SONIC AUTOMOTIVE INC
Form 10-Q
October 31, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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

Commission file number 1-13395

SONIC AUTOMOTIVE, INC.

(Exact name of registrant as specified in its charter)

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 x No ¨

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

Large Accelerated Filer x	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 x

As of October 28, 2008, there were 28,056,128 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)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Revenues:				
New vehicles	$ 1,302,852	$ 1,042,383	$ 3,649,192	$ 3,299,681
Used vehicles	363,785	339,498	1,034,375	1,088,808
Wholesale vehicles	100,201	72,316	304,173	239,118
Total vehicles	1,766,838	1,454,197	4,987,740	4,627,607
Parts, service and collision repair	292,044	284,132	853,650	871,713
Finance, insurance and other	53,600	46,512	152,729	150,148
Total revenues	2,112,482	1,784,841	5,994,119	5,649,468
Cost of Sales:				
New vehicles	(1,211,134)	(970,744)	(3,392,840)	(3,073,785)
Used vehicles	(331,808)	(312,261)	(938,946)	(996,320)
Wholesale vehicles	(101,705)	(73,655)	(306,992)	(243,361)
Total vehicles	(1,644,647)	(1,356,660)	(4,638,778)	(4,313,466)
Parts, service and collision repair	(143,872)	(142,488)	(422,014)	(436,797)
Total cost of sales	(1,788,519)	(1,499,148)	(5,060,792)	(4,750,263)
Gross profit	323,963	285,693	933,327	899,205
Selling, general and administrative expenses	(240,243)	(267,961)	(701,621)	(749,651)
Depreciation and amortization	(5,338)	(8,912)	(19,163)	(25,656)
Operating income	78,382	8,820	212,543	123,898
Other income / (expense):				
Interest expense, floor plan	(16,660)	(9,744)	(49,002)	(34,467)
Interest expense, other, net	(10,898)	(16,661)	(28,446)	(43,439)
Other income / (expense), net	(5)	(10)	85	87
Total other expense	(27,563)	(26,415)	(77,363)	(77,819)
Income / (loss) from continuing operations before taxes	50,819	(17,595)	135,180	46,079
Income tax (provision) benefit	(19,903)	6,214	(53,159)	(19,256)
Income / (loss) from continuing operations	30,916	(11,381)	82,021	26,823
Discontinued operations:				
Loss from operations and the sale of discontinued franchises	(6,870)	(19,954)	(13,651)	(38,790)
Income tax benefit	2,061	5,986	4,096	11,637

Loss from discontinued operations	(4,809)	(13,968)	(9,555)	(27,153)
Net income / (loss)	$ 26,107	$ (25,349)	$ 72,466	$ (330)
Basic earnings (loss) per share:				
Earnings / (loss) per share from continuing operations	$ 0.73	$ (0.28)	$ 1.92	$ 0.66
Loss per share from discontinued operations	(0.12)	(0.35)	(0.23)	(0.67)
Earnings / (loss) per share	$ 0.61	$ (0.63)	$ 1.69	$ (0.01)
Weighted average common shares outstanding	42,539	40,138	42,769	40,447
Diluted earnings (loss) per share:				
Earnings/ (loss) per share from continuing operations	$ 0.68	$ (0.28)	$ 1.79	$ 0.66
Loss per share from discontinued operations	(0.10)	(0.35)	(0.20)	(0.67)
Earnings / (loss) per share	$ 0.58	$ (0.63)	$ 1.59	$ (0.01)
Weighted average common shares outstanding	46,978	40,138	47,631	40,626
Dividends declared per common share	$ 0.12	$ 0.12	$ 0.36	$ 0.36

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, 2007	September 30, 2008 (Unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 16,514	$ 7,340
Receivables, net	347,309	214,625
Inventories	1,093,017	1,030,704
Assets held for sale	87,342	110,815
Other current assets	35,879	34,836
Total Current Assets	1,580,061	1,398,320
Property and Equipment, net	286,591	381,950
Goodwill	1,276,074	1,254,403
Other Intangible Assets, net	111,342	95,974
Other Assets	28,676	21,705
Total Assets	$ 3,282,744	$ 3,152,352
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Notes payable - floor plan - trade	$ 298,376	$ 233,746
Notes payable - floor plan - non-trade	827,294	757,825
Trade accounts payable	66,026	49,903
Accrued interest	19,202	14,543
Other accrued liabilities	162,430	158,842
Liabilities associated with assets held for sale - trade	25,057	12,019
Liabilities associated with assets held for sale - non-trade	23,535	30,909
Current maturities of long-term debt	4,197	131,705
Total Current Liabilities	1,426,117	1,389,492
Long-Term Debt	697,800	638,970
Other Long-Term Liabilities	83,829	97,510
Deferred Income Taxes	144,170	124,644
Commitments and Contingencies		
Stockholders Equity:		
Class A convertible preferred stock, none issued		
Class A common stock, $.01 par value; 100,000,000 shares authorized; 42,413,646 shares issued and 29,298,482 shares outstanding at December 31, 2007; 42,912,201 shares issued and 28,056,128 shares outstanding at September 30, 2008	424	428
Class B common stock; $.01 par value; 30,000,000 shares authorized; 12,400,000 shares issued and 12,029,375 shares outstanding at December 31, 2007 and September 30, 2008	121	121
Paid-in capital	488,983	503,148
Retained earnings	664,280	649,692
Accumulated other comprehensive income	(15,114)	(15,151)
Treasury stock, at cost (13,115,164 Class A shares held at December 31, 2007 and 14,856,073 Class A shares held at September 30, 2008)	(207,866)	(236,502)

