

SONIC AUTOMOTIVE INC

Form 10-Q

October 25, 2018

SONIC AUTOMOTIVE INC Large Accelerated

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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

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

Commission File Number: 1-13395

**SONIC AUTOMOTIVE, INC.**

(Exact name of registrant as specified in its charter)

**Delaware 56-2010790**

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

**4401  
Colwick  
Road  
Charlotte, 28211  
North  
Carolina**

(Address of principal executive offices) (Zip Code)

**(704) 566-2400**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 23, 2018, there were 30,721,226 shares of the registrant’s Class A Common Stock and 12,029,375 shares of the registrant’s Class B Common Stock outstanding.

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### **Uncertainty of Forward-Looking Statements and Information**

This Quarterly Report on Form 10-Q 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 our Annual Report on Form 10-K for the year ended December 31, 2017 and in “Item 1A. Risk Factors” of this report and elsewhere herein, 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, 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 store operations;
- 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;
- the adverse resolution of one or more significant legal proceedings against us or our franchised dealerships or EchoPark stores;
- changes in laws and regulations governing the operation of automobile franchises, accounting standards, taxation requirements and environmental laws;
- changes in vehicle and parts import quotas, duties, tariffs or other restrictions;
- 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 retail automotive 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.

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**SONIC AUTOMOTIVE, INC.  
FORM 10-Q  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018**

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**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements.****SONIC AUTOMOTIVE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	<b>Three Months Ended September 30,</b>			<b>Nine Months Ended</b>
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>September 30,</b>
	<b>2017</b>			
	<b>(Dollars and shares in thousands, except per share amounts)</b>			
Revenues:				
New vehicles	\$ 1,235,094	\$ 1,362,301	\$ 3,654,510	\$ 3,809,302
Used vehicles	745,998	659,724	2,217,616	1,936,088
Wholesale vehicles	48,578	43,098	167,726	130,174
Total vehicles	2,029,670	2,065,123	6,039,852	5,875,564
Parts, service and collision repair	343,118	347,717	1,041,630	1,060,873
Finance, insurance and other, net	98,061	92,861	295,890	262,832
Total revenues	2,470,849	2,505,701	7,377,372	7,199,269
Cost of Sales:				
New vehicles	(1,173,453)	(1,296,063)	(3,478,802)	(3,622,264)
Used vehicles	(710,681)	(620,579)	(2,108,219)	(1,816,076)
Wholesale vehicles	(49,877)	(46,390)	(176,806)	(136,555)
Total vehicles	(1,934,011)	(1,963,032)	(5,763,827)	(5,574,895)
Parts, service and collision repair	(176,302)	(180,047)	(538,135)	(550,788)
Total cost of sales	(2,110,313)	(2,143,079)	(6,301,962)	(6,125,683)
Gross profit	360,536	362,622	1,075,410	1,073,586
Selling, general and administrative expenses	(289,022)	(283,974)	(871,410)	(870,139)
Impairment charges	—	(200)	(13,961)	(3,315)
Depreciation and amortization	(23,377)	(22,686)	(71,067)	(65,751)
Operating income (loss)	48,137	55,762	118,972	134,381
Other income (expense):				
Interest expense, floor plan	(12,192)	(8,882)	(34,815)	(26,413)
Interest expense, other, net	(13,313)	(13,028)	(40,144)	(39,200)
Other income (expense), net	—	4	107	(14,490)
Total other income (expense)	(25,505)	(21,906)	(74,852)	(80,103)
Income (loss) from continuing	22,632	33,856	44,120	54,278

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operations before taxes					
Provision for income taxes for continuing operations - benefit (expense)	(7,331)	(14,126)	(13,711)	(22,254)	
Income (loss) from continuing operations	15,301	19,730	30,409	32,024	
Discontinued operations:					
Income (loss) from discontinued operations before taxes	(252)	(481)	(797)	(1,650)	
Provision for income taxes for discontinued operations - benefit (expense)	69	191	218	657	
Income (loss) from discontinued operations	(183)	(290)	(579)	(993)	
Net income (loss)	\$ 15,118	\$ 19,440	\$ 29,830	\$ 31,031	
Basic earnings (loss) per common share:					
Earnings (loss) per share from continuing operations	\$ 0.36	\$ 0.45	\$ 0.71	\$ 0.72	
Earnings (loss) per share from discontinued operations	(0.01)	—	(0.01)	(0.02)	
Earnings (loss) per common share	\$ 0.35	\$ 0.45	\$ 0.70	\$ 0.70	
Weighted average common shares outstanding	42,673	43,496	42,708	44,281	
Diluted earnings (loss) per common share:					
Earnings (loss) per share from continuing operations	\$ 0.36	\$ 0.45	\$ 0.71	\$ 0.72	
Earnings (loss) per share from discontinued operations	(0.01)	(0.01)	(0.02)	(0.02)	
Earnings (loss) per common share	\$ 0.35	\$ 0.44	\$ 0.69	\$ 0.70	
Weighted average common	42,994	43,811	42,964	44,585	

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shares  
outstanding

Dividends declared per common share	\$ 0.06	\$ 0.05	\$ 0.18	\$ 0.15
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See notes to condensed consolidated financial statements.

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**SONIC AUTOMOTIVE, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Net income (loss)	\$ 15,118	\$ 19,440	\$ 29,830	\$ 31,031
Other comprehensive income (loss) before taxes:				
Change in fair value of interest rate swap and interest rate cap agreements	533	747	5,736	2,891
Provision for income tax benefit (expense) related to components of other comprehensive income (loss)	(145)	(284)	(1,563)	(1,099)
Other comprehensive income (loss)	388	463	4,173	1,792
Comprehensive income (loss)	\$ 15,506	\$ 19,903	\$ 34,003	\$ 32,823

See notes to condensed consolidated financial statements.

**SONIC AUTOMOTIVE, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**

September 30, 2018	December 31, 2017
(Dollars in thousands)	
<b>ASSETS</b>	
Current Assets:	
Cash and cash equivalents	
\$ 7,582	\$ 6,352
Receivables, net	
350,912	482,126
Inventory	
474,832	1,512,745
Other current assets	
30,649	18,574
Total current assets	
868,975	2,019,797
Property and Equipment, net	
1,207,263	1,146,881
Goodwill	
510,160	525,780
Other Intangible Assets, net	
71,957	74,589
Other Assets	
50,576	51,471
Total Assets	
\$ 3,703,931	\$ 3,818,518

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current Liabilities:	
Notes payable	
-	-
defined plan	
\$ 750,512	\$ 804,238
trade	
656,535	709,098

Notes payable	-
floor plan	-
non-trade	
Trade accounts payable	129,903
Accrued interest	12,316
Other accounts liabilities	237,963
Current maturities of long-term debt	61,314
Total current liabilities	1,954,832
Long-Term Debt	963,389
Other Long-Term Liabilities	61,918
Deferred Income Taxes	51,619
Commitments and Contingencies	—
Stockholders' Equity:	
Class A Convertible Preferred Stock, none issued	—
Class A Common Stock, \$0.01	635

par  
value;  
100,000,000  
shares  
authorized;  
64,197,385  
shares  
issued  
and  
30,721,226  
shares  
outstanding  
at  
September  
30,  
2018;  
63,456,698  
shares  
issued  
and  
31,166,205  
shares  
outstanding  
at  
December  
31,  
2017  
Class  
B  
Common  
Stock,  
\$0.01  
par  
value;  
30,000,000  
shares  
authorized;  
12,029,375  
shares  
issued  
and  
outstanding  
at  
September  
30,  
2018  
and  
December  
31,  
2017

121

Paid-in capital	743,788	732,854	
Retained earnings	651,436	625,356	
Accumulated other comprehensive income (loss)	5,480	1,307	
Treasury stock, at cost;	33,476,159		
Class A Common Stock shares held at September 30, 2018	(597,623)	(573,513)	
and Class A Common Stock shares held at December 31, 2017	32,290,493		
Total Stockholders' Equity	803,844	786,760	
Total Liabilities and Stockholders' Equity	\$ 3,703,931	\$	3,818,518

See notes to condensed consolidated financial statements.



