

SONIC AUTOMOTIVE INC
Form 10-K
February 27, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

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 (State or other jurisdiction of incorporation or organization)	56-2010790 (I.R.S. Employer Identification No.)
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4401 Colwick Road Charlotte, North Carolina (Address of principal executive offices)	28211 (Zip Code)
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Registrant's telephone number, including area code: (704) 566-2400

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Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A common stock, \$0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 Act). Yes No

The aggregate market value of the voting common stock held by non-affiliates of the registrant was approximately \$554.9 million based upon the closing sales price of the registrant's Class A common stock on June 30, 2016 of \$17.11 per share.

As of February 21, 2017, there were 32,855,850 shares of Class A common stock, par value \$0.01 per share, and 12,029,375 shares of Class B common stock, par value \$0.01 per share, outstanding.

Documents incorporated by reference. Portions of the registrant's definitive Proxy Statement for the 2017 Annual Meeting of Stockholders to be held April 18, 2017 are incorporated by reference into Part III of this Form 10-K.

UNCERTAINTY OF FORWARD-LOOKING STATEMENTS AND INFORMATION

This Annual Report on Form 10-K contains, and written or oral statements made from time to time by us or by our authorized officers may contain, “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address our future objectives, plans and goals, as well as our intent, beliefs and current expectations regarding future operating performance, results and events, and can generally be identified by words such as “may,” “will,” “should,” “believe,” “expect,” “estimate,” “anticipate,” “intend,” “plan,” “foresee” or similar words or phrases.

These forward-looking statements are based on our current estimates and assumptions and involve various risks and uncertainties. As a result, you are cautioned that these forward-looking statements are not guarantees of future performance, and that actual results could differ materially from those projected in these forward-looking statements. Factors which may cause actual results to differ materially from our projections include those risks described in “Item 1A. Risk Factors” of this Annual Report on Form 10-K and elsewhere in this report, as well as:

- the number of new and used vehicles sold in the United States as compared to our expectations and the expectations of the market;
- our ability to generate sufficient cash flows or obtain additional financing to fund our EchoPark® expansion, our One Sonic-One Experience initiative, capital expenditures, our share repurchase program, dividends on our common stock, acquisitions and general operating activities;
- our business and growth strategies, including, but not limited to, our EchoPark® initiative and our One Sonic-One Experience initiative;
- the reputation and financial condition of vehicle manufacturers whose brands we represent, the financial incentives vehicle manufacturers offer and their ability to design, manufacture, deliver and market their vehicles successfully;
- our relationships with manufacturers, which may affect our ability to obtain desirable new vehicle models in inventory or complete additional acquisitions;
- adverse resolution of one or more significant legal proceedings against us or our dealerships or EchoPark® stores;
- changes in laws and regulations governing the operation of automobile franchises, accounting standards, taxation requirements and environmental laws;
- general economic conditions in the markets in which we operate, including fluctuations in interest rates, employment levels, the level of consumer spending and consumer credit availability;
- high competition in the automotive retailing industry, which not only creates pricing pressures on the products and services we offer, but also on businesses we may seek to acquire;
- our ability to successfully integrate potential future acquisitions; and
- the rate and timing of overall economic recovery or decline.

These forward-looking statements speak only as of the date of this report or when made, and we undertake no obligation to revise or update these statements to reflect subsequent events or circumstances, except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission.

SONIC AUTOMOTIVE, INC.

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016

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SONIC AUTOMOTIVE, INC.

PART I

Item 1. Business.

Sonic Automotive, Inc. was incorporated in Delaware in 1997. We are one of the largest automotive retailers in the United States (as measured by total revenue). As of December 31, 2016, we operated 116 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 December 31, 2016, we operated 107 franchised dealership stores and five EchoPark stores.

Our franchised dealerships provide comprehensive services, including (1) sales of both new and used cars and light trucks; (2) sales of replacement parts and performance of vehicle maintenance, manufacturer warranty repairs, and 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.

EchoPark® provides the same services (excluding new vehicle sales and manufacturer warranty repairs) in unique stand-alone specialty retail locations. Our EchoPark® business operates independently from our franchised new and used dealership sales operations. Sales operations in our first EchoPark® market in Denver, Colorado began in the fourth quarter of 2014. As of December 31, 2016, we had five EchoPark® stores in operation, and we expect to open another store in Colorado in the first half of 2017. During the second quarter of 2016, we announced that we have begun the process of expanding EchoPark® operations into additional markets in North Carolina, South Carolina and Texas with operations in these markets expected to begin in 2017 and 2018. We believe that our EchoPark® business will provide long-term benefits to us, our stockholders and guests. However, in the short term, this initiative may negatively impact our overall operating results as we allocate management and capital resources to this business.

