

SONIC AUTOMOTIVE INC
Form 10-Q
July 27, 2018

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from _____ to _____

Commission File Number: 1-13395

SONIC AUTOMOTIVE, INC.

(Exact name of registrant as specified in its charter)

Delaware 56-2010790
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) 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 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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

Exchange Act.

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

As of July 25, 2018, there were 30,682,181 shares of the registrant's Class A common stock and 12,029,375 shares of the registrant's Class B common stock outstanding.

Uncertainty of Forward-Looking Statements and Information

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

These forward-looking statements are based on our current estimates and assumptions and involve various risks and uncertainties. As a result, you are cautioned that these forward-looking statements are not guarantees of future performance, and that actual results could differ materially from those projected in these forward-looking statements. Factors which may cause actual results to differ materially from our projections include those risks described in “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2017 and elsewhere in this report, as well as:

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

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

SONIC AUTOMOTIVE, INC.
FORM 10-Q
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2018
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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

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

Three Months Ended June 30, 2018 Six Months Ended June 30, 2018
2017 2017
(Dollars and shares in thousands, except per share amounts)

Revenues:				
New vehicles	\$1,238,571	\$1,275,069	\$2,419,416	\$2,447,001
Used vehicles	762,572	641,891	1,471,618	1,276,364
Wholesale vehicles	53,748	40,765	119,148	87,076
Total vehicles	2,054,891	1,957,725	4,010,182	3,810,441
Parts, service and collision repair	346,754	361,113	698,512	713,156
Finance, insurance and other, net	104,104	86,908	197,829	169,971
Total revenues	2,505,749	2,405,746	4,906,523	4,693,568
Cost of Sales:				
New vehicles	(1,181,303)	(1,212,547)	(2,305,349)	(2,326,201)
Used vehicles	(725,263)	(601,856)	(1,397,538)	(1,195,497)
Wholesale vehicles	(57,105)	(42,682)	(126,929)	(90,163)
Total vehicles	(1,963,671)	(1,857,085)	(3,829,816)	(3,611,861)
Parts, service and collision repair	(179,703)	(188,043)	(361,833)	(370,742)
Total cost of sales	(2,143,374)	(2,045,128)	(4,191,649)	(3,982,603)
Gross profit	362,375	360,618	714,874	710,965
Selling, general and administrative expenses	(277,462)	(293,931)	(582,387)	(586,165)
Impairment charges	(10,317)	(2,605)	(13,960)	(3,115)
Depreciation and amortization	(23,949)	(21,911)	(47,692)	(43,065)
Operating income (loss)	50,647	42,171	70,835	78,620
Other income (expense):				
Interest expense, floor plan	(11,945)	(9,144)	(22,622)	(17,531)
Interest expense, other, net	(13,375)	(12,764)	(26,831)	(26,172)
Other income (expense), net	17	7	106	(14,495)
Total other income (expense)	(25,303)	(21,901)	(49,347)	(58,198)
Income (loss) from continuing operations before taxes	25,344	20,270	21,488	20,422
Provision for income taxes for continuing operations - benefit (expense)	(8,222)	(7,956)	(6,380)	(8,128)
Income (loss) from continuing operations	17,122	12,314	15,108	12,294
Discontinued operations:				
Income (loss) from discontinued operations before taxes	(297)	(301)	(545)	(1,168)
Provision for income taxes for discontinued operations - benefit (expense)	80	119	148	465
Income (loss) from discontinued operations	(217)	(182)	(397)	(703)
Net income (loss)	\$16,905	\$12,132	\$14,711	\$11,591
Basic earnings (loss) per common share:				
Earnings (loss) per share from continuing operations	\$0.40	\$0.28	\$0.35	\$0.27

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Earnings (loss) per share from discontinued operations	—	(0.01) (0.01) (0.01)
Earnings (loss) per common share	\$0.40	\$0.27	\$0.34	\$0.26	
Weighted average common shares outstanding	42,662	44,570	42,725	44,680	
Diluted earnings (loss) per common share:					
Earnings (loss) per share from continuing operations	\$0.40	\$0.27	\$0.35	\$0.27	
Earnings (loss) per share from discontinued operations	(0.01) —	(0.01) (0.01)
Earnings (loss) per common share	\$0.39	\$0.27	\$0.34	\$0.26	
Weighted average common shares outstanding	42,920	44,810	42,948	44,976	
Dividends declared per common share	\$0.06	\$0.05	\$0.12	\$0.10	

See notes to condensed consolidated financial statements.

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

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2018	2017	2018	2017
	(Dollars in thousands)			
Net income (loss)	\$16,905	\$12,132	\$14,711	\$11,591
Other comprehensive income (loss) before taxes:				
Change in fair value of interest rate swap and interest rate cap agreements	1,197	42	5,203	2,144
Provision for income tax benefit (expense) related to components of other comprehensive income (loss)	(326)	(16)	(1,418)	(815)
Other comprehensive income (loss)	871	26	3,785	1,329
Comprehensive income (loss)	\$17,776	\$12,158	\$18,496	\$12,920

See notes to condensed consolidated financial statements.

