SONIC AUTOMOTIVE INC
Form 10-Q
October 23, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2014

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	28211

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

(704) 566-2400

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of October 17, 2014, there were 39,145,916 shares of Class A Common Stock and 12,029,375 shares of Class B Common Stock outstanding.

INDEX TO FORM 10-Q

PART I—FINANCIAL INFORMATION

Item 1: Financial Statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Third Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(Dollars and shares in thousands, except per share amounts)			
Revenues:				
New vehicles	$1,327,837	$1,261,270	$3,773,234	$3,651,486
Used vehicles	583,570	559,848	1,747,254	1,625,006
Wholesale vehicles	41,433	42,731	127,797	134,556
Total vehicles	1,952,840	1,863,849	5,648,285	5,411,048
Parts, service and collision repair	325,740	309,600	973,646	913,290
Finance, insurance and other, net	77,024	68,747	223,340	203,461
Total revenues	2,355,604	2,242,196	6,845,271	6,527,799
Cost of Sales:				
New vehicles	(1,258,811)	(1,188,862)	(3,563,342)	(3,444,818)
Used vehicles	(542,325)	(520,872)	(1,627,842)	(1,510,391)
Wholesale vehicles	(42,519)	(45,928)	(130,290)	(140,899)
Total vehicles	(1,843,655)	(1,755,662)	(5,321,474)	(5,096,108)
Parts, service and collision repair	(170,460)	(160,453)	(506,361)	(468,784)
Total cost of sales	(2,014,115)	(1,916,115)	(5,827,835)	(5,564,892)
Gross profit	341,489	326,081	1,017,436	962,907
Selling, general and administrative expenses	(270,144)	(254,564)	(803,031)	(748,479)
Impairment charges	(208)	(18)	(215)	(69)
Depreciation and amortization	(14,235)	(13,744)	(43,047)	(39,020)
Operating income (loss)	56,902	57,755	171,143	175,339
Other income (expense):				
Interest expense, floor plan	(4,406)	(5,463)	(13,941)	(16,267)
Interest expense, other, net	(12,893)	(13,553)	(40,576)	(42,302)
Other income (expense), net	(1)	29	98	(28,143)
Total other income (expense)	(17,300)	(18,987)	(54,419)	(86,712)
Income (loss) from continuing operations before taxes	39,602	38,768	116,724	88,627
Provision for income taxes - benefit (expense)	(15,045)	(14,066)	(45,122)	(33,510)
Income (loss) from continuing operations	24,557	24,702	71,602	55,117
Discontinued operations:				
Income (loss) from operations and the sale of dealerships	254	(2,057)	(838)	(2,434)
Income tax benefit (expense)	(99)	682	327	852
Income (loss) from discontinued operations	155	(1,375)	(511)	(1,582)
Net income (loss)	$24,712	$23,327	$71,091	$53,535

Basic earnings (loss) per common share:				
Earnings (loss) per share from continuing operations	$0.47	$0.47	$1.36	$1.04
Earnings (loss) per share from discontinued operations	-	(0.03)	(0.01)	(0.03)
Earnings (loss) per common share	$0.47	$0.44	$1.35	$1.01
Weighted average common shares outstanding	52,070	52,553	52,333	52,578
Diluted earnings (loss) per common share:				
Earnings (loss) per share from continuing operations	$0.47	$0.46	$1.35	$1.03
Earnings (loss) per share from discontinued operations	-	(0.02)	(0.01)	(0.03)
Earnings (loss) per common share	$0.47	$0.44	$1.34	$1.00
Weighted average common shares outstanding	52,553	52,918	52,808	52,930
Dividends declared per common share	$0.025	$0.025	$0.075	$0.075

See notes to Unaudited Condensed Consolidated Financial Statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Third Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
		(Dollars in thousands)		
Net income (loss)	$24,712	$23,327	$71,091	$53,535
Other comprehensive income (loss) before taxes:				
Change in fair value of interest rate swap agreements	4,037	350	5,223	13,377
Provision for income tax benefit (expense) related to components of other comprehensive income (loss)	(1,534)	(133)	(1,985)	(5,083)
Other comprehensive income (loss)	2,503	217	3,238	8,294
Comprehensive income (loss)	$27,215	$23,544	$74,329	$61,829

See notes to Unaudited Condensed Consolidated Financial Statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2014	December 31, 2013
	(Dollars in thousands)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$1,664	$3,016
Receivables, net	270,386	354,138
Inventories	1,203,394	1,282,138
Assets held for sale	14,811	4,101
Other current assets	137,271	88,792
Total current assets	1,627,526	1,732,185
Property and Equipment, net	742,081	702,011
Goodwill	474,088	476,315
Other Intangible Assets, net	82,449	87,866
Other Assets	57,769	52,793
Total Assets	$2,983,913	$3,051,170
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Notes payable - floor plan - trade	$630,667	$681,030
Notes payable - floor plan - non-trade	462,703	570,661
Trade accounts payable	102,806	126,025
Accrued interest	12,163	12,653
Other accrued liabilities	200,839	185,951
Liabilities associated with assets held for sale - non-trade	6,587	-
Current maturities of long-term debt	24,018	18,216
Total current liabilities	1,439,783	1,594,536
Long-Term Debt	759,463	730,157
Other Long-Term Liabilities	71,476	81,286
Deferred Income Taxes	59,620	31,552
Commitments and Contingencies		
Stockholders' Equity:		
Class A convertible preferred stock, none issued	-	-
Class A common stock, $0.01 par value; 100,000,000 shares authorized; 62,006,636 shares issued and 39,438,090 shares outstanding at September 30, 2014; 61,584,248 shares issued and 40,683,984 shares outstanding at December 31, 2013	620	616
Class B common stock; $0.01 par value; 30,000,000 shares authorized; 12,029,375 shares issued and outstanding at September 30, 2014 and December 31, 2013	121	121
Paid-in capital	694,869	685,782
Retained earnings	351,507	284,368
Accumulated other comprehensive income (loss)	(5,344)	(8,582)
Treasury stock, at cost; 22,568,546 Class A shares held at September 30, 2014 and 20,900,264 Class A shares		

held at December 31, 2013	(388,202)	(348,666)
Total Stockholders' Equity	653,571	613,639
Total Liabilities and Stockholders' Equity	$2,983,913	$3,051,170

See notes to Unaudited Condensed Consolidated Financial Statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Class A Common Stock		Class A Treasury Stock		Class B Common Stock		Paid-In	Retained	Accumulated Other Comprehensive Income	Total Stockholders'
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Earnings	(Loss)	Equity
	(Dollars and shares in thousands)									
Balance at December 31, 2013	61,584	$616	(20,900)	$(348,666)	12,029	$121	$685,782	$284,368	$(8,582)	$613,639
Shares awarded under stock compensation plans	403	4	-	-	-	-	2,548	-	-	2,552
Purchases of treasury stock	-	-	(1,669)	(39,536)	-	-	-	-	-	(39,536)
Income tax benefit associated with stock compensation plans	-	-	-	-	-	-	336	-	-	336
Fair value of interest rate swap agreements, net of tax expense of $1,985	-	-	-	-	-	-	-	-	3,238	3,238
Restricted stock amortization	-	-	-	-	-	-	6,203	-	-	6,203
Other	20	-	-	-	-	-	-	-	-	-
Net income (loss)	-	-	-	-	-	-	-	71,091	-	71,091
Dividends ($0.075 per share)	-	-	-	-	-	-	-	(3,952)	-	(3,952)
Balance at September 30, 2014	62,007	$620	(22,569)	$(388,202)	12,029	$121	$694,869	$351,507	$(5,344)	$653,571

See notes to Unaudited Condensed Consolidated Financial Statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2014	2013
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$71,091	$53,535
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	43,042	39,048
Provision for bad debt expense	331	125
Other amortization	987	1,170
Debt issuance cost amortization	1,654	2,189
Debt discount amortization, net of premium amortization	43	(110)
Stock - based compensation expense	6,203	5,559
Deferred income taxes	21,273	16,256
Equity interest in earnings of investee	(221)	(311)
Asset impairment charges	215	69
Loss (gain) on disposal of dealerships and property and equipment	(11,646)	291
Loss (gain) on exit of leased dealerships	(272)	2,331
(Gain) loss on retirement of debt	-	28,238
Changes in assets and liabilities that relate to operations:		
Receivables	96,778	82,708
Inventories	52,070	(25,002)
Other assets	(53,589)	15,485
Notes payable - floor plan - trade	(50,363)	(2,839)
Trade accounts payable and other liabilities	(22,054)	(38,099)
Total adjustments	84,451	127,108
Net cash provided by (used in) operating activities	155,542	180,643
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of businesses, net of cash acquired	(15,288)	(88,184)
Purchases of land, property and equipment	(89,930)	(127,538)
Proceeds from sales of property and equipment	6,406	673
Proceeds from sales of dealerships	51,391	-
Distributions from equity investee	400	500
Net cash provided by (used in) investing activities	(47,021)	(214,549)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (repayments) borrowings on notes payable - floor plan - non-trade	(101,371)	(37,821)
Borrowings on revolving credit facilities	97,847	156,079
Repayments on revolving credit facilities	(88,068)	(162,255)
Proceeds from issuance of long-term debt	40,420	353,693
Debt issuance costs	(2,956)	(5,394)
Principal payments on long-term debt	(15,134)	(15,725)
Repurchase of debt securities	-	(233,574)
Purchases of treasury stock	(39,536)	(14,480)
Income tax benefit (expense) associated with stock compensation plans	336	612
Issuance of shares under stock compensation plans	2,552	1,066

Dividends paid	(3,963)	(2,673)
Net cash provided by (used in) financing activities	(109,873)	39,528
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,352)	5,622
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	3,016	3,371
CASH AND CASH EQUIVALENTS, END OF PERIOD	$1,664	$8,993
SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:		
Change in fair value of cash flow hedging instruments (net of tax expense of $1,985 and $5,083 in the nine-month periods ended September 30, 2014 and 2013, respectively)	$3,238	$8,294
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid (received) during the period for:		
Interest, including amount capitalized	$54,267	$62,190
Income taxes	$34,278	$29,758

See notes to Unaudited Condensed Consolidated Financial Statements.

1. Summary of Significant Accounting Policies

Basis of Presentation – The accompanying Unaudited Condensed Consolidated Financial Statements of Sonic Automotive, Inc. and its wholly-owned subsidiaries ("Sonic," the "Company," "we," "us" and "our") for the third quarter and nine-month periods ended September 30, 2014 and 2013, have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") for interim financial information and applicable rules and regulations of the Securities and Exchange Commission ("SEC"). These Unaudited Condensed Consolidated Financial Statements reflect, in the opinion of management, all material normal recurring adjustments necessary to fairly state the financial position, results of operations and cash flows for the periods presented. The results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year or future interim periods, because the first quarter normally contributes less operating profit than the second, third and fourth quarters. These interim financial statements should be read in conjunction with the audited Consolidated Financial Statements included in Sonic's Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Accounting Pronouncements – In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-08, which amended the definition of and the reporting requirements for discontinued operations. The amendments in this ASU require that a disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial position in order to qualify as a discontinued operation. The ASU also requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. This ASU is effective for interim and annual filings beginning with the quarter ending March 31, 2015. Early adoption is permitted, and Sonic elected to adopt and apply the guidance beginning with its Quarterly Report on Form 10-Q for the period ended June 30, 2014. The adoption of this ASU impacts the presentation of certain items in Sonic's consolidated financial position, results of operations and other disclosures.

In May 2014, the FASB issued ASU 2014-09 related to revenue recognition. This ASU provides a five-step analysis to use in determining the timing and method of revenue recognition. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2016 (early adoption is not permitted). Sonic does not expect this ASU to have a significant impact on its consolidated financial position, results of operations or cash flows.

Principles of Consolidation – All of Sonic's dealership and non-dealership subsidiaries are wholly owned and consolidated in the accompanying Unaudited Condensed Consolidated Financial Statements, except for one fifty-percent owned dealership that is accounted for under the equity method. All material intercompany balances and transactions have been eliminated in the accompanying Unaudited Condensed Consolidated Financial Statements.

Lease Exit Accruals – Lease exit accruals relate to facilities Sonic has ceased using in its operations. The accruals represent the present value of the lease payments, net of estimated or actual sublease proceeds, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord. These situations could include the relocation of an existing facility or the sale of a dealership whereby the buyer will not be subleasing the property for either the remaining term of the lease or for an amount of rent equal to Sonic's obligation under the lease. Please see Note 12, "Commitments and Contingencies," of the Notes to Consolidated Financial Statements in Sonic's Annual Report on Form 10-K for the year ended December 31, 2013 for further discussion.

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

	(In thousands)
Balance, December 31, 2013	$ 27,234
Lease exit expense (1)	(272)

Payments (2)	(5,445)
Lease buyout (3)	(1,556)
Balance, September 30, 2014	$ 19,961

(1) Expense of approximately $0.2 million is recorded in interest expense, other, net, expense of approximately $0.1 million is recorded in selling, general and administrative expenses, and income of approximately $0.6 million is recorded in income (loss) from discontinued operations in the accompanying Unaudited Condensed Consolidated Statements of Income.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(2) Amount is recorded as an offset to rent expense in selling, general and administrative expenses, with approximately $0.6 million in continuing operations and $4.8 million in income (loss) from discontinued operations in the accompanying Unaudited Condensed Consolidated Statements of Income.

(3) Amount represents write-off of accrual related to an early lease buyout agreement which was completed and paid, relieving Sonic of any future lease obligation.

Income Tax Expense – The overall effective tax rate from continuing operations was 38.0% and 38.7% for the third quarter and nine-month periods ended September 30, 2014, respectively, and was 36.3% and 37.8% for the third quarter and nine-month periods ended September 30, 2013, respectively. The effective rate for the third quarter and nine-month periods ended September 30, 2014 was higher than the prior year periods as a result of the favorable resolution of previously outstanding tax matters in the prior year periods.

2. Business Acquisitions and Dispositions

Acquisitions – Sonic acquired one mid-line import franchise during the third quarter ended September 30, 2014 and one luxury franchise during the nine-month period ended September 30, 2014 for a combined aggregate purchase price of approximately $15.3 million. The balance sheet as of September 30, 2014 includes preliminary allocations of the purchase price of the acquired assets and liabilities based on their estimated fair market values at the date of acquisition and are subject to final adjustment. On a pro forma basis as if the results of these acquisitions had been included in Sonic's consolidated results for the entire third quarter and nine-month periods ended September 30, 2014 and 2013, revenue and net income would not have been materially different from Sonic's reported revenue and net income for these periods.

