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

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): November 3, 2005

SONIC AUTOMOTIVE, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation)

1-13395	**56-201079**
(Commission File Number)	**(IRS Employer Identification No.)**
6415 Idlewild Road, Suite 109 **Charlotte, North Carolina**	**28212**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code: (704) 566-2400

N/A
(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02. Results of Operations and Financial Condition

Sonic Automotive, Inc. ("Sonic") is filing this Current Report on Form 8-K to reflect the reclassifications of franchises between discontinued and continuing operations in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Although the information in this Current Report is being furnished to the Securities and Exchange Commission (the "Commission") under Items 2.02 and 9.01 of Form 8-K, we are hereby incorporating this Current Report by reference into our existing and future prospectuses, registration statements and other filings with the Commission under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

During 2004, Sonic sold four franchises and terminated three franchises and as of December 31, 2004 had approved, but not yet completed, the disposition of 24 additional franchises. In accordance with the provisions of SFAS No. 144, the results of operations of these franchises for the years ended December 31, 2002, 2003 and 2004 were reported as discontinued operations in Sonic's Annual Report on Form 10-K filed for the year ended December 31, 2004.

In the first nine months of 2005, Sonic added 12 additional franchises to assets held for sale, sold six of those franchises and sold eight of the 24 franchises held for sale at December 31, 2004. Therefore, as of September 30, 2005, Sonic had 22 franchises classified as held for sale. In accordance with the provisions of SFAS No. 144, the results of operations of these franchises that were identified for sale subsequent to December 31, 2004 were removed from the results of continuing operations and were included in the results of discontinued operations in Sonic's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2005.

This Current Report on Form 8-K updates certain financial information for the years ended December 31, 2002, 2003 and 2004 presented in Items 1, 3, 6, 7, 7A and 15(a) of the 2004 10-K to reflect the reclassifications of franchises to discontinued operations from continuing operations as discussed above. Other reclassifications, including reclassifications made to the consolidated statements of cash flows in accordance with SFAS No. 95, "Statement of Cash Flows", are described in Note 1 to the consolidated financial statements as presented in Exhibit 99.1 to this Current Report. These reclassifications had no effect on Sonic's:

- reported net income or net income per share;
- statements of stockholders' equity; and
- liquidity and capital resources for these periods.

The updated financial information is set forth in Exhibit 99.1 to this Current Report. Unless otherwise noted, the information in this Current Report and the exhibits filed here with is as of the date of this Current Report.

Item 9.01: Financial Statements and Exhibits.

(c) Exhibits

Exhibit No.	Description
12.1	Computation of Ratio of Earnings to Fixed Charges
23.1	Consent of Deloitte & Touche LLP
99.1	Reclassified financial information for the years ended December 31, 2002, 2003 and 2004 in accordance with the provisions of SFAS No. 144
99.2	Risk Factors

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this to be signed on its behalf by the undersigned hereunto duly authorized.

SONIC AUTOMOTIVE, INC.

By: /s/ Greg D. Young

Greg D. Young
Chief Accounting Officer
(principal accounting officer)

Dated: November 3, 2005

EXHIBIT INDEX

Attached as exhibits to this form are the documents listed below:

Exhibit	Document
12.1	Computation of Ratio of Earnings to Fixed Charges
23.1	Consent of Deloitte & Touche LLP
99.1	Reclassified financial information for the years ended December 31, 2002, 2003 and 2004 in accordance with the provisions of SFAS No. 144
99.2	Risk Factors

Exhibit 12.1

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

	Year Ended December 31,					Nine Months Ended September 30,	
	2000	2001	2002	2003	2004	2004	2005
	(dollars in thousands)						
Fixed charges:							
Interest expense, other	$ 39,468	$ 33,261	$ 40,810	$ 41,480	$ 42,436	$ 31,277	$ 34,445
Rent expense (interest factor)	13,958	16,476	18,853	21,901	26,217	19,245	22,636
Total fixed charges	53,426	49,737	59,663	63,381	68,653	50,522	57,081
Income from continuing operations before income taxes and cummulative effect of change in accounting principle	108,229	130,397	172,564	129,440	150,461	117,319	123,200
Income from continuing operations before income taxes and cummulative effect of change in accounting principle & fixed charges	$ 161,655	$ 180,134	$ 232,227	$ 192,821	$ 219,114	$ 167,841	$ 180,281
Ratio of earnings to fixed charges	3.0x	3.6x	3.9x	3.0x	3.2x	3.3x	3.2x

INDEPENDENT AUDITORS' CONSENT

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the following Registration Statements of Sonic Automotive, Inc.:

Registration Statement No. 333-82615 on Form S-3;
Registration Statement No. 333-81059 on Form S-8;
Post-Effective Amendment No. 1 to the Registration Statement No. 333-81059 on Form S-8;
Registration Statement No. 333-81053 on Form S-8;
Post-Effective Amendment No. 1 to the Registration Statement No. 333-81053 on Form S-8;
Registration Statement No. 333-71803 on Form S-3;
Registration Statement No. 333-77407 on Form S-3MEF;
Registration Statement No. 333-69907 on Form S-8;
Registration Statement No. 333-69899 on Form S-8;
Registration Statement No. 333-68183 on Form S-3;
Registration Statement No. 333-65447 on Form S-8;
Registration Statement No. 333-49113 on Form S-8;
Registration Statement No. 333-96023 on Form S-3;
Registration Statement No. 333-51978 on Form S-4;
Registration Statement No. 333-50430 on Form S-3; and Nos. 333-50430-01 through 333-50430-G7;
Registration Statement No. 333-69901 on Form S-8;
Post-Effective Amendment No. 2 to the Registration Statement No. 333-69901 on Form S-8;
Registration Statement No. 333-95791 on Form S-8;
Post-Effective Amendment No. 1 to the Registration Statement No. 333-95791 on Form S-8;
Registration Statement No. 333-46272 on Form S-8;
Post-Effective Amendment No. 1 to the Registration Statement No. 333-46272 on Form S-8;
Registration Statement No. 333-46274 on Form S-8;
Post-Effective Amendment No. 1 to the Registration Statement No. 333-46274 on Form S-8;
Registration Statement No. 333-86672 and Nos. 333-86672-01 through 333-86672-216 on Form S-3;
Registration Statement No. 333-102052 on Form S-8;
Registration Statement No. 333-102053 on Form S-8;
Registration Statement No. 333-109411 on Form S-8;
Registration Statement No. 333-109426 and Nos. 333-109426-1 through 333-109426-261 on Form S-4;
Registration Statement No. 333-111463 and Nos. 333-111463-01 through 333-111463-263 on Form S-4;
Registration Statement No. 333-117065 on Form S-8; and Registration Statement No. 333-124370 on Form S-8.

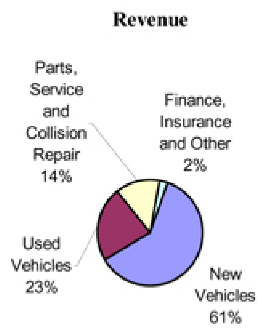
of our report dated March 4, 2005, (November 2, 2005 as to Notes 1, 2, 3, 4, 6, 7, 9, 11, and 12) relating to the financial statements of Sonic Automotive, Inc. (which report expresses an unqualified opinion and includes an explanatory paragraph relating to Sonic Automotive, Inc.'s adoption of Emerging Issues Task Force 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, effective January 1, 2003) appearing in this Current Report on Form 8-K of Sonic Automotive, Inc. dated November 2, 2005.

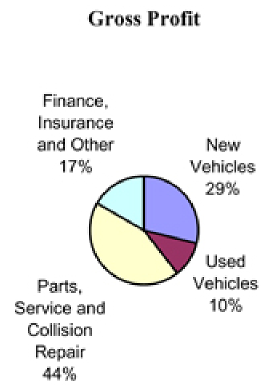
Charlotte, North Carolina
November 2, 2005

Item 1. ***Business*****.**

Sonic Automotive, Inc. was incorporated in Delaware in 1997. We are one of the largest automotive retailers in the United States. As of March 1, 2005, we operated 192 dealership franchises at 159 dealership locations, representing 38 different brands of cars and light trucks, and 40 collision repair centers in 15 states. Our dealerships provide comprehensive services including (1) sales of both new and used cars and light trucks, (2) sales of replacement parts and performance of vehicle maintenance, warranty, paint and collision repair services and (3) arrangement of extended service contracts, financing, insurance, vehicle protection products and other aftermarket products (collectively, “F&I”) for our automotive customers.

The following charts depict the diversity of our sources of revenue and gross profit for the year ended December 31, 2004:





BUSINESS STRATEGY

Further Develop Strategic Markets and Brands. Our growth strategy is focused on metropolitan markets, predominantly in the Southeast, Southwest, Midwest and California, that on average are experiencing population growth that exceeds the national average. Where practicable, we also seek to acquire franchises that we believe have above average sales prospects. A majority of our dealerships are either luxury or mid-line import brands. For the year ended December 31, 2004, 74.4% of our total revenue was generated by import/luxury dealerships. We expect this trend toward more import/luxury dealerships to continue in the near future. Our dealership network is geographically organized into divisional and regional dealership groups. As of December 31, 2004, we operated dealerships in the following geographic areas:

Region	Number of Dealerships	Number of Franchises	Percent of 2004 Total Revenue
North Carolina/ South Carolina	17	22	8.2%
Alabama/Georgia	15	20	7.6%
Florida	12	15	8.7%
Tennessee/Birmingham	11	13	6.8%
Southeastern Division	55	70	31.3%
Ohio	6	9	2.7%
Michigan/Mid-Atlantic	10	11	7.4%
Northern Division	16	20	10.1%
Houston	19	23	13.8%
Dallas/Oklahoma	17	18	12.9%
Central Division	36	41	26.7%
North Bay	10	12	8.0%
South Bay	11	11	7.8%
LA North	12	16	5.5%
LA South	10	10	5.6%
Las Vegas/Colorado	9	12	5.0%
Western Division	52	61	31.9%
	159	192	100.0%

During 2004, we acquired 11 dealerships, representing 13 franchises, disposed of four dealerships, representing four franchises, and terminated three franchises. Our 2004 acquisitions were limited to acquisitions that were in the negotiation stage at the end of 2003. We expect to continue to limit our acquisition activity to approximately 10% of annual revenues each year. This will allow us to continue to reduce our leverage and maintain liquidity for our dividend and share repurchase activities and also allow our management infrastructure to focus on improving operating performance and integrating acquired dealerships. For additional discussion regarding our reduced growth pace and the anticipated resulting effect on our liquidity, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

We generally seek to acquire larger, well-managed dealerships or multiple franchise dealership groups located in metropolitan or high growth suburban markets ("hub" acquisitions). We also look to acquire single franchise dealerships that will allow us to capitalize upon professional management practices and provide greater breadth of products and services in our existing markets ("spoke" acquisitions). We also intend to acquire dealerships that have under performed the industry average but represent attractive franchises or have attractive locations that would immediately benefit from our professional management practices.

The automotive retailing industry remains highly fragmented and we believe that further consolidation is likely. We believe that attractive acquisition opportunities continue to exist for dealership groups with the capital and experience to identify, acquire and professionally manage dealerships.

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

Finance, Insurance and Other Aftermarket Products: Each sale of a new or used vehicle provides us with an opportunity to earn financing fees and insurance commissions and to sell extended service contracts, vehicle protection products and other aftermarket products. We currently offer a wide range of nonrecourse financing, leasing, vehicle protection products, other aftermarket products, service contracts and insurance products to our customers. We believe there are opportunities at acquired dealerships to increase earnings from the sale of finance, vehicle protection products, other aftermarket products, insurance and service contracts. We are continuing to emphasize menu-selling techniques and other best practices to increase our sales of extended service contracts.

Rate spread is another term for the commission earned by our dealerships for arranging vehicle financing for customers. The amount of the commission could be zero, a flat fee or an actual spread between the interest rate charged to the customer and the interest rate provided by the direct financing source (bank, credit union or manufacturers' captive finance company). In 2004, we estimate that our average rate spread on finance contracts was 1.2%. In 2004, including credit unions, over 23% of our financings were for no fee or a flat dollar fee to our dealerships. In 2002, we established caps on the amount of potential rate spread our dealerships could earn with all finance sources. We believe the rate spread we earn for arranging financing represents value to the customer because of the following:

- Lower cost, sub-vented financing is often available only from the manufacturers' captives and franchised dealers;
- Lease-financing alternatives are largely available only from manufacturers' captives or other indirect lenders;
- Customers with substandard credit frequently do not have direct access to potential sources of sub-prime financing; and
- Customers with significant "negative equity" in their current vehicle (i.e., the customer's current vehicle is worth less than the balance of their vehicle loan or lease obligation) frequently are unable to pay off the loan on their current vehicle and finance the purchase or lease of a replacement new or used vehicle without the assistance of a franchised dealer.

Parts, Service & Collision Repair ("Fixed Operations"): Each of our dealerships offers a fully integrated service and parts department. Manufacturers permit warranty work to be performed only at franchised dealerships. As a result, franchised dealerships are uniquely qualified to perform work covered by manufacturer warranties on increasingly complex vehicles. We believe we can continue to grow our profitable parts and service business by using our access to capital to increase service capacity, investing in sophisticated equipment and well trained technicians, using variable rate pricing structures, focusing on customer service and efficiently managing our parts inventory. In addition, we believe our emphasis on selling extended service contracts will drive further service and parts business in our dealerships as we increase the potential to retain a current parts and service customer beyond the term of the standard manufacturer warranty period.

We operated collision repair centers at 40 locations at March 1, 2005. We believe we can improve these operations by capitalizing on the synergies between our franchised dealerships and our collision repair centers. These synergies include access to customer networks, ready access to parts and the ability to share employees.

Certified Pre-Owned Vehicles. Various manufacturers provide franchised dealers the opportunity to sell certified pre-owned ("CPO") vehicles. This certification process extends the standard manufacturer warranty on the particular vehicle. We typically earn higher revenues and gross margins on CPO vehicles compared to non-certified vehicles. We also believe the extended manufacturer warranty increases our potential to retain the pre-owned purchaser as a future parts and service customer. Since CPO vehicle warranty work can only be performed at franchised dealerships, we believe the used vehicle business will become more clearly segmented and CPO vehicle sales and similar products will become a larger share of used vehicle sales.

Emphasize Expense Control. We continually focus on controlling expenses and expanding margins at the dealerships we acquire and integrate into our organization. We manage these costs, such as advertising and variable compensation expenses, so that they are generally related to vehicle sales and can be adjusted in response to changes in vehicle sales volume. Salespersons, sales managers, service managers, parts managers, service advisors, service technicians and the majority of other non-clerical dealership personnel are paid either a commission or a modest salary plus commissions. In addition, dealership management compensation is tied to individual dealership profitability. We believe we can further manage these types of costs through best practices, standardization of compensation plans, controlled oversight and accountability and centralized processing systems.

Train, Develop and Motivate Qualified Management. We believe that our well-trained dealership personnel are key to our long-term prospects. We require all of our employees, from service technicians to regional vice presidents, to participate in our in-house training programs each year. Our Sonic Dealer Academy includes training modules not only for our dealer operators but also for general sales managers and Fixed Operations managers. Our training programs repeatedly emphasize our company's core philosophy of "Take The High Road," stressing the importance of complying with applicable laws and regulations and our company's code of business conduct and ethics. We believe that this training and organizational structure provides high-level supervision over the dealerships, accurate financial reporting and the ability to maintain effective controls as we expand. In order to motivate management, we employ an incentive-based compensation program for each officer, vice president and dealer operator, with additional incentives based on the performance of individual profit centers. We believe that this organizational structure, together with the opportunity for promotion within our large organization, serves as a strong motivation for our employees.

Achieve High Levels of Customer Satisfaction. We focus on maintaining high levels of customer satisfaction. Our personalized sales process is designed to satisfy customers by providing high-quality vehicles in a positive, “consumer friendly” buying environment. Several manufacturers offer specific financial incentives on a per vehicle basis if certain Customer Satisfaction Index (“CSI”) levels (which vary by manufacturer) are achieved by a dealer. In addition, all manufacturers consider CSI scores in approving acquisitions. In order to keep management focused on customer satisfaction, we include CSI results as a component of our incentive-based compensation programs. Based on data from our manufacturers, for the year ended December 31, 2004, 70.4% and 71.1% of our dealerships exceeded the national average for customer satisfaction in sales and service, respectively.

Relationships with Manufacturers

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

Many automobile manufacturers have developed policies regarding public ownership of dealerships, and we also have entered into framework agreements with most major vehicle manufacturers. To the extent that new or amended manufacturer policies or our framework agreements with manufacturers restrict the number of dealerships which may be owned by us, or the transferability of our common stock, such policies could have a material adverse effect on us. We believe that we will be able to renew at expiration substantially all of our existing franchise and dealer agreements. Policies implemented by manufacturers, either unilaterally or composed within framework agreements that we have entered into with many major vehicle manufacturers, include the following restrictions:

- The ability to force the sale of their respective franchises upon a change in control of our company or a material change in the composition of our Board of Directors;
- The ability to force the sale of their respective franchises if an automobile manufacturer or distributor acquires more than 5% of the voting power of our securities; and
- The ability to force the sale of their respective franchises if an individual or entity acquires more than 20% of the voting power of our securities, and the manufacturer disapproves of such individual’s or entity’s ownership interest.

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

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

Competition

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

We believe that the principal competitive factors in vehicle sales are the marketing campaigns conducted by manufacturers, the ability of dealerships to offer a wide selection of the most popular vehicles, the location of dealerships, pricing (including manufacturer rebates and other special offers) and the quality of customer service. Other competitive factors include customer preference for makes of automobiles and manufacturer warranties.

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

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

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

Governmental Regulations and Environmental Matters

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

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

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

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

We believe that we comply in all material respects with the laws affecting our business. However, claims arising out of actual or alleged violations of laws may be asserted against us or our dealerships by individuals or governmental entities, and may expose us to significant damages or other penalties, including possible suspension or revocation of our licenses to conduct dealership operations and fines.

As with automobile dealerships generally, and service, parts and body shop operations in particular, our business involves the use, storage, handling and contracting for recycling or disposal of hazardous or toxic substances or wastes and other environmentally sensitive materials. Our business also involves the past and current operation and/or removal of above ground and underground storage tanks containing such substances or wastes. Accordingly, we are subject to regulation by federal, state and local authorities that establish health and environmental quality standards, provide for liability related to those standards, and in certain circumstances provide penalties for violations of those standards. We are also subject to laws, ordinances and regulations governing remediation of contamination at facilities we own or operate or to which we send hazardous or toxic substances or wastes for treatment, recycling or disposal.

We do not have any known material environmental liabilities and we believe that compliance with environmental laws and regulations will not, individually or in the aggregate, have a material adverse effect on our results of operations or financial condition. However, soil and groundwater contamination is known to exist at certain properties used by us. Further, environmental laws and regulations are complex and subject to frequent change. In addition, in connection with our acquisitions, it is possible that we will assume or become subject to new or unforeseen environmental costs or liabilities, some of which may be material. We cannot assure you that compliance with current or amended, or new or more stringent, laws or regulations, stricter interpretations of existing laws or the future discovery of environmental conditions will not require additional expenditures by us, or that such expenditures will not be material.

Executive Officers of the Registrant

The executive officers are elected annually by, and serve at the discretion of, our Board of Directors. Our executive officers as of October 31, 2005, are as follows:

Name	Age	Position(s) with Sonic
O. Bruton Smith	78	Chairman, Chief Executive Officer and Director
B. Scott Smith	37	Vice Chairman, Chief Strategic Officer and Director
Jeffrey C. Rachor	43	President, Chief Operating Officer and Director
Mark J. Iuppenlatz	45	Executive Vice President of Corporate Development

O. Bruton Smith, 78, is our Chairman, Chief Executive Officer and a director and has served as such since our organization in January 1997, and he currently is a director and executive officer of many of our subsidiaries. Mr. Smith has worked in the retail automobile industry since 1966. Mr. Smith is also the Chairman and Chief Executive Officer, a director and controlling stockholder of Speedway Motorsports, Inc. ("SMI"). SMI is a public company traded on the New York Stock Exchange (the "NYSE"). Among other things, SMI owns and operates the following NASCAR racetracks: Atlanta Motor Speedway, Bristol Motor Speedway, Lowe's Motor Speedway, Las Vegas Motor Speedway, Infineon Raceway and Texas Motor Speedway. He is also an executive officer or a director of most of SMI's operating subsidiaries.

B. Scott Smith, 37, is our Vice Chairman and Chief Strategic Officer. Prior to his appointment as Vice Chairman and Chief Strategic Officer in October 2002, Mr. Smith was President and Chief Operating Officer from April 1997 until October 2002. Mr. Smith has been a director of our company since our organization in January 1997. Mr. Smith also serves as a director and executive officer of many of our subsidiaries. Mr. Smith, who is the son of O. Bruton Smith, has been an executive officer of Town & Country Ford since 1993, and was a minority owner of both Town & Country Ford and Fort Mill Ford before our acquisition of these dealerships in 1997. Mr. Smith became the General Manager of Town & Country Ford in November 1992 where he remained until his appointment as President and Chief Operating Officer in April 1997. Mr. Smith has over eighteen years experience in the automobile dealership industry.

Jeffrey C. Rachor, 43, is our President and Chief Operating Officer. Prior to his promotion to President in April 2004, Mr. Rachor served as Executive Vice President and Chief Operating Officer, a position he had held with our company since October 2002. In May 1999, Mr. Rachor was appointed a director of our company and in November 1999 promoted to executive officer status as Executive Vice President of Retail Operations. He originally joined us as the Regional Vice President—Mid-South Region upon our 1997 acquisition of dealerships in Chattanooga, Tennessee and was subsequently promoted to Vice President of Retail Operations in September 1998 and again promoted to Executive Vice President – Retail Operations in November 1999. Mr. Rachor has over nineteen years of experience in automobile retailing and was the Chief Operating Officer of the Chattanooga dealerships from 1989 until their acquisition by us in 1997.

Mark J. Iuppenlatz, 45, is our Executive Vice President of Corporate Development. In April 2004, Mr. Iuppenlatz was promoted to Executive Vice President from Senior Vice President, a position which he had held since May 2002. Prior to May 2002, he served as our Vice President of Corporate Development from August 1999. Before joining us, Mr. Iuppenlatz served as the Executive Vice President — Acquisitions and Chief Operating Officer of Mar Mar Realty Trust ("MMRT"), a real estate investment trust specializing in sale/leaseback financing of automotive-related real estate, from September 1998 to August 1999. From 1996 to September 1998, Mr. Iuppenlatz was employed by Brookdale Living Communities, Inc., a company that owns, operates, develops and manages luxury senior housing communities, where he was responsible for the company's development operations. From 1994 to 1996, he served as Vice President of Schlotzky's, Inc., a publicly traded restaurant chain. From 1991 to 1994, Mr. Iuppenlatz served in Spain as the director of marketing and the assistant director of development for Kepro S.A., a real estate development company.

Employees

As of March 1, 2005, we employed approximately 11,600 people. We believe that many dealerships in the retail automobile industry have difficulty in attracting and retaining qualified personnel for a number of reasons, including the historical inability of dealerships to provide employees with a liquid freely-tradeable equity interest in the profitability of the dealership. We provide certain executive officers, managers and other employees with stock options and all employees with a stock purchase plan. We believe this type of freely-tradeable equity incentive is attractive to our existing and prospective employees.

We believe that our relationships with our employees are good. Approximately 234 of our employees, primarily service technicians in our Northern California markets, are represented by a labor union. Because of our dependence on the manufacturers, however, we may be affected by labor strikes, work slowdowns and walkouts at the manufacturer's manufacturing facilities.

Company Information

Our website is located at www.sonicautomotive.com. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports, as well as proxy statements and other information we file with, or furnish to, the Securities and Exchange Commission ("SEC") are available free of charge on our website. We make these documents available as soon as reasonably practicable after we file them with, or furnish them to, the SEC. Except as otherwise stated in these documents, the information contained on our website or available by hyperlink from our website is not incorporated into this Current Report on Form 8-K or other documents we file with, or furnish to, the SEC.

Item 3: *Legal Proceedings*.

Several of our Texas dealership subsidiaries have been named in three class action lawsuits brought against the Texas Automobile Dealers Association ("TADA") and new vehicle dealerships in Texas that are members of the TADA. Approximately 630 Texas dealerships are named as defendants in two of the actions, and approximately 700 dealerships are named as defendants in the other action. The three actions allege that since January 1994, Texas automobile dealerships have deceived customers with respect to a vehicle inventory tax and violated federal antitrust and other laws. In April 2002, in two actions, the Texas state court certified two classes of consumers on whose behalf the actions would proceed. The Texas Court of Appeals subsequently affirmed the trial court's order of class certification in the state actions, and the Texas Supreme Court issued an order for the second time in September 2004 stating that it would not hear the merits of the defendant's appeal on class certification. The federal trial court conditionally certified a class of consumers in the federal antitrust case, but on appeal by the defendant dealerships, the U.S. Court of Appeals for the Fifth Circuit reversed the certification of the plaintiff class in October 2004 and remanded the case back to the federal trial court for further proceedings not inconsistent with the Fifth Circuit's ruling. The plaintiffs have appealed this ruling by the Fifth Circuit.

In June 2005, our Texas dealerships and several other dealership defendants entered into a settlement agreement with the plaintiffs in both the state and the federal cases that would settle each of the cases on behalf of our Texas dealerships. The settlements are contingent upon court approval, and the court has not yet scheduled a date for a hearing on that approval. The estimated expense of the proposed settlement is not a material amount to Sonic as a whole, and it includes our Texas dealerships issuing coupons for discounts off future vehicle purchases, refunding cash in certain circumstances, and paying attorneys' fees and certain costs. Under the terms of the settlements, our Texas dealerships would continue to itemize and pass through to the customer the cost of the inventory tax. If the TADA matters are not settled, our Texas dealership subsidiaries would then vigorously defend themselves and assert available defenses. In addition, we may have rights of indemnification with respect to certain aspects of the TADA matters. However, an adverse resolution of the TADA matters could result in the payment of significant costs and damages and negatively impact our Texas dealerships' ability to itemize and pass through to the customer the cost of the vehicle inventory tax in the future, which could have a material adverse effect on our future results of operations, financial condition and cash flows.

We are also 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 we and our 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. We subsequently filed a notice of appeal of the court's class certification ruling with the Florida Court of Appeals. We intend to continue vigorous defense of this lawsuit, including the appeal of the trial court's class certification order, 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 our future results of operations, financial condition and cash flows.

We are involved, and expect to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of our 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 we vigorously defend ourselves in all legal and administrative proceedings, the outcomes of pending and future proceedings arising out of the conduct of our 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 our business, financial condition, results of operations, cash flows or prospects.

Item 6: *Selected Financial Data*.

This selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes included elsewhere in this Form 8-K.

We have accounted for all of our dealership acquisitions using the purchase method of accounting and, as a result, we do not include in our consolidated financial statements the results of operations of these dealerships prior to the date we acquired them. Our selected consolidated financial data reflect the results of operations and financial positions of each of our dealerships acquired prior to December 31, 2004. As a result of the effects of our acquisitions and other potential factors in the future, the historical consolidated financial information described in selected consolidated financial data is not necessarily indicative of the results of our operations and financial position in the future or the results of operations and financial position that would have resulted had such acquisitions occurred at the beginning of the periods presented in the selected consolidated financial data.

	Year Ended December 31,				
	2000	2001	2002 (3)	2003	2004
	(dollars and shares in thousands except per share amounts)				
Income Statement Data (1) (4):					
Total revenues	$ 4,827,235	$ 5,290,077	$ 6,210,597	$ 6,718,790	$ 7,178,399
Income from continuing operations before income taxes	$ 108,227	$ 130,397	$ 172,564	$ 129,440	$ 150,461
Income from continuing operations	$ 67,084	$ 79,933	$ 107,214	$ 85,211	$ 93,826
Basic earnings per share from continuing operations	$ 1.58	$ 1.97	$ 2.57	$ 2.08	$ 2.27
Diluted earnings per share from continuing operations (2)	$ 1.53	$ 1.92	$ 2.44	$ 1.99	$ 2.17
Consolidated Balance Sheet Data (4):					
Total assets	$ 1,782,993	$ 1,810,369	$ 2,375,308	$ 2,686,229	$ 2,901,611
Total long-term debt	$ 493,309	$ 519,963	$ 645,809	$ 696,285	$ 671,796
Total long-term liabilities (including long-term debt)	$ 517,930	$ 553,998	$ 703,183	$ 792,354	$ 801,519
Cash dividends declared	$ —	$ —	$ —	$ 8,218	$ 18,207

(1) In accordance with the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”, income statement data reflects reclassifications from the prior years presentation to exclude additional franchises sold or identified for sale subsequent to December 31, 2004 which had not been previously included in discontinued operations. See Note 2 to our accompanying Consolidated Financial Statements, *Business Acquisitions and Dispositions*, which discusses these and other factors that affect the comparability of the information for the periods presented.