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

	June 30, 2018	December 31, 2017
	(Dollars in thousands)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$8,154	\$6,352
Receivables, net	347,847	482,126
Inventories	1,527,661	1,512,745
Other current assets	26,033	18,574
Total current assets	1,909,695	2,019,797
Property and Equipment, net	1,162,786	1,146,881
Goodwill	510,160	525,780
Other Intangible Assets, net	72,109	74,589
Other Assets	50,064	51,471
Total Assets	\$3,704,814	\$3,818,518
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Notes payable - floor plan - trade	\$744,500	\$804,238
Notes payable - floor plan - non-trade	720,233	709,098
Trade accounts payable	111,128	129,903
Accrued interest	12,435	12,316
Other accrued liabilities	221,180	237,963
Current maturities of long-term debt	37,786	61,314
Total current liabilities	1,847,262	1,954,832
Long-Term Debt	933,128	963,389
Other Long-Term Liabilities	87,558	61,918
Deferred Income Taxes	49,886	51,619
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; 64,126,133 shares issued and 30,682,181 shares outstanding at June 30, 2018; 63,456,698 shares issued and 31,166,205 shares outstanding at December 31, 2017	641	635
Class B common stock, \$0.01 par value; 30,000,000 shares authorized; 12,029,375 shares issued and outstanding at June 30, 2018 and December 31, 2017	121	121
Paid-in capital	739,212	732,854
Retained earnings	638,895	625,356
Accumulated other comprehensive income (loss)	5,092	1,307
Treasury stock, at cost; 33,443,952 Class A common stock shares held at June 30, 2018 and 32,290,493 Class A common stock shares held at December 31, 2017	(596,981)	(573,513)
Total Stockholders' Equity	786,980	786,760
Total Liabilities and Stockholders' Equity	\$3,704,814	\$3,818,518

See notes to condensed consolidated financial statements.

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

	Class A Common Stock		Class A Treasury Stock		Class B Common Stock		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
(Dollars in thousands)										
Balance at December 31, 2017	63,457	\$ 635	(32,290)	\$(573,513)	12,029	\$ 121	\$732,854	\$625,356	\$ 1,307	\$ 786,760
Shares awarded under stock compensation plans	669	6	—	—	—	—	347	—	—	353
Purchases of treasury stock	—	—	(1,154)	(23,468)	—	—	—	—	—	(23,468)
Change in fair value of interest rate swap and interest rate cap agreements, net of tax expense of \$1,418	—	—	—	—	—	—	—	—	3,785	3,785
Restricted stock amortization	—	—	—	—	—	—	6,011	—	—	6,011
Net income (loss)	—	—	—	—	—	—	—	14,711	—	14,711
Cumulative effect of change in accounting principle (1)	—	—	—	—	—	—	—	3,918	—	3,918
Dividends declared	—	—	—	—	—	—	—	(5,090)	—	(5,090)
Balance at June 30, 2018	64,126	\$ 641	(33,444)	\$(596,981)	12,029	\$ 121	\$739,212	\$638,895	\$ 5,092	\$ 786,980

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

See notes to condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2018	2017
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$14,711	\$11,591
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	47,689	43,062
Provision for bad debt expense	283	495
Other amortization	310	325
Debt issuance cost amortization	1,217	1,193
Debt discount amortization, net of premium amortization	—	99
Stock-based compensation expense	6,011	5,723
Deferred income taxes	(6,188)	182
Net distributions from equity investee	162	190
Asset impairment charges	13,960	3,115
Loss (gain) on disposal of dealerships and property and equipment	(41,439)	(67)
Loss (gain) on exit of leased dealerships	2,564	1,827
Loss (gain) on retirement of debt	—	14,607
Changes in assets and liabilities that relate to operations:		
Receivables	151,391	144,029
Inventories	(73,100)	(51,637)
Other assets	500	(19,837)
Notes payable - floor plan - trade	(59,738)	(48,282)
Trade accounts payable and other liabilities	(20,225)	(13,732)
Total adjustments	23,397	81,292
Net cash provided by (used in) operating activities	38,108	92,883
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of land, property and equipment	(99,602)	(121,222)
Proceeds from sales of property and equipment	12,584	291
Proceeds from sales of dealerships	122,404	—
Net cash provided by (used in) investing activities	35,386	(120,931)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (repayments) borrowings on notes payable - floor plan - non-trade	11,135	3,722
Borrowings on revolving credit facilities	514,915	44,017
Repayments on revolving credit facilities	(572,519)	(44,017)
Proceeds from issuance of long-term debt	21,072	282,458
Debt issuance costs	(131)	(4,512)
Principal payments and repurchase of long-term debt	(18,344)	(11,051)
Repurchase of debt securities	—	(210,914)
Purchases of treasury stock	(23,468)	(25,948)
Issuance of shares under stock compensation plans	353	46
Dividends paid	(4,705)	(4,481)
Net cash provided by (used in) financing activities	(71,692)	29,320
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,802	1,272

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CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	6,352	3,108
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$8,154	\$4,380

SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:

Change in fair value of interest rate swap and interest rate cap agreements (net of tax expense of \$1,418 and \$815 in the six months ended June 30, 2018 and 2017, respectively)	\$3,785	\$1,329
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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: