SONIC AUTOMOTIVE INC
Form 10-Q
May 08, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission file number 1-13395

SONIC AUTOMOTIVE, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**56-2010790**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6415 Idlewild Road, Suite 109, Charlotte, North Carolina	**28212**
(Address of principal executive offices)	**(Zip Code)**

(704) 566-2400

(Registrant s telephone number, including area code)

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

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

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

Large Accelerated Filer ¨	Accelerated Filer x	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 April 29, 2009, there were 28,140,000 shares of Class A Common Stock and 12,029,375 shares of Class B Common Stock outstanding.

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PART I - FINANCIAL INFORMATION

Item 1: Condensed Consolidated Financial Statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Dollars and shares in thousands except per share amounts)

(Unaudited)

	First Quarter Ended March 31,	
	2008	2009
Revenues:		
New vehicles	$ 897,679	$ 590,266
Used vehicles	320,713	290,256
Wholesale vehicles	69,966	32,180
Total vehicles	1,288,358	912,702
Parts, service and collision repair	249,987	240,724
Finance, insurance and other	44,841	31,971
Total revenues	1,583,186	1,185,397
Cost of Sales:		
New vehicles	(836,305)	(550,264)
Used vehicles	(290,931)	(263,008)
Wholesale vehicles	(71,028)	(32,314)
Total vehicles	(1,198,264)	(845,586)
Parts, service and collision repair	(125,851)	(121,569)
Total cost of sales	(1,324,115)	(967,155)
Gross profit	259,071	218,242
Selling, general and administrative expenses	(204,675)	(181,535)
Impairment charges	(156)	(32)
Depreciation and amortization	(6,723)	(7,788)
Operating income	47,517	28,887
Other income / (expense):		
Interest expense, floor plan	(11,048)	(4,303)
Interest expense, FSP APB 14-1	(2,639)	(2,566)
Interest expense, other, net	(10,665)	(14,810)
Other income, net	63	41
Total other expense	(24,289)	(21,638)
Income from continuing operations before taxes	23,228	7,249
Income tax provision	(9,292)	(3,262)
Income from continuing operations	13,936	3,987
Discontinued operations:		

Loss from operations and the sale of discontinued franchises		(1,273)		(3,078)
Income tax (provision) benefit		(38)		769
Loss from discontinued operations		(1,311)		(2,309)
Net income	$	12,625	$	1,678
Basic earnings per share:				
Earnings per share from continuing operations	$	0.34	$	0.10
Loss per share from discontinued operations		(0.03)		(0.06)
Earnings per share	$	0.31	$	0.04
Weighted average common shares outstanding		40,774		40,099
Diluted earnings per share:				
Earnings per share from continuing operations	$	0.34	$	0.10
Loss per share from discontinued operations		(0.03)		(0.06)
Earnings per share	$	0.31	$	0.04
Weighted average common shares outstanding		41,069		40,338
Dividends declared per common share	$	0.12	$	

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

(Unaudited)

	December 31, 2008 (1)	March 31, 2009
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 6,971	$ 614
Receivables, net	247,025	205,957
Inventories	916,837	802,830
Assets held for sale	406,576	365,452
Other current assets	16,822	23,523
Total Current Assets	1,594,231	1,398,376
Property and Equipment, net	369,892	382,129
Goodwill	327,007	327,007
Other Intangible Assets, net	82,328	81,914
Other Assets	32,087	22,195
Total Assets	$ 2,405,545	$ 2,211,621
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Notes payable - floor plan - trade	$ 208,438	$ 186,402
Notes payable - floor plan - non-trade	712,585	593,700
Trade accounts payable	53,215	53,688
Accrued interest	17,096	12,320
Other accrued liabilities	207,627	138,861
Liabilities associated with assets held for sale - trade	65,405	57,212
Liabilities associated with assets held for sale - non-trade	134,077	92,778
Current maturities of long-term debt	738,447	211,584
Total Current Liabilities	2,136,890	1,346,545
Long-Term Debt		557,278
Other Long-Term Liabilities	71,132	90,689
Commitments and Contingencies		
Stockholders Equity:		
Class A convertible preferred stock, none issued		
Class A common stock, $.01 par value; 100,000,000 shares authorized; 42,922,557 shares issued and 28,063,141 shares outstanding at December 31, 2008; 42,978,977 shares issued and 28,101,251 shares outstanding at March 31, 2009	429	430
Class B common stock; $.01 par value; 30,000,000 shares authorized; 12,400,000 shares issued and 12,029,375 shares outstanding at December 31, 2008 and March 31, 2009	121	121
Paid-in capital	537,023	538,505
Accumulated deficit	(66,900)	(65,057)
Accumulated other comprehensive income	(36,636)	(20,345)
Treasury stock, at cost (14,859,416 Class A shares held at December 31, 2008 and 14,877,726 Class A shares held at March 31, 2009)	(236,514)	(236,545)

Total Stockholders Equity	197,523	217,109
Total Liabilities and Stockholders Equity	$ 2,405,545	$ 2,211,621

(1) Restated for the adoption effects of FSP APB 14-1

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(Dollars and shares in thousands)

(Unaudited)

	Class A Common Stock		Class B Common Stock					Accumulated Other	Total	Compre-
	Shares	**Amount**	**Shares**	**Amount**	**Paid-In Capital**	**Accumulated Deficit**	**Treasury Stock**	**Comprehensive Income**	**Stockholders Equity**	**hensive Income**
BALANCE AT DECEMBER 31, 2008	42,923	$ 429	1,209	$ 121	$ 502,985	$ (40,597)	$ (236,514)	$ (36,635)	$ 189,789	
FSP APB 14-1 adoption					34,038	(26,303)			7,735	
BALANCE AT DECEMBER 31, 2008 (1)	42,923	429	12,029	121	537,023	(66,900)	(236,514)	(36,635)	197,524	
Shares awarded under stock compensation plans	56	1			94				95	
Purchases of treasury stock							(31)		(31)	
Income tax benefit associated with convertible note hedge					569				569	
Fair value of interest rate swap agreements, net of tax expense of $9,984								16,290	16,290	16,290
Stock-based compensation expense					108				108	
Restricted stock amortization, net of forfeitures					711				711	
Net income						1,678			1,678	1,678
Other						165			165	
BALANCE AT MARCH 31, 2009	42,979	$ 430	12,029	$ 121	$ 538,505	$ (65,057)	$ (236,545)	$ (20,345)	$ 217,109	$ 17,968

(1) Restated for the adoption effects of FSP APB 14-1

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	First Quarter Ended March 31,	
	2008 (1)	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 12,625	$ 1,678
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	8,033	7,733
Provision for bad debt expense	835	262
Other amortization	334	414
Debt issuance cost amortization	291	338
Debt discount amortization, net of premium amortization	2,876	2,791
Stock - based compensation expense	1,387	108
Amortization of restricted stock	1,072	711
Restricted stock forfeiture	(41)	
Deferred income taxes	(1,975)	(1,338)
Equity interest in earnings of investees	(158)	(157)
Asset impairment charges	2,526	1,586
(Gain) Loss on disposal of franchises and property and equipment	(798)	4
Loss on exit of leased dealerships	1,282	946
Changes in assets and liabilities that relate to operations:		
Receivables	40,850	26,732
Inventories	(111,615)	153,528
Other assets	(10,137)	(20,801)
Notes payable - floor plan - trade	28,312	(30,229)
Trade accounts payable and other liabilities	(12,572)	22,556
Total adjustments	(49,498)	165,184
Net cash (used in) / provided by operating activities	(36,873)	166,862
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of businesses, net of cash acquired	(22,174)	
Purchases of property and equipment	(67,626)	(20,407)
Proceeds from sales of property and equipment	285	435
Proceeds from sale of franchises	16,467	
Distributions from equity investees	600	
Net cash used in investing activities	(72,448)	(19,972)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings on notes payable floor plan - non-trade	47,593	(160,184)
Borrowings on revolving credit facilities	308,230	226,596
Repayments on revolving credit facilities	(232,359)	(197,552)
Payments on long-term debt	(907)	(1,421)
Settlement of cash flow swaps		(16,454)
Purchases of treasury stock	(20,128)	(31)

