

SONIC AUTOMOTIVE INC

Form 10-K

February 24, 2011

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

**Form 10-K**

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2010**
- OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from        to**

**Commission file number 1-13395**  
**SONIC AUTOMOTIVE, INC.**  
*(Exact Name of Registrant as Specified in its Charter)*

**DELAWARE**  
*(State or Other Jurisdiction of  
Incorporation or Organization)*

**56-2010790**  
*(I.R.S. Employer  
Identification No.)*

**6415 IDLEWILD ROAD, SUITE 109**  
**CHARLOTTE, NORTH CAROLINA**  
*(Address of Principal Executive Offices)*

**28212**  
*(Zip Code)*

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

**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

| <b>Title of Each Class</b>                   | <b>Name of Each Exchange on Which Registered</b> |
|--|--|
| <b>Class A Common Stock, \$.01 Par Value</b> | <b>New York Stock Exchange</b>                   |

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:**

*(Title of Class)*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant was approximately \$213,038,584 based upon the closing sales price of the registrant's Class A common stock on June 30, 2010 of \$8.56 per share. As of February 18, 2011 there were 40,760,973 shares of Class A common stock, par value \$0.01 per share, and 12,029,375 shares of Class B common stock, par value \$0.01 per share, outstanding.

**Documents incorporated by reference.** Portions of the registrant's Proxy Statement for the Annual Meeting of Stockholders to be held April 21, 2011 are incorporated by reference into Part III of this Form 10-K.

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This Annual Report on Form 10-K contains numerous forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address our future objectives, plans and goals, as well as our intent, beliefs and current expectations regarding future operating performance, and can commonly be identified by words such as may, will, should, believe, expect, anticipate, intend, plan, similar words or phrases. Specific events addressed by these forward-looking statements include, but are not limited to:

vehicle sales rates and same store sales growth;

future liquidity trends or needs;

our business and growth strategies;

future covenant compliance;

our financing plans and our ability to repay or refinance existing debt when due;

future acquisitions or dispositions;

level of fuel prices;

industry trends; and

general economic trends, including employment rates and consumer confidence levels.

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

the number of new and used cars sold in the United States generally, and as compared to our expectations and the expectations of the market;

our ability to generate sufficient cash flows or obtain additional financing to fund acquisitions, capital expenditures, our share repurchase program, dividends on our Common Stock, and general operating activities;

the reputation and financial condition of vehicle manufacturers whose brands we represent, the financial incentives vehicle manufacturers offer and their ability to design, manufacture, deliver and market their vehicles successfully;

our relationships with manufacturers, which may affect our ability to complete additional acquisitions;

changes in laws and regulations governing the operation of automobile franchises, accounting standards, taxation requirements, and environmental laws;

adverse resolutions of one or more significant legal proceedings against us or our dealerships;

general economic conditions in the markets in which we operate, including fluctuations in interest rates, employment levels, the level of consumer spending and consumer credit availability;

the terms of any refinancing of our existing indebtedness;

high competition in the automotive retailing industry, which not only creates pricing pressures on the products and services we offer, but also on businesses we seek to acquire;

our ability to successfully integrate potential future acquisitions; and

the rate and timing of overall economic recovery or decline.

**Table of Contents****PART I****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 December 31, 2010, we operated 135 dealership franchises at 118 dealership locations, representing 29 different brands of cars and light trucks, and 25 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 repair services (collectively, Fixed Operations ); and (3) arrangement of extended service contracts, financing and insurance and other aftermarket products (collectively, F&I ) for our customers.

The following charts depict the multiple sources of continuing operations revenue and gross profit for the year ended December 31, 2010:

**Revenue****Gross Profit**

As of December 31, 2010, we operated dealerships in the following markets:

| <b>Market</b>                | <b>Number of Dealerships</b> | <b>Number of Franchises</b> | <b>Percent of 2010 Total Revenue</b> |
|------------------------------|------------------------------|-----------------------------|--------------------------------------|
| Houston                      | 21                           | 25                          | 21.7%                                |
| Alabama/Tennessee            | 16                           | 22                          | 10.4%                                |
| North/South Carolina/Georgia | 13                           | 16                          | 10.4%                                |
| South Bay (San Francisco)    | 6                            | 6                           | 7.5%                                 |
| Los Angeles North            | 11                           | 13                          | 7.4%                                 |
| Los Angeles South            | 4                            | 4                           | 7.3%                                 |
| Florida                      | 10                           | 10                          | 6.5%                                 |
| Mid-Atlantic                 | 5                            | 6                           | 6.3%                                 |
| North Bay (San Francisco)    | 10                           | 9                           | 6.0%                                 |
| Dallas                       | 4                            | 4                           | 5.0%                                 |
| Oklahoma                     | 5                            | 5                           | 2.9%                                 |
| Ohio                         | 4                            | 6                           | 2.7%                                 |
| Colorado                     | 2                            | 2                           | 2.1%                                 |
| Michigan                     | 4                            | 4                           | 1.9%                                 |
| Las Vegas                    | 3                            | 3                           | 1.9%                                 |
| <b>Total</b>                 | <b>118</b>                   | <b>135</b>                  | <b>100.0%</b>                        |





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In the future, we plan to purchase franchises that enrich our franchise portfolio and divest franchises that we believe will not yield acceptable returns over the long-term. Currently, we are not pursuing any significant acquisition opportunities. Although we believe growth through acquisitions will be a significant source of growth for us in the future, we do not see this being a significant source of growth in the near-term. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources for a discussion of our plans for the use of capital generated through operations. Our ability to complete acquisitions in the future will depend on many factors, including the availability of financing and the existence of any contractual provisions that may restrict our acquisition activity.

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

## **Business Strategy**

*Maximize Asset Returns Through Process Execution.* We have developed standardized operating processes which are documented in operating playbooks for our dealerships. Through the continued implementation of these operating playbooks, we believe organic growth opportunities exist. Through the implementation of our standard operating practices at all of our dealerships, we believe we are able to offer a more favorable buying experience to our customers and create efficiencies in our business processes. We believe the development, refinement and implementation of these operating processes will enhance the customer experience, make us more competitive in the marketplace and drive revenue growth across each of our revenue streams.

*Invest in Dealership Properties.* Historically, we have operated our dealerships primarily on property financed through long-term operating leases. As these leases mature or as we have an opportunity to purchase the underlying real estate prior to renewal, we have begun to purchase and own more of our dealership properties. We remain opportunistic in purchasing existing properties or relocating dealership operations to owned real estate where the returns are favorable. We believe owning our properties will, over the long-term, strengthen our balance sheet and reduce our overall cost of operating and financing our dealership facilities.

*Reduce Leverage.* As we generate cash through operations and have the ability to repay or repurchase outstanding indebtedness, we will continue to reduce our non-mortgage related leverage.

*Diverse Revenue Streams.* We have multiple revenue streams. In addition to new vehicle sales, our revenue sources include used vehicle sales, which we believe are less sensitive to economic cycles and seasonal influences that exist with new vehicle sales. Our fixed operations sales carry a higher gross margin and, in the past, have not been as economically sensitive as vehicle sales. We also offer customers assistance in obtaining financing and a range of automobile related insurance products.

*Portfolio Management.* Although we are not currently pursuing any significant acquisition opportunities, our long-term growth strategy is focused on large metropolitan markets, predominantly in the Southeast, Southwest, Midwest and California. A majority of our dealerships are either luxury or mid-line import brands. For the year ended December 31, 2010, 85.1% of our total revenue was generated by mid-line import and luxury dealerships, which usually have higher operating margins, more stable fixed operations departments, lower associate turnover and lower inventory levels.

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The following table depicts the breakdown of our new vehicle revenues by brand:

|                   | <b>Percentage of New Vehicle<br/>Revenue</b> |             |             |
|-------------------|--|-------------|-------------|
|                   | <b>Year Ended December 31,</b>               |             |             |
|                   | <b>2008</b>                                  | <b>2009</b> | <b>2010</b> |
| <b>Brand(1)</b>   |  |             |             |
| BMW               | 18.6%  | 17.2%       | 17.4%       |
| Honda             | 15.0%  | 15.2%       | 13.9%       |
| Toyota            | 11.7%  | 11.7%       | 11.1%       |
| Mercedes          | 10.5%  | 9.7%        | 9.8%        |
| Ford              | 5.0%   | 9.6%        | 8.8%        |
| General Motors(2) | 10.5%  | 6.5%        | 6.7%        |
| Lexus             | 5.9%   | 6.2%        | 6.0%        |
| Cadillac          | 5.6%   | 4.6%        | 5.5%        |
| Other(3)          | 3.6%   | 3.8%        | 3.3%        |
| Audi              | 1.8%   | 2.6%        | 3.1%        |
| Volkswagen        | 1.8%   | 2.1%        | 2.3%        |
| Land Rover        | 1.3%   | 1.7%        | 2.0%        |
| Hyundai           | 1.4%   | 1.8%        | 2.0%        |
| Porsche           | 1.4%   | 1.5%        | 1.8%        |
| Infiniti          | 1.2%   | 1.2%        | 1.4%        |
| Nissan            | 0.9%   | 1.1%        | 1.3%        |
| Volvo             | 1.2%   | 1.4%        | 1.2%        |
| Other Luxury(4)   | 1.1%   | 1.0%        | 1.1%        |
| Acura             | 1.1%   | 0.8%        | 1.0%        |
| Chrysler(5)       | 0.4%   | 0.3%        | 0.3%        |
| Total             | 100.0%                                       | 100.0%      | 100.0%      |

(1) In accordance with the provisions of Presentation of Financial Statements in the Accounting Standards Codification (the ASC), prior years income statement data reflect reclassifications to (i) exclude franchises sold, identified for sale, or terminated subsequent to December 31, 2009 which had not been previously included in discontinued operations or (ii) include franchises previously held for sale which subsequently were reclassified to held and used. See Notes 1 and 2 to our accompanying Consolidated Financial Statements which discuss these and other factors that affect the comparability of the information for the periods presented.

(2) Includes Buick, Chevrolet and GMC.

(3) Includes Isuzu, Kia, Mini, Scion and Subaru.

(4) Includes Hummer, Jaguar and Saab.

(5) Includes Chrysler, Dodge and Jeep.

*Expand our eCommerce Capabilities.* Automotive customers have become increasingly more comfortable using technology to research their vehicle buying alternatives and communicate with dealership personnel. The internet presents a unique marketing, advertising and automotive sales channel which we will exploit nationally to drive demand creation and demand maximization for our dealerships. Our technology platforms have given us the ability to leverage technology to more efficiently integrate systems, customize our dealership websites and use our data to improve the effectiveness of our advertising and interaction with our customers. This also allows us to market all of our products and services to a national audience and, at the same time, support the market penetration of our individual dealerships.

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*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 dealership. In addition, all manufacturers consider CSI scores in approving acquisitions. In order to keep dealership management focused on customer satisfaction, we include CSI results as a component of our incentive-based compensation programs.

*Train, Develop and Retain Associates.* We believe our associates are the cornerstone of our business and crucial to our financial success. Our goal is to develop our associates and foster an environment where our associates can contribute and grow with the company. Associate satisfaction is very important to us and we believe a high level of associate satisfaction reduces turnover and enhances our customers' experience at our stores by pairing our customers with well-trained, seasoned associates. We believe that our comprehensive training of all employees provides us with a competitive advantage over other dealership groups.

*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 ( F&I ):* Each sale of a new or used vehicle gives us an opportunity to provide our customer with financing and insurance options and earn financing fees and insurance commissions. We also offer our customers the opportunity to purchase extended service contracts and other aftermarket products. We currently offer a wide range of non-recourse financing, leasing, other aftermarket products, service contracts and insurance products to our customers. We emphasize menu-selling techniques and other best practices to increase our sales of F&I products at both newly acquired and existing dealerships.

*Parts, Service & Repair:* Each of our dealerships offers a fully integrated service and parts department. Manufacturers permit warranty work to be performed only at franchised dealerships such as ours. As a result, our franchised dealerships are uniquely qualified and positioned to perform work covered by manufacturer warranties on increasingly complex vehicles. We believe we can continue to grow our profitable parts and service business over the long-term by increasing 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 associated with new and used vehicle retail sales will drive further service and parts business in our dealerships as we increase the potential to retain current customers beyond the term of the standard manufacturer warranty period.

*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 CPO vehicle. We typically earn higher revenues and gross profits on CPO vehicles compared to non-certified pre-owned 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 warranty work can only be performed at franchised dealerships, we believe CPO warranty work will increase our fixed operations business.

*Value Used Vehicle:* We believe the market for value vehicles (used vehicles with retail prices below \$10,000) is broad and not as sensitive to market fluctuations as higher priced used vehicles. Our strategy in retailing these vehicles includes the use of technology and market data to determine optimal pricing and placement of these vehicles at our stores.

## **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. Each franchise or 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 sales volume. A franchise or dealer

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agreement requires the dealer to meet specified standards regarding showrooms, facilities and equipment for servicing vehicles, inventories, minimum net working capital, personnel training and other aspects of the business. Each franchise or dealer agreement also gives the related manufacturer the right to approve the dealer operator and any material change in management or ownership of the dealership. Each manufacturer may terminate a franchise or 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 new vehicle financing arrangements, insolvency or bankruptcy of the dealership or a material breach of other provisions of the applicable franchise or dealer agreement.

Many automobile manufacturers have developed policies regarding public ownership of dealerships. Policies implemented by 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 (other than an automobile manufacturer or distributor) acquires more than 20% of the voting power of our securities, and the manufacturer disapproves of such individual's or entity's ownership interest.

To the extent that new or amended manufacturer policies restrict the number of dealerships which may be owned by a dealership group 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 all of our existing franchise and dealer agreements.

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 manufacturer attempts to establish dealerships of the same brand 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, leasing companies and services offered on the internet 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 location of dealerships, the marketing campaigns conducted by manufacturers, the ability of dealerships to offer an attractive selection of the most popular vehicles, 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

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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 services 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 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, even though 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.

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, including 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 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 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, financial condition and cash flows. However, soil and groundwater contamination is known to exist at certain properties owned and 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.

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Our executive officers as of the date of this Form 10-K, are as follows:

| <b>Name</b>      | <b>Age</b> | <b>Position(s) with Sonic</b>                   |
|------------------|------------|---|
| O. Bruton Smith  | 84         | Chairman, Chief Executive Officer and Director  |
| B. Scott Smith   | 43         | President, Chief Strategic Officer and Director |
| Jeff Dyke        | 43         | Executive Vice President of Operations          |
| David P. Cospers | 56         | Vice Chairman and Chief Financial Officer       |
| David B. Smith   | 36         | Executive Vice President and Director           |

*O. Bruton Smith*, 84, is our Founder, Chairman, Chief Executive Officer and a director and has served as such since our formation 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, Charlotte Motor Speedway, Infineon Raceway, Las Vegas Motor Speedway, New Hampshire Motor Speedway, Texas Motor Speedway, and Kentucky Speedway. He is also an executive officer or a director of most of SMI s operating subsidiaries.