**SONIC AUTOMOTIVE, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**  
**(Unaudited)**

	Class A Common Stock		Class A Treasury Stock		Class B Common Stock		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
(Dollars in thousands)										
Balance at December 31, 2017	635	\$ 635	(32,290)	\$ (573,518)	121	\$ 121	\$ 732,856	625,356	1,307	\$ 786,760
Shares awarded under stock compensation plans	740	7	—	—	—	—	345	—	—	352
Purchases of treasury stock	—	—	(1,186)	(24,110)	—	—	—	—	—	(24,110)
Change in fair value of interest rate swap and interest rate cap agreements, net of tax expense of \$1,563	—	—	—	—	—	—	—	—	4,173	4,173
Restricted stock amortization	—	—	—	—	—	—	10,589	—	—	10,589
Net income (loss)	—	—	—	—	—	—	29,830	—	—	29,830
Cumulative effect of change in accounting principle (1)	—	—	—	—	—	—	3,918	—	—	3,918
Dividends declared	—	—	—	—	—	—	(7,668)	—	—	(7,668)
Balance at September 30,	642	\$ 642	(33,476)	\$ (597,628)	121	\$ 121	\$ 743,788	651,436	5,480	\$ 803,844

2018

(1) See Note 1, "Summary of Significant Accounting Policies," of the notes to the condensed consolidated financial statements for further discussion.

See notes to condensed consolidated financial statements.

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**SONIC AUTOMOTIVE, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b>(Dollars in thousands)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 29,830	\$ 31,031
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	71,063	65,747
Provision for bad debt expense	370	657
Other amortization	463	487
Debt issuance cost amortization	1,828	1,784
Debt discount amortization, net of premium amortization	—	157
Stock-based compensation expense	10,589	8,902
Deferred income taxes	(5,708)	2,745
Net distributions from equity investee	(21)	17
Asset impairment charges	13,961	3,315
Loss (gain) on disposal of dealerships and property and equipment	(41,116)	(8,594)
Loss (gain) on exit of leased dealerships	2,697	2,016
Loss (gain) on retirement of debt	—	14,607
Changes in assets and liabilities that relate to operations:		
Receivables	150,013	24,330
Inventories	(20,270)	191,077
Other assets	2,017	(4,286)
Notes payable - floor plan - trade	(53,726)	(131,578)
Trade accounts payable and other liabilities	(6,517)	(14,282)
Total adjustments	125,643	157,101

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Net cash provided by (used in) operating activities	155,473	188,132
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of businesses, net of cash acquired	—	(76,610)
Purchases of land, property and equipment	(133,918)	(181,893)
Proceeds from sales of property and equipment	13,290	392
Proceeds from sales of dealerships	121,859	22,578
Net cash provided by (used in) investing activities	1,231	(235,533)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net (repayments) borrowings on notes payable - floor plan - non-trade	(52,563)	(74,974)
Borrowings on revolving credit facilities	738,262	253,668
Repayments on revolving credit facilities	(799,736)	(118,668)
Proceeds from issuance of long-term debt	21,072	288,419
Debt issuance costs	(149)	(4,673)
Principal payments and repurchase of long-term debt	(31,337)	(31,194)
Repurchase of debt securities	—	(210,914)
Purchases of treasury stock	(24,110)	(37,347)
Issuance of shares under stock compensation plans	352	46
Dividends paid	(7,265)	(6,691)
Net cash provided by (used in) financing activities	(155,474)	57,672
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>1,230</b>	<b>10,271</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>6,352</b>	<b>3,108</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 7,582</b>	<b>\$ 13,379</b>

SUPPLEMENTAL  
SCHEDULE OF  
NON-CASH  
FINANCING  
ACTIVITIES:

Change in fair value  
of interest rate swap  
and interest rate cap  
agreements (net of  
tax expense of  
\$1,563 and \$1,099 in  
the nine months  
ended September 30,  
2018 and 2017,  
respectively)

SUPPLEMENTAL  
DISCLOSURES OF  
CASH FLOW  
INFORMATION:

Cash paid (received)  
during the period  
for:

Interest, including amount capitalized	\$	73,372	\$	67,523
Income taxes	\$	32,956	\$	30,752

See notes to condensed consolidated financial statements.

**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. Summary of Significant Accounting Policies**

**Basis of Presentation** – The accompanying condensed consolidated financial statements of Sonic Automotive, Inc. and its wholly owned subsidiaries (“Sonic,” the “Company,” “we,” “us” and “our”) for the three and nine months ended September 30, 2018 and 2017 are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and applicable rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The accompanying condensed consolidated financial statements reflect, in the opinion of management, all material normal recurring adjustments necessary to fairly state the financial position, results of operations and cash flows for the periods presented. The operating results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year or future interim periods, because the first quarter historically has contributed less operating profit than the second, third and fourth quarters. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2017.

**Recent Accounting Pronouncements** – In May 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) 2014-09 as well as several subsequent amendments to amend the accounting guidance on revenue recognition. The amendments to the revenue recognition accounting guidance are included in Accounting Standards Codification (“ASC”) 606, “Revenue from Contracts with Customers,” and are intended to provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices and improve disclosure requirements. The amendments to this guidance must be applied using either of the following transition methods: (1) a full retrospective approach reflecting the application of the amendments in each prior reporting period with the option to elect certain practical expedients; or (2) a modified retrospective approach with the cumulative effect of initially applying the amendments recognized at the date of adoption (which requires additional footnote disclosures). These amendments were effective for reporting periods beginning after December 15, 2017. On January 1, 2018, Sonic adopted ASC 606 (the “new revenue standard”) using the modified retrospective transition approach applied to contracts not completed as of the date of adoption. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative financial information has not been restated and continues to be reported under the accounting standards in effect for that period. We do not expect the adoption of the new revenue standard to have a material impact on our net income on an ongoing basis.

Under the new revenue standard, revenue is recognized when a customer obtains control of promised goods or services and in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. The principles apply a five-step model that includes: (1) identifying the contract(s) with the customer; (2) identifying the performance obligation(s) in the contract(s); (3) determining the transaction price; (4) allocating the transaction price to the performance obligation(s) in the contract(s); and (5) recognizing revenue as the performance obligation(s) are satisfied. The new revenue standard also requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Sonic does not include the cost of obtaining contracts within the related revenue streams. Sonic has elected the practical expedient to expense the costs to obtain a contract when incurred.

During the implementation process, management evaluated its established business processes, revenue transaction streams and accounting policies, and generally expects similar performance obligations to result under the new revenue standard as compared with prior U.S. GAAP. Management identified its material revenue streams to be (1) the sale of new vehicles; (2) the sale of used vehicles to retail customers; (3) the sale of wholesale used vehicles at third-party auctions; (4) the arrangement of vehicle financing and the sale of service and other insurance contracts; and (5) the performance of vehicle maintenance and repair services and the sale of related parts and accessories. As a result of this evaluation during the implementation process, management expects the amounts and timing of revenue recognition to generally remain the same, with the exception of the timing of revenue recognition related to: (1) service and collision repair orders that are incomplete as of a reporting date (“work in process”) and (2) certain retrospective finance and insurance revenue earned in periods subsequent to the completion of the initial performance

obligation (“F&I retro revenues”), both of which are subject to accelerated recognition under the new revenue standard. Work in process revenues are recognized over time based on the completed work to date and F&I retro revenues are recognized when the product contract has been executed with the end customer and are estimated each reporting period based on the expected value method using historical and projected data. F&I retro revenues, which represent variable consideration, subject to a constraint, are to be included in the transaction price and recognized when or as the performance obligation is satisfied. F&I retro revenues can vary based on a variety of factors, including number of contracts and history of cancellations and claims. Accordingly, Sonic utilizes this historical and projected data to constrain the consideration to the extent that it is probable that a significant reversal in the amount of cumulative revenue will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

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**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Generally, performance conditions are satisfied when the associated vehicle is either delivered or returned to a customer and customer acceptance has occurred or over time as the maintenance and repair services are performed. Sonic does not have any revenue streams with significant financing components as payments are typically received within a short period of time following completion of the performance obligation(s).

The cumulative effect of the adjustments to our September 30, 2018 condensed consolidated statements of income and January 1, 2018 condensed consolidated balance sheet for the adoption of ASC 606 were as follows:

<b>Income Statement</b>	<b>Pre-ASC 606 Results</b>	<b>As Reported</b>	
	<b>Three Months Ended</b>	<b>Effects of Adoption of ASC 606</b>	<b>Three Months Ended</b>
	<b>September 30, 2018</b>		<b>September 30, 2018</b>
	<b>(In thousands)</b>		
Revenues:			
Parts, service and collision repair	\$ 340,600	\$ 2,518	\$ 343,118
Finance, insurance and other, net	96,031	2,030	98,061
Total revenues	\$ 436,631	\$ 4,548	\$ 441,179
Cost of Sales:			
Parts, service and collision repair	\$ (175,153)	\$ (1,149)	\$ (176,302)
Selling, general and administrative expenses	\$ (288,639)	\$ (383)	\$ (289,022)
Operating income (loss):	\$ 45,121	\$ 3,016	\$ 48,137

<b>Income Statement</b>	<b>Pre-ASC 606 Results</b>	<b>As Reported</b>	
	<b>Nine Months Ended</b>	<b>Effects of Adoption of ASC 606</b>	<b>Nine Months Ended</b>
	<b>September 30, 2018</b>		<b>September 30, 2018</b>
	<b>(In thousands)</b>		
Revenues:			
Parts, service and collision repair	\$ 1,041,424	\$ 206	\$ 1,041,630
Finance, insurance and other, net	289,937	5,953	295,890
Total revenues	\$ 1,331,361	\$ 6,159	\$ 1,337,520
Cost of Sales:			
Parts, service and collision repair	\$ (537,990)	\$ (145)	\$ (538,135)

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Selling, general and administrative expenses	\$ (871,394)	\$ (16)	\$ (871,410)
Operating income (loss):	\$ 112,974	\$ 5,998	\$ 118,972

Balance Sheet	December 31, 2017	Effects of Adoption of ASC 606 (In thousands)	January 1, 2018
Assets:			
Receivables, net	\$ 482,126	\$ 4,590	\$ 486,716
Contract assets (1)	—	2,082	2,082
Liabilities:			
Other accrued liabilities	\$ 237,963	\$ 1,286	\$ 239,249
Deferred income taxes	51,619	1,468	53,087
Stockholders' Equity:			
Retained earnings	\$ 625,356	\$ 3,918	\$ 629,274

(1) Contract assets are included in receivables, net in the accompanying condensed consolidated balance sheets. Receivables, net at September 30, 2018 includes approximately \$4.7 million related to work in process and a contract asset of approximately \$8.0 million related to F&I retro revenues. Changes in contract assets from January 1, 2018 to September 30, 2018 were primarily due to ordinary business activity.

In February 2016, the FASB issued ASU 2016-02 to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this ASU require that leases are classified as either finance or operating leases, a right-of-use asset and lease liability is recognized in the statement of financial position and repayments are classified within operating activities in the

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**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

statement of cash flows. The amendments in this ASU are to be applied using a modified retrospective approach and are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (early adoption is permitted). We plan to adopt this ASU effective January 1, 2019. While management is still in the process of quantifying the impact of adopting the provisions of this ASU, management expects that upon adoption of this ASU, the presentation of certain items in our consolidated financial position, cash flows and other disclosures will be materially impacted, primarily due to the recognition of a right-of-use asset and an associated liability in our consolidated balance sheets and a change in the timing and classification of certain items in our consolidated statements of income and consolidated statements of cash flows as a result of the derecognition of the lease liability. We are currently implementing the changes required under this ASU by identifying and assessing our existing lease contracts and importing lease data into specialized lease accounting software to meet the future reporting requirements of this ASU. As part of our implementation plan, we are also evaluating the changes in internal controls and processes that are necessary to implement this ASU, but do not expect material changes. We expect to provide a quantitative disclosure of the impact of the adoption of this ASU in our Form 10-K for the year ending December 31, 2018.

In August 2017, the FASB issued ASU 2017-12 which amends the hedge accounting recognition and presentation requirements in ASC Topic 815, Derivatives and Hedging. This ASU expands and refines hedge accounting for both non-financial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. It also includes certain targeted improvements to simplify the application of current guidance related to hedge accounting. For public companies, this ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (early adoption is permitted). We do not believe the effects of this ASU will materially impact our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, which allows the reclassification of stranded tax effects, as a result of the Tax Cuts and Jobs Acts of 2017, from accumulated other comprehensive income to retained earnings. For public companies, this ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (early adoption is permitted). We are currently in the process of evaluating the effects of this ASU on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07 to expand the scope of ASC Topic 718, Compensation - Stock Compensation, to include share-based payment transactions for acquiring goods and services from non-employees. For public companies, this ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (early adoption is permitted). We are currently in the process of evaluating the effects of this ASU on our consolidated financial statements.

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

**Income Tax Expense** – Beginning January 1, 2018, the federal corporate income tax rate changed from 35.0% to 21.0% along with other tax provision changes that affect the deductibility of certain expenses. Sonic considered these items in its calculation of income tax amounts as of September 30, 2018 and for the three and nine months ended September 30, 2018. The overall effective tax rate from continuing operations was 32.4% and 31.1% for the three and nine months ended September 30, 2018, respectively, and 41.7% and 41.0% for the three and nine months ended September 30, 2017, respectively. Income tax expense for the three months ended September 30, 2018 includes a \$0.8 million discrete charge for non-deductible executive officer compensation related to executive transition costs. Income tax expense for the nine months ended September 30, 2018 includes a \$0.8 million discrete charge for non-deductible executive officer compensation related to executive transition costs, a \$0.2 million discrete charge related to changes in uncertain tax positions and a \$0.6 million discrete charge for non-deductible book goodwill related to dealership dispositions, offset partially by a \$0.9 million discrete benefit related to vested or exercised stock compensation. Income tax expense for the three months ended September 30, 2017 includes a \$0.4 million discrete charge related to a non-deductible asset impairment charge. Income tax expense for the nine months ended September 30, 2017 includes a \$0.4 million discrete charge related to a non-deductible asset impairment charge and a benefit of



approximately \$0.5 million as a result of the adoption of ASU 2016-09 which requires all book-tax differences related to the exercise of stock options or vesting of restricted stock or restricted stock units to flow through the provision for income taxes. Sonic's effective tax rate varies from year to year based on the distribution of taxable income between states in which the Company operates and other tax adjustments. Sonic expects the annual effective tax rate in future periods to fall within a range of 26.0% to 28.0% before the impact, if any, of changes in valuation allowances related to deferred income tax assets or discrete tax adjustments.

**2. Business Acquisitions and Dispositions**

*Acquisitions* -Sonic did not acquire any businesses during the three and nine months ended September 30, 2018.

During the three months ended September 30, 2017, Sonic acquired a pre-owned vehicle business for approximately \$76.6 million.

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**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Dispositions** -Sonic disposed of six franchised dealerships during the nine months ended September 30, 2018 that generated net cash of approximately \$121.9 million. In addition to these dispositions, Sonic terminated one luxury franchised dealership and ceased operations at three stores in our EchoPark Segment. Sonic disposed of one mid-line import franchised dealership during the three months ended September 30, 2017 that generated net cash of approximately \$22.6 million.

Revenues and other activities associated with disposed franchised dealerships classified as discontinued operations were as follows:

	Three Months Ended September 30,			Nine Months Ended
	2018	2017	2018	September 30, 2017
	(In thousands)			
Income (loss) from operations	\$ (148)	\$ (119)	\$ (478)	\$ (561)
Lease exit accrual adjustments and charges	(104)	(362)	(319)	(1,089)
Pre-tax income (loss)	\$ (252)	\$ (481)	\$ (797)	\$ (1,650)
Total revenues	\$ —	\$ —	\$ —	\$ —

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

	Three Months Ended September 30,			Nine Months Ended
	2018	2017	2018	September 30, 2017
	(In thousands)			
Income (loss) from operations	\$ (910)	\$ (1,779)	\$ (6,039)	\$ (4,067)
Gain (loss) on disposal	(88)	8,490	39,149	8,466
Lease exit accrual adjustments and charges	(15)	—	(33)	—
Pre-tax income (loss)	\$ (1,013)	\$ 6,711	\$ 33,077	\$ 4,399
Total revenues	\$ —	\$ 127,313	\$ 108,754	\$ 393,662

**3. Inventories**

Inventories consist of the following:

September 30, 2018	December 31, 2017
(In thousands)	
\$ 992,935	\$ 1,017,523

New vehicles		
Used vehicles	280,143	294,496
Service loaners	137,337	130,406
Parts, accessories and other	64,417	70,320
Net inventories	\$ 1,474,832	\$ 1,512,745

**SONIC AUTOMOTIVE, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**4. Property and Equipment**

Property and equipment, net consists of the following:

	September 30, 2018 (In thousands)	December 31, 2017
Land	\$ 385,814	\$ 370,828
Building and improvements	984,214	893,768
Software and computer equipment	127,515	147,812
Parts and service equipment	108,281	105,123
Office equipment and fixtures	94,942	96,066
Company vehicles	9,144	9,723
Construction in progress	74,576	54,429
Total, at cost	1,784,486	1,677,749
Less accumulated depreciation	(567,559)	(527,379)
Subtotal	1,216,927	1,150,370
Less assets held for sale (1)	(9,664)	(3,489)
Property and equipment, net	\$ 1,207,263	\$ 1,146,881

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

In the three and nine months ended September 30, 2018, capital expenditures were approximately \$34.3 million and \$133.9 million, respectively, and in the three and nine months ended September 30, 2017, capital expenditures were approximately \$60.7 million and \$181.9 million, respectively. Capital expenditures in all periods were primarily related to real estate acquisitions, construction of new franchised dealerships and EchoPark stores, building improvements and equipment purchased for use in our franchised dealerships and EchoPark stores. Assets held for sale as of September 30, 2018 consists of real property not being used in operations that we expect to dispose of in the next 12 months.

There were no impairment charges for the three months ended September 30, 2018. Impairment charges for the nine months ended September 30, 2018 were approximately \$14.0 million, which include the write-off of certain costs associated with internally developed software as well as the write-off of capitalized costs associated with the abandonment of certain construction projects. Impairment charges for the three and nine months ended September 30, 2017 were approximately \$0.2 million and \$3.3 million, respectively, which include the write-off of goodwill and property and equipment related to the closure of two pre-owned stores that were purchased in 2016 as well as the write-off of capitalized costs associated with the abandonment of certain construction projects.

**5. Goodwill and Intangible Assets**

The carrying amount of goodwill was approximately \$510.2 million and \$525.8 million as of September 30, 2018 and December 31, 2017, respectively. The carrying amount of goodwill is net of accumulated impairment losses of

approximately \$797.6 million as of both September 30, 2018 and December 31, 2017. The carrying amount of franchise assets was approximately \$67.8 million and \$69.9 million as of September 30, 2018 and December 31, 2017, respectively. The changes in the carrying amount of both goodwill and franchise assets are related to the disposition of several franchised dealerships during the nine months ended September 30, 2018. At December 31, 2017, Sonic had approximately \$4.7 million of definite life intangibles related to favorable lease agreements. After the effect of amortization of the definite life intangibles, the balance recorded at September 30, 2018 was approximately \$4.2 million. Both franchise assets and favorable lease agreement assets are included in other intangible assets, net in the accompanying condensed consolidated balance sheets.

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**SONIC AUTOMOTIVE, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**6. Long-Term Debt**

Long-term debt consists of the following:

	September 30, 2018	December 31, 2017
	(In thousands)	
2016		
Revolving Credit Facility (1)	\$ 13,526	\$ 75,000
5.0% Senior Subordinated Notes due 2023 (the "5.0% Notes")	289,273	289,273
6.125% Senior Subordinated Notes due 2027 (the "6.125% Notes")	250,000	250,000
Mortgage notes to finance companies - fixed rate, bearing interest from 3.51% to 7.03%	226,548	199,972
Mortgage notes to finance companies - variable rate, bearing interest at 1.50 to 2.90 percentage points above one-month or three-month LIBOR	183,499	219,719
Debt issuance costs	(11,528)	(13,208)
Other	39,311	3,947
Total debt	\$ 990,629	\$ 1,024,703
Less current maturities	(33,110)	(61,314)

Long-term debt	\$	957,519	\$	963,389
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(1) The interest rate on the 2016 Revolving Credit Facility (as defined below) was 250 and 225 basis points above the London Interbank Offer Rate (“LIBOR”) at September 30, 2018 and December 31, 2017, respectively.

### **2016 Credit Facilities**

On November 30, 2016, Sonic entered into an amended and restated syndicated revolving credit facility (the “2016 Revolving Credit Facility”) and amended and restated syndicated new and used vehicle floor plan credit facilities (the “2016 Floor Plan Facilities” and, together with the 2016 Revolving Credit Facility, the “2016 Credit Facilities”), which are scheduled to mature on November 30, 2021.

Availability under the 2016 Revolving Credit Facility is calculated as the lesser of \$250.0 million or a borrowing base calculated based on certain eligible assets, less the aggregate face amount of any outstanding letters of credit under the 2016 Revolving Credit Facility (the “2016 Revolving Borrowing Base”). The 2016 Revolving Credit Facility may be increased at Sonic’s option up to \$300.0 million upon satisfaction of certain conditions. As of September 30, 2018, the 2016 Revolving Borrowing Base was approximately \$222.5 million based on balances as of such date. As of September 30, 2018, Sonic had approximately \$13.5 million of outstanding borrowings and approximately \$16.2 million in outstanding letters of credit under the 2016 Revolving Credit Facility, resulting in total borrowing availability of approximately \$192.8 million under the 2016 Revolving Credit Facility.

The 2016 Floor Plan Facilities are comprised of a new vehicle revolving floor plan facility (the “2016 New Vehicle Floor Plan Facility”) and a used vehicle revolving floor plan facility (the “2016 Used Vehicle Floor Plan Facility”), subject to a borrowing base, in a combined amount of up to \$1.015 billion. We may, under certain conditions, request an increase in the 2016 Floor Plan Facilities to a maximum borrowing limit of up to \$1.265 billion, which shall be allocated between the 2016 New Vehicle Floor Plan Facility and the 2016 Used Vehicle Floor Plan Facility as we request, with no more than 30% of the aggregate commitments allocated to the commitments under the 2016 Used Vehicle Floor Plan Facility. Outstanding obligations under the 2016 Floor Plan Facilities are guaranteed by us and certain of our subsidiaries and are secured by a pledge of substantially all of our and our subsidiaries’ assets. The amounts outstanding under the 2016 Credit Facilities bear interest at variable rates based on specified percentages above LIBOR.

We agreed under the 2016 Credit Facilities not to pledge any assets to any third parties (other than those explicitly allowed under the amended terms of the 2016 Credit Facilities), including other lenders, subject to certain stated exceptions, including floor plan financing arrangements. In addition, the 2016 Credit Facilities contain certain negative 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. Specifically, the 2016 Credit Facilities permit cash dividends on our Class A and Class B Common Stock so long as no event of default (as defined in the 2016 Credit Facilities) has occurred and is continuing and provided that we remain in compliance with all financial covenants under the 2016 Credit Facilities.

**SONIC AUTOMOTIVE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

***5.0% Notes***

On May 9, 2013, Sonic issued \$300.0 million in aggregate principal amount of unsecured senior subordinated 5.0% Notes, which are scheduled to mature on May 15, 2023. The 5.0% Notes were issued at a price of 100.0% of the principal amount thereof. The 5.0% Notes are guaranteed by Sonic's domestic operating subsidiaries. Interest on the 5.0% Notes is payable semi-annually in arrears on May 15 and November 15 of each year. On September 30, 2016, Sonic repurchased approximately \$10.7 million of the outstanding 5.0% Notes for approximately \$10.6 million in cash, plus accrued and unpaid interest related thereto. Sonic may redeem the remaining outstanding 5.0% Notes, in whole or in part, at any time.

The indenture governing the 5.0% 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, guarantees, liens, certain types of investments, certain transactions with affiliates, mergers, consolidations, issuance of preferred stock, cash dividends to stockholders, distributions, redemptions and the sale, assignment, lease, conveyance or disposal of certain assets. Specifically, the indenture governing the 5.0% Notes limits Sonic's ability to pay quarterly cash dividends on Sonic's Class A and Class B Common Stock in excess of \$0.10 per share. Sonic may only pay quarterly cash dividends on Sonic's Class A and Class B Common Stock if Sonic complies with the terms of the indenture governing the 5.0% Notes. Sonic was in compliance with all restrictive covenants in the indenture governing the 5.0% Notes as of September 30, 2018.

***6.125% Notes***

On March 10, 2017, Sonic issued \$250.0 million in aggregate principal amount of unsecured senior subordinated 6.125% Notes, which are scheduled to mature on March 15, 2027. The 6.125% Notes were issued at a price of 100.0% of the principal amount thereof. Sonic used the net proceeds from the issuance of the 6.125% Notes (i) to repurchase all of its then outstanding 7.0% Senior Subordinated Notes due 2022 on March 27, 2017 (the "7.0% Notes") and (ii) for other general corporate purposes. The 6.125% Notes are guaranteed by Sonic's domestic operating subsidiaries. Interest on the 6.125% Notes is payable semi-annually in arrears on March 15 and September 15 of each year. Sonic may redeem the 6.125% Notes, in whole or in part, at any time on or after March 15, 2022.

The indenture governing the 6.125% 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, guarantees, liens, certain types of investments, certain transactions with affiliates, mergers, consolidations, issuance of preferred stock, cash dividends to stockholders, distributions, redemptions and the sale, assignment, lease, conveyance or disposal of certain assets. Specifically, the indenture governing the 6.125% Notes limits Sonic's ability to pay quarterly cash dividends on Sonic's Class A and Class B Common Stock in excess of \$0.12 per share. Sonic may only pay quarterly cash dividends on Sonic's Class A and Class B Common Stock if Sonic complies with the terms of the indenture governing the 6.125% Notes. Sonic was in compliance with all restrictive covenants in the indenture governing the 6.125% Notes as of September 30, 2018.

***Mortgage Notes***

During the nine months ended September 30, 2018, Sonic obtained approximately \$21.1 million in mortgage financing related to three of its operating locations. As of September 30, 2018, the weighted average interest rate was 4.61% and the total outstanding mortgage principal balance was approximately \$410.0 million. These mortgage notes require monthly payments of principal and interest through their respective maturities, are secured by the underlying properties and contain certain cross-default provisions. Maturity dates for these mortgage notes range between 2018 and 2033.

***Other***

Other debt consists of capital lease obligations, which increased approximately \$35.4 million during the nine months ended September 30, 2018 due to several new lease contracts executed in the three months ended September 30, 2018 meeting the criteria to be treated as a capital lease obligation. The recorded capital lease obligation and corresponding lease asset will be amortized into earnings over the term of the agreements.

***Covenants***



Under the 2016 Credit Facilities, Sonic agreed not to pledge any assets to any third parties (other than those explicitly allowed under the amended terms of the 2016 Credit Facilities), including other lenders, subject to certain stated exceptions, including floor plan financing arrangements. In addition, the 2016 Credit Facilities contain certain negative 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.

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**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Sonic was in compliance with the covenants under the 2016 Credit Facilities as of September 30, 2018. Financial covenants include required specified ratios (as each is defined in the 2016 Credit Facilities) of:

Covenant	Minimum Consolidated Liquidity Ratio	Minimum Consolidated Fixed Charge Coverage Ratio	Maximum Consolidated Total Lease Adjusted Leverage Ratio
Required ratio	1.05	1.20	5.75
September 30, 2018 actual	1.13	1.45	5.11

The 2016 Credit Facilities contain events of default, including cross defaults to other material indebtedness, change of control events and other events of default customary for syndicated commercial credit facilities. Upon the future occurrence of an event of default, Sonic could be required to immediately repay all outstanding amounts under the 2016 Credit Facilities.

After giving effect to the applicable restrictions on the payment of dividends under its debt agreements, as of September 30, 2018, Sonic had approximately \$151.8 million of net income and retained earnings free of such restrictions. Sonic was in compliance with all restrictive covenants under its debt agreements as of September 30, 2018.

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 under the guarantee agreement are identical to those under the 2016 Credit Facilities with the exception of one financial covenant related to the ratio of EBTDAR to Rent (as defined in the guarantee agreement) with a required ratio of no less than 1.50 to 1.00. As of September 30, 2018, the ratio was 3.55 to 1.00.

***Derivative Instruments and Hedging Activities***

Sonic has interest rate cap agreements designated as hedging instruments to limit its exposure to increases in LIBOR rates above certain levels. Under the terms of these interest rate caps, interest rates reset monthly. The fair value of these interest rate cap positions at September 30, 2018 was an asset of approximately \$8.6 million, with approximately \$6.6 million included in other assets and approximately \$2.0 million included in other current assets in the accompanying condensed consolidated balance sheets. During the nine months ended September 30, 2018, Sonic terminated all of its previously outstanding interest rate cash flow swap agreements for net cash proceeds of approximately \$4.8 million, which will be amortized into income as a reduction of interest expense, other, net on a ratable basis over the original term of these agreements (through July 1, 2020). The fair value of the outstanding interest rate swap and interest rate cap positions at December 31, 2017 was a net asset of approximately \$4.7 million, with approximately \$5.1 million included in other assets and approximately \$0.9 million included in other current assets in the accompanying condensed consolidated balance sheets, offset partially by approximately \$1.0 million included in other accrued liabilities and approximately \$0.3 million included in other long-term liabilities in the accompanying condensed consolidated balance sheets.

Under the terms of the interest rate cap agreements, Sonic will receive and pay interest based on the following:

Notional Amount (In millions)	Pay Rate (1)	Receive Rate (2)	Start Date	End Date
\$ 250.0	2.000%	one-month LIBOR	September 1, 2017	June 30, 2018
\$ 375.0	2.000%			

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			one-month LIBOR	July 1, 2018	June 30, 2019
\$	375.0	3.000%	one-month LIBOR	July 1, 2018	June 30, 2019
\$	312.5	2.000%	one-month LIBOR	July 1, 2019	June 30, 2020
\$	250.0	3.000%	one-month LIBOR	July 1, 2019	June 30, 2020
\$	225.0	3.000%	one-month LIBOR	July 1, 2020	June 30, 2021
\$	150.0	2.000%	one-month LIBOR	July 1, 2020	July 1, 2021
\$	250.0	3.000%	one-month LIBOR	July 1, 2021	July 1, 2022

(1) Under these interest rate cap agreements, no payment to or from the counterparty will occur unless the stated receive rate exceeds the stated pay rate, in which case a net payment to Sonic from the counterparty based on the spread between the receive rate and the pay rate will be recognized as a reduction of interest expense, other, net in the accompanying condensed consolidated statements of income.

(2) The one-month LIBOR rate was approximately 2.261% at September 30, 2018.

**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The interest rate caps are designated as cash flow hedges, and the changes in the fair value of these instruments are recorded in other comprehensive income (loss) in the accompanying condensed consolidated statements of comprehensive income and are disclosed in the supplemental schedule of non-cash financing activities in the accompanying condensed consolidated statements of cash flows. The incremental interest income (the excess of interest received over interest paid) related to interest rate caps and interest rate swaps was approximately \$0.1 million for the three months ended September 30, 2018 and the incremental interest expense (the excess of interest paid over interest received) related to interest rate caps and interest rate swaps was approximately \$0.1 million for the nine months ended September 30, 2018, and is included in interest expense, other, net in the accompanying condensed consolidated statements of income, and the interest paid amount is disclosed in the supplemental disclosures of cash flow information in the accompanying condensed consolidated statements of cash flows. The incremental interest expense (the excess of interest paid over interest received) related to interest rate caps and interest rate swaps was approximately \$0.7 million and \$2.6 million for the three and nine months ended September 30, 2017, respectively, and is included in interest expense, other, net in the accompanying condensed consolidated statements of income, and the interest paid amount is disclosed in the supplemental disclosures of cash flow information in the accompanying condensed consolidated statements of cash flows. The estimated net benefit expected to be reclassified out of accumulated other comprehensive income (loss) into results of operations during the next 12 months is approximately \$2.7 million.