(2) In accordance with the provisions of EITF Issue No. 04-8, “Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share”, which was adopted during the fourth quarter of 2004, diluted earnings per share data for 2002, 2003 and 2004 reflects the dilutive impact of our 5.25% Convertible Senior Subordinated Notes using the “if-converted method”. There was no impact for 2003. See *Management’s Discussion and Analysis of Financial Condition and Results of Operations - Recent Accounting Pronouncements.*

(3) In accordance with the provisions of SFAS No. 142, “Goodwill and Other Intangible Assets”, effective January 1, 2002, goodwill is no longer amortized. Goodwill amortization expense for continuing operations prior to the adoption of SFAS No. 142 was $14.4 million and $15.5 million for 2000 and 2001, respectively.

(4) As mentioned in *Management’s Discussion and Analysis of Financial Condition and Results of Operations -Liquidity and Capital Resources* and Note 2, *Business Acquisitions and Dispositions*, to our accompanying Consolidated Financial Statements, business combinations have had a material impact on our reported financial information.

Item 7: *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 accompanying Sonic Automotive, Inc. and Subsidiaries Consolidated Financial Statements and the related notes thereto appearing elsewhere in this report. The financial and statistical data contained in the following discussion for all periods presented reflects our September 30, 2005 classification of franchises between continuing and discontinued operations in accordance with SFAS No. 144.

Overview

We are one of the largest automotive retailers in the United States. As of March 1, 2005 we operated 192 dealership franchises, representing 38 different brands of cars and light trucks, at 159 locations and 40 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, vehicle protection products and other aftermarket products for our customers. In addition, although vehicle sales are cyclical and are affected by many factors, including general economic conditions, consumer confidence, levels of discretionary personal income, interest rates and available credit, our parts, service and collision repair services are not closely tied to vehicle sales and are not as dependent upon near-term sales volume. As a result, we believe the diversity of these products and services reduces the risk of periodic economic downturns.

The automobile industry's total amount of new vehicles sold increased by 1.5% to 16.9 million vehicles in 2004 from 16.6 million vehicles in 2003. This was the first annual increase in industry sales since 2000. Many factors such as brand and geographic concentrations have caused our past results to differ from the industry's total amount of new vehicles sold. In 2004, our import stores performance fell short of the industry's 5.6% import unit sales growth and our domestic stores underperformed the industry's domestic sales contraction of 1.2%.

The following table depicts the breakdown of our new vehicle revenues by brand for each of the past three years:

	Percentage of New Vehicle Revenues Year Ended December 31,		
	2002	2003	2004
Brand (1)			
Honda	15.4%	15.5%	13.1%
BMW	11.0%	10.3%	12.3%
Cadillac	11.1%	12.4%	12.2%
General Motors (2)	12.2%	11.1%	11.0%
Toyota	10.9%	12.5%	10.9%
Ford	15.5%	11.8%	9.8%
Lexus	5.0%	5.1%	6.3%
Volvo	2.8%	3.9%	4.0%
Mercedes	3.4%	3.1%	3.3%
Nissan	2.7%	2.7%	2.7%
Chrysler (3)	2.9%	2.7%	2.5%
Volkswagen	0.8%	1.6%	1.8%
Hyundai	1.1%	1.3%	1.6%
Audi	1.2%	1.0%	1.5%
Other Luxury (4)	2.2%	3.7%	5.2%
Other (5)	1.8%	1.3%	1.8%
Total	100.0%	100.0%	100.0%

(1) In accordance with the provisions of SFAS No. 144, income statement data reflects reclassifications for all years presented to exclude additional franchises sold or identified for sale subsequent to December 31, 2004 which had not been previously included in discontinued operations. See Notes 1 and 2 to our accompanying Consolidated Financial Statements which discusses these and other factors that affect the comparability of the information for the periods presented.

(2) Includes Buick, Chevrolet, GMC, Oldsmobile, Pontiac and Saturn

(3) Includes Chrysler, Dodge and Jeep

(4) Includes Acura, Hummer, Infiniti, Jaguar, Land Rover, Maybach, Morgan, Porsche and Saab

(5) Includes Isuzu, KIA, Lincoln, Mercury, Mini, Mitsubishi, Scion and Subaru

We sell similar products and services that exhibit similar economic characteristics, use similar processes in selling our products and services and sell our products and services to similar classes of customers. As a result of this and the way we manage our business, we have aggregated our operating segments into a single segment for purposes of reporting financial condition and results of operations.

In the ordinary course of business we evaluate our dealership franchises for possible disposition based on various performance criteria. During the year ended December 31, 2004, we sold four franchises, terminated three franchises, and had approved, but not completed, the disposition of 24 additional franchises. In the first nine months of 2005, we added 12 additional franchises to assets held for sale, sold six of those franchises and sold eight of the 24 franchises held for sale at December 31, 2004. Therefore, as of September 30, 2005, we had 22 franchises classified as held for sale. These franchises have been identified as held for sale because of unprofitable operations or various strategic considerations. We believe the disposition of these dealerships will allow us to focus our management attention on those remaining stores with the highest potential return on investment.

Use of Estimates and Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Critical accounting policies are those that are both most important to the portrayal of our financial position and results of operations and require the most subjective and complex judgments. The following is a discussion of what we believe are our critical accounting policies and estimates. See Note 1 to our consolidated financial statements for additional discussion regarding our accounting policies.

Finance, Insurance and Service Contracts—We arrange financing for customers through various financial institutions and receive a commission from the lender either in a flat fee amount or in an amount equal to the difference between the actual interest rates charged to customers and the predetermined base rates set by the financing institution. We also receive commissions from the sale of various insurance contracts and non-recourse third party extended service contracts to customers. Under these contracts, the applicable manufacturer or third party warranty company is directly liable for all warranties provided within the contract.

In the event a customer terminates a financing, insurance or extended service contract prior to the original termination date, we may be required to return a portion of the commission revenue originally recorded to the third party provider ("chargebacks"). The commission revenue for the sale of these products and services is recorded net of estimated chargebacks at the time of sale. Our estimate of future chargebacks is established based on our historical chargeback rates, termination provisions of the applicable contracts and industry data. While chargeback rates vary depending on the type of contract sold, a 100 basis point change in the estimated chargeback rates used in determining our estimates of future chargebacks would have changed our estimated reserve for chargebacks at December 31, 2004 by $2.7 million. Our estimate of chargebacks ($17.8 million as of December 31, 2004) is influenced by early contract termination events such as vehicle repossessions, refinancings and early pay-off. If these factors change, the resulting impact is a change in our estimate for chargebacks. During the fourth quarter of 2004, we recorded a charge of $3.8 million relating to finance, insurance and extended service contracts as a result of a change in estimates for chargeback rates.

Goodwill—Goodwill is tested for impairment at least annually, or more frequently when events or circumstances indicate that impairment might have occurred. Based on criteria established by the applicable accounting pronouncements, we allocate the carrying value of goodwill and test it for impairment based on our geographic divisions. The $1,065.2 million of goodwill on our balance sheet, including approximately $8.3 million classified in assets held for sale, at December 31, 2004 was allocated to the following geographic divisions (dollars in millions):

Northern Division	$106.0
Southeastern Division	$285.0
Central Division	$353.1
Western Division	$321.1

In evaluating goodwill for impairment, we compare the carrying value of the goodwill allocated to each division to the fair value of the underlying dealerships in each division. This represents the first step of the impairment test. If the fair value of a division is less than the carrying value of the goodwill allocated to that division, we are then required to proceed to the second step of the impairment test. The second step involves allocating the calculated fair value to all of the assets of the respective division as if the calculated fair value was the purchase price of the business combination. This allocation would include assigning value to any previously unrecognized identifiable assets which means the fair value that would be allocated to goodwill is significantly reduced. (See discussion regarding franchise agreements acquired prior to July 1, 2001 in Note 1 to our accompanying Consolidated Financial Statements). We then compare the value of the goodwill resulting from this allocation process to the carrying value of the goodwill in the respective division with the difference representing the amount of impairment.

We use several assumptions and various fair value approaches in estimating the fair value of the goodwill in each division. These assumptions and approaches include: an earnings multiple for private dealership valuations (as determined by the historical multiple paid for dealerships we have purchased) applied to actual earnings; an earnings multiple for public consolidators in our peer group applied to actual earnings; and a discounted cash flow utilizing estimated future earnings and our weighted average cost of capital. These approaches are blended to arrive at a fair value of goodwill for each division.

At December 31, 2004 (the date of our latest impairment test), the fair value of each of our divisions exceeded the carrying value of the goodwill allocated to them (step one of the impairment test). As a result, we were not required to conduct the second step of the impairment test described above, and we recognized no impairment of the carrying value of our goodwill on our balance sheet at December 31, 2004.

However, if in future periods we determine that the fair value of the goodwill allocated to one or more of our divisions is less than the carrying value of the goodwill allocated to such division(s), we believe that application of the second step of the impairment test would result in a substantial impairment charge to the goodwill allocated to such division(s) and the amount of such impairment charge would likely be materially adverse to our consolidated operating results, financial position and cash flows.

Insurance Reserves—We have various self-insured and high deductible insurance programs which require us to make estimates in determining the ultimate liability we may incur for claims arising under these programs. These insurance reserves are estimated by management using actuarial evaluations based on historical claims experience, claims processing procedures, medical cost trends and, in certain cases, a discount factor. We estimate the ultimate liability under these programs is between $20.6 million and $22.9 million. At December 31, 2004, we had $21.5 million reserved for such programs. We used an experience modification factor in estimating reserves for workers' compensation claims of 0.58. A change of five basis points in this factor would change the reserve by $0.7 million. We used a discount rate of 3.0% to calculate the present value of our estimated workers' compensation claims. A change of 100 basis points in the discount rate would change the reserve by $0.3 million. A discount rate of 3.0% was used to calculate the present value of our general liability claim reserves. A change of 100 basis points in the discount rate would have changed the reserve by $0.2 million.

Legal Proceedings—We are involved, and will continue to be involved, in numerous legal proceedings arising in the ordinary course of our business, including litigation with customers, employment related lawsuits, contractual disputes, class actions, purported class actions and actions brought by governmental authorities. During 2004 we recorded an additional $2.9 million in legal reserves. Currently, with the exception of the TADA and Galura litigation matters discussed in "Item 3: Legal Proceedings" herein, we believe no legal proceedings are pending against or involve us that could reasonably be expected to have a material adverse effect on our business, financial condition or results of operations. However, the results of legal proceedings cannot be predicted with certainty, and an unfavorable resolution of one or more of these proceedings could have a material adverse effect on our business, financial condition, results of operations, cash flows and prospects.

Classification of Franchises in Continuing and Discontinued Operations—We classify the results from operations of our continuing and discontinued operations in our consolidated statements of income based on the provisions of SFAS No. 144. Many of these provisions involve judgment in determining whether a franchise will be reported as continuing or discontinued operations. Such judgments include whether a franchise will be sold or terminated, the period required to complete the disposition and the likelihood of changes to a plan for sale. If in future periods we determine that a franchise should be either reclassified from continuing operations to discontinued operations or from discontinued operations to continuing operations, previously reported consolidated statements of income may be reclassified in order to reflect the current classification.

Income Taxes—As a matter of course, we are regularly audited by various taxing authorities and from time to time, these audits result in proposed assessments where the ultimate resolution may result in us owing additional taxes. We believe that our tax positions comply in all material respects with applicable tax law and that we have adequately provided for any reasonably foreseeable outcome related to these matters. Included in other accrued liabilities at December 31, 2003 and 2004 are $2.9 million in reserves that we have provided for these matters.

We have $8.3 million in deferred tax assets related to state net operating loss carryforwards that will expire between 2012 and 2024. Management reviews these carryforward positions, the time remaining until expiration and other opportunities to utilize these carryforwards in making an assessment as to whether it is more likely than not that these carryforwards will be utilized. Based on our judgment, we have not recorded a valuation allowance because it is more likely than not that taxable income for these states will be sufficient to realize the benefits of the associated deferred tax assets. However, the results of future operations, regulatory framework of these taxing authorities and other related matters cannot be predicted with certainty. Therefore, actual utilization of the losses which created these deferred tax assets which differs from the assumptions used in the development of our judgment could result in a charge that will be material to our consolidated operating results, financial position and cash flows.

Recent Accounting Pronouncements

In September 2004, the Emerging Issues Task Force reached a consensus on Issue No. 04-8, "Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share." Issue No. 04-8 requires issuers of contingently convertible securities to include the dilutive effect of these securities in the calculation of dilutive weighted average shares outstanding, regardless of whether conversion is likely, starting with periods ending after December 15, 2004. Issue No. 04-8 also requires retroactive application to all prior periods for which contingently convertible securities were outstanding. We have adopted the conclusion of Issue No. 04-8 and have determined the impact on our consolidated diluted earnings per share using the "if-converted method" to be a reduction of $0.04, $0.01 and $0.03 for diluted net income per share for the years ended December 31, 2002, 2003 and 2004, respectively.

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123R, "Share-Based Payment" which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" and supercedes APB 25, "Accounting for Stock Issued to Employees". SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). Tax benefits associated with share-based payments will be recognized as an addition to paid-in capital. Cash retained as a result of these tax benefits will be presented in the statement of cash flows as financing cash inflows. We are currently evaluating the provisions of SFAS No. 123R and have not determined the impact on our consolidated operating results, financial position and cash flows.

In October 2005, the FASB staff issued FSP FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period*. FSP FAS 13-1 requires companies to expense real estate rental costs under operating leases during periods of construction beginning with periods commencing after December 15, 2005 with no requirement for retroactive application. We are currently evaluating the provisions of FSP FAS 13-1 and have not determined the impact on our consolidated operating results, financial position and cash flows from FSP FAS 13-1.

Results of Operations

The following table summarizes the percentages of total revenues represented by certain items reflected in our accompanying Consolidated Statements of Income.

	Percentage of Total Revenues (1) for the Year Ended December 31,		
	2002	2003	2004
Revenues:			
New vehicles	60.1%	61.3%	61.0%
Used vehicles	17.3%	16.4%	15.9%
Wholesale vehicles	6.6%	6.1%	6.7%
Parts, service and collision repair	13.1%	13.4%	13.9%
Finance, insurance and other	2.9%	2.8%	2.5%
Total revenues	100.0%	100.0%	100.0%
Cost of sales (2)	84.3%	84.7%	84.6%
Gross profit	15.7%	15.3%	15.4%
Selling, general and administrative expenses	11.9%	12.1%	12.1%
Depreciation and amortization	0.1%	0.2%	0.3%
Operating income	3.7%	3.0%	3.0%
Interest expense, floor plan	0.3%	0.3%	0.4%
Interest expense, other, net	0.7%	0.6%	0.5%
Other expense/(income), net	(0.1)%	0.2%	0.0%
Income from continuing operations before income taxes	2.8%	1.9%	2.1%
Income tax expense	1.1%	0.6%	0.8%
Income from continuing operations	1.7%	1.3%	1.3%

(1) In accordance with the provisions of SFAS No. 144, income statement data reflects reclassifications for all years presented to exclude additional franchises sold or identified for sale subsequent to December 31, 2004 which had not been previously included in discontinued operations. See Note 2 to our accompanying Consolidated Financial Statements, *Business Acquisitions and Dispositions*, which discusses these and other factors that affect the comparability of the information for the periods presented.

(2) The cost of sales line item includes the cost of new and used vehicles, vehicle parts and all costs directly linked to servicing customer vehicles.

During the year ended December 31, 2004, we sold four franchises, terminated three franchises, and had approved, but not completed, the disposition of 24 additional franchises. In the first nine months of 2005, we added 12 additional franchises to assets held for sale, sold six of those franchises and sold eight of the 24 franchises held for sale at December 31, 2004. Therefore, as of September 30, 2005, we had 22 franchises classified as held for sale. The results of operations for franchises that were classified as continuing operations as of December 31, 2004 in our 2004 Form 10-K and were identified as held for sale during the first nine months of 2005 have been reclassified to discontinued operations. Accordingly, the following discussion regarding results of operations for 2002, 2003 and 2004 (including all revenues (including unit data); gross profit and gross margins; selling, general and administrative expenses; depreciation and amortization; interest expense, floor plan; interest expense, other, net; other income/expense, net; and provision for income taxes) have been reclassified from our 2004 Form 10-K to the updated presentation as of September 30, 2005. This reclassification has no effect on Sonic's reported net income or net income per share; statement's of stockholders' equity; and the discussion of liquidity and capital resources. In addition to these dispositions, during the years ended December 31, 2003 and 2002, we disposed of 18 and 16 franchises, respectively.

Annual "same store" results of operations represent the aggregate of the same store results for each of the four quarters in that year. Same store results for each quarter include dealerships that were owned and operated for the entire quarter in both periods. Unless otherwise noted, our discussion of the Results of Operations is on a same store basis.

New Vehicles

New vehicle revenues include both the sale and lease of new vehicles, as well as the sale of fleet vehicles. New vehicle revenues are highly dependent on manufacturer incentives, which vary from cash-back incentives to low interest rate financing. New vehicle revenues are also dependent on manufacturers for adequate vehicle allocations to meet customer demands.

The automobile manufacturing industry is cyclical and historically has experienced periodic downturns characterized by oversupply and weak demand. As an automotive retailer, we seek to mitigate the effects of this cyclicality by maintaining a diverse mix of domestic and import branded dealerships. Our brand diversity allows us to offer a broad range of products at a wide range of prices from lower priced, or economy vehicles, to luxury vehicles. We believe that this diversity reduces the risk of changes in customer preferences, product supply shortages and aging products. For the year ended December 31, 2004, 73.0% of our total new vehicle revenue was generated by import and luxury dealerships compared to 72.5% for 2003. We expect this trend toward more import and domestic luxury dealerships to continue. We believe demographic and other trends favor luxury and near-luxury brands and expect our acquisition activity in the future to concentrate primarily, but not completely, on these brands.

We expect that industry-wide new vehicle sales will continue their overall long-term trend of growing modestly faster than population growth after considering the impact of normal business cycles. We also believe the trend toward ownership of more vehicles per household will continue.

	For the Year Ended		Units or $ Change	% Change	For the Year Ended		Units or $ Change	% Change
	12/31/2003	12/31/2004			12/31/2002	12/31/2003		
Total New Vehicle Units								
Same Store	143,452	136,564	(6,888)	(4.8)%	132,614	131,374	(1,240)	(0.9)%
Acquisitions and Other	1,319	10,440	9,121	691.5%	2,179	13,397	11,218	514.8%
Total as Reported	144,771	147,004	2,233	1.5%	134,793	144,771	9,978	7.4%
Total New Vehicle Revenues (in thousands)								
Same Store	$4,088,849	$4,021,740	$ (67,109)	(1.6)%	$3,668,381	$3,728,339	$ 59,958	1.6%
Acquisitions and Other	30,753	355,005	324,252	1054.4%	65,453	391,263	325,810	497.8%
Total as Reported	$4,119,602	$4,376,745	$257,143	6.2%	$3,733,834	$4,119,602	$385,768	10.3%
Total New Vehicle Unit Price								
Same Store	$ 28,503	$ 29,449	$ 946	3.3%	$ 27,662	$ 28,380	$ 718	2.6%
Total Dealerships as Reported	$ 28,456	$ 29,773	$ 1,317	4.6%	$ 27,701	$ 28,456	$ 755	2.7%

Our same store new vehicle unit sales decline in 2004 was driven by import dealerships decreases of 4,471 units, or 5.1%, and domestic dealership decreases of 2,417 units, or 4.4%, as compared to 2003. Our Toyota dealerships declined 2,518 units, or 12.0%, compared to 2003 due to increased competition at several of our locations and extremely high unit volume in 2003 due to a strategic decision in 2003 to increase our market share at several of our key Toyota dealerships. Our Honda dealerships decreased 2,922 units, or 9.8%, which was primarily attributed to turnover in dealership management, increased competition in key markets and high sales volume in 2003. Our top performing import brands for 2004 were BMW, Acura and Hyundai which had a combined increase of 1,363 units, or 8.7%. The majority of the domestic dealership declines were from our Chrysler and Ford dealerships (down 11.0% and 12.6%, respectively). Our Ford dealerships experienced above average market declines and continued to show lower sales volumes during the current year. We believe this decline is in part attributed to stronger competition with GM which is offering attractive incentive packages. Our GM, excluding Cadillac, dealerships increased 881 units, or 5.0%, for the year, and was our only domestic brand that had an increase in same store units sold for 2004.

On a geographic basis, our strongest performing regions were North Los Angeles (up 947 units, or 13.4%) and Birmingham/Tennessee (up 874 units, or 12.2%), both of which have a high concentration of import and/or luxury brands. These regions offset some significant decreases in the unit sales of other regions with concentrations of domestic dealerships, the most notable being Ohio (down 1,063, or 16.5%), Dallas (down 1,657, or 10.4%) and Houston (down 885, or 4.7%). Florida had a decline in new units sold of 1,324, or 10.2%, which was partially attributed to four hurricanes that disrupted the region during the third quarter of 2004. However, subsequent to the hurricane disruptions, vehicle sales posted positive increases in the final months of 2004. In addition, San Diego and South Los Angeles experienced decreases of 1,802 units, or 20.2%, as compared to 2003.

All of our dealerships except Honda and Volvo stores experienced sales price per unit increases during 2004 generally due to increases in the manufacturers' suggested retail price.

During 2003, total same store new vehicle unit sales decreased because of decreases in our domestic dealerships which were partially offset by increases at our import dealerships. Our import dealerships experienced increases of 5,371 units, or 7.1%, as compared to 2002. This is compared to an industry increase in unit sales at import dealerships generally of 3.2%. Our Toyota, Honda and Volvo dealerships experienced combined growth of 4,073 units, or 8.6%. These increases can be primarily attributed to the introduction of new models and new body styles for existing models. On a geographic basis, our strongest performing regions were San Diego/Nevada (up 1,174 units, or 16.5%), Birmingham/Tennessee (up 758 units, or 13.3%) and Northern California (up 758 units, or 3.3%), all of which have a high concentration of import and/or luxury brands. Our domestic dealerships experienced unit sales declines of 6,611 units, or 11.6%, during 2003. This was compared to an industry decrease in unit sales at domestic dealerships of 3.4%. Our Ford dealerships were responsible for 60.2% of the domestic decline due primarily to Ford's continued loss of market share to import brands. Also, the Central Division (which consists of the Dallas, Houston and Oklahoma regions) experienced decreases of 3,547 units, or 8.7%, as compared to 2002, because of a concentration of domestic dealerships and local economic factors such as unusually high unemployment rates compared to the national average. Our GM, excluding Cadillac, and Chrysler dealerships were responsible for the remainder of our domestic decline, experiencing decreases of 1,365 units, or 8.2%, and 1,239 units, or 21.2%, respectively. All of our dealerships except BMW, Toyota and VW stores experienced sales price per unit increases during 2003. Our Honda, Cadillac, Volvo and Lexus dealerships experienced the most significant price increases due to an increase in truck and sport-utility vehicle sales. However, the average price per unit at our BMW dealerships decreased because of increased competition in the luxury sport-utility vehicle market. The average price per unit at our Toyota dealerships remained relatively flat.

Used Vehicles

Used vehicle revenues are directly affected by the level of manufacturer incentives on new vehicles, the number and quality of trade-ins and lease turn-ins and the availability of consumer credit. In addition, various manufacturers provide franchised dealers the opportunity to "certify" pre-owned vehicles ("CPO vehicles") based on criteria established by the manufacturer. This certification process extends the standard manufacturer warranty. We believe the used vehicle business will become more clearly segmented and CPO vehicles and similar products will continue to grow as a larger share of dealership used vehicle sales. Our sales of CPO vehicles increased to 21,985 units in 2004 (33.9% of total used units) from 19,798 units in 2003 (30.0% of total used units), an 11.0% increase.

	For the Year Ended				For the Year Ended			
	12/31/2003	12/31/2004	Units or $ Change	% Change	12/31/2002	12/31/2003	Units or $ Change	% Change
Total Used Vehicle Units								
Same Store	65,698	60,330	(5,368)	(8.2)%	63,087	59,640	(3,447)	(5.5)%
Acquisitions and Other	369	4,587	4,218	1143.1%	1,094	6,427	5,333	487.5%
Total as Reported	66,067	64,917	(1,150)	(1.7)%	64,181	66,067	1,886	2.9%
Total Used Vehicle Revenues (in thousands)								
Same Store	$1,097,276	$1,045,706	$(51,570)	(4.7)%	$1,059,413	$ 996,885	$(62,528)	(5.9)%
Acquisitions and Other	5,411	95,910	90,499	1672.5%	16,004	105,802	89,798	561.1%
Total as Reported	$1,102,687	$1,141,616	$ 38,929	3.5%	$1,075,417	$1,102,687	$ 27,270	2.5%
Total Used Vehicle Unit Price								
Same Store	$ 16,702	$ 17,333	$ 631	3.8%	$ 16,793	$ 16,715	$ (78)	(0.5)%
Total Dealerships as Reported	$ 16,690	$ 17,586	$ 896	5.4%	$ 16,756	$ 16,690	$ (66)	(0.4)%

We continued to experience challenges in the used vehicle market in 2004 due to manufacturer incentives on new vehicles. Since these new vehicle incentives remain attractive to consumers, we expect volume and pricing pressure to continue in the used vehicle market. We have, however, seen pricing begin to stabilize and improve as there are fewer low mileage vehicles coming off of lease than historically experienced.

The decreases in used units sold occurred primarily in our domestic dealerships. The largest percentage declines in used units sold were in our Colorado and Ohio regions and our San Diego market (down 449 units, or 18.4%, 901 units, or 19.3%, and 412 units, or 20.0%, respectively). Used unit sales in our Florida region declined by 1,014, or 16.3%, due primarily to the hurricanes that disrupted the region during the third quarter. Consistent with new vehicle sales, Florida used vehicle units posted positive increases in the final months of 2004. Our Florida, Colorado and Ohio regions represented 44.0% of the total unit decline in 2004. The remaining decreases were generally evenly distributed throughout our other geographic regions with only one region, Birmingham/Tennessee, which has a high concentration of import and/or luxury brands reporting a relatively strong increase of 8.4%.

Despite the decline in used unit volumes, the average used selling price per unit increased $631 or 3.8% for 2004 compared to the prior year. The average price per unit increase in 2004 was in line with the industry increase of approximately 3.0%. The average increase per unit was attributable to an increase in CPO vehicles sold as a percentage of total used units sold (increasing from 30% in 2003 to 34% in 2004).

During 2003, the used vehicle market faced challenging conditions arising from the continuation of significant manufacturer incentives on new vehicles and a lack of sub-prime credit availability. The Central Division was most adversely affected by these factors due to a greater dependence on used vehicle sales than our other divisions. This division accounted for 68.1% of our total same store used unit decline in 2003. The available credit in the sub-prime category declined due to certain national lenders reducing their exposure in this area and other lenders increasing their credit standards. We reduced the effect of the sub-prime credit market's tightening by utilizing regional finance sources to replace the national lenders and by increasing the number of units that we financed through our wholly-owned sub-prime lending company, Cornerstone Acceptance. The declines in used unit sales generated in the Central Division were partially offset by increases in unit sales volume in the San Diego/Nevada (up 3.3%), Ohio (up 4.5%), and Mid-Atlantic (up 21.1%) regions.