Total Stockholders Equity	930,828	901,736
Total Liabilities and Stockholders Equity	$ 3,282,744	$ 3,152,352

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							
	Shares	Amount	Shares	Amount	Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Stockholders Equity	Comprehensive Income
BALANCE AT DECEMBER 31, 2007	42,414	$ 424	12,029	$ 121	$ 488,983	$ 664,280	$ (207,866)	$ (15,114)	$ 930,828	
Shares awarded under stock compensation plans	498	4			5,143				5,147	
Purchases of treasury stock							(28,636)		(28,636)	
Income tax benefit associated with stock compensation plans					1,195				1,195	
Income tax benefit associated with convertible note hedge					1,625				1,625	
Fair value of interest rate swap agreements, net of tax expense of $43								(352)	(352)	(352)
Unrealized loss on available-for-sale securities, net of tax benefit of $66								315	315	315
Stock-based compensation expense					2,102				2,102	
Restricted stock amortization, net of forfeitures					4,100				4,100	
Net loss						(330)			(330)	(330)
Dividends ($0.36 per share)						(14,258)			(14,258)	
BALANCE AT SEPTEMBER 30, 2008	42,912	$ 428	12,029	$ 121	$ 503,148	$ 649,692	$ (236,502)	$ (15,151)	$ 901,736	$ (367)

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, 2007	Nine Months Ended September 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 72,466	$ (330)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	20,258	26,418
Provision for bad debt expense	2,569	2,072
Other amortization	829	966
Debt issuance cost amortization	856	909
Debt discount amortization, net of premium amortization	588	719
Stock based compensation expense	4,367	2,102
Amortization of restricted stock	2,845	4,206
Restricted stock forfeiture	(2,426)	(106)
Deferred income taxes	(2,216)	(20,531)
Equity interest in earnings of investees	(499)	(279)
Impairment of favorable lease asset		1,903
Impairment of franchise agreements	3,100	15,700
Impairment of property and equipment and other assets	2,662	24,118
Loss on disposal of franchises and property and equipment	16	2,579
Loss on exit of leased dealerships	568	16,440
Changes in assets and liabilities that relate to operations:		
Receivables	23,022	130,612
Inventories	16,263	54,156
Other assets	2,532	2,324
Notes payable - floor plan - trade	(146,338)	(77,668)
Trade accounts payable and other liabilities	25,983	(27,964)
Total adjustments	(45,021)	158,676
Net cash provided by operating activities	27,445	158,346
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of businesses, net of cash acquired	(211,671)	(22,929)
Purchases of property and equipment	(59,592)	(122,312)
Proceeds from sales of property and equipment	29,657	2,156
Proceeds from sale of franchises	52,415	23,851
Distributions from equity investees	900	600
Net cash used in investing activities	(188,291)	(118,634)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings on notes payable floor plan non-trade	108,837	(62,095)
Borrowings on revolving credit facilities	856,273	703,132
Repayments on revolving credit facilities	(784,859)	(703,961)
Proceeds from long-term debt	17,335	56,913

Payments on long-term debt	(1,580)	(7,807)
Purchases of treasury stock	(34,423)	(28,636)
Income tax benefit associated with stock compensation plans	3,398	1,195
Income tax benefit associated with convertible hedge	1,416	1,625
Issuance of shares under stock compensation plans	13,172	5,147
Dividends paid	(15,732)	(14,399)
Net cash provided by/(used in) financing activities	163,837	(48,886)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	2,991	(9,174)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	12,696	16,514
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 15,687	$ 7,340
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING ACTIVITIES:		
Adoption of FIN 48	$ (8,582)	$
SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:		
Change in fair value of cash flow hedging instruments (net of tax (benefit) / expense of $(3,022) and $43 for the nine month period ended September 30, 2007 and 2008, respectively)	$ (4,930)	$ (352)
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest, net of amount capitalized	$ 87,127	$ 87,590
Income taxes	$ 37,698	$ 12,804

See notes to unaudited condensed consolidated financial statements.