Income tax benefit associated with stock compensation plans	14	
Income tax benefit associated with convertible hedge	521	569
Issuance of shares under stock compensation plans	219	94
Dividends paid	(5,264)	(4,864)
Net cash provided by / (used in) financing activities	97,919	(153,247)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(11,402)	(6,357)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	16,514	6,971
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 5,112	$ 614
SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:		
Change in fair value of cash flow hedging instruments (net of tax (benefit) / expense of $(8,303) and $9,984 for the three month period ended March 31, 2008 and 2009, respectively)	$ (13,547)	$ 16,290
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid (received) during the year for:		
Interest, net of amount capitalized	$ 32,701	$ 29,627
Income taxes	$ 709	$ (10,897)

(1) Restated for the adoption effects of FSP APB 14-1

See notes to unaudited condensed consolidated financial statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The accompanying unaudited condensed consolidated financial information for the first quarter ended March 31, 2009 has been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). All significant intercompany accounts and transactions have been eliminated. These unaudited condensed consolidated financial statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to fairly state the financial position and the results of operations for the periods presented. The results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year. These interim financial statements should be read in conjunction with the audited consolidated financial statements of Sonic for the year ended December 31, 2008, which were included in Sonic s Annual Report on Form 10-K.

Recent Developments On May 7, 2009, Sonic completed a restructuring of its 5.25% convertible senior subordinated notes that were scheduled to mature on May 7, 2009 (the 5.25% Convertible Notes). In conjunction with this restructuring, Sonic paid cash of approximately $15.7 million, issued $85.6 million in 6.00% senior secured second lien convertible notes due 2012 in two series (i.e., Series A and Series B) (the 6.00% Convertible Notes) and issued 860,723 shares of Class A common stock to satisfy its obligations under the 5.25% Convertible Notes. In addition, Sonic executed an amendment effective May 4, 2009 to its credit facility with Bank of America, NA, as administrative agent, and a syndicate of commercial banks and commercial finance entities (the 2006 Credit Facility) which, among other things, removes the requirement for Sonic to deliver to the administrative agent under the 2006 Credit Facility and the lenders thereto an opinion of Sonic s independent registered public accounting firm with respect to Sonic s fiscal year ended December 31, 2008 without any going concern or like qualification. The amendment to the 2006 Credit Facility and a description of the 6.00% Convertible Notes are discussed further in Note 6. Also in conjunction with the restructuring, Sonic sold for cash, in a private placement primarily to certain of its officers, directors and management employees, 487,796 shares of the Sonic s Class A common stock at a price of $5.74 per share. Sonic has agreed to register the shares issued primarily to certain of its directors and management employees upon request.

On April 30, 2009, Chrysler LLC filed for bankruptcy protection and submitted a plan of reorganization. As of April 30, 2009, Sonic owned nine Chrysler franchises located at three dealerships. As a result of the bankruptcy filing, Sonic may be required to record impairment charges related to lease obligations, fixed assets, accounts receivable and inventory. Currently, Sonic cannot estimate the effect this bankruptcy filing may have on its financial results and condition.

Reclassifications The statement of income for the first quarter ended March 31, 2008 reflects the reclassification of balances from continuing operations to discontinued operations from the prior year presentation for additional franchises sold and terminated or identified for sale subsequent to March 31, 2008. The statement of income for the quarter ended March 31, 2008 also reflects the reclassification of balances from discontinued operations to continuing operations for franchises identified for sale as of March 31, 2008 but which Sonic has decided to retain and operate as of March 31, 2009.

Recent Accounting Pronouncements Sonic adopted the provisions of FSP APB 14-1 Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-1) as of January 1, 2009. FSP APB 14-1 applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). FSP APB 14-1 requires that the issuer of a convertible debt instrument within its scope separately account for the liability and equity components in a manner that reflects the issuer s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The excess of the principal amount of the liability component over its initial fair value must be amortized to interest cost using the effective interest method. The provisions of FSP APB 14-1 apply to Sonic s 4.25% Convertible Senior Subordinated Notes due 2015 (the 4.25% Convertible Notes) and 5.25% Convertible Notes. In conjunction with the adoption of FSP APB 14-1, Sonic estimated the nonconvertible borrowing rates related to its 4.25% Convertible Notes and 5.25% Convertible Notes to be 8.0% and 10.0%, respectively. Accordingly, the fair value of the equity component of the 4.25% Convertible Notes was $25.1 million ($15.1 million, net of tax) at the date of issuance of the 4.25% Convertible Notes and the fair value of the equity component of the 5.25% Convertible Notes was $31.6 million ($19.0 million, net of tax) at the date of the issuance of the 5.25% Convertible Notes. FSP ABP 14-1 requires retrospective treatment of its provisions to all periods presented. Therefore, previously reported balances (prior to January 1, 2009), have been adjusted to effectively record a debt discount equal to the fair value of the equity component, a deferred tax liability for the tax effect of the recorded debt discount and an increase to paid-in capital for the tax-effected fair value of the equity component as of the date of issuance of the underlying notes. Previously reported balances have also been adjusted to provide for the amortization of the debt discount through

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

interest expense and the associated decrease in the deferred tax liability recorded through income tax expense. As of December 31, 2008, the unamortized debt discount associated with FSP APB 14-1 related to the 4.25% Convertible Notes and the 5.25% Convertible Notes was $10.8 million and $2.1 million, respectively. As of March 31, 2009, the unamortized debt discount associated with FSP APB 14-1 related to the 4.25% Convertible Notes and the 5.25% Convertible Notes was $9.5 million and $0.8 million, respectively. The unamortized discount will be amortized through interest expense into earnings over the remaining expected term of the convertible notes which is through November 2010 for the 4.25% Convertible Notes and through May 2009 for the 5.25% Convertible Notes. A summary of the effect of applying these provisions on our prior and current period consolidated statements of income is as follows:

	(dollars in thousands) Twelve Months Ended December 31,							(dollars in thousands) First Quarter Ended March 31,	
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2008**	**2009**
Increase in Interest Expense	(2,108)	(3,530)	(3,899)	(4,656)	(9,044)	(9,898)	(10,704)	(2,639)	(2,566)
Tax Benefit	843	1,412	1,560	1,862	3,617	3,959	4,282	1,056	1,027
Effect on Net Income	(1,265)	(2,118)	(2,339)	(2,794)	(5,427)	(5,939)	(6,422)	(1,583)	(1,539)

In June 2008, the FASB issued Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities (FSP 03-6-1). In FSP 03-6-1, unvested share-based payment awards that contain rights to receive nonforfeitable dividends or dividend equivalents (whether paid or unpaid) are participating securities, and thus, should be included in the two-class method of computing earnings per share. This FSP is effective for fiscal years beginning after December 31, 2008 and interim periods within those years and requires that all prior period earnings per share disclosures be adjusted retroactively to apply the two-class method of computing earnings per share. The adoption of this standard in the current reporting period resulted in no changes in the prior period or the current year period presentation of earnings per share.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133, and how derivative instruments and related hedged items affect an entity s operating results, financial position and cash flows. SFAS 161 is effective for fiscal years beginning after November 15, 2008. Sonic s adoption in the current reporting period did not have a material impact on its consolidated operating results, financial position or cash flows.

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

Sonic s adoption of the provisions of SFAS No. 157, Fair Value Measurements (SFAS 157) on January 1, 2008, related to fair value measurements and related disclosures of financial assets and liabilities, did not have a material impact on its financial statements. Sonic s adoption of the provisions of SFAS 157 related to nonfinancial assets and liabilities on January 1, 2009, affects, among other items, the valuation of goodwill, franchise assets and fixed assets when assessing for impairments and the valuation of assets acquired and liabilities assumed in business combinations. The adoption of the required provisions of SFAS 157 in the quarter ended March 31, 2009, did not have a material impact on Sonic s fair value measurements or its financial statements.

Derivative Instruments and Hedging Activities Sonic utilizes derivative financial instruments to manage its capital structure and interest rate risk. The types of risks hedged are primarily related to the variability of cash flows caused by movements in interest rates. Sonic documents its risk management strategy and assesses hedge effectiveness at the inception and during the term of each hedge. Derivatives are reported at fair value on the accompanying Condensed Consolidated

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Balance Sheets. The changes in fair value of the effective portion of cash flow hedges are reported as a component of accumulated other comprehensive loss. Amounts in accumulated other comprehensive loss are reclassified to interest expense to the extent the hedge becomes ineffective. Measurements of hedge effectiveness are based on comparisons between the gains or losses of the actual interest rate swaps and the gains or losses of hypothetical interest rate swaps, which have the exact same critical terms of the defined hedged items. Ineffective portions of these interest rate swaps are reported as a component of interest expense in the accompanying Condensed Consolidated Statements of Income. There was no ineffectiveness resulting from any of our hedging relationships for the quarters ending March 31, 2008 and 2009.

At March 31, 2009, Sonic had interest rate swap agreements (the Fixed Swaps) to effectively convert a portion of its LIBOR-based variable rate debt to a fixed rate. The fair value of these positions at March 31, 2009 was a liability of $18.2 million and is recorded, net of tax of $6.7 million, in accumulated other comprehensive income in the accompanying Condensed Consolidated Balance Sheets. Under the terms of the Fixed Swaps, Sonic will receive and pay interest based on the following:

Notional (in millions)	Pay Rate	Receive Rate (1)	Maturing Date
$200.0	4.935%	one-month LIBOR	May 1, 2012
$100.0	5.265%	one-month LIBOR	June 1, 2012
$ 4.0	7.100%	one-month LIBOR	July 10, 2017
$ 25.0	5.160%	one-month LIBOR	September 1, 2012
$ 15.0	4.965%	one-month LIBOR	September 1, 2012
$ 25.0	4.885%	one-month LIBOR	October 1, 2012
$ 12.4	4.655%	one-month LIBOR	December 10, 2017
$ 9.2	6.860%	one-month LIBOR	August 1, 2017
$ 7.6	4.330%	one-month LIBOR	July 1, 2013

(1) One-month LIBOR was 0.501% at March 31, 2009.

All the Fixed Swaps, with the exception of one with a notional amount of $9.2 million, have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of these swaps have been recorded in accumulated other comprehensive income, net of related income taxes in the Condensed Consolidated Statement of Stockholders Equity. The amounts reclassified out of accumulated other comprehensive income into results of operations for the quarters ended March 31, 2008 and 2009 were $1.1 million and $7.1 million, respectively. The amount expected to be reclassified out of accumulated other comprehensive income into earnings (through interest expense, other) in the next twelve months is approximately $17.5 million. The effect of the mark-to-market adjustment related to the one swap for which hedge accounting was not applied decreased expense by $2.4 million in the quarter ended March 31, 2009 and is included in selling general and administrative expenses in the accompanying Condensed Consolidated Statements of Income.

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

	(dollars in thousands)
Balance, December 31, 2008	$ 19,882
Lease exit expense	946
Payments	(1,150)
Balance, March 31, 2009	$ 19,678

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. Discontinued Operations

Dispositions All franchises held for sale are expected to be sold within one year from March 31, 2009**.** The operating results of these franchises are included in the loss from discontinued operations in Sonic s statements of income. Assets to be disposed of in connection with franchises held for sale but not yet sold have been classified in assets held for sale in Sonic s balance sheets along with other assets held for sale. The major components of assets held for sale consist of the following:

	(dollars in thousands)	
	December 31, 2008	March 31, 2009
Inventories	$ 207,308	$ 167,594
Property and equipment, net	39,094	39,083
Goodwill	154,940	153,541
Franchise assets	5,234	5,234
Assets held for sale	$ 406,576	$ 365,452

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

	(dollars in thousands) First Quarter Ended March 31,	
	2008	2009
Income / (loss) from operations	$ 1,628	$ (661)
Gain (loss) on disposal of franchises	488	(81)
Lease exit charges	(1,020)	(782)
Property impairment charges	(466)	(155)
Goodwill impairment charges		(1,399)
Favorable lease asset impairment charges	(1,903)	
Pre-tax loss	$ (1,273)	$ (3,078)
Total Revenues	$ 438,006	$ 265,396

Lease exit charges recorded for the first quarter ended March 31, 2008 and 2009 relate to the revision of estimates and establishment of lease exit accruals. The lease exit accruals are calculated by either discounting the remaining lease payments, net of estimated sublease proceeds or estimating the amount necessary to satisfy the lease commitment to the landlord. For a discussion of property impairment charges, see Note 4 and for a discussion of goodwill impairment charges and favorable lease asset impairment charges see Note 5.

Sonic allocates corporate level interest expense to discontinued operations based on the net assets of the discontinued operations group. Interest allocated to discontinued operations for the first quarter ended March 31, 2008 and 2009 was $2.3 million and $4.1 million, respectively.

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3. Inventories

Inventories consist of the following:

	(dollars in thousands)	
	December 31, 2008	**March 31, 2009**
New vehicles	$ 910,462	$ 726,317
Used vehicles	87,895	121,609
Parts and accessories	57,057	55,402
Other	68,731	67,096
	$ 1,124,145	$ 970,424
Less inventories classified as assets held for sale	(207,308)	(167,594)
Inventories	$ 916,837	$ 802,830

4. Property and Equipment

Property and equipment consists of the following:

	(dollars in thousands)	
	December 31, 2008	**March 31, 2009**
Land	$ 63,153	$ 57,918
Building and improvements	308,530	313,161
Office equipment and fixtures	68,054	72,134
Parts and service equipment	54,577	55,401
Company vehicles	8,700	8,531
Construction in progress	30,989	46,390
Total, at cost	534,003	553,535
Less accumulated depreciation	(125,017)	(132,323)
Subtotal	408,986	421,212
Less assets held for sale	(39,094)	(39,083)
Property and equipment, net	$ 369,892	$ 382,129

Property and equipment impairment charges of approximately $0.2 million were recorded in the first quarter ended March 31, 2009, all of which was included in discontinued operations in the accompanying Condensed Consolidated Statements of Income.

Property and equipment impairment charges of approximately $0.6 million were recorded in the first quarter ended March 31, 2008. In the first quarter ended March 31, 2008, $0.5 million was included in discontinued operations and $0.1 million was included in continuing operations in the accompanying Condensed Consolidated Statements of Income.

The impairment charges recorded in discontinued operations in all periods were recorded based on the estimated fair value of the property and equipment to be sold in connection with the disposal of associated franchises and recorded values. The impairment charges recorded in continuing operations in 2008 were recorded based on Sonic s decision to abandon certain facility construction projects.

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5. Goodwill and Intangible Assets

	(dollars in thousands)	
	Franchise Agreements	**Goodwill**
Balance, December 31, 2008	$ 64,701	$ 327,007
Impairment of import dealerships		(1,399)
Reclassification from assets held for sale		1,399
Balance, March 31, 2009	$ 64,701	$ 327,007

During the fourth quarter of 2008, Sonic recorded an estimated goodwill impairment charge of $786.5 million in continuing operations in accordance with the provisions of SFAS No. 142, Goodwill and Other Intangible Assets . An estimate was recorded because Sonic had not finalized the valuation of certain assets and liabilities that were necessary to complete its evaluation at December 31, 2008. During the first quarter ended March 31, 2009, Sonic completed the valuation of these certain assets and liabilities. Based on the completion of its evaluation of the goodwill impairment charge during the current year quarter no adjustment to the estimate that was recorded at December 31, 2008 was required.

During the first quarter ended March 31, 2009, Sonic determined that a portion of the goodwill allocated to franchises held for sale was not recoverable based on asset disposal agreements entered into during the first quarter ended March 31, 2009. Accordingly, Sonic recorded a goodwill impairment charge of $1.4 million in discontinued operations for the first quarter ended March 31, 2009 which represented the difference between estimated proceeds and recorded balances.

At December 31, 2008, Sonic had $17.6 million of definite life intangibles recorded relating to favorable lease agreements. After the effect of amortization of the definite life intangibles, the balance recorded at March 31, 2009 was $17.2 million and was included in Other Intangible Assets, net, in the accompanying Condensed Consolidated Balance Sheets. In the first quarter ended March 31, 2008, Sonic recorded an impairment charge of $1.9 million within discontinued operations related to its definite life intangibles. The impairment charge was recorded based on management s estimate that sublease income from certain properties would not allow Sonic to recover the recorded value of favorable lease assets related to the properties.

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6. LONG-TERM DEBT

Long-term debt consists of the following:

	(dollars in thousands)	
	December 31, 2008	**March 31, 2009**
2006 Revolving Credit Sub-Facility (1)	$ 70,842	$ 99,886
Senior Subordinated Notes bearing interest at 8.625%	273,116	273,196
Convertible Senior Subordinated Notes bearing interest at 5.25%	102,990	104,366
Convertible Senior Subordinated Notes bearing interest at 4.25%	147,538	149,065
Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19%)	22,946	22,281
Mortgage notes to finance companies-fixed rate, bearing interest from 5.80% to 7.03%	80,622	80,078
Mortgage notes to finance companies-variable rate, bearing interest at 1.25 to 2.65 percentage points above one-month LIBOR	33,764	33,399
Other	6,629	6,591
	$ 738,447	$ 768,862
Less current maturities (2)	(738,447)	(211,584)
Long-term debt	$	$ 557,278

(1) Interest rate on the revolving credit sub-facility is based on a performance based grid that ranges from 1.75% to 2.75% above LIBOR. The rate was 2.00% above LIBOR at December 31, 2008 and 2.50% above LIBOR at March 31, 2009.

(2) At December 31, 2008, as a result of the uncertainty related to Sonic s compliance with the covenants under its 2006 Credit Facility for the fiscal year 2009, Sonic classified all its indebtedness as current in the accompanying Condensed Consolidated Balance Sheets due to cross default provisions governing its other indebtedness. At March 31, 2009, current maturities include amounts outstanding related to the 5.25% Convertible Notes and the 2006 Revolving Credit Sub-Facility as a result of these obligations maturing within one year of the balance sheet date.

As a result of the adoption of FSP APB 14-1 (discussed in Note 1) debt discount was required to be recorded related to Sonic s 4.25% Convertible Notes and 5.25% Convertible Notes at the date of the issuance of the Notes. Accordingly, the balances in the table above include unamortized debt discount related to the adoption of FSP APB 14-1 of $10.8 million and $9.5 million related to Sonic s 4.25% Convertible Notes as of December 31, 2008 and March 31, 2009, respectively, and $2.1 million and $0.8 million related to Sonic s 5.25% Convertible Notes as of December 31, 2008 and March 31, 2009, respectively.

Availability under the Revolving Credit Sub-Facility is subject to a borrowing base calculation and is reduced on a dollar for dollar basis by any outstanding letters of credit. The borrowing base was $208.7 million, letters of credit outstanding were $67.1 million and availability of additional borrowings was $41.7 million at March 31, 2009.

Neither of the conversion features on the 5.25% or 4.25% convertible senior subordinated notes was satisfied during the first quarter ended March 31, 2009. Sonic was in compliance with all financial covenants under the above long-term debt and credit facilities as of March 31, 2009.

In connection with the amendment to the 2006 Credit Facility executed March 31, 2009, Sonic agreed to increase the interest rates for amounts outstanding and the quarterly commitment fees payable by it on the unused portion. Before April 1, 2009, the 2006 Credit Facility bore interest at a specified percentage above LIBOR according to a performance-based pricing grid determined by the Total Senior Secured Debt to EBITDA Ratio as of the last day of the immediately preceding fiscal quarter. The quarterly commitment fees were also determined according to a performance-based pricing grid determined by the Total Senior Secured Debt to EBITDA Ratio as of the last day of the immediately preceding fiscal quarter. On and after April 1, 2009, the 2006 Credit Facility will bear interest as follows: 2.50% above LIBOR for amounts outstanding under the revolving credit sub-facility under the 2006 Credit Facility; 1.75% above LIBOR for amounts outstanding under the new vehicle floor plan sub-facility under the 2006 Credit Facility; and 2.00% above LIBOR for amounts outstanding under the used vehicle floor plan sub-facility under the 2006 Credit Facility. The quarterly commitment fee on and after April 1, 2009 will be 0.75% on the unused portion of the revolving credit sub-facility under the 2006 Credit Facility, 0.25% on the unused portion of the new vehicle floor plan sub-facility under the 2006 Credit Facility, 0.30% on the unused portion of the used vehicle floor plan sub-facility under the 2006 Credit Facility, and 2.50% letter of credit fee.

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There were also certain other concessions Sonic provided to the lenders under the 2006 Credit Facility in connection with the March 31, 2009 amendment, which includes the following. Sonic agreed to limit its borrowing under the 2006 Credit Facility to ordinary course of business operating expenditures, and in any event, not for the repayment of certain indebtedness, including the 5.25% Convertible Notes, the 4.25% Convertible Notes and the 8.625% Notes. In addition, Sonic was prohibited from making any acquisitions and Sonic agreed that net proceeds from certain asset sales until May 4, 2009 would be used to permanently reduce the amount available under the 2006 Revolving Credit Sub-Facility.

On May 4, 2009, Sonic executed an additional amendment to the 2006 Credit Facility. The amendment allowed for borrowings of $15.0 million to be used in the restructuring of the 5.25% Convertible Notes and increased the interest rates related to outstanding borrowings under the revolving credit sub-facility to 3.50% above LIBOR, increased the letter of credit fee to 3.50%. In addition, beginning October 1, 2009, the commitments under the 2006 Credit Facility will be reduced to $635.0 million related to new vehicle floor plan financing, $100.0 million related to used vehicle floor plan financing and $225.0 million related to general use revolving credit financing. The amendment included a change to the borrowing base which restricts the effect of twelve-month EBITDA on the borrowing base to 50% prior to September 1, 2009 and 25% beginning October 1, 2009.

The amendment executed on May 4, 2009 permanently extended the provision in the amendment executed March 31, 2009, requiring Sonic to apply 100% of the net cash proceeds received in conjunction with certain dispositions of assets to balances outstanding under the revolving credit sub-facility. However, under certain circumstances, if after giving pro forma effect to the disposition of assets, Sonic s borrowings under the revolving credit sub-facility do not exceed $25.0 million and Sonic s borrowing availability is at least $75.0 million, then Sonic is required to apply not less than 50% of the net cash proceeds received in conjunction with the disposition of the assets to balances outstanding under the revolving credit sub-facility. The revolving commitment under the 2006 Credit Facility will be permanently reduced in the amount of such mandatory prepayments until the revolving commitment is reduced to $185.0 million.

