SONIC AUTOMOTIVE INC
Form 10-Q
October 28, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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

Commission files number 1-13395

SONIC AUTOMOTIVE, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	**56-2010790**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6415 Idlewild Road, Suite 109, Charlotte, North Carolina	**28212**
(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 ý No o

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

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 o	Accelerated Filer ý	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Compa

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

As of October 22, 2010, there were 40,707,683 shares of Class A Common Stock and 12,029,375 shares of Class B Common Stock outstanding.

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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)

	Third Quarter Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Revenues:				
New vehicles	$ 903,716	$ 937,709	$ 2,367,236	$ 2,611,988
Used vehicles	379,389	453,815	1,081,855	1,339,323
Wholesale vehicles	34,588	47,597	105,451	108,336
Total vehicles	1,317,693	1,439,121	3,554,542	4,059,647
Parts, service and collision repair	268,801	283,741	807,556	842,697
Finance, insurance and other	43,403	47,398	116,558	133,607
Total revenues	1,629,897	1,770,260	4,478,656	5,035,951
Cost of Sales:				
New vehicles	(840,173)	(877,691)	(2,207,435)	(2,440,097)
Used vehicles	(347,187)	(418,576)	(986,355)	(1,231,720)
Wholesale vehicles	(36,216)	(49,053)	(108,275)	(112,270)
Total vehicles	(1,223,576)	(1,345,320)	(3,302,065)	(3,784,087)
Parts, service and collision repair	(132,018)	(143,141)	(400,328)	(421,711)
Total cost of sales	(1,355,594)	(1,488,461)	(3,702,393)	(4,205,798)
Gross profit	274,303	281,799	776,263	830,153
Selling, general and administrative expenses	(214,140)	(226,331)	(619,560)	(672,542)
Impairment charges	(620)	(87)	(5,707)	(132)
Depreciation and amortization	(8,131)	(8,731)	(23,865)	(25,729)
Operating income	51,412	46,650	127,131	131,750
Other income (expense):				
Interest expense, floor plan	(4,533)	(5,430)	(14,925)	(15,615)
Interest expense, other, net	(18,277)	(15,226)	(57,998)	(48,024)
Interest expense, non-cash, convertible debt	7,818	(1,768)	1,556	(5,175)
Interest expense, non-cash, cash flow swaps	(2,180)	(1,484)	(5,359)	(5,402)
Other income (expense), net	2,449	(351)	2,519	(7,522)
Total other expense	(14,723)	(24,259)	(74,207)	(81,738)
Income from continuing operations before taxes	36,689	22,391	52,924	50,012
Income tax provision	(16,510)	(8,442)	(23,816)	(19,905)

Income from continuing operations	20,179	13,949	29,108	30,107
Discontinued operations:				
Loss from operations and the sale of discontinued franchises	(8,551)	(633)	(19,203)	(6,149)
Income tax benefit (expense)	3,966	(331)	7,393	1,617
Loss from discontinued operations	(4,585)	(964)	(11,810)	(4,532)
Net income	$ 15,594	$ 12,985	$ 17,298	$ 25,575
Basic earnings per share:				
Earnings per share from continuing operations	$ 0.47	$ 0.26	$ 0.70	$ 0.57
Loss per share from discontinued operations	(0.10)	(0.01)	(0.28)	(0.09)
Earnings per share	$ 0.37	$ 0.25	$ 0.42	$ 0.48
Weighted average common shares outstanding	42,305	52,311	41,130	52,151
Diluted earnings per share:				
Earnings per share from continuing operations	$ 0.24	$ 0.25	$ 0.48	$ 0.56
Loss per share from discontinued operations	(0.07)	(0.02)	(0.22)	(0.07)
Earnings per share	$ 0.17	$ 0.23	$ 0.26	$ 0.49
Weighted average common shares outstanding	63,195	65,851	52,529	65,711

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	December 31, 2009	(Unaudited) September 30, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 30,035	$ 10,623
Receivables, net	232,969	166,546
Inventories	795,275	863,917
Assets held for sale	12,167	13,548
Other current assets	14,937	15,582
Total Current Assets	1,085,383	1,070,216
Property and Equipment, net	382,085	392,173
Goodwill	469,482	468,516
Other Intangible Assets, net	80,806	79,563
Other Assets	51,099	61,633
Total Assets	$ 2,068,855	$ 2,072,101
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Notes payable - floor plan - trade	$ 214,871	$ 436,444
Notes payable - floor plan - non-trade	548,493	339,117
Trade accounts payable	55,345	47,968
Accrued interest	16,146	10,035
Other accrued liabilities	144,709	145,447
Liabilities associated with assets held for sale - non-trade	3,346	-
Current maturities of long-term debt	23,991	23,704
Total Current Liabilities	1,006,901	1,002,715
Long-Term Debt	552,150	529,632
Other Long-Term Liabilities	141,052	143,631
Stockholders Equity:		
Class A convertible preferred stock, none issued	-	-
Class A common stock, $.01 par value; 100,000,000 shares authorized; 54,986,875 shares issued and 40,099,559 shares outstanding at December 31, 2009; 55,635,206 shares issued and 40,657,683 shares outstanding at September 30, 2010	550	556
Class B common stock; $.01 par value; 30,000,000 shares authorized; 12,029,375 shares outstanding at December 31, 2009 and September 30, 2010	121	121
Paid-in capital	662,186	666,401
Accumulated deficit	(35,180)	(9,604)
Accumulated other comprehensive income (loss)	(22,350)	(23,703)