Wholesale Vehicles

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

	For the Year Ended				For the Year Ended			
	12/31/2003	12/31/2004	Units or $ Change	% Change	12/31/2002	12/31/2003	Units or $ Change	% Change
Total Wholesale Vehicle Units								
Same Store	52,620	51,861	(759)	(1.4)%	52,534	47,724	(4,810)	(9.2)%
Acquisitions and Other	1,892	5,715	3,823	202.1%	2,374	6,788	4,414	185.9%
Total as Reported	54,512	57,576	3,064	5.6%	54,908	54,512	(396)	(0.7)%
Total Wholesale Vehicle Revenues (in thousands)								
Same Store	$386,772	$410,657	$23,885	6.2%	$380,677	$349,337	$(31,340)	(8.2)%
Acquisitions and Other	23,926	71,271	47,345	197.9%	28,751	61,361	32,610	113.4%
Total as Reported	$410,698	$481,928	$71,230	17.3%	$409,428	$410,698	$ 1,270	0.3%
Total Wholesale Unit Price								
Same Store	$ 7,350	$ 7,918	$ 568	7.7%	$ 7,246	$ 7,320	$ 74	1.0%
Total Dealerships as Reported	$ 7,534	$ 8,370	$ 836	11.1%	$ 7,457	$ 7,534	$ 77	1.0%

Higher revenues realized in 2004 were driven by higher unit sales prices for both our domestic and import dealerships which increased 7.2% and 7.7%, respectively. Favorable pricing increases followed the increases experienced in used retail sales and were consistent with the industry. These increases were partially offset by a 7.6% decrease in domestic dealership unit volume. Lower vehicle retail sales activity, the principal source of wholesale vehicles via trade-in, contributed to the lower volume.

During 2003, the decrease in same store wholesale vehicle revenues was due to a decrease in retail units sold in our domestic dealerships. Our domestic dealerships' total new and used retail units sold decreased 10,203 units, or 11.5%, thus there were fewer vehicles available for trade-ins. Therefore, there were fewer vehicles that required wholesaling. Conversely, our import dealerships' wholesale unit sales remained flat, while import dealerships' retail unit sales increased. This was the result of more effective sales practices as compared to our domestic dealerships.

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

Parts, service and collision repair revenue consists of customer requested repairs ("customer pay"), warranty repairs, retail parts, wholesale parts and collision repairs. Same store revenue from these items was as follows (amounts in thousands):

	For the Year Ended				For the Year Ended			
	12/31/2003	12/31/2004	$ Change	% Change	12/31/2002	12/31/2003	$ Change	% Change
Parts	$489,945	$486,628	$(3,317)	-0.7%	$449,195	$449,666	$ 471	0.1%
Service	349,087	357,752	8,665	2.5%	307,153	318,015	10,862	3.5%
Collision repair	56,517	55,940	(577)	-1.0%	46,664	47,277	613	1.3%
	$895,549	$900,320	$ 4,771	0.5%	$803,012	$814,958	$11,946	1.5%

Service revenue is driven by the mix of warranty repairs versus customer pay repairs, available service capacity, vehicle quality and manufacturer warranty programs. During 2004, 20.0% of our service and parts revenue was generated by warranty repairs and 36.7% by customer pay repairs compared to 18.8% by warranty repairs and 36.2% by customer pay repairs in 2003.

We believe that, over time, vehicle quality will improve but that vehicle complexity will offset any revenue lost from improvement in vehicle quality. We also believe we have the ability, through our access to capital, to continue to add service capacity and increase revenues. In addition, manufacturers continue to extend new vehicle warranty periods and have also begun to include regular maintenance items in the warranty coverage. These factors, combined with the extended manufacturer warranties on CPO vehicles (see the discussion in "Business—Business Strategy—Certified Pre-Owned Vehicles" above), should allow continued growth in our service and parts business.

Parts revenue is driven by the mix of warranty repairs versus customer pay repairs as prices for warranty parts are established by the manufacturer. We believe that long-term trends in retail parts sales will be affected by the same trends as discussed above for service (additional capacity, customer satisfaction, etc.).

One of the key metrics we use to analyze the profitability of our fixed operations business is fixed absorption. This metric represents the percentage of a dealership's fixed costs which are covered by the operating profit of the service, parts, and collision repair departments. Our fixed absorption rate was 82.7% in 2004 compared to 81.4% in 2003. We believe that we substantially exceed the industry's average fixed absorption rate.

As of December 31, 2004, we operated 40 collision repair centers. Collision revenues are heavily impacted by trends in the automotive insurance industry. Over the last few years collision repair revenues have either declined or remained flat because customers are choosing higher deductible policies, thus choosing not to make minor repairs that were previously covered by lower deductible policies. Also, insurance companies generally are declaring more vehicles "totaled" in recent years; thus, the vehicles do not need to be repaired.

	For the Year Ended				For the Year Ended			
	12/31/2003	12/31/2004	$ Change	% Change	12/31/2002	12/31/2003	$ Change	% Change
Total Parts, Service and Collision Repair (in thousands)								
Same Store	$895,549	$900,320	$ 4,771	0.5%	$803,012	$814,958	$11,946	1.5%
Acquisitions and Other	5,188	94,052	88,864	1712.9%	11,046	85,779	74,733	676.6%
Total As Reported	$900,737	$994,372	$93,635	10.4%	$814,058	$900,737	$86,679	10.6%

Same store Fixed Operations revenues increased slightly during 2004, primarily due to the performance of our import dealerships (up 5.0%) outpacing decreases in our domestic dealerships (down 5.3%). Warranty sales at our import dealerships increased $14.7 million, or 14.3%. Our BMW dealerships experienced an increase in revenues of $17.0 million, or 16.2%, compared to 2003 as a result of BMW's vehicle maintenance programs and strong same store new vehicle sales. These import increases were partially offset by decreases in our domestic dealerships, which declined $3.1 million, or 4.7%, compared to 2003. The overall domestic dealership revenue declines primarily relate to our Ford dealerships which decreased $9.7 million, or 12.1%, compared to 2003. The declines in our Ford dealerships were primarily caused by a decrease in wholesale parts sales of $4.5 million, or 30.4%. Our Ford wholesale parts revenues have continued to decrease during 2004 as competition has increased and the scale of those operations have declined. In addition, consistent with unit declines in new vehicles of 12.6%, warranty sales at our Ford stores experienced declines of $2.1 million, or 16.4%, as compared to 2003. Same store collision revenues were flat when compared to 2003.

Same store Fixed Operations revenues increased during 2003, primarily from the strong performance of our import dealerships. Our Honda and BMW dealerships experienced increases of $8.1 million, or 6.8%, and $6.9 million, or 7.1%, respectively, compared to 2002. Increases in our import dealerships were primarily attributable to warranty work as import manufacturers continue to extend warranty periods and include regular maintenance items as part of their new vehicle manufacturer warranty. Warranty sales at our import dealerships increased $8.5 million, or 9.7%. These import increases were partially offset by decreases in our domestic dealerships, which declined $7.4 million, or 11.6%, compared to 2002. Domestic dealerships' revenues were largely impacted by our Ford stores which experienced declines of $12.3 million, or 13.2%, compared to 2002. The declines in our Ford dealerships were primarily caused by a decrease in wholesale parts sales of $8.9 million, or 37.3%, because of Ford Motor Company's decision to open a parts depot in the Houston area in the second half of 2003 near a Sonic wholesale parts operation. Also, warranty sales at our Ford stores experienced declines of $4.2 million, or 25.0%, as compared to 2002. Same store collision revenues increased slightly due to greater capacity and the relocation of an existing collision center to a new stand-alone location.

Finance, Insurance and Other

Finance, insurance and other revenues include commissions for arranging vehicle financing and insurance, sales of third-party extended service contracts for vehicles, vehicle protection products and other aftermarket products. In connection with vehicle financing, service contracts, vehicle protection products, other aftermarket products and insurance contracts, we receive a commission from the provider for originating the contract.

Finance, insurance and other revenues are driven by the level of new and used vehicle sales, manufacturer financing or leasing incentives and our penetration rate. The penetration rate represents the percentage of vehicle sales on which we are able to originate financing or sell extended service contracts, vehicle protection products, other aftermarket products or insurance contracts. Our finance penetration rate increased slightly to 70.8% in 2004 from 70.7% in 2003. Our extended service contract penetration rate increased to 35.0% in 2004 from 34.4% in 2003. We expect our finance and insurance penetration rate to increase over time as we continue to emphasize the sale of extended service contracts and other products.

	For the Year Ended				For the Year Ended			
	12/31/2003	12/31/2004	$ Change	% Change	12/31/2002	12/31/2003	$ Change	% Change
Total Finance, Insurance and Other Revenue (in thousands)								
Same Store	$180,143	$165,994	$(14,149)	(7.9)%	$170,232	$164,072	$ (6,160)	(3.6)%
Acquisitions and Other	4,923	17,744	12,821	260.4%	7,628	20,994	13,366	175.2%
Total as Reported	$185,066	$183,738	$ (1,328)	(0.7)%	$177,860	$185,066	$ 7,206	4.1%
Total F&I per Unit (excluding fleet)								
Same Store	$ 905	$ 899	$ (6)	(0.7)%	$ 918	$ 906	$ (12)	(1.3)%
Total Dealerships as Reported	$ 924	$ 921	$ (3)	(0.3)%	$ 943	$ 924	$ (19)	(2.0)%

Same store finance, insurance and other revenues decreased during 2004 primarily due to lower retail vehicle unit sales. Finance and insurance revenues in the Florida region declined $2.9 million, or 18.6%, in 2004. Within the Central Division, Dallas and Oklahoma experienced declines of $3.8 million, or 17.3%, and $1.4 million, or 13.4%, respectively, compared to 2003. In the Western Division, the Colorado and San Diego regions also experienced large revenue declines, $1.3 million, or 25.9%, and $1.2 million or, 20.4%, respectively. These declines were partially offset by increases in our regions that have a strong BMW presence. Our Tennessee/Birmingham region experienced finance and insurance revenue increases during 2004 of $0.9 million, or 10.8%. Ford dealerships represented the majority of the decline among the domestic brands. Import dealerships saw a decline in retail unit sales of 5.0%, but a disproportionate finance and insurance revenue decline of $9.7 million, or 9.0%. Our Honda and Toyota dealerships led the decline with decreases of $7.4 million, or 19.7%, and $3.0 million, or 12.4%, respectively. Both the Honda and Toyota declines were attributable to large decreases both in the number of retail units sold and the amount of revenue per unit. These import declines were partially offset by our BMW dealerships which increased revenue $1.1 million, or 7.9%, versus a retail unit increase of 5.4%.

Same store finance, insurance and other revenues decreased during 2003 primarily due to lower used vehicle unit sales. Our domestic dealerships, concentrated in the Central Division, represented the majority of the decline due to these dealerships' dependence on used vehicle sales. Finance, insurance and other revenue in the Central Division declined $4.8 million, or 9.7% in 2003. Within the Central Division, Dallas and Oklahoma experienced declines of $2.3 million, or 11.9%, and $2.1 million, or 19.4%, respectively, compared to 2002. These declines were partially offset by increases in our regions that have heavy concentration of import and luxury brands. Our San Diego/Nevada region experienced finance, insurance and other revenue increases during 2003 of $1.8 million, or 17.2%. Additionally, our Volvo stores experienced significant revenue increases of $1.3 million, or 30.1%, compared to 2002.

Gross Profit and Gross Margins

The cost of sales line item includes the cost of new and used vehicles, vehicle parts and all costs directly linked to servicing customer vehicles (labor for parts, service and collision repair associates, depreciation on service equipment and service consumables). Our overall gross profit and gross profit as a percentage of revenues generally vary depending on changes in our revenue mix. Although sales of new vehicles comprise the majority of our total revenues, new vehicles generally carry the lowest margin rate of any product or service we offer. As a result, sales of new vehicles comprise a relatively small portion of total gross profits when compared to revenue. Retail sales of used vehicles generally carry a slightly higher gross margin rate than new vehicles. Parts, service and collision repair carry a higher gross margin rate than retail used sales. Product mix also has an impact on the gross margins that we realize. Historically, our import and luxury brands provide higher margins than our domestic brands. As we continue to acquire more import and luxury dealerships, we would expect our gross margins to increase. Our same store revenue mix between different products is shown in the following table:

	For the Year Ended		Basis Point Change	For the Year Ended		Basis Point Change
	12/31/2003	12/31/2004		12/31/2002	12/31/2003	
Revenues as a Percentage of Total Revenues						
New Vehicles	61.5%	61.5%	—	60.3%	61.6%	130
Used Vehicles	16.5%	16.0%	(50)	17.4%	16.5%	(90)
Wholesale Vehicles	5.8%	6.3%	50	6.3%	5.8%	(50)
Fixed Operations	13.5%	13.8%	30	13.2%	13.5%	30
Finance, Insurance and Other	2.7%	2.4%	(30)	2.8%	2.6%	(20)
Total as Reported	100.0%	100.0%	—	100.0%	100.0%	—

	For the Year Ended		$ Change	% Change	For the Year Ended		$ Change	% Change
	12/31/2003	12/31/2004			12/31/2002	12/31/2003		
Total Gross Profit (in thousands)								
Same Store	$1,014,677	$1,002,033	$(12,644)	(1.2)%	$951,815	$ 925,237	$(26,578)	(2.8)%
Acquisitions and Other	12,996	100,518	87,522	673.5%	22,054	102,436	80,382	364.5%
Total as Reported	$1,027,673	$1,102,551	$ 74,878	7.3%	$973,869	$1,027,673	$ 53,804	5.5%

The overall same store gross margin rate on our various revenue lines on a same store basis were as follows:

	For the Year Ended		Basis Point Change	For the Year Ended		Basis Point Change
	12/31/2003	12/31/2004		12/31/2002	12/31/2003	
New vehicles	7.2%	7.3%	10	8.0%	7.3%	(70)
Used vehicles - retail	10.5%	10.6%	10	10.8%	10.5%	(30)
Wholesale vehicles	(2.2)%	(1.4)%	80	(2.3)%	(2.1)%	20
Parts, service and collision repair	48.3%	48.6%	30	47.6%	48.2%	60
Finance, insurance and other	100.0%	100.0%	—	100.0%	100.0%	—
Overall gross margin	15.3%	15.3%	—	15.7%	15.3%	(40)

The overall same store gross margin percentage remained flat at 15.3% in 2004 and 2003, primarily due to lower finance, insurance and other revenue resulting from lower overall units retailed. Improvements experienced in all other categories were offset by the effect of finance, insurance and other revenue. The largest increases in margin percentages relate to used and wholesale vehicles which were primarily attributed to price increases driven by a lower supply of higher quality used vehicles than in previous years. Fixed Operations gross margin percentages improved primarily due to increases experienced at our high volume BMW and Honda dealerships.

The overall same store gross margin percentage declined to 15.3% in 2003 from 15.7% in 2002, primarily due to continued pressure on new and used retail vehicle margins. Our overall gross margin also declined due to the fact that a higher percentage of our total revenues are being generated by new vehicle sales which have the lowest gross margin of all our business lines. This was offset somewhat by the fact that the percentage of revenue contributed by Fixed Operations increased in 2003 from 2002 due to the fact that some manufacturers have extended warranty periods on certain models and the increasing trend of certain manufacturers to include regular maintenance items in their new vehicle standard warranty. The percentage of revenue contributed by finance, insurance and other revenues decreased slightly in 2003 which also contributed to the overall decrease. New vehicle gross margins decreased in 2003 as compared to 2002, due to an effort on our part to increase market share and maintain appropriate inventory levels. The used vehicle margin percentage decreased in 2003 because of new vehicle incentives and a shortage of quality trade-ins and lease turn-ins. These retail vehicle decreases were slightly offset by a favorable decrease in the wholesale loss percentage in 2003. Declining vehicle margins were partially offset by an increase in the parts, service, and collision gross margin percentage in 2003.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses are comprised of four major groups: compensation expenses, advertising expense, operating rent and rent related expense, and other expense. Compensation expense primarily relates to dealership personnel who are paid a commission or a modest salary plus commission (which typically vary depending on gross profits realized) and support personnel who are paid a fixed salary. Due to the salary component of dealership personnel's compensation, gross profits and compensation expense are not 100% correlated. Advertising expense and other expense vary based on the level of actual or anticipated business activity and number of dealerships owned. Rent and rent related expense typically vary with the number of dealerships owned, investments made for facility improvements and interest rates. Although not completely correlated, we believe the best way to measure SG&A expenses is as a percentage of gross profit.

	For the Year Ended		$ Change	% Change	For the Year Ended		$ Change	% Change
	12/31/2003	12/31/2004			12/31/2002	12/31/2003		
Total SG&A (in thousands)								
Same Store	$775,510	$753,190	$(22,320)	(2.9)%	$697,586	$701,888	$ 4,302	0.6%
Acquisitions and Other	36,394	114,342	77,948	214.2%	38,468	110,016	71,548	186.0%
Total as Reported	$811,904	$867,532	$ 55,628	6.9%	$736,054	$811,904	$75,850	10.3%

Total SG&A expense rose 6.9% for the year ended 2004 compared to 2003 as a result of acquisitions. The increase from acquisitions was somewhat offset by lower spending on a same store basis. However, as a percentage of gross profit, SG&A expenses improved slightly from 79.0% in 2003 to 78.7% in 2004. This improvement was driven by decreases in compensation expense and advertising expense offset slightly by increases in rent and other variable expenses.

Total compensation expense increased $17.2 million in 2004 compared with 2003. This increase was caused by a $20.8 million decline on a same store basis offset by a $38.0 million increase due to acquisitions. Compensation expense as a percentage of gross profit in 2004 improved to 45.9% from 47.5% in 2003. During 2004, we implemented standardized pay plans at our dealerships to more closely align compensation with gross profit. This implementation, which decreased spending levels, was the primary contributing factor in the decrease in same store compensation expense.

As a percentage of gross profit, advertising declined to 5.4% in 2004 compared to 6.4% in 2003. Advertising spending was more closely controlled in 2004 with a centralized allocation process implemented in early 2004.

Total rent and rent related expense increases offset the improvements in compensation and advertising as these expenses increased $14.9 million in 2004 compared to 2003. As a percentage of gross profit, rent and rent related expense increased to 10.6% in 2004 compared to 10.0% in 2003. Facility improvement projects on existing facilities contributed $1.0 million to the increase, while acquisitions contributed $10.5 million.

Other SG&A expenses increased $30.3 million, or 19.6%, compared to 2003, of which acquisitions contributed $11.4 million. Accounting and legal costs increased $5.9 million primarily due to Sarbanes-Oxley compliance costs and a higher level of legal activity (increase in reserves for legal settlements and fees paid to outside legal counsel). The remaining increases were driven by a broad range of equally weighted factors related to operating our dealerships (service loaners, freight, customer delivery, insurance costs, small tools and supplies).

In 2003, total SG&A expense as a percentage of gross profit increased to 79.0% from 75.6% in 2002. This increase was driven primarily by sales compensation expense, advertising expense and rent and rent related expense. In 2003 and 2002, compensation expense comprised 60.2% and 62.1%, respectively, of total SG&A expense and 47.5% and 46.9%, respectively, of gross profit. Compensation expense in 2003 increased as a percentage of gross profit due to declines in gross margin rates at our domestic dealerships in 2003 as well as increases in sales compensation spending levels. We estimate that of the overall increase of $31.8 million in sales compensation expense in 2003, $19.1 million was due to the change in gross profit volume and $9.5 million was due to an increase in absolute spending levels. Some of the increase in sales compensation expense was offset by reductions in support personnel compensation, which declined $7.3 million in 2003 compared to 2002.

In 2003, advertising expense increased $8.9 million compared to 2002. This increase was caused by a $2.7 million increase on a same store basis and a $6.2 million increase due to acquisitions. Rent and rent related expense increased $15.5 million in 2003 compared to 2002. Of this increase, $2.7 million was related to existing facilities where we completed facility improvement projects and $8.1 million of the increase was due to dealership acquisitions.

Depreciation and Amortization

Depreciation expense increased $5.4 million, or 49.7%, in 2004 compared to 2003. This increase was due primarily to a $30.6 million increase in gross property and equipment related to franchises classified as continuing operations, excluding land and construction in progress. The increase in depreciable property was due to dealership acquisitions and facility projects on existing dealerships.

Depreciation expense increased $3.4 million, or 45.1%, in 2003 compared to 2002. This increase was due primarily to a $37.1 million increase in gross property and equipment related to franchises classified as continuing operations, excluding land and construction in progress. The increase in depreciable property was due to dealership acquisitions and facility projects on existing dealerships.

Interest Expense, Floor Plan

Interest expense, floor plan increased $5.8 million, or 28.6%, in 2004 compared to 2003. The average floor plan interest rate incurred by franchises classified as continuing operations was 2.84% for the year ended December 31, 2004, compared to 2.74% for the year ended December 31, 2003, which increased interest expense by approximately $0.7 million. In addition to this, during 2004, the average floor plan balance increased by $176.1 million, resulting in an increase in expense of approximately $5.0 million. Approximately $79.5 million of the increase in the average floor plan balance was due to additional franchises we acquired in 2004. The average floor plan balance also increased due to an increase in the average price of vehicles due to general trends in the industry and our continued focus on luxury vehicles.

Interest expense, floor plan decreased $0.1 million, or 0.7%, in 2003 compared to 2002. The average floor plan interest rate incurred by franchises classified as continuing operations was 2.74% for the year ended December 31, 2003, compared to 3.44% for the year ended December 31, 2002, which reduced interest expense by approximately $4.1 million. This decrease was offset by an increase in the average floor plan balance of $144.7 million which resulted in an increase in expense of approximately $4.0 million. Approximately $55.8 million of the increase in the average floor plan balance was due to additional franchises we acquired in 2003. The average floor plan balance also increased due to an increase in the average price of vehicles due to general trends in the industry and our continued focus on luxury vehicles.

Our floor plan expenses are substantially offset by amounts received from manufacturers in the form of floor plan assistance. These payments are credited against our cost of sales upon the sale of the vehicle. For franchises classified as continuing operations, the amounts we recognized in our Consolidated Income Statements from floor plan assistance exceeded our floor plan interest expense by approximately $12.9 million, $14.6 million and $10.8 million in 2002, 2003 and 2004, respectively.

Interest Expense, Other, Net

On August 12, 2003, we refinanced our $182.4 million 11% senior subordinated notes (the “11% Notes”) with $200.0 million of 8.625% senior subordinated notes (the “8.625% Notes”). The redemption of the 11% Notes was completed on September 10, 2003. During this call period from August 12 to September 10 we incurred additional interest expense due to having both the 11% Notes and 8.625% Notes outstanding at the same time. In November 2003 we completed a $75.0 million add-on offering of the 8.625% Notes.

In order to reduce our exposure to market risks from fluctuations in interest rates, we have two separate interest rate swap agreements (the “Fixed Swaps”) to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate. The first swap agreement matured October 31, 2004 and had a notional principal amount of $100.0 million. The second swap agreement will mature June 6, 2006 and has a notional principal of $100.0 million. Under the terms of the first swap agreement, we received interest payments on the notional amount at a rate equal to the one month LIBOR rate and made interest payments at a fixed rate of 3.88%. Under the terms of the second swap agreement, we receive interest payments on the notional amount at a rate equal to the one month LIBOR rate, and make interest payments at a fixed rate of 4.50%.

In 2003, we entered into five separate interest rate swaps totaling $150.0 million (collectively, the “Variable Swaps”) to effectively convert a portion of our fixed rate debt to a LIBOR-based variable rate debt. Under the Variable Swaps’ agreements, we receive 8.625% on the respective notional amounts and pay interest payments on the respective notional amounts at a rate equal to the six month LIBOR in arrears (as determined on February 15 and August 15 of each year) plus a spread ranging from 3.50% to 3.84% with a weighted average spread of 3.64%. The benefit realized (the difference between interest paid and interest received) as a result of the Variable Swaps was $1.0 million and $4.2 million in 2003 and 2004, respectively, and has been included in interest expense, other, net in the accompanying Consolidated Statements of Income.

These changes and other changes in other interest expense are summarized in the schedule below:

	2003	2004
	Increase/(Decrease) in Interest Expense (in millions)	Increase/(Decrease) in Interest Expense (in millions)
Interest rates –		
• Changes in the average interest rate on the Revolving Facility (4.14% in 2004, 4.02% in 2003 and 4.62% in 2002)	$ (1.5)	$ 0.3
• Refinancing $182.4 million of the 11% Notes with $200.0 million of 8.625% Notes in Q3 2003	(0.4)	(2.1)
Debt balances –		
• Increase/(Decrease) in the average balance of the Revolving Facility	(0.5)	0.4
• Notes payable assumed in a 2004 acquisition	—	1.3
• Repurchase of the 11% Notes	(9.5)	—
• 5.25% Convertible Notes outstanding for all of 2004 and 2003 vs. seven months in 2002	2.9	—
• Issuance of an additional $75.0 million of 8.625% Senior Subordinated Notes	7.7	5.8
• Double carry of the 11% Senior Notes and the 8.625% Senior Subordinated Notes during the 30-day call period in 2003	1.2	(1.2)
Other factors –		
• (Increase)/Decrease in capitalized interest	(0.5)	0.2
• Incremental interest expense / (savings) related to the Fixed Swaps	2.3	(0.6)
• Incremental interest savings related to the Variable Swaps	(1.0)	(3.2)
• Increase in other expense, net	—	0.1
	$ 0.7	$ 1.0

In 2004, we reclassified interest income from our wholly-owned sub-prime lending company, Cornerstone Acceptance ("Cornerstone") to SG&A in order to conform with industry classifications. Interest income from Cornerstone's finance contracts ($3.5 million in 2002, $4.3 million in 2003 and $7.2 million in 2004) has been reclassified as a reduction of selling, general and administrative expenses. Cornerstone's interest income has been reclassified for all periods presented in our accompanying Consolidated Statements of Income.

Other Income / Expense, Net

Other income / expense increased approximately $13.9 million in 2004 compared to 2003 primarily due to debt repurchases. We experienced debt retirement losses of $13.9 million in 2003 related to the call premium paid and write-offs of discounts and deferred loan costs in connection with the repayment in full of our 11% Notes.

Provision for Income Taxes

The effective tax rate from continuing operations was 37.6% in 2004 compared to 34.2% in 2003. The increase in the rate was primarily attributed to lower state taxes in 2003 resulting from tax planning strategies and the benefits realized through the favorable resolution of tax contingencies. This also caused a decline in the effective rate from continuing operations in 2003 compared to 2002 of 34.2% in 2003 versus 37.9% in 2002. We expect the effective tax rate in future periods to fall within a range of 37.0 % to 39.0 %.

Liquidity and Capital Resources

We require cash to finance acquisitions and fund debt service and working capital requirements. We rely on cash flows from operations, borrowings under our Revolving Facility and offerings of debt and equity securities to meet these requirements.

Because the majority of our consolidated assets are held by our dealership subsidiaries, the majority of our cash flows from operations is generated by our subsidiaries. As a result, our cash flows and ability to service debt depends to a substantial degree on the results of operations of these subsidiaries and their ability to provide us with cash based on their ability to generate cash. Uncertainties in the economic environment as well as uncertainties associated with the ultimate resolution of geopolitical conflicts may therefore affect our overall liquidity.

A significant portion of our cash flow is used to fund dealership acquisitions. Following is a summary of acquisition activity in recent years:

	(in millions)	
	Subsequent Year Revenues	Cash Portion of Purchase Price (net of cash acquired)
2000 Acquisitions	$ 664.1	$ 91.6
2001 Acquisitions	911.0	120.2
2002 Acquisitions	1,462.9	202.4
2003 Acquisitions	362.5	68.8
2004 Acquisitions (1)	693.9	194.0

(1) Revenues are estimated

Prior to 2004 we had maintained a long-term debt to total capital ratio of approximately 48% to 52% depending on the timing of our dealership acquisitions. We expect to limit our acquisition activity in 2005 and 2006 to approximately 10% of annual revenues. We believe this reduced pace will allow us to reduce our debt to total capital ratio to 40% over the next few years. At December 31, 2004 our long-term debt to total capital ratio was 46.6%. Our long-term debt structure consists of the Revolving Facility due in 2006 and various senior subordinated notes due in 2009 and 2013. These are discussed in more detail below. We believe the combination of cash flows from operations, and the availability under our Revolving Facility (approximately $253.3 million at December 31, 2004) is sufficient to fund both our working capital needs and the targeted acquisition level discussed above.

Floor Plan Facilities

We finance all of our new vehicle inventory through standardized floor plan facilities with DaimlerChrysler Financial Company, LLC (“DaimlerChrysler Financial”), Ford Motor Credit Company (“Ford Credit”), General Motors Acceptance Corporation (“GMAC”), Toyota Financial Services (“Toyota Financial”), Bank of America and JP Morgan Chase Bank. These floor plan facilities bear interest at variable rates based on prime and LIBOR. The weighted average interest rate for all our floor plan facilities was 2.88% for 2004 and 2.76% for 2003. Our floor plan interest expense is offset by amounts received from manufacturers, in the form of floor plan assistance. Floor plan assistance received is capitalized in inventory and charged against cost of sales when the associated inventory is sold. In 2004, we received approximately $40.2 million in manufacturer assistance, which resulted in an effective borrowing rate under our floor plan facilities of 0%. Interest payments under each of our floor plan facilities are due monthly and we are generally not required to make principal repayments prior to the sale of the vehicles.

Long-Term Debt and Credit Facilities

The Revolving Facility: At December 31, 2004 our Revolving Facility had a borrowing limit of $550.0 million, subject to a borrowing base calculated on the basis of our receivables, inventory and equipment and a pledge of certain additional collateral by one of our affiliates (the borrowing base was approximately $577.0 million at December 31, 2004). The amount available to be borrowed under the Revolving Facility is reduced on a dollar-for-dollar basis by the cumulative face amount of outstanding letters of credit. At December 31, 2004, we had $58.1 million in letters of credit outstanding and $253.3 million of borrowing availability. The amounts outstanding under the Revolving Facility bear interest at 2.55 percentage points above LIBOR. The total outstanding balance was approximately $238.6 million as of December 31, 2004. Balances under our Revolving Facility are guaranteed by our operating domestic subsidiaries. On October 6, 2005, we extended the maturity on the Revolving Facility from October 31, 2006 to January 31, 2007.

Senior Subordinated 11% and 8.625% Notes: On August 12, 2003, we issued $200.0 million in aggregate principal amount of 8.625% Notes. The net proceeds, before expenses, of approximately $194.3 million together with an advance from our Revolving Facility, were used to redeem all of the 11% Notes for $194.6 million which included accrued but unpaid interest and the redemption premium of 5.5% on September 10, 2003. A resulting loss of $13.9 million, which includes the redemption premium, and the write-off of unamortized discounts and deferred debt issuance costs is included in other income/(expense), net in the accompanying Consolidated Statement of Income for 2003. On November 19, 2003 we issued an additional $75.0 million in aggregate principal amount of the 8.625% Notes. The net proceeds, before expenses, were approximately $78.9 million, and were used to pay down our Revolving Facility. This $75.0 million issuance contained the same provisions and terms as the $200.0 million issuance. The 8.625% Notes are unsecured obligations that rank equal in right of payment to all of our existing and future senior subordinated indebtedness, mature on August 15, 2013 and are redeemable at our option after August 15, 2008. The redemption premiums for the twelve-month periods beginning August 15 of the years 2008, 2009 and 2010 are 104.313%, 102.875% and 101.438%, respectively. In addition, up to 35% of the aggregate principal amount of the 8.625% Notes may be redeemed on or before August 15, 2006 with net cash proceeds from certain equity offerings. Our obligations under the 8.625% Notes are guaranteed by our operating domestic subsidiaries.

Convertible Senior Subordinated Notes: On May 7, 2002, we issued $149.5 million in aggregate principal amount of 5.25% convertible senior subordinated notes (the "Convertibles") with net proceeds, before expenses, of approximately $145.1 million. The net proceeds were used to repay a portion of the amounts outstanding under our Revolving Facility. The Convertibles are unsecured obligations that rank equal in right of payment to all of our existing and future senior subordinated indebtedness, mature on May 7, 2009, and are redeemable at our option after May 7, 2005. Our obligations under the Convertibles are not guaranteed by any of our subsidiaries.

The Convertibles are convertible into shares of Class A common stock, at the option of the holder, if as of the last day of the preceding fiscal quarter, the closing sale price of our Class A common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of such preceding fiscal quarter is more than 110% of the conversion price per share of Class A common stock on the last day of such preceding fiscal quarter. If this condition is satisfied, then the Convertibles will be convertible at any time, at the option of the holder, through maturity. The initial conversion price per share was $46.87, which is subject to adjustment for certain distributions on, or changes in our Class A common stock, if any, prior to the conversion date. In addition, on or before May 7, 2007, a holder also may convert their Convertibles into shares of our Class A common stock at any time after a 10 consecutive trading day period in which the average of the trading day prices for the Convertibles for that 10 trading day period is less than 103% of the average conversion value for the Convertibles during that period. The conversion value is equal to the product of the closing sale price for our Class A common stock on a given day multiplied by the then current conversion rate, which is the number of shares of Class A common stock into which each $1,000 principal amount of Convertibles is then convertible. None of the conversion features were triggered in 2004.

Notes Payable to a Finance Company: Three notes payable totaling $26.6 million in aggregate principal were assumed with the purchase of certain dealerships during the second quarter of 2004 (the "Assumed Notes"). The Assumed Notes bear interest rates from 9.52% to 10.52% (with a weighted average of 10.19%), have a combined monthly principal and interest payment of $0.3 million, mature November 1, 2015 through September 1, 2016 and are collateralized by letters of credit. We recorded the Assumed Notes at fair value using an interest rate of 5.35%. The interest rate used to calculate the fair value was based on a quoted market price for notes with similar terms as of the date of assumption. As a result of calculating the fair value, a premium of $7.3 million was recorded that will be amortized over the lives of the Assumed Notes. Although the Assumed Notes allow for prepayment, the penalties and fees are disproportionately burdensome relative to the Assumed Notes' principal balance. Therefore, we do not currently intend to prepay the Assumed Notes.

The Mortgage Facility: We have a revolving real estate and construction (the "Construction Loan") and mortgage refinancing (the "Permanent Loan") line of credit with Toyota Credit (collectively, "The Mortgage Facility"). Under the Construction Loan, our dealership development subsidiaries can borrow up to $50.0 million to finance land acquisition and dealership construction costs. Advances can be made under the Construction Loan until November 2007. All advances will mature on December 31, 2007, bear interest at 2.25 percentage points above LIBOR and are secured by our guarantee and a lien on all of the borrowing subsidiaries' real estate and other assets. Under the Permanent Loan, we can refinance up to $100.0 million in advances under the Construction Loan once the projects are completed and can finance real estate acquisition costs to the extent these costs were not previously financed under the Construction Loan. Advances can be made under the Permanent Loan until December 2007. All advances under the Permanent Loan mature on December 31, 2012, bear interest at 2.00% above LIBOR and are secured by the same collateral given under the Construction Loan. The Mortgage Facility allows us to borrow up to $100.0 million in the aggregate under the Construction Loan and the Permanent Loan. The Mortgage Facility is not cross-collateralized with the Revolving Facility; however, a default under one will cause a default under the other. Borrowings under the Mortgage Facility were repaid during 2004. We do not currently intend to borrow on the Construction and Permanent Loans in the future.

Covenants and Default Provisions: We were in compliance with all of the restrictive and financial covenants on all of our floor plan and long-term debt facilities at December 31, 2004. Noncompliance with covenants, including a failure to make any payment when due, under our Revolving Facility, Mortgage Facility, floor plan facilities, 8.625% Notes and

Convertibles (collectively, our “Material Debt Agreements”) could result in a default and an acceleration of our repayment obligation under our Revolving Facility. A default under our Revolving Facility would constitute a default under our Mortgage Facility and floor plan facilities and could entitle these lenders to accelerate our repayment obligations under the Mortgage Facility and/or one or more of the floor plan facilities. A default under our Revolving Facility, Mortgage Facility and one or more floor plan facilities would not result in a default under our 8.625% Notes or Convertibles unless our repayment obligations under the Revolving Facility, Mortgage Facility and/or one or more of the floor plan facilities were accelerated. An acceleration of our repayment obligation under any of our Material Debt Agreements could result in an acceleration of our repayment obligations under our other Material Debt Agreements. We expect to be in compliance with the covenants for all of our long-term debt agreements for the foreseeable future. Our financial covenant calculations for the Revolving Facility were as follows as of and for the year ended December 31, 2004:

Covenant	Actual	Required
Current ratio	1.23	³ 1.23
Fixed charge coverage	1.62	³ 1.40
Adjusted fixed charge coverage	1.35	³ 1.15
Interest coverage	3.17	³ 2.00
Adjusted debt to EBITDA	1.39	£ 2.25

As discussed in Note 6 to our Consolidated Financial Statements, we will remain in compliance with the required specified current ratio if there is adequate availability on the Revolving Facility which will, when added to our total current assets, make the current ratio greater than or equal to 1.23.

Acquisitions and Dispositions

During 2004, we acquired 13 franchises for a combined purchase price of $194.0 million in cash. The cash utilized for these acquisitions was financed by cash generated from our existing operations and by borrowings under our Revolving Facility. During 2004, we disposed of or terminated seven franchises. These disposals generated cash of $32.5 million.

Sale-Leaseback Transactions

In an effort to generate additional cash flow, we typically seek to structure our operations to minimize the ownership of real property. As a result, facilities either constructed by us or obtained in acquisitions are typically sold to third parties in sale-leaseback transactions. The resulting leases generally have initial terms of 10-20 years and include a series of five-year renewal options. We have no continuing obligations under these arrangements other than lease payments. The majority of our sale-leaseback transactions are completed with CARS. In 2004, we sold $49.0 million in dealership property and equipment in sale-leaseback transactions. There were no material gains or losses on these sales.

Capital Expenditures

Our capital expenditures include the construction of new dealerships and collision repair centers, building improvements and equipment purchased for use in our dealerships. Capital expenditures in 2004 were approximately $105.6 million, of which approximately $77.4 million related to the construction of new dealerships and collision repair centers and real estate acquired in connection with such construction. Once completed, these new dealerships and collision repair centers are generally sold in sale-leaseback transactions. Capital expenditures incurred during 2004 expected to be sold within a year or sold in 2004 in sale-leaseback transactions were $80.7 million. We do not expect any significant gains or losses from these sales. As of December 31, 2004, commitments for facilities construction projects totaled approximately $20.2 million. We expect $17.9 million of this amount to be financed through future sale-leaseback transactions.

Stock Repurchase Program

Our Board of Directors has authorized us to expend up to $185.0 million to repurchase shares of our Class A common stock or redeem securities convertible into Class A common stock. In 2004, we repurchased 951,500 shares for approximately $20.9 million which was somewhat offset by proceeds received from the exercise of stock options under stock compensation plans of $15.8 million. As of December 31, 2004 we had $32.8 million remaining under our Board authorization.

Dividends

Our Board of Directors approved four quarterly cash dividends totaling $0.44 per share during 2004. We intend to pay dividends in the future based on available cash flows, covenant compliance and other factors.

Cash Flows

In 2004, we focused our efforts on working capital management and applying excess cash against the Revolving Facility. As a result of this working capital management and lower fourth quarter tax payments, cash flow from operations in 2004 of $258.2 million exceeded comparative amounts. In 2002 and 2003, working capital uses were substantially offset by cash adjustments to net income such as depreciation and amortization, gains and losses on the retirement of debt, deferred taxes and the cumulative effect of change in accounting principle resulting in cash flows from operating activities approximating net income.

Cash used for investing activities in 2004 was $199.0 million, the majority of which was related to dealership acquisitions and capital expenditures on construction in progress projects offset by proceeds received from dealership dispositions and the sales of property and equipment. Net cash used in financing activities was $131.3 million and primarily related to payments on our Revolving Facility and notes payable – floor plan – non-trade, stock repurchases and dividend payments.

Guarantees

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

In connection with franchise dispositions, certain of our dealership subsidiaries have assigned or sublet to the buyer their interests in real property leases associated with such dealerships. In general, the subsidiaries retain responsibility for the performance of certain obligations under such leases, including rent payments and repairs to leased property upon termination of the lease, to the extent that the assignee or sublessee does not perform. The total estimated rent payments remaining under such leases as of December 31, 2004 was approximately $54.7 million. However, in accordance with the terms of the assignment and sublease agreements, the assignees and sublessees have generally agreed to indemnify Sonic and its subsidiaries in the event of non-performance. Additionally, in connection with certain dispositions, we have obtained indemnifications from the parent company or owners of these assignees and sublessees in the event of non-performance.

In accordance with the terms of agreements entered into for the sale of our franchises, we generally agree 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 our exposure with respect to environmental remediation and repairs is difficult to quantify, we estimate our maximum exposure associated with these general indemnifications was approximately $46.0 million at December 31, 2004. 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.

We expect the value of these various guarantees to continue to increase as we dispose of additional franchises.

Future Liquidity Outlook

Our future obligations as of December 31, 2004 are as follows:

	(Amounts in thousands)						
	2005	2006	2007	2008	2009	Thereafter	Total
Floor Plan Facilities (1)	$ 1,050,858	$ —	$ —	$ —	$ —	$ —	$ 1,050,858
Long-Term Debt (2)	2,970	241,722	2,462	2,596	130,231	291,815	671,796
Estimated Interest Payments on Floor Plan Financings (3)	6,428	—	—	—	—	—	6,428
Estimated Interest Payments on Long-Term Debt (4)	45,152	42,814	32,813	32,638	27,973	91,992	273,382
Operating Leases	137,621	137,126	128,459	121,343	104,501	908,940	1,537,990
Construction Contracts	20,244	—	—	—	—	—	20,244
Other Purchase Obligations	6,267	4,759	3,409	284	—	—	14,719
Acquisition Purchase Commitments (5)	25,721	—	—	—	—	—	25,721
Total	$ 1,295,261	$ 426,421	$ 167,143	$ 156,861	$ 262,705	$ 1,292,747	$ 3,601,138

(1) Floor plan facilities includes amounts classified as liabilities associated with assets held for sale.

(2) Certain amounts are redeemable at our option (see preceding discussion regarding long-term debt and credit facilities) but have been classified in this schedule according to contractual maturity. On October 6, 2005, we extended the maturity on the Revolving Facility from October 31, 2006 to January 31, 2007.

(3) Floor plan facilities balances (included amount classified as liabilities associated with assets held for sale) are correlated with the amount of vehicle inventory and are generally due at the time that a vehicle is sold. Estimated interest payments were calculated using the December 31, 2004 floor plan facilities balance, the weighted average interest rate for the fourth quarter of 2004 of 3.67% and the assumption that floor plan facilities balances at December 31, 2004 would be relieved within sixty days in connection with the sale of the associated vehicle inventory.

(4) Estimated interest payments calculated assuming contractual maturities, no principal payments on the Revolving Facility before the contractual maturity and the interest rate in effect at December 31, 2004 (4.95%) for the Revolving Facility. Estimated interest payments do not include net interest expense from our interest rate swaps. See *Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations - Interest Expense, Other, Net*, and *Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Risk*, for discussion regarding our interest rate swaps.

(5) Amount represents estimated purchase price of tangible and intangible assets net of floor plan facilities balances.

We believe our best source of liquidity for future growth remains cash flows generated from operations combined with our availability of borrowings under our floor plan facilities (or any replacements thereof) and our Revolving Facility. Though uncertainties in the economic environment as well as uncertainties associated with geopolitical conflicts may affect our ability to generate cash from operations, we expect to generate more than sufficient cash flow to fund our debt service and working capital requirements and any seasonal operating requirements, including our currently anticipated internal growth for our existing businesses, for the foreseeable future. Once these needs are met, we may use remaining cash flow to support our acquisition strategy or repurchase shares of our Class A common stock or publicly traded debt securities, as market conditions warrant.

Seasonality

Our operations are subject to seasonal variations. The first and fourth quarters generally contribute less revenue and operating profits than the second and third quarters. Weather conditions, the timing of manufacturer incentive programs and model changeovers cause seasonality in, and may adversely affect, our profitability and new vehicle demand. Parts and service demand remains more stable throughout the year.

Item 7A: ***Quantitative and Qualitative Disclosures About Market Risk***

Interest Rate Risk

Our variable rate floor plan facilities, Revolving Facility borrowings and other variable rate notes expose us to risks caused by fluctuations in the applicable interest rates. The total outstanding balance of such variable instruments after considering the effect of our interest rate swaps (see below) was approximately $1,241.0 million at December 31, 2004 and approximately $1,292.4 million at December 31, 2003. A change of 100 basis points in the underlying interest rate would have caused a change in interest expense of approximately $11.8 million in 2004 and approximately $10.1 million in 2003. Of the total change in interest expense, approximately $8.0 million in 2004 and approximately $8.0 million in 2003 would have resulted from the floor plan notes facilities.

Our exposure with respect to floor plan facilities is mitigated by floor plan assistance payments received from manufacturers that are generally based on rates similar to those incurred under our floor plan financing arrangements. These payments are capitalized as inventory and charged against cost of sales when the associated inventory is sold. During 2004 and 2003, the amounts we recognized from manufacturer floor plan assistance for both continuing and discontinued franchises exceeded our floor plan interest expense by approximately $11.0 million and $17.2 million, respectively. A change in interest rates of 100 basis points would have had an estimated impact on floor plan assistance of approximately $5.3 million in 2004 and $6.9 million in 2003. Should the amount of floor plan assistance payments received from manufacturers decrease from the current levels, it is likely that this decrease could adversely affect our future operating results to the extent that this decrease is not recaptured in prices charged to new vehicle customers.

In addition to our variable rate debt, approximately 25% of our dealership facilities have monthly lease payments that fluctuate based on LIBOR interest rates. Many of our lease agreements have interest rate floors whereby our lease expense would not fluctuate significantly in periods when LIBOR is relatively low.

In order to reduce our exposure to market risks from fluctuations in interest rates, we have two separate interest rate swap agreements (the “Fixed Swaps”) to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate. The first swap agreement matured October 31, 2004 and had a notional principal amount of $100.0 million. The second swap agreement will mature June 6, 2006 and has a notional principal of $100.0 million. Under the terms of the first swap agreement, we received interest payments on the notional amount at a rate equal to the one month LIBOR rate, adjusted monthly, and made interest payments at a fixed rate of 3.88%. Under the terms of the second swap agreement, we receive interest payments on the notional amount at a rate equal to the one month LIBOR rate, adjusted monthly, and make interest payments at a fixed rate of 4.50%.

In 2003, we entered into five separate interest rate swaps totaling $150.0 million (collectively, the “Variable Swaps”) to effectively convert a portion of our fixed rate debt to a LIBOR-based variable rate debt. Under the Variable Swaps’ agreements, we receive 8.625% on the respective notional amounts and pay interest payments on the respective notional amounts at a rate equal to the six month LIBOR in arrears (as determined on February 15 and August 15 of each year) plus a spread ranging from 3.50% to 3.84% with a weighted average spread of 3.64%. The Variable Swaps expire on August 15, 2013.

Future maturities of variable and fixed rate debt, and related interest rate swaps are as follows:

	(Amounts in thousands, except for interest rates)							
	2005	2006	2007	2008	2009	Thereafter	Total	Fair Value
Liabilities								
Long-term Debt:								
Fixed Rate	$2,215	$ 2,334	$2,462	$2,596	$130,231	$ 291,815	$ 431,653	$465,185
Average Stated Interest Rate	10.19%	10.19%	10.19%	10.19%	5.32%	8.72%	7.70%	
Variable Rate (1)	755	239,388	—	—	—	—	240,143	240,143
Average Stated Interest Rate	8.00%	4.91%					4.92%	
Interest Rate Derivatives								
Interest Rate Swaps:								
Variable to Fixed	—	100,000	—	—	—	—	100,000	2,013
Average pay rate		4.50%					4.50%	
Average receive rate		1Month Libor					1Month Libor	
Fixed to Variable	—	—	—	—	—	150,000	150,000	145
Average pay rate						3.64% + 6 month LIBOR	3.64% + 6 month LIBOR	
Average receive rate						8.625%	8.625%	

(1) On October 6, 2005, we extended the maturity on the Revolving Facility from October 31, 2006 to January 31, 2007.

Foreign Currency Risk

In common with other automotive retailers, we purchase certain of our new vehicle and parts inventories from foreign manufacturers. Although we purchase our inventories in U.S. Dollars, our business is subject to foreign exchange rate risk which may influence automobile manufacturers' ability to provide their products at competitive prices in the United States. To the extent that we cannot recapture this volatility in prices charged to customers or if this volatility negatively impacts consumer demand for our products, this volatility could adversely affect our future operating results.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Sonic Automotive, Inc.
Charlotte, North Carolina

We have audited the consolidated balance sheets of Sonic Automotive, Inc. and Subsidiaries (the "Company") as of December 31, 2003 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2003 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2003, the Company adopted the provisions of Emerging Issues Task Force Issue No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor.*

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 4, 2005 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Charlotte, North Carolina
March 4, 2005 (November 2, 2005 as to Notes 1, 2, 3, 4, 6, 7, 9, 11, and 12)

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2003 and 2004
(Dollars in thousands)

	December 31, 2003	December 31, 2004
ASSETS		
Current Assets:		
Cash	$ 82,082	$ 9,991
Receivables, net	306,498	357,403
Inventories	966,318	1,024,342
Assets held for sale	104,072	98,530
Other current assets	95,227	101,277
Total current assets	1,554,197	1,591,543
Property and Equipment, net	125,356	134,490
Goodwill, net	909,091	1,056,924
Other Intangible Assets, net	75,230	84,777
Other Assets	22,355	33,877
Total Assets	$ 2,686,229	$ 2,901,611
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Notes payable - floor plan - trade	$ 542,783	$ 609,422
Notes payable - floor plan - non-trade	375,344	375,127
Trade accounts payable	63,577	88,616
Accrued interest	13,851	15,421
Other accrued liabilities	121,744	175,510
Liabilities associated with assets held for sale - trade	62,178	54,513
Liabilities associated with assets held for sale - non-trade	16,065	11,796
Current maturities of long-term debt	1,387	2,970
Total current liabilities	1,196,929	1,333,375
Long-Term Debt	694,898	668,826
Other Long-Term Liabilities	19,136	28,888
Deferred Income Taxes	76,933	100,835
Commitments and Contingencies		
Stockholders' Equity:		
Class A convertible preferred stock, none issued	—	—
Class A common stock, $.01 par value; 100,000,000 shares authorized; 38,588,913 shares issued and 29,192,549 shares outstanding at December 31, 2003; 39,979,567 shares issued and 29,631,703 shares outstanding at December 31, 2004	384	397
Class B common stock; $.01 par value; 30,000,000 shares authorized; 12,029,375 shares issued and outstanding at December 31, 2003 and December 31, 2004	121	121
Paid-in capital	416,892	441,503
Retained earnings	402,799	470,663
Accumulated other comprehensive loss	(4,419)	(1,228)
Deferred compensation related to restricted stock	—	(3,408)
Treasury stock, at cost (9,396,364 Class A shares held at December 31, 2003 and 10,347,864 Class A shares held at December 31, 2004)	(117,444)	(138,361)
Total stockholders' equity	698,333	769,687
Total Liabilities and Stockholders' Equity	$ 2,686,229	$ 2,901,611

See notes to consolidated financial statements.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2002, 2003 and 2004
(Dollars and shares in thousands, except per share amounts)

	Year Ended December 31,		
	2002	2003	2004
Revenues:			
New vehicles	$ 3,733,834	$ 4,119,602	$ 4,376,745
Used vehicles	1,075,417	1,102,687	1,141,616
Wholesale vehicles	409,428	410,698	481,928
Total vehicles	5,218,679	5,632,987	6,000,289
Parts, service and collision repair	814,058	900,737	994,372
Finance, insurance and other	177,860	185,066	183,738
Total revenues	6,210,597	6,718,790	7,178,399
Cost of sales	5,236,728	5,691,117	6,075,848
Gross profit	973,869	1,027,673	1,102,551
Selling, general and administrative expenses	736,054	811,904	867,532
Depreciation and amortization	7,507	10,890	16,304
Operating income	230,308	204,879	218,715
Other income / (expense):			
Interest expense, floor plan	(20,249)	(20,116)	(25,866)
Interest expense, other, net	(40,810)	(41,480)	(42,436)
Other income / (expense), net	3,315	(13,843)	48
Total other expense	(57,744)	(75,439)	(68,254)
Income from continuing operations before taxes and cumulative effect of change in accounting principle	172,564	129,440	150,461
Provision for income taxes	65,350	44,229	56,635
Income from continuing operations before cumulative effect of change in accounting principle	107,214	85,211	93,826
Discontinued operations:			
Loss from operations and the sale of discontinued franchises	(645)	(9,618)	(10,648)
Income tax benefit	(5)	1,586	2,893
Loss from discontinued operations	(650)	(8,032)	(7,755)
Income before cumulative effect of change in accounting principle	106,564	77,179	86,071
Cumulative effect of change in accounting principle, net of tax benefit of $3,325	—	(5,619)	—
Net income	$ 106,564	$ 71,560	$ 86,071
Basic earnings (loss) per share:			
Earnings per share from continuing operations	$ 2.57	$ 2.08	$ 2.27
Loss per share from discontinued operations	(0.02)	(0.19)	(0.19)
Earnings per share before cumulative effect of change in accounting principle	2.55	1.89	2.08
Cumulative effect of change in accounting principle	—	(0.14)	—
Earnings per share	$ 2.55	$ 1.75	$ 2.08
Weighted average common shares outstanding	41,728	40,920	41,375
Diluted earnings (loss) per share:			
Earnings per share from continuing operations	$ 2.44	$ 1.99	$ 2.17
Loss per share from discontinued operations	(0.01)	(0.18)	(0.17)
Earnings per share before cumulative effect of change in accounting principle	2.43	1.81	2.00
Cumulative effect of change in accounting principle	—	(0.12)	—
Earnings per share	$ 2.43	$ 1.69	$ 2.00
Weighted average common shares outstanding	45,153	45,197	45,217
Dividends declared per common share	$ —	$ 0.20	$ 0.44

See notes to consolidated financial statements

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2002, 2003 and 2004
(Dollars and shares in thousands)

	Preferred Stock		Class A Common Stock		Class B Common Stock		Deferred Compensation Related to Restricted Stock	Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Compre-hensive Income
	Shares	Amount	Shares	Amount	Shares	Amount							
BALANCE AT DECEMBER 31, 2001	—	—	34,851	$ 348	12,029	$ 121	—	$343,256	$232,893	$ (59,357)	—	$ 517,261	$ —
Shares awarded under stock compensation plans	—	—	1,059	10	—	—	—	12,246		—	—	12,256	—
Issuance of Class A Common Stock for Acquisitions	—	—	1,336	13	—	—	—	34,496	—	—	—	34,509	—
Purchases of treasury stock	—	—	—	—	—	—	—	—	—	(33,780)	—	(33,780)	—
Income tax benefit associated with stock compensation plans	—	—	—	—	—	—	—	6,815	—	—	—	6,815	
Fair value of interest rate swap agreements, net of tax benefit of $4,122	—	—	—	—	—	—	—	—	—	—	$ (6,447)	(6,447)	(6,447)
Net income	—	—	—	—	—	—	—	—	106,564	—	—	106,564	106,564
BALANCE AT DECEMBER 31, 2002	—	—	37,246	$ 371	12,029	$ 121	—	$396,813	$339,457	$ (93,137)	$ (6,447)	$ 637,178	$100,117
Shares awarded under stock compensation plans	—	—	1,343	13	—	—	—	14,689	—	—	—	14,702	—
Purchases of treasury stock	—	—	—	—	—	—	—	—	—	(24,307)	—	(24,307)	—
Income tax benefit associated with stock compensation plans	—	—	—	—	—	—	—	5,390	—	—		5,390	—
Fair value of interest rate swap agreements, net of tax expense of $1,296	—	—	—	—	—	—	—	—	—	—	2,028	2,028	2,028
Net income	—	—	—	—	—	—	—	—	71,560	—	—	71,560	71,560
Dividends ($.20 per share)	—	—	—	—	—	—	—	—	(8,218)	—	—	(8,218)	
BALANCE AT DECEMBER 31, 2003	—	—	38,589	$ 384	12,029	$ 121	$ —	$416,892	$402,799	$(117,444)	$ (4,419)	$ 698,333	$ 73,588
Shares awarded under stock compensation plans	—	—	1,391	13	—	—	(3,570)	19,341	—		—	15,784	—
Purchases of treasury stock	—	—	—	—	—	—	—		—	(20,917)	—	(20,917)	—
Income tax benefit associated with stock compensation plans	—	—	—	—	—	—	—	5,270	—	—	—	5,270	—
Fair value of interest rate swap agreements, net of tax expense of $2,040	—	—	—	—	—	—	—	—	—	—	3,191	3,191	3,191
Restricted stock amortization							162					162	
Net income	—	—	—	—	—	—	—	—	86,071	—	—	86,071	86,071
Dividends ($.44 per share)	—	—	—	—	—	—	—	—	(18,207)	—	—	(18,207)	
BALANCE AT DECEMBER 31, 2004	—	—	39,980	$ 397	12,029	$ 121	$ (3,408)	$441,503	$470,663	$(138,361)	$ (1,228)	$ 769,687	$ 89,262

See notes to consolidated financial statements

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2002	2003	2004
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 106,564	$ 71,560	$ 86,071
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of property, plant and equipment	8,974	12,313	17,131
Other amortization	—	105	281
Debt issuance cost amortization	413	417	526
Debt discount amortization, net of premium amortization	785	923	78
Restricted stock amortization	—	—	162
Cumulative effect of change in accounting principle, net of tax	—	5,619	—
Deferred income taxes	15,048	18,610	15,781
Equity interest in earnings of investees	(354)	(758)	(807)
Impairment of franchise agreements	—	500	1,075
Gain on disposal of franchises and property and equipment	(3,470)	(3,458)	(1,389)
(Gain)/Loss on retirement of debt	(3,144)	13,928	—
Income tax benefit associated with stock compensation plans	6,815	5,390	5,270
Changes in assets and liabilities that relate to operations:			
Receivables	(26,888)	(7,274)	(50,406)
Inventories	(27,254)	(122,789)	28,055
Other assets	(403)	(21,815)	10
Notes payable - floor plan - trade	10,514	73,994	64,177
Trade accounts payable and other liabilities	19,271	16,560	92,210
Total adjustments	307	(7,735)	172,154
Net cash provided by operating activities	106,871	63,825	258,225
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of businesses, net of cash acquired	(202,365)	(68,814)	(194,017)
Purchases of property and equipment	(92,516)	(90,419)	(105,603)
Proceeds from sales of property and equipment	42,320	49,910	68,136
Proceeds from sale of franchises	17,575	26,390	32,477
Net cash used in investing activities	(234,986)	(82,933)	(199,007)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net borrowings/(repayments) on notes payable floor plan - non-trade	32,710	69,087	(49,511)
Net borrowings/(repayments) on revolving credit facilities	18,257	(34,644)	(56,927)
Proceeds from long-term debt	145,074	271,631	164
Debt issuance costs	(698)	(619)	—
Payments on long-term debt	(2,382)	(8,747)	(2,537)
Repurchase of debt securities	(32,746)	(192,390)	—
Purchases of treasury stock	(33,780)	(24,307)	(20,917)
Issuance of shares under stock compensation plans	12,256	14,702	15,784
Dividends paid	—	(4,099)	(17,365)
Net cash provided by (used in) financing activities	138,691	90,614	(131,309)
NET INCREASE (DECREASE) IN CASH	10,576	71,506	(72,091)
CASH, BEGINNING OF YEAR	—	10,576	82,082
CASH, END OF YEAR	$ 10,576	$ 82,082	$ 9,991
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING ACTIVITIES:			
Change in accrual for purchases of property and equipment	$ —	$ 5,656	$ (1,226)
SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:			
Restricted stock issuance	$ —	$ —	$ 3,570
Long-term debt assumed in purchase of business, including premium of $7,254	$ —	$ —	$ 33,824
Class A Common Stock issued for acquisitions	$ 34,509	$ —	$ —
Change in fair value of cash flow hedging instrument (net of tax benefit of $4,122 in 2002, tax expense of $1,296 and $2,040 in 2003 and 2004, respectively)	$ (6,447)	$ 2,028	$ 3,191
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest, net of amount capitalized	$ 65,019	$ 66,994	$ 74,398
Income taxes	$ 42,239	$ 24,319	$ 14,731

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(All tables in thousands except per share amounts)

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Business—Sonic Automotive, Inc. ("Sonic" or the "Company") is one of the largest automotive retailers in the United States (as measured by total revenue), operating 192 dealership franchises and 40 collision repair centers throughout the United States as of December 31, 2004. Sonic sells new and used cars and light trucks, sells replacement parts, provides vehicle maintenance, warranty, paint and repair services, and arranges related financing, insurance, vehicle protection protects and other aftermarket products for its automotive customers. As of December 31, 2004, Sonic sold a total of 38 foreign and domestic brands of new vehicles.

Principles of Consolidation—All of Sonic's dealership and non-dealership subsidiaries are wholly owned and consolidated in the accompanying consolidated financial statements except for the one fifty-percent owned dealership subsidiary that is accounted for under the equity method in accordance with Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock". All material intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

Reclassifications—In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", individual franchises sold, terminated or classified as held for sale are required to be reported as discontinued operations. During 2004, Sonic completed the disposal of four franchises, terminated three franchises and as of December 31, 2004 had approved, but not yet completed, the disposition of 24 additional franchises. In the first nine months of 2005, Sonic added 12 additional franchises to assets held for sale, sold six of those franchises and sold eight of the 24 franchises held for sale at December 31, 2004. Therefore, as of September 30, 2005, Sonic had 22 franchises classified as held for sale. In accordance with the provisions of SFAS No. 144, the results of operations of these franchises for the years ended December 31, 2002, 2003 and 2004 were reported as discontinued operations for all periods presented. Many of the provisions of SFAS No. 144 involve judgment in determining whether a franchise will be reported as continuing or discontinued operations. Such judgments include whether a franchise will be sold or terminated, the period required to complete the disposition and the likelihood of changes to a plan for sale. If in future periods Sonic determines that a franchise should be either reclassified from continuing operations to discontinued operations or from discontinued operations to continuing operations, previously reported consolidated statements of income are reclassified in order to reflect the current classification.

Certain cash flows in the accompanying Consolidated Statements of Cash Flows have been reclassified in accordance with SFAS No. 95, "Statement of Cash Flows". Sonic's previous policy was to classify all of the cash flow activities associated with floor plan notes payable as an operating activity in its Consolidated Statements of Cash Flows consistent with industry practice. Sonic has decided to classify borrowings and repayments on floor plan notes payable for new vehicle inventory purchased from a manufacturer affiliated with floor plan lenders as an operating activity (floor plan notes payable – trade) on the statement of cash flows. Borrowings and repayments on floor plan notes payable for new vehicle inventory purchased from a manufacturer unaffiliated with the floor plan lender (floor plan notes payable – non-trade) have been classified as a net financing activity on the statement of cash flows because these borrowings are due on demand from the floor plan lenders. The following table shows the effects of this reclassification and other reclassifications, which did not impact Sonic's beginning or endings cash positions or total change in cash, on the consolidated statement of cash flows.

	(Dollars in thousands) Years Ended December 31,		
	2002	2003	2004
Net cash provided by operating activities as previously reported	$ 139,581	$138,568	$ 209,750
Reclassification of floor plan notes payable - non-trade	(32,710)	(69,087)	49,511
Other reclassifications	—	(5,656)	(1,036)
Revised net cash provided by operating activities	$ 106,871	$ 63,825	$ 258,225
Net cash used in investing activities as previously reported	$(234,986)	$ (88,589)	$(200,043)
Other reclassifications	—	5,656	1,036
Revised net cash used in investing activities	$(234,986)	$ (82,933)	$(199,007)
Net cash provided by (used in) financing activities as previously reported	$ 105,981	$ 21,527	$ (81,798)
Reclassification of floor plan notes payable - non-trade	32,710	69,087	(49,511)
Revised net cash provided by (used in) financing activities	$ 138,691	$ 90,614	$(131,309)

Sonic has also decided to classify notes-payable for new vehicle inventory purchased from a manufacturer affiliated with a floor plan lender as “Notes payable – floor plan – trade” and the remaining floor plan notes payable have been renamed “Notes payable – floor plan – non-trade” on the accompanying consolidated balance sheets. Further, notes payable– floor plan classified as “Liabilities associated with assets held for sale” (see Note 2) have been similarly split into “trade” and “non-trade” classifications on the accompanying consolidated balance sheets.

In addition, in order to maintain consistency and comparability between periods, certain other amounts in Sonic’s consolidated financial statements have been reclassified from previously reported balances to conform to the current year presentation. These reclassifications primarily relate to the presentation of assets and liabilities for franchises classified as held for sale (see Note 2), the presentation of assets relating to real estate and construction costs expected to be sold in one year in sale-leaseback transactions in the accompanying consolidated balance sheets (see Note 4) and accompanying consolidated income statement reclassifications relating to the Company’s wholly owned finance subsidiary Cornerstone Acceptance (“Cornerstone”). Interest income from Cornerstone’s finance contracts ($3.5 million in 2002, $4.3 million in 2003 and $7.2 million in 2004) has been reclassified from a reduction of interest expense, other, net to a reduction of selling, general and administrative expenses. A portion of bad debt expense from Cornerstone’s finance contracts ($1.4 million in 2002, $2.4 million in 2003 and $4.6 million in 2004) has been reclassified from cost of sales to selling, general and administrative expenses. As a result of this reclassification, all of Cornerstone’s bad debt expense is now classified as selling, general and administrative expenses.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Sonic’s management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates particularly related to allowance for credit loss, realization of inventory, intangible asset and deferred tax asset values, reserves for tax contingencies, legal matters, reserves for future chargebacks, results reported as continuing and discontinued operations, insurance reserves and certain accrued expenses.

Revenue Recognition—Sonic records revenue when vehicles are delivered to customers, when vehicle service work is performed and when parts are delivered.

Sonic arranges financing for customers through various financial institutions and receives a commission from the financial institution either in a flat fee amount or in an amount equal to the difference between the interest rates charged to customers over the predetermined interest rates set by the financial institution. Sonic also receives commissions from the sale of various insurance contracts to customers. Sonic may be assessed a chargeback fee in the event of early cancellation of a loan or insurance contract by the customer. Finance and insurance commission revenue is recorded net of estimated chargebacks at the time the related contract is placed with the financial institution.

Sonic also receives commissions from the sale of non-recourse third party extended service contracts to customers. Under these contracts, the applicable manufacturer or third party warranty company is directly liable for all warranties provided within the contract. Commission revenue from the sale of these third party extended service contracts is recorded net of estimated chargebacks at the time of sale. As of December 31, 2003 and 2004, the amounts recorded as allowances for commission chargeback reserves were $12.8 million and $17.8 million, respectively. The majority of these amounts recorded as allowances for commission chargeback reserves were classified in the accompanying consolidated financial statements as other accrued liabilities and the remaining amount was classified as other long-term liabilities.

Floor Plan Assistance—Sonic receives floor plan assistance payments from certain manufacturers. This assistance reduces the carrying value of Sonic's new vehicle inventory and is recognized as a reduction of cost of sales at the time the vehicle is sold. Amounts included in cost of sales were $33.1 million, $34.7 million and $36.6 million for the years ended December 31, 2002, 2003 and 2004, respectively.

Contracts in Transit—Contracts in transit represent customer finance contracts evidencing loan agreements or lease agreements between Sonic, as creditor, and the customer, as borrower, to acquire or lease a vehicle in situations where a third-party finance source has given Sonic initial, non-binding approval to assume Sonic's position as creditor. Funding and final approval from the finance source is provided upon the finance source's review of the loan or lease agreement and related documentation executed by the customer at the dealership. These finance contracts are typically funded within ten days of the initial approval of the finance transaction given by the third-party finance source. The finance source is not contractually obligated to make the loan or lease to the customer until it gives its final approval and funds the transaction, and until such final approval is given, the contracts in transit represent amounts due from the customer to Sonic. Contracts in transit are included in receivables on the accompanying consolidated balance sheets and totaled $126.4 million at December 31, 2003 and $139.2 million at December 31, 2004.

Accounts Receivable—Sonic's accounts receivable consist primarily of amounts due from the manufacturers for repair services performed on vehicles with a remaining factory warranty and amounts due from third parties from the sale of parts. Sonic believes that there is a minimal risk of uncollectability on warranty receivables. Sonic evaluates parts and other receivables for collectability based on the age of the receivable, the credit history of the customer and past collection experience. The allowance for doubtful accounts receivable is not significant.

Inventories—Inventories of new, net of manufacturer credits, and used vehicles, including demonstrators, are stated at the lower of specific cost or market. Inventories of parts and accessories are accounted for using the "first-in, first-out" ("FIFO") method of inventory accounting and are stated at the lower of FIFO cost or market. Other inventories are primarily service loaner vehicles and, to a lesser extent, vehicle chassis, other supplies and capitalized customer work-in-progress (open customer vehicle repair orders). Other inventories are stated at the lower of specific cost (depreciated cost for service loaner vehicles) or market.

Sonic assesses the valuation of all of its vehicle and parts inventories and maintains a reserve where the cost basis exceeds the fair market value. In making this assessment for new vehicles, Sonic primarily considers the age of the vehicles along with the timing of annual and model changeovers. For used vehicles, Sonic considers recent market data and trends such as loss histories along with the current age of the inventory. Parts inventories are primarily assessed considering excess quantity and continued usefulness of the part. The risk with parts inventories is minimized by the fact that excess or obsolete parts can generally be returned to the manufacturer. Sonic recorded a $0.9 million reserve during 2004 related to wholesale parts operations. This reserve was classified as cost of sales in the 2004 consolidated statement of income. Sonic did not record any significant reserves on any inventory balances in 2002 and 2003.

Property and Equipment—Property and equipment are stated at cost. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets. Sonic amortizes leasehold improvements over the shorter of the estimated useful life or the remaining lease life. This lease life includes renewal options if a renewal has been determined to be reasonably assured. The range of estimated useful lives is as follows:

Leasehold and land improvements	10-30 years
Buildings	10-20 years
Parts and service equipment	7-10 years
Office equipment and fixtures	3-10 years
Company vehicles	3-5 years

Sonic reviews the carrying value of property and equipment and other long-term assets (other than goodwill) for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If such an indication is present, Sonic compares the carrying amount of the asset to the estimated undiscounted cash flows related to those assets. Sonic concludes that an asset is impaired if the sum of such expected future cash flows is less than the carrying amount of the related asset. If Sonic determines an asset is impaired, the impairment loss would be the amount by which the carrying amount of the related asset exceeds its fair value. The fair value of the asset would be determined based on the quoted market prices, if available. If quoted market prices are not available, Sonic determines fair value by using a discounted cash flow model.

In 2004, property and equipment impairment charges totaling $0.8 million were recorded in continuing operations (selling, general and administrative expenses) relating to the abandonment of construction projects and the abandonment and disposal of dealership equipment. These construction project impairment charges were recorded in connection with the decision to abandon the construction projects. The dealership equipment impairment charges were recorded in connection with the decision to downsize certain wholesale parts operations. Additional property and equipment impairment charges of $2.4 million were recorded during 2004 in discontinued operations relating to the abandonment of construction projects and the write-down of leasehold improvements for franchises classified as assets held for sale. The construction projects were abandoned in connection with the decision to sell the related franchises. The impairment charge for leasehold improvements relates to the difference between the discounted cash flows of sublease receipts for property where the leasehold improvements reside and the carrying value of the leasehold improvements. An impairment charge for the leasehold improvements was recorded when it was determined that Sonic would not recover the carrying value of the leasehold improvements when considering the lease costs net of sublease receipts.

In 2003, property and equipment impairment charges totaling $0.6 million were recorded in continuing operations (selling, general and administrative expenses) relating to losses incurred on leasehold improvements and dealership equipment abandoned in connection with relocating several dealerships. It was estimated that the dealerships associated with the soon to be vacated properties would not produce cash flows sufficient to recover the leasehold improvements and dealership equipment. The 2003 fixed asset impairment charge of $0.9 million recorded in discontinued operations relates to the estimated loss on the disposal of property formerly used for dealership operations. This estimate was determined by using the results of a real estate appraisal.

Derivative Instruments and Hedging Activities—Sonic utilizes derivative financial instruments for the purpose of hedging the risks of certain identifiable and anticipated transactions and the fair value of certain obligations classified as long-term debt on the accompanying consolidated balance sheets. In general, the types of risks being hedged are those relating to the variability of cash flows and long-term debt fair values caused by fluctuations in interest rates. Sonic documents its risk management strategy and hedge effectiveness at the inception of and during the term of each hedge. The only derivatives currently being used are interest rate swaps used for the purposes of hedging cash flows of variable rate debt and the fair value of fixed rate long-term debt. These derivatives are used only for these purposes and are not used for speculation or trading purposes. The derivatives, which have been designated and qualify as cash flow and fair value hedging instruments, are reported at fair value as determined by market quotations in the accompanying consolidated balance sheets. The gain or loss on the effective portion of the cash flow hedges is initially reported as a component of accumulated other comprehensive loss, net of related income taxes. The gain or loss on the effective portion of the fair value hedges is recorded against long-term debt.

In order to reduce the Company's exposure to market risks from fluctuations in interest rates, Sonic entered into two separate interest rate swap agreements (the "Fixed Swaps") in 2002 to effectively convert a portion of the LIBOR-based variable rate debt to a fixed rate. The first swap agreement matured October 31, 2004 and had a notional principal amount of $100.0 million. The second swap agreement will mature June 6, 2006 and has a notional principal of $100.0 million. Under the terms of the first swap agreement, Sonic received interest payments on the notional amount at a rate equal to the one month LIBOR rate, adjusted monthly, and made interest payments at a fixed rate of 3.88%. Under the terms of the second swap agreement, Sonic receives interest payments on the notional amount at a rate equal to the one month LIBOR rate, adjusted monthly, and makes interest payments at a fixed rate of 4.50%. Incremental interest expense incurred (the difference between interest received and interest paid) as a result of the Fixed Swaps was $6.0 million in 2003 and $5.4 million in 2004 and has been included in interest expense, other, net in the accompanying consolidated statements of income. The Fixed Swaps have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of the Fixed Swaps have been recorded in other comprehensive loss, net of related income taxes, in the statements of stockholders' equity.

In 2003, Sonic entered into five separate interest rate swaps totaling $150.0 million (collectively the "Variable Swaps") to effectively convert a portion of the Company's fixed rate debt to a LIBOR-based variable rate debt. Under the Variable Swaps' agreements, Sonic receives 8.625% on the notional amounts and makes interest payments on the notional amounts at a rate equal to the six month LIBOR in arrears (as determined on February 15 and August 15 of each year) plus a spread ranging from 3.50% to 3.84% with a weighted average spread of 3.64%. The Variable Swaps expire on August 15, 2013 and have been designated and qualify as fair value hedges and, as a result, the fair value of the Variable Swaps of $0.1 million has been recorded against the long-term debt with an offsetting $0.1 million recorded as a derivative liability within other long-term liabilities. The benefit realized (the difference between interest paid and interest received) as a result of the Variable Swaps was $1.0 million and $4.2 million in 2003 and 2004, respectively, and has been included in interest expense, other, net in the accompanying consolidated statements of income.

Goodwill—Goodwill is recognized to the extent that the purchase price of the acquisition exceeds the estimated fair value of the net assets acquired, including other identifiable intangible assets.

Goodwill is tested for impairment at least annually, or more frequently when events or circumstances indicate that impairment might have occurred. Based on criteria established by the applicable accounting pronouncements, Sonic allocates the carrying value of goodwill and tests it for impairment based on Sonic's geographic divisions. The $1,065.2 million of goodwill on the balance sheet, including approximately $8.3 million classified in assets held for sale, at December 31, 2004 was allocated to the following geographic divisions (dollars in millions):

Northern Division	$106.0
Southeastern Division	$285.0
Central Division	$353.1
Western Division	$321.1

In evaluating goodwill for impairment, Sonic compares the carrying value of the goodwill allocated to each division to the fair value of the underlying dealerships in each division. This represents the first step of the impairment test. If the fair value of a division is less than the carrying value of the goodwill allocated to that division, Sonic is then required to proceed to the second step of the impairment test. The second step involves allocating the calculated fair value to all of the assets of the respective division as if the calculated fair value was the purchase price of the business combination. This allocation would include assigning value to any previously unrecognized identifiable assets which means the fair value would be allocated to goodwill is significantly reduced. (See discussion regarding franchise agreements acquired prior to July 1, 2001 in "Other Intangible Assets" below). Sonic then compares the value of the goodwill resulting from this allocation process to the carrying value of the goodwill in the respective division with the difference representing the amount of impairment.

Sonic uses several assumptions and various fair value approaches in estimating the fair value of the goodwill in each division. These assumptions and approaches include: an earnings multiple for private dealership valuations (as determined by the historical multiple paid for dealerships Sonic has purchased) applied to actual earnings; an earnings multiple for public consolidators in Sonic's peer group applied to actual earnings; and a discounted cash flow utilizing estimated future earnings and Sonic's weighted average cost of capital. These approaches are blended to arrive at a fair value of Sonic's goodwill for each division.

At December 31, 2004 (the date of Sonic's latest impairment test), the fair value of each of the divisions exceeded the carrying value of the goodwill allocated to them (step one of the impairment test). As a result, Sonic was not required to conduct the second step of the impairment test described above, and Sonic recognized no impairment of the carrying value of its goodwill on the balance sheet at December 31, 2004.

However, if in future periods Sonic determines that the fair value of the goodwill allocated to one or more of its divisions is less than the carrying value of the goodwill allocated to such division(s), Sonic believes that application of the second step of the impairment test would result in a substantial impairment charge to the goodwill allocated to such division(s) and the amount of such impairment charge would likely be materially adverse to Sonic's consolidated operating results, financial position and cash flows.

Other Intangible Assets—The principal identifiable intangible assets other than goodwill acquired in an acquisition are rights under franchise agreements with manufacturers. Sonic generally expects franchise agreements to continue for an indefinite period. When these agreements do not have indefinite terms, Sonic anticipates and has generally experienced routine renewals without substantial cost and material modifications. As such, Sonic believes that its franchise agreements will contribute to cash flows for an indefinite period, therefore the carrying amount of franchise rights is not amortized. Franchise agreements acquired after July 1, 2001 have been included in other intangible assets on the accompanying consolidated balance sheets. Prior to July 1, 2001, franchise agreements were recorded and amortized as part of goodwill and remain as part of goodwill on the accompanying consolidated balance sheets. See Note 5 regarding impairment charges on franchise agreements. Other intangible assets acquired in acquisitions include favorable lease agreements with definite lives which are amortized on a straight-line basis over the remaining lease term. Sonic tests other intangible assets for impairment annually, or more frequently if events or circumstances indicate possible impairment.

Insurance Reserves—Sonic has various self-insured and high deductible insurance programs which require the Company to make estimates in determining the ultimate liability it may incur for claims arising under these programs. These insurance reserves are estimated by management using actuarial evaluations based on historical claims experience, claims processing procedures, medical cost trends and, in certain cases, a discount factor. At December 31, 2004, Sonic had $21.5 million reserved for such programs.

Income Taxes—Income taxes are provided for the tax effects of transactions reported in the accompanying consolidated financial statements and consist of taxes currently due plus deferred taxes. Deferred taxes are provided at currently enacted tax rates for the tax effects of carryforward items and temporary differences between the tax basis of assets and liabilities and their reported amounts.

As a matter of course, the Company is regularly audited by various taxing authorities and from time to time, these audits result in proposed assessments where the ultimate resolution may result in the Company owing additional taxes. Sonic's management believes that the Company's tax positions comply in all material respects with applicable tax law and that the Company has adequately provided for any reasonably foreseeable outcome related to these matters. Included in other accrued liabilities at December 31, 2003 and 2004 are $2.9 million in reserves that the Company has provided for these matters.

Sonic has $8.3 million in deferred tax assets related to state net operating loss carryforwards that will expire between 2012 and 2024. Management reviews these carryforward positions, the time remaining until expiration and other opportunities to utilize these carryforwards in making an assessment as to whether it is more likely than not that these carryforwards will be utilized. Based on management's judgment, Sonic has not recorded a valuation allowance for any period presented because it is more likely than not that taxable income for these states will be sufficient to realize the benefits of the associated deferred tax assets. However, the results of future operations, regulatory framework of these taxing authorities and other related matters cannot be predicted with certainty. Therefore, actual utilization of the losses which created these deferred tax assets which differs from the assumptions used in the development of management's judgment could result in a charge that will be material to the Company's consolidated operating results, financial position and cash flows.

Stock-Based Compensation—At December 31, 2004, Sonic has several stock-based employee compensation plans, which are described more fully in Note 10. Sonic accounts for those plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. In accordance with those provisions, because the exercise price of all options granted under those plans equaled the market value of the underlying stock at the grant date, no stock-based employee compensation cost is recorded in the accompanying consolidated financial statements. Using the Black-Scholes option pricing model for all options granted, the following table illustrates the effect on net income and earnings per share if Sonic had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", to stock-based employee compensation:

	(Dollars in Thousands Except Per Share Amounts) For the Year ended December 31,		
	2002	2003	2004
Net income as reported	$ 106,564	$ 71,560	$ 86,071
Fair value compensation cost, net of tax benefits of $4,865, $5,633 and $4,692 for 2002, 2003 and 2004, respectively	(7,933)	(10,195)	(7,514)
Pro forma net income	$ 98,631	$ 61,365	$ 78,557
Basic earnings (loss) per share:			
Net income as reported	$ 2.55	$ 1.75	$ 2.08
Fair value compensation cost, net of tax	(0.19)	(0.25)	(0.18)
Pro forma net income	$ 2.36	$ 1.50	$ 1.90
Diluted earnings (loss) per share:			
Net income as reported	$ 2.43	$ 1.69	$ 2.00
Fair value compensation cost, net of tax	(0.17)	(0.22)	(0.16)
Pro forma net income	$ 2.26	$ 1.47	$ 1.84

The weighted average fair value of options granted or assumed was $15.12, $7.39 and $9.09 per share in 2002, 2003 and 2004, respectively. The fair value of each option granted during 2002, 2003 and 2004 was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2002	2003	2004
Employee Stock Purchase Plan			
Dividend yield	n/a	n/a	1.68%
Risk free interest rates	2.28%	1.42%	1.31%
Expected lives	0.25 - 1.0 year	0.5 year	0.5 year
Volatility	52.36%	55.05%	41.98%
Stock Option Plans			
Dividend yield	n/a	0.0 - 1.52%	1.60-2.56%
Risk free interest rates	3.26 - 4.58%	1.15 - 3.24%	2.80-3.65%
Expected lives	5 years	5 years	5 years
Volatility	53.27%	54.18%	50.17%

Concentrations of Credit Risk—Financial instruments that potentially subject Sonic to concentrations of credit risk consist principally of cash on deposit with financial institutions. At times, amounts invested with financial institutions may exceed FDIC insurance limits. Concentrations of credit risk with respect to receivables are limited primarily to automobile manufacturers and financial institutions. The large number of customers comprising the trade receivables balances reduces credit risk arising from trade receivables from commercial customers.

As of December 31, 2004, Sonic has outstanding notes receivable from Cornerstone finance contracts of $33.4 million, net of an allowance for credit losses of $4.5 million. Outstanding notes receivable at December 31, 2003 were $19.7 million, net of an allowance for credit losses of $2.3 million. These notes have average terms of approximately thirty-six months and are secured by the related vehicles. Sonic's assessment of allowance for credit losses considers historical loss ratios and the performance of the current portfolio with respect to past due accounts. These notes are recorded in other current assets and other assets on the accompanying consolidated balance sheets. Consistent with industry practice, interest income from Cornerstone's finance contracts ($3.5 million in 2002, $4.3 million in 2003 and $7.2 million in 2004) has been recorded as a reduction of selling, general and administrative expenses.

Financial Instruments and Market Risks—As of December 31, 2003 and 2004 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% senior subordinated notes, 5.25% convertible senior subordinated 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 (as determined by market quotations) of Sonic's 8.625% senior subordinated notes as of December 31, 2003 and 2004 were $293.4 million and $302.6 million, respectively. The carrying value of Sonic's 8.625% senior subordinated notes as of December 31, 2003 and 2004 were $271.5 million and $271.9 million, respectively.

The fair value (as determined by market quotations) of Sonic's 5.25% convertible senior subordinated notes as of December 31, 2003 and 2004 was approximately $122.1 million and $130.1 million, respectively. The carrying value of Sonic's 5.25% convertible senior subordinated notes as of December 31, 2003 and 2004 was approximately $127.0 million and $127.5 million, respectively.

The fair value (as determined by discounted cash flows) of Sonic's notes payable to a finance company as of December 31, 2004 was approximately $32.5 million. The carrying value of these notes as of December 31, 2004 was approximately $32.4 million.

Sonic has variable rate notes payable—floor plan, revolving credit facilities and other variable rate notes that expose Sonic to risks caused by fluctuations in the underlying interest rates. The total outstanding balance of such facilities before the effects of interest rate swaps was approximately $1,294.1 million at December 31, 2003 and $1,291.0 million at December 31, 2004.

Advertising—Sonic expenses advertising costs in the period incurred, net of earned cooperative manufacturer credits that represent reimbursements for specific, identifiable and incremental advertising costs. Advertising expense amounted to $57.1 million, $66.1 million and $59.3 million for the years ended December 31, 2002, 2003 and 2004, respectively, and have been classified as selling, general and administrative expenses on the accompanying consolidated statements of income.

Sonic has cooperative advertising reimbursement agreements with approximately one-third of automobile manufacturers. In general, these cooperative programs require Sonic to provide the manufacturer with support for qualified, actual advertising expenditures in order to receive reimbursement under these cooperative agreements. It is uncertain whether or not Sonic would maintain the same level of advertising expenditures if these manufacturers discontinued their cooperative programs. Cooperative manufacturer credits classified as an offset to advertising costs were $0.4 million and $5.5 million in 2003 and 2004, respectively, and an immaterial amount in 2002.

Segment Information—Sonic sells similar products and services that exhibit similar economic characteristics, uses similar processes in selling products and services, and sells its products and services to similar classes of customers. As a result of this and the way Sonic manages its business, Sonic has aggregated its operating segments into a single segment for purposes of reporting financial condition and results of operations.

Recent Accounting Pronouncements—In January 2003, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") reached a consensus on Issue No. 02-16, "Accounting by a Customer for Certain Consideration Received from a Vendor." In accordance with Issue No. 02-16, which was effective January 1, 2003, payments received from manufacturers for floor plan assistance and certain types of advertising allowances are recorded as a reduction of the cost of inventory and recognized as a reduction of cost of sales when the inventory is sold. Previous practice was to recognize such payments as a reduction of cost of sales at the time of vehicle purchase. The cumulative effect of the adoption of Issue No. 02-16 resulted in a decrease to income of $5.6 million, net of applicable income taxes of $3.3 million for 2003. Had the guidance from Issue No. 02-16 been retroactively applied, results of operations and earnings per share for 2002 would not have been materially different from the previously reported results.

In July 2003, the EITF reached a consensus on Issue No. 03-10, "Application of Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers." Issue No. 03-10 requires certain consideration offered directly from manufacturers to consumers to be recorded as a reduction of cost of sales. Issue No. 03-10 was effective January 1, 2004. The adoption of Issue No. 03-10 had no effect on Sonic's consolidated operating results, financial position or cash flows.

In September 2004, the EITF reached a consensus on Issue No. 04-8, "Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share." Issue No. 04-8 requires issuers of contingently convertible securities to include the dilutive effect of these securities in the calculation of dilutive weighted average shares outstanding regardless of whether conversion is likely starting with periods ending after December 15, 2004. Issue No. 04-8 also requires retroactive application to all prior periods for which contingently convertible securities were outstanding. Sonic has adopted the conclusions of Issue No. 04-8 and has determined the impact on Sonic's consolidated diluted earnings per share using the "if-converted method" to be reductions of $0.04, $0.01 and $0.03 for diluted earnings per share for 2002, 2003 and 2004, respectively.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities", ("FIN 46") and in December 2003 issued FIN 46R. FIN 46 requires the consolidation of variable interest entities with certain attributes. FIN 46 was immediately effective for variable interest entities formed after January 31, 2003. FIN 46R requires the adoption of either FIN 46 or FIN 46R in the financial statements of public entities that have interests in structures that are commonly referred to as special purpose entities for periods ending after December 15, 2003. Application for all other types of variable interest entities is required in financial statements for periods ending after March 15, 2004. The adoption of FIN 46 and FIN 46R had no effect on Sonic's consolidated operating results, financial position or cash flows.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment" which replaces SFAS No. 123, "Accounting for Stock-Based Compensation", and supercedes APB 25, "Accounting for Stock Issued to Employees". SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). Tax benefits associated with share-based payments will be recognized as an addition to paid-in capital. Cash retained as a result of these tax benefits will be presented in the statement of cash flows as financing cash inflows. Sonic is currently evaluating the provisions of SFAS No. 123R, which will be effective for the first quarter of 2006, and has not determined the impact on the Company's consolidated operating results, financial position and cash flows.

In October 2005, the FASB staff issued FSP FAS 13-1,*Accounting for Rental Costs Incurred during a Construction Period*. FSP FAS 13-1 requires companies to expense real estate rental costs under operating leases during periods of construction beginning with periods commencing after December 15, 2005 with no requirement for retroactive application. Sonic is currently evaluating the provisions of FSP FAS 13-1 and has not determined the impact on Sonic's consolidated operating results, financial position and cash flows from FSP FAS 13-1.

2. BUSINESS ACQUISITIONS AND DISPOSITIONS

Acquisitions

Sonic generally seeks to acquire larger, well managed dealerships or multiple franchise dealership groups located in metropolitan or high growth suburban markets. Sonic also looks to acquire single franchise dealerships that will allow Sonic to capitalize on professional management practices and provide greater breadth of products and services in existing markets. Occasionally, Sonic acquires dealerships that have under performed the industry average, but represent attractive franchises or have attractive locations that would immediately benefit from Sonic's professional management.

During the first quarter of 2004, Sonic acquired two franchises located in Ontario, California (the "California Acquisition") for an aggregate purchase price of approximately $58.9 million in cash, net of cash acquired, funded by cash from operations and borrowings under the revolving credit facility. As a result of the California Acquisition, Sonic has recorded the following:

- $7.6 million of net assets relating to dealership operations;
- $3.7 million of intangible assets representing rights acquired under franchise agreements; and
- $47.6 million of goodwill, all of which is expected to be tax deductible.

During the second and third quarters of 2004, Sonic acquired eleven franchises in Houston, Texas (the "Houston Acquisition") for approximately $168.8 million, net of cash acquired. The Houston Acquisition's purchase price was comprised of $135.0 million in cash from operations and borrowings under the revolving credit facility and the assumption of $33.8 million in debt, including premium of $7.3 million (see Note 6). The accompanying consolidated balance sheet as of December 31, 2004 includes preliminary allocations of the purchase price of the Houston Acquisition to the assets and liabilities acquired based on their estimated fair market values at the dates of acquisition and are subject to final adjustment.

As a result of these allocations, Sonic has recorded the following (dollars in thousands):

Inventories	$ 88,070
Floor plan notes payable	(51,908)
Other working capital, net	(1,611)
Property and equipment	6,368
Goodwill (all of which is expected to be tax deductible)	126,893
Intangible assets representing rights under franchise agreements	10,800
Liabilities representing leases with unfavorable terms	(6,124)
Non-current liabilities	(3,679)
Purchase price	$168,809
Notes payable to a finance company (see Note 6)	(33,824)
Cash purchase price	$134,985

During 2003, Sonic acquired 15 franchises for approximately $68.8 million in cash, net of cash acquired. During 2002, Sonic acquired 46 franchises for approximately $202.4 million in cash, net of cash acquired, and $34.5 million in Sonic's Class A Common Stock.

The following unaudited pro forma financial information presents a summary of consolidated results of operations as if all of the above 2004 acquisitions had occurred at the beginning of 2004 and at the beginning of 2003, after giving effect to certain adjustments, including interest expense on acquisition debt and related income tax effects. The pro forma financial information does not give effect to adjustments relating to net reductions in floorplan interest expense resulting from renegotiated floorplan financing agreements or to reductions in salaries and fringe benefits of former owners or officers of acquired dealerships who have not been retained by Sonic or whose salaries have been reduced pursuant to employment agreements with Sonic. The pro forma results have been prepared for comparative purposes only and are not necessarily indicative of the results of operations that would have occurred had the 2004 acquisitions actually been completed at the beginning of the periods presented. The pro forma results are also not necessarily indicative of the results of future operations.

	Year Ended December 31,	
	2003	2004
	(dollars in thousands, except per share amounts)	
Total revenues	$ 7,467,000	$ 7,371,784
Gross profit	$ 1,119,127	$ 1,126,409
Income before cumulative effect of change in accounting principle	$ 80,220	$ 86,647
Net income	$ 74,493	$ 86,647
Diluted earnings per share	$ 1.76	$ 2.02

Dispositions

During 2004, Sonic sold or terminated seven franchises. These disposals generated cash of $32.5 million and resulted in a net loss of $0.8 million which is included in discontinued operations in the accompanying consolidated statements of income for 2004. During 2002 and 2003, Sonic completed 16 and 18 franchise dispositions, respectively. These disposals generated cash of $17.6 million and $26.4 million, respectively, and resulted in net gains of $3.6 million and $5.3 million.

In conjunction with franchise dispositions, Sonic generally agrees to indemnify the buyers from certain liabilities and costs arising from operations or events that occurred prior to sale but which may or may not be known at the time of sale, including environmental liabilities and liabilities associated from the breach of representations or warranties made under the agreements. The additional exposure associated with current year dispositions related to subleases was $10.2 million. However, Sonic's maximum exposure associated with general indemnifications increased by $31.6 million as a result of these dispositions. These indemnifications expire within a period of one to three years following the date of the sale. The estimated fair value of these indemnifications was not material.

In addition to the dispositions described above, as of December 31, 2004, Sonic had approved, but not completed, the disposition of 24 additional franchises. In the first nine months of 2005, Sonic added 12 additional franchises to assets held for sale, sold six of those franchises added and sold eight of the 24 franchises held for sale at December 31, 2004. Therefore, as of September 30, 2005, Sonic had 22 franchises classified as held for sale. These franchises have been identified as held for sale because of unprofitable operations or various strategic considerations. The operating results of these franchises are included in discontinued operations on the accompanying consolidated statements of income. Assets to be disposed of in connection with franchises not yet sold, which have been classified in assets held for sale in the accompanying consolidated balance sheets, consist of the following:

	December 31, 2003	December 31, 2004
	(Dollars in thousands)	
Inventories	$ 80,592	$ 70,715
Property and equipment, net	8,474	14,056
Goodwill	11,206	8,259
Franchise assets	3,800	5,500
Assets held for sale	$ 104,072	$ 98,530

Liabilities to be disposed in connection with these dispositions are comprised entirely of notes payable – floor plan and are classified as liabilities associated with assets held for sale on the accompanying consolidated balance sheets. Results associated with franchises classified as discontinued operations were as follows:

	(Dollars in thousands) Twelve Months Ended December 31,		
	2002	2003	2004
Revenues	$1,197,660	$861,659	$707,619
Pre-tax losses (before gains or loss on the sale of disposed franchises)	(4,270)	(14,879)	(9,688)

3. INVENTORIES AND RELATED NOTES PAYABLE—FLOOR PLAN

Inventories consist of the following:

	December 31, 2003	December 31, 2004
	(Dollars in thousands)	
New vehicles	$ 825,189	$ 848,197
Used vehicles	126,872	130,354
Parts and accessories	49,782	53,932
Other	45,067	62,574
	$1,046,910	$1,095,057
Less inventories classified as assets held for sale	(80,592)	(70,715)
Inventories	$ 966,318	$1,024,342

Sonic finances all of its new and certain of its used vehicle inventory through standardized floor plan facilities with DaimlerChrysler Financial Company, LLC ("DaimlerChrysler Financial"), Ford Motor Credit Company ("Ford Credit"), General Motors Acceptance Corporation ("GMAC"), Toyota Financial Services ("Toyota Financial"), Bank of America and JP Morgan Chase Bank. These floor plan facilities (floor plan notes payable-trade, floor plan notes payable-non-trade, liabilities associated with assets held for sale-trade, and liabilities associated with assets held for sale-non-trade) bear interest at variable rates based on prime and LIBOR. The weighted average interest rate for Sonic's floor plan facilities was 2.76% for 2003 and 2.88% for 2004. Sonic's floor plan interest expense is substantially offset by amounts received from manufacturers, in the form of floor plan assistance. Floor plan assistance received is capitalized in inventory and charged against cost of sales when the associated inventory is sold. In 2004, Sonic recognized approximately $36.6 million in manufacturer assistance, which resulted in an effective borrowing rate under the floor plan facilities of 0%. Interest payments under each of Sonic's floor plan facilities are due monthly, and Sonic is generally not required to make principal repayments prior to the sale of the vehicles. The floor plan facilities are collateralized by vehicle inventories and other assets, excluding franchise agreements, of the relevant dealership subsidiary. The floor plan facilities contain a number of covenants, including, among others, covenants restricting Sonic with respect to the creation of liens and changes in ownership, officers and key management personnel. Sonic was in compliance with all restrictive covenants as of December 31, 2004.

4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	December 31,	
	2003	2004
	(Dollars in thousands)	
Land	$ 34,686	$ 32,414
Building and improvements	73,159	90,236
Office equipment and fixtures	37,796	46,389
Parts and service equipment	29,334	34,478
Company vehicles	8,559	9,122
Construction in progress	48,069	57,759
Total, at cost	231,603	270,398
Less accumulated depreciation	(32,264)	(44,567)
Subtotal	199,339	225,831
Less assets held for sale	(8,474)	(14,056)
Less other current assets - construction in progress held for sale	(65,509)	(77,285)
Property and equipment, net	$125,356	$134,490

Interest capitalized in conjunction with construction projects was approximately $2.5 million, $3.0 million and $2.8 million for the years ended December 31, 2002, 2003 and 2004, respectively. As of December 31, 2004, commitments for facilities construction projects totaled approximately $20.2 million.

Other current assets – construction in progress held for sale represent dealership facilities that are or were expected to be completed and sold within one year in sale-leaseback transactions. These assets have been classified as other current assets on the accompanying consolidated balance sheets. Under the terms of the sale-leaseback transactions, Sonic sells the properties to a third party entity and enters into long-term operating leases on the facilities. Sonic sold $26.4 million, $41.4 million and $49.0 million in 2002, 2003 and 2004, respectively, in dealership equipment and properties in sale-leaseback transactions which resulted in no material gains and losses. Sonic has no continuing involvement or obligations under these arrangements other than lease payments.

5. INTANGIBLE ASSETS AND GOODWILL

The changes in the carrying amount of franchise agreements and goodwill for the years ended December 31, 2003 and 2004 were as follows (dollars in thousands):

	Franchise Agreements	Goodwill
Balance before assets held for sale classification, December 31, 2002	$ 61,800	$ 885,781
Amount classified as assets held for sale	—	(9,887)
Balance, December 31, 2002	61,800	875,894
Additions through current year acquisitions	15,000	42,484
Prior year acquisition allocations	(900)	5,068
Impairment expense (discontinued operations)	(500)	—
Reductions from sales of franchises	(1,300)	(13,036)
Sub-total, December 31, 2003	74,100	910,410
Increase in amount classified as assets held for sale	(3,800)	(1,319)
Balance, December 31, 2003	$ 70,300	$ 909,091
Additions through current year acquisitions	14,500	174,472
Prior year acquisition allocations	(125)	(3,279)
Impairment expense (discontinued operations)	(1,075)	—
Reductions from sales of franchises	(1,400)	(26,307)
Sub-total, December 31, 2004	82,200	1,053,977
(Increase)/Decrease in amount classified as assets held for sale	(1,700)	2,947
Balance, December 31, 2004	$ 80,500	$1,056,924

Definite life intangible assets consist of the following:

	December 31,	
	2003	2004
	(Dollars in thousands)	
Lease agreements	$ 5,035	$ 4,704
Less accumulated amortization	(105)	(427)
Definite life intangibles, net	$ 4,930	$ 4,277

Franchise values and definite life intangible assets are classified as Other Intangible Assets, net on the accompanying consolidated balance sheets.

Amortization expense for definite life intangible assets was $0.1 million and $0.3 million for the years ended December 31, 2003 and 2004. There was no amortization expense for 2002. Future amortization expense is as follows:

Year ending December 31,	(Dollars in thousands)
2005	$ 281
2006	281
2007	281
2008	281
2009	281
Thereafter	2,872
Total	$ 4,277

6. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31	
	2003	2004
	(Dollars in thousands)	
$550 million revolving credit facility bearing interest at 2.55 percentage points above LIBOR (2.40% at December 31, 2004), collateralized by all assets of Sonic	$ 285,523	$ 238,633
Senior Subordinated Notes bearing interest at 8.625% maturing August 15, 2013, net of net discount of $3,299 and $3,065, respectively	271,701	271,935
Convertible Senior Subordinated Notes bearing interest at 5.25%, maturing May 7, 2009, net of discount of $3,121 and $2,606, respectively	126,979	127,494
$50 million revolving construction line of credit with Toyota Financial bearing interest at 2.25 percentage points above LIBOR and maturing December 31, 2007, collateralized by Sonic's guarantee and a lien on all of the borrowing subsidiaries' real estate and other assets	4,568	—
$100 million revolving real estate acquisition line of credit with Toyota Financial bearing interest at 2.00 percentage points above LIBOR and maturing December 31, 2012, collateralized by Sonic's guarantee and a lien on all of the borrowing subsidiaries' real estate and other assets	5,470	—
Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19%), with combined monthly principal and interest payments of $325, maturing November 1, 2015 through September 1, 2016, and collateralized by letters of credit, including premium of $6,583	—	32,369
Fair value of Variable Swaps	(157)	(145)
Other notes payable (primarily equipment notes)	2,201	1,510
	$ 696,285	$ 671,796
Less current maturities	(1,387)	(2,970)
Long-term debt	$ 694,898	$ 668,826

The indenture governing Sonic's 8.625% senior subordinated notes limits Sonic's ability to pay quarterly cash dividends in excess of $0.10 per share. Sonic may only pay quarterly cash dividends in excess of this amount if Sonic complies with Section 1009 of the indenture governing these notes, which was filed as Exhibit 4.4 to the Registration Statement on Form S-4 (Reg. No. 333-109426). The indenture governing Sonic's convertible senior subordinated notes (the "Convertibles") does not limit Sonic's ability to pay dividends. Sonic's credit agreement for the revolving credit facility permits cash dividends so long as no event of default or unmatured default (as defined in the credit agreement) has occurred and is continuing and provided that, after giving effect to the payment of a dividend, Sonic remains in compliance with the other terms and conditions of the credit agreement.

Future maturities of long-term debt are as follows:

Year ending December 31,	(Dollars in thousands)
2005	2,970
2006	241,722
2007	2,462
2008	2,596
2009	130,231
Thereafter	291,815
Total	$ 671,796

The Revolving Facility

At December 31, 2004, Sonic's Revolving Facility (the "Revolving Facility") with Ford Credit, DaimlerChrysler Financial, Toyota Financial, Bank of America, JP Morgan Chase Bank and Merrill Lynch had a borrowing limit of $550.0 million, subject to a borrowing base calculated on the basis of receivables, inventory and equipment and a pledge of certain additional collateral by one of Sonic's affiliates (the borrowing base was approximately $577.0 million at December 31, 2004). The amount available to be borrowed under the Revolving Facility is reduced on a dollar-for-dollar basis by the cumulative face amount of outstanding letters of credit. At December 31, 2004, Sonic had $58.1 million in letters of credit outstanding and $253.3 million of borrowing availability. The amounts outstanding under the Revolving Facility bear interest at 2.55 percentage points above LIBOR. The Revolving Facility includes an annual commitment fee equal to 0.25% of the unused portion of the Revolving Facility. Balances under the Revolving Facility are guaranteed by Sonic's operating domestic subsidiaries.

Sonic agreed under the Revolving Facility not to pledge any assets to any third party (with the exception of currently encumbered assets of Sonic's dealership subsidiaries that are subject to previous pledges or liens). In addition, the Revolving 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. Specifically, the Revolving Facility permits cash dividends on Sonic's Class A and Class B common stock so long as no event of default or unmatured default (as defined in the Revolving Facility) has occurred and is continuing and provided that, after giving effect to the payment of a dividend, Sonic remains in compliance with other terms and conditions of the Revolving Facility. Financial covenants include actual (as of and for the year ended December 31, 2004) and required specified ratios of:

Covenant	Actual	Required
Current ratio	1.23	³ 1.23
Fixed charge coverage	1.62	³ 1.40
Adjusted fixed charge coverage	1.35	³ 1.15
Interest coverage	3.17	³ 2.00
Adjusted debt to EBITDA	1.39	£ 2.25

Sonic will remain in compliance with the required specified current ratio of greater than or equal to 1.23 if there is adequate availability on the Revolving Facility which will, when added to Sonic's total current assets, make the current ratio greater than or equal to 1.23. Additionally, the Revolving Facility availability used for the current ratio calculation is added to Sonic's long-term debt for purposes of calculating the adjusted debt to EBITDA ratio.

In 2004, the Revolving Facility's covenants were amended to include an adjusted fixed charge coverage ratio. This new ratio is similar to the fixed charge coverage ratio in all respects except that it considers equity repurchases and dividend payments as fixed charges. On October 6, 2005, Sonic extended the maturity on the Revolving Facility from October 31, 2006 to January 31, 2007.

Sonic expects to be in compliance with the covenants for all long-term agreements for the foreseeable future.

In addition, the loss of voting control over Sonic by O. Bruton Smith, Chairman and Chief Executive Officer, Scott Smith, Chief Strategic Officer and Vice Chairman, and their spouses or immediate family members or Sonic's failure, with certain exceptions, to own all the outstanding equity, membership or partnership interests in Sonic's dealership subsidiaries will constitute an event of default under the Revolving Facility. Sonic was in compliance with all financial and restrictive covenants as of December 31, 2004.

8.625% Senior Subordinated Notes

On August 12, 2003, Sonic issued $200.0 million in aggregate principal amount of 8.625% senior subordinated notes due 2013 (the "8.625% Notes") in a private offering to qualified institutional buyers as defined by the Securities Act of 1933 (the "Act"). The net proceeds, before expenses, of approximately $194.3 million together with an advance from the Revolving Facility, were used to redeem all of the 11% senior subordinated notes due 2008 (the "11% Notes") for $194.6 million which included accrued but unpaid interest and the redemption premium of 5.5% on September 10, 2003. A resulting loss of $13.9 million, which includes the redemption premium and the write-off of unamortized discounts and deferred debt issuance costs is included in other income/(expense), net in the accompanying consolidated statement of income for 2003. The 8.625% Notes are unsecured obligations that rank equal in right of payment to all of Sonic's existing and future senior subordinated indebtedness, mature on August 15, 2013 and are redeemable at Sonic's option after August 15, 2008. In addition, up to 35% of the aggregate principal amount of the 8.625% Notes may be redeemed on or before August 15, 2006 with net cash proceeds from certain equity offerings. Sonic's obligations under the 8.625% Notes are guaranteed by Sonic's operating domestic subsidiaries.

On November 19, 2003 Sonic issued an additional $75.0 million in aggregate principal amount of the 8.625% Notes in an add-on private offering to qualified institutional buyers as defined by the Act. The net proceeds, before expenses, of approximately $78.9 million, were used to pay down the Revolving Facility. This $75.0 million issuance contains the same provisions and terms as the $200.0 million issuance on August 12, 2003.

In 2002, Sonic repurchased $17.6 million in aggregate principal amount of the 11% Notes on the open market for approximately $18.2 million. A resulting loss of $1.1 million, net of write-offs of unamortized discounts and deferred debt issuance costs, is included in other income/(expense), net in the accompanying consolidated statement of income for 2002.

The indentures governing the 8.625% Notes contain certain specified restrictive and required financial covenants. Sonic has agreed not to pledge any assets to any third party except under certain limited circumstances. Sonic also has agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, capital stock, guaranties, asset sales, investments, cash dividends to shareholders, distributions and redemptions. Specifically, the indenture governing Sonic's 8.625% Notes limits Sonic's ability to pay quarterly cash dividends on Sonic's Class A and B common stock in excess of $0.10 per share. Sonic may only pay quarterly cash dividends on Sonic's Class A and B common stock if Sonic complies with Section 1009 of the indenture governing the 8.625% Notes, which was filed as Exhibit 4.4 to Sonic's Registration Statement on Form S-4 (Reg. No. 333-109426). Sonic was in compliance with all restrictive covenants as of December 31, 2004.

5.25% Convertible Senior Subordinated Notes

On May 7, 2002, Sonic issued $149.5 million in aggregate principal amount of 5.25% convertible senior subordinated notes due 2009 (the "Convertibles") with net proceeds, before expenses, of approximately $145.1 million. The net proceeds were used to repay a portion of the amounts outstanding under the Revolving Facility. The Convertibles are unsecured obligations that rank equal in right of payment to all of Sonic's existing and future senior subordinated indebtedness, mature on May 7, 2009 and are redeemable at Sonic's option after May 7, 2005. Sonic's obligations under the Convertibles are not guaranteed by any of Sonic's subsidiaries.

The Convertibles are convertible into shares of Class A common stock, at the option of the holder, if as of the last day of the preceding fiscal quarter, the closing sale price of the Class A common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading-day of such preceding fiscal quarter is more than 110% of the conversion price per share of Class A common stock on the last day of such preceding fiscal quarter. If this condition is satisfied, then the Convertibles will be convertible at any time, at the option of the holder, through maturity. The initial conversion price per share is $46.87, and will be subject to adjustment for certain distributions on, or other changes in the Class A common stock, if any, prior to the conversion date. In addition, on or before May 7, 2007, a holder also may convert the Convertibles into shares of the Class A common stock at any time after a 10 consecutive trading-day period in which the average of the trading day prices for the Convertibles for that 10 trading-day period is less than 103% of the average conversion value for the Convertibles during that period. The conversion value is equal to the product of the closing sale price for Sonic's Class A common stock on a given day multiplied by the then current conversion rate, which is the number of shares of Class A common stock into which each $1,000 principal amount of Convertibles is then convertible. Neither of these conversion features were satisfied during 2004.

In 2002, Sonic repurchased $19.4 million in aggregate principal amount of the Convertibles on the open market for approximately $14.5 million. A resulting gain of $4.3 million, net of write-offs of unamortized discounts and deferred debt issuance costs, is included in other income/(expense), net in the accompanying consolidated statement of income for 2002. Sonic did not repurchase any Convertibles in 2003 or 2004.

The Mortgage Facility

Sonic has a revolving real estate and construction (the "Construction Loan") and mortgage refinancing (the "Permanent Loan") line of credit with Toyota Credit (collectively, "The Mortgage Facility"). Under the Construction Loan, Sonic's dealership development subsidiaries can borrow up to $50.0 million to finance land acquisition and dealership construction costs. Advances can be made under the Construction Loan until November 2007. All advances will mature on December 31, 2007, bear interest at 2.25 percentage points above LIBOR and are secured by Sonic's guarantee and a lien on all of the borrowing subsidiaries' real estate and other assets.

Under the Permanent Loan, Sonic can refinance up to $100.0 million in advances under the Construction Loan once the projects are completed and can finance real estate acquisition costs to the extent these costs were not previously financed under the Construction Loan. Advances can be made under the Permanent Loan until December 2007. All advances under the Permanent Loan mature on December 31, 2012, bear interest at 2.00% above LIBOR and are secured by the same collateral provided under the Construction Loan.

The Mortgage Facility allows Sonic to borrow up to $100.0 million in the aggregate under the Construction Loan and the Permanent Loan. The Mortgage Facility is not cross-collateralized with the Revolving Facility; however, a default under one will cause a default under the other. Among other customary covenants, the borrowing subsidiaries under the Mortgage Facility agreed not to incur any other liens on their property (except for existing encumbrances on property acquired) and not to transfer their property or more than 20% of their ownership interests to any third party. In addition, the loss of voting control by O. Bruton Smith, B. Scott Smith and their spouses or immediate family members, with certain exceptions, will result in an event of default under the Mortgage Facility. Sonic was in compliance with all restrictive covenants as of December 31, 2004.

Notes Payable to a Finance Company

Three notes payable totaling $26.6 million in aggregate principal were assumed in connection with the Houston Acquisition during the second quarter of 2004 (the "Assumed Notes"). Sonic recorded the Assumed Notes at fair value using an interest rate of 5.35%. The interest rate used to calculate the fair value was based on a quoted market price for notes with similar terms as of the date of assumption. As a result of calculating the fair value, a premium of $7.3 million was recorded that will be amortized over the lives of the Assumed Notes. At December 31, 2004, the principal balance on the Assumed Notes was $25.8 million.

Subsidiary Guarantees

Balances outstanding under Sonic's Revolving Facility and 8.625% Notes are guaranteed by all of Sonic's operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor as defined by the Securities and Exchange Commission (the "SEC").

7. INCOME TAXES

The provision for income taxes from continuing operations consists of the following:

	2002	2003	2004
		(Dollars in thousands)	
Current:			
Federal	$44,853	$36,201	$37,168
State	5,801	3,591	7,017
	50,654	39,792	44,185
Deferred	14,696	4,437	12,450
Total provision for income taxes for continuing operations	$65,350	$44,229	$56,635

The reconciliation of the statutory federal income tax rate with Sonic's federal and state overall effective income tax rate from continuing operations is as follows:

	2002	2003	2004
Statutory federal rate	35.00%	35.00%	35.00%
Effective state income tax rate	2.41	0.23	2.63
Other	0.46	(1.06)	0.01
Effective tax rate	37.87%	34.17%	37.64%

Deferred income taxes reflect the net tax effects of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Significant components of Sonic's deferred tax assets and liabilities as of December 31 are as follows:

	2003	2004
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for bad debts	$ 504	$ 810
Accruals and reserves	15,431	23,308
Fair value of Fixed Swaps	2,825	785
Net operating loss carryforwards	10,456	8,270
Other	127	3
Total deferred tax assets	29,343	33,176
Deferred tax liabilities:		
Basis difference in inventory	(3,801)	(6,434)
Basis difference in property and equipment	(10,399)	(14,421)
Basis difference in goodwill	(79,816)	(95,390)
Other	(2,917)	(2,342)
Total deferred tax liability	(96,933)	(118,587)
Net deferred tax liability	$(67,590)	$ (85,411)

Net current deferred tax assets are recorded in other current assets on the accompanying consolidated balance sheets. As of December 31, 2004, Sonic had state net operating loss carryforwards of $197.5 million that will expire between 2012 and 2024.

8. RELATED PARTIES

Registration Rights Agreement

Prior to the Company's initial public offering, Sonic signed a Registration Rights Agreement dated as of June 30, 1997 with Sonic Financial Corporation ("SFC"), O. Bruton Smith, B. Scott Smith and William S. Egan (collectively, the "Class B Registration Rights Holders"). SFC currently owns 8,881,250 shares of Class B common stock; Bruton Smith, 2,171,250 shares; and Scott Smith, 976,875 shares; all of which are covered by the Registration Rights Agreement. The Egan Group

LLC, an assignee of Mr. Egan, also owns certain shares of Class A common stock to which the Registration Rights Agreement applies. If, among other things provided in Sonic's charter, offers and sales of shares of Class B common stock are registered with the SEC, then such shares will automatically convert into a like number of shares of Class A common stock.

The Class B Registration Rights Holders have certain limited piggyback registration rights under the Registration Rights Agreement. These rights permit them to have their shares of Sonic's common stock included in any Sonic registration statement registering Class A common stock, except for registrations on Form S-4, relating to exchange offers and certain other transactions, and Form S-8, relating to employee stock compensation plans. The Registration Rights Agreement expires in November 2007. SFC is controlled by O. Bruton Smith.

Dealership Leases

Sonic leases three dealership properties in Northern California from the Price Trust. Tom Price, who served as Sonic's Vice Chairman until December 2002, and his wife are the sole beneficiaries of the Price Trust. Lease costs associated with these leases were approximately $2.3 million in 2002.

Sonic leases three dealership properties in Northern California from Bay Automotive, LLC, in which Mr. Price owns a 50% interest. Annual aggregate rent under these leases was approximately $2.6 million in 2002.

Sonic leases office space in Charlotte from a subsidiary of SFC for a majority of its headquarters personnel. Annual aggregate rent under this lease was approximately $0.4 million in 2002, $0.5 million in 2003 and $0.6 million in 2004.

Other Transactions

Sonic rents various aircraft owned by SFC, subject to their availability, for business-related travel by Sonic executives. Sonic incurred costs of approximately $1.2 million in 2002, $1.5 million in 2003 and $0.5 million in 2004 for the use of these aircraft.

Certain of Sonic's dealerships purchase the Z-Max oil additive product from Oil Chem Research Company, a subsidiary of Speedway Motorsports, Inc. ("SMI") whose Chairman and Chief Executive Officer is O. Bruton Smith, for resale to service customers of the dealerships in the ordinary course of business. Total purchases from Oil Chem by Sonic dealerships totaled approximately $1.8 million in 2002 and 2003 and $1.4 million in 2004.

Sonic and its dealerships frequently purchase apparel items, which are screen-printed with Sonic and dealership logos, as part of internal marketing and sales promotions. Sonic and its dealerships purchase such items from several companies, including Speedway Systems, LLC, a company owned by SMI. Total purchases from Speedway Systems by Sonic and its dealerships totaled approximately $0.4 million in 2002 and $0.2 million in 2003.

Sonic donates money throughout the year to Speedway Children's Charities, a non-profit organization founded by O. Bruton Smith. O. Bruton Smith and B. Scott Smith are both board members of Speedway Children's Charities. Donations to this organization amounted to $0.2 million, $0.4 million and $0.2 million in 2002, 2003 and 2004, respectively.

9. CAPITAL STRUCTURE AND PER SHARE DATA

Preferred Stock—Sonic has 3 million shares of "blank check" preferred stock authorized with such designations, rights and preferences as may be determined from time to time by the Board of Directors. The Board of Directors has designated 300,000 shares of preferred stock as Class A convertible preferred stock, par value $0.10 per share (the "Preferred Stock") which is divided into 100,000 shares of Series I Preferred Stock, 100,000 shares of Series II Preferred Stock, and 100,000 shares of Series III Preferred Stock. There were no shares of Preferred Stock issued or outstanding at December 31, 2004 and 2003.

Common Stock—Sonic has two classes of common stock. Sonic has authorized 100.0 million shares of Class A common stock at a par value of $0.01 per share. Class A common stock entitles its holder to one vote per share. There were 29,192,549 and 29,631,703 shares outstanding at December 31, 2003 and 2004, respectively. Sonic has also authorized 30 million shares of Class B common stock at a par value of $.01 per share. Class B common stock entitles its holder to ten votes per share, except in certain circumstances. Each share of Class B common stock is convertible into one share of Class A common stock either upon voluntary conversion at the option of the holder, or automatically upon the occurrence of certain events, as provided in Sonic's charter.

Restricted Stock—In the fourth quarter of 2004, 160,000 restricted shares of Sonic Class A common stock were awarded to certain executive officers. The restrictions on these shares expire in August 2007. Holders of these restricted shares have voting rights and receive dividends prior to the time the restrictions lapse if, and to the extent, dividends are paid on Sonic's common stock. Compensation expense for the issuance of these restricted shares was $0.2 million in 2004.

Share Repurchases—Sonic's Board of Directors has authorized Sonic to expend up to $185.0 million to repurchase shares of its Class A common stock or redeem securities convertible into Class A common stock. As of December 31, 2004, Sonic had repurchased a total of 10,347,865 shares of Class A common stock at an average price per share of approximately $14.69 and had redeemed 13,801.5 shares of Class A convertible preferred stock at an average price of $1,000 per share. As of December 31, 2004, Sonic had $32.8 million remaining under the Board's authorization.

Per Share Data—The calculation of diluted earnings per share considers the potential dilutive effect of options and shares under Sonic's stock compensation plans, Class A common stock purchase warrants and the Convertibles (see Notes 1 and 6). The following table illustrates the dilutive effect of such items on earnings per share:

	For the Year Ended December 31, 2004								
		Income From Continuing Operations		Loss From Discontinued Operations		Cumulative Effect of Change in Accounting Principle		Net Income	
	Shares	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(Amounts in Thousands Except Per Share Amounts)								
Basic Earnings Per Share	41,375	$ 93,826	$ 2.27	$ (7,755)	$ (0.19)	$ —	$ —	$ 86,071	$ 2.08
Effect of Dilutive Securities:									
Contingently Convertible Debt	2,776	4,412		159				4,571	
Stock Compensation Plans	1,066								
Diluted Earnings Per Share	45,217	$ 98,238	$ 2.17	$ (7,596)	$ (0.17)	$ —	$ —	$ 90,642	$ 2.00

	For the Year Ended December 31, 2003								
		Income From Continuing Operations		Loss From Discontinued Operations		Cumulative Effect of Change in Accounting Principle		Net Income	
	Shares	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(Amounts in Thousands Except Per Share Amounts)								
Basic Earnings Per Share	40,920	$ 85,211	$ 2.08	$ (8,032)	$ (0.19)	$ (5,619)	$ (0.14)	$ 71,560	$ 1.75
Effect of Dilutive Securities:									
Contingently Convertible Debt	2,776	4,670		178				4,848	
Stock Compensation Plans	1,500								
Warrants	1								
Diluted Earnings Per Share	45,197	$ 89,881	$ 1.99	$ (7,854)	$ (0.18)	$ (5,619)	$ (0.12)	$ 76,408	$ 1.69

	For the Year Ended December 31, 2002								
		Income From Continuing Operations		Loss From Discontinued Operations		Cumulative Effect of Change in Accounting Principle		Net Income	
	Shares	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(Amounts in Thousands Except Per Share Amounts)								
Basic Earnings Per Share	41,728	$ 107,214	$ 2.57	$ (650)	$ (0.02)	$ —	$ —	$ 106,564	$ 2.55
Effect of Dilutive Securities:									
Contingently Convertible Debt	1,995	3,090		159				3,249	
Stock Compensation Plans	1,428								
Warrants	2								
Diluted Earnings Per Share	45,153	$ 110,304	$ 2.44	$ (491)	$ (0.01)	$ —	$ —	$ 109,813	$ 2.43

In addition to the stock options included in the tables above, options to purchase approximately 2,138,000, 1,167,000 and 1,909,000 shares of Class A common stock were outstanding during the years ended December 31, 2002, 2003 and 2004, respectively, but were not included in the computation of diluted net income per share because the options were antidilutive.

10. EMPLOYEE BENEFIT PLANS

Substantially all of the employees of Sonic are eligible to participate in a 401(k) plan. In accordance with the formula in the 401(k) plan agreement, contributions by Sonic to the 401(k) plan were $4.0 million in 2002, $3.8 million in 2003 and $4.1 million in 2004.

Stock Option Plans

Sonic currently has four option plans, the Sonic Automotive, Inc. 2004 Stock Incentive Plan (the “2004 Plan”), the Sonic Automotive, Inc. 1997 Stock Option Plan (the “1997 Plan”), the Sonic Automotive, Inc. Formula Stock Option Plan for Independent Directors (the “Directors’ Plan”), and the FirstAmerica Automotive, Inc. 1997 Stock Option Plan (the “First America Plan”) (collectively, the “Stock Option Plans”).

The 2004 Plan and the 1997 Plan were adopted by the Board of Directors in order to attract and retain key personnel and currently authorizes the issuance of options to purchase 2.0 million and 9.0 million shares of Class A common stock, respectively. Under the 2004 Plan and the 1997 Plan, options to purchase shares of Class A common stock may be granted to key employees of Sonic and its subsidiaries and to officers, directors, consultants and other individuals providing services to Sonic. The options are granted at the fair market value of Sonic’s Class A common stock at the date of grant, vest over a period ranging from six months to three years, are exercisable upon vesting and expire ten years from the date of grant.

The Directors’ Plan authorizes options to purchase up to an aggregate of 0.6 million shares of Class A common stock. Under the plan, each outside director will be awarded on or before March 31 of each year an option to purchase 10,000 shares at an exercise price equal to the fair market value of the Class A common stock at the date of the award. Options granted under the Directors’ Plan become exercisable after six months and expire ten years from their date of grant.

A summary of the status of the Stock Option Plans is presented below:

	Number of Options	Exercise Price Per Share	Weighted Average Exercise Price
	(shares in thousands)		
Outstanding at December 31, 2001	4,848	$2.85 - 16.51	$ 10.91
Granted	1,763	16.20 - 37.50	29.68
Exercised	(794)	2.85 - 16.51	9.70
Forfeited	(232)	7.25 - 37.50	18.04
Outstanding at December 31, 2002	5,585	2.85 - 37.50	16.57
Granted	1,211	14.40 - 26.36	16.96
Exercised	(937)	2.85 - 26.92	10.72
Forfeited	(302)	7.94 - 37.50	24.94
Outstanding at December 31, 2003	5,557	2.85 - 37.50	17.26
Granted	1,285	18.73 - 25.05	22.83
Exercised	(1,043)	2.85 - 16.51	11.80
Forfeited	(564)	7.94 - 37.50	24.19
Outstanding at December 31, 2004	5,235	6.00 - 37.50	19.01

The following table summarizes information about stock options outstanding at December 31, 2004 (shares in thousands):

Range of Exercise Prices	Shares Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Exercise Price
$ 6.00 - $ 7.25	181	2.9	$ 6.14	181	$ 6.14
7.80 - 11.19	1,055	5.0	9.50	1,055	9.50
12.41 - 14.50	156	6.9	14.13	111	14.00
15.03 - 18.73	1,854	6.9	16.08	1,237	15.94
18.88 - 20.65	151	9.8	20.05	—	0.00
23.42 - 25.05	919	9.2	23.71	70	25.05
26.36 - 26.92	289	7.8	27.44	179	28.00
37.50	630	7.4	37.50	420	37.50
	5,235	7.0	$ 19.01	3,253	$ 16.89

Employee Stock Purchase Plan and Nonqualified Employee Stock Purchase Plan

The Board of Directors and stockholders of Sonic adopted the Sonic Automotive, Inc. Employee Stock Purchase Plan (the “ESPP”) to attract and retain key personnel. The ESPP authorizes the issuance of options to purchase 3.0 million shares of Class A common stock. Under the terms of the ESPP, on January 1 of each year all eligible employees electing to participate will be granted an option to purchase shares of Class A common stock. Sonic’s Compensation Committee of the Board of Directors will annually determine the number of shares of Class A common stock available for purchase under each award. The purchase price at which Class A common stock will be purchased through the ESPP will be 85% of the lesser of (i) the fair market value of the Class A common stock on the applicable grant date and (ii) the fair market value of the Class A common stock on the applicable exercise date. The grant dates are January 1 of each year plus any other interim dates designated by the Compensation Committee. The exercise dates are the last trading days on the New York Stock Exchange for March, June, September and December, plus any other interim dates designated by the Compensation Committee. ESPP options will expire on the last exercise date of the calendar year in which granted.

The Board of Directors of Sonic adopted the Sonic Automotive, Inc. Nonqualified Employee Stock Purchase Plan (the “Nonqualified ESPP”) to provide options to purchase Class A common stock to employees of Sonic’s subsidiaries that are not eligible to participate in the ESPP. Employees of Sonic who are eligible to participate in the ESPP are not eligible to participate in the Nonqualified ESPP. Under the terms of the Nonqualified ESPP, on January 1 of each year all employees eligible to participate in the Nonqualified ESPP and who elect to participate in the Nonqualified ESPP will be granted an option to purchase shares of Class A common stock. Sonic’s Compensation Committee will annually determine the number of shares of Class A common stock available for purchase under each award.

The purchase price at which Class A common stock will be purchased through the Nonqualified ESPP will be 85% of the lesser of (i) the fair market value of the Class A common stock on the applicable grant date and (ii) the fair market value of the Class A common stock on the applicable exercise date. The grant dates are January 1 of each year plus any other interim dates designated by the Compensation Committee. The exercise dates are the last trading days on the New York Stock Exchange for March, June, September and December, plus any other interim dates designated by the Compensation Committee. Nonqualified ESPP options will expire on the last exercise date of the calendar year in which granted. In adopting the Nonqualified ESPP the Board of Directors authorized options for 300,000 shares of Class A common stock to be granted under the Nonqualified ESPP.

Under both the ESPP and the Nonqualified ESPP, Sonic issued options exercisable for approximately 932,000 shares in 2002, 1,061,000 shares in 2003, and 1,058,000 shares in 2004. Sonic issued approximately 237,000 shares in 2002, 416,000 shares in 2003 and 208,000 shares to employees in 2004 at a weighted average purchase price of $17.78, $12.50 and $18.95 per share, respectively. The weighted average fair value of shares granted under both the ESPP and the Nonqualified ESPP was $4.92, $7.39 and $9.09 per share in 2002, 2003 and 2004, respectively.

11. COMMITMENTS AND CONTINGENCIES

Facility and Equipment Leases

The Company leases facilities for the majority of its dealership operations under operating lease arrangements. These facility lease arrangements generally have fifteen to twenty year terms with one or two five year renewal options and do not contain provisions for contingent rent related to dealership's operations. Approximately 25% of these facility leases are based on capitalization rates with terms that vary based on interest rates. The Company also leases certain equipment for use in dealership operations. These equipment lease arrangements generally have three to five year terms with one or two year renewal options. Minimum future lease payments for both facility and equipment leases and sub-leases to be received as required under noncancelable operating leases for both continuing and discontinued operations based on interest rates as of the inception of each lease are as follows:

	(Dollars in thousands)	
Year ending December 31,	Future Minimum Lease Payments	Receipts from Future Subleases
2005	$ 137,621	$ (7,829)
2006	137,126	(7,754)
2007	128,459	(7,213)
2008	121,343	(5,924)
2009	104,501	(5,116)
Thereafter	908,940	(39,643)

Total lease expense for continuing operations in 2002, 2003 and 2004 was approximately $66.1 million, $79.9 million and $94.9 million, respectively. Total lease expense for discontinued operations in 2002, 2003 and 2004 was approximately $18.1, $14.4 and $12.6 million, respectively. The total net contingent rent benefit relating to a decrease in interest rates since the underlying leases commenced for continuing operations in 2002, 2003 and 2004 was $2.4 million, $2.5 million and $2.4 million, respectively. The total net contingent rent benefit relating to a decrease in interest rates since the underlying leases commenced for discontinued operations in 2002, 2003 and 2004 was $0.5 million, $0.4 million and $0.4 million, respectively.

Other Matters

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

In connection with franchise dispositions, certain of Sonic's dealership subsidiaries have assigned or sublet to the buyer its interests in real property leases associated with such dealerships. In general, the subsidiaries retain responsibility for the performance of certain obligations under such leases, including rent payments, and repairs to leased property upon termination of the lease, to the extent that the assignee or sublessee does not perform. The total estimated rent payments remaining under such leases as of December 31, 2004 was approximately $54.7 million. However, in accordance with the terms of the assignment and sublease agreements, the assignees and sublessees have generally agreed to indemnify Sonic and its subsidiaries in the event of non-performance. Additionally, in connection with certain dispositions, Sonic has obtained indemnifications from the parent company or owners of these assignees and sublessees in the event of non-performance.

In accordance with the terms of agreements entered into for the sale of Sonic's dealership franchises, Sonic generally agrees to indemnify the buyer from certain liabilities and costs arising subsequent to the date of sale, including environmental exposure and exposure resulting from the breach of representations or warranties made in accordance with the agreement. While Sonic's exposure with respect to environmental remediation and repairs is difficult to quantify, Sonic's estimated maximum exposure associated with these general indemnifications was approximately $46.0 million at December 31, 2004. 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.

Several of Sonic's Texas dealership subsidiaries have been named in three class action lawsuits brought against the Texas Automobile Dealers Association ("TADA") and new vehicle dealerships in Texas that are members of the TADA. Approximately 630 Texas dealerships are named as defendants in two of the actions, and approximately 700 dealerships are named as defendants in the other action. The three actions allege that since January 1994, Texas automobile dealerships have deceived customers with respect to a vehicle inventory tax and violated federal antitrust and other laws. In April 2002, in two actions, the Texas state court certified two classes of consumers on whose behalf the actions would proceed. The Texas Court of Appeals subsequently affirmed the trial court's order of class certification in the state actions, and the Texas Supreme Court issued an order for the second time in September 2004 stating that it would not hear the merits of the defendant's appeal on class certification. The federal trial court conditionally certified a class of consumers in the federal antitrust case, but on appeal by the defendant dealerships, the U.S. Court of Appeals for the Fifth Circuit reversed the certification of the plaintiff class in October 2004 and remanded the case back to the federal trial court for further proceedings not inconsistent with the Fifth Circuit's ruling. The plaintiffs have appealed this ruling by the Fifth Circuit.

In June 2005, Sonic's Texas dealerships and several other dealership defendants entered into a settlement agreement with the plaintiffs in both the state and the federal cases that would settle each of the cases on behalf of Sonic's Texas dealerships. The settlements are contingent upon court approval, and the court has not yet scheduled a date for a hearing on that approval. The estimated expense of the proposed settlements is not a material amount to Sonic as a whole, and it includes Sonic's Texas dealerships issuing coupons for discounts off future vehicle purchases, refunding cash in certain circumstances, and paying attorneys' fees and certain costs. Under the terms of the settlements, Sonic's Texas dealerships would continue to itemize and pass through to the customer the cost of the inventory tax. If the TADA matters are not settled, Sonic's Texas dealership subsidiaries would then vigorously defend themselves and assert available defenses. In addition, Sonic may have rights of indemnification with respect to certain aspects of the TADA matters. However, an adverse resolution of the TADA matters could result in the payment of significant costs and damages and negatively impact Sonic's Texas dealerships' ability to itemize and pass through to the customer the cost of the vehicle inventory tax in the future, which could have a material adverse effect on Sonic's future results of operations, financial condition and cash flows.

Sonic is also 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 Sonic's 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 Sonic's 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. Sonic intends to continue its vigorous defense of this lawsuit, including the aforementioned appeal of the trial court's class certification order, 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.

Sonic is involved, and expects to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of Sonic's 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, 2003 and 2004 were $0.4 million and $2.9 million, respectively, in reserves that the Company has provided for pending proceedings.

12. SUMMARY OF QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table summarizes Sonic's results of operations as presented in the consolidated statements of income by quarter for 2003 and 2004.

	(Dollars in thousands, except per share amounts) First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year Ended December 31, 2003:				
Total revenues	$ 1,504,837	$ 1,747,570	$ 1,815,601	$ 1,650,782
Gross profit	$ 240,434	$ 264,213	$ 272,061	$ 250,965
Income before cumulative effect of change in accounting principle	$ 17,304	$ 28,516	$ 17,541	$ 13,818
Net income	$ 11,685	$ 28,516	$ 17,541	$ 13,818
Earnings per share - Basic	$ 0.28	$ 0.70	$ 0.43	$ 0.34
Earnings per share - Diluted	$ 0.29	$ 0.66	$ 0.41	$ 0.33
Year Ended December 31, 2004:				
Total revenues	$ 1,623,291	$ 1,804,067	$ 1,905,705	$ 1,845,336
Gross profit	$ 255,965	$ 279,159	$ 285,698	$ 281,729
Net income	$ 22,185	$ 29,992	$ 19,281	$ 14,613
Earnings per share - Basic	$ 0.53	$ 0.72	$ 0.47	$ 0.35
Earnings per share - Diluted	$ 0.51	$ 0.69	$ 0.45	$ 0.35

(1) Operations are subject to seasonal variations. The first and fourth quarters generally contribute less revenue and operating profits than the second and third quarters. Parts and service demand remains more stable throughout the year.

(2) The sum of diluted net income per share for the quarters may not equal the full year amount due to weighted average common shares being calculated on a quarterly versus annual basis.

(3) Amounts presented differ from amounts previously reported on Form 10-Q due to the classification of certain franchises in discontinued and continuing operations in accordance with SFAS No. 144 (see Note 2) and the dilutive impact of the 5.25% Convertible Senior Subordinated Notes in accordance with EITF Issue No. 04-8 which was adopted during the fourth quarter of 2004 (see Note 1). The effect of the adoption of EITF 04-8 was to lower fully diluted earnings per share by $0.02, $0.01 and $0.01 in the quarters ended June 30, 2003, June 30, 2004 and September 30, 2004, respectively, from amounts previously reported. The effect of the adoption of EITF 04-8 on all other quarters in 2003 and 2004 was zero.

SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES

RISK FACTORS

Risks Related to Our Indebtedness

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

As of September 30, 2005, our total outstanding indebtedness was approximately $1,542.9 million, including the following:

- $260.6 million under a revolving credit facility;
- $853.2 million under standardized secured inventory floor plan facilities, including $59.6 million classified as liabilities held for sale;
- $127.9 million in 5 1/4% convertible senior subordinated notes due 2009 representing $130.1 million in aggregate principal amount outstanding less unamortized discount of approximately $2.2 million;
- $272.1 million in 8 5/8% senior subordinated notes due 2013 representing $275.0 million in aggregate principal amount outstanding less unamortized net discount of approximately $2.9 million; and
- $29.1 million of other secured debt, representing $23.2 million in aggregate principal amount plus unamortized premium of approximately $5.9 million.

As of September 30, 2005, we had approximately $229.0 million available for additional borrowings under a revolving credit facility. We also had approximately $100.0 million available under a construction/mortgage credit facility for real estate acquisitions and new dealership construction. We also have significant additional capacity under the floor plan facilities. In addition, the indentures relating to our senior subordinated notes, convertible senior subordinated notes and other debt instruments allow us to incur additional indebtedness, including secured indebtedness.

The degree to which we are leveraged could have important consequences to the holders of our securities, including the following:

- our ability to obtain additional financing for acquisitions, capital expenditures, working capital or general corporate purposes may be impaired in the future;
- a substantial portion of our current cash flow from operations must be dedicated to the payment of principal and interest on our indebtedness, thereby reducing the funds available to us for our operations and other purposes;
- some of our borrowings are and will continue to be at variable rates of interest, which exposes us to the risk of increasing interest rates;
- the indebtedness outstanding under our revolving credit facility and floor plan facilities are secured by a pledge of substantially all the assets of our dealerships; and
- we may be substantially more leveraged than some of our competitors, which may place us at a relative competitive disadvantage and make us more vulnerable to changing market conditions and regulations.

In addition, our debt agreements contain numerous covenants that limit our discretion with respect to business matters, including mergers or acquisitions, paying dividends, incurring additional debt, making capital expenditures or disposing of assets.

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

Our revolving credit facility, floor plan facilities and the indenture governing our senior subordinated notes contain numerous financial and operating covenants. A breach of any of these covenants could result in a default under the applicable agreement or indenture. If a default were to occur, we may be unable to adequately finance our operations and the value of our common stock would be materially adversely affected. In addition, a default under one agreement or indenture could result in a default and acceleration of our repayment obligations under the other agreements or indentures, including the indentures governing our outstanding convertible senior subordinated notes and our 8 $^5/_8$% senior subordinated notes, under the cross default provisions in those agreements or indentures. If a cross default were to occur, we may not be able to pay our debts or borrow sufficient funds to refinance them. Even if new financing were available, it may not be on terms acceptable to us. As a result of this risk, we could be forced to take actions that we otherwise would not take, or not take actions that we otherwise might take, in order to comply with the covenants in these agreements and indentures.

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

Substantially all of our consolidated assets are held by our subsidiaries and substantially all of our consolidated cash flow and net income are generated by our subsidiaries. Accordingly, our cash flow and ability to service debt depends to a substantial degree on the results of operations of subsidiaries and upon the ability of our subsidiaries to provide us with cash. We may receive cash from our subsidiaries in the form of dividends, loans or otherwise. We may use this cash to service our debt obligations or for working capital. Our subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to distribute cash to us or to make funds available to service debt. In addition, the ability of our subsidiaries to pay dividends or make loans to us are subject to contractual limitations under the floor plan facilities, minimum net capital requirements under manufacturer franchise agreements and laws of the state in which a subsidiary is organized and depend to a significant degree on the results of operations of our subsidiaries and other business considerations.

Risks Related to Our Relationships with Vehicle Manufacturers

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

Each of our dealerships operates under a franchise agreement with the applicable automobile manufacturer or distributor. Without a franchise agreement, we cannot obtain new vehicles from a manufacturer. As a result, we are significantly dependent on our relationships with these manufacturers.

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

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

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

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

- customer rebates or below market financing on new vehicles;
- dealer incentives on new vehicles;
- warranties on new and used vehicles; and
- sponsorship of used vehicle sales by authorized new vehicle dealers.

Manufacturers are currently offering very favorable incentives to potential customers. A reduction or discontinuation of a manufacturer's incentive programs may materially adversely affect our profitability.

We depend on manufacturers to supply us with sufficient numbers of popular and profitable new models.

Manufacturers typically allocate their vehicles among dealerships based on the sales history of each dealership. Supplies of popular new vehicles may be limited by the applicable manufacturer's production capabilities. Popular new vehicles that are in limited supply typically produce the highest profit margins. We depend on manufacturers to provide us with a desirable mix of popular new vehicles. Our operating results may be materially adversely affected if we do not obtain a sufficient supply of these vehicles.

Adverse conditions affecting one or more key manufacturers may negatively impact our profitability.

During the three and nine month periods ended September 30, 2005, approximately 65.9% and 67.4% of our new vehicle revenue was derived from the sale of new vehicles manufactured by Ford, Honda, General Motors (including Cadillac), BMW and Toyota, respectively. Our success depends to a great extent on these manufacturers':

- financial condition;
- marketing;
- vehicle design;
- publicity concerning a particular manufacturer or vehicle model;
- production capabilities;
- management;
- reputation; and
- labor relations.

Events such as labor strikes that may adversely affect a manufacturer may also adversely affect us. In particular, labor strikes at a manufacturer that continue for a substantial period of time could have a material adverse effect on our business. Similarly, the delivery of vehicles from manufacturers at a time later than scheduled, which may occur particularly during periods of new product introductions, could limit sales of those vehicles during those periods. This has been experienced at some of our dealerships from time to time. Adverse conditions affecting these and other important aspects of manufacturers' operations and public relations may adversely affect our ability to sell their automobiles and, as a result, significantly and detrimentally affect our profitability.

Manufacturer stock ownership restrictions may impair our ability to maintain or renew franchise agreements or issue additional equity.

Some of our franchise agreements prohibit transfers of any ownership interests of a dealership and, in some cases, its parent, without prior approval of the applicable manufacturer. A number of manufacturers impose restrictions on the transferability of our Class A common stock and our ability to maintain franchises if a person acquires a significant percentage of the voting power of our common stock. Our existing franchise agreements could be terminated if a person or entity acquires a substantial ownership interest in us or acquires voting power above certain levels without the applicable manufacturer's approval. Violations of these levels by an investor are generally outside of our control and may result in the termination or non-renewal of existing franchise agreements or impair our ability to negotiate new franchise agreements for dealerships we acquire. In addition, if we cannot obtain any requisite approvals on a timely basis, we may not be able to issue additional equity or otherwise raise capital on terms acceptable to us. These restrictions may also prevent or deter a prospective acquiror from acquiring control of us. This could adversely affect the market price of our Class A common stock.

The current holders of our Class B common stock maintain voting control over us. However, we are unable to prevent our stockholders from transferring shares of our common stock, including transfers by holders of the Class B common stock. If such transfer results in a change in control, it could result in the termination or non-renewal of one or more of our existing franchise agreements, the triggering of provisions in our agreements with certain manufacturers requiring us to sell our dealerships franchised with such manufacturers and/or a default under our credit arrangements.

Manufacturers' restrictions on acquisitions could limit our future growth.

We are required to obtain the approval of the applicable manufacturer before we can acquire an additional dealership franchise of that manufacturer. In determining whether to approve an acquisition, manufacturers may consider many factors such as our financial condition and manufacturer-determined consumer satisfaction index, or "CSI" scores. Obtaining manufacturer approval of acquisitions also takes a significant amount of time, typically three to five months. We cannot assure you that manufacturers will approve future acquisitions or do so on a timely basis, which could impair the execution of our acquisition strategy.

Certain manufacturers also limit the number of its dealerships that we may own, our national market share of that manufacturer's products or the number of dealerships we may own in a particular geographic area. In addition, under an applicable franchise agreement or under state law, a manufacturer may have a right of first refusal to acquire a dealership that we seek to acquire.

A manufacturer may condition approval of an acquisition on the implementation of material changes in our operations or extraordinary corporate transactions, facilities improvements or other capital expenditures. If we are unable or unwilling to comply with these conditions, we may be required to sell the assets of that manufacturer's dealerships or terminate our franchise agreement.

Our dealers depend upon vehicle sales and, therefore, their success depends in large part upon customer demand for the particular vehicles they carry.

The success of our dealerships depends in large part on the overall success of the vehicle lines they carry. New vehicle sales generate the majority of our total revenue and lead to sales of higher-margin products and services such as finance, insurance, vehicle protection products and other aftermarket products, and parts and service operations. Although we have sought to limit our dependence on any one vehicle brand, we have focused our new vehicle sales operations in mid-line import and luxury brands.

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

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

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

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

In addition, these laws restrict the ability of automobile manufacturers to directly enter the retail market in the future. If manufacturers obtain the ability to directly retail vehicles and do so in our markets, such competition could have a material adverse effect on us.

Risks Related to Our Acquisition Strategy

Failure to effectively integrate acquired dealerships with our existing operations could adversely affect our future operating results.

Our future operating results depend on our ability to integrate the operations of recently acquired dealerships, as well as dealerships we acquire in the future, with our existing operations. In particular, we need to integrate our management information systems, procedures and organizational structures, which can be difficult. Our growth strategy has focused on the pursuit of strategic acquisitions that either expand or complement our business.

We cannot assure you that we will effectively and profitably integrate the operations of these dealerships without substantial costs, delays or operational or financial problems, due to:

- the difficulties of managing operations located in geographic areas where we have not previously operated;
- the management time and attention required to integrate and manage newly acquired dealerships;
- the difficulties of assimilating and retaining employees; and
- the challenges of keeping customers.

These factors could have a material adverse effect on our financial condition and results of operations.

We may not adequately anticipate all of the demands that growth through acquisitions will impose.

The automobile retailing industry is considered a mature industry in which minimal growth is expected in total unit sales. Accordingly, our ability to generate higher revenue and earnings in future periods depends in large part on our ability to acquire additional dealerships, manage geographic expansion, control costs in our operations and consolidate both past and future dealership acquisitions into our existing operations. In pursuing a strategy of acquiring other dealerships, we face risks commonly encountered with growth through acquisitions. These risks include, but are not limited to:

- incurring significantly higher capital expenditures and operating expenses;
- failing to assimilate the operations and personnel of acquired dealerships;
- entering new markets with which we are unfamiliar;
- potential undiscovered liabilities and operational difficulties at acquired dealerships;
- disrupting our ongoing business;
- diverting our limited management resources;
- failing to maintain uniform standards, controls and policies;
- impairing relationships with employees, manufacturers and customers as a result of changes in management;
- increased expenses for accounting and computer systems, as well as integration difficulties;
- failure to obtain a manufacturer's consent to the acquisition of one or more of its dealership franchises or renew the franchise agreement on terms acceptable to us; and
- incorrectly valuing entities to be acquired.

We may not adequately anticipate all of the demands that growth will impose on our systems, procedures and structures.

We may not be able to capitalize on acquisition opportunities because our financial resources available for acquisitions are limited; our financing of our acquisitions may adversely affect us and our stock holders and convertible bond holders.

We intend to finance our acquisitions with cash generated from operations, through issuances of our stock or debt securities and through borrowings under credit arrangements. We may not be able to obtain additional financing by issuing stock or debt securities due to the market price of our Class A common stock, overall market conditions or the need for manufacturer consent to the issuance of equity securities. Using cash to complete acquisitions could substantially limit our operating or financial flexibility. If we issue equity, for acquisitions or other purposes, our stock price may be negatively impacted and the holders of our outstanding common stock may be diluted. If we are unable to obtain financing on acceptable terms, we may be required to reduce the scope of our presently anticipated expansion, which could materially adversely affect our overall growth strategy.

In addition, we are dependent to a significant extent on our ability to finance our new vehicle inventory with “floor plan financing.” Floor plan financing arrangements allow us to borrow money to buy a particular vehicle from the manufacturer and pay off the loan when we sell that particular vehicle. We must obtain new floor plan financing or obtain consents to assume existing floor plan financing in connection with our acquisition of dealerships.

Substantially all the assets of our dealerships are pledged to secure our floor plan indebtedness and the indebtedness under the revolving credit facility. In addition, substantially all the real property and assets of our subsidiaries that are constructing new dealerships are pledged under our construction/mortgage facility with Toyota Credit. These pledges may impede our ability to borrow from other sources. Moreover, because Toyota Credit is associated with Toyota Motor Sales, U.S.A., Inc., any deterioration of our relationship with one could adversely affect our relationship with the other. The same is true of our relationships with Chrysler, GM and Ford and the floor plan financing divisions of each of these manufacturers.

We may not be able to continue executing our acquisition strategy without the costs of future acquisitions escalating.

We have grown our business primarily through acquisitions. We may not be able to consummate any future acquisitions at acceptable prices and terms or identify suitable candidates. In addition, increased competition for acquisition candidates could result in fewer acquisition opportunities for us and higher acquisition prices. The magnitude, timing, pricing and nature of future acquisitions will depend upon various factors, including:

- the availability of suitable acquisition candidates;
- competition with other dealer groups for suitable acquisitions;
- the negotiation of acceptable terms;
- our financial capabilities;
- our stock price; and
- the availability of skilled employees to manage the acquired companies.

We may not be able to determine the actual financial condition of dealerships we acquire until after we complete the acquisition and take control of the dealerships.

The operating and financial condition of acquired businesses cannot be determined accurately until we assume control. Although we conduct what we believe to be a prudent level of investigation regarding the operating and financial condition of the businesses we purchase, in light of the circumstances of each transaction, an unavoidable level of risk remains regarding the actual operating condition of these businesses. Similarly, many of the dealerships we acquire, including our largest acquisitions, do not have financial statements audited or prepared in accordance with generally accepted accounting principles. We may not have an accurate understanding of the historical financial condition and performance of our acquired entities. Until we actually assume control of business assets and their operations, we may not be able to ascertain the actual value or understand the potential liabilities of the acquired entities and their operations.

Although O. Bruton Smith, our chairman and chief executive officer, has previously assisted us with obtaining acquisition financing, we cannot assure you that he will be willing or able to do so in the future.

Our obligations under the revolving credit facility are secured with a pledge of shares of common stock of Speedway Motorsports, Inc., a publicly traded owner and operator of automobile racing facilities. These shares of Speedway Motorsports common stock are beneficially owned by Sonic Financial Corporation, an entity controlled by Mr. Smith. Presently, the $550.0 million borrowing limit of the revolving credit facility is subject to a borrowing base calculation that is based, in part, on the value of the Speedway Motorsports shares pledged by Sonic Financial. Consequently, a withdrawal of this pledge by Sonic Financial or a significant decrease in the value of Speedway Motorsports common stock could reduce the amount we can currently borrow under the revolving credit facility.

Mr. Smith has also guaranteed additional indebtedness incurred to complete certain dealership acquisitions. Mr. Smith may not be willing or able to provide similar guarantees or credit support in the future. This could impair our ability to obtain acquisition financing on favorable terms.

Risks Related to the Automotive Retail Industry

Increasing competition among automotive retailers reduces our profit margins on vehicle sales and related businesses. Further, the use of the Internet in the car purchasing process could materially adversely affect us.

Automobile retailing is a highly competitive business. Our competitors include publicly and privately owned dealerships, some of which are larger and have greater financial and marketing resources than we do. Many of our competitors sell the same or similar makes of new and used vehicles that we offer in our markets at competitive prices. We do not have any cost advantage in purchasing new vehicles from manufacturers due to economies of scale or otherwise. In addition, the popularity of short-term vehicle leasing in the past few years also has resulted, as these leases expire, in a large increase in the number of late model used vehicles available in the market, which puts added pressure on new and used vehicle margins. We typically rely on advertising, merchandising, sales expertise, service reputation and dealership location to sell new vehicles. Our revenues and profitability could be materially adversely affected if manufacturers decide to enter the retail market directly.

Our financing, insurance, vehicle protection product and other aftermarket product (“F&I”) business and other related businesses, which have higher margins than sales of new and used vehicles, are subject to strong competition from various financial institutions and other third parties.

This competition is increasing as these products are now being marketed and sold over the Internet.

The Internet has become a significant part of the sales process in our industry. Customers are using the Internet to compare pricing for cars and related F&I services, which may further reduce margins for new and used cars and profits for related F&I services. If Internet new vehicle sales are allowed to be conducted without the involvement of franchised dealers, our business could be materially adversely affected. In addition, other franchise groups have aligned themselves with Internet car sellers or are investing heavily in the development of their own Internet capabilities, which could materially adversely affect our business.

Our franchise agreements do not grant us the exclusive right to sell a manufacturer’s product within a given geographic area. Our revenues or profitability could be materially adversely affected if any of our manufacturers award franchises to others in the same markets where we operate or if existing franchised dealers increase their market share in our markets.

As we seek to acquire dealerships in new markets, we may face increasingly significant competition as we strive to gain market share through acquisitions or otherwise. Our gross margins may decline over time as we expand into markets where we do not have a leading position.

Our business will be harmed if overall consumer demand suffers from a severe or sustained downturn.

Our business is heavily dependent on consumer demand and preferences. Our revenues will be materially and adversely affected if there is a severe or sustained downturn in overall levels of consumer spending. Retail vehicle sales are cyclical and historically have experienced periodic downturns characterized by oversupply and weak demand. These cycles are often dependent on general economic conditions and consumer confidence, as well as the level of discretionary personal income and credit availability. Future recessions may have a material adverse effect on our retail business, particularly sales of new and used automobiles. In addition, severe or sustained increases in gasoline prices may lead to a reduction in automobile purchases or a shift in buying patterns from luxury and sport utility vehicle models (which typically provide high margins to retailers) to smaller, more economical vehicles (which typically have lower margins).

A decline of available financing in the sub-prime lending market has, and may continue to, adversely affect our sales of used vehicles.

A significant portion of vehicle buyers, particularly in the used car market, finance their purchases of automobiles. Sub-prime lenders have historically provided financing for consumers who, for a variety of reasons including poor credit histories and lack of down payment, do not have access to more traditional finance sources. Our recent experience suggests that sub-prime lenders have tightened their credit standards and may continue to apply these higher standards in the future. This has adversely affected our used vehicle sales. If sub-prime lenders continue to apply these higher standards or if there is any further tightening of credit standards used by sub-prime lenders or if there is any additional decline in the overall availability of credit in the sub-prime lending market, the ability of these consumers to purchase vehicles could be limited which could have a material adverse effect on our used car business, revenues and profitability.

Our business may be adversely affected by import product restrictions and foreign trade risks that may impair our ability to sell foreign vehicles profitably.

A significant portion of our new vehicle business involves the sale of vehicles, parts or vehicles composed of parts that are manufactured outside the United States. As a result, our operations are subject to customary risks of importing merchandise, including fluctuations in the relative values of currencies, import duties, exchange controls, trade restrictions, work stoppages and general political and socio-economic conditions in other countries. The United States or the countries from which our products are imported may, from time to time, impose new quotas, duties, tariffs or other restrictions, or adjust presently prevailing quotas, duties or tariffs, which may affect our operations and our ability to purchase imported vehicles and/or parts at reasonable prices.

The seasonality of our business magnifies the importance of second and third quarter operating results.

Our business is subject to seasonal variations in revenues. In our experience, demand for automobiles is generally lower during the first and fourth quarters of each year. We therefore receive a disproportionate amount of revenues generally in the second and third quarters and expect our revenues and operating results to be generally lower in the first and fourth quarters. Consequently, if conditions surface during the second and third quarters that impair vehicle sales, such as higher fuel costs, depressed economic conditions or similar adverse conditions, our revenues for the year could be disproportionately adversely affected.

General Risks Related to Investing in Our Securities

Concentration of voting power and anti-takeover provisions of our charter, Delaware law and our dealer agreements may reduce the likelihood of any potential change of control.

Our common stock is divided into two classes with different voting rights. This dual class stock ownership allows the present holders of the Class B common stock to control us. Holders of Class A common stock have one vote per share on all matters. Holders of Class B common stock have 10 votes per share on all matters, except that they have only one vote per share on any transaction proposed by the Board of Directors or a Class B common stockholder or otherwise benefiting the Class B common stockholders constituting a:

- "going private" transaction;
- disposition of substantially all of our assets;
- transfer resulting in a change in the nature of our business; or
- merger or consolidation in which current holders of common stock would own less than 50% of the common stock following such transaction.

The holders of Class B common stock currently hold less than a majority of our outstanding common stock, but a majority of our voting power. This may prevent or discourage a change of control of us even if the action was favored by holders of Class A common stock.

Our charter and bylaws make it more difficult for our stockholders to take corporate actions at stockholders' meetings. In addition, options under our 1997 Stock Option Plan and 2004 Stock Incentive Plan become immediately exercisable on a change in control. Delaware law also makes it difficult for stockholders who have recently acquired a large interest in a company to consummate a business combination transaction with the company against its directors' wishes. Finally, restrictions imposed by our dealer agreements may impede or prevent any potential takeover bid. Generally, our franchise agreements allow the manufacturers the right to terminate the agreements upon a change of control of our company and impose restrictions upon the transferability of any significant percentage of our stock to any one person or entity who may be unqualified, as defined by the manufacturer, to own one of its dealerships. The inability of a person or entity to qualify with one or more of our manufacturers may prevent or seriously impede a potential takeover bid. In addition, provisions of our lending arrangements create an event of default on a change in control. These agreements, corporate governance documents and laws may have the effect of delaying or preventing a change in control or preventing stockholders from realizing a premium on the sale of their shares if we were acquired.

The outcome of legal and administrative proceedings we are or may become involved in could have an adverse effect on our business, results of operations and profitability.

We are involved, and expect to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of our 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, such as the following.

In September 2002, the Los Angeles County District Attorney's office served a search warrant on one of our dealership subsidiaries located in Los Angeles County relating to alleged deceptive practices of the dealership's finance and insurance department. Our dealership is cooperating with the Los Angeles County District Attorney in its investigation. No charges have been filed and no proceedings have been instituted to date by the Los Angeles County District Attorney's office against either our dealership or our company. However, in late September 2005, the Los Angeles County District Attorney's office filed felony criminal charges against six former employees of the dealership in connection with its investigation. The former employees who were indicted by the Los Angeles County District Attorney's office have not been employed by the dealership or our company for more than three years.

In December 2003, the North Carolina Attorney General's office notified us that it had initiated an inquiry into the sales practices of our North Carolina dealerships following a negative media report on our company. We are cooperating with the North Carolina Attorney General's office in its inquiry. No charges have been filed and no proceedings have been instituted to date by the North Carolina Attorney General's office.

Because these regulatory investigations against our dealerships or our company are continuing, we cannot assure you as to the outcomes of these proceedings. Nevertheless, we do not believe that the ultimate resolution of these matters will have a material adverse effect on our business, results of operations, financial condition, cash flows or prospects. We may be involved in other regulatory investigations from time to time in the future, the outcomes of which cannot be predicted. We vigorously defend ourselves and assert available defenses in regulatory investigations, but an unfavorable resolution of one or more regulatory investigations could have a material adverse effect on our business, results of operations, financial condition, cash flows or prospects.

Several private civil actions have been filed against Sonic Automotive, Inc. and several of our 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 our South Carolina subsidiaries. We have been advised that the plaintiffs' attorneys in this South Carolina private civil action intend to file private civil class actions against Sonic Automotive, Inc. and certain of its subsidiaries in other states. This group of plaintiffs' attorneys has filed another one of these private civil class action lawsuits in state court in North Carolina seeking certification of a multi-state class of plaintiffs. Another one of these private civil actions has been filed in Tennessee state court against Sonic Automotive, Inc. and one of our Tennessee subsidiaries. Another one of these private civil actions has been filed in Florida state court against Sonic Automotive, Inc. and two of our Florida subsidiaries. This lawsuit also names as a defendant the administrator of the settlement agreement reached between two of our Florida subsidiaries, and the Florida Department of Financial Affairs and Attorney General's office. This private civil action alleges, among other things, that the settlement was unfair to the customers who were offered refunds through the settlement with the Florida Department of Financial Services and Attorney General's office. Finally, a private civil action has also been filed against one of our dealerships in Los Angeles County stating allegations similar to those underlying the Los Angeles County District Attorney's investigation described above. The plaintiffs in this private civil action purport to represent a class of customers as potential plaintiffs, although no motion for class certification has been filed.

The outcomes of the civil actions brought by plaintiffs purporting to represent a class of customers, as well as other pending and future legal proceedings arising out of the conduct of our 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 our business, financial condition, results of operations, cash flows or prospects.

In addition, several of our Texas dealership subsidiaries have been named in three class action lawsuits brought against the Texas Automobile Dealers Association ("TADA") and new vehicle dealerships in Texas that are members of the TADA. Approximately 630 Texas dealerships are named as defendants in two of the actions, and approximately 700 Texas dealerships are named as defendants in the other action. The three actions allege that since January 1994, Texas automobile dealerships have deceived customers with respect to a vehicle inventory tax and violated federal antitrust and other laws. In April 2002, in two actions the Texas state court certified two classes of consumers on whose behalf the actions would proceed. The Texas Court of Appeals subsequently affirmed the trial court's order of class certification in the state actions, and the Texas Supreme Court issued an order for the second time in September 2004 stating that it would not hear the merits of the defendant's appeal on class certification. The federal trial court conditionally certified a class of consumers in the federal antitrust case, but on appeal by the defendant dealerships, the U.S. Court of Appeals for the Fifth Circuit reversed the certification of the plaintiff class in October 2004 and remanded the case back to the federal trial court for further proceedings not inconsistent with the Fifth Circuit's ruling. The plaintiffs have appealed this ruling by the Fifth Circuit.

In June 2005, our Texas dealerships and several other dealership defendants entered into a settlement agreement with the plaintiffs in both the state and the federal cases that would settle each of the cases on behalf of our Texas dealerships. The settlements are contingent upon court approval, and the court has not yet scheduled a date for a hearing on that approval. If the TADA matters are not settled, our Texas dealership subsidiaries would then vigorously defend themselves and assert available defenses. In addition, we may have rights of indemnification with respect to certain aspects of the TADA matters. However, an adverse resolution of the TADA matters could result in the payment of significant costs and damages and negatively impact our Texas dealerships' ability to itemize and pass through to the customer the cost of the vehicle inventory tax in the future, which could have a material adverse effect on our future results of operations, financial condition and cash flows.

Our company is also 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 we and our 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. We have subsequently filed a notice of appeal of the court's class certification ruling with the Florida Court of Appeals. We intend to continue our vigorous defense of this lawsuit, including the aforementioned appeal of the trial court's class certification order, 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 our future results of operations, financial condition and cash flows.

Our business may be adversely affected by claims alleging violations of laws and regulations in our advertising, sales and finance and insurance activities.

Our business is highly regulated. In the past several years, private plaintiffs and state attorney generals have increased their scrutiny of advertising, sales, and finance and insurance activities in the sale and leasing of motor vehicles. The conduct of our business is subject to numerous federal, state and local laws and regulations regarding unfair, deceptive and/or fraudulent trade practices (including advertising, marketing, sales, insurance, repair and promotion practices), truth-in-lending, consumer leasing, fair credit practices, equal credit opportunity, privacy, insurance, motor vehicle finance, installment finance, closed-end credit, usury and other installment sales. Claims arising out of actual or alleged violations of law may be asserted against us or any of our dealers by individuals, either individually or through class actions, or by governmental entities in civil or criminal investigations and proceedings. Such actions may expose us to substantial monetary damages and legal defense costs, injunctive relief and criminal and civil fines and penalties, including suspension or revocation of our licenses and franchises to conduct dealership operations.

Our business may be adversely affected by unfavorable conditions in our local markets, even if those conditions are not prominent nationally.

Our performance is subject to local economic, competitive, weather and other conditions prevailing in geographic areas where we operate. For example, our current results of operations depend substantially on general economic conditions and consumer spending habits in the Southeast and in our Northern California and Houston markets. Sales in our Northern California and Houston markets represented approximately 29.6% and 30.2% of our total revenues for the three and nine month periods ended September 30, 2005, respectively. We may not be able to expand geographically and any geographic expansion may not adequately insulate us from the adverse effects of local or regional conditions.

The loss of key personnel and limited management and personnel resources could adversely affect our operations and growth.

Our success depends to a significant degree upon the continued contributions of our management team, particularly our senior management, and service and sales personnel. Additionally, manufacturer franchise agreements may require the prior approval of the applicable manufacturer before any change is made in franchise general managers. We do not have employment agreements with certain members of our senior management team, our dealership managers and other key dealership personnel. Consequently, the loss of the services of one or more of these key employees could have a material adverse effect on our results of operations.

In addition, as we expand we may need to hire additional managers. The market for qualified employees in the industry and in the regions in which we operate, particularly for general managers and sales and service personnel, is highly competitive and may subject us to increased labor costs during periods of low unemployment. The loss of the services of key employees or the inability to attract additional qualified managers could have a material adverse effect on our results of operations. In addition, the lack of qualified management or employees employed by potential acquisition candidates may limit our ability to consummate future acquisitions.

Governmental regulation and environmental regulation compliance costs may adversely affect our profitability.

We are subject to a wide range of federal, state and local laws and regulations, such as local licensing requirements, retail financing and consumer protection laws and regulations, and wage-hour, anti-discrimination and other employment practices laws and regulations. Our facilities and operations are also subject to federal, state and local laws and regulations relating to environmental protection and human health and safety, including those governing wastewater discharges, air emissions, the operation and removal of underground and aboveground storage tanks, the use, storage, treatment, transportation, release, recycling and disposal of solid and hazardous materials and wastes and the cleanup of contaminated property or water. The violation of these laws and regulations can result in administrative, civil or criminal penalties against us or in a cease and desist order against our operations that are not in compliance. Our future acquisitions may also be subject to regulation, including antitrust reviews. We believe that we comply in all material respects with all laws and regulations applicable to our business, but future regulations may be more stringent and require us to incur significant additional compliance costs.

Our past and present business operations are subject to environmental laws and regulations. We may be required by these laws to pay the full amount of the costs of investigation and/or remediation of contaminated properties, even if we are not at fault for disposal of the materials or if such disposal was legal at the time. Like many of our competitors, we have incurred, and will continue to incur, capital and operating expenditures and other costs in complying with these laws and regulations. In addition, soil and groundwater contamination exists at certain of our properties. We cannot assure you that our other properties have not been or will not become similarly contaminated. In addition, we could become subject to potentially material new or unforeseen environmental costs or liabilities because of our acquisitions.

Potential conflicts of interest between us and our officers or directors could adversely affect our future performance.

O. Bruton Smith serves as the chairman and chief executive officer of Speedway Motorsports. Accordingly, we compete with Speedway Motorsports for the management time of Mr. Smith.

We have in the past and will likely in the future enter into transactions with Mr. Smith, entities controlled by Mr. Smith or our other affiliates. We believe that all of our existing arrangements with affiliates are as favorable to us as if the arrangements were negotiated between unaffiliated parties, although the majority of these transactions have neither been independently verified in that regard nor are likely to be so verified in the future. Potential conflicts of interest could arise in the future between us and our officers or directors in the enforcement, amendment or termination of arrangements existing between them.

An impairment of our goodwill could have a material adverse impact on our earnings.

Pursuant to applicable accounting pronouncements, we test goodwill for impairment annually or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. We describe the process for testing goodwill more thoroughly in our Annual Report on Form 10-K for the year ended December 31, 2004 under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Use of Estimates and Critical Accounting Policies.” If we determine that the amount of our goodwill is impaired at any point in time, we will be required to reduce goodwill on our balance sheet. A reduction in the amount of goodwill on our balance sheet will require us to record a non-cash impairment charge against our earnings for the period in which the impairment of goodwill occurred. This would have a material adverse impact on our earnings for that period.

Poor performance in one or more of our geographic divisions could constitute an event or change in circumstances for purposes of determining whether the fair value of our goodwill has been reduced below the carrying amount. We would therefore be required to test our goodwill for impairment. As of September 30, 2005, our balance sheet reflected a carrying amount of approximately $1,105.2 million in goodwill (including goodwill classified as assets held for sale), which was allocated between four geographic reporting units. If the goodwill in any of our reporting units is impaired, we will record a significant non-cash impairment charge that would likely have a material adverse effect on our earnings for the period in which the impairment of goodwill occurred.