*B. Scott Smith*, 43, is our Co-Founder, President, Chief Strategic Officer and a director. Prior to his appointment as President in March 2007, Mr. Smith served as our Vice Chairman and Chief Strategic Officer since October 2002. He held the position of President and Chief Operating Officer from April 1997 to October 2002. Mr. Smith has been a director of our company since our organization was formed 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 and brother of David B. 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 twenty years experience in the automobile dealership industry.

*Jeff Dyke*, 43, is our Executive Vice President of Operations and is responsible for direct oversight for all retail automotive operations of Sonic. From March 2007 to October 2008, Mr. Dyke served as our Division Chief Operating Officer South East Division, where he oversaw retail automotive operations for the states of Alabama, Georgia, Florida, North Carolina, Tennessee, Texas and South Carolina. Mr. Dyke first joined Sonic in October 2005 as its Vice President of Retail Strategy, a position that he held until April 2006, when he was promoted to Division Vice President Eastern Division, a position he held from April 2006 to March 2007. Prior to joining Sonic, Mr. Dyke worked in the automotive retail industry at AutoNation from 1996 to 2005, where he held several positions in divisional, regional and dealership management with that company.

*David P. Cospers*, 56, is our Vice Chairman and Chief Financial Officer. In March 2007, Mr. Cospers was appointed to Vice Chairman after serving as Executive Vice President since March 2006. He joined Sonic Automotive on March 1, 2006 as an Executive Vice President and became our Chief Financial Officer and Treasurer on March 16, 2006. Mr. Cospers served as Treasurer through the end of 2006 and relinquished the position in February 2007. Prior to joining Sonic, he was Vice Chairman and Chief Financial Officer of Ford Motor Credit Company, a position held since 2003. From 1979, when he joined Ford Motor Company, Mr. Cospers served in a variety of positions in Ford Motor Company and Ford Motor Credit Company, including Vice President and Treasurer of Ford Motor Credit Company and Executive Director of Corporate Finance at Ford Motor Company. In such positions, he was responsible

for worldwide profit analysis and treasury matters, risk management, business planning, and competitive and strategic analysis.

*David B. Smith*, 36, is our Executive Vice President and a director and has served our organization beginning in October 2000. Prior to being named a director and Executive Vice President of Sonic in October 2008, Mr. Smith, also a son of O. Bruton Smith and brother of B. Scott Smith, served as our Senior Vice President of Corporate Development since March 2007. Prior to that appointment, Mr. Smith served as our Vice President of Corporate Strategy from October 2005 to March 2007, and also served us prior to that time as Dealer Operator of one of our

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Arnold Palmer Cadillac dealerships from January 2004 to October 2005, our Fort Mill Ford dealership from January 2003 to January 2004, and our Town and Country Ford dealership from October 2000 to December 2002.

## **Employees**

As of January 31, 2011, we employed approximately 9,200 associates. We believe that our relationships with our employees are good. Approximately 225 of our employees, primarily service technicians in our Northern California markets, are represented by a labor union. However, due to our dependence on automobile manufacturers, we may be affected by labor strikes, work slowdowns and walkouts at the manufacturers' manufacturing facilities.

## **Company Information**

Our website is located at [www.sonicautomotive.com](http://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 filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), 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 electronically 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 Annual Report on Form 10-K or other documents we file with, or furnish to, the SEC.

## **Item 1A: Risk Factors**

### **Risks Related to Our Sources of Financing and Liquidity**

*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 December 31, 2010, our total outstanding indebtedness was approximately \$1.4 billion, including the following:

\$862.0 million under the secured new and used inventory floor plan facilities;

\$208.6 million in 9.0% Senior Subordinated Notes due 2018 (the 9.0% Notes), representing \$210.0 million in aggregate principal amount outstanding less unamortized discount of approximately \$1.4 million;

\$42.7 million in 8.625% Senior Subordinated Notes due 2013 (the 8.625% Notes), representing \$42.9 million in aggregate principal amount outstanding less unamortized net discount of approximately \$0.2 million;

\$147.8 million in 5.0% Convertible Senior Notes due 2029 which are redeemable by us and which may be put to us by the holders after October 1, 2014 under certain circumstances (the 5.0% Convertible Notes), representing \$172.5 million in aggregate principal amount outstanding less unamortized discount of approximately \$24.7 million;

\$132.9 million of mortgage notes, representing \$133.9 million in aggregate principal amount less unamortized net discount of approximately \$1.0 million, due from June 2013 to December 2029, with a weighted average interest rate of 4.91%; and

\$23.5 million of other secured debt, representing \$21.7 million in aggregate principal amount plus unamortized premium of approximately \$1.8 million.

We have \$150.0 million of maximum borrowing availability under a syndicated revolving credit facility (the 2010 Revolving Credit Facility ), up to \$321.0 million in maximum borrowing availability for new vehicle inventory floor plan financing and up to \$50.0 million in maximum borrowing availability for used vehicle inventory floor plan financing (the 2010 Floor Plan Facilities ). We refer to the 2010 Revolving Credit Facility and 2010 Floor Plan Facilities collectively as our 2010 Credit Facilities . As of December 31, 2010, we had \$97.9 million available for additional borrowings under the 2010 Revolving Credit Facility based on the borrowing

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base calculation, which is affected by numerous factors including eligible asset balances and the market value of certain additional collateral. We are able to borrow under our 2010 Revolving Credit Facility only if, at the time of the borrowing, we have met all representations and warranties and are in compliance with all financial and other covenants contained therein. We also have capacity to finance new and used vehicle inventory purchases under bilateral floor plan agreements with various manufacturer-affiliated finance companies and other lending institutions (the Silo Floor Plan Facilities ) as well as our 2010 Floor Plan Facilities. In addition, the indentures relating to our 9.0% Notes, 8.625% Notes, 5.0% Convertible Notes and our other debt instruments allow us to incur additional indebtedness, including secured indebtedness, as long as we comply with the terms thereunder.

In addition, the majority of our dealership properties are leased under long-term operating lease arrangements that commonly have initial terms of fifteen to twenty years with renewal options ranging from five to ten years. These operating leases require compliance with financial and operating covenants similar to those under our 2010 Credit Facilities, and monthly payments of rent that may fluctuate based on interest rates and local consumer price indices. The total future minimum lease payments related to these operating leases and certain equipment leases are significant and are disclosed in the Notes to the accompanying Consolidated Financial Statements under the heading

Commitments and Contingencies in this Annual Report on Form 10-K.

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

Our 2010 Credit Facilities, the indentures governing our 9.0% Notes, 8.625% Notes and many of our facility operating leases 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 because of acceleration and cross default provisions. 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 9.0% Notes, 8.625% Notes, and 5.0% Convertible 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 our future performance.***

Our ability to meet our debt obligations and other expenses will depend on our future performance, which will be affected by financial, business, domestic and foreign economic conditions, the regulatory environment and other factors, many of which we are unable to control. If our cash flow is not sufficient to service our debt as it becomes due, we may be required to refinance the debt, sell assets or sell shares of our common stock on terms that we do not find attractive. Further, our failure to comply with the financial and other restrictive covenants relating to the 2010 Credit Facilities and the indentures pertaining to our outstanding notes could result in a default under these agreements that would prevent us from borrowing under the 2010 Revolving Credit Facility, which could adversely affect our business, financial condition and results of operations.

***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 our 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 distributions. 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

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is subject to minimum net capital requirements under manufacturer franchise agreements and laws of the state in which a subsidiary is organized and depends to a significant degree on the results of operations of our subsidiaries and other business considerations.

***The conversion of the 5.0% Convertible Notes, if triggered, may adversely affect our liquidity and financial condition and results of operations.***

If the conversion features of the 5.0% Convertible Notes are triggered, holders of those notes will be entitled to convert their notes in accordance with the terms of the indenture governing those notes. We may be required to make cash payments to satisfy our conversion obligations. In the event we have the ability to, and choose to, settle the 5.0% Convertible Notes with cash payments in lieu of settlement with shares of common stock, the amount of these cash payments could have a material adverse effect on our liquidity. In addition, even if the holders of the 5.0% Convertible Notes do not elect to convert their respective notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long-term liability, which could result in a material reduction of our net working capital or could have a material adverse effect on our financial condition and results of operations.

***We depend on the performance of sublessees to offset costs related to certain of our lease agreements.***

In most cases when we sell a dealership franchise, the buyer of the franchise will sublease the dealership property from us, but we are not released from the underlying lease obligation to the primary landlord. We rely on the sublease income from the buyer to offset the expense incurred related to our obligation to pay the primary landlord. We also rely on the buyer to maintain the property in accordance with the terms of the sublease (which in most cases mirror the terms of the lease we have with the primary landlord). Although we assess the financial condition of a buyer at the time we sell the franchise, and seek to obtain guarantees of the buyer's sublease obligation from the stockholders or affiliates of the buyer, the financial condition of the buyer and/or the sublease guarantors may deteriorate over time. In the event the buyer does not perform under the terms of the sublease agreement (due to the buyer's financial condition or other factors), we may not be able to recover amounts owed to us under the terms of the sublease agreement or the related guarantees. Our operating results, financial condition and cash flows may be materially adversely affected if sublessees do not perform their obligations under the terms of the sublease agreements.

***Our use of hedging transactions could limit our gains and result in financial losses.***

To reduce our exposure to fluctuations in cash flow due to interest rate fluctuations, we have entered into, and in the future expect to enter into, derivative instruments (or hedging agreements). No hedging activity can completely insulate us from the risks associated with changes in interest rates. As of December 31, 2010, we had interest rate swap agreements to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate. See *Derivative Instruments and Hedging Activities* under Note 6, Long-Term Debt, to our accompanying Consolidated Financial Statements. We intend to hedge as much of the interest rate risk as management determines is in our best interests given the cost of such hedging transactions.

Our hedging transactions expose us to certain risks and financial losses, including, among other things:

counterparty credit risk;

available interest rate hedging may not correspond directly with the interest rate risk for which we seek protection;

the duration of the amount of the hedge may not match the duration or amount of the related liability;



the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair-value. Downward adjustments, or mark-to-market losses, would reduce our stockholders equity; and

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all of our hedging instruments contain terms and conditions with which we are required to meet. In the event those terms and conditions are not met, we may be required to settle the instruments prior to the instruments maturity with cash payments which could significantly affect our liquidity.

A failure on our part to effectively hedge against interest rate changes may adversely affect our financial condition and results of operations.

***We may not be able to satisfy our debt obligations upon the occurrence of a change in control or a fundamental change.***

Upon the occurrence of a change in control or a fundamental change, as defined in our 9.0% Notes, 8.625% Notes and 5.0% Convertible Notes, holders of these instruments will have the right to require us to purchase all or any part of such holders' notes at a price equal to either 101% (in the case of the 9.0% Notes and 8.625% Notes) or 100% (in the case of the 5.0% Convertible Notes) of principal amount thereof, plus accrued and unpaid interest, if any. The events that constitute a change of control under these indentures may also constitute a default under our 2010 Credit Facility. There can be no assurance that we would have sufficient resources available to satisfy all of our obligations under these debt instruments in the event of a change in control or fundamental change. In the event we were unable to satisfy our obligations under the change in control or fundamental change control provisions, it could have an adverse material impact on us and our Class A and Class B common stock holders. Any future debt instruments that we may incur may contain similar provisions regarding repurchases in the event of a change in control or fundamental change triggering event.

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

Our obligations under the 2010 Credit Facilities are secured with a pledge of 5,000,000 shares of Speedway Motorsports, Inc. Common Stock, a publicly traded owner and operator of automobile racing facilities. These shares of Speedway Motorsports, Inc. Common Stock are owned by Sonic Financial Corporation ( SFC ), an entity controlled by Mr. Smith. Presently, the \$150.0 million borrowing limit of our 2010 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 SFC. Consequently, a withdrawal of this pledge by SFC or a significant decrease in the value of Speedway Motorsports common stock could reduce the amount we can borrow under the 2010 Revolving Credit Facility.

## **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 or advertise as an authorized factory service center. As a result, we are significantly dependent on our relationships with the 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 certain changes in the financial condition of the dealerships and 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, financial condition and cash flows. We cannot guarantee that any of our existing franchise agreements will be renewed or that the terms and conditions of such renewals will be favorable to us.

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

Many manufacturers attempt to measure customers' satisfaction with their sales and warranty service experiences through manufacturer-determined 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.

In addition, a manufacturer may condition its allotment of vehicles, participation in bonus programs, or acquisition of additional franchises upon our compliance with its facility standards. This may put us in a competitive disadvantage with other competing dealerships and may ultimately result in our decision to sell a franchise when we believe it may be difficult to recover the cost of the required investment to reach the manufacturer's facility standards.

***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 non-renewal. 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 non-renewal. 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. However, the ability of a manufacturer to grant additional franchises is based on several factors which are not within our control. If manufacturers grant new franchises in areas near or within our existing markets, this could significantly impact our revenues and/or profitability. Further, 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.

***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 and used vehicles;

employee pricing;

dealer incentives on new vehicles;

manufacturer floor plan interest and advertising assistance;

warranties on new and used vehicles; and

sponsorship of used vehicle sales by authorized new vehicle dealers.

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Manufacturers frequently offer incentives to potential customers. A reduction or discontinuation of a manufacturer's incentive programs may materially adversely impact vehicle demand and affect our profitability.

***Our sales volume may be materially adversely affected if manufacturer captives change their customer financing programs or are unable to provide floor plan financing.***

One of the primary finance sources used by consumers in connection with the purchase of a new or used vehicle is the manufacturer captive finance companies. These captive finance companies rely, to a certain extent, on the public debt markets to provide the capital necessary to support their financing programs. In addition, the captive finance companies will occasionally change their loan underwriting criteria to alter the risk profile of their loan portfolio. A limitation or reduction of available consumer financing for these or other reasons could affect consumers' ability to purchase a vehicle, and thus, could have a material adverse effect on our sales volume.

***Our parts and service sales volume and profitability are dependent on manufacturer warranty programs.***

Franchised automotive retailers perform factory authorized service work and sell original replacement parts on vehicles covered by warranties issued by the automotive manufacturer. Dealerships which perform work covered by a manufacturer warranty are reimbursed at rates established by the manufacturer. For the year ended December 31, 2010, approximately 17.4% of our parts and service revenue was for work covered by manufacturer warranties. To the extent a manufacturer reduces the labor rates or markup of replacement parts for such warranty work, our fixed operations sales volume and profitability could be adversely affected.

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

During the year ended December 31, 2010, approximately 82.7% of our new vehicle revenue was derived from the sale of new vehicles manufactured by BMW, Honda (including Acura), Toyota (including Lexus), Mercedes, General Motors (including Cadillac) and Ford. 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

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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 the future. 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 acquirer from acquiring control of us.

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.

***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.

***A decline in the quality of vehicles we sell, or consumers' perception of the quality of those vehicles may adversely affect our business.***

Our business is highly dependent on consumer demand and preferences. Events such as manufacturer recalls, negative publicity or legal proceedings related to these events may have a negative impact on the products we sell. If such events are significant, the profitability of our franchises related to those manufacturers could be adversely affected and we could experience a material adverse affect on our overall results of operations, financial position and cash flows.

## **Risks Related to Our Growth Strategy**

***Pursuant to the terms of the 2010 Credit Facilities, our ability to make acquisitions is restricted.***

Pursuant to the 2010 Credit Facilities, we are restricted from making dealership franchise acquisitions in any fiscal year if the aggregate cost of all such acquisitions occurring in any fiscal year is in excess of \$25.0 million, without the written consent of the Required Lenders (as that term is defined in the 2010 Credit Facilities). With this restriction on our ability to make acquisitions, our growth strategy may be limited. In addition, we may have to forfeit the opportunity to acquire profitable dealerships at attractive valuations.

***We may not be able to capitalize on real estate and dealership franchise acquisition opportunities because our ability to obtain capital to fund these acquisitions is limited.***

We intend to finance our real estate and dealership franchise 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, and covenants under our 2010 Credit Facilities which restrict our ability to issue additional indebtedness, 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.



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.

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Substantially all the assets of our dealerships are pledged to secure the indebtedness under our Silo Floor Plan Facilities and the 2010 Credit Facilities. These pledges may impede our ability to borrow from other sources. Moreover, because the identified manufacturer-affiliated finance subsidiaries are either owned or affiliated with BMW, Mercedes, Ford and Toyota, respectively, any deterioration of our relationship with the particular manufacturer-affiliated finance subsidiary could adversely affect our relationship with the affiliated manufacturer, and vice-versa.

### ***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 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.

### ***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 acquired dealerships 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;
- the challenges of keeping customers; and
- the challenge of retaining or attracting appropriate dealership management personnel.

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.***

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;

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disrupting our ongoing business;

diverting our 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 reinstitute 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 with the seller and with the manufacturer;

our financial capabilities and ability to obtain financing on acceptable terms;

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 some of 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.

**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 vehicle 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

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scale or otherwise. 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 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.

The internet has become a significant part of the sales process in our industry. Customers are using the internet to compare pricing for vehicles and related F&I services, which may further reduce margins for new and used vehicles 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 services offered on the internet 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.

We may face increasingly significant competition as we strive to gain market share through acquisitions or otherwise. Our operating margins may decline over time as we expand into markets where we do not have a leading position.

***Our dealers depend upon new 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, and our parts and service operations and used vehicle sales may serve to offset some of this risk, we have focused our new vehicle sales operations in mid-line import and luxury brands.

***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. Retail vehicle sales are cyclical and historically have experienced periodic downturns characterized by oversupply and weak demand. These cycles are often dependent on economic conditions, consumer confidence, the level of discretionary personal income and credit availability. Deterioration in any of these conditions 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 lending market may adversely affect our vehicle sales volume.***

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. In the event lenders

further tighten their credit standards or there is a further decline in the availability of credit in the lending market, the ability of these consumers to purchase vehicles could be limited which could have a material adverse effect on our business, revenues and profitability.

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***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.

***Natural disasters and adverse weather events can disrupt our business.***

Our stores are concentrated in states and regions in the United States, including primarily Florida, Texas, and California, in which actual or threatened natural disasters and severe weather events (such as hurricanes, earthquakes, fires, landslides, and hail storms) may disrupt our store operations, which may adversely impact our business, results of operations, financial condition, and cash flows. In addition to business interruption, the automotive retailing business is subject to substantial risk of property loss due to the significant concentration of property values at store locations. Although we have, subject to certain deductibles, limitations, and exclusions, substantial insurance, we cannot assure you that we will not be exposed to uninsured or underinsured losses that could have a material adverse effect on our business, financial condition, results of operations, or cash flows.

***The seasonality of our business may adversely affect our operating results.***

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

**General Risks Related to Investing in Our Securities**

***Concentration of voting power and anti-takeover provisions of our charter, bylaws, 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 or approved 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 (which include O. Bruton Smith, Sonic's Chairman, Chief Executive Officer and Director, his family members and entities they control). 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, stock options, restricted stock and restricted stock units granted under our 1997 Stock Option Plan and 2004 Stock Incentive Plan become immediately exercisable or automatically vest upon a change in

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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. 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 a material adverse effect on our future business, 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.

We are 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. In April 2007, the Florida Court of Appeals affirmed a portion of the trial court's class certification, and overruled a portion of the trial court's class certification. The Florida trial court granted Summary Judgment in our favor against Plaintiff Enrique Galura, and his claim has been dismissed. Virginia Galura's claim is still pending. We currently intend to continue our vigorous appeal and defense of this lawsuit and to assert available defenses. However, an adverse resolution of this lawsuit could result in the payment of significant costs and damages, which could have a material adverse effect on our future results of operations, financial condition and cash flows. At a mediation held February 4, 2011, our company reached an agreement in principle with the plaintiffs to settle this class action lawsuit. This agreement in principle remains conditioned upon execution of a definitive settlement agreement and subsequent approval by the Florida state court. In the event that a definitive settlement of this lawsuit is finalized upon terms and conditions consistent with the agreement in principle, such a settlement would not have a material adverse effect on our future results of operations, financial condition and cash flows.

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 made 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 was filed on November 15, 2004 in South Carolina state court, York County Court of Common Pleas, against Sonic Automotive, Inc. and 10 of our South Carolina subsidiaries. The plaintiffs in that lawsuit were Misty J. Owens, James B. Wright, Vincent J. Astey and Joseph Lee Williams, on behalf of themselves and all other persons

similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The group of plaintiffs attorneys representing the plaintiffs in the South Carolina lawsuit also filed another private civil class action lawsuit against Sonic Automotive, Inc. and 3 of our subsidiaries on February 14, 2005 in state court in North Carolina, Lincoln County Superior Court, which similarly sought

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certification of a multi-state class of plaintiffs and alleged that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. The plaintiffs in this North Carolina lawsuit were Robert Price, Carolyn Price, Marcus Cappeletti and Kathy Cappeletti, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The South Carolina state court action and the North Carolina state court action have since been consolidated into a single proceeding in private arbitration before the American Arbitration Association. On November 12, 2008, claimants in the consolidated arbitration filed a Motion for Class Certification as a national class action including all of the states in which we operate dealerships. Claimants are seeking monetary damages and injunctive relief on behalf of this class of customers. The parties have briefed and argued the issue of class certification.

On July 19, 2010, the Arbitrator issued a Partial Final Award on Class Certification, certifying a class which includes all customers who, on or after November 15, 2000, purchased or leased from a Sonic dealership a vehicle with the Etch product as part of the transaction, but not including customers who purchased or leased such vehicles from a Sonic dealership in Florida. The Partial Final Award on Class Certification is not a final decision on the merits of the action. The merits of Claimants' assertions and potential damages will still have to be proven through the remainder of the arbitration. The Arbitrator stayed the Arbitration for thirty days to allow either party to petition a court of competent jurisdiction to confirm or vacate the award. Sonic will seek review of the class certification ruling by a court of competent jurisdiction and will continue to press its argument that this action is not suitable for a class-based arbitration. On July 22, 2010, the plaintiffs in this consolidated arbitration filed a Motion to Confirm the Arbitrator's Partial Final Award on Class Certification in state court in North Carolina, Lincoln County Superior Court. On August 17, 2010, Sonic filed to remove this North Carolina state court action to federal court, and simultaneously filed a Petition to Vacate the Arbitrator's Partial Final Award on Class Certification, with both filings made in the United States District Court for the Western District of North Carolina.

We intend to continue our vigorous defense of this arbitration and to assert all available defenses. However, an adverse resolution of this arbitration could result in the payment of significant costs and damages, which could have a material adverse effect on our future results of operations, financial condition and cash flows. Currently, we are unable to estimate a range of potential loss related to this matter.

***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. 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 economic conditions. In addition, due to the

provisions and terms contained in our operating lease agreements, we may not be able to relocate a dealership operation to a more favorable location without incurring significant costs or penalties.

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***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.

***Climate change legislation or regulations restricting emission of greenhouse gases could result in increased operating costs and reduced demand for the vehicles we sell.***

On December 15, 2009, the U.S. Environmental Protection Agency ( EPA ) published its findings that emissions of carbon dioxide, methane and other greenhouse gases present an endangerment to public health and the environment because emissions of such gases are, according to the EPA, contributing to warming of the earth's atmosphere and other climatic changes. These findings allow the EPA to adopt and implement regulations that would restrict emissions of greenhouse gases under existing provisions of the federal Clean Air Act. Accordingly, the EPA has proposed regulations that would require a reduction in emissions of greenhouse gases from motor vehicles and could

trigger permit review for greenhouse gas emissions from certain stationary sources. In addition, on October 30, 2009, the EPA published a final rule requiring the reporting of greenhouse gas emissions from specified large greenhouse gas emission sources in the United States, including facilities that emit more than 25,000 tons of greenhouse gases on an annual basis, beginning in 2011 for emissions occurring in 2010. At the state level, more than one-third of the states, either individually or through multi-state regional initiatives, already have begun

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implementing legal measures to reduce emissions of greenhouse gases. The adoption and implementation of any regulations imposing reporting obligations on, or limiting emissions of greenhouse gases from, our equipment and operations or from the vehicles that we sell could adversely affect demand for those vehicles and require us to incur costs to reduce emissions of greenhouse gases associated with our operations.

***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 verified by third parties 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.

***We may be subject to substantial withdrawal liability assessments in the future related to a multi-employer pension plan to which certain of our dealerships make contributions pursuant to collective bargaining agreements.***

Six of our dealership subsidiaries in Northern California currently make fixed-dollar contributions to the Automotive Industries Pension Plan (the AI Pension Plan) pursuant to collective bargaining agreements between our subsidiaries and the International Association of Machinists (the IAM). The AI Pension Plan is a multi-employer pension plan as defined under the Employee Retirement Income Security Act of 1974, as amended, and our six dealership subsidiaries are among approximately 100 automobile dealerships that make contributions to the AI Pension Plan pursuant to collective bargaining agreements with the IAM. In June 2006, we received information that the AI Pension Plan was substantially underfunded as of December 31, 2005. In July 2007, we received updated information that the AI Pension Plan continued to be substantially underfunded as of December 31, 2006, with the amount of such underfunding increasing versus year end 2005. In March 2008, the Board of Trustees of the AI Pension Plan notified participants, participating employers and local unions that the Plan's actuary, in accordance with the requirements of the federal Pension Protection Act of 2006, had issued a certification that the AI Pension Plan is in Critical Status effective with the plan year commencing January 1, 2008. In conjunction with this finding, the Board of Trustees of the AI Pension Plan adopted a Rehabilitation Plan that implements reductions or eliminations of certain adjustable benefits that were previously available under the Plan (including some forms of early retirement benefits, and disability and death benefits), and also implements a requirement on all participating employers to increase employer contributions to the Plan for a seven year period commencing in 2013. Under applicable federal law, any employer contributing to a multi-employer pension plan that completely ceases participating in the plan while the plan is underfunded is subject to payment of such employer's assessed share of the aggregate unfunded vested benefits of the plan. In certain circumstances, an employer can be assessed withdrawal liability for a partial withdrawal from a multi-employer pension plan. In addition, if the financial condition of the AI Pension Plan were to continue to deteriorate to the point that the Plan is forced to terminate and be assumed by the Pension Benefit Guaranty Corporation, the participating employers could be subject to assessments by the PBGC to cover the participating employers' assessed share of the unfunded vested benefits. If any of these adverse events were to occur in the future, it could result in a substantial withdrawal liability assessment that could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***A change in historical experience and/or assumptions used to estimate reserves could have a material impact on our earnings.***



As described in Item 7 under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations Use of Estimates and Critical Accounting Policies management relies on estimates in various areas of accounting and financial reporting. For example, our estimates for finance, insurance and service

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contracts and insurance reserves are based on historical experience. Differences between actual results and our historical experiences and/or our assumptions could have a material impact on our earnings in the period of the change and in periods subsequent to the change.

### ***Impairment of our goodwill could have a material adverse impact on our earnings.***

Pursuant to applicable accounting pronouncements, we evaluate 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 Item 7 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 are required to reduce goodwill on our balance sheet. If goodwill of our single reporting unit is impaired based on a future impairment test, we will be required to record a significant non-cash impairment charge that may also have a material adverse effect on our results of operations for the period in which the impairment of goodwill occurs. As of December 31, 2010, our balance sheet reflected a carrying amount of approximately \$468.5 million in goodwill.

### **Item 1B: *Unresolved Staff Comments***

None.

### **Item 2: *Properties.***

Our principal executive offices are located at 6415 Idlewild Road, Suite 109, Charlotte, North Carolina 28212, and our telephone number is (704) 566-2400. We lease these offices from a related party. See Note 8, Related Parties, to our accompanying Consolidated Financial Statements.

Our dealerships are generally located along major U.S. or interstate highways. One of the principal factors we consider in evaluating an acquisition candidate is its location. We prefer to acquire dealerships or build dealership facilities located along major thoroughfares, which can be easily visited by prospective customers.

We lease the majority of the properties utilized by our dealership operations from affiliates of Capital Automotive REIT ( CARS ) and other individuals and entities. The properties utilized by our dealership operations that are owned by us or one of our subsidiaries are pledged as security for our 2010 Credit Facilities or under mortgages. We believe that our facilities are adequate for our current needs.

Under the terms of our franchise agreements, each of our dealerships must maintain an appropriate appearance and design of its dealership facility and is restricted in its ability to relocate.

### **Item 3: *Legal Proceedings.***

We are 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. In April 2007, the Florida Court of Appeals affirmed a portion of the trial court's class certification, and overruled a portion of the trial

court's class certification. In November 2009, the Florida trial court granted Summary Judgment in our favor against Plaintiff Enrique Galura, and his claim has been dismissed. Marisa Hazelton's claim is still pending. We currently intend to continue our vigorous appeal and defense of this lawsuit and to assert available defenses. However, an adverse resolution of this lawsuit could result in the payment of significant costs and damages, which could have a material adverse effect on our future results of operations, financial condition and cash flows. At a mediation held February 4, 2011, our company reached an agreement in

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principle with the plaintiffs to settle this class action lawsuit. This agreement in principle remains conditioned upon execution of a definitive settlement agreement and subsequent approval by the Florida state court. In the event that a definitive settlement of this lawsuit is finalized upon terms and conditions consistent with the agreement in principle, such a settlement would not have a material adverse affect on our future results of operations, financial condition and cash flows.

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 made 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 was filed on November 15, 2004 in South Carolina state court, York County Court of Common Pleas, against Sonic Automotive, Inc. and 10 of our South Carolina subsidiaries. The plaintiffs in that lawsuit were Misty J. Owens, James B. Wright, Vincent J. Astey and Joseph Lee Williams, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The group of plaintiffs attorneys representing the plaintiffs in the South Carolina lawsuit also filed another private civil class action lawsuit against Sonic Automotive, Inc. and 3 of our subsidiaries on February 14, 2005 in state court in North Carolina, Lincoln County Superior Court, which similarly sought certification of a multi-state class of plaintiffs and alleged that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. The plaintiffs in this North Carolina lawsuit were Robert Price, Carolyn Price, Marcus Cappelletti and Kathy Cappelletti, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The South Carolina state court action and the North Carolina state court action have since been consolidated into a single proceeding in private arbitration before the American Arbitration Association. On November 12, 2008, claimants in the consolidated arbitration filed a Motion for Class Certification as a national class action including all of the states in which we operate dealerships. Claimants are seeking monetary damages and injunctive relief on behalf of this class of customers. The parties have briefed and argued the issue of class certification.

On July 19, 2010, the Arbitrator issued a Partial Final Award on Class Certification, certifying a class which includes all customers who, on or after November 15, 2000, purchased or leased from a Sonic dealership a vehicle with the Etch product as part of the transaction, but not including customers who purchased or leased such vehicles from a Sonic dealership in Florida. The Partial Final Award on Class Certification is not a final decision on the merits of the action. The merits of Claimants assertions and potential damages will still have to be proven through the remainder of the arbitration. The Arbitrator stayed the Arbitration for thirty days to allow either party to petition a court of competent jurisdiction to confirm or vacate the award. Sonic will seek review of the class certification ruling by a court of competent jurisdiction and will continue to press its argument that this action is not suitable for a class-based arbitration. On July 22, 2010, the plaintiffs in this consolidated arbitration filed a Motion to Confirm the Arbitrator s Partial Final Award on Class Certification in state court in North Carolina, Lincoln County Superior Court. On August 17, 2010, Sonic filed to remove this North Carolina state court action to federal court, and simultaneously filed a Petition to Vacate the Arbitrator s Partial Final Award on Class Certification, with both filings made in the United Stated District Court for the Western District of North Carolina. We intend to continue our vigorous defense of this arbitration and to assert all available defenses. However, an adverse resolution of this arbitration could result in the payment of significant costs and damages, which could have a material adverse effect on our future results of operations, financial condition and cash flows. Currently, we are unable to estimate a range of potential loss related to this matter.

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.

**Table of Contents****Item 4:** *[Removed and Reserved]***PART II****Item 5:** *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.*

Our Class A common stock is currently traded on the NYSE under the symbol SAH. Our Class B Common Stock is not traded on a public market.

As of February 18, 2011, there were 40,760,973 shares of Sonic's Class A common stock and 12,029,375 shares of Sonic's Class B common stock outstanding. As of February 18, 2011, there were 95 record holders of the Class A common stock and three record holders of the Class B common stock. As of February 18, 2011, the closing stock price for the Class A common stock was \$14.80.

Our Board of Directors approved four quarterly cash dividends on all outstanding shares of common stock totaling \$0.48 per share during 2008. No dividends were declared during 2009, but in the fourth quarter of 2010 our Board of Directors approved a cash dividend on all outstanding shares of common stock of \$0.025 per share. Subsequent to December 31, 2010, our Board of Directors approved a cash dividend on all outstanding shares of common stock of \$0.025 per share for shareholders of record on March 15, 2011 to be paid on April 15, 2011. There is no guarantee that additional dividends will be declared and paid at any time in the future. See Note 6, Long-Term Debt, to the accompanying Consolidated Financial Statements and Item 7: *Management's Discussion and Analysis of Financial Condition and Results of Operations* for additional discussion of dividends and for a description of restrictions on the payment of dividends.

The following table sets forth the high and low closing sales prices for Sonic's Class A common stock for each calendar quarter during the periods indicated as reported by the NYSE Composite Tape and the dividends declared during such periods.

|                | Market Price |         | Cash Dividend Declared |
|----------------|--------------|---------|------------------------|
|                | High         | Low     |                        |
| 2010           |              |         |                        |
| First Quarter  | \$ 12.51     | \$ 9.05 | \$                     |
| Second Quarter | 13.18        | 8.45    |                        |
| Third Quarter  | 10.23        | 8.39    |                        |
| Fourth Quarter | 13.64        | 9.50    | 0.025                  |
| 2009           |              |         |                        |
| First Quarter  | \$ 4.16      | \$ 0.95 | \$                     |
| Second Quarter | 11.03        | 1.06    |                        |
| Third Quarter  | 14.77        | 8.35    |                        |
| Fourth Quarter | 13.04        | 8.54    |                        |

**Table of Contents****Issuer Purchases of Equity Securities**

The following table sets forth information about the shares of Class A Common Stock we repurchased during the quarter ended December 31, 2010.

|                      | <b>Total Number of Shares Purchased(1)(2)</b> | <b>Average Price Paid per Share (In thousands, except per share data)</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(2)(3)</b> | <b>Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs</b> |
|----------------------|---|---|---|---|
| <b>October 2010</b>  | <b>1</b>                                      | <b>\$ 10.53</b>   | <b>1</b>  | <b>\$ 43,547</b>  |
| <b>November 2010</b> |   |   |   | <b>43,547</b>   |
| <b>December 2010</b> | <b>2</b>                                      | <b>13.23</b>  | <b>2</b>  | <b>43,511</b>   |
| <b>Total</b>         | <b>3</b>                                      | <b>\$ 12.92</b>   | <b>3</b>  | <b>\$ 43,511</b>  |

(1) All shares repurchased were part of publicly announced share repurchase programs

(2) Shares purchased represent the required tax withholding upon issuance of restricted stock.

(3) Our publicly announced Class A Common Stock repurchase authorizations occurred as follows:

|               | <b>(Amounts in thousands)</b> |
|---------------|-------------------------------|
| November 1999 | \$ 25,000                     |
| February 2000 | 25,000                        |
| December 2000 | 25,000                        |
| May 2001      | 25,000                        |
| August 2002   | 25,000                        |
| February 2003 | 20,000                        |
| December 2003 | 20,000                        |
| July 2004     | 20,000                        |
| July 2007     | 30,000                        |
| October 2007  | 40,000                        |
| April 2008    | 40,000                        |
| <b>Total</b>  | <b>\$ 295,000</b>             |

**Table of Contents****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 Annual Report on Form 10-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, 2010. 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.

|  | <b>Year Ended December 31,</b>              |             |             |             |             |
|--|---|-------------|-------------|-------------|-------------|
|  | <b>2006</b>                                 | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> |
|  | <b>(In millions, except per share data)</b> |             |             |             |             |
| <b>Income Statement Data(1)(2):</b>                          |   |             |             |             |             |
| Total revenues   | \$ 7,376.9                                  | \$ 7,767.0  | \$ 6,900.2  | \$ 6,055.3  | \$ 6,880.8  |
| Impairment charges   | \$ 4.7                                      | \$ 0.9      | \$ 812.0    | \$ 23.5     | \$ 0.2      |
| Income (loss) from continuing operations before income taxes | \$ 139.1                                    | \$ 172.1    | \$ (756.1)  | \$ 27.9     | \$ 78.4     |
| Income (loss) from continuing operations                     | \$ 82.9                                     | \$ 104.6    | \$ (633.8)  | \$ 57.2     | \$ 95.9     |
| Basic earnings (loss) per share from continuing operations   | \$ 1.95                                     | \$ 2.44     | \$ (15.70)  | \$ 1.29     | \$ 1.82     |
| Diluted earnings (loss) per share from continuing operations | \$ 1.91                                     | \$ 2.36     | \$ (15.70)  | \$ 1.07     | \$ 1.58     |
| <b>Consolidated Balance Sheet Data(2):</b>                   |   |             |             |             |             |
| Total assets   | \$ 3,124.8                                  | \$ 3,282.7  | \$ 2,405.5  | \$ 2,068.9  | \$ 2,250.8  |
| Current maturities of long-term debt                         | \$ 2.7                                      | \$ 4.2      | \$ 738.4    | \$ 24.0     | \$ 9.1      |
| Total long-term debt   | \$ 567.8                                    | \$ 678.4    | \$ 738.4    | \$ 576.1    | \$ 555.5    |
| Total long-term liabilities (including long-term debt)       | \$ 768.2                                    | \$ 915.8    | \$ 809.6    | \$ 717.2    | \$ 689.5    |
| Cash dividends declared per common share                     | \$ 0.48                                     | \$ 0.48     | \$ 0.48     | \$          | \$ 0.025    |

(1) In accordance with the provisions of Presentation of Financial Statements in the ASC, prior years' income statement data reflect reclassifications to (i) exclude franchises sold, identified for sale, or terminated subsequent to December 31, 2009 which had not been previously included in discontinued operations or (ii) include franchises previously held for sale which subsequently were reclassified to held and used. See Notes 1 and 2 to our accompanying Consolidated Financial Statements which discuss these and other factors that affect the comparability of the information for the periods presented.

(2) As mentioned in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and Notes 2, 5 and 6 to our accompanying Consolidated Financial Statements, impairment charges, business combinations and dispositions and debt refinancings have had a material impact on



our reported financial information.

**Item 7: *Management's Discussion and Analysis of Financial Condition and Results of Operations.***

**2010 Events**

In January 2010, we replaced our 2006 Credit Facility, which was scheduled to mature in February 2010, with a new revolving credit and vehicle floor plan facility (the 2010 Credit Facilities ), which matures in August 2012, and additional manufacturer-affiliated finance company floor plan agreements (the Silo Floor Plan Facilities ).

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In March 2010, we issued \$210.0 million in aggregate principal amount of 9.0% Senior Subordinated Notes (the 9.0% Notes ) which mature on March 15, 2018. In April 2010, we used net proceeds from this issuance together with cash on hand to redeem \$200.0 million in aggregate principal amount of our 8.625% Senior Subordinated Notes due 2013 (the 8.625% Notes ). During the second and third quarters of 2010, we repurchased an additional \$32.1 million in aggregate principal amount of the 8.625% Notes, resulting in \$42.9 million in remaining aggregate principal amount outstanding at December 31, 2010.

In November 2010, we redeemed \$16.0 million in remaining aggregate principal amount outstanding of the 4.25% Convertible Senior Subordinated Notes (the 4.25% Convertible Notes ), completely extinguishing our obligations under the 4.25% Convertible Notes.

As a result of these refinancing activities, other than principal payments due on mortgage notes and certain term notes, we do not have another significant debt maturity until the 2010 Credit Facilities expire in 2012 or when the remaining aggregate principal amount outstanding of the 8.625% Notes matures in 2013.

In 2009, General Motors offered financial assistance with winding down the operations of the franchises for which we executed termination agreements in conjunction with the restructuring of General Motors. Assistance to be received from General Motors totaled \$3.3 million, all of which had been collected by December 31, 2010. As of December 31, 2010, we operated 23 General Motors franchises (under the Cadillac, Chevrolet, GMC, Saab and Buick brands) at 18 dealership locations.

During 2010, Toyota Motor Corporation issued recalls affecting certain of its most popular models in certain model years. Toyota Motor Corporation had instructed its dealerships to stop selling vehicles affected by the recall until it developed a solution to the problem and provided the necessary parts and instructions to fix it. During the period of time when affected vehicles could not be sold, Toyota Motor Corporation offered its dealers floor plan assistance to help reduce dealers' cost of carrying vehicles which dealers could not sell due to the recall, which reduced our floor plan interest expense. As of December 31, 2010, we operated 11 Toyota franchises. During the year ended December 31, 2010, we experienced a benefit to our fixed operations business as a result of work performed on vehicles affected by the recall which was paid for by the manufacturer and provided free of charge to the customer. We cannot estimate how this recall will affect consumer preferences over the long-term.

The following discussion and analysis of the results of operations and financial condition should be read in conjunction with the Sonic Automotive, Inc. and Subsidiaries Consolidated Financial Statements and the related notes thereto appearing elsewhere in this Annual Report on Form 10-K. The financial and statistical data contained in the following discussion for all periods presented reflects our December 31, 2010 classification of franchises between continuing and discontinued operations in accordance with Presentation of Financial Statements in the ASC.

## **Overview**

We are one of the largest automotive retailers in the United States. As of December 31, 2010, we operated 135 dealership franchises, representing 29 different brands of cars and light trucks, at 118 locations and 25 collision repair centers in 15 states. As a result of the way we manage our business, we have a single operating segment for purposes of reporting financial condition and results of operations.

Our dealerships provide comprehensive services including sales of both new and used cars and light trucks, sales of replacement parts, performance of vehicle maintenance, manufacturer warranty repairs, paint and collision repair services, and arrangement of extended service contracts, financing, insurance and other aftermarket products for our customers. Although vehicle sales are cyclical and are affected by many factors, including overall 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.

The automobile industry's total amount of new vehicles sold increased by 11.5% to 11.6 million vehicles in 2010 from 10.4 million vehicles in 2009. From an industry perspective, new vehicle unit sales on a year-over-year basis increased 9.3% for import brands and 13.4% for domestic brands. Average industry expectations for new vehicle sales volume in 2011 are between 12.0 million and 13.0 million vehicles which, if realized, would be an

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increase of 3.4% to 12.1% from the 2010 level. Changes in consumer confidence, availability of consumer financing or changes in the financial stability of the automotive manufacturers could cause 2011 industry results to vary. Many factors such as brand and geographic concentrations have caused our past results to differ from the industry's overall trend.

### **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, Description of Business and Summary of Significant Accounting Policies, in the accompanying 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, 2010 by approximately \$1.6 million. Our estimate of chargebacks (\$11.3 million as of December 31, 2010) is influenced by early contract termination events such as vehicle repossessions, refinancings and early pay-offs. If these factors negatively change, the resulting impact would affect our future estimate for chargebacks and could have a negative adverse impact on our operations, financial position and cash flows. Our actual chargeback experience has not been materially different from our recorded estimates.

### ***Goodwill and Franchise Assets***

Goodwill is tested for impairment at least annually, or more frequently when events or circumstances indicate that impairment might have occurred. An exception to the annual impairment test is provided by Intangibles Goodwill and Other in the ASC, wherein a detailed determination of the fair value of a reporting unit may be carried forward from one year to the next if the following criteria have been met: (i) the assets and liabilities that make up the reporting unit have not changed significantly since the most recent fair value determination; (ii) the most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin; and (iii) based on the analysis of events that have occurred and circumstances that have changed since the most recent

fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote. As of December 31, 2010, we determined that we had met the criteria necessary to carry forward our step one testing from December 31, 2009.

In completing step one of our impairment analyses as of December 31, 2009, we used a discounted cash flow ( DCF ) model to calculate fair value. We believe a discounted cash flow model is the most reliable valuation

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method to use because the fair value of our business is dependent on our ability to generate cash through sales and service of new and used vehicles. The DCF method is based on forward-looking projections that incorporate current trends and market expectations. We also analyzed our market capitalization along with potential adjustments to market capitalization such as control premium and cost synergies in evaluating our estimate of fair value. The results of our DCF model compared to our adjusted market capitalization determine whether the DCF model provided an accurate measure of fair value for the purpose of the impairment test. Our estimate of fair value was then compared to our book value at December 31, 2009 to determine whether an indicator of impairment existed. At December 31, 2009, the fair value of our reporting unit exceeded the carrying value of the reporting unit by a substantial margin. As a result, we were not required to conduct the second step of the impairment test, and determined that no indicator of impairment existed at December 31, 2009.

The significant assumptions in our DCF model include projected earnings, weighted average cost of capital (and estimates in the weighted average cost of capital inputs) and residual growth rates. To the extent the reporting unit's earnings decline significantly or there are changes in one or more of these assumptions that would result in lower valuation results, it could cause the carrying value of the reporting unit to exceed its fair value and thus require us to conduct the second step of the impairment test described above. In projecting our reporting unit's earnings, we develop many assumptions which include, but are not limited to, new and used vehicle unit sales, internal revenue enhancement initiatives, cost control initiatives, internal investment programs such as training and technology, infrastructure and inventory floor plan borrowing rates. Our expectation of new vehicle unit sales is driven by our expectation of the SAAR of new vehicles. The estimate of the industry SAAR in future periods is the basis of our assumptions related to new vehicle unit sales volumes in our DCF model because we believe the historic and projected level of SAAR is the best indicator of our new vehicle unit sales trends. The level of SAAR assumed in our projection of earnings for 2010 was approximately 11.0 million units with a gradual increase in the level of SAAR to approximately 14.0 million units in 2013, and remaining level thereafter. Actual SAAR in 2010 was approximately 11.6 million units, and average industry expectations for the SAAR in 2011 are between 12.0 million and 13.0 million units, consistent with the expectations used in our DCF model in 2009.

Our DCF model is dependent on the assumptions used and is sensitive to changes in assumptions. For example, assuming all other factors remain the same, a 10% change in projected earnings would change the calculated fair value estimate as of December 31, 2009 by approximately \$136.3 million. In the event the weighted average cost of capital changed 100 basis points, assuming all other factors remain the same, the calculated fair value estimate as of December 31, 2009 would change by approximately \$143.9 million. Finally, if the residual growth estimate changed 100 basis points, assuming all other factors remain the same, the calculated fair value estimate as of December 31, 2009 would change by approximately \$119.9 million. Based on our DCF model estimating the fair value of our reporting unit, none of the items above, if realized, would have resulted in lowering the fair value of the reporting unit below the reporting unit's carrying value.

We continue to face a challenging automotive retail environment. As a result of these conditions, there can be no assurances that a material impairment charge will not occur in a future period. We will continue to monitor events in future periods to determine if additional asset impairment testing should be performed. If we are required to apply the second step of the goodwill impairment test in future periods, we could be required to record an impairment charge to goodwill that would have a material adverse impact on our financial condition.

We test franchise assets for impairment annually or more frequently if events or circumstances indicate possible impairment. We estimate the value of our franchise assets using a discounted cash flow model. The discounted cash flow model used contains inherent uncertainties, including significant estimates and assumptions related to growth rates, projected earnings and cost of capital. We are subject to financial risk to the extent that our franchise assets become impaired due to deterioration of the underlying businesses. The risk of a franchise asset impairment loss may increase to the extent the underlying businesses' earnings or projected earnings decline. As a result of our impairment

testing in 2010, no franchise asset impairments were required. The balance of our franchise assets (related to continuing operations and discontinued operations) totaled \$64.8 million at December 31, 2010.

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### ***Insurance Reserves***

We have various high deductible retention and insurance programs which require us to make estimates in determining the ultimate liability we may incur for claims arising under these programs. We accrue for insurance reserves on a pro-rata basis throughout the year based on the expected year-end liability. We estimate the ultimate liability under these programs is between \$20.0 million and \$22.2 million. At December 31, 2010, we had \$21.0 million reserved for such programs. Changes in significant assumptions used in the development of the ultimate liability for these programs could have a material impact on the level of reserves, our operating results, financial position and cash flows. These significant assumptions would include the volume of claims, medical cost trends, claims handling and reporting patterns, historical claims experience, the effect of related court rulings and current or projected changes in state laws. From a sensitivity analysis perspective, it is difficult to quantify the effect of changes in any of these significant assumptions with the exception of the volume of claims. We believe a 10% change in the volume of claims would have a proportional effect on our reserves. We believe our actual loss experience has not been materially different from our recorded estimates.

### ***Lease Exit Accruals***

The majority of our dealership properties are leased under long-term operating lease arrangements. When leased properties are no longer utilized in operations, we record lease exit accruals. These situations could include the relocation of an existing facility or the sale of a franchise where the buyer will not be subleasing the property for either the remaining term of the lease or for an amount equal to our obligation under the lease, or in situations where a store is closed as a result of the associated franchise being terminated by the manufacturer and no other operations continue on the leased property. The lease exit accruals represent the present value of the lease payments, net of estimated sublease rentals, for the remaining life of the operating leases and other accruals necessary to satisfy lease commitments to the landlords. At December 31, 2010, we had \$43.5 million accrued for lease exit costs. A significant change in our assumptions regarding the time period necessary to obtain a subtenant or the amount of the anticipated sublease income could have a material effect on our accrual and, as a result, earnings. For example, assuming all other factors remain the same, a 50% decrease in our estimated proceeds from subleases would change our lease exit accruals by approximately \$1.1 million. In addition, based on the terms and conditions negotiated in the sale of franchises in the future, additional accruals may be necessary if the purchaser of the franchise does not assume the lease of the associated franchise, or we are unable to negotiate a sublease with the buyer of the franchise on terms that are identical to or better than those associated with the original lease.

### ***Legal Proceedings***

We are involved, and expect to continue to be involved, in numerous legal proceedings arising out of the conduct of our business, including litigation with customers, employment related lawsuits, contractual disputes and actions brought by governmental authorities. As of December 31, 2010, we had accrued \$9.1 million in legal reserves. 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 that are significant could exceed the amount of our legal reserve and have a material adverse effect on our business, financial condition, results of operations, cash flows or 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 Presentation of Financial Statements in the ASC. 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 will be reclassified in order to reflect that classification. During the year ended December 31, 2010, we identified one franchise that was held for

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sale and previously included in discontinued operations, which we chose to continue to hold and operate in continuing operations in 2010. At December 31, 2010 there were no dealership franchises classified as held for sale.

***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, 2010 is \$27.6 million in reserves that we have provided for these matters (including estimates related to possible interest and penalties). From time to time, we engage in transactions in which the tax consequences may be subject to uncertainty. Examples of such transactions include business acquisitions and disposals, including consideration paid or received in connection with such transactions. Significant judgment is required in assessing and estimating the tax consequences of these transactions. We determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, we presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. A tax position that does not meet the more-likely-than-not recognition threshold is measured to determine the amount of benefit to be recognized in the financial statements. The tax position is measured at the largest amount of benefit that is likely of being realized upon ultimate settlement.

We adjust our estimates periodically because of ongoing examinations by and settlements with the various taxing authorities, as well as changes in tax laws, regulations and precedent. The effects on our financial statements of income tax uncertainties are discussed in Note 7, *Income Taxes*, to our Consolidated Financial Statements.

We continually review all deferred tax asset positions (including state net operating loss carryforwards) to determine whether it is more-likely-than-not that the deferred tax assets will be utilized. Certain factors considered in evaluating the potential for realization of deferred tax assets include the time remaining until expiration (related to state net operating loss carryforwards) and various sources of taxable income that may be available under the tax law to realize a tax benefit related to a deferred tax asset. This evaluation requires management to make certain assumptions about future profitability, the execution of tax strategies that may be available to us and the likelihood that these assumptions or execution of tax strategies would occur. This evaluation is highly judgmental. The results of future operations, regulatory framework of these taxing authorities and other related matters cannot be predicted with certainty. Therefore, actual realization of these deferred tax assets may be materially different from management's estimate.

At December 31, 2008, 2009 and 2010, we had a valuation allowance recorded totaling \$116.3 million, \$61.9 million and \$10.9 million, respectively.

During the years ended December 31, 2009 and 2010, we reduced the recorded valuation allowance amount by \$54.4 million and \$51.0 million, respectively. These changes were the result of the use of certain state net operating loss carryforwards as well as a change in estimate that we would be able to ultimately realize the benefits of recorded deferred tax balances. These changes in estimate were primarily driven by the improvement experienced in our operating results, the overall improvement of the automotive retailing industry and the expectation that our results and those of the automotive retailing industry would continue to improve in the future. Notwithstanding these facts, at December 31, 2010, we maintained valuation allowance amounts of \$10.9 million related to certain state net operating loss carryforwards as it was likely that we would not be able to generate sufficient state taxable income in the related entities to utilize the accumulated net operating loss carryforward balances.

We accrue for income taxes on a pro-rata basis throughout the year based on the expected year end liability. These estimates, judgments and assumptions are made quarterly by our management based on available information and take into consideration estimated income taxes based on prior year income tax returns, changes in income tax law, our income tax strategies and other factors. If our management receives information which causes us to change our estimate of the year end liability, the amount of expense or expense reduction required to be recorded in any particular quarter could be material to our operating results, financial position and cash flows.

**Table of Contents****Results of Operations**

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

|  | <b>Percentage of Total Revenue(1)</b><br><b>for the Year Ended December 31,</b> |             |             |
|--|---|-------------|-------------|
|  | <b>2008</b>   | <b>2009</b> | <b>2010</b> |
| Revenues:  |   |             |             |
| New vehicles   | 58.1%   | 53.3%       | 53.0%       |
| Used vehicles  | 19.5%   | 24.0%       | 25.8%       |
| Wholesale vehicles   | 3.9%  | 2.4%        | 2.2%        |
| Parts, service and collision repair                          | 15.9%   | 17.7%       | 16.4%       |
| Finance, insurance and other                                 | 2.6%  | 2.6%        | 2.6%        |
| Total revenue  | 100.0%  | 100.0%      | 100.0%      |
| Cost of sales(2)   | 84.0%   | 82.9%       | 83.8%       |
| Gross profit   | 16.0%   | 17.1%       | 16.2%       |
| Selling, general and administrative expenses                 | 13.1%   | 13.7%       | 13.0%       |
| Impairment charges   | 11.7%   | 0.4%        | 0.0%        |
| Depreciation and amortization                                | 0.5%  | 0.6%        | 0.5%        |
| Operating income   | (9.3%)  | 2.4%        | 2.7%        |
| Interest expense, floor plan                                 | 0.6%  | 0.3%        | 0.3%        |
| Interest expense, other, net                                 | 0.9%  | 1.3%        | 1.0%        |
| Interest expense, non-cash, convertible debt                 | 0.2%  | 0.0%        | 0.1%        |
| Interest expense, non-cash, cash flow swaps                  | 0.0%  | 0.2%        | 0.1%        |
| Other expense, net   | 0.0%  | 0.1%        | 0.1%        |
| Income (loss) from continuing operations before income taxes | (11.0%)   | 0.5%        | 1.1%        |
| Income tax expense (benefit)                                 | (1.8%)  | (0.4%)      | (0.3%)      |
| Income (loss) from continuing operations                     | (9.2%)  | 0.9%        | 1.4%        |

(1) In accordance with the provisions of Presentation of Financial Statements in the ASC, prior years income statement data reflect reclassifications to (i) exclude franchises sold, identified for sale, or terminated subsequent to December 31, 2009 which had not been previously included in discontinued operations or (ii) include franchises previously held for sale which subsequently were reclassified to held and used. See Notes 1 and 2 to our accompanying Consolidated Financial Statements which discuss 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, 2010, we disposed of 13 franchises and, at December 31, 2010, had no other franchises held for sale. The results of operations of these dealerships, including gains or losses on disposition, have been included in discontinued operations on the accompanying Consolidated Statements of Income for all periods presented. In addition to these dispositions, we disposed of 10 and 18 franchises, respectively, in each of the years ended December 31, 2008 and 2009. See additional discussions of franchises held for sale in the Liquidity and Capital Resources discussion.

The following discussions are based on reported figures. Same store amounts do not vary significantly from reported totals since there were no significant dealership franchise acquisitions in the years ended December 31, 2009 and 2010.

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***Impairments and Other Charges***

We recorded various charges in connection with the decision to exit certain facility leases since the planned use of certain leased properties will not occur. See the table below for the amounts and classification of the charges recorded. Of the \$27.6 million recorded in discontinued operations in the year ending December 31, 2009, \$11.4 million relates to lease exit accruals for our General Motors dealerships which were terminated in the fourth quarter of 2009.

Annually, we review franchise asset and property and equipment valuations. Based on historical and projected operating losses for certain continuing operating dealerships, we determined that certain dealerships would not be able to recover recorded franchise asset and property and equipment asset balances and that we would not complete certain capital projects at these stores. As such, we partially or fully impaired the franchise asset, property and equipment asset values as well as costs for construction in progress for those stores. Further, as a result of lowering the estimates of expected proceeds from the sale of certain dealership franchises held for sale based on market conditions, we recorded franchise asset, property and equipment and other asset impairment charges in discontinued operations. See the table below for the amounts and classification of the charges recorded for the years ended December 31, 2008, 2009 and 2010. In 2010, we recorded \$0.2 million of impairment related to property and equipment and construction in progress in continuing operations.

Goodwill is tested for impairment at least annually, or more frequently when events or circumstances indicate that impairment might have occurred. An exception to the annual impairment test provided by Intangibles Goodwill and Other in the ASC allowed us to carry forward our goodwill impairment analysis from 2009, resulting in no goodwill impairment in 2010. For the year ended December 31, 2009, we recorded goodwill impairment charges of \$1.1 million within continuing operations and \$1.6 million within discontinued operations due to the determination that a portion of the goodwill was not recoverable, based on estimated proceeds, while certain dealership operations were held for sale. For the year ended December 31, 2008, we recorded an impairment of \$797.3 million related to our evaluation of goodwill. We recorded \$795.3 million in continuing operations and \$2.0 million in discontinued operations as a result of step two of our goodwill impairment test and based on the determination that a portion of goodwill was not recoverable from assets held for sale based on estimated proceeds. See additional discussion of goodwill impairment testing in the previous heading Use of Estimates and Critical Accounting Policies Goodwill and Franchise Assets.

For the year ended December 31, 2008, our results of operations were negatively impacted by the effects of Hurricane Ike and hail storms in the Houston and mid-west markets. We estimate the overall impact (physical damage and business interruption) in 2008 lowered pre-tax earnings by approximately \$8.0 million. For the year ended December 31, 2010, our results of operations were negatively impacted by the effects of hail storms in the Mid-Atlantic market. We estimate the overall impact (physical damage and business interruption) in 2010 lowered pre-tax earnings by approximately \$0.6 million.

We have entered into interest rate swap agreements (the Fixed Swaps ) to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate, in order to reduce our exposure to market risks from fluctuations in interest rates. As a result of the refinancing of our 2006 Credit Facility and the new terms of the 2010 Credit Facilities, at December 31, 2009 we determined it was no longer probable that we would incur interest payments that match the terms of certain Fixed Swaps that previously were designated and qualified as cash flow hedges, as we would be borrowing certain amounts under the Silo Floor Plan Facilities rather than under the new 2010 Credit Facilities. Certain of the lenders terms under the Silo Floor Plan Facilities did not match the terms of our Fixed Swaps that previously qualified as cash flow hedges. Of the Fixed Swaps (including the two \$100.0 million notional swaps which were settled in 2009), \$565.0 million of the notional amount had previously been documented as hedges against the variability of cash flows related to interest payments on certain debt obligations. At December 31, 2010, we estimate that under the new 2010 Credit Facilities and other facilities with matching terms, it is probable that the expected debt

balance with interest payments that match the terms of the Fixed Swaps will be \$400.0 million. As a result, non-cash charges were recorded in interest expense, non-cash, cash flow swaps in the accompanying Consolidated Statements of Income related to the Fixed Swaps and amortization of amounts in accumulated other comprehensive income (loss) related to other terminated cash flow swaps. The non-cash charges for the year ended December 31, 2010 were \$4.9 million, and for the year ended December 31, 2009 were

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\$11.8 million. Changes in the fair value of the notional amount of certain cash flow swaps are recognized through earnings. See the heading **Derivative Instruments and Hedging Activities** in Note 1, **Description of Business and Summary of Significant Accounting Policies**, in the notes to the accompanying Consolidated Financial Statements for further discussion.

In the year ended December 31, 2009, we recognized a non-cash benefit of \$11.3 million related to the extinguishment of the derivative liability associated with the redemption of the 6.0% Convertible Notes. In the table below, this amount partially offsets the \$11.8 million non-cash charge related to cash flow swaps discussed above.

In the year ended December 31, 2009, we recorded \$12.0 million of debt restructuring charges. Of the \$12.0 million, \$6.6 million related to the amendment of our 2006 Credit Facility executed March 31, 2009, in which we agreed to the payment of amendment fees and increases in the interest rates for amounts outstanding and the quarterly commitment fees payable by us on the unused portion and \$5.4 million related to the loan cost amortization on our 6.0% Convertible Notes which we repurchased on October 28, 2009.

For the year ended December 31, 2009, other income (expense), net, includes a gain of approximately \$0.4 million on the repurchase of a portion of the 4.25% Convertible Notes at a discount and a gain of approximately \$0.1 million related to the derecognition of liability and equity components of the 4.25% Convertible Notes upon repurchase of a portion of the 4.25% Convertible Notes during the third quarter of 2009. These gains were offset by a loss of approximately \$7.2 million related to the write-off of the unamortized debt discount associated with the redemption of the 6.0% Convertible Notes during the fourth quarter of 2009, resulting in a net loss on debt extinguishment of approximately \$6.7 million. We recorded a loss on extinguishment of debt of approximately \$7.7 million in the year ended December 31, 2010, related to the retirement of \$232.1 million in aggregate principal amount of the 8.625% Notes. See Note 6, **Long-Term Debt**, in the notes to the accompanying Consolidated Financial Statements for further discussion.

At December 31, 2009, we had a total of \$61.9 million of valuation allowances recorded related to our deferred tax asset balances, \$15.9 million related to state net operating loss carryforwards and \$46.0 million related to all other deferred tax asset balances. The change in the recorded valuation allowance balances in the year ended December 31, 2009 was primarily driven by the assumption that state net operating loss carryforwards generated in 2010 would not be realizable, the utilization of net deferred tax assets to reduce income tax payments and changes in assumptions related to the overall realization of net deferred tax asset balances.

At December 31, 2010, we had \$10.9 million of valuation allowances recorded related to our deferred tax asset balances, the total balance of which was related to state net operating loss carryforwards. During the year ended December 31, 2010, we lowered the recorded valuation allowance amount by \$51.0 million. This was the result of the use of certain state net operating loss carryforwards as well as a change in estimate that we will be able to ultimately realize the benefits of recorded deferred tax balances. See the table below for amounts and classification of the charges recorded.



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The amount and location of the pre-tax charges discussed above in the accompanying Consolidated Statements of Income are presented in the following table:

|   | <b>Continuing Operations for the<br/>Year Ended December 31,<br/>2008      2009      2010<br/>(In millions)</b>       |         |        |
|---|---|---------|--------|
| <b>Selling, general &amp; administrative expenses</b>                   |   |         |        |
| Hurricane and hail storm related expenses                               | 8.0   |         | 0.6    |
| Lease exit and other accruals   | 13.5  | 1.1     |        |
| Franchise tax assessment  |   | 2.9     |        |
| Total selling, general & administrative expenses                        | 21.5  | 4.0     | 0.6    |
| <b>Impairment charges</b>   |   |         |        |
| Property impairment charges   | 10.0  | 18.1    | 0.2    |
| Goodwill impairment charges   | 795.3   | 1.1     |        |
| Franchise agreement and other asset impairment charges                  | 6.7   | 4.3     |        |
| Total impairment charges  | 812.0   | 23.5    | 0.2    |
| <b>Interest expense</b>   |   |         |        |
| Cash-flow swap ineffectiveness, mark-to-market and amortization charges |   | 0.5     | 4.9    |
| Debt restructuring charges  |   | 12.0    | 1.5    |
| Total interest expense  |   | 12.5    | 6.4    |
| <b>Other (income) expense</b>   |   |         |        |
| Loss on debt extinguishment   |   | 6.7     | 7.7    |
| <b>Income tax related adjustments</b>                                   |   |         |        |
| Valuation allowances and other tax adjustment expense (benefit)         | 111.6   | (41.3)  | (48.2) |
|   | <b>Discontinued Operations<br/>for the Year Ended<br/>December 31,<br/>2008      2009      2010<br/>(In millions)</b> |         |        |
| <b>Gross profit, selling, general &amp; administrative expenses</b>     |   |         |        |
| Lease exit and other accruals   | \$ 12.8   | \$ 27.6 | \$ 0.9 |
| <b>Impairment charges</b>   |   |         |        |
| Property impairment charges   | 14.9  | 5.0     |        |
| Goodwill impairment charges   | 2.0   | 1.6     |        |
| Franchise agreement and other asset impairment charges                  | 20.5  |         |        |
| Favorable lease asset impairment charges                                | 1.9   |         |        |
| Total impairment charges  | 39.3  | 6.6     |        |
| <b>Income tax related adjustments</b>                                   |   |         |        |
| Valuation allowances and other tax adjustment expense / (benefit)       | 3.4   | (6.1)   |        |

*New Vehicles*

New vehicle revenues include the sale of new vehicles to retail customers, 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 to provide adequate vehicle allocations to meet customer demands and the availability of consumer credit.

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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 cyclicity by maintaining a diverse brand mix of 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. For the year ended December 31, 2010, 84.2% of our total new vehicle revenue was generated by import and luxury dealerships compared to 83.7% for 2009.

The automobile retail industry uses the SAAR to measure the amount of new vehicle unit sales activity within the United States market. The SAAR averages below reflect a blended average of all brands marketed or sold in the United States market. The SAAR includes brands we do not sell and markets in which we do not operate.

| SAAR                    | 2009 | 2010 | %<br>Change<br>(In millions of vehicles) | 2008 | 2009 | %<br>Change |
|-------------------------|------|------|--|------|------|-------------|
| Year Ended December 31, | 10.4 | 11.6 | 11.5%                                    | 13.2 | 10.4 | (21.2%)     |

Source: Bloomberg Financial Markets, via Stephens Inc.

During 2010 we experienced an increase in customer traffic at our dealerships as compared to 2009. We believe this was caused in part by the improved overall economic conditions in 2010. Despite increases in new vehicle volume in 2010, year-over-year new vehicle sales comparisons are impacted by the government's Car Allowance Rebate System (CARS) program in effect in the third quarter of 2009, which significantly affected new vehicle sales in 2009. Average industry expectations for the 2011 SAAR are currently between 12.0 million and 13.0 million vehicles which, if realized, would be an increase of 3.4% to 12.1% from the 2010 level. Following is information related to our new vehicle sales:

|                                | For the Year-Ended<br>December 31,             |              | Change     | Better/(Worse)<br>%<br>Change |
|--------------------------------|--|--------------|------------|-------------------------------|
|                                | 2009   | 2010         |            |                               |
|                                | (In thousands, except units and per unit data) |              |            |                               |
| Revenue                        | \$ 3,229,948                                   | \$ 3,646,200 | \$ 416,252 | 12.9%                         |
| Gross profit                   | \$ 219,158                                     | \$ 237,071   | \$ 17,913  | 8.2%                          |
| Unit sales                     | 99,361   | 107,151      | 7,790      | 7.8%                          |
| Revenue per unit               | \$ 32,507                                      | \$ 34,029    | \$ 1,522   | 4.7%                          |
| Gross profit per unit          | \$ 2,206                                       | \$ 2,212     | \$ 6       | 0.3%                          |
| Gross profit as a % of revenue | 6.8%   | 6.5%         | (30)bps    |                               |

|  | For the Year-Ended<br>December 31,             |      | Change | Better/(Worse)<br>%<br>Change |
|--|--|------|--------|-------------------------------|
|  | 2008   | 2009 |        |                               |
|  | (In thousands, except units and per unit data) |      |        |                               |

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|                                |              |              |              |         |
|--------------------------------|--------------|--------------|--------------|---------|
| Revenue                        | \$ 4,009,496 | \$ 3,229,948 | \$ (779,548) | (19.4%) |
| Gross profit                   | \$ 264,962   | \$ 219,158   | \$ (45,804)  | (17.3%) |
| Unit sales                     | 123,356      | 99,361       | (23,995)     | (19.5%) |
| Revenue per unit               | \$ 32,503    | \$ 32,507    | \$ 4         | 0.0%    |
| Gross profit per unit          | \$ 2,148     | \$ 2,206     | \$ 58        | 2.7%    |
| Gross profit as a % of revenue | 6.6%         | 6.8%         | 20bps        |         |

During 2010, our luxury and import dealerships experienced increases in new vehicle volume of 12.1% and 6.4%, respectively. The majority of our luxury and import brands experienced increases in new vehicle volume, with the most notable increases being experienced by our Cadillac, BMW and Mercedes dealerships. These stores experienced increases of 34.1%, 13.2% and 9.3%, respectively. Our domestic brands experienced a new vehicle volume increase in 2010 of 4.4%, led by our General Motors ( GM ) dealerships (excluding Cadillac), which increased 15.5% compared to the prior year. Our domestic brands new vehicle volume increases were partially offset by declines at our Ford stores of 1.9% compared to 2009. However, excluding fleet, our GM stores increased

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9.3%, while our Ford stores increased 15.3% compared to 2009. The increase in new vehicle gross profit in 2010 compared to 2009 was due primarily to a 7.8% increase in new vehicle sales volume.

Overall, our new vehicle price per unit increased \$1,522, or 4.7%, compared to 2009, with our luxury stores increasing \$1,909, or 4.1%, our domestic stores increasing \$1,554, or 5.5%, and our import stores increasing \$542, or 2.3% in 2010. The increase in our overall new vehicle price per unit in 2010 can be attributed to a larger percentage of our sales being generated by higher priced luxury vehicles.

During 2009, our dealerships experienced a 19.5% decrease in new unit volume, with our luxury stores declining 21.1%, our import stores declining 16.9% and our domestic dealerships declining 22.6% compared to 2008. Our price per unit remained relatively flat in 2009 compared to 2008, which can be attributed to the decrease in new luxury unit volume in 2009 primarily due to a shift in consumer preferences as a result of the CARS program. Our gross profit decreased in 2009 compared to 2008, which can be attributed to the volatile economic conditions and the lack of credit availability to consumers in 2009.

**Used Vehicles**

Used vehicle revenues are directly affected by a number of factors including the level of manufacturer incentives on new vehicles, the number and quality of trade-ins and lease turn-ins and the availability of consumer credit. In addition, various manufacturers provide franchised dealers the opportunity to certify pre-owned vehicles based on criteria established by the manufacturer. This certification process extends the standard manufacturer warranty. In 2010, we continued to see improvements in our CPO unit volume, which increased 9.6% as compared to 2009. However, our sales of CPO vehicles decreased as a percentage of total used vehicle units to 35.4% from 38.4% in 2009. This percentage decrease was primarily due to an increase in our sales of non-CPO used vehicles of 11,697 units, or 25.1%, during 2010. Following is information related to our used vehicle sales:

|                                | For the Year-Ended<br>December 31,             |              | Better/(Worse)<br>% |        |
|--------------------------------|--|--------------|---------------------|--------|
|                                | 2009   | 2010         | Change              | Change |
|                                | (In thousands, except units and per unit data) |              |                     |        |
| Revenue                        | \$ 1,451,870                                   | \$ 1,776,581 | \$ 324,711          | 22.4%  |
| Gross profit                   | \$ 123,993                                     | \$ 139,620   | \$ 15,627           | 12.6%  |
| Unit sales                     | 75,795   | 90,290       | 14,495              | 19.1%  |
| Revenue per unit               | \$ 19,155                                      | \$ 19,676    | \$ 521              | 2.7%   |
| Gross profit per unit          | \$ 1,636                                       | \$ 1,546     | \$ (90)             | (5.5%) |
| Gross profit as a % of revenue | 8.5%   | 7.9%         | (60)bps             |        |
| CPO revenue                    | \$ 744,244                                     | \$ 849,323   | \$ 105,079          | 14.1%  |
| CPO unit sales                 | 29,135   | 31,933       | 2,798               | 9.6%   |

|  | For the Year-Ended<br>December 31,             |      | Better/(Worse)<br>% |        |
|--|--|------|---------------------|--------|
|  | 2008   | 2009 | Change              | Change |
|  | (In thousands, except units and per unit data) |      |                     |        |

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|                                |              |              |            |        |
|--------------------------------|--------------|--------------|------------|--------|
| Revenue                        | \$ 1,342,486 | \$ 1,451,870 | \$ 109,384 | 8.1%   |
| Gross profit                   | \$ 119,077   | \$ 123,993   | \$ 4,916   | 4.1%   |
| Unit sales                     | 67,237       | 75,795       | 8,558      | 12.7%  |
| Revenue per unit               | \$ 19,966    | \$ 19,155    | \$ (811)   | (4.1%) |
| Gross profit per unit          | \$ 1,771     | \$ 1,636     | \$ (135)   | (7.6%) |
| Gross profit as a % of revenue | 8.9%         | 8.5%         | (40)bps    |        |
| CPO revenue                    | \$ 708,663   | \$ 744,244   | \$ 35,581  | 5.0%   |
| CPO unit sales                 | 27,951       | 29,135       | 1,184      | 4.2%   |

During 2010, our used vehicle unit volume increased significantly compared to 2009, primarily due to the continued implementation of our standardized used vehicle merchandising process. This process allows us to price

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our used vehicles more competitively, market them more effectively and physically move certain used vehicles to specific dealerships within a particular region that have shown success in retailing that specific type of used vehicle. Our import dealerships used unit sales volume increased 21.5% compared to 2009. Our domestic and luxury dealerships used unit sales increased by 19.9% and 17.0%, respectively.

In 2010, gross profit per unit from used vehicles declined compared to the prior year due in part to a shift toward purchasing more vehicles from auction as obtaining vehicles through trade did not fulfill our used inventory requirements. However, obtaining more used vehicles from auction allowed us to better implement the standardized used vehicle merchandising process, as buying cars at auction allowed us to optimize the used vehicle inventory mix at each dealership, increasing unit sales and overall gross profit.

In 2009, the overall increase in gross profit when compared to 2008 can be mainly attributed to rebounding consumer confidence levels despite a challenging consumer credit environment. Gross margin rates for used vehicles declined in 2009 compared to 2008 primarily due to sourcing more vehicles through wholesale auctions versus trades and actively managing our vehicle days supply, resulting in more favorable pricing to customers.

**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. Following is information related to wholesale vehicles:

|                              | For the Year-Ended<br>December 31,             |            | Better/(Worse)<br>% |        |
|------------------------------|--|------------|---------------------|--------|
|                              | 2009   | 2010       | Change              | Change |
|                              | (In thousands, except units and per unit data) |            |                     |        |
| Revenue                      | \$ 147,002                                     | \$ 149,041 | \$ 2,039            | 1.4%   |
| Gross loss                   | \$ (5,486)                                     | \$ (5,041) | \$ 445              | 8.1%   |
| Unit sales                   | 25,271   | 24,128     | (1,143)             | (4.5%) |
| Revenue per unit             | \$ 5,817                                       | \$ 6,177   | \$ 360              | 6.2%   |
| Gross loss per unit          | \$ (217)                                       | \$ (209)   | \$ 8                | 3.7%   |
| Gross loss as a % of revenue | (3.7%)   | (3.4%)     | 30bps               |        |

|                              | For the Year-Ended<br>December 31,             |            | Better/(Worse)<br>% |         |
|------------------------------|--|------------|---------------------|---------|
|                              | 2008   | 2009       | Change              | Change  |
|                              | (In thousands, except units and per unit data) |            |                     |         |
| Revenue                      | \$ 272,172                                     | \$ 147,002 | \$ (125,170)        | (46.0%) |
| Gross loss                   | \$ (6,191)                                     | \$ (5,486) | \$ 705              | 11.4%   |
| Unit sales                   | 35,802   | 25,271     | (10,531)            | (29.4%) |
| Revenue per unit             | \$ 7,602                                       | \$ 5,817   | \$ (1,785)          | (23.5%) |
| Gross loss per unit          | \$ (173)                                       | \$ (217)   | \$ (44)             | (25.4%) |
| Gross loss as a % of revenue | (2.3%)   | (3.7%)     | (140)bps            |         |

During 2010, there was a decrease in wholesale unit sales, in part due to an increased focus on selling vehicles through our retail channel. Further, consumer demand has increased in 2010 for used vehicles which historically would have been wholesaled. Consequently, pre-owned vehicles are in higher demand and are staying on the lot for less time, resulting in lower wholesale volume. Wholesale vehicle gross loss decreased in 2010 compared to 2009 as a result of the decreased unit sales combined with a lower gross loss per unit.

During 2009, there was a decrease in wholesale gross loss due primarily to decreased wholesale unit sales, offset by a higher gross loss per unit. The decrease in wholesale unit volume and gross margins compared to 2008 can be primarily attributed to our increased focus on retailing used vehicles which historically we would have disposed of through the wholesale market and fewer vehicles received in trades for new and used vehicles.



**Table of Contents*****Parts, Service and Collision Repair ( Fixed Operations )***

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

We believe that over time, vehicle quality will improve, but vehicle complexity will offset any revenue lost from improvement in vehicle quality. We also believe that over the long-term we have the ability to continue to add service capacity and increase revenues. However, based on current market conditions, we do not anticipate a near-term increase in additional service capacity. Manufacturers continue to extend new vehicle warranty periods and have also begun to include regular maintenance items in the warranty coverage. These factors, over the long-term, combined with the extended manufacturer warranties on CPO vehicles (see the discussion in Business Business Strategy Certified Pre-Owned Vehicles above), should facilitate long-term growth in our service and parts business. Barriers to long-term growth may include reductions in the rate paid by manufacturers to dealers for warranty work performed. Following is information related to fixed operations:

|                                | <b>For the Year-Ended<br/>December 31,</b> |              | <b>Better / (Worse)<br/>%</b> |               |
|--------------------------------|--|--------------|-------------------------------|---------------|
|                                | <b>2009</b>                                | <b>2010</b>  | <b>Change</b>                 | <b>Change</b> |
|                                | <b>(In thousands)</b>                      |              |                               |               |
| Revenue                        |  |              |                               |               |
| Parts                          | \$ 581,056                                 | \$ 599,348   | \$ 18,292                     | 3.1%          |
| Service                        | 443,247                                    | 479,759      | 36,512                        | 8.2%          |
| Collision Repair               | 47,522                                     | 48,947       | 1,425                         | 3.0%          |
| Total                          | \$ 1,071,825                               | \$ 1,128,054 | \$ 56,229                     | 5.2%          |
| Gross profit                   |  |              |                               |               |
| Parts                          | \$ 199,193                                 | \$ 199,850   | \$ 657                        | 0.3%          |
| Service                        | 314,227                                    | 335,377      | 21,150                        | 6.7%          |
| Collision Repair               | 26,891                                     | 26,833       | (58)                          | (0.2%)        |
| Total                          | \$ 540,311                                 | \$ 562,060   | \$ 21,749                     | 4.0%          |
| Gross profit as a % of revenue |  |              |                               |               |
| Parts                          | 34.3%                                      | 33.3%        | (100)bps                      |               |
| Service                        | 70.9%                                      | 69.9%        | (100)bps                      |               |
| Collision Repair               | 56.6%                                      | 54.8%        | (180)bps                      |               |
| Total                          | 50.4%                                      | 49.8%        | (60)bps                       |               |

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|                                | <b>For the Year-Ended<br/>December 31,</b> |                       | <b>Better/(Worse)<br/>%</b> |               |
|--------------------------------|--|-----------------------|-----------------------------|---------------|
|                                | <b>2008</b>                                | <b>2009</b>           | <b>Change</b>               | <b>Change</b> |
|                                |  | <b>(In thousands)</b> |                             |               |
| Revenue                        |  |                       |                             |               |
| Parts                          | \$ 589,758                                 | \$ 581,056            | \$ (8,702)                  | (1.5%)        |
| Service                        | 454,534                                    | 443,247               | (11,287)                    | (2.5%)        |
| Collision Repair               | 51,482                                     | 47,522                | (3,960)                     | (7.7%)        |
| Total                          | \$ 1,095,774                               | \$ 1,071,825          | \$ (23,949)                 | (2.2%)        |
| Gross profit                   |  |                       |                             |               |
| Parts                          | \$ 202,973                                 | \$ 199,193            | \$ (3,780)                  | (1.9%)        |
| Service                        | 317,212                                    | 314,227               | (2,985)                     | (0.9%)        |
| Collision Repair               | 28,891                                     | 26,891                | (2,000)                     | (6.9%)        |
| Total                          | \$ 549,076                                 | \$ 540,311            | \$ (8,765)                  | (1.6%)        |
| Gross profit as a % of revenue |  |                       |                             |               |
| Parts                          | 34.4%                                      | 34.3%                 | (10)bps                     |               |
| Service                        | 69.8%                                      | 70.9%                 | 110bps                      |               |
| Collision Repair               | 56.1%                                      | 56.6%                 | 50bps                       |               |
| Total                          | 50.1%                                      | 50.4%                 | 30bps                       |               |

Our total fixed operations revenues increased in 2010 compared to 2009, led by increases at our Cadillac, BMW, and Toyota dealerships which all experienced significant fixed operations revenue increases in 2010 compared to 2009, accounting for 49.1% of the year-over-year improvement in overall fixed operations revenues. Overall customer pay sales increased \$15.1 million, or 3.0%, during 2010. Internal sales, primarily related to reconditioning work on used vehicles, increased \$20.0 million, or 15.6%, compared to 2009. Warranty sales decreased \$3.5 million, or 1.8%, in 2010 compared to 2009, primarily due to decreases at our BMW dealerships partially offset by an 86.3% increase in warranty sales at our Toyota dealerships due to the 2010 Toyota recalls discussed previously. Our Lexus dealerships experienced a 7.2% decrease in warranty sales in 2010 due to the Lexus recalls that occurred in 2009.

Our fixed operations gross profit increased \$21.7 million, or 4.0%, in 2010 compared to 2009. An increase in fixed operations revenue contributed approximately \$28.2 million in gross profit increase, partially offset by a \$6.5 million decrease in gross profit due to a 60 basis point decline in the gross margin rate.

Fixed operations revenues decreased \$23.9 million, or 2.2%, during 2009 compared to 2008, primarily due to an \$11.0 million, or 13.9%, decrease at our Cadillac dealerships and a \$10.7 million, or 7.2%, decrease at our Honda dealerships. Customer pay sales remained flat in 2009 compared to 2008. Warranty sales decreased \$10.6 million, or 5.3%, during 2009 compared to 2008, which was primarily caused by decreases at our BMW and Mercedes dealerships. Our fixed operations gross profit decreased \$8.8 million, or 1.6%, during 2009 compared to 2008, primarily due to a \$10.7 million, or 7.2%, gross profit decrease at our Honda dealerships.

As of December 31, 2010, we operated 25 collision repair centers. Reported collision repair revenues increased \$1.4 million, or 3.0%, during 2010 compared to 2009, primarily due to an increase in sublet revenues of \$0.8 million, or 14.6%. Collision repair revenues decreased \$4.0 million, or 7.7%, during 2009 compared to 2008, primarily due to a decline in customer pay revenues of \$3.0 million, or 8.3%.

***Finance, Insurance and Other ( F&I )***

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

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Rate spread is another term for the commission earned by our dealerships for arranging vehicle financing for consumers. The amount of the commission could be zero, a flat fee or an actual spread between the interest rate charged to the consumer and the interest rate provided by the direct financing source (bank, credit union or manufacturers captive finance company). We have established caps on the potential rate spread our dealerships can earn with all finance sources. We believe the rate spread we earn for arranging financing represents value to the consumer in numerous ways, including the following:

Lower cost, below-market financing is often available only from the manufacturers captives and franchised dealers;

Generally easy access to multiple high-quality lending sources;

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.

F&I revenues are driven by the level of new and used vehicle unit sales, manufacturer financing or leasing incentives and our F&I penetration rate. The F&I penetration rate represents the percentage of vehicle sales on which we are able to originate financing or sell extended service contracts, other aftermarket products or insurance contracts. Our finance penetration rates increased to 67.8% in 2010 from 65.0% in 2009. Our extended service contract penetration rates declined to 26.1% in 2010 from 30.2% in 2009. Further, the aftermarket products penetration rate increased to 87.0% in 2010 from 82.9% in 2009. Penetration rates were positively impacted by a strengthening economy and increasing consumer confidence, combined with an effective roll-out of our F&I best practices during 2010. Following is information related to F&I:

|  | <b>For the Year-Ended</b>                   |                              | <b>Better/(Worse)</b> |                 |
|--|---|------------------------------|-----------------------|-----------------|
|  | <b>2009</b>                                 | <b>December 31,<br/>2010</b> | <b>Change</b>         | <b>% Change</b> |
|  | <b>(In thousands, except per unit data)</b> |                              |                       |                 |
| Revenue  | \$ 154,696                                  | \$ 180,968                   | \$ 26,272             | 17.0%           |
| Gross profit per retail unit (excluding fleet) | \$ 929                                      | \$ 957                       | \$ 28                 | 3.0%            |

|  | <b>For the Year-Ended</b>                   |                              | <b>Better/(Worse)</b> |                 |
|--|---|------------------------------|-----------------------|-----------------|
|  | <b>2008</b>                                 | <b>December 31,<br/>2009</b> | <b>Change</b>         | <b>% Change</b> |
|  | <b>(In thousands, except per unit data)</b> |                              |                       |                 |
| Revenue  | \$ 180,274                                  | \$ 154,696                   | \$ (25,578)           | (14.2%)         |
| Gross profit per retail unit (excluding fleet) | \$ 1,015                                    | \$ 929                       | \$ (86)               | (8.5%)          |

F&I revenues increased during 2010 compared to 2009 primarily due to an increase in total new and used retail (excluding fleet) unit volume of 22,651 units, or 13.6%, increased penetration rates and higher profit per unit. Gross profit per retail unit increased 3.0% in 2010 compared to 2009, primarily due to better pricing on finance contracts in 2010 and a 19.2% increase in aftermarket products sold. Finance contracts may be under pressure in the event manufacturers offer attractive financing rates from their captive finance affiliates as we tend to earn lower commissions under these programs.

F&I revenues decreased during 2009 when compared to 2008 primarily due to a decrease in total new and used retail (excluding fleet) unit volume of 11,224 or 6.3%. In addition to the unit decline, F&I gross profit per unit decreased during 2009 when compared to 2008. This decrease in F&I revenue per unit can be attributed to a decrease in finance contract penetration rates to 65.0% in 2009 from 69.4% in 2008 and a decrease in service contract penetration rates to 30.2% in 2009 from 32.8% in 2008.

**Table of Contents*****Selling, General and Administrative ( SG&A ) Expenses***

SG&A expenses are comprised of four major groups: compensation expense, advertising expense, 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 for certain dealership and corporate personnel, gross profits and compensation expense do not change in direct proportion to one another. Advertising expense and other expenses vary based on the level of actual or anticipated business activity and number of dealerships owned. Rent and rent related expense typically varies 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 are as a percentage of gross profit. Following is information related to our SG&A expenses:

|                       | For the Year-Ended<br>December 31, |            | Better/(Worse)<br>% |         |
|-----------------------|------------------------------------|------------|---------------------|---------|
|                       | 2009                               | 2010       | Change              | Change  |
|                       | (In thousands)                     |            |                     |         |
| Compensation          | \$ 470,293                         | \$ 526,577 | \$ (56,284)         | (12.0%) |
| Advertising           | 44,736                             | 46,908     | (2,172)             | (4.9%)  |
| Rent and Rent Related | 131,262                            | 130,739    | 523                 | 0.4%    |
| Other                 | 182,929                            | 192,473    | (9,544)             | (5.2%)  |
| Total                 | \$ 829,220                         | \$ 896,697 | \$ (67,477)         | (8.1%)  |
| SG&A as a % of gross  |                                    |            |                     |         |
| Compensation          | 45.5%                              | 47.2%      | (170)bps            |         |
| Advertising           | 4.3%                               | 4.2%       | 10bps               |         |
| Rent and Rent Related | 12.7%                              | 11.7%      | 100bps              |         |
| Other                 | 17.8%                              | 17.3%      | 50bps               |         |
| Total                 | 80.3%                              | 80.4%      | (10)bps             |         |

|                       | For the Year-Ended<br>December 31, |            | Better/(Worse)<br>% |        |
|-----------------------|------------------------------------|------------|---------------------|--------|
|                       | 2008                               | 2009       | Change              | Change |
|                       | (In thousands)                     |            |                     |        |
| Compensation          | \$ 489,922                         | \$ 470,293 | \$ 19,629           | 4.0%   |
| Advertising           | 56,837                             | 44,736     | 12,101              | 21.3%  |
| Rent and Rent Related | 133,278                            | 131,262    | 2,016               | 1.5%   |
| Other                 | 226,206                            | 182,929    | 43,277              | 19.1%  |
| Total                 | \$ 906,243                         | \$ 829,220 | \$ 77,023           | 8.5%   |

SG&A as a % of gross

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|                       |       |       |          |
|-----------------------|-------|-------|----------|
| Compensation          | 44.2% | 45.5% | (130)bps |
| Advertising           | 5.1%  | 4.3%  | 80bps    |
| Rent and Rent Related | 12.0% | 12.7% | (70)bps  |
| Other                 | 20.6% | 17.8% | 280bps   |
| Total                 | 81.9% | 80.3% | 160bps   |

*2010 Compared to 2009*

Total SG&A expenses increased both in dollar amount and as a percentage of gross profit in 2010. The increase can be attributed to the increases in revenue and gross profit as well as higher compensation costs.