Dispositions – As discussed in Note 1, "Summary of Significant Accounting Policies," the FASB issued ASU 2014-08 which amended the definition of and reporting requirements for discontinued operations. Sonic elected to adopt and apply this guidance beginning with its Quarterly Report on Form 10-Q for the period ended June 30, 2014. The results of operations for those dealerships that were classified as discontinued operations as of March 31, 2014 are included in income (loss) from discontinued operations in the accompanying Unaudited Condensed Consolidated Statements of Income and will continue to be reported within discontinued operations in the future. There were no unsold dealerships classified in discontinued operations at March 31, 2014. Revenues and other activities associated with dealerships classified as discontinued operations were as follows:

	Third Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Income (loss) from operations	$(900)	$(1,389)	$(1,670)	$(22)
Gain (loss) on disposal	148	(57)	201	(435)
Lease exit accrual adjustments and charges	1,006	(611)	631	(1,977)
Pre-tax income (loss)	$254	$(2,057)	$(838)	$(2,434)
Total revenues	$-	$-	$-	$-

Beginning with disposals occurring during the second quarter ended June 30, 2014, only the operating results of disposals that represent a strategic shift that has (or will have) a major impact on Sonic's results of operations and financial position will be included in the income (loss) from discontinued operations in the accompanying Unaudited Condensed Consolidated Statements of Income. Sonic disposed of two franchises during the quarter ended September 30, 2014 and disposed of five franchises during the nine-month period ended September 30, 2014. These disposals generated net cash from disposition of approximately $14.9 million and $30.1 million, respectively.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Third Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Income (loss) from operations	$(99)	$(132)	$268	$(936)
Gain (loss) on disposal	3,111	-	10,734	-
Pre-tax income (loss)	$3,012	$(132)	$11,002	$(936)
Total revenues	$4,117	$43,181	$86,467	$125,139

In the ordinary course of business, Sonic evaluates its dealership franchises for possible disposition based on various performance criteria, and the disposals during the nine-month period ended September 30, 2014 represent dealerships identified based on their unprofitable operations and other operational considerations. As of September 30, 2014, Sonic had one franchise classified as held for sale, the disposition of which was completed subsequent to September 30, 2014. In the future, Sonic may also sell other franchises that are not currently held for sale.

The major classes of assets and liabilities classified as held for sale for all periods presented in the statement of financial position are as follows:

	September 30, 2014	December 31, 2013
	(In thousands)	
Inventories	$7,630	$ -
Property and equipment, net (1)	6,170	4,101
Goodwill	1,011	-
Assets held for sale	$14,811	$ 4,101
Liabilities associated with assets held for sale - non-trade	$6,587	$ -

(1) September 30, 2014 includes approximately $0.2 million related to franchises classified as held for sale, and

approximately $6.0 million related to real estate not being used in operations.
December 31, 2013 includes
approximately $4.1 million related to real estate not being used in operations.

3. Inventories

Inventories consist of the following:

	September 30, 2014	December 31, 2013
	(In thousands)	
New vehicles	$856,393	$938,263
Used vehicles	187,071	171,909
Service loaners	106,915	108,136
Parts, accessories and other	60,645	63,830
Subtotal	$1,211,024	$1,282,138
Less inventories classified as assets held for sale	(7,630)	-
Net inventories	$1,203,394	$1,282,138

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. Property and Equipment

Property and equipment, net consists of the following:

	September 30, 2014	December 31, 2013
	(In thousands)	
Land	$212,945	$194,639
Building and improvements	573,329	569,619
Office equipment and fixtures	138,887	135,221
Parts and service equipment	72,614	70,950
Company vehicles	7,986	8,002
Construction in progress	71,125	27,716
Total, at cost	1,076,886	1,006,147
Less accumulated depreciation	(328,635)	(300,035)
Subtotal	748,251	706,112
Less assets held for sale	(6,170)	(4,101)
Property and equipment, net	$742,081	$702,011

In the third quarter and nine-month periods ended September 30, 2014, capital expenditures were approximately $41.3 million and $89.9 million, respectively, and in the third quarter and nine-month periods ended September 30, 2013, capital expenditures were approximately $38.4 million and $127.5 million, respectively. Capital expenditures in both periods were primarily related to real estate acquisitions, construction of new dealerships and EchoPark® stores (stand-alone pre-owned stores), building improvements and equipment purchased for use in Sonic’s dealerships and EchoPark® stores.

5. Goodwill and Intangible Assets

	Franchise Assets	Net Goodwill
	(In thousands)	

Balance, December 31, 2013	$79,535	$476,315	(1)
Additions through current year acquisitions	1,000	7,034	
Prior year acquisition allocations	-	(3)	
Reclassifications to assets held for sale	-	(1,011)	
Reductions from dispositions	(5,435)	(8,247)	
Balance, September 30, 2014	$75,100	$474,088	(1)

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

At December 31, 2013, Sonic had approximately $8.3 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, 2014 was approximately $7.3 million and is included in other intangible assets, net, in the accompanying Unaudited Condensed Consolidated Balance Sheets. Additions through current year acquisition are preliminary allocations subject to change upon the finalization of purchase accounting.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. Long-Term Debt

Long-term debt consists of the following:

	September 30, 2014	December 31, 2013
	(In thousands)	
2011 Revolving Credit Facility (1)	$-	$-
2014 Revolving Credit Facility (2)	9,779	-
7.0% Senior Subordinated Notes due 2022 (the "7.0% Notes")	200,000	200,000
5.0% Senior Subordinated Notes due 2023 (the "5.0% Notes")	300,000	300,000
Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19%)	5,214	7,629
Mortgage notes to finance companies-fixed rate, bearing interest from 3.51% to 7.03%	149,364	157,571
Mortgage notes to finance companies-variable rate, bearing interest at 1.25 to 3.50 percentage points above one-month LIBOR	115,990	79,893
Net debt discount and premium (3)	(1,785)	(1,800)
Other	4,919	5,080
Total debt	$783,481	$748,373
Less current maturities	(24,018)	(18,216)
Long-term debt	$759,463	$730,157

(1) The interest rate on the 2011 Revolving Credit Facility was 2.00% above LIBOR at December 31, 2013.
(2) The interest rate on the 2014 Revolving Credit Facility was 2.25% above LIBOR at September 30, 2014.
(3) September 30, 2014 includes $1.5 million discount associated with the 7.0% Notes, $0.2 million premium associated with
notes payable to a finance company and $0.5 million discount associated with mortgage notes payable.
December 31, 2013 includes $1.6 million discount associated with the 7.0% Notes, $0.4 million premium associated with
the notes payable to a finance company and $0.6 million discount associated with mortgage notes payable.

2011 Credit Facilities

Prior to July 23, 2014, Sonic had a syndicated revolving credit agreement (the “2011 Revolving Credit Facility”) and syndicated new and used vehicle floor plan credit facilities (the “2011 Floor Plan Facilities” and, together with the 2011 Revolving Credit Facility, the “2011 Credit Facilities”), which were scheduled to mature on August 15, 2016. On July 23, 2014, Sonic entered into an amendment to the 2011 Credit Facilities, which among other things, extended the maturity to August 15, 2019. See the heading “2014 Credit Facilities” below for additional information.

Availability under the 2011 Revolving Credit Facility was calculated as the lesser of $175.0 million or a borrowing base calculated based on certain eligible assets, less the aggregate face amount of any outstanding letters of credit under the 2011 Revolving Credit Facility (the “2011 Revolving Borrowing Base”). The 2011 Floor Plan Facilities were comprised of a new vehicle revolving floor plan facility (the “2011 New Vehicle Floor Plan Facility”) and a used vehicle revolving floor plan facility (the “2011 Used Vehicle Floor Plan Facility”), subject to a borrowing base, in a combined amount up to $605.0 million. Outstanding obligations under the 2011 Floor Plan Facilities were guaranteed by Sonic and certain of its subsidiaries and were secured by a pledge of substantially all of the assets of Sonic and its subsidiaries.

2014 Credit Facilities

On July 23, 2014, Sonic entered into an amendment to the 2011 Credit Facilities, which among other things, extended the maturity to August 15, 2019. The amended and extended syndicated revolving credit agreement (the “2014 Revolving Credit Facility”) and syndicated new and used vehicle floor plan credit facilities (the “2014 Floor Plan Facilities” and, together with the 2014 Revolving Credit Facility, the “2014 Credit Facilities”), are scheduled to mature on August 15, 2019.

Availability under the 2014 Revolving Credit Facility is calculated as the lesser of $225.0 million or a borrowing base calculated based on certain eligible assets, less the aggregate face amount of any outstanding letters of credit under the 2014 Revolving Credit Facility (the “2014 Revolving Borrowing Base”). The 2014 Revolving Credit Facility may be increased at Sonic’s option up to $275.0 million upon satisfaction of certain conditions. Based on balances as of September 30, 2014, the 2014 Revolving Borrowing Base was approximately $144.2 million. Sonic had approximately $9.8 million of outstanding borrowings as of September 30, 2014 and $29.2 million in outstanding letters of credit under the 2014 Revolving Credit Facility, resulting in total borrowing availability of $105.2 million under the 2014 Revolving Credit Facility.