**7. Per Share Data and Stockholders' Equity**

The calculation of diluted earnings per share considers the potential dilutive effect of stock options and shares under Sonic's stock compensation plans and Class A Common Stock purchase warrants. Certain of Sonic's non-vested restricted stock awards contain rights to receive non-forfeitable dividends and, thus, are considered participating securities and are included in the two-class method of computing earnings per share. The following tables illustrate the dilutive effect of such items on earnings per share for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018							
	Income (Loss)			Income (Loss)				Net Income (Loss)
	From Continuing Operations		Amount	From Discontinued Operations		Per Share Amount	Per Share Amount	
Weighted Average Shares	Per Share Amount	Per Share Amount		Amount	Per Share Amount			
(In thousands, except per share amounts)								
Earnings (loss) and shares	42,67	\$ 15,301	\$	(183)	\$	15,118		
Effect of participating securities:								
Non-vested restricted stock	(14)		—		(14)			
Basic earnings (loss) and shares	42,67	\$ 15,287	\$	0.36	\$	(183)	\$	(0.01)
Effect of dilutive securities:								
Stock compensation plans								
Diluted earnings	42,99	\$ 15,287	\$	0.36	\$	(183)	\$	(0.01)
			\$	15,104	\$	0.35		

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(loss) and  
shares

Three Months Ended September 30, 2017

	Income (Loss)			Income (Loss)			Net Income (Loss)
	From Continuing Operations			From Discontinued Operations			
	Weighted Average Shares	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	
<b>(In thousands, except per share amounts)</b>							
Earnings (loss) and shares	43,496	19,730	\$ (290)		\$ 19,440		
Effect of participating securities:							
Non-vested restricted stock	(18)		—		(18)		
Basic earnings (loss) and shares	43,496	19,712	\$ 0.45	\$ (290)	\$ —	\$ 19,422	\$ 0.45
Effect of dilutive securities:							
Stock compensation plans							
Diluted earnings (loss) and shares	43,811	19,712	\$ 0.45	\$ (290)	\$ (0.01)	\$ 19,422	\$ 0.44

**SONIC AUTOMOTIVE, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Nine Months Ended September 30, 2018								
	Income (Loss)				Income (Loss)			Net Income (Loss)
	From Continuing Operations				From Discontinued Operations			
	Weighted Average Shares	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	
(In thousands, except per share amounts)								
Earnings (loss) and shares	42,708	30,409		\$ (579)		\$ 29,830		
Effect of participating securities:								
Non-vested restricted stock	(29)			—		(29)		
Basic earnings (loss) and shares	42,708	30,380	\$ 0.71	\$ (579)	\$ (0.01)	\$ 29,801	\$ 0.70	
Effect of dilutive securities:								
Stock compensation plans								
Diluted earnings (loss) and shares	42,968	30,380	\$ 0.71	\$ (579)	\$ (0.02)	\$ 29,801	\$ 0.69	

Nine Months Ended September 30, 2017								
	Income (Loss)				Income (Loss)			Net Income (Loss)
	From Continuing Operations				From Discontinued Operations			
	Weighted Average Shares	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	
(In thousands, except per share amounts)								
Earnings (loss) and shares	44,288	32,024		\$ (993)		\$ 31,031		
Effect of participating securities:								
Non-vested restricted stock	(28)			—		(28)		
Basic earnings (loss) and shares	44,288	31,996	\$ 0.72	\$ (993)	\$ (0.02)	\$ 31,003	\$ 0.70	
Effect of dilutive securities:								

Stock compensation304 plans												
Diluted earnings (loss) and shares	44,585	31,996	\$	0.72	\$	(993)	\$	(0.02)	\$	31,003	\$	0.70

## 8. Commitments and Contingencies

### *Lease Exit Accruals*

A significant number of our dealership properties are leased under long-term operating lease arrangements. When leased properties are no longer utilized in operations, we record lease exit accruals. These situations could include the relocation of an existing facility or the sale of a dealership when the buyer will not be subleasing the property for either the remaining term of the lease or for an amount equal to our obligation under the lease, or situations in which a store is closed as a result of the associated franchise being terminated by us or the manufacturer and no other operations continue on the leased property. The lease exit 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 lease commitments to the landlords. As of September 30, 2018, we had approximately \$6.3 million accrued for lease exit costs. In addition, based on the terms and conditions negotiated in the sale of dealerships in the future, additional accruals may be necessary if the purchaser of the dealership does not assume any of the associated lease, or we are unable to negotiate a sublease with the buyer of the dealership on terms that are identical to or better than those associated with the original lease.

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

#### **(In thousands)**

Balance at December 31, 2017	\$	6,478
Lease exit expense (1)	2,697	
Payments (2)	(2,336)	
Lease buyout/other (3)	(580)	
Balance at September 30, 2018	\$	6,259

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**SONIC AUTOMOTIVE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(1) Expense of approximately \$2.3 million is recorded in selling, general and administrative expenses and expense of approximately \$0.1 million is recorded in interest expense, other, net in the accompanying condensed consolidated statements of income. In addition, expense of approximately \$0.3 million is recorded in income (loss) from discontinued operations before taxes in the accompanying condensed consolidated statements of income.

(2) Amount is recorded as an offset to rent expense, with approximately \$0.8 million and \$1.5 million recorded in selling, general and administrative expenses and income (loss) from discontinued operations before taxes, respectively, in the accompanying condensed consolidated statements of income.

(3) Amount represents cash paid to settle deferred maintenance costs related to terminating and exiting leased properties.

***Legal and Other Proceedings***

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

Included in other accrued liabilities and other long-term liabilities at September 30, 2018 was approximately \$2.1 million and \$0.2 million, respectively, in reserves that Sonic was holding for pending proceedings. Included in other accrued liabilities and other long-term liabilities at December 31, 2017 was approximately \$3.0 million and \$0.2 million, respectively, for such reserves. Except as reflected in such reserves, Sonic is currently unable to estimate a range of reasonably possible loss, or a range of reasonably possible loss in excess of the amount accrued, for pending proceedings.

***Guarantees and Indemnification Obligations***

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

In connection with dealership dispositions and facility relocations, certain of Sonic's subsidiaries have assigned or sublet to the buyer their interests in real property leases associated with such dealerships. In general, the subsidiaries retain responsibility for the performance of certain obligations under such leases, including rent payments and repairs to leased property upon termination of the lease, to the extent that the assignee or sublessee does not perform. In the event an assignee or a sublessee does not perform its obligations, Sonic remains liable for the lease payments. See Note 12, "Commitments and Contingencies," to the consolidated financial statements in Sonic's Annual Report on Form 10-K for the year ended December 31, 2017 for further discussion.

In accordance with the terms of agreements entered into for the sale of Sonic's dealerships, Sonic generally agrees to indemnify the buyer from certain liabilities and costs arising subsequent to the date of sale, including environmental exposure and exposure resulting from the breach of representations or warranties made in accordance with the agreements. While Sonic's exposure with respect to environmental remediation and repairs is difficult to quantify, Sonic's maximum exposure associated with these general indemnifications was approximately \$14.0 million and \$5.0 million at September 30, 2018 and December 31, 2017, respectively. These indemnifications typically expire within a period of one to three years following the date of sale. The estimated fair value of these indemnifications was not material and the amount recorded for this contingency was not significant at September 30, 2018.

Sonic also guarantees the floor plan commitments of its 50%-owned joint venture, the amount of which was approximately \$2.8 million at both September 30, 2018 and December 31, 2017.

***Earnout Consideration***

In association with the acquisition of a business in the three months ended September 30, 2017, Sonic entered into an earnout agreement whereby the seller may be entitled to certain variable earnout payments, subject to certain



restrictions, based on the acquired business achieving specified earnings targets over a 10-year period, not to exceed a maximum aggregate earnout payment of \$80.0 million. Sonic will recognize the accrual of any such variable earnout payments as compensation expense as earned. Sonic had recorded approximately \$23.3 million in earnout accruals as of September 30, 2018, with approximately \$7.7 million and \$15.6 million recorded in other accrued liabilities and other long-term liabilities, respectively, in the accompanying condensed consolidated balance sheets.

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**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****9. Fair Value Measurements**

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

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

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

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

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

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

Assets and liabilities recorded at fair value in the accompanying condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017 are as follows:

	<b>Fair Value Based on Significant Other Observable Inputs (Level 2)</b>	
	<b>September 30, 2018</b>	<b>December 31, 2017</b>
	<b>(In thousands)</b>	
<b>Assets:</b>		
Cash surrender value of life insurance policies (1)	\$ 34,699	\$ 33,747
Cash flow swaps and interest rate caps designated as hedges (2)	8,604	5,968

Total assets	\$	43,303	\$	39,715
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**Liabilities:**

Cash flow swaps and interest rate caps designated as hedges (3)	\$	—	\$	1,286
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Deferred compensation plan (4)	20,412	18,417
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Total liabilities	\$	20,412	\$	19,703
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(1) Included in other assets in the accompanying condensed consolidated balance sheets.

(2) As of September 30, 2018, approximately \$2.0 million and \$6.6 million were included in other current assets and other assets, respectively, in the accompanying condensed consolidated balance sheets. As of December 31, 2017, approximately \$0.9 million and \$5.1 million were included in other current assets and other assets, respectively, in the accompanying condensed consolidated balance sheets.

**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(3) As of December 31, 2017, approximately \$1.0 million and \$0.3 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying condensed consolidated balance sheets.