References to “Sonic,” the “Company,” “we,” “us,” and “our” used throughout this Annual Report on Form 10-K refer to Sonic Automotive, Inc. and its subsidiaries.

The following charts depict the multiple sources of continuing operations revenue and gross profit for the year ended December 31, 2016:

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As of December 31, 2016, we operated in the following states:

Market	Percent of		
	Number of	2016 Total	
	Franchises	Revenue	
California	24	30.3	%
Texas	29	25.0	%
Tennessee	11	7.3	%
Florida	9	6.1	%
Alabama	13	5.3	%
Colorado	4	4.7	%
Georgia	4	3.5	%
North Carolina	4	3.2	%
Virginia	2	2.9	%
Ohio	5	2.7	%
Maryland	3	2.7	%
South Carolina	5	2.4	%
Nevada	3	2.1	%
Disposed franchises and holding companies	-	0.5	%
Total Franchised Dealerships	116	98.7	%
EchoPark® - Colorado	5	1.3	%
Total	121	100.0	%

In the future, we may purchase dealerships and open new stores that we believe will enrich our portfolio and divest dealerships or close stores that we believe will not yield acceptable returns over the long term. The automotive retailing industry remains highly fragmented, and we believe that further consolidation may occur. We believe that attractive acquisition opportunities continue to exist for dealership groups with the capital and experience to identify, acquire and professionally manage dealerships. Our ability to complete acquisitions and open new stores in the future will depend on many factors, including the availability of financing and the existence of any contractual provisions that may restrict our acquisition activity.

See “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources,” for a discussion of our plans for the use of capital generated from operations.

Operating Segments

As of December 31, 2016, we had two operating segments: Franchised Dealerships and EchoPark®. The Franchised Dealerships segment is comprised of retail automotive franchises that sell new vehicles and buy and sell used vehicles, sell replacement parts, perform vehicle repair and maintenance services, and arrange finance and insurance products. The EchoPark® segment is comprised of stand-alone specialty retail locations that provide customers an opportunity to search, buy, service, finance and sell pre-owned vehicles.

For the year ended December 31, 2016, EchoPark® revenue represented approximately 1.3% of total revenue. See Note 14, “Segment Information,” to the accompanying consolidated financial statements for additional financial information regarding our two operating segments.

Unless otherwise noted, the following discussion of our business is presented on a consolidated basis.

Business Strategy

Execute our Stand-Alone Pre-Owned Store Initiative. We have augmented our manufacturer-franchised dealership operations with our EchoPark® stand-alone pre-owned specialty retail locations. Our EchoPark® business operates independently from our franchised new and used dealership sales operations and offers customers an exciting shopping and buying experience. Sales operations for our EchoPark® initiative began in Denver, Colorado in the fourth quarter of 2014. As of December 31, 2016, we had five EchoPark® stores in operation, and expect to open an additional EchoPark® store in Colorado in the first half of 2017.

Execute our Customer Experience Initiative. Our One Sonic-One Experience (“OSOE”) initiative includes several new processes and proprietary technologies from inventory management, electronic desking and pricing tools to a fully developed “customer-centric” Customer Relationship Management tool. We believe that the development of these processes and technologies

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will allow us to better serve our customers across our entire platform of stores. Our goal is to allow our guests to control the buying process and move at their pace so that once the vehicle has been selected our team can utilize these processes and technologies to allow our guests to complete a new or pre-owned vehicle sales transaction in less than an hour. During the latter half of 2014 and throughout 2015, we rolled out the OSOE initiative at our dealerships in Charlotte, North Carolina. In 2016, we introduced the technology component of the initiative to 14 additional stores in our Alabama, Tennessee and California markets.

Achieve High Levels of Customer Satisfaction. We focus on maintaining high levels of customer satisfaction. Our personalized sales process is designed to satisfy customers by providing high-quality vehicles and service in a positive, “consumer friendly” buying environment. Several manufacturers offer specific financial incentives on a per vehicle basis if certain Customer Satisfaction Index (“CSI”) levels (which vary by manufacturer) are achieved by a dealership. In addition, all manufacturers consider CSI scores in approving acquisitions or awarding new dealership open points. In order to keep dealership and executive management focused on customer satisfaction, we include CSI results as a component of our incentive-based compensation programs for certain groups of associates.