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The 2014 Floor Plan Facilities are comprised of a new vehicle revolving floor plan facility (the "2014 New Vehicle Floor Plan Facility") and a used vehicle revolving floor plan facility (the "2014 Used Vehicle Floor Plan Facility"), subject to a borrowing base, in a combined amount up to $800.0 million. Sonic may, under certain conditions, request an increase in the 2014 Floor Plan Facilities of up to $1.0 billion, which shall be allocated between the 2014 New Vehicle Floor Plan Facility and the 2014 Used Vehicle Floor Plan Facility as Sonic requests, with no more than 20% of the aggregate commitments allocated to the commitments under the 2014 Used Vehicle Floor Plan Facility. Outstanding obligations under the 2014 Floor Plan Facilities are guaranteed by Sonic and certain of its subsidiaries and are secured by a pledge of substantially all of the assets of Sonic and its subsidiaries. The amounts outstanding under the 2014 Credit Facilities bear interest at variable rates based on specified percentages above LIBOR.

7.0% Senior Subordinated Notes

On July 2, 2012, Sonic issued $200.0 million in aggregate principal amount of unsecured senior subordinated 7.0% Notes which mature on July 15, 2022. The 7.0% Notes were issued at a price of 99.11% of the principal amount thereof, resulting in a yield to maturity of 7.125%. Interest is payable semi-annually in arrears on January 15 and July 15 of each year. Sonic may redeem the 7.0% Notes in whole or in part at any time after July 15, 2017 at the following redemption prices, which are expressed as percentages of the principal amount:

	Redemption Price	
Beginning on July 15, 2017	103.500	%
Beginning on July 15, 2018	102.333	%
Beginning on July 15, 2019	101.167	%
Beginning on July 15, 2020 and thereafter	100.000	%

In addition, on or before July 15, 2015, Sonic may redeem up to 35% of the aggregate principal amount of the 7.0% Notes at 107% of the par value of the 7.0% Notes plus accrued and unpaid interest with proceeds from certain equity offerings. The indenture also provides that holders of the 7.0% Notes may require Sonic to repurchase the 7.0% Notes at 101% of the par value of the 7.0% Notes, plus accrued and unpaid interest, if Sonic undergoes a Change of Control (as defined in the indenture).

The indenture governing the 7.0% 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 Sonic's 7.0% Notes limits Sonic's ability to pay quarterly cash dividends on Sonic's Class A and B Common Stock in excess of $0.10 per share. Sonic may only pay quarterly cash dividends on Sonic's Class A and B Common Stock if Sonic complies with the terms of the indenture governing the 7.0% Notes. Sonic was in compliance with all restrictive covenants as of September 30, 2014.

Balances outstanding under Sonic’s 7.0% Notes are guaranteed by all of Sonic’s operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor.

Sonic’s obligations under the 7.0% Notes may be accelerated by the holders of 25% of the outstanding principal amount of the 7.0% Notes then outstanding if certain events of default occur, including: (1) defaults in the payment of principal or interest when due; (2) defaults in the performance, or breach, of Sonic’s covenants under the 7.0% Notes; and (3) certain defaults under other agreements under which Sonic or its subsidiaries have outstanding indebtedness in excess of $35.0 million.

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5.0% Senior Subordinated Notes

On May 9, 2013, Sonic issued $300.0 million in aggregate principal amount of unsecured senior subordinated 5.0% Notes which mature on May 15, 2023. The 5.0% Notes were issued at 100.0% of the principal amount thereof. Interest is payable semi-annually in arrears on May 15 and November 15 of each year. Sonic may redeem the 5.0% Notes in whole or in part at any time after May 15, 2018 at the following redemption prices, which are expressed as percentages of the principal amount:

	Redemption Price	
Beginning on May 15, 2018	102.500	%
Beginning on May 15, 2019	101.667	%
Beginning on May 15, 2020	100.833	%
Beginning on May 15, 2021 and thereafter	100.000	%

In addition, on or before May 15, 2016, Sonic may redeem up to 35% of the aggregate principal amount of the 5.0% Notes at 105% of the par value of the 5.0% Notes plus accrued and unpaid interest with proceeds from certain equity offerings. On or before May 15, 2018, Sonic may redeem all or a part of the aggregate principal amount of the 5.0% Notes at a redemption price equal to 100% of the principal amount of the 5.0% Notes redeemed plus an applicable premium (as defined in the Indenture) and any accrued and unpaid interest as of the redemption date. The indenture also provides that holders of the 5.0% Notes may require Sonic to repurchase the 5.0% Notes at 101% of the par value of the 5.0% Notes, plus accrued and unpaid interest, if Sonic undergoes a Change of Control, as defined in the indenture.

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 Sonic’s 5.0% Notes limits Sonic’s ability to pay quarterly cash dividends on Sonic’s Class A and B Common Stock in excess of $0.10 per share. Sonic may only pay quarterly cash dividends on Sonic’s Class A and B Common Stock if Sonic complies with the terms of the indenture governing the 5.0% Notes. Sonic was in compliance with all restrictive covenants as of September 30, 2014.

Balances outstanding under Sonic’s 5.0% Notes are guaranteed by all of Sonic’s operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor.

Sonic's obligations under the 5.0% Notes may be accelerated by the holders of 25% of the outstanding principal amount of the 5.0% Notes then outstanding if certain events of default occur, including: (1) defaults in the payment of principal or interest when due; (2) defaults in the performance, or breach, of Sonic's covenants under the 5.0% Notes; and (3) certain defaults under other agreements under which Sonic or its subsidiaries have outstanding indebtedness in excess of $50.0 million.

Notes Payable to a Finance Company

Three notes payable (due October 2015 and August 2016) were assumed in connection with an acquisition in 2004 (the "Assumed Notes"). Sonic recorded the Assumed Notes at fair value using an interest rate of 5.35%. The interest rate used to calculate the fair value was based on a quoted market price for notes with similar terms as of the date of assumption. As a result of calculating the fair value, a premium of $7.3 million was recorded that is being amortized over the lives of the Assumed Notes. At September 30, 2014, the outstanding principal balance on the Assumed Notes was approximately $5.2 million with a remaining unamortized premium balance of approximately $0.2 million.

Mortgage Notes

At September 30, 2014, Sonic had mortgage financing totaling approximately $265.4 million related to approximately 30% of its dealership properties. These mortgage notes require monthly payments of principal and interest through their respective maturities and are secured by the underlying properties. Maturity dates range between 2015 and 2033. The weighted average interest rate was 3.76% at September 30, 2014.

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Covenants

Sonic was in compliance with the covenants under the 2014 Credit Facilities as of September 30, 2014. Financial covenants include required specified ratios (as each is defined in the 2014 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	5.50
September 30, 2014 actual	1.22	1.74	4.14

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

In addition, many of Sonic’s facility leases are governed by a guarantee agreement between the landlord and Sonic that contains financial and operating covenants. The financial covenants are identical to those under the 2014 Credit Facilities with the exception of one financial covenant related to the ratio of EBTDAR to Rent (as defined in the lease agreements) with a required ratio of no less than 1.50 to 1.00. As of September 30, 2014, the ratio was 3.56 to 1.00.

Derivative Instruments and Hedging Activities

Sonic has interest rate cash flow swap agreements to effectively convert a portion of its LIBOR-based variable rate debt to a fixed rate. The fair value of these swap positions at September 30, 2014 was a net liability of approximately \$10.6 million, with \$9.3 million included in other accrued liabilities and \$3.3 million included in other long-term liabilities, offset partially by an asset of approximately \$2.0 million included in other assets in the accompanying Unaudited Condensed Consolidated Balance Sheets. The fair value of these swap positions at December 31, 2013 was a net liability of approximately \$16.3 million, with \$11.6 million included in other accrued liabilities and \$8.4 million included in other long-term liabilities, offset partially by an asset of approximately \$3.7 million included in other assets in the accompanying Unaudited Condensed Consolidated Balance Sheets.