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

There were no instances during the nine months ended September 30, 2018 which required a fair value measurement of assets ordinarily measured at fair value on a non-recurring basis. Therefore, the carrying value of assets measured at fair value on a non-recurring basis in the accompanying condensed consolidated balance sheet as of September 30, 2018 has not changed since December 31, 2017. These assets will be evaluated as of the annual valuation assessment date of October 1, 2018 or as events or changes in circumstances require.

As of September 30, 2018 and December 31, 2017, the fair values of Sonic's financial instruments, including receivables, notes receivable from finance contracts, notes payable – floor plan, trade accounts payable, borrowings under the revolving credit facilities and certain mortgage notes, approximated their carrying values due either to length of maturity or existence of variable interest rates that approximate prevailing market rates.

At September 30, 2018 and December 31, 2017, the fair value and carrying value of Sonic's significant fixed rate long-term debt were as follows:

	September 30, 2018		December 31, 2017	
	Fair Value (In thousands)	Carrying Value	Fair Value	Carrying Value
5.0% Notes (1)	\$ 271,917	\$ 289,273	\$ 279,148	\$ 289,273
6.125% Notes (1)	\$ 233,125	\$ 250,000	\$ 248,750	\$ 250,000
Mortgage Notes (2)	\$ 229,626	\$ 226,548	\$ 203,031	\$ 199,972
Other (2)	\$ 39,177	\$ 39,311	\$ 3,760	\$ 3,947

(1) As determined by market quotations as of September 30, 2018 and December 31, 2017, respectively (Level 1).

(2) As determined by discounted cash flows (Level 3) based on estimated current market interest rates for comparable instruments.

**10. Accumulated Other Comprehensive Income (Loss)**

The changes in accumulated other comprehensive income (loss) by component for the nine months ended September 30, 2018 are as follows:

	Gains and Losses on Cash Flow Hedges	Defined Benefit Pension Plan	Total Accumulated Other Comprehensive Income (Loss)
	(In thousands)		
Balance at December 31, 2017	\$ 1,750	\$ (443)	\$ 1,307
Other comprehensive income (loss) before reclassifications (1)	4,140	—	4,140
Amounts reclassified out of accumulated other comprehensive income (loss) (2)	33	—	33

Net current-period other comprehensive income (loss)	4,173	—	4,173
Balance at September 30, 2018	\$ 5,923	\$ (443)	\$ 5,480

(1) Net of tax expense of \$1,551.

(2) Net of tax expense of \$12.

See the heading “Derivative Instruments and Hedging Activities” in Note 6, “Long-Term Debt,” for further discussion of Sonic’s cash flow hedges. For further discussion of Sonic’s defined benefit pension plan, see Note 10, “Employee Benefit Plans,” to the consolidated financial statements in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2017.

### **11. Segment Information**

As of September 30, 2018, Sonic had two operating segments comprised of: (1) 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 “Franchised Dealerships Segment”) and (2) stand-alone pre-owned vehicle specialty retail locations that buy and sell used vehicles, perform vehicle repair and maintenance services, and arrange finance and insurance products under the EchoPark brand (the “EchoPark Segment”).

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**SONIC AUTOMOTIVE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The operating segments identified above are the business activities of Sonic for which discrete financial information is available and for which operating results are regularly reviewed by Sonic's chief operating decision maker to assess operating performance and allocate resources. Sonic's chief operating decision maker is a group of three individuals consisting of: (1) the Company's Chief Executive Officer; (2) the Company's Chief Financial Officer; and (3) the Company's President. Sonic has determined that its operating segments also represent its reportable segments. Reportable segment revenues and segment income (loss) for the three and nine months ended September 30, 2018 and 2017 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Revenues:				
Franchised Dealerships Segment	\$ 2,284,931	\$ 2,448,574	\$ 6,879,783	\$ 7,051,291
EchoPark Segment	185,918	57,127	497,589	147,978
Total consolidated revenues	\$ 2,470,849	\$ 2,505,701	\$ 7,377,372	\$ 7,199,269

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Segment income (loss) (1):				
Franchised Dealerships Segment (2)	\$ 40,971	\$ 51,486	\$ 130,856	\$ 125,553
EchoPark Segment (3)	(5,026)	(4,606)	(46,699)	(17,585)
Total segment income (loss)	35,945	46,880	84,157	107,968
Interest expense, other, net	(13,313)	(13,028)	(40,144)	(39,200)
Other income (expense), net	—	4	107	(14,490)
Income (loss) from continuing	\$ 22,632	\$ 33,856	\$ 44,120	\$ 54,278

operations  
before taxes

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

(2) For the three months ended September 30, 2018, the above amount includes approximately \$0.3 million of net loss on the disposal of franchised dealerships, approximately \$1.6 million of executive transition costs and approximately \$1.2 million of storm-related physical damage and legal costs. For the three months ended September 30, 2017, the above amount includes approximately \$8.5 million of net gain on the disposal of franchised dealerships, offset partially by approximately \$3.5 million of storm-related physical damage and legal costs and approximately \$0.2 million of impairment expense.

For the nine months ended September 30, 2018, the above amount includes approximately \$38.9 million of net gain on the disposal of franchised dealerships, offset partially by approximately \$5.8 million of storm-related physical damage and legal costs, approximately \$2.2 million of lease exit charges, approximately \$1.6 million of executive transition costs and approximately \$14.0 million of impairment expense. For the nine months ended September 30, 2017, the above amount includes approximately \$8.5 million of net gain on the disposal of franchised dealerships, offset partially by approximately \$10.3 million of storm-related physical damage and legal costs, approximately \$0.3 million of lease exit charges, approximately \$14.6 million of net loss on the extinguishment of debt, approximately \$0.7 million of double-carry interest and approximately \$3.3 million of impairment expense.

(3) For the three months ended September 30, 2017, the above amount includes approximately \$0.5 million of long-term compensation-related charges.

For the nine months ended September 30, 2018, the above amount includes approximately \$32.5 million of long-term compensation-related charges. For the nine months ended September 30, 2017, the above amount includes approximately \$0.6 million of lease exit charges and approximately \$0.5 million of long-term compensation-related charges.

**SONIC AUTOMOTIVE, INC.**

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

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying condensed consolidated financial statements and related notes thereto and "Item 1A. Risk Factors" in this report, as well as the consolidated financial statements and related notes thereto, "Item 1A. Risk Factors" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing in our Annual Report on Form 10-K for the year ended December 31, 2017.

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

**Overview**

We are one of the largest automotive retailers in the United States (as measured by total revenue). As of September 30, 2018, we operated 107 new vehicle franchises in 13 states (representing 23 different brands of cars and light trucks), 15 collision repair centers and seven EchoPark stores. As a result of the way we manage our business, we had two operating segments as of September 30, 2018: (1) Franchised Dealerships Segment and (2) EchoPark Segment. For management and operational reporting purposes, we group certain businesses together that share management and inventory (principally used vehicles) into "stores." As of September 30, 2018, we operated 96 stores in the Franchised Dealerships Segment and seven stores in the EchoPark Segment.

The Franchised Dealerships Segment provides 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. The EchoPark Segment provides the same services (excluding new vehicle sales and manufacturer warranty repairs) in stand-alone pre-owned vehicle specialty retail locations. Our EchoPark business operates independently from our franchised dealerships business. Sales operations in our first EchoPark market in Denver, Colorado began in the fourth quarter of 2014. As of September 30, 2018, we had four EchoPark stores in operation in Colorado and three EchoPark stores in Texas. By the end of 2018, we expect to open two additional EchoPark stores in North Carolina and Texas. We believe that the expansion of our EchoPark stores will provide long-term benefits to us, our stockholders and our guests. However, in the short term, this strategic initiative may negatively impact our overall operating results as we allocate management and capital resources to this business.