Invest in Dealership Properties. Historically, we have operated our dealerships primarily on property financed through long-term operating leases. As these leases mature, or as we have an opportunity to purchase the underlying real estate prior to renewal, we take actions to own more of our dealership properties when the effect is financially or operationally favorable to us. We remain opportunistic in purchasing existing properties or relocating dealership operations to owned real estate where the returns are favorable. We believe owning our properties will, over the long term, strengthen our balance sheet and reduce our overall cost of operating and financing our facilities.

Improve Capital Structure. As we generate cash through operations, we will opportunistically repurchase our Class A common stock in open-market or structured transactions.

Maximize Asset Returns Through Process Execution. We have developed standardized operating processes that are documented in operating playbooks for our dealerships. Through the continued implementation of our operating playbooks, we believe organic growth opportunities exist by offering a more favorable buying experience to our customers and creating efficiencies in our business processes. We believe the development, refinement and implementation of these operating processes will enhance the customer experience, make us more competitive in the markets we serve and drive profit growth across each of our revenue streams.

Maintain Diverse Revenue Streams. We have multiple revenue streams. In addition to new vehicle sales, our revenue sources include used vehicle sales, which we believe are less sensitive to economic cycles and seasonal influences that exist with new vehicle sales. Our Fixed Operations sales carry a higher gross margin than new and used vehicle sales and, in the past, have not been as economically sensitive as new vehicle sales. We also offer customers assistance in obtaining financing and a range of automobile related warranty, aftermarket and insurance products.

Manage Portfolio. Our long-term growth and acquisition strategy is focused on large metropolitan markets, predominantly in the Southeast, Southwest, Midwest and California. We seek to add like-branded dealerships to our portfolio that exist in regions in which we already operate; however, we may look outside of our existing geographic footprint when considering the location of new EchoPark[®] stores. A majority of our franchised dealerships are either luxury or mid-line import brands. For the year ended December 31, 2016, approximately 88.1% of our total new vehicle revenue was generated by luxury and mid-line import dealerships, which usually have higher operating margins, more stable Fixed Operations departments, lower associate turnover and lower inventory levels.

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The following table depicts the breakdown of our new vehicle revenues from continuing operations by brand:

Brand	Percentage of New Vehicle Revenue Year Ended December 31,					
	2016		2015		2014	
Luxury:						
BMW	20.2	%	21.7	%	21.8	%
Mercedes	10.6	%	9.7	%	9.6	%
Lexus	5.9	%	5.6	%	5.2	%
Audi	5.3	%	4.8	%	5.0	%
Land Rover	3.3	%	4.0	%	2.8	%
Cadillac	3.3	%	3.2	%	4.1	%
Porsche	2.3	%	2.5	%	2.4	%
MINI	1.6	%	1.9	%	2.1	%
Other luxury (1)	3.0	%	3.1	%	3.1	%
Total Luxury	55.5	%	56.5	%	56.1	%
Mid-line Import:						
Honda	16.8	%	15.5	%	14.9	%
Toyota	11.4	%	11.1	%	10.4	%
Volkswagen	1.5	%	1.7	%	1.9	%
Hyundai	1.2	%	1.4	%	1.6	%
Other imports (2)	1.7	%	1.6	%	2.3	%
Total Mid-line Import	32.6	%	31.3	%	31.1	%
Domestic:						
Ford	6.8	%	6.8	%	7.3	%
General Motors (3)	5.1	%	5.4	%	5.5	%
Total Domestic	11.9	%	12.2	%	12.8	%
Total	100.0	%	100.0	%	100.0	%

(1) Includes Volvo, Acura, Infiniti, Jaguar and Smart.

(2) Includes Nissan, Kia, Scion and Subaru.

(3) Includes Buick, Chevrolet and GMC.

Expand our eCommerce Capabilities. Automotive customers have become increasingly more comfortable using technology to research their vehicle buying alternatives and communicate with dealership personnel. The internet presents a marketing, advertising and automotive sales channel that we will continue to utilize to drive value for our dealerships and enhance the customer experience. Our technology platforms give us the ability to leverage technology

to efficiently integrate systems, customize our dealership websites and use our data to improve the effectiveness of our advertising and interaction with our customers. These platforms also allow us to market all of our products and services to a national audience and, at the same time, support the local market penetration of our individual dealerships.

Train, Develop and Retain Associates. We believe our associates are the cornerstone of our business and crucial to our financial success. Our goal is to develop our associates and foster an environment where our associates can contribute and grow with the Company. Associate satisfaction is very important to us, and we believe a high level of associate satisfaction reduces associate turnover and enhances our customers' experience at our dealerships by pairing our customers with well-trained associates. We believe that our comprehensive training of all employees provides us with a competitive advantage over other dealership groups.