Treasury stock, at cost (14,887,316 Class A shares held at December 31, 2009 and 14,977,523 Class A shares held at September 30, 2010)	(236,575)	(237,648)
Total Stockholders Equity	368,752	396,123
Total Liabilities and Stockholders Equity	$ 2,068,855	$ 2,072,101

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(Dollars and shares in thousands)
(Unaudited)

	Class A Common Stock		Class B Common Stock		Paid-In	Accumulated	Treasury	Accumulated Other Comprehensive Income (Loss)	Total Stockholders	Compre-hensive
	Shares	Amount	Shares	Amount	Capital	Deficit	Stock		Equity	Income
BALANCE AT DECEMBER 31, 2009	54,987	550	12,029	121	662,186	(35,180)	(236,575)	(22,350)	368,752	
Shares awarded under stock compensation plans	292	3	-	-	1,185	-	-	-	1,188	-
Purchases of treasury stock	-	-	-	-	-	-	(1,073)	-	(1,073)	-
Income tax benefit associated with stock compensation plans	-	-	-	-	636	-	-	-	636	-
Income tax benefit associated with convertible note hedge	-	-	-	-	205	-	-	-	205	-
Fair value of interest rate swap agreements, net of tax benefit of $830	-	-	-	-	-	-	-	(1,353)	(1,353)	(1,353)
Stock-based compensation expense	-	-	-	-	419	-	-	-	419	-

Restricted stock amortization, net of forfeitures	-	-	-	-	1,773	-	-	-	1,773	-
Net income	-	-	-	-	-	25,575	-	-	25,575	25,575
Other	356	3	-	-	(3)	1	-	-	1	-
BALANCE AT SEPTEMBER 30, 2010	55,635	556	12,029	$ 121	$ 666,401	$ (9,604)	$ (237,648)	$ (23,703)	$ 396,123	$ 24,222

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 17,298	$ 25,575
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	24,905	25,938
Provision for bad debt expense	1,255	756
Other amortization	1,242	1,242
Debt issuance cost amortization	9,909	2,702
Debt discount amortization, net of premium amortization	9,957	3,872
Stock - based compensation expense	437	419
Amortization of restricted stock	1,802	1,773
Restricted stock forfeiture	(182)	-
Deferred income taxes	(2,390)	(656)
Equity interest in earnings of investees	(501)	(585)
Asset impairment charges	9,116	132
Loss (gain) on disposal of franchises and property and equipment	(226)	(978)
Loss on exit of leased dealerships	7,511	2,321
Loss (gain) on retirement of debt	(2,095)	7,665
Derivative fair value adjustments	(11,300)	-
Changes in assets and liabilities that relate to operations:		
Receivables	68,535	65,667
Inventories	383,205	(82,768)
Other assets	(24,362)	(14,706)
Notes payable - floor plan - trade	(92,597)	221,573
Trade accounts payable and other liabilities	41,207	(21,886)
Total adjustments	425,428	212,481
Net cash provided by operating activities	442,726	238,056
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(36,048)	(44,039)
Proceeds from sales of property and equipment	1,797	979
Proceeds from sale of franchises	22,839	24,644
Distributions from equity investees	300	600
Net cash used in investing activities	(11,112)	(17,816)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (repayments) borrowings on notes payable floor plan - non-trade	(369,726)	(212,722)
Borrowings on revolving credit facilities	534,585	40,000
Repayments on revolving credit facilities	(584,854)	(40,000)

Proceeds from long-term debt	167,039	209,977
Principal payments on long-term debt	(162,948)	(4,673)
Increase in restricted cash	(106,913)	-
Settlement of cash flow swaps	(16,454)	-
Repurchase of debt securities	-	(233,190)
Purchase of treasury stock	(61)	(1,073)
Income tax benefit associated with stock compensation plans	-	636
Income tax benefit associated with convertible hedge	4,442	205
Issuance of shares under stock compensation plans	-	1,188
Issuance of common stock related to private placement	101,812	-
Dividends paid	(4,893)	-
Net cash used in financing activities	(437,971)	(239,652)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(6,357)	(19,412)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	6,971	30,035
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 614	$ 10,623
SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:		
Change in fair value of cash flow hedging instruments (net of tax expense of $5,859 and tax benefit of $830 for the nine-month period ended September 30, 2009 and 2010, respectively)	$ 9,728	$ (1,353)
Issuance of shares related to debt refinance	$ 3,947	$ -
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid (received) during the year for:		
Interest, net of amount capitalized	$ 90,116	$ 74,778
Income taxes	$ (21,229)	$ (15,289)

See notes to unaudited condensed consolidated financial statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation The accompanying unaudited condensed consolidated financial information for the third quarter and nine-month periods ended September 30, 2009 and 2010 have 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 normal recurring adjustments) necessary to fairly state the financial position and the results of operations for the periods presented. The results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year. These interim financial statements should be read in conjunction with the audited Consolidated Financial Statements of Sonic Automotive, Inc. (Sonic or the Company) for the year ended December 31, 2009, which were included in Sonic s Annual Report on Form 10-K .