**Executive Summary**

The U.S. retail automotive industry's total new vehicle seasonally adjusted annual rate of sales ("SAAR") decreased 1.2% to 16.9 million vehicles in the three months ended September 30, 2018, compared to 17.1 million vehicles in the three months ended September 30, 2017, according to data from Bloomberg Financial Markets, provided by Stephens Inc. The SAAR increased 0.6% to 17.1 million vehicles in the nine months ended September 30, 2018, compared to 17.0 million vehicles in the nine months ended September 30, 2017, according to data from Bloomberg Financial Markets, provided by Stephens Inc. For 2018, analysts' average industry expectation for the new vehicle SAAR is approximately 16.8 million vehicles. We currently estimate the 2018 new vehicle SAAR will be between 16.8 million and 17.0 million vehicles. Changes in consumer confidence, replacement demand as a result of natural disasters, availability of consumer financing, manufacturer inventory production levels or incentive levels from automotive manufacturers could cause actual 2018 new vehicle SAAR to vary from expectations. Many factors, including brand and geographic concentrations as well as the industry sales mix between retail and fleet new vehicle unit sales volume, have caused our past results to differ from the industry's overall trend. As a result of our minimal fleet new vehicle sales volume, we believe it is appropriate to compare our new vehicle unit sales volume to the retail new vehicle SAAR (which excludes fleet new vehicle sales). According to the Power Information Network ("PIN") from J.D. Power, retail new vehicle SAAR was 13.7 million vehicles for the three months ended September 30, 2018, a decrease of 2.8% from the prior year period, and 13.5 million vehicles for the nine months ended September 30, 2018, a decrease of 2.2% from the prior year period.

As a result of the disposition, termination or closure of several franchised dealership stores since September 30, 2017, the change in consolidated reported amounts from period to period may not be indicative of the actual operational or



financial performance of our current group of operating stores. Unless otherwise noted, all discussion of increases or decreases are for the three and nine months ended September 30, 2018 and are compared to the same prior year period, as applicable. The following discussion of new vehicles, used vehicles, wholesale vehicles, parts, service and collision repair, and finance, insurance and other, net are on a same store basis, except where otherwise noted. All currently operating continuing operations

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

stores (both our franchised dealerships and EchoPark stores) are included within the same store group in the first full month following the first anniversary of the store's opening or acquisition.

New vehicle revenue decreased 4.2% and 0.1% during the three and nine months ended September 30, 2018, respectively, driven by a decrease in new vehicle unit sales volume. New vehicle gross profit decreased 3.9% during both the three and nine months ended September 30, 2018, primarily due to lower new vehicle unit sales volume as a result of higher new vehicle unit sales volume in the three months ended September 30, 2017 related to replacement demand in the Houston market as a result of Hurricane Harvey. New vehicle gross profit per unit increased \$53 per unit, or 2.8%, to \$1,971 per unit in the three months ended September 30, 2018, and decreased \$19 per unit, or 1.0%, to \$1,944 per unit in the nine months ended September 30, 2018. Beginning in the second quarter of 2018, new vehicle gross profit per unit at our BMW and Honda dealerships was significantly lower than expected due primarily to lower manufacturer-to-dealer incentives on certain models. We experienced some improvement in both brands during the third quarter of 2018, but are still below historical levels. We continue to be optimistic that support from our manufacturer partners and highly anticipated new model releases from BMW in the fourth quarter of 2018 will drive consumer demand and increased profitability on new vehicle unit sales.

Retail used vehicle revenue increased 6.3% and 6.6% during the three and nine months ended September 30, 2018, respectively. Retail used vehicle unit sales volume increased 7.8% and 6.5% during the three and nine months ended September 30, 2018, respectively, primarily driven by increased volumes at our EchoPark stores. Retail used vehicle gross profit increased 0.1% during the three months ended September 30, 2018, primarily driven by an increase in retail used vehicle unit sales volume, offset partially by lower retail used vehicle gross profit per unit. Retail used vehicle gross profit decreased 2.4% during the nine months ended September 30, 2018, primarily driven by a decrease in retail used vehicle gross profit per unit. Retail used vehicle gross profit per unit decreased \$89 per unit, or 7.1%, to \$1,156 per unit in the three months ended September 30, 2018 and decreased \$107 per unit, or 8.3%, to \$1,175 per unit in the nine months ended September 30, 2018, driven primarily by a shift in pricing strategy at our EchoPark stores which reduces front-end gross profit per unit but increases unit sales volume and total gross profit, more than offsetting the decrease in front-end gross profit. Wholesale vehicle gross loss decreased approximately \$1.7 million during the three months ended September 30, 2018 primarily driven by a decrease in wholesale vehicle gross loss per unit of \$242, or 59.6%. Wholesale vehicle gross loss increased approximately \$3.6 million during the nine months ended September 30, 2018 primarily driven by market pricing declines, inventory supply and allocation challenges related to the Houston market that negatively impacted the first quarter of 2018. We focus on maintaining used vehicle inventory days' supply in the 30 to 40 day range in order to limit our exposure to market pricing volatility. Our used vehicle inventory days' supply was approximately 31 and 38 days as of September 30, 2018 and 2017, respectively.

Fixed Operations revenue increased 2.4% and 1.2% during the three and nine months ended September 30, 2018, respectively. Fixed Operations gross profit increased 2.8% and 2.1% during the three and nine months ended September 30, 2018, respectively, driven primarily by a 4.6% and 5.6% increase in customer pay (as hereinafter defined) gross profit, respectively. Fixed Operations gross margin increased 20-basis points, to 48.3%, during the three months ended September 30, 2018 and increased 40 basis points, to 48.3%, during the nine months ended September 30, 2018.

F&I revenue increased 2.1% and 6.8% during the three and nine months ended September 30, 2018, respectively, driven primarily by an increase in F&I gross profit per retail unit. F&I gross profit per retail unit increased \$39 per unit, or 2.8%, to \$1,444 per unit, for the three months ended September 30, 2018, and increased \$71 per unit, or 5.1%, to \$1,452 per unit, for the nine months ended September 30, 2018. We believe that our proprietary software applications, playbook processes and customer-centric selling approach enable us to maximize gross profit per F&I contract and penetration rates (the number of F&I products sold per vehicle) across our F&I product lines. We believe that we will continue to increase revenue in this area as we refine our processes, train our associates and continue to sell high levels of retail new and used vehicles at our stores.

## SONIC AUTOMOTIVE, INC.

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

The following table depicts the breakdown of our new vehicle revenues from continuing operations by brand for the three and nine months ended September 30, 2018 and 2017:

Brand	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Luxury:				
BMW	19%	17%	19%	19%
Mercedes	9%	9%	10%	10%
Lexus	6%	6%	6%	5%
Audi	6%	6%	6%	5%
Land Rover	4%	3%	4%	3%
Porsche	2%	2%	2%	2%
Cadillac	2%	2%	2%	2%
MINI	1%	1%	1%	1%
Other luxury (1)	3%	3%	2%	2%
Total Luxury	55%	52%	55%	53%
Mid-line				
Import:				
Honda	18%	17%	17%	18%
Toyota	10%	12%	10%	12%
Volkswagen	2%	1%	2%	1%
Hyundai	1%	1%	1%	1%
Other imports (2)	1%	1%	1%	1%
Total Mid-line Import	34%	35%	33%	34%
Domestic:				
Ford	5%	7%	5%	7%
General Motors (3)	4%	4%	4%	4%
Total Domestic	10%	12%	10%	11%
Total	100.0	100.0	100.0	100.0

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

(2) Includes Nissan, Kia and Subaru.

(3) Includes Buick, Chevrolet and GMC.

**Results of Operations**

As a result of the disposition, termination or closure of several franchised dealership stores since September 30, 2017, the change in consolidated reported amounts from period to period may not be indicative of the actual operational or financial performance of our current group of operating stores. Please refer to the same store tables and discussion on the following pages for more meaningful comparison and discussion of financial results on a comparable store basis.

Unless otherwise noted, all discussion of increases or decreases are for the three and nine months ended September 30, 2018 and are compared to the same prior year period, as applicable. The following discussion of new vehicles, used vehicles, wholesale vehicles, parts, service and collision repair, and finance, insurance and other, net are on a same store basis, except where otherwise noted. All currently operating continuing operations stores (both our franchised dealerships and EchoPark stores) are included within the same store group in the first full month following the first anniversary of the store's opening or acquisition.

***Results of Operations - Consolidated***

***New Vehicles - Consolidated***

The retail automotive industry uses the total new vehicle SAAR to measure the annual amount of expected new vehicle unit sales activity (both retail and fleet sales) within the United States. The total and retail SAAR below reflect all brands marketed or sold in the United States. The total and retail SAAR include brands we do not sell and markets in which we do not operate; therefore, our new vehicle sales may not trend directly in line with the total and retail SAAR. We believe that retail SAAR is a more meaningful metric for comparing our new vehicle unit sales volume to the industry due to our minimal fleet vehicle business.

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**SONIC AUTOMOTIVE, INC.**

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

<b>Three Months Ended September 30, 2018</b>	<b>Better / (Worse)</b>	<b>Nine Months Ended September 30,</b>	<b>Better / (Worse)</b>
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