Increase Sales of Higher-Margin Products and Services. We continue to pursue opportunities to increase our sales of higher-margin products and services by expanding the following:

Finance, Insurance and Other Aftermarket Products. Each sale of a new or used vehicle gives us an opportunity to provide our customers with financing and insurance options and earn financing fees and insurance commissions. We also offer our customers the opportunity to purchase extended warranties, service contracts and other aftermarket products. We currently offer a wide range of non-recourse financing, leasing, other aftermarket products, extended warranties, service contracts and insurance

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products to our customers. We emphasize menu-selling techniques and other best practices to increase our sales of F&I products at our dealerships.

Parts, Service and Collision Repair. Each of our franchised dealerships offers a fully integrated service and parts department. Manufacturers permit warranty work to be performed only at franchised dealerships such as ours. As a result, our franchised dealerships are uniquely qualified and positioned to perform work covered by manufacturer warranties on increasingly complex vehicles. We believe we can continue to grow our profitable parts and service business over the long term by increasing service capacity, investing in sophisticated equipment and well-trained technicians, using variable rate pricing structures, focusing on customer service and efficiently managing our parts inventory. In addition, we believe our emphasis on selling extended service contracts associated with new and used vehicle retail sales will drive further service and parts business in our dealerships as we increase the potential to retain current customers beyond the term of the standard manufacturer warranty period.

Certified Pre-Owned Vehicles. Various manufacturers provide franchised dealers the opportunity to sell certified pre-owned (“CPO”) vehicles. This certification process extends the standard manufacturer warranty on the CPO vehicle, which we believe increases our potential to retain the pre-owned purchaser as a future parts and service customer. Since CPO warranty work can only be performed at franchised dealerships, we believe CPO warranty work adds additional stability and will increase our Fixed Operations business.

Relationships with Manufacturers

Each of our dealerships operates under a separate franchise or dealer agreement that governs the relationship between the dealership and the manufacturer. Each franchise or dealer agreement specifies the location of the dealership for the sale of vehicles and for the performance of certain approved services in a specified market area. The designation of such areas generally does not guarantee exclusivity within a specified territory. In addition, most manufacturers allocate vehicles on a “turn and earn” basis that rewards high unit sales volume. A franchise or dealer agreement incentivizes the dealer to meet specified standards regarding showrooms, facilities and equipment for servicing vehicles, inventories, minimum net working capital, personnel training and other aspects of the business. Each franchise or dealer agreement also gives the related manufacturer the right to approve the dealer operator and any material change in management or ownership of the dealership. Each manufacturer may terminate a franchise or dealer agreement under certain circumstances, such as a change in control of the dealership without manufacturer approval, the impairment of the reputation or financial condition of the dealership, the death, removal or withdrawal of the dealer operator, the conviction of the dealership or the dealership’s owner or dealer operator of certain crimes, the failure to adequately operate the dealership or maintain new vehicle financing arrangements, insolvency or bankruptcy of the dealership or a material breach of other provisions of the applicable franchise or dealer agreement.

Many automobile manufacturers have developed and implemented policies regarding public ownership of dealerships, which include the ability to force the sale of their respective franchises:

- upon a change in control of our company or a material change in the composition of our Board of Directors;
- if an automobile manufacturer or distributor acquires more than 5% of the voting power of our securities; and
- if an individual or entity (other than an automobile manufacturer or distributor) acquires more than 20% of the voting power of our securities, and the manufacturer disapproves of such individual’s or entity’s ownership interest.

To the extent that new or amended manufacturer policies restrict the number of dealerships that may be owned by a dealership group or the transferability of our common stock, such policies could have a material adverse effect on us.

We believe that we will be able to renew at expiration all of our existing franchise and dealer agreements.

Many states have placed limitations upon manufacturers' and distributors' ability to sell new motor vehicles directly to customers in their respective states in an effort to protect dealers from practices they believe constitute unfair competition. In general, these statutes make it unlawful for a manufacturer or distributor to compete with a new motor vehicle dealer in the same brand operating under an agreement or franchise from the manufacturer or distributor in the relevant market area. Certain states, including Florida, Georgia, North Carolina, South Carolina and Virginia, limit the amount of time that a manufacturer or distributor may temporarily operate a dealership.

In addition, all of the states in which our dealerships currently do business require manufacturers or distributors to show "good cause" for terminating or failing to renew a dealer's franchise or dealer agreement. Further, each of the states provides some method for dealers to challenge manufacturer attempts to establish dealerships of the same brand in their relevant market area.