Recent Developments On August 18, 2010, Sonic redeemed $20.0 million in aggregate principal amount of its 8.625% Senior Subordinated Notes at the applicable redemption price (101.438% of principal redeemed) plus accrued but unpaid interest. Sonic recorded a loss on extinguishment of debt of $0.4 million related to the redemption. On October 20, 2010, Sonic issued a redemption notice to holders of the 4.25% Convertible Senior Subordinated Notes due 2015 (the 4.25% Convertible Notes) to redeem the remaining $16.0 million in aggregate principal amount of its outstanding 4.25% Convertible Notes. Sonic will use available cash to redeem the $16.0 million in aggregate principal amount at the applicable redemption price (100.00% of principal redeemed) plus accrued but unpaid interest on November 30, 2010.

Reclassifications The Condensed Consolidated Statements of Income for the third quarter and nine-month periods ended September 30, 2009 reflect 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 September 30, 2009. The Condensed Consolidated Statements of Income for the third quarter and nine-month periods ended September 30, 2009 also reflect the reclassification of balances from discontinued operations to continuing operations for franchises identified for sale as of September 30, 2009, but which Sonic has decided to retain and operate as of September 30, 2010.

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 sublease proceeds, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord. A summary of the activity of these lease exit accruals consists of the following:

	(dollars in thousands)
Balance, December 31, 2009	$ 47,825
Lease exit expense	2,321
Payments	(6,567)
Balance, September 30, 2010	$ 43,579

Income Tax Expense The overall effective tax rates for the third quarter and nine-month periods ended September 30, 2009 and 2010 are higher than federal statutory rates due to the effect of state income taxes. The overall effective tax rate from continuing operations was 37.7% and 39.8% for the third quarter and nine-month periods ended September 30, 2010, respectively. The overall effective tax rate from continuing operations was 45.0% for both the third quarter and nine-month periods ended September 30, 2009. The effective rate for the third quarter and nine-month periods ended September 30, 2010 was lower than the prior year periods due to the shift in the distribution of taxable income between states in which Sonic operates, lower expense effects related to tax positions as a result of Accounting for Uncertainty in Income Taxes in the ASC, and the effect of gross receipts tax structures in certain states.

2. Discontinued Operations

Dispositions The operating results of franchises held for sale are included in the loss from discontinued operations in Sonic s Condensed Consolidated Statements of Income. Assets to be disposed of in connection with franchises held for sale but not yet sold have been classified in assets held for sale in Sonic s Condensed Consolidated Balance Sheets along with other assets held for sale. At September 30, 2010 there were no dealership franchises held for sale. The held for sale balance

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

of property and equipment, net, is comprised of real estate held for sale by non-dealership entities. Assets held for sale consist of the following:

	(dollars in thousands)	
	December 31, 2009	**September 30, 2010**
Inventories	$ 4,528	$ -
Property and equipment, net	4,838	13,548
Goodwill	2,801	-
Assets held for sale	$ 12,167	$ 13,548

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)			
	Third Quarter Ended September 30,		**Nine Months Ended September 30,**	
	2009	**2010**	**2009**	**2010**
Loss from operations	$ (3,302)	$ (1,773)	$ (8,548)	$ (5,920)
Gain (loss) on disposal of franchises	(103)	829	(572)	2,182
Lease exit charges	(5,146)	311	(6,675)	(2,411)
Property impairment charges	-	-	(1,822)	-
Goodwill impairment charges	-	-	(1,586)	-
Pre-tax loss	$ (8,551)	$ (633)	$ (19,203)	$ (6,149)
Total Revenues	$ 74,018	$ 9,473	$ 245,935	$ 55,127

Lease exit charges recorded for the third quarter and nine-month periods ended September 30, 2009 and 2010 relate to the revision of estimates on previously established lease exit accruals and the establishment of lease exit accruals in the third quarter ended September 30, 2009. The lease exit accruals are calculated by either discounting the remaining lease payments, net of estimated sublease proceeds, or estimating the amount necessary to satisfy the lease commitment to the landlord. See Note 4 for a discussion of property impairment charges and see Note 5 for a discussion of goodwill impairment charges.

Sonic allocates interest expense to discontinued operations based on the net assets of the discontinued operations group. Interest allocated to discontinued operations for the third quarter ended September 30, 2009 was $0.6 million. Interest allocated to discontinued operations for the third quarter ended September 30, 2010 was immaterial. Interest allocated to discontinued operations for the nine-month periods ended September 30, 2009 and 2010 was $2.1 million and $0.2 million, respectively.

3. Inventories

Inventories consist of the following:

(dollars in thousands)

	December 31, 2009	September 30, 2010
New vehicles	$ 557,319	$ 607,742
Used vehicles	138,401	149,890
Parts and accessories	51,470	50,702
Other	52,613	55,583
	$ 799,803	$ 863,917
Less inventories classified as assets held for sale	(4,528)	-
Inventories	$ 795,275	$ 863,917

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, 2009	**September 30, 2010**
Land	$ 61,886	$ 64,870
Building and improvements	322,632	320,389
Office equipment and fixtures	75,801	77,939
Parts and service equipment	54,981	55,910
Company vehicles	8,440	8,151
Construction in progress	40,000	51,557
Total, at cost	563,740	578,816
Less accumulated depreciation	(176,817)	(173,095)
Subtotal	386,923	405,721
Less assets held for sale	(4,838)	(13,548)
Property and equipment, net	$ 382,085	$ 392,173

In both the third quarter and nine-month periods ended September 30, 2010, Sonic recorded fixed asset impairment charges of $0.1 million, which was recorded in continuing operations. In the third quarter and nine-month periods ended September 30, 2009, Sonic recorded fixed asset impairment charges of $0.4 million and $4.3 million, respectively, of which $0.4 million and $2.5 million were recorded in continuing operations, respectively.

5. Goodwill And Intangible Assets

	(dollars in thousands)			
	Franchise Agreements	**Gross Goodwill**	**Accumulated Impairment**	**Net Goodwill**
Balance, December 31, 2009	$ 64,835	$ 1,266,207	$ (796,725)	$ 469,482
Reductions from sales of franchises	-	(3,767)	-	(3,767)
Reclassification from assets held for sale, net	-	2,801	-	2,801
Balance, September 30, 2010	$ 64,835	$ 1,265,241	$ (796,725)	$ 468,516

In the third quarter and nine-month periods ended September 30, 2009, Sonic recorded goodwill impairment charges of $0.2 million and $2.7 million, respectively, of which $0.2 million and $1.1 million were recorded in continuing operations, respectively. The impairment charges recorded were based on the determination that recorded values were not recoverable under asset disposal agreements entered into during the nine-month period ended September 30, 2009. Sonic recorded franchise asset impairment charges of $2.1 million in continuing operations in the nine-month period ended September 30, 2009.

At December 31, 2009, Sonic had $16.0 million of definite life intangibles recorded relating to favorable lease agreements. After the effect of amortization of the definite life intangibles, the balance recorded at September 30, 2010 was $14.7 million and was included in other intangible assets, net, in the accompanying Condensed Consolidated Balance Sheets.

6. Long-term Debt

Long-term debt consists of the following:

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	(dollars in thousands)	
	December 31, 2009	**September 30, 2010**
2010 Revolving Credit Facility (1)	$ -	$ -
Senior Subordinated Notes bearing interest at 9.0%	-	210,000
Senior Subordinated Notes bearing interest at 8.625%	275,000	42,855
Convertible Senior Notes bearing interest at 5.0%	172,500	172,500
Convertible Senior Subordinated Notes bearing interest at 4.25%	17,045	16,000
Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19%)	17,778	16,180
Mortgage notes to finance companies-fixed rate, bearing interest from 4.50% to 7.03%	78,424	84,341
Mortgage notes to finance companies-variable rate, bearing interest at 1.25 to 3.30 percentage points above one-month LIBOR	38,251	30,842
Net debt discount and premium (2)	(29,199)	(25,506)
Other	6,342	6,124
	$ 576,141	$ 553,336
Less current maturities	(23,991)	(23,704)
Long-term debt	$ 552,150	$ 529,632

(1) Interest rate was 2.00% above one-month LIBOR at September 30, 2010.
(2) December 31, 2009 includes $1.5 million discount associated with the 8.625% Notes, $29.8 million discount associated with the 5.0% Convertible Notes, $0.6 million discount associated with the 4.25% Convertible Notes, $2.5 million premium associated with notes payable to a finance company and $0.2 million premium associated with mortgage notes payable. September 30, 2010 includes $1.4 million discount associated with the 9.0% Notes, $0.2 million discount associated with the 8.625% Notes, $26.0 million discount associated with the 5.0% Convertible Notes, $0.1 million discount associated with the 4.25% Convertible Notes, $2.0 million premium associated with notes payable to a finance company and $0.2 million premium associated with mortgage notes payable.

2006 Credit Facility

The 2006 Revolving Credit Sub-Facility, the 2006 New Vehicle Floor Plan Sub-Facility and the 2006 Used Vehicle Floor Plan Sub-Facility (collectively the 2006 Credit Facility) would have matured on February 17, 2010. The 2006 Credit Facility was refinanced on January 15, 2010. See 2010 Credit Facilities discussion below.

2010 Credit Facilities

On January 15, 2010, Sonic entered into an amended and restated syndicated revolving credit agreement (the 2010 Revolving Credit Facility) and a syndicated floor plan credit facility (the 2010 Floorplan Facility). The 2010 Revolving Credit Facility and 2010 Floorplan Facility (collectively the 2010 Credit Facilities) mature on August 15, 2012.