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

Notional Amount (In millions)		Pay Rate	Receive Rate (1)	Maturing Date
$2.8		7.100%	one-month LIBOR + 1.50%	July 10, 2017
$8.8		4.655%	one-month LIBOR	December 10, 2017
$7.5	(2)	6.860%	one-month LIBOR + 1.25%	August 1, 2017
$100.0		3.280%	one-month LIBOR	July 1, 2015
$100.0		3.300%	one-month LIBOR	July 1, 2015
$6.4	(2)	6.410%	one-month LIBOR + 1.25%	September 12, 2017
$50.0		3.240%	one-month LIBOR	July 1, 2015
$50.0		3.070%	one-month LIBOR	July 1, 2015
$100.0	(3)	2.065%	one-month LIBOR	June 30, 2017
$100.0	(3)	2.015%	one-month LIBOR	June 30, 2017
$200.0	(3)	0.788%	one-month LIBOR	July 1, 2016
$50.0	(4)	1.320%	one-month LIBOR	July 1, 2017
$250.0	(5)	1.887%	one-month LIBOR	June 30, 2018
$25.0	(4)	2.080%	one-month LIBOR	July 1, 2017
$100.0	(3)	1.560%	one-month LIBOR	July 1, 2017

(1) The one-month LIBOR rate was 0.153% at September 30, 2014.
(2) Changes in fair value are recorded through earnings.
(3) The effective date of these forward-starting swaps is July 1, 2015.
(4) The effective date of these forward-starting swaps is July 1, 2016.
(5) The effective date of this forward-starting swap is July 3, 2017.

During the second quarter ended June 30, 2014, Sonic entered into two forward-starting interest rate cash flow swap agreements with notional amounts of $25.0 million and $100.0 million. These swap agreements become effective in July 2016 and July 2015, respectively, and terminate in July 2017. These interest rate swaps have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of these swaps are recorded in other comprehensive income (loss) before taxes in the accompanying Unaudited Condensed Consolidated Statements of Comprehensive Income.

For the interest rate swaps not designated as cash flow hedges (changes in the fair value of these swaps are recognized through earnings) and amortization of amounts in accumulated other comprehensive income (loss) related to terminated cash flow swaps, certain benefits and charges were included in interest expense, other, net, in the accompanying Unaudited Condensed Consolidated Statements of Income. For the third quarter and nine-month periods ended September 30, 2014, these items were a benefit of approximately $0.2 million and $0.4 million, respectively, and for the third quarter and nine-month periods ended September 30, 2013, these items were a benefit of approximately $0.1 million and $0.7 million, respectively.

For the cash flow swaps that qualify as cash flow hedges, the changes in the fair value of these swaps have been recorded in other comprehensive income (loss), net of related income taxes, in the accompanying Unaudited Condensed Consolidated Statements of Comprehensive Income and are disclosed in the supplemental schedule of non-cash financing activities in the accompanying Unaudited Condensed Consolidated Statements of Cash Flows. The incremental interest expense (the difference between interest paid and interest received) related to these cash flow swaps was approximately $2.4 million and $8.3 million in the third quarter and nine-month periods ended September 30, 2014, respectively, and $3.0 million and $8.8 million in the third quarter and nine-month periods ended September 30, 2013, respectively, and is included in interest expense, other, net, in the accompanying Unaudited Condensed Consolidated Statements of Income and the interest paid amount disclosed in the supplemental disclosures of cash flow information in the accompanying Unaudited Condensed Consolidated Statements of Cash Flows. The estimated net expense expected to be reclassified out of accumulated other comprehensive income (loss) into results of operations during the next twelve months is approximately $5.8 million.

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7. Per Share Data and Stockholders' Equity

The calculation of diluted earnings per share considers the potential dilutive effect of options and shares under Sonic's stock compensation plans. Certain of Sonic's non-vested restricted stock and restricted stock units contain rights to receive non-forfeitable dividends and, as a result, are considered participating securities and are included in the two-class method of computing earnings per share. The following table illustrates the dilutive effect of such items on earnings per share for the third quarter and nine-month periods ended September 30, 2014 and 2013:

	Third Quarter Ended September 30, 2014						
		Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
	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	52,070	$24,557		$ 155		$24,712	
Effect of participating securities:							
Non-vested restricted stock and restricted stock units		(79)		-		(79)	
Basic earnings (loss) and shares	52,070	$24,478	$ 0.47	$ 155	$ -	$24,633	$ 0.47
Effect of dilutive securities:							
Stock compensation plans	483						
Diluted earnings (loss) and shares	52,553	$24,478	$ 0.47	$ 155	$ -	$24,633	$ 0.47

	Third Quarter Ended September 30, 2013						
		Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
	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	52,553	$24,702		$(1,375)		$23,327		
Effect of participating securities:								
Non-vested restricted stock								
and restricted stock units		(172)		-		(172)		
Basic earnings (loss) and shares	52,553	$24,530	$ 0.47	$(1,375)	$ (0.03)	$23,155	$ 0.44	
Effect of dilutive securities:								
Stock compensation plans	365							
Diluted earnings (loss) and shares	52,918	$24,530	$ 0.46	$(1,375)	$ (0.02)	$23,155	$ 0.44	

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	Nine Months Ended September 30, 2014						
		Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
	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	52,333	$71,602		$(511)		$71,091	
Effect of participating securities:							
Non-vested restricted stock and restricted stock units		(229)		-		(229)	
Basic earnings (loss) and shares	52,333	$71,373	$ 1.36	$(511)	$ (0.01)	$70,862	$ 1.35
Effect of dilutive securities:							
Stock compensation plans	475						
Diluted earnings (loss) and shares	52,808	$71,373	$ 1.35	$(511)	$ (0.01)	$70,862	$ 1.34

	Nine Months Ended September 30, 2013						
		Income (Loss) From Continuing Operations		Income (Loss) From Discontinued Operations		Net Income (Loss)	
	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	52,578	$55,117		$(1,582)		$53,535	
Effect of participating securities:							
Non-vested restricted stock and restricted stock units		(393)		-		(393)	
Basic earnings (loss) and shares	52,578	$54,724	$ 1.04	$(1,582)	$ (0.03)	$53,142	$ 1.01
Effect of dilutive securities:							
Stock compensation plans	352						
Diluted earnings (loss) and shares	52,930	$54,724	$ 1.03	$(1,582)	$ (0.03)	$53,142	$ 1.00

In addition to the stock options included in the table above, options to purchase approximately 0.4 million shares and 0.9 million shares of Class A Common Stock were outstanding at September 30, 2014 and 2013, respectively, but were not included in the computation of diluted earnings per share because the options were not dilutive.

8. Contingencies

Legal and Other Proceedings

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

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Included in other accrued liabilities and other long-term liabilities was approximately $2.1 million and $0.2 million, respectively, at September 30, 2014, and approximately $0.3 million and $0.9 million, respectively, at December 31, 2013, in reserves that Sonic was holding for pending proceedings. Except as reflected in such reserves, Sonic is currently unable to estimate a range of reasonably possible loss, or a range of reasonably possible loss in excess of the amount accrued, for pending proceedings.

Guarantees and Indemnification Obligations

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

In connection with dealership dispositions, certain of Sonic's dealership subsidiaries have assigned or sublet to the buyer their interests in real property leases associated with such dealerships. In general, the subsidiaries retain responsibility for the performance of certain obligations under such leases, including rent payments, and repairs to leased property upon termination of the lease, to the extent that the assignee or sub-lessee does not perform. In the event the sub-lessees do not perform under their obligations Sonic remains liable for the lease payments. Please see Note 12, "Commitments and Contingencies," of the Notes to Consolidated Financial Statements in Sonic's Annual Report on Form 10-K for the year ended December 31, 2013 for further discussion.