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Competition

The retail automotive industry is highly competitive. Depending on the geographic market, we compete both with dealers offering the same brands and product lines as ours and dealers offering other manufacturers' vehicles. We also compete for vehicle sales with auto brokers, leasing companies and services offered on the internet that provide customer referrals to other dealerships or who broker vehicle sales between customers and other dealerships. We compete with small, local dealerships and with large multi-franchise and pre-owned automotive dealership groups.

We believe that the principal competitive factors in vehicle sales are the customer experience provided, the location of dealerships, the marketing campaigns conducted by manufacturers, the ability of dealerships to offer an attractive selection of the most popular vehicles and the quality of services and pricing (including manufacturer rebates and other special offers). In particular, pricing has become more important as a result of price-savvy customers using sources available on the internet to determine current market retail prices. Other competitive factors include customer preference for makes of automobiles and coverage under manufacturer warranties.

In addition to competition for vehicle sales, we also compete with other auto dealers, service stores, auto parts retailers and independent mechanics in providing parts and service. We believe that the principal competitive factors in parts and service sales are price, the use of factory-approved replacement parts, factory-trained technicians, the familiarity with a manufacturer's makes and models and the quality of customer service. A number of regional and national chains offer selected parts and services at prices that may be lower than our prices.

In arranging or providing financing for our customers' vehicle purchases, we compete with a broad range of financial institutions. In addition, financial institutions are now offering F&I products through the internet. We believe the principal competitive factors in providing financing are convenience, interest rates and contract terms.

Our success depends, in part, on national and regional automobile-buying trends, local and regional economic factors and other regional competitive pressures. Conditions and competitive pressures affecting the markets in which we operate, such as price-cutting by dealers in these areas, or in any new markets we enter, could adversely affect us, even though the retail automobile industry as a whole might not be affected.

Governmental Regulations and Environmental Matters

Numerous federal and state regulations govern our business of marketing, selling, financing and servicing automobiles. We are also subject to laws and regulations relating to business corporations.

Under the laws of the states in which we currently operate as well as the laws of other states into which we may expand, we must obtain a license in order to establish, operate or relocate a dealership or operate an automotive repair service. These laws also regulate our conduct of business, including our sales, operating, advertising, financing and employment practices, including federal and state wage-hour, anti-discrimination and other employment practices laws.

Our financing activities with customers are subject to federal truth-in-lending, consumer privacy, consumer leasing and equal credit opportunity regulations as well as state and local motor vehicle finance laws, installment finance laws, usury laws and other installment sales laws. Some states regulate finance fees that may be paid as a result of vehicle sales.

Federal, state and local environmental regulations, including regulations governing air and water quality, the clean-up of contaminated property and the use, storage, handling, recycling and disposal of gasoline, oil and other materials, also apply to us and our dealership properties.

As with automobile dealerships generally, and service, parts and body shop operations in particular, our business involves the use, storage, handling and contracting for recycling or disposal of hazardous or toxic substances or wastes and other environmentally sensitive materials. Our business also involves the past and current operation and/or removal of above ground and underground storage tanks containing such substances, wastes or materials.

Accordingly, we are subject to regulation by federal, state and local authorities that establish health and environmental quality standards, provide for liability related to those standards and provide penalties for violations of those standards. We are also subject to laws, ordinances and regulations governing remediation of contamination at facilities we own or operate or to which we send hazardous or toxic substances or wastes and other environmentally sensitive materials for treatment, recycling or disposal.

We do not have any known material environmental liabilities, and we believe that compliance with environmental laws and regulations will not, individually or in the aggregate, have a material adverse effect on our results of operations, financial condition

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and cash flows. However, soil and groundwater contamination is known to exist at certain properties owned and used by us. Further, environmental laws and regulations are complex and subject to frequent change. In addition, in connection with our past or future acquisitions, it is possible that we will assume or become subject to new or unforeseen environmental costs or liabilities, some of which may be material.