The 2010 Revolving Credit Facility, which is subject to a borrowing base, has a borrowing limit of $150.0 million, which may be expanded up to $215.0 million in total credit availability upon satisfaction of certain conditions. The amount available for borrowing under the 2010 Revolving Credit Facility (the 2010 Revolving Borrowing Base) is reduced on a dollar-for-dollar basis by the aggregate face amount of any outstanding letters of credit under the 2010 Revolving Credit Facility. The borrowing base is calculated based on the value of eligible accounts, eligible inventory, eligible equipment and 5,000,000 shares of common stock of Speedway Motorsports, Inc. (SMI) pledged as collateral by one of Sonic s affiliates, Sonic Financial Corporation (SFC).

As of September 30, 2010, the 2010 Revolving Borrowing Base was approximately $137.6 million. At September 30, 2010, Sonic had no outstanding borrowings and $49.9 million in outstanding letters of credit resulting in total borrowing availability of $87.7 million under the 2010 Revolving Credit Facility.

Outstanding obligations under the 2010 Revolving Credit Facility are secured by a pledge of substantially all of the assets of Sonic and its subsidiaries, and by the pledge of 5,000,000 shares of common stock of SMI by SFC. The collateral also provides for the pledge of the franchise agreements and stock or equity interests of Sonic s dealership franchise subsidiaries, except for those dealership franchise subsidiaries where the applicable manufacturer prohibits such a pledge, in

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

which cases the stock or equity interests of the dealership franchise subsidiary is subject to an escrow arrangement with the administrative agent. Substantially all of Sonic s subsidiaries also guarantee its obligations under the 2010 Revolving Credit Facility.

The 2010 Floorplan Facility is comprised of a new vehicle revolving floor plan facility in an amount up to $321.0 million (the 2010 New Vehicle Floorplan Facility) and a used vehicle revolving floor plan facility in an amount up to $50.0 million, subject to a borrowing base (the 2010 Used Vehicle Floorplan Facility). Sonic may, under certain conditions, request an increase in the 2010 Floorplan Facility by up to $125.0 million, which shall be allocated between the 2010 New Vehicle Floorplan Facility and the 2010 Used Vehicle Floorplan Facility as Sonic requests, with no more than 15% of the aggregate commitments allocated to the commitments under the 2010 Used Vehicle Floorplan Facility. Outstanding obligations under the 2010 Floorplan Facility are guaranteed by Sonic and certain of its subsidiaries and are secured by a pledge of substantially all of the assets of Sonic and its subsidiaries.

The amounts outstanding under the 2010 Credit Facilities bear interest at variable rates based on specified percentages above LIBOR according to a performance-based pricing grid determined by Sonic s Consolidated Total Debt to EBITDA Ratio (as defined in the 2010 Credit Facilities agreement) as of the last day of the immediately preceding fiscal quarter.

Covenants

The 2010 Credit Facilities contain certain covenants, including covenants which could restrict or prohibit indebtedness, liens, the payment of dividends, capital expenditures and material dispositions and acquisitions of assets as well as other customary covenants and default provisions. Sonic was in compliance with the covenants under the 2010 Credit Facilities as of September 30, 2010 and expects to be in compliance with the covenants for the foreseeable future. Financial covenants include required specified ratios (as each is defined in the 2010 Credit Facilities) of:

	Consolidated Liquidity Ratio	Covenant Consolidated Fixed Charge Coverage Ratio	Consolidated Total Senior Secured Debt to EBITDA Ratio
Through March 30, 2011	≥ 1.00	≥ 1.10	≤ 2.25
March 31, 2011 through and including March 30, 2012	≥ 1.05	≥ 1.15	≤ 2.25
March 31, 2012 and thereafter	≥ 1.10	≥ 1.20	≤ 2.25
September 30, 2010 actual	1.15	1.29	1.12

The 2010 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 occurrence of an event of default, Sonic could be required to immediately repay all outstanding amounts under the 2010 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 2010 Credit Facilities with the exception of one financial covenant related to the ratio of EBTDAR to Rent (as defined in the lease agreements) with a required ratio of no less than 1.5 to 1.0. At September 30, 2010, the ratio was 1.94 to 1.0.

9.0% Senior Subordinated Notes (9.0% Notes)

On March 12, 2010, Sonic issued $210.0 million aggregate principal amount of 9.0% Notes which mature on March 15, 2018. On April 12, 2010, Sonic used the net proceeds, together with cash on hand, to redeem $200.0 million aggregate principal amount of its 8.625% Notes due 2013. The 9.0% Notes are unsecured senior subordinated obligations of Sonic and are guaranteed by Sonic s domestic operating subsidiaries. Interest is payable semi-annually on March 15 and September 15 each year. Sonic may redeem the 9.0% Notes in whole or in part at any time after March 15, 2014 at the following redemption prices, which are expressed as percentages of the principal amount:

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

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

The indenture governing the 9.0% Notes contains certain specified restrictive covenants. Sonic has agreed not to pledge any assets to any third party lender of senior subordinated debt except under certain limited circumstances. Sonic also has agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, capital stock, guarantees, asset sales, investments, cash dividends to stockholders, distributions and redemptions. Specifically, the indenture governing Sonic s 9.0% Notes limits Sonic s ability to pay quarterly cash dividends on Sonic s Class A and B common stock in excess of $0.10 per share. Sonic may only pay quarterly cash dividends on Sonic s Class A and B common stock if Sonic complies with the terms of the indenture governing the 9.0% Notes. Sonic was in compliance with all restrictive covenants as of September 30, 2010.