In accordance with the terms of agreements entered into for the sale of Sonic's franchises, Sonic generally agrees to indemnify the buyer from certain exposure and costs arising subsequent to, but that existed prior to, the date of sale, including environmental exposure and exposure resulting from the breach of representations or warranties made in accordance with the agreement. While Sonic's exposure with respect to environmental remediation and repairs is difficult to quantify, Sonic's maximum exposure associated with these general indemnifications was approximately $16.8 million and $14.0 million at September 30, 2014 and December 31, 2013, respectively. These indemnifications expire within a period of one to two 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, 2014. 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, 2014 and December 31, 2013, respectively.

9. Fair Value Measurements

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

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

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

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

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

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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 Unaudited Condensed Consolidated Balance Sheets as of September 30, 2014 and December 31, 2013 are as follows:

	Fair Value Based on Significant Other Observable Inputs (Level 2)	
	September 30, 2014	December 31, 2013
	(In thousands)	
Assets:		
Cash surrender value of life insurance policies (1)	$27,412	$ 25,301
Cash flow swaps designated as hedges (1)	2,022	3,707
Total assets	$29,434	$ 29,008
Liabilities:		
Cash flow swaps designated as hedges (2)	$11,088	$ 17,995
Cash flow swaps not designated as hedges (3)	1,578	2,046
Deferred compensation plan (4)	15,917	14,842
Total liabilities	$28,583	$ 34,883

(1) Included in other assets in the accompanying Unaudited Condensed Consolidated Balance Sheets.

(2) As of September 30, 2014, approximately $8.6 million and $2.5 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying Unaudited Condensed Consolidated Balance Sheets. As of December 31, 2013, approximately $10.6 million and $7.4 million were included in other accrued liabilities and other long-term liabilities, respectively, in the accompanying Unaudited Condensed Consolidated Balance Sheets.

(3) As of September 30, 2014, approximately $0.7 million and $0.9 million were included in other accrued liabilities

and other long-term liabilities, respectively, in the accompanying Unaudited Condensed Consolidated Balance Sheets.
As of December 31, 2013, approximately $1.0 million was included in both other accrued liabilities
and other long-term liabilities in the accompanying Unaudited Condensed Consolidated Balance Sheets.
(4) Included in other long-term liabilities in the accompanying Unaudited Condensed Consolidated Balance Sheets.

There were no instances in the third quarter and nine-month periods ended September 30, 2014 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 Unaudited Condensed Consolidated Balance Sheets as of September 30, 2014 have not changed since December 31, 2013.

As of September 30, 2014 and December 31, 2013, the fair values of Sonic's financial instruments including receivables, notes receivable from finance contracts, notes payable – floor plan, trade accounts payable, borrowings under the 2014 Credit Facilities and certain mortgage notes approximate their carrying values due either to length of maturity or existence of variable interest rates that approximate prevailing market rates.

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At September 30, 2014 and December 31, 2013, the fair value and carrying value of Sonic's fixed rate long-term debt were as follows:

	September 30, 2014		December 31, 2013	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(In thousands)			
7.0% Notes (1)	$215,500	$198,519	$218,000	$198,414
5.0% Notes (1)	$290,250	$300,000	$285,000	$300,000
Mortgage Notes (2)	$154,668	$149,364	$165,381	$157,571
Assumed Notes (2)	$5,214	$5,372	$7,636	$7,993
Other (2)	$4,613	$4,919	$4,774	$5,080

(1) As determined by market quotations as of September 30, 2014 and December 31, 2013, respectively (Level 1).
(2) As determined by discounted cash flows (Level 3).

10. Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss) for the nine-month period ended September 30, 2014 are as follows:

	Changes in Accumulated Other Comprehensive Income (Loss) by Component for the Nine Months Ended September 30, 2014		
	Gains and Losses on Cash Flow Hedges	Defined Benefit Pension Plan	Total Accumulated Other Comprehensive Income (Loss)

	(In thousands)		
Balance at December 31, 2013	$(8,859)	$ 277	$ (8,582)
Other comprehensive income (loss) before reclassifications (1)	(2,052)	-	(2,052)
Amounts reclassified out of accumulated other comprehensive income (loss) (2)	5,290	-	5,290
Net current-period other comprehensive income (loss)	3,238	-	3,238
Balance at September 30, 2014	$(5,621)	$ 277	$ (5,344)

(1) Net of tax benefit of $1,257.
(2) Net of tax expense of $3,242.

See the heading “Derivative Instruments and Hedging Activities” in Note 6, “Long-Term Debt,” for further discussion of Sonic’s cash flow hedges. For further discussion of Sonic’s defined benefit pension plan, see Note 10, “Employee Benefit Plans,” of the Notes to Consolidated Financial Statements in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2013.

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

The following discussion and analysis of the results of operations and financial condition should be read in conjunction with the Sonic Automotive, Inc. and Subsidiaries Unaudited Condensed Consolidated Financial Statements and related notes thereto appearing elsewhere in this report, as well as the audited financial statements and related notes, "Risk Factors" and "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, 2013.

Overview

We are one of the largest automotive retailers in the United States. As of September 30, 2014, we operated 120 franchises in 13 states (representing 25 different brands of cars and light trucks) and 18 collision repair centers. For management and operational reporting purposes, we group certain franchises together that share management and inventory (principally used vehicles) into "stores." As of September 30, 2014, we operated 101 stores. As a result of the way we manage our business, we have a single operating segment for purposes of reporting financial condition and results of operations. Our dealerships provide comprehensive services including (1) sales of both new and used cars and light trucks; (2) sales of replacement parts, performance of vehicle maintenance, manufacturer warranty repairs, paint and collision repair services (collectively, "Fixed Operations"); and (3) arrangement of extended warranties, service contracts, financing, insurance and other aftermarket products (collectively, "F&I") for our customers.

As we announced during the fourth quarter of 2013, we plan to augment our manufacturer-franchised dealership operations with stand-alone pre-owned specialty retail sales locations branded as EchoPark®. Our EchoPark® business will operate independently from the existing new and used dealership sales operations and introduce customers to an exciting shopping and buying experience. The first target market is planned for Denver, Colorado, and we expect sales operations to begin in the fourth quarter of 2014.

In the fourth quarter of 2013, we also announced our customer experience initiative known as "One Sonic-One Experience." This initiative includes several new processes and proprietary technologies from inventory management and pricing tools to a fully developed "customer-centric" Customer Relationship Management ("CRM") tool. The development of these processes and tools will allow us to better serve our customers across our entire platform of stores. Our goal is to allow our guests to control the buying process and move at their pace so that once the vehicle has been selected our team can use these processes and technologies to get our guests on the road in their new vehicle in less than an hour. During the third quarter of 2014, we began rolling out the One Sonic-One Experience initiative at one of our Toyota dealerships in Charlotte, North Carolina.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

The following is a detail of our new vehicle revenues by brand for the third quarter and nine-month periods ended September 30, 2014 and 2013:

Brand	Percentage of New Vehicle Revenue Third Quarter Ended September 30, 2014	2013	Percentage of New Vehicle Revenue Nine Months Ended September 30, 2014	2013
Luxury:				
BMW	20.8 %	18.0 %	20.8 %	19.1 %
Mercedes	8.7 %	8.3 %	9.0 %	8.2 %
Lexus	5.6 %	5.3 %	5.1 %	4.8 %
Audi	5.0 %	4.3 %	4.9 %	4.2 %
Cadillac	4.1 %	5.2 %	4.4 %	4.7 %
Land Rover	2.5 %	2.7 %	2.7 %	2.5 %
Porsche	2.5 %	2.1 %	2.4 %	2.1 %
Mini	2.1 %	2.5 %	2.2 %	2.6 %
Acura	0.8 %	0.9 %	0.9 %	0.8 %
Volvo	0.8 %	0.8 %	0.8 %	0.9 %
Infiniti	0.7 %	0.9 %	0.7 %	0.9 %
Jaguar	0.7 %	0.8 %	0.7 %	0.7 %
Total Luxury	54.3 %	51.8 %	54.6 %	51.5 %
Mid-line Import:				
Honda	16.0 %	15.8 %	15.4 %	15.7 %
Toyota	11.3 %	10.6 %	10.6 %	10.4 %
Volkswagen	2.3 %	2.3 %	2.0 %	2.6 %
Hyundai	1.6 %	1.9 %	1.7 %	1.9 %
Other (1)	1.2 %	1.7 %	1.6 %	1.2 %
Nissan	0.8 %	1.1 %	1.0 %	1.1 %
Total Mid-line Import	33.2 %	33.4 %	32.3 %	32.9 %
Domestic:				
Ford	7.1 %	8.9 %	7.6 %	8.9 %
General Motors (2)	5.4 %	5.9 %	5.5 %	6.7 %
Total Domestic	12.5 %	14.8 %	13.1 %	15.6 %
Total	100.0 %	100.0 %	100.0 %	100.0 %

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

Results of Operations

Unless otherwise noted, all discussion of increases or decreases for the third quarter or nine-month periods ended September 30, 2014 are compared to the third quarter or nine-month periods ended September 30, 2013, as applicable. The following discussion of new vehicles, used vehicles, wholesale vehicles, Fixed Operations and F&I are on a same store basis, except where otherwise noted. All currently operating continuing operations stores are included within the same store group in the first full month following the first anniversary of the store's opening or acquisition. During the second quarter of 2014, we adopted the provisions of ASU 2014-08. See Note 1, "Summary of Significant Accounting Policies," to the accompanying Unaudited Condensed Consolidated Financial Statements for a discussion of the effects of our adoption of this ASU.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

New Vehicles

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

	Third Quarter Ended September 30,			Nine Months Ended September 30,		
(in millions of vehicles)	2014	2013	% Change	2014	2013	% Change
SAAR	16.7	15.6	7.1 %	16.3	15.4	5.8 %

Source: Bloomberg Financial Markets, via Stephens Inc.

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

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

	Third Quarter Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Reported:				
Revenue	$1,327,837	$1,261,270	$66,567	5.3 %
Gross profit	$69,026	$72,408	$(3,382)	(4.7 %)
Unit sales	36,774	35,538	1,236	3.5 %
Revenue per unit	$36,108	$35,491	$617	1.7 %
Gross profit per unit	$1,877	$2,037	$(160)	(7.9 %)
Gross profit as a % of revenue	5.2 %	5.7 %	(50) bps	

Better / (Worse)

	Nine Months Ended September 30,			
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Reported:				
Revenue	$3,773,234	$3,651,486	$121,748	3.3 %
Gross profit	$209,892	$206,668	$3,224	1.6 %
Unit sales	103,310	103,023	287	0.3 %
Revenue per unit	$36,523	$35,443	$1,080	3.0 %
Gross profit per unit	$2,032	$2,006	$26	1.3 %
Gross profit as a % of revenue	5.6 %	5.7 %	(10)	bps

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

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

	Third Quarter Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Same Store:				
Revenue	$1,310,138	$1,235,089	$75,049	6.1 %
Gross profit	$67,766	$70,602	$(2,836)	(4.0 %)
Unit sales	36,443	34,992	1,451	4.1 %
Revenue per unit	$35,950	$35,296	$654	1.9 %
Gross profit per unit	$1,860	$2,018	$(158)	(7.8 %)
Gross profit as a % of revenue	5.2 %	5.7 %	(50)	bps

	Nine Months Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Same Store:				
Revenue	$3,673,608	$3,586,365	$87,243	2.4 %
Gross profit	$203,132	$202,181	$951	0.5 %
Unit sales	101,392	101,663	(271)	(0.3 %)
Revenue per unit	$36,232	$35,277	$955	2.7 %
Gross profit per unit	$2,003	$1,989	$14	0.7 %
Gross profit as a % of revenue	5.5 %	5.6 %	(10)	bps

During the third quarter and nine-month periods ended September 30, 2014, we continued to test our new car pricing model with True Price®. As we move toward our national One Sonic-One Experience launch (our new customer experience initiative), we believe we will become more aggressive in pricing as well as gain market share as customers benefit from the entire complement of our new shopping experience.

The increases in new vehicle revenue during the third quarter and nine-month periods ended September 30, 2014, were primarily driven by new vehicle price per unit increases of 1.9% and 2.7%, respectively. Also contributing to the increase in new vehicle revenue during the third quarter ended September 30, 2014 was a new unit sales volume increase of 4.1%. New unit sales volume was flat in the nine-month period ended September 30, 2014. Excluding fleet sales (which we began to scale back in 2014), our retail new revenue increased 8.5% and 4.4% for the third quarter and nine-month periods ended September 30, 2014, respectively, and retail new unit sales volume increased 7.2% and 2.3% during the third quarter and nine-month periods ended September 30, 2014, respectively. Our Audi, BMW, Toyota and Honda dealerships led our new retail unit sales volume growth with increases of 27.4%, 19.2%, 11.0% and 10.6%, respectively, in the third quarter ended September 30, 2014, and our Audi, Lexus and BMW dealerships led our new retail unit sales volume growth with increases of 22.7% 12.6% and 10.0%, respectively, in the nine-month period ended September 30, 2014.

Total new vehicle gross profit dollars decreased $2.8 million, or 4.0%, during the third quarter ended September 30, 2014 and remained flat in the nine-month period ended September 30, 2014. Our gross profit per new unit decrease of $158 per unit in the third quarter ended September 30, 2014 was driven primarily by our Honda, Ford and Volkswagen dealerships. During the nine-month period ended September 30, 2014, increases in gross profit per new unit at our Audi, Land Rover and Cadillac dealerships were offset partially by decreases at our Ford and Toyota dealerships.

Our luxury dealerships (which include Cadillac) experienced new vehicle revenue increases of 11.7% and 8.7% in the third quarter and nine-month periods ended September 30, 2014, respectively, primarily due to new unit sales volume increases of 8.9% and 6.5% in the third quarter and nine-month periods ended September 30, 2014, respectively. Luxury dealership new vehicle gross profit increased 1.6% and 5.7% during the third quarter and nine-month periods ended September 30, 2014, respectively, primarily due to new unit sales volume increases at our Audi, BMW and Mercedes dealerships. Luxury dealership new vehicle gross profit per unit decreased 6.7% during the third quarter ended September 30, 2014, driven primarily by our MINI, Lexus and Jaguar dealerships, and remained flat during the nine-month period ended September 30, 2014.

Our mid-line import dealerships experienced a new vehicle revenue increase of 5.4% in the third quarter ended September 30, 2014, primarily due to a 7.4% increase in new unit volume during the same period, driven primarily by higher unit sales at our Toyota and Honda dealerships, which experienced a 11.4% and a 10.7% increase in new vehicle unit sales, respectively, in the third quarter ended September 30, 2014. New vehicle revenue from our mid-line import dealerships remained flat in the nine-month period ended September 30, 2014. Mid-line import gross profit decreased 16.2% and 6.7% in the third quarter and nine-month periods ended September 30, 2014, respectively, driven primarily by gross profit per new unit decreases at our Honda and Toyota dealerships.

Excluding fleet sales, our domestic dealerships experienced a new retail vehicle revenue increase of 6.0% in the third quarter ended September 30, 2014, driven by an increase unit sales volume of 4.1% during the same period. New retail vehicle revenue remained flat in the nine-month period ended September 30, 2014, driven by a new retail unit sales volume decrease of 3.1%, offset by an increase in price per unit of 3.5% during the same period. Our domestic dealerships experienced a new retail vehicle gross profit increase of 0.9% and a decrease of 4.5% for the third quarter and nine-month periods ended September 30, 2014, respectively. New retail vehicle gross profit per unit at our Ford dealerships decreased 13.2% and 10.1% during the third quarter and nine-month periods ended September 30, 21014, driving new vehicle gross profit decreases of 12.6% and 12.8% during the same period. Our General Motors dealerships (excluding Cadillac) experienced increases of 6.8% and 8.8% in new retail vehicle price per unit as well as increases in gross profit per unit of 9.6% and 9.7% during the third quarter and nine-month periods ended September 30, 2014, respectively, driving new vehicle gross profit increases of 19.1% and 6.1%, respectively, during the same period.

Including fleet sales, our domestic dealerships experienced new vehicle revenue decreases of 11.4% and 12.7% in the third quarter and nine-month periods ended September 30, 2014, respectively, driven by new unit sales volume decreases of 16.5% and 18.4% in the third quarter and nine-month periods ended September 30, 2014, respectively. These unit sales volume decreases were partially offset by price per unit increases of 6.1% and 7.0% in the third quarter and nine-month periods ended September 30, 2014, respectively. Domestic fleet unit sales volume decreased 67.4% and 54.2% in the third quarter and nine-month periods ended September 30, 2014, respectively, driving a fleet revenue decrease of 63.5% and 50.3% in the third quarter and nine-month periods ended September 30, 2014, respectively. The decreases in fleet revenue and unit sales are due to a reduced focus on fleet sales as a result of our operational decision to move away from the low margin fleet business.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

Used Vehicles

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

Our reported used vehicle results are as follows:

	Third Quarter Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Reported:				
Revenue	$583,570	$559,848	$23,722	4.2 %
Gross profit	$41,245	$38,976	$2,269	5.8 %
Unit sales	27,536	27,632	(96)	(0.3 %)
Revenue per unit	$21,193	$20,261	$932	4.6 %
Gross profit per unit	$1,498	$1,411	$87	6.2 %
Gross profit as a % of revenue	7.1 %	7.0 %	10	bps

	Nine Months Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Reported:				
Revenue	$1,747,254	$1,625,006	$122,248	7.5 %
Gross profit	$119,412	$114,615	$4,797	4.2 %
Unit sales	83,707	80,700	3,007	3.7 %
Revenue per unit	$20,873	$20,136	$737	3.7 %
Gross profit per unit	$1,427	$1,420	$7	0.5 %
Gross profit as a % of revenue	6.8 %	7.1 %	(30)	bps

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

Our same store used vehicle results are as follows:

	Third Quarter Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Same Store:				
Revenue	$569,226	$544,018	$25,208	4.6 %
Gross profit	$40,617	$38,074	$2,543	6.7 %
Unit sales	27,000	26,953	47	0.2 %
Revenue per unit	$21,082	$20,184	$898	4.4 %
Gross profit per unit	$1,504	$1,413	$91	6.4 %
Gross profit as a % of revenue	7.1 %	7.0 %	10	bps

	Nine Months Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Same Store:				
Revenue	$1,677,794	$1,580,336	$97,458	6.2 %
Gross profit	$115,743	$111,673	$4,070	3.6 %
Unit sales	80,928	78,785	2,143	2.7 %
Revenue per unit	$20,732	$20,059	$673	3.4 %
Gross profit per unit	$1,430	$1,417	$13	0.9 %
Gross profit as a % of revenue	6.9 %	7.1 %	(20)	bps

In the third quarter and nine-month periods ended September 30, 2014, our used vehicle unit volume increased 0.2% and 2.7%, respectively. Gross profit per used unit for the third quarter and nine-month periods ended September 30, 2014, increased 6.4% and 0.9%, respectively, as a result of better control over the procurement, pricing and placement of used inventory through our centralized retail trade center. As we move toward our national One Sonic-One Experience launch and continue to test our used car pricing model with True Price®, we believe we will have the opportunity to experience gains in our used vehicle unit volume and used vehicle revenue levels.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

Wholesale Vehicles

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

Our reported wholesale vehicle results are as follows:

	Third Quarter Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Reported:				
Revenue	$41,433	$42,731	$(1,298)	(3.0%)
Gross profit (loss)	$(1,086)	$(3,197)	$2,111	66.0%
Unit sales	7,916	7,641	275	3.6%
Revenue per unit	$5,234	$5,592	$(358)	(6.4%)
Gross profit (loss) per unit	$(137)	$(418)	$281	67.2%
Gross profit (loss) as a % of revenue	(2.6%)	(7.5%)	490	bps

	Nine Months Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Reported:				
Revenue	$127,797	$134,556	$(6,759)	(5.0%)
Gross profit (loss)	$(2,493)	$(6,343)	$3,850	60.7%
Unit sales	23,034	23,291	(257)	(1.1%)
Revenue per unit	$5,548	$5,777	$(229)	(4.0%)
Gross profit (loss) per unit	$(108)	$(272)	$164	60.3%
Gross profit (loss) as a % of revenue	(2.0%)	(4.7%)	270	bps

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

Our same store wholesale vehicle results are as follows:

	Third Quarter Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Same Store:				
Revenue	$40,894	$42,141	$(1,247)	(3.0 %)
Gross profit (loss)	$(1,043)	$(3,105)	$2,062	66.4 %
Unit sales	7,829	7,545	284	3.8 %
Revenue per unit	$5,223	$5,585	$(362)	(6.5 %)
Gross profit (loss) per unit	$(133)	$(412)	$279	67.7 %
Gross profit (loss) as a % of revenue	(2.6 %)	(7.4 %)	480	bps

	Nine Months Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
	(In thousands, except units and per unit data)			
Same Store:				
Revenue	$123,962	$132,528	$(8,566)	(6.5 %)
Gross profit (loss)	$(2,262)	$(6,019)	$3,757	62.4 %
Unit sales	22,509	22,987	(478)	(2.1 %)
Revenue per unit	$5,507	$5,765	$(258)	(4.5 %)
Gross profit (loss) per unit	$(100)	$(262)	$162	61.8 %
Gross profit (loss) as a % of revenue	(1.8 %)	(4.5 %)	270	bps

Wholesale vehicle revenue and unit sales volume fluctuations are typically a result of new and used retail vehicle unit volumes that generate additional trade-in vehicle volume that we are not always able to sell as retail used vehicles and choose to sell at auction. Wholesale gross profit for the third quarter and nine-month periods ended September 30, 2014, increased 66.4% and 62.4%, respectively. Wholesale vehicle revenue decreased in the third quarter and nine-month periods ended September 30, 2014 as a result of our focus on acquiring the right used inventory at our dealerships, pricing the vehicles effectively and turning our used inventory quickly.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

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

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

Our reported Fixed Operations results are as follows:

	Third Quarter Ended September 30,		Better / (Worse)	
	2014	2013	Change	% Change
Reported:	(In thousands)			
Revenue				
Customer pay	$141,458	$137,106	$4,352	3.2 %
Warranty	48,431	45,405	3,026	6.7 %
Wholesale parts	46,983	43,349	3,634	8.4 %
Internal, sublet and other	88,868	83,740	5,128	6.1 %
Total	$325,740	$309,600	$16,140	5.2 %
Gross profit				
Customer pay	$77,546	$75,203	$2,343	3.1 %
Warranty	26,254	24,374	1,880	7.7 %
Wholesale parts	8,122	7,881	241	3.1 %
Internal, sublet and other	43,358	41,689	1,669	4.0 %
Total	$155,280	$149,147	$6,133	4.1 %
Gross profit as a % of revenue				
Customer pay	54.8 %	54.9 %	(10) bps	
Warranty	54.2 %	53.7 %	50 bps	
Wholesale parts	17.3 %	18.2 %	(90) bps	
Internal, sublet and other	48.8 %	49.8 %	(100) bps	
Total	47.7 %	48.2 %	(50) bps	

	Nine Months Ended September 30,	Better / (Worse)

	2014	2013	Change	% Change
Reported:	(In thousands)			
Revenue				