Executive Officers of the Registrant

Our executive officers as of the date of this Form 10-K, are as follows:

Name	Age	Position(s) with Sonic
O. Bruton Smith	89	Executive Chairman and Director
B. Scott Smith	49	Chief Executive Officer, President and Director
David Bruton Smith	42	Vice Chairman and Director
Heath R. Byrd	50	Executive Vice President and Chief Financial Officer
Jeff Dyke	49	Executive Vice President of Operations

O. Bruton Smith is the Founder of Sonic and has served as Sonic's Executive Chairman since July 2015. Prior to his appointment as Executive Chairman, Mr. Smith had served as Chairman and Chief Executive Officer of the Company since its organization in January 1997. Mr. Smith has also served as a director of Sonic since its organization in January 1997. Mr. Smith is also a director of many of Sonic's subsidiaries. Mr. Smith has worked in the retail automobile industry since 1966. Mr. Smith is also the Executive Chairman and a director of Speedway Motorsports, Inc. ("SMI"), which is controlled by Mr. Smith and his family. SMI is a public company whose shares are traded on the New York Stock Exchange (the "NYSE"). Among other things, SMI owns and operates the following Speedways: Atlanta Motor Speedway, Bristol Motor Speedway, Charlotte Motor Speedway, Kentucky Speedway, Las Vegas Motor Speedway, New Hampshire Motor Speedway, Sonoma Raceway and Texas Motor Speedway. He is also a director of most of SMI's operating subsidiaries.

B. Scott Smith is the Co-Founder of Sonic. He is also Chief Executive Officer, President and a director of Sonic. Prior to his appointment as Chief Executive Officer in July 2015, Mr. Smith had served as President and Chief Strategic Officer of Sonic since March 2007. Prior to that, Mr. Smith served as Sonic's Vice Chairman and Chief Strategic Officer from October 2002 to March 2007 and President and Chief Operating Officer from April 1997 to October 2002. Mr. Smith has been a director of Sonic since its organization in January 1997. Mr. Smith also serves as a director and executive officer of many of Sonic's subsidiaries. Mr. Smith, who is the son of O. Bruton Smith and the brother of David Bruton Smith, has been an executive officer of Town & Country Ford since 1993, and was a minority owner of both Town & Country Ford and Fort Mill Ford before Sonic's acquisition of those dealerships in 1997. Mr. Smith became the General Manager of Town & Country Ford in November 1992 where he remained until his appointment as President and Chief Operating Officer of Sonic in April 1997. Mr. Smith has over 27 years of experience in the automobile dealership industry.

David Bruton Smith was appointed to the office of Vice Chairman in March 2013. He has served as Executive Vice President and a director of Sonic since October 2008 and has served in Sonic's organization since 1998. Prior to being named a director and Executive Vice President in 2008, Mr. Smith served as Sonic's Senior Vice President of Corporate Development. Mr. Smith served as Sonic's Vice President of Corporate Strategy from October 2005 to March 2007, and also served prior to that time as Dealer Operator and General Manager of several Sonic

dealerships. He is the son of Mr. O. Bruton Smith and the brother of Mr. B. Scott Smith.

Heath R. Byrd has served as Sonic's Executive Vice President and Chief Financial Officer since April 2013. Mr. Byrd was previously a Vice President and Sonic's Chief Information Officer from December 2007 to March 2013, and has served our organization since 2007. Prior to joining Sonic, Mr. Byrd served in a variety of management positions at HR America, Inc., a workforce management firm that provided customized human resource and workforce development through co-sourcing arrangements, including as a director, as President and Chief Operating Officer and as Chief Financial Officer and Chief Information Officer. Prior to HR America, Mr. Byrd served as a Manager in the Management Consulting Division of Ernst & Young LLP.

Jeff Dyke has served as Sonic's Executive Vice President of Operations since October 2008 and is responsible for direct oversight for all of Sonic's retail automotive operations. From March 2007 to October 2008, Mr. Dyke served as our Division Chief Operating Officer – Southeast Division, where he oversaw retail automotive operations for the states of Alabama, Florida, Georgia, North Carolina, South Carolina, Tennessee and Texas. Mr. Dyke first joined Sonic in October 2005 as our Vice President of Retail Strategy, a position that he held until April 2006, when he was promoted to Division Vice President – Eastern Division, a position he held from April 2006 to March 2007. Prior to joining Sonic, Mr. Dyke worked in the automotive retail industry at AutoNation, Inc. from 1996 to 2005, where he held several positions in divisional, regional and dealership management with that company.

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SONIC AUTOMOTIVE, INC.

Employees

As of December 31, 2016, we employed approximately 9,800 associates. We believe that our relationships with our associates are good. Approximately 275 of our associates, primarily service technicians in our northern California markets, are represented by a labor union. Although only a small percentage of our associates is represented by a labor union, we may be affected by labor strikes, work slowdowns and walkouts at automobile manufacturers' manufacturing facilities.