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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 period ended September 30, 2008 has been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). All significant intercompany accounts and transactions have been eliminated. These unaudited condensed consolidated financial statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to fairly state the financial position and the results of operations for the periods presented. The results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year. These interim financial statements should be read in conjunction with the audited consolidated financial statements of Sonic for the year ended December 31, 2007, which were included in Sonic s Annual Report on Form 10-K.

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

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

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

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

Sonic adopted the provisions of Statements of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

elected in earnings at each subsequent reporting date. Sonic has elected not to apply the fair value option to any eligible items as defined by SFAS 159.

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

Operating Lease Accruals Operating lease accruals relate to facilities Sonic has ceased using in its operations. The accruals represent the present value of the lease payments, net of estimated sublease rentals, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord. A summary of the activity of these operating lease accruals consists of the following:

	(dollars in thousands)	
Balance, December 31, 2007	$	8,164
Lease exit expense		16,440
Lease exit expense recovery		(221)
Payments		(5,881)
Balance, September 30, 2008	$	18,502

2. Business Acquisitions and Dispositions

Acquisitions The aggregate purchase price for franchises acquired during the nine month period ended September 30, 2008 totaled approximately $22.4 million in cash, net of cash acquired. These cash outflows were funded by cash from operations, borrowings under our revolving credit facility and borrowings under our floor plan facilities. The balance sheet as of September 30, 2008 includes preliminary allocations of the purchase price of these acquisitions to the assets and liabilities acquired based on their estimated fair market values at the date of acquisition and are subject to final adjustment. As a result of these allocations, Sonic has recorded the following related to 2008 acquisitions:

$13.1 million of net assets relating to dealership operations;

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

$6.1 million of goodwill, all of which is expected to be tax deductible.

Dispositions In the nine month period ended September 30, 2008, Sonic identified an additional 14 franchises to be held for sale and Sonic decided to retain and operate four franchises which were held for sale as of December 31, 2007. These 14 additional franchises have been identified as held for sale because of unprofitable operations or various strategic considerations. All franchises held for sale are expected to be sold within one year from September 30, 2008**.** The operating results of these franchises are included in the loss from discontinued operations in

Sonic s statements of income. Assets to be disposed of in connection with franchises held for sale but not yet sold have been classified in assets held for sale in Sonic s balance sheets along with other assets held for sale. The major components of assets held for sale consist of the following:

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	(dollars in thousands)	
	December 31, 2007	September 30, 2008
Inventories	$ 54,028	$ 49,058
Property and equipment, net	22,137	29,529
Goodwill	8,777	31,228
Franchise assets	2,400	1,000
Assets held for sale	$ 87,342	$ 110,815

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

	(dollars in thousands)		(dollars in thousands)	
	Quarter Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Revenues	$ 205,564	$ 75,857	$ 637,090	$ 313,554
Franchise agreement and other asset impairments	(1,850)	(2,700)	(3,100)	(7,000)
Lease exit charges	(286)	(10,927)	(884)	(12,444)
Property impairment charges	(1,534)	(3,317)	(1,974)	(5,434)
Favorable lease asset impairment charges				(1,903)
Gain / (Loss) on disposal of franchises	579	(137)	803	(3,080)
Pre-tax losses	(6,870)	(19,954)	(13,651)	(38,790)

Franchise asset and other asset impairment charges recorded relate to revising the estimated fair value of franchises and other assets held for sale. Lease exit charges recorded for the third quarter and nine month period ended September 30, 2007 and 2008 relate to the revision of estimates and establishment of lease exit accruals. 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. For a discussion of property impairment charges, see footnote 4 and for a discussion of favorable lease asset impairment charges see footnote 5.

Sonic allocates corporate level interest expense to discontinued operations based on the net assets of the discontinued operations group. Interest allocated to discontinued operations for the third quarter ended September 30, 2007 and 2008 was $0.9 million and $0.6 million, respectively. Interest allocated to discontinued operations for the nine month period ended September 30, 2007 and 2008 was $2.7 million and $1.9 million, respectively.

3. INVENTORIES

Inventories consist of the following:

	(dollars in thousands)	
	December 31, 2007	September 30, 2008
New vehicles	$ 836,252	$ 814,067
Used vehicles	168,851	132,186

Parts and accessories	61,153	57,693
Other	80,789	75,816
	$ 1,147,045	$ 1,079,762