Sonic agreed to limit its borrowings to ordinary course of business operating expenses, and in any event, not the repayment of certain indebtedness, including the 4.25% Convertible Notes, the 6.00% Convertible Notes and the 8.625% Notes. The May 4, 2009 amendment restricts the payment by Sonic of cash interest with respect to the 6.00% Convertible Notes and debt to be issued in respect of Sonic s 4.25% Convertible Notes to a certain aggregate amount. This amendment also restricts the amount of the 4.25% Convertible Notes, the 8.625% Notes and the 5.25% Convertible Notes to the aggregate principal amount of such indebtedness existing as of the date of the May 4, 2009 amendment. In addition, the May 4, 2009 amendment restricts the amount of the 6.00% Convertible Notes to the aggregate principal amount of the 5.25% Convertible Notes prior to the refinancing, less the amount of such notes that are prepaid as permitted under the 2006 Credit Facility. The May 4, 2009 amendment also adjusted certain financial covenant ratios. The minimum required consolidated liquidity ratio was adjusted from 1.15 to 1.10 and the minimum required consolidated fixed charge coverage ratio was adjusted from 1.20 to 1.15.

On May 7, 2009, Sonic paid the holders of its 5.25% Convertible Notes $15.7 million in cash, issued $85.6 million in aggregate principal of 6.00% Convertible Notes (collectively, Series A notes of $78.9 million and Series B of $6.7 million) and issued 860,723 shares of its Class A common stock in full satisfaction of its obligations under the 5.25% Convertible Notes. Interest on the 6.00% Convertible Notes is payable semi-annually on May 1 and November 1 of each year, beginning November 1, 2009. The 6.00% Convertible Notes mature on May 15, 2012. Sonic may redeem some or all of the 6.00% Convertible Notes for cash at any time prior to May 1, 2010 at a redemption price equal to 100% of the principal amount. After May 1, 2010, but before May 1, 2011, Sonic may redeem some or all of the 6.00% Convertible Notes for cash at a redemption price equal to 106% of the principal amount. Beginning May 1, 2011 through the stated maturity of the notes, May 15, 2012, Sonic may redeem some or all of the 6.00% Convertible Notes for cash at a redemption price equal to 112% of the principal amount. The holders of the 6.00% Convertible Notes may require Sonic to redeem these notes at a redemption price equal to 100% of the principal amount on August 25, 2010 if Sonic has not refinanced at least 85% of its 4.25% Notes as of August 25, 2010. The holders of the 6.00% Convertible Notes may also require Sonic to redeem the 6.00% Convertible Notes at 100% of the principal amount in the event of a change in control.

If Sonic completes asset dispositions and after giving pro forma effect to the disposition of assets Sonic s borrowings under the revolving credit sub-facility do not exceed $25.0 million, Sonic s borrowing availability is at least $75.0 million and certain other conditions exist, Sonic is required to use 50% of the proceeds from asset dispositions to redeem all or portions of the 6.00% Convertible Notes at 100% of the principal amount.

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The 6.00% Convertible Notes are secured by a second priority lien on substantially all of Sonic s assets that secure the 2006 Credit Facility on a first priority basis, which excludes property financed by manufacturer-affiliated finance companies that are secured on a first priority basis by the financed property. The 6.00% Convertible Notes are fully and unconditionally guaranteed on a senior basis by substantially all of the direct and indirect operative domestic subsidiaries of Sonic. The 6.00% Convertible Notes are subject to covenants restricting additional indebtedness, liens, certain payments and transactions with affiliates, in each case, subject to exclusions, and other customary covenants.

The 6.00% Convertible Notes are convertible into shares of Class A common stock, at the option of the holder, on or after August 25, 2011. At such time, the holders of the Series A notes may convert their notes into Class A common stock representing approximately 19.9% of Sonic s outstanding shares of Class A common stock (after giving effect to the 857,614 share issued in connection with the restructuring of the 5.25% Convertible Notes and the shares into which Series B notes are convertible), which is based on the maximum number of shares that may be issued without requiring Sonic to seek shareholder authorization for the issuance of the 6.00% Convertible Notes. The Series A notes are subject to certain adjustments, including upon the issuance of certain securities in the future that are convertible at a per share price that is below market on the date of issuance or below $4.00. Only with respect to the Series A notes, upon receipt of shareholder approval, the conversion price shall be adjusted to $4.00 per share, or a conversion rate of 250 shares per $1,000 principal amount of Series A notes. Sonic has agreed to use its reasonable best efforts to cause to obtain, as promptly as practicable after the issue date, the necessary approval of the adjustment of the conversion price to $4.00 per share within 90 days, subject to an extension if the preliminary proxy statement in connection with the shareholder approval is reviewed by the Securities and Exchange Commission. Failure to obtain shareholder approval of the $4.00 conversion price will result in a default under the indenture governing the 6.00% Convertible Notes. Sonic s Chairman and Chief Executive Officer O. Bruton Smith, who directly and indirectly controls approximately 74.7% of the total voting power of Sonic, has announced that he will vote in favor of approving the full conversion rate for the 6.00% Convertible Notes at the special stockholders meeting called for that purpose.

Holders of the Series B notes may convert their notes on or after August 25, 2011, in multiples of $1,000 principal amount, into Class A common stock at a price per share of $8.00, or a conversion rate of 125 shares per $1,000 principal of the Series B notes. Any Series B note holder may elect to exchange its Series B notes for Series A notes for a like aggregate principal amount at any time after such Series B note holder receives notice from Sonic that a registration statement relating to such Series A notes has been declared effective.

Upon conversion of the 6.00% Convertible Notes, Sonic has the option to deliver the shares of Class A common stock into which the notes are converted or an amount in cash equal to the number of shares the holder is eligible to receive upon conversion multiplied by the average sale price per share of Sonic s Class A common stock for the five consecutive trading days immediately following the date of Sonic s notice of its election to deliver cash.

Sonic continues to explore options related to its other debt obligations with the assistance of a financial advisor. Sonic is evaluating restructuring options for $160.0 million principal amount outstanding of 4.25% Convertible Notes that we may be required to repurchase at the option of the holders on November 30, 2010 and its 2006 Credit Facility that matures February 17, 2010. Although Sonic believes it will be successful in refinancing these debt obligations to avoid events of default under one or more of these arrangements, Sonic cannot assure its investors that it will succeed in these efforts. A default under one or more of its debt arrangements, including the 2006 Credit Facility, could cause cross defaults of other debt, lease facilities and operating agreements, any of which could have a material adverse effect on Sonic s business, financial condition, liquidity, operations and ability to continue as a going concern.

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Sonic agreed under the 2006 Credit Facility not to pledge any assets to any third party (other than those explicitly allowed under the amended terms of the facility), including other lenders, subject to certain stated exceptions, including floor plan financing arrangements. In addition, the 2006 Credit Facility contains certain negative covenants, including covenants which could restrict or prohibit the payment of dividends, capital expenditures and material dispositions of assets as well as other customary covenants and default provisions. Financial covenants related to outstanding indebtedness and certain operating leases include required specified ratios of:

Covenant	Required	March 31, 2009 Actual
Consolidated liquidity ratio	≥ 1.15	1.16
Consolidated fixed charge coverage ratio	≥ 1.20	1.23
Consolidated total senior secured debt to EBITDA ratio	≤ 2.25	1.50
EBTDAR to rent ratio	≥ 1.50	1.61

7. Stock-Based Compensation

Sonic currently has two active stock compensation plans, the Sonic Automotive, Inc. 2004 Stock Incentive Plan (the 2004 Plan) and the 2005 Formula Restricted Stock Plan for Non-Employee Directors (the 2005 Formula Plan), and three inactive stock compensation plans which only have grants outstanding, the Sonic Automotive, Inc. Formula Stock Option Plan for Independent Directors, the Sonic Automotive, Inc. 1997 Stock Option Plan and the First America Automotive, Inc. 1997 Stock Option Plan (collectively, the Stock Plans). See Sonic s Annual Report on Form 10-K for the year ended December 31, 2008 for a more detailed description of the Stock Plans. A summary of the status of the options related to the Stock Plans is presented below:

	Options Outstanding (in thousands)	Exercise Price Per Share	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance - December 31, 2008	3,339	$ 7.80 - 37.50	$ 21.90	4.6	$
Granted	1,393	1.81	1.81		
Forfeited	(264)	$ 7.94 - 37.50	23.62		
Balance - March 31, 2009	4,468	$ 1.81 - 37.50	$ 15.54	6.1	$
Exercisable	2,996	$ 7.80 - 37.50	$ 21.58	4.2	$

(dollars in thousands, except per option amounts)	First Quarter Ended March 31, 2009
Weighted Average Grant-Date Fair Value Per Option of Options Granted	$ 0.99

The weighted average fair value of options granted in the first quarter ended March 31, 2009 was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2009
Stock Option Plans	

Dividend yield	0.00%
Risk free interest rate	1.67%
Expected life	5 years
Volatility	64.13%

Sonic used an expected term of five years for current year option grants based on observations of past grants and exercises. The historical exercise experience indicates that the expected term is at least three years (consistent with the three year graded vesting period attached to the majority of these options).