Company Information

Our website is located at www.sonicautomotive.com. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as well as proxy statements and other information we file with, or furnish to, the Securities and Exchange Commission (the "SEC") are available free of charge on our website. We make these documents available as soon as reasonably practicable after we electronically transmit them to the SEC. Except as otherwise stated in these documents, the information contained on our website or available by hyperlink from our website is not incorporated into this Annual Report on Form 10-K or other documents we transmit to the SEC.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

RISK FACTORS

Item 1A. Risk Factors.

Our business, financial condition, results of operations, cash flows, prospects and the prevailing market price and performance of our Class A common stock may be adversely affected by a number of factors, including the material risks noted below. Our stockholders and prospective investors should consider these risks, uncertainties and other factors prior to making an investment decision.

Risks Related to Our Sources of Financing and Liquidity

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

As of December 31, 2016, our total outstanding indebtedness was approximately \$2.4 billion, which includes floor plan notes payable, long-term debt and short-term debt.

We have up to \$250.0 million of maximum borrowing availability under a syndicated revolving credit facility (the “2016 Revolving Credit Facility”) and up to \$1.0 billion of maximum borrowing availability for combined syndicated new and used vehicle inventory floor plan financing (the “2016 Floor Plan Facilities”). We refer to the 2016 Revolving Credit Facility and the 2016 Floor Plan Facilities collectively as our “2016 Credit Facilities.” Based on balances as of December 31, 2016, we had approximately \$207.0 million available for additional borrowings under the 2016 Revolving Credit Facility based on the borrowing base calculation, which is affected by numerous factors including eligible asset balances. We are able to borrow under our 2016 Revolving Credit Facility only if, at the time of the borrowing, we have met all representations and warranties and are in compliance with all financial and other covenants contained therein. We also have capacity to finance new and used vehicle inventory purchases under floor plan agreements with various manufacturer-affiliated finance companies and other lending institutions (the “Silo Floor Plan Facilities”) as well as our 2016 Floor Plan Facilities. In addition, the indentures relating to our 5.0% Senior Subordinated Notes due 2023 (the “5.0% Notes”), our 7.0% Senior Subordinated Notes due 2022 (the “7.0% Notes”) and our other debt instruments allow us to incur additional indebtedness, including secured indebtedness, as long as we comply with the terms thereunder.

In addition, the majority of our dealership properties are leased under long-term operating lease arrangements that commonly have initial terms of fifteen to twenty years with renewal options generally ranging from five to ten years. These operating leases require compliance with financial and operating covenants similar to those under our 2016 Credit Facilities, and monthly payments of rent that may fluctuate based on interest rates and local consumer price indices. The total future minimum lease payments related to these operating leases and certain equipment leases are significant and are disclosed in Note 12, “Commitments and Contingencies,” to the accompanying consolidated financial statements.

Our failure to comply with certain covenants in these agreements or indentures could materially adversely affect our ability to access our borrowing capacity, subject us to acceleration of our outstanding debt, result in a cross default on other indebtedness and could have a material adverse effect on our ability to continue our business.

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

Our 2016 Credit Facilities, the indentures governing the 5.0% Notes and the 7.0% Notes and many of our operating leases contain numerous financial and operating covenants. A breach of any of these covenants could result in a default under the applicable agreement or indenture. In addition, a default under one agreement or indenture could result in a default and acceleration of our repayment obligations under the other agreements or indentures, including the indentures governing our outstanding 5.0% Notes and 7.0% Notes. If a cross default were to occur, we may not be able to pay our debts or borrow sufficient funds to refinance them. Even if new financing were available, it may not be on terms acceptable to us. If a default were to occur, we may be unable to adequately finance our operations and the value of our common stock would be materially adversely affected because of acceleration and cross-default provisions. As a result of this risk, we could be forced to take actions that we otherwise would not take, or not take actions that we otherwise might take, in order to comply with the covenants in these agreements and indentures.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

RISK FACTORS

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

Our ability to meet our debt obligations and other expenses will depend on our future performance, which will be affected by financial, business, domestic and foreign economic conditions, the regulatory environment and other factors, many of which we are unable to control. Substantially all of our consolidated assets are held by our subsidiaries and substantially all of our consolidated cash flow and net income are generated by our subsidiaries. Accordingly, our cash flow and ability to service debt depend to a substantial degree on the results of operations of our subsidiaries and upon the ability of our subsidiaries to provide us with cash. We may receive cash from our subsidiaries in the form of dividends, loans or distributions. We may use this cash to service our debt obligations or for working capital. Our subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to distribute cash to us or to make funds available to service debt.