Balances outstanding under Sonic s 9.0% Notes are guaranteed by all of Sonic s operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor as defined by the SEC.

Sonic s obligations under the 9.0% Notes may be accelerated by the holders of 25% of the outstanding principal amount of the 9.0% Notes then outstanding if certain events of default occur, including: (1) defaults in the payment of principal or interest when due; (2) defaults in the performance, or breach, of Sonic s covenants under the 9.0% Notes; and (3) certain defaults under other agreements under which Sonic or its subsidiaries have outstanding indebtedness in excess of $35.0 million.

8.625% Senior Subordinated Notes (8.625% Notes)

The 8.625% Notes are unsecured obligations that rank equal in right of payment to all of Sonic s existing and future senior subordinated indebtedness, mature on August 15, 2013 and are redeemable at Sonic s option after August 15, 2008. Of the original $275.0 million principal amount of the 8.625% Notes, Sonic had $42.9 million in aggregate principal amount outstanding at September 30, 2010.

On April 12, 2010, Sonic used the net proceeds obtained from the issuance of the 9.0% Notes, together with cash on hand, to redeem $200.0 million in aggregate principal amount of the outstanding 8.625% Notes at the then applicable redemption price (102.875% of principal redeemed) plus accrued but unpaid interest. Sonic recorded a loss on extinguishment of debt of approximately $7.0 million related to the redemption which was recognized in the second quarter ended June 30, 2010. During the second quarter of 2010 Sonic repurchased approximately $12.1 million of additional principal amount of the 8.625% Notes and recorded an additional loss on extinguishment of debt of approximately $0.3 million related to these repurchases. During the third quarter Sonic redeemed an additional $20.0 million in aggregate principal amount of the outstanding 8.625% Notes and recorded a loss on extinguishment of debt of approximately $0.4 million related to the redemption.

The total loss on extinguishment of debt related to repurchases and redemptions of the 8.625% Notes of $7.7 million for the nine-month period ended September 30, 2010 is recorded in other income (expense), net in the Condensed Consolidated Statements of Income.

The indenture governing the 8.625% Notes contains certain specified restrictive covenants. Sonic has agreed not to pledge any assets to any third party lender of senior subordinated debt except under certain limited circumstances.

Sonic also has agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, capital stock, guarantees, asset sales, investments, cash dividends to shareholders, distributions and redemptions. Specifically, the indenture

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governing Sonic s 8.625% Notes limits Sonic s ability to pay quarterly cash dividends on Sonic s Class A and B common stock in excess of $0.10 per share. Sonic may only pay quarterly cash dividends on Sonic s Class A and B common stock if Sonic complies with the terms of the indenture governing the 8.625% Notes. Sonic was in compliance with all restrictive covenants as of September 30, 2010.

Balances outstanding under Sonic s 8.625% Notes are guaranteed by all of Sonic s operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor as defined by the SEC.

5.0% Convertible Senior Notes (5.0% Convertible Notes)

Sonic has $172.5 million in aggregate principal amount of 5.0% Convertible Notes outstanding. The 5.0% Convertible Notes bear interest at a rate of 5.0% per year, payable semiannually in arrears on April 1 and October 1 of each year. The 5.0% Convertible Notes mature on October 1, 2029. Sonic may redeem some or all of the 5.0% Convertible Notes for cash at any time subsequent to October 1, 2014 at a repurchase price equal to 100% of the principal amount of the Notes. Holders have the right to require Sonic to purchase the 5.0% Convertible Notes on each of October 1, 2014, October 1, 2019 and October 1, 2024 or in the event of a change in control for cash at a purchase price equal to 100% of the principal amount of the notes.

Holders of the 5.0% Convertible Notes may convert their notes at their option prior to the close of business on the business day immediately preceding July 1, 2029 only under the following circumstances: (1) during any fiscal quarter commencing after December 31, 2009, if the last reported sale price of the Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the measurement period) in which the trading price (as defined below) per $1,000 principal amount of notes for each day of that measurement period was less than 98% of the product of the last reported sale price of Sonic s Class A common stock and the applicable conversion rate on each such day; (3) if Sonic calls any or all of the notes for redemption, at any time prior to the close of business on the third scheduled trading day prior to the redemption date; or (4) upon the occurrence of specified corporate events. On and after July 1, 2029 to (and including) the close of business on the third scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of the foregoing circumstances. The conversion rate is 74.7245 shares of Class A common stock per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $13.38 per share of Class A common stock. None of the conversion features on the 5.0% Convertible Notes were triggered in the nine-month period ended September 30, 2010.