Expected volatility was estimated using Sonic s stock price over the last five years. Sonic recognized compensation expense related to stock options within selling, general and administrative expenses of $1.4 million and $0.1 million in the first quarter ended March 31, 2008 and 2009, respectively. Tax benefits recognized related to the compensation expenses

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were $0.5 million and $0.1 million for the first quarter ended March 31, 2008 and 2009, respectively. The total compensation cost related to unvested options not yet recognized at March 31, 2009 was $1.6 million and is expected to be recognized over a weighted average period of 2.7 years.

A summary of the status of restricted stock and restricted stock unit grants related to the Stock Plans is presented below:

	Unvested Restricted Stock and Restricted Stock Units (in thousands)	Weighted Average Grant Date Fair Value
Balance - December 31, 2008	348	$ 22.99
Vested	(57)	29.04
Balance - March 31, 2009	291	$ 21.82

Sonic recognized compensation expense related to restricted stock and restricted stock units of $1.0 million and $0.7 million in the first quarter ended March 31, 2008 and 2009, respectively. Sonic recognized $0.4 million and $0.3 million of tax benefit related to the compensation expenses for the first quarter ended March 31, 2008 and 2009. Total compensation cost related to unvested restricted stock and restricted stock units not yet recognized at March 31, 2009 was $1.8 million, and is expected to be recognized over a weighted average period of 1.1 years.

8. Per Share Data and Stockholders Equity

The calculation of diluted earnings per share considers the potential dilutive effect of Sonic s contingently convertible debt issuances and stock options to purchase shares of Class A common stock under the Stock Plans. The following table illustrates the dilutive effect of such items:

	For the First Quarter Ended March 31, 2008						
		Income From Continuing Operations		Loss From Discontinued Operations		Net Income	
	Shares	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(dollars in thousands except per share amounts)						
Basic Earnings (Loss) Per Share	40,774	$ 13,936	$ 0.34	$ (1,311)	$ (0.03)	$ 12,625	$ 0.31
Effect of Dilutive Securities:							
Stock Plans	295						
Diluted Earnings (Loss) Per Share	41,069	$ 13,936	$ 0.34	$ (1,311)	$ (0.03)	$ 12,625	$ 0.31

	For the First Quarter Ended March 31, 2009						
		Income From Continuing Operations		Loss From Discontinued Operations		Net Income	
	Shares	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(dollars in thousands except per share amounts)						

Basic Earnings (Loss) Per Share	40,099	$	3,987	$	0.10	$	(2,309)	$	(0.06)	$	1,678	$	0.04
Effect of Dilutive Securities:													
Stock Plans	239												
Diluted Earnings (Loss) Per Share	40,338	$	3,987	$	0.10	$	(2,309)	$	(0.06)	$	1,678	$	0.04

In addition to the stock options included in the table above, options to purchase 2.4 million shares and 3.1 million shares of Class A common stock were outstanding at March 31, 2008 and 2009, respectively, but were not included in the computation of diluted earnings per share because the options were not dilutive.

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9. CONTINGENCIES

Legal and Other Proceedings:

Sonic is a defendant in the matter of Galura, et al. v. Sonic Automotive, Inc., a private civil action filed in the Circuit Court of Hillsborough County, Florida. In this action, originally filed on December 30, 2002, the plaintiffs allege that Sonic and its Florida dealerships sold an antitheft protection product in a deceptive or otherwise illegal manner, and further sought representation on behalf of any customer of any of our Florida dealerships who purchased the antitheft protection product since December 30, 1998. The plaintiffs are seeking monetary damages and injunctive relief on behalf of this class of customers. In June 2005, the court granted the plaintiffs motion for certification of the requested class of customers, but the court has made no finding to date regarding actual liability in this lawsuit. Sonic subsequently filed a notice of appeal of the court s class certification ruling with the Florida Court of Appeals. In April 2007, the Florida Court of Appeals affirmed a portion of the trial court s class certification and overruled a portion of the trial court s class certification. Sonic intends to continue its vigorous appeal and defense of this lawsuit and to assert available defenses. However, an adverse resolution of this lawsuit could result in the payment of significant costs and damages, which could have a material adverse effect on Sonic s future results of operations, financial condition and cash flows.

Several private civil actions have been filed against Sonic Automotive, Inc. and several of its dealership subsidiaries that purport to represent classes of customers as potential plaintiffs and make allegations that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. One of these private civil actions has been filed in South Carolina state court against Sonic Automotive, Inc. and 10 of Sonic s South Carolina subsidiaries. This group of plaintiffs attorneys has filed another private civil class action lawsuit in state court in North Carolina seeking certification of a multi-state class of plaintiffs. The South Carolina state court action and the North Carolina state court action have since been consolidated into a single proceeding in private arbitration. On November 12, 2008, claimants in the consolidated arbitration filed a Motion for Class Certification as a national class action including all of the states in which Sonic operates dealerships, excluding California and Florida. Claimants are seeking monetary damages and injunctive relief on behalf of this class of customers. Sonic is aggressively opposing claimants Motion for Class Certification, and intends to continue its vigorous defense of this arbitration. However, an adverse resolution of this arbitration could result in the payment of significant costs and damages, which could have a material adverse effect on Sonic s future results of operations, financial condition and cash flows.

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. Included in other accrued liabilities at December 31, 2008 and March 31, 2009 were $9.0 million in reserves that Sonic has provided for pending proceedings.

Guarantees and Indemnifications:

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 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 estimates that the maximum exposure associated with these general indemnifications if the counterparties failed to perform under their contractual obligations was approximately $15.9 million and $11.9 million at December 31, 2008 and March 31, 2009, respectively. These indemnifications generally expire within a period of one to three years following the date of sale. The estimated fair value of these indemnifications was not material.

10. FAIR VALUE MEASUREMENTS

In determining fair value, Sonic uses various valuation approaches including market, income and/or cost approaches. SFAS 157 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

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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 fair value and cash flow swap instruments.

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 under Financial Accounting Standards No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* and those used in the reporting unit valuation in the first step of the annual goodwill impairment evaluation. For instance, certain assets held for sale in the accompanying condensed consolidated balance sheets are valued based on estimated proceeds to be received in connection with the disposal of those assets.

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 instruments 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 or liabilities recorded at fair value in the accompanying balance sheet as of March 31, 2009 are as follows:

		Fair Value at Reporting Date Using:		
(dollars in millions)	**Total**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Trading Securities (1)	2.5	$ 2.5	$	$
Cash Flow Swaps (2)	(18.2)		(18.2)	
Total	$ (15.7)	$ 2.5	$ (18.2)	$

(1) - Included within other current assets in the accompanying balance sheet

(2) - Included net of taxes of $6.7 million in accumulated other comprehensive income in the accompanying balance sheet

During the first quarter ended March 31, 2008 and 2009, Sonic recorded unrealized losses related to trading securities in the amount of $0.2 million and $0.2 million, respectively. These losses are included within selling, general and administrative expenses in the accompanying Condensed Consolidated Statements of Income.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

During the first quarter ended March 31, 2009, Sonic settled its $100 million notional, pay 5.002% and $100 million notional, pay 5.319% swaps with a payment to the counterparty of $16.5 million. This settlement loss was deferred and will be amortized into earnings over the swaps initial remaining term.