If our cash flow is not sufficient to service our debt as it becomes due, we may be required to refinance the debt, sell assets or sell shares of our common stock on terms that we do not find attractive. Further, our failure to comply with the financial and other restrictive covenants relating to the 2016 Credit Facilities and the indentures pertaining to our outstanding notes could result in a default under these agreements and indentures that would prevent us from borrowing under the 2016 Credit Facilities, which could materially adversely affect our business, financial condition and results of operations. If a default and acceleration of repayment were to occur, we may be unable to adequately finance our operations and the value of our Class A common stock could be materially adversely affected.

We have financed the purchase of certain dealership properties with mortgage notes that require balloon payments at the end of the notes' terms.

Many of our mortgage notes' principal and interest payments are based on an amortization period longer than the actual terms (maturity dates) of the notes. We will be required to repay or refinance the remaining principal balances for certain of our mortgages with balloon payments at the notes' maturity dates, which range from 2017 to 2033. The amounts to be repaid or refinanced at the maturity dates could be significant. We may not have sufficient liquidity to make such payments at the notes' maturity dates. In the event we do not have sufficient liquidity to completely repay the remaining principal balances at maturity, we may not be able to refinance the notes at interest rates that are acceptable to us, or depending on market conditions, refinance the notes at all. Our inability to repay or refinance these notes could have a material adverse effect on our business, financial condition and results of operations.

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

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

sublessees do not perform their obligations under the terms of the sublease agreements.

Our use of hedging transactions could limit our financial gains or result in financial losses.

To reduce our exposure to fluctuations in cash flow due to interest rate fluctuations, we have entered into, and in the future expect to enter into, certain derivative instruments (or hedging agreements). No hedging activity can completely insulate us from the risks associated with changes in interest rates. As of December 31, 2016, we had interest rate swap agreements to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate. See the heading “Derivative Instruments and Hedging Activities” under Note 6, “Long-Term Debt,” to the accompanying consolidated financial statements. We intend to hedge as much of the interest rate risk as management determines is in our best interests given the cost of such hedging transactions.

Our hedging transactions expose us to certain risks and financial losses, including, among other things:

- counterparty credit risk;
- available interest rate hedging may not correspond directly with the interest rate risk for which we seek protection;

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

RISK FACTORS

- the duration or the amount of the hedge may not match the duration or the amount of the related liability;
- the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value, downward adjustments, or “mark-to-market losses,” which would affect our stockholders’ equity; and
- all of our hedging instruments contain terms and conditions with which we are required to meet. In the event those terms and conditions are not met, we may be required to settle the instruments prior to the instruments’ maturity with cash payments which could significantly affect our liquidity.

A failure on our part to effectively hedge against interest rate changes may adversely affect our financial condition and results of operations.

We may not be able to satisfy our debt obligations upon the occurrence of a change of control.

Upon the occurrence of a change of control, as defined in the 5.0% Notes and the 7.0% Notes, holders of these instruments will have the right to require us to purchase all or any part of such holders’ notes at a price equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any. The events that constitute a change of control under these indentures may also constitute a default under our 2016 Credit Facilities. Any future debt instruments that we may incur may contain similar provisions regarding repurchases in the event of a change of control triggering event. There can be no assurance that we would have sufficient resources available to satisfy all of our obligations under these debt instruments in the event of a change of control. In the event we were unable to satisfy these obligations, it could have a material adverse impact on our business and our stockholders.

Risks Related to Our Relationships with Vehicle Manufacturers

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

Each of our dealerships operates under a separate franchise or dealer agreement with the applicable automobile manufacturer. Without a franchise or dealer agreement, we cannot obtain new vehicles from a manufacturer or advertise as an authorized factory service center. As a result, we are significantly dependent on our relationships with the manufacturers.

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

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

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

A manufacturer may condition its allotment of vehicles, participation in bonus programs, or acquisition of additional franchises upon our compliance with its brand and facility standards. These standards may require investments in technology and facilities that we otherwise would not make. This may put us in a competitive disadvantage with other competing dealerships and may ultimately result in our decision to sell a franchise when we believe it may be difficult to recover the cost of the required investment to reach the manufacturer's brand and facility standards.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

RISK FACTORS

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

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

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

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

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

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

- customer rebates or below market financing on new and used vehicles;
- employee pricing;
- dealer incentives on new vehicles;
- manufacturer floor plan interest and advertising assistance;
- warranties on new and used vehicles; and
- sponsorship of certified pre-owned vehicle sales by authorized new vehicle dealers.

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

Our sales volume may be materially adversely affected if manufacturer captives change their customer financing programs or are unable to provide floor plan financing.

One of the