	\$(137 )	\$(182 )	(132.8)	%
Gross profit (loss) as a % of revenue	(6.5 %)	(2.6 %)	(390 )		bps

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	Nine Months Ended September 30,		Better / (Worse) %	
	2015	2014	Change	Change
(In thousands, except units and per unit data)				
<b>Reported:</b>				
Revenue	\$120,760	\$127,797	\$(7,037)	(5.5 %)
Gross profit (loss)	\$(5,366 )	\$(2,493 )	\$(2,873)	(115.2 %)
Unit sales	23,574	23,034	540	2.3 %
Revenue per unit	\$5,123	\$5,548	\$(425 )	(7.7 %)
Gross profit (loss) per unit	\$(228 )	\$(108 )	\$(120 )	(111.1 %)
Gross profit (loss) as a % of revenue	(4.4 %)	(2.0 %)	(240 )	bps

## SONIC AUTOMOTIVE, INC.

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

Our same store wholesale vehicle results are as follows:

	Three Months Ended		Better / (Worse)	
	September 30,		%	
	2015	2014	Change	Change
	(In thousands, except units and per unit data)			
<b>Same Store:</b>				
Revenue	\$36,803	\$40,338	\$(3,535)	(8.8 %)
Gross profit (loss)	\$(2,445 )	\$(1,065 )	\$(1,380)	(129.6 %)
Unit sales	7,463	7,750	(287 )	(3.7 %)
Revenue per unit	\$4,931	\$5,205	\$(274 )	(5.3 %)
Gross profit (loss) per unit	\$(328 )	\$(137 )	\$(191 )	(139.4 %)
Gross profit (loss) as a % of revenue	(6.6 %)	(2.6 %)	(400 )	bps

	Nine Months Ended		Better / (Worse)	
	September 30,		%	
	2015	2014	Change	Change
	(In thousands, except units and per unit data)			
<b>Same Store:</b>				
Revenue	\$117,037	\$123,910	\$(6,873)	(5.5 %)
Gross profit (loss)	\$(4,969 )	\$(2,396 )	\$(2,573)	(107.4 %)
Unit sales	22,622	22,371	251	1.1 %
Revenue per unit	\$5,174	\$5,539	\$(365 )	(6.6 %)
Gross profit (loss) per unit	\$(220 )	\$(107 )	\$(113 )	(105.6 %)
Gross profit (loss) as a % of revenue	(4.2 %)	(1.9 %)	(230 )	bps

Wholesale vehicle revenue and unit sales volume fluctuations are typically a result of new and used retail vehicle unit volumes that generate additional trade-in vehicle volume that we are not always able to sell as retail used vehicles and choose to sell at auction. Whenever possible, we prefer to sell a used vehicle through retail channels rather than wholesaling the vehicle at auction. In the three and nine months ended September 30, 2015, wholesale unit volume as a percentage of total used unit volume (retail plus wholesale) declined 200 basis points and 70 basis points, respectively. This shift toward retailing a higher percentage of our used inventory contributed to higher levels of gross loss per wholesale unit, as the remaining wholesale vehicles are typically lower in quality/value.

#### Parts, Service and Collision Repair ("Fixed Operations")

Parts and service revenue consists of customer requested parts and service orders ("customer pay"), warranty repairs, wholesale parts and collision repairs. Parts and service revenue is driven by the mix of warranty repairs versus customer pay repairs, available service capacity, vehicle quality, customer loyalty and manufacturer warranty

programs.

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SONIC AUTOMOTIVE, INC.

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

Our reported Fixed Operations results are as follows:

Three Months  
Ended  
September 30,