As of December 31, 2008 and March 31, 2009, the fair values of Sonic s financial instruments including receivables, notes receivable from finance contracts, notes payable-floor plan, trade accounts payable, payables for acquisitions and long-term debt, excluding Sonic s 8.625% Notes, 5.25% Convertible Notes, 4.25% Convertible Notes, mortgage notes and certain notes payable to a finance company, approximate their carrying values due either to length of maturity or existence of variable interest rates that approximate prevailing market rates.

The fair value and carrying value of Sonic s fixed rate long-term debt was as follows:

	(dollars in thousands)			
	December 31, 2008		March 31, 2009	
	Fair Value	Carrying Value	Fair Value	Carrying Value
8.625% Senior Subordinated Notes (1)	$ 104,500	$ 273,116	$ 79,750	$ 273,196
5.25% Convertible Senior Subordinated Notes (1) (3)	$ 97,883	$ 102,990	$ 53,678	$ 104,366
4.25% Convertible Senior Subordinated Notes (1) (3)	$ 53,600	$ 147,538	$ 34,400	$ 149,065
Mortgage Notes	$ 80,530	$ 80,622	$ 79,986	$ 80,078
Notes Payable to a Finance Company (2)	$ 18,629	$ 22,946	$ 18,211	$ 22,281

(1) As determined by market quotations.

(2) As determined by discounted cash flows.

(3) Adjusted for effect of FSP APB 14-1 (See Note 1).

11. SUBSEQUENT EVENTS

See Notes 1 and 6 which discuss restructuring of the 5.25% Convertible Notes and an amendment to the 2006 Credit Facility subsequent to March 31, 2009.

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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 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 the related notes thereto appearing elsewhere in this report, as well as the audited financial statements and related notes 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, 2008.

Overview

We are one of the largest automotive retailers in the United States. As of March 31, 2009, we operated 164 dealership franchises, representing 33 different brands of cars and light trucks, at 135 locations and 31 collision repair centers in 15 states. Our dealerships provide comprehensive services including sales of both new and used cars and light trucks, sales of replacement parts, performance of vehicle maintenance, manufacturer warranty repairs, paint and collision repair services, and arrangement of extended service contracts, financing, insurance and other aftermarket products for our customers.

Economic Conditions

Beginning near the end of the second quarter of 2008 and continuing into and throughout the first quarter of 2009, the automobile retailing industry was severely negatively affected by prevailing economic conditions. The uncertainty that exists related to the overall economy in the United States continues through the date of this report. As discussed in the paragraphs that follow, the demand for new and used vehicles has declined significantly and has negatively impacted our results of operations. Due to the turmoil in the financial services industry, the availability of credit has declined substantially for all consumers except those with high credit scores. Our business is cyclical in nature and dependent on consumer confidence and the availability of consumer credit. Typical sources of financing, including captive finance companies associated with vehicle manufacturers, have also reduced the amount of credit available. The lack of liquidity resulting from the financial services industry crisis has also negatively affected our ability to refinance our debt obligations in 2009 and 2010. We cannot predict when an economic recovery will begin and the timing of its impact on our business.

On April 30, 2009, Chrysler LLC filed for bankruptcy protection and submitted a plan of reorganization. As of April 30, 2009, we owned nine Chrysler franchises located at three dealerships. As a result of the bankruptcy filing, we may be required to record impairment charges related to related lease obligations, fixed assets, accounts receivable and inventory. Currently, we cannot estimate the effect this bankruptcy filing may have on our financial results and condition.

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General Motors has been provided government assistance and may require additional governmental assistance in 2009 to avoid seeking bankruptcy protection. In addition, there can be no assurances that Ford will not need government assistance in the future to continue its operations. Each of these manufacturers would need debtor-in-possession financing to emerge from bankruptcy which may be challenging to obtain without additional assistance from the government. The bankruptcy of General Motors or Ford could have a material adverse impact on our financial results and condition. In the event a manufacturer enters bankruptcy protection, we may be required to record impairment charges related to related franchise assets, fixed assets, accounts receivable and inventory. At March 31, 2009, we had the following balances recorded related to domestic manufacturers:

	(dollars in millions) March 31, 2009
General Motors	
New Vehicle Inventory	$ 131.6
Parts Inventory	11.5
Factory Receivables	7.2
Property and Equipment, net	24.6
Franchise Assets	17.2
Ford (including Volvo)	
New Vehicle Inventory	75.9
Parts Inventory	4.3
Factory Receivables	3.7
Property and Equipment, net	9.4
Franchise Assets	2.2
Chrysler	
New Vehicle Inventory	12.5
Parts Inventory	1.3
Factory Receivables	0.5
Property and Equipment, net	1.5
Franchise Assets	

In addition, additional goodwill impairment charges related to our single reporting unit or impairment charges related to our operating lease arrangements may also be necessary. These events may affect our ability to remain in compliance with the financial covenants under our debt and operating leases agreements.

In addition, we rely on the manufacturer captive finance companies associated with these domestic manufacturers for new vehicle floor plan financing. The bankruptcy of any of these domestic manufacturers could result in an attempt by the related captive finance company to terminate our floor plan financing, which would have a material adverse impact on our operations and liquidity. Also, in the event of bankruptcy, there can be no assurances that warranties provided by the domestic manufacturers will be honored, that parts and services will be available to repair and maintain vehicles or that consumer demand for new vehicle from these manufacturers will not be negatively affected.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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

Results of Operations

Except where otherwise noted, the following discussions are on a same store basis.

New Vehicles

The automobile retail industry uses the Seasonally Adjusted Annual Rate (SAAR) to measure the amount of 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, including brands we do not sell.

	First Quarter Ended March 31,		
	2008	2009	% Change
SAAR (in millions of vehicles)	15.2	9.5	(37.5%)

Our reported and same store new vehicle results are as follows:

	First Quarter Ended March 31,		Better / (Worse)	
(in thousands except units and per unit data)	2008	2009	Change	% Change
Reported:				
Revenue	$ 897,679	$ 590,266	$ (307,413)	(34.2%)
Gross profit	$ 61,374	$ 40,002	$ (21,372)	(34.8%)
Unit sales	26,525	17,444	(9,081)	(34.2%)
Revenue per Unit	$ 33,843	$ 33,838	$ (5)	(0.0%)
Gross profit per unit	$ 2,314	$ 2,293	$ (21)	(0.9%)
Gross profit as a % of revenue	6.8%	6.8%	bps	

	First Quarter Ended March 31,		Better / (Worse)	
(in thousands except units and per unit data)	2008	2009	Change	% Change
Same Store:				
Revenue	$ 897,679	$ 587,069	$ (310,610)	(34.6%)
Gross profit	$ 61,559	$ 38,956	$ (22,603)	(36.7%)
Unit sales	26,525	17,391	(9,134)	(34.4%)
Revenue per unit	$ 33,843	$ 33,757	$ (86)	(0.3%)
Gross profit per unit	$ 2,321	$ 2,240	$ (81)	(3.5%)
Gross profit as a % of revenue	6.9%	6.6%	(30)bps	

For the first quarter ended March 31, 2009, new vehicle revenues declined from the same period in the prior year due primarily to lower unit volume. The decline in new unit volume we experienced was relatively consistent with the decline in SAAR. Our import and domestic stores both experienced declines in new vehicle revenues compared to the prior year with our import stores declining $217.9 million, or 31.2%, and our domestic stores declining $92.7 million, or 46.5%.