To recognize the equity component of the convertible borrowing instrument, upon issuance of the 5.0% Convertible Notes in September 2009, Sonic recorded a debt discount of $31.0 million and a corresponding amount (net of taxes of $12.8 million) to equity. The debt discount is being amortized to interest expense through October 2014, the earliest redemption date of the 5.0% Convertible Notes.

4.25% Convertible Senior Subordinated Notes (4.25% Convertible Notes)

Sonic had approximately $16.0 million aggregate principal amount of 4.25% Convertible Notes outstanding at September 30, 2010 classified in current maturities of Long-Term Debt in the accompanying Condensed Consolidated Balance Sheet. Sonic repurchased approximately $1.0 million of the aggregate principal amount of the 4.25% Convertible Notes during the second quarter of 2010 at amounts close to par. On October 20, 2010, Sonic issued a redemption notice to redeem the remaining $16.0 million in aggregate principal amount. Sonic will use available cash on November 30, 2010 to redeem the $16.0 million in aggregate principal amount at the applicable redemption price (100.00% of principal redeemed) plus accrued but unpaid interest on November 30, 2010.

The 4.25% Convertible Notes bear interest at an annual rate of 4.25% until November 30, 2010 and 4.75% thereafter. The 4.25% Convertible Notes are unsecured obligations that rank equal in right of payment to all of Sonic s existing and future senior subordinated indebtedness, mature on November 30, 2015 and are redeemable by Sonic or the holders on or after November 30, 2010. Sonic s obligations under the 4.25% Convertible Notes are not guaranteed by any of Sonic s subsidiaries. Holders of the 4.25% Convertible Notes may convert them into cash and shares of Sonic s Class A common stock at an initial conversion rate of 41.4185 shares per $1,000 of principal amount, subject to distributions on, or other changes in Sonic s Class A common stock, if any, prior to the conversion date.

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The 4.25% Convertible Notes are convertible into cash and shares of Sonic s Class A common stock if prior to October 31, 2010, during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of 4.25% Convertible Notes was less than 103% of the product of the closing price of Sonic s Class A common stock and the applicable conversion rate for the 4.25% Convertible Notes; if Sonic calls the 4.25% Convertible Notes for redemption; upon the occurrence of certain corporate transactions; or on or after October 31, 2010. Upon conversion of the 4.25% Convertible Notes, Sonic will be required to deliver cash equal to the lesser of the aggregate principal amount of the 4.25% Convertible Notes being converted and Sonic s total conversion obligation. If Sonic s total conversion obligation exceeds the aggregate principal amount of the 4.25% Convertible Notes being converted, Sonic will deliver shares of Class A common stock to the extent of the excess amount, if any. None of the conversion features on the 4.25% Convertible Notes were triggered in the third quarter ended September 30, 2010. The conversion features were triggered on October 20, 2010 when Sonic called the 4.25% Convertible Notes for redemption.

Notes Payable to a Finance Company

Three notes payable (due October 2015 and August 2016) were assumed in connection with an acquisition in 2005 (the Assumed Notes). Sonic recorded the Assumed Notes at fair value using an interest rate of 5.35%. The interest rate used to calculate the fair value was based on a quoted market price for notes with similar terms as of the date of assumption. As a result of calculating the fair value, a premium of $7.3 million was recorded and is being amortized over the lives of the Assumed Notes. As of September 30, 2010, the remaining unamortized premium was $2.0 million.

Mortgage Notes

Sonic has mortgage financing related to many of its dealership properties. These mortgage notes require monthly payments of principal and interest through maturity and are secured by the underlying properties. Maturity dates occur between June 2013 and December 2029. The weighted average interest rate was 5.18% at September 30, 2010.

Derivative Instruments and Hedging Activities

At September 30, 2010 Sonic had interest rate swap agreements (the Fixed Swaps) 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, 2010 was a liability of $40.0 million included in other long-term liabilities in the accompanying Condensed Consolidated Balance Sheets. Under the terms of the Fixed Swaps, Sonic will receive and pay interest based on the following:

Notional Amount (in millions)		Pay Rate	Receive Rate (1)	Maturing Date
$ 200.0		4.935%	one-month LIBOR	May 1, 2012
$ 100.0		5.265%	one-month LIBOR	June 1, 2012
$ 3.6		7.100%	one-month LIBOR	July 10, 2017
$ 25.0	(2)	5.160%	one-month LIBOR	September 1, 2012
$ 15.0	(2)	4.965%	one-month LIBOR	September 1, 2012
$ 25.0	(2)	4.885%	one-month LIBOR	October 1, 2012
$ 11.4		4.655%		

				one-month LIBOR	December 10, 2017
$	8.8		6.860%	one-month LIBOR	August 1, 2017
$	7.0		4.330%	one-month LIBOR	July 1, 2013
$	100.0	(3)	3.280%	one-month LIBOR	July 1, 2015
$	100.0	(3)	3.300%	one-month LIBOR	July 1, 2015

(1) One-month LIBOR was 0.256% at September 30, 2010.

(2) After December 31, 2009 changes in fair value are recorded through earnings.

(3) The effective date of these forward-starting swaps is July 2, 2012.

During the first quarter ended March 31, 2009, Sonic settled two $100.0 million notional fixed swaps with a payment to the counterparty of $16.5 million. This settlement loss was deferred and is being amortized into earnings over the swaps initial remaining term.

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During the second quarter ended June 30, 2010, Sonic entered into two $100.0 million notional forward-starting interest rate swap agreements which become effective in July 2012 and terminate in July 2015. 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 will be recorded in other comprehensive income (loss), net of related income taxes, in the Condensed Consolidated Statements of Stockholders Equity.

As a result of the refinancing of Sonic s 2006 Credit Facility and the new terms of the 2010 Credit Facilities, at December 31, 2009 it was determined that it was no longer probable that Sonic would incur interest payments that match the terms of certain Fixed Swaps that previously were designated and qualified as cash flow hedges. Of the Fixed Swaps (including the two $100.0 million notional swaps which were settled in 2009), $565.0 million of the notional amount had previously been documented as hedges against the variability of cash flows related to interest payments on certain debt obligations. At September 30, 2010, Sonic estimates that under the new 2010 Credit Facilities and other facilities with matching terms, it is probable that the expected debt balance with interest payments that match the terms of the Fixed Swaps will be $400.0 million. As a result, for the third quarter and nine-month periods ended September 30, 2010, non-cash charges of approximately $1.5 million and $5.4 million, respectively, related to the Fixed Swaps and amortization of amounts in accumulated other comprehensive income (loss) related to other existing and terminated cash flow swaps were included in interest expense, non-cash, cash flow swaps in the accompanying Condensed Consolidated Statements of Income.

For the Fixed Swaps which 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 Condensed Consolidated Statements of Stockholders Equity. The incremental interest expense (the difference between interest paid and interest received) related to the Fixed Swaps was $4.4 million and $14.1 million for the third quarter and nine-month periods ended September 30, 2009, respectively, and $4.4 million and $13.1 million for the third quarter and nine-month periods ended September 30, 2010, respectively. This expense is included in interest expense, other, net in the accompanying Condensed Consolidated Statements of Income. The estimated net expense expected to be reclassified out of other comprehensive income (loss) into results of operations during the next twelve months is approximately $12.4 million.

7. 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 several equity compensation plans. The following table illustrates the dilutive effect of such items on earnings per share for the third quarter and nine-month periods ended September 30, 2009 and 2010:

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	For the Third Quarter Ended September 30, 2009						
		Income From Continuing Operations		Loss From Discontinued Operations		Net Income	
	Class A & B Shares	Amount	Per Common Share Amount	Amount	Per Common Share Amount	Amount	Per Common Share Amount
	(dollars in thousands except per share amounts)						
Earnings (Loss) and Shares	42,305	$ 20,179		$ (4,585)		$ 15,594	
Effect of Participating Securities:							
Unvested Restricted Stock and Stock Units	-	(151)		-		(151)	
Basic Earnings (Loss) Per Share	42,305	$ 20,028	$ 0.47	$ (4,585)	$ (0.10)	$ 15,443	$ 0.37
Effect of Dilutive Securities:							
Contingently Convertible Debt (2009 6.0% Convertibles)	19,004	(4,720)		(196)		(4,916)	
Contingently Convertible Debt (2009 5.0% Convertibles)	981	-		-		-	
Contingently Convertible Debt (2002 5.25% Convertibles)	-	(15)		16		1	
Equity compensation plans	905	-		-		-	
Diluted Earnings (Loss) Per Share	63,195	$ 15,293	$ 0.24	$ (4,765)	$ (0.07)	$ 10,528	$ 0.17

	For the Third Quarter Ended September 30, 2010						
		Income From Continuing Operations		Loss From Discontinued Operations		Net Income	
	Class A & B Shares	Amount	Per Common	Amount	Per Common	Amount	Per Common

			Share Amount		Share Amount		Share Amount
				(dollars in thousands except per share amounts)			
Earnings (Loss) and Shares	52,311	$ 13,949		$ (964)		$ 12,985	
Effect of Participating Securities:							
Unvested Restricted Stock and Stock Units	-	(137)		-		(137)	
Basic Earnings (Loss) Per Share	52,311	$ 13,812	$ 0.26	$ (964)	$ (0.01)	$ 12,848	$ 0.25
Effect of Dilutive Securities:							
Contingently Convertible Debt (2009 5.0% Convertibles)	12,890	2,498		16		2,514	
Equity compensation plans	650	-		-		-	
Diluted Earnings (Loss) Per Share	65,851	$ 16,310	$ 0.25	$ (948)	$ (0.02)	$ 15,362	$ 0.23

	For the Nine Months Ended September 30, 2009						
		Income From Continuing Operations		Loss From Discontinued Operations		Net Income	
	Shares	Amount	Per Common Share Amount	Amount	Per Common Share Amount	Amount	Per Common Share Amount
	(amounts in thousands except per share amounts)						
Earnin							