New vehicle unit volume decreased at our import stores by 5,922 units, or 29.5%. The decline in import new vehicle unit sales was led by our Toyota, Honda, and BMW stores, which posted declines of 1,758 units, or 37.3%, 1,633 units, or 34.2%, and 1,004 units, or 24.0%, respectively. Both our Toyota and Honda stores tracked closely to the industry declines while our BMW stores slightly outperformed the BMW industry decline. New vehicle unit volume decreased at our domestic stores by 3,212 units, or 49.8%, compared to the prior year. Our GM stores, excluding Cadillac, and Ford stores declined by 1,768 units, or 49.5%, and 958 units, or 51.6%, respectively. The decline in our GM new vehicle

unit volume was the result of a sharp decline in fleet unit volume, decreasing 1,095 units, or 80.4%. Both our GM and Ford stores, which declined 48.8% and 43.0%, respectively, underperformed their respective brand markets. New vehicle unit volume declines are concentrated primarily within our California markets. Approximately 30.8% of our same store new vehicle unit volume was generated from our California markets. We expect the new vehicle market to continue to be challenging at least through the end of the current year.

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Decreases in same store new vehicle gross profit for the first quarter ended March 31, 2009 compared to the same period in the prior year were primarily due to the mix of vehicles retailed.

Used Vehicles

Our reported and same store used vehicle results are as follows:

	First Quarter Ended March 31,		Better / (Worse)	
(in thousands except units and per unit data)	**2008**	**2009**	**Change**	**% Change**
Reported:				
Revenue	$ 320,713	$ 290,256	$ (30,457)	(9.5%)
Gross profit	$ 29,782	$ 27,248	$ (2,534)	(8.5%)
Unit sales	15,782	15,155	(627)	(4.0%)
Revenue per Unit	$ 20,321	$ 19,152	$ (1,169)	(5.8%)
Gross profit per unit	$ 1,887	$ 1,798	$ (89)	(4.7%)
Gross profit as a % of revenue	9.3%	9.4%	10bps	
CPO revenue	$ 159,657	$ 162,883	$ 3,226	2.0%
CPO unit sales	6,049	6,513	464	7.7%
CPO revenue per unit	$ 26,394	$ 25,009	$ (1,385)	(5.2%)
CPO gross profit per unit	$ 1,561	$ 1,463	$ (98)	(6.3%)
CPO gross profit as % of revenue	5.9%	5.8%	(10)bps	

	First Quarter Ended March 31,		Better / (Worse)	
(in thousands except units and per unit data)	**2008**	**2009**	**Change**	**% Change**
Same Store:				
Revenue	$ 320,713	$ 289,304	$ (31,409)	(9.8%)
Gross profit	$ 29,035	$ 27,704	$ (1,331)	(4.6%)
Unit sales	15,782	15,110	(672)	(4.3%)
Revenue per unit	$ 20,321	$ 19,147	$ (1,174)	(5.8%)
Gross profit per unit	$ 1,840	$ 1,833	(7)	(0.4%)
Gross profit as a % of revenue	9.1%	9.6%	50bps	
CPO revenue	$ 159,657	$ 162,485	$ 2,828	1.8%
CPO unit sales	6,049	6,497	448	7.4%
CPO revenue per unit	$ 26,394	$ 25,009	$ (1,385)	(5.2%)
CPO gross profit per unit	$ 1,561	$ 1,463	$ (98)	(6.3%)
CPO gross profit as % of revenue	5.9%	5.9%	0bps	

For the first quarter ended March 31, 2009, used vehicle revenues declined as compared to the same period in 2008 as a result of a decrease in unit volume and a decrease in average retail unit price. Used vehicle unit volumes and revenue per unit were lower in the first quarter of 2009 versus the first quarter of 2008 primarily due to the unfavorable economic conditions that existed in the first quarter of 2009, the strong sales volume experienced in the first quarter of 2008 and the result of our decision to reduce our used inventory levels due to unstable used vehicle values. We continue to see improvements in our certified pre-owned (CPO) unit volume. On a same store basis, CPO units increased from 6,049 units, or 38.3% of total used retail units, for the first quarter ended March 31, 2008, to 6,497 units, or 43.0% of total used retail units for the first quarter ended March 31, 2009.

Used vehicle gross profit per unit declined due to economic softness and a shift toward smaller more fuel efficient vehicles. However, gross profit as a percent of revenue for used vehicles increased in the first quarter ended March 31, 2009 compared to the same prior year period primarily due to the continued implementation of our standardized used vehicle merchandising process. We believe this process allows us to

price our used vehicles more competitively and physically move certain used vehicles to specific dealerships within a particular region that have shown success in retailing the specific type of used vehicle.

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SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

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Wholesale Vehicles

Our wholesale vehicle reported and same store results are as follows:

(in thousands except units and per unit data)	First Quarter Ended March 31, 2008	2009	Better / (Worse) Change	% Change
Reported:				
Revenue	$ 69,966	$ 32,180	$ (37,786)	(54.0%)
Gross profit	$ (1,062)	$ (134)	$ 928	87.4%
Unit sales	8,342	5,362	(2,980)	(35.7%)
Revenue per Unit	$ 8,387	$ 6,001	$ (2,386)	(28.4%)
Gross profit per unit	$ (127)	$ (25)	$ 102	80.3%
Gross profit as a % of revenue	(1.5%)	(0.4%)	110bps	

(in thousands except units and per unit data)	First Quarter Ended March 31, 2008	2009	Better / (Worse) Change	% Change
Same Store:				
Revenue	$ 69,966	$ 32,162	$ (37,804)	(54.0%)
Gross profit	$ (1,062)	$ (134)	$ 928	87.4%
Unit sales	8,342	5,360	(2,982)	(35.7%)
Revenue per unit	$ 8,387	$ 6,000	$ (2,387)	(28.5%)
Gross profit per unit	$ (127)	$ (25)	$ 102	80.3%
Gross profit as a % of revenue	(1.5%)	(0.4%)	110bps	

Lower wholesale vehicle revenues during the first quarter ended March 31, 2009 resulted from a decline in wholesale unit volume coupled with a decrease in average wholesale price per unit. The decrease in wholesale unit volume and wholesale price per unit can be primarily attributed to fewer vehicles received in trades for new and used vehicles due to declines in overall retail activity. In addition, fewer units were sold through wholesale channels as a result of our efforts to sell vehicles we historically would have wholesaled through our retail channel.

Wholesale vehicles gross margin percentage increased compared to the same period in the prior year due to an increase in gross profit per unit. This increase can be attributed to the higher market value of wholesale vehicles as consumer preferences have shifted from new retail vehicles to the purchase of pre-owned vehicles.

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Parts, Service and Collision Repair (Fixed Operations)

Our reported and same store Fixed Operations results are as follows:

	First Quarter Ended March 31,		Better / (Worse)	
(in thousands)	**2008**	**2009**	**Change**	**% Change**
Reported:				
Revenue				
Parts	$ 134,443	$ 131,650	$ (2,793)	(2.1%)
Service	102,667	97,306	(5,361)	(5.2%)
Collision Repair	12,877	11,768	(1,109)	(8.6%)
Total	$ 249,987	$ 240,724	$ (9,263)	(3.7%)
Gross profit				
Parts	$ 45,868	$ 44,096	$ (1,772)	(3.9%)
Service	71,007	68,425	(2,582)	(3.6%)
Collision Repair	7,261	6,634	(627)	(8.6%)
Total	$ 124,136	$ 119,155	$ (4,981)	(4.0%)
Gross profit as a % of revenue				
Parts	34.1%	33.5%	(60)bps	
Service	69.2%	70.3%	110bps	
Collision Repair	56.4%	56.4%	0bps	
Total	49.7%	49.5%	(20)bps	

	First Quarter Ended March 31,		Better / (Worse)	
(in thousands)	**2008**	**2009**	**Change**	**% Change**
Same Store:				
Revenue				
Parts	$ 134,280	$ 130,713	$ (3,567)	(2.7%)
Service	102,667	96,603	(6,064)	(5.9%)
Collision Repair	12,876	11,769	(1,107)	(8.6%)
Total	$ 249,823	$ 239,085	$ (10,738)	