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In 2010, total compensation expense increased in both dollar amount and as a percentage of gross profit compared to 2009. Compensation costs were higher in the first half of 2010 and improved in the latter half of the year when pay plans were adjusted to compensate for higher than expected retail activity.

Advertising expense increased in dollar amount but improved slightly as a percentage of gross profit. Total advertising costs were higher versus prior year primarily due to the rebound in economic activity in 2010.

In 2010, rent and rent related expenses remained flat as compared to 2009. As a percentage of gross profit, rent and rent related expenses decreased in 2010 compared to 2009, primarily due to increases in gross profit resulting from an improved sales environment.

Other SG&A expenses increased compared to 2009, primarily due to higher insurance related expenses and investments in our employees through training. Other SG&A as a percentage of gross profit decreased due to gross profit increases in an improved economic environment.

*2009 Compared to 2008*

Total SG&A expenses decreased both in dollar amount and as a percentage of gross profit in 2009 as compared to 2008. The dollar decrease can be attributed to lower sales volume in 2009, while the decrease as a percentage of gross profit is primarily attributable to reductions in other SG&A expenses due to hail and hurricane damage, loss on marketable securities and legal expenses incurred in 2008.

In 2009, total reported compensation expense decreased compared to 2008. However, as a percentage of gross profit, total compensation expense increased. The dollar decrease was the result of overall declines in retail volume due to a slow sales environment which led to lower sales commissions. The unfavorable increase as a percentage of gross profit was primarily the result of sales compensation not being perfectly correlated with changes in gross profit.

Advertising expense decreased both in dollar amount and as a percentage of gross profit in 2009 compared to 2008. Total advertising costs were lower versus prior year due to adjustments in advertising strategies in response to the soft operating environment and an overall effort to reduce costs in 2009. In addition, during 2009 we shifted our advertising strategy away from traditional media and more towards internet and other outlets.

Rent and rent related expenses decreased slightly in 2009 as compared to 2008. Rent and rent related expenses were negatively impacted by lease exit charges recorded in 2008. As a percentage of gross profit, rent and rent related expenses increased slightly in 2009 compared to 2008 due to declines in gross profit in a slower sales environment in 2009.

Other SG&A expenses decreased in 2009 as compared to 2008, primarily due to our efforts to reduce costs in 2009. Further, we incurred \$4.4 million of hail and hurricane damage and loss on marketable securities of \$6.4 million in 2008. In 2009, there were no significant losses from weather events and we recorded a \$3.8 million gain on marketable securities, further contributing to the decrease.

***Impairment Charges***

Impairment charges decreased \$23.3 million from 2009 to 2010 due to impairment charges recorded in 2009 and no significant charges in 2010 related to goodwill, franchise assets and fixed assets. See the table and discussion included under the previous heading **Impairments and Other Charges** for a detail of other impairment charges recorded during 2009 and 2010.



In 2009, impairment charges decreased \$788.5 million compared to 2008 primarily due to goodwill impairment recorded in 2008. See the table and discussion included under the previous heading Impairments and Other Charges for a detail of impairment charges recorded during 2009 and 2008.

***Depreciation and Amortization***

Depreciation expense increased \$0.2 million, or 0.7%, in 2010 compared to 2009, and \$2.1 million, or 6.6%, in 2009 compared to 2008. The increases were primarily related to additions to gross property and equipment of

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\$35.0 million in 2010 and \$31.2 million in 2009 related to continuing operations, excluding land and construction in progress. The increases in depreciable property were due in part to our strategic shift to continue to own and hold more dealership properties. Also, the increase in 2010 compared to 2009 was partially due to infrastructure investments in facilities that were completed and transferred out of construction in progress and placed into service in 2010.

***Interest Expense, Floor Plan***

Interest expense, floor plan for new vehicles increased \$1.1 million, or 6.2%, in 2010 compared to 2009. The average new vehicle floor plan interest rate related to new vehicles incurred by continuing dealerships was 2.69% for the year ended December 31, 2010, compared to 2.50% for the year ended December 31, 2009, which increased interest expense by approximately \$1.4 million. The average floor plan balance for new vehicles decreased by \$11.0 million in 2010, resulting in a decrease in expense of approximately \$0.3 million.

Interest expense, floor plan for used vehicles incurred by continuing operations increased \$0.6 million, or 37.1%, in 2010 compared to 2009. Before considering used vehicle floor plan interest expense allocated to discontinued operations for the year ended December 31, 2009 of \$0.2 million, the weighted average used vehicle floor plan interest rate incurred by both continuing and discontinued operations was 2.88% for the year ended December 31, 2010, compared to 2.31% for the year ended December 31, 2009, which increased interest expense by approximately \$0.4 million. The average used vehicle floor plan notes payable balance from continuing and discontinued dealerships increased \$2.2 million in 2010 compared to 2009, resulting in an increase in used vehicle floor plan interest expense of approximately \$0.1 million.

Interest expense, floor plan for new vehicles decreased \$21.6 million, or 54.2%, in 2009 compared to 2008. The average floor plan interest rate for new vehicles incurred by continuing dealerships was 2.50% for the year ended December 31, 2009, compared to 4.12% for the year ended December 31, 2008, which decreased interest expense by approximately \$11.8 million. During 2009 the average floor plan balance for new vehicles decreased \$237.3 million which resulted in a decrease in expense of approximately \$9.8 million.

Interest expense, floor plan for used vehicles incurred by continuing operations decreased \$2.0 million, or 55.5%, in 2009 compared to 2008. Before considering used vehicle floor plan interest expense allocated to discontinued operations for the year ended December 31, 2009 and December 31, 2008 of \$0.2 million and \$0.6 million, respectively, the weighted average used vehicle floor plan interest rate incurred by both continuing and discontinued operations was 2.31% for the year ended December 31, 2009, compared to 4.37% for the year ended December 31, 2008, which decreased interest expense by approximately \$1.6 million. The average used vehicle floor plan notes payable balance from continuing and discontinued dealerships decreased \$19.0 million in 2009 compared to 2008, resulting in a decrease in used vehicle floor plan interest expense of approximately \$0.7 million.

**Table of Contents*****Interest Expense, Other, Net***

Interest expense, other, net, was \$59.0 million, \$78.3 million and \$63.4 million in 2008, 2009 and 2010, respectively. Changes in interest expense, other, net, are summarized in the schedule below:

|   | <b>2009</b>        |    | <b>2010</b>                |
|---|--------------------|----|----------------------------|
|   | <b>Increase</b>    |    | <b>Increase (Decrease)</b> |
|   | <b>(Decrease)</b>  |    | <b>Increase (Decrease)</b> |
|   | <b>in Interest</b> |    | <b>in Interest Expense</b> |
|   | <b>Expense</b>     |    | <b>(In millions)</b>       |
| Debt balances   |                    |    |                            |
| - Increase (decrease) in debt balances  | \$ (2.1)           | \$ | (3.6)                      |
| Other factors   |                    |    |                            |
| - (Increase) decrease in capitalized interest                                       | 0.8                |    | (1.6)                      |
| - Incremental interest expense (benefit) related to variable to fixed rate swaps(1) | 6.1                |    | (0.9)                      |
| - Incremental interest expense (benefit) related to fixed rate to variable swaps(1) | 0.8                |    |                            |
| - Interest expense (benefit) allocation to discontinued operations                  | 1.1                |    | 1.8                        |
| - Increase (decrease) in deferred loan cost amortization(2)                         | 11.7               |    | (10.3)                     |
| - Increase (decrease) in other expense, net   | 0.9                |    | (0.3)                      |
|   | \$ 19.3            | \$ | (14.9)                     |

(1) Represent difference in cash payments to and from the counterparty.

(2) Includes loan costs related to the issuance of the 6.0% Convertible Notes and amendments to the 2006 Credit Facility.

***Interest Expense, Non-Cash, Convertible Debt***

Non-cash convertible debt interest expense for the year ended December 31, 2010 is comprised of the amortization of the debt discount and deferred loan costs associated with our 5.0% Convertible Notes and 4.25% Convertible Notes. The initial debt discount was determined based on a valuation of the debt component of these notes and is being amortized monthly to interest expense over the expected life of the notes.

Interest expense of approximately \$10.7 million, \$6.2 million and \$0.5 million in 2008, 2009 and 2010, respectively, represents the non-cash amortization of the debt discount associated with the 5.25% Convertible Notes and 4.25% Convertible Notes. Interest expense of approximately \$1.2 million and \$5.1 million in 2009 and 2010, respectively, was recorded related to amortization of the debt discount on the 5.0% Convertible Notes. Interest expense of approximately \$4.1 million in 2009 represents the non-cash amortization of the debt discount associated with the 6.0% Convertible Notes. We recognized a non-cash benefit of \$11.3 million for the year ended December 31, 2009 due to the extinguishment of the derivative liability associated with the redemption of our 6.0% Convertible Notes during 2009. Deferred loan cost amortization related to the 4.25% Convertible Notes and 5.0% Convertible

Notes was \$1.3 million for the year ended December 31, 2010.

Interest expense, non-cash, convertible debt is summarized in the schedule below:

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2008</b>                    | <b>2009</b> | <b>2010</b> |
|  | <b>(In millions)</b>           |             |             |
| Amortization of debt discount          | \$ 10.7                        | \$ 11.5     | \$ 5.6      |
| Amortization of deferred loan costs    |                                | 0.5         | 1.3         |
| Mark-to-market on derivative liability |                                | (11.3)      |             |
|  | \$ 10.7                        | \$ 0.7      | \$ 6.9      |

**Table of Contents*****Interest Expense/Amortization, Non-Cash, Cash Flow Swaps***

We have entered into the Fixed Swaps to effectively convert a portion of our LIBOR-based variable rate debt to a fixed rate, in order to reduce our exposure to market risks from fluctuations in interest rates. As a result of the refinancing of our 2006 Credit Facility and the new terms of the 2010 Credit Facilities, it is no longer probable that we will incur interest payments that match the terms of certain Fixed Swaps that previously were designated and qualified as cash flow hedges, as we would be borrowing certain amounts under the Silo Floor Plan Facilities rather than under the new 2010 Credit Facilities. Certain of the lenders' terms under the Silo Floor Plan Facilities did not match the terms of our Fixed Swaps that previously qualified as cash flow hedges. Of the Fixed Swaps (including the two \$100.0 million notional swaps which were settled in 2009), \$565.0 million of the notional amount had previously been documented as hedges against the variability of cash flows related to interest payments on certain debt obligations. At December 31, 2010, we estimate that under the new 2010 Credit Facilities and other facilities with matching terms, it is probable that the expected debt balance with interest payments that match the terms of the Fixed Swaps will be \$400.0 million. As a result, for the years ended December 31, 2010 and December 31, 2009, non-cash charges of approximately \$4.9 million and \$11.8 million, respectively, related to the Fixed Swaps and amortization of amounts in accumulated other comprehensive income (loss) related to other existing and terminated cash flow swaps were included in interest expense/amortization, non-cash, cash flow swaps in the accompanying Consolidated Statements of Income. Changes in the fair value of notional amounts of certain cash flow swaps are recognized through earnings. See the heading *Derivative Instruments and Hedging Activities* in Note 6 *Long-Term Debt*, in the accompanying notes to the Consolidated Financial Statements for further discussion.

For the Fixed Swaps which qualify as cash flow hedges, the changes in the fair value of these swaps have been recorded in other comprehensive income (loss), net of related income taxes in the Consolidated Statements of Stockholders' Equity. The incremental interest expense (the difference between interest paid and interest received) related to the Fixed Swaps was \$17.6 million in 2010, \$18.5 million in 2009 and \$12.4 million in 2008, and is included in interest expense, other, net, in the accompanying Consolidated Statements of Income. The estimated net expense expected to be reclassified out of other comprehensive income (loss) into results of operations during the year ended December 31, 2011 is approximately \$10.8 million.

***Other Income (Expense), Net***

We recorded a loss on extinguishment of debt of approximately \$7.7 million in the year ended December 31, 2010, related to the retirement of \$232.1 million in aggregate principal amount of the 8.625% Notes. For the year ended December 31, 2009, other income (expense), net, includes a gain of approximately \$0.4 million on the repurchase of a portion of the 4.25% Convertible Notes at a discount and a gain of approximately \$0.1 million related to the derecognition of liability and equity components of the 4.25% Convertible Notes upon repurchase of a portion of the 4.25% Convertible Notes during the third and fourth quarter of 2009. These gains were offset by a loss of approximately \$7.2 million related to the write-off of the unamortized debt discount associated with the redemption of the 6.0% Convertible Notes during the fourth quarter of 2009. See Note 6, *Long-Term Debt*, in the notes to the accompanying Consolidated Financial Statements for further discussion.

***Provision for Income Taxes***

The effective tax rate from continuing operations was (22.3%) in 2010, (105.0%) in 2009 and 16.2% in 2008. In 2010 and 2009, a reduction of valuation allowances on deferred tax assets and other tax adjustments of \$48.2 million and \$41.3 million, respectively, resulted in an overall tax benefit from continuing operations. Excluding the effect of these items, the effective tax rate from continuing operations would have been 43.2% and 39.9% for the years ended December 31, 2009 and 2010, respectively. The 2008 effective tax rate for continuing operations was affected by valuation allowance and other account adjustments as well as the effect of non-deductible goodwill. Absent these

items the effective tax rate for the year ended December 31, 2008 would have been 38.5%. Our effective tax rate varies from year to year based on the distribution of taxable income between states in which we operate. We expect the effective tax rate in future periods to fall within a range of 38.0% to 41.0% before the impact, if any, of changes in valuation allowances related to deferred income tax assets.

**Table of Contents*****Discontinued Operations***

The pre-tax losses from operations and the sale of discontinued franchises were as follows:

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2008</b>                    | <b>2009</b> | <b>2010</b> |
|  | <b>(In thousands)</b>          |             |             |
| Loss from operations                                   | \$ (20,103)                    | \$ (12,579) | \$ (6,634)  |
| Gain (loss) on disposal of franchises                  | (2,325)                        | (293)       | 2,629       |
| Lease exit charges                                     | (13,747)                       | (30,794)    | (4,232)     |
| Property impairment charges                            | (14,912)                       | (4,992)     |             |
| Goodwill impairment charges                            | (2,025)                        | (1,586)     |             |
| Franchise agreement and other asset impairment charges | (20,500)                       |             |             |
| Favorable lease asset impairment charges               | (1,903)                        |             |             |
| <br>   |                                |             |             |
| Pre-tax loss   | \$ (75,515)                    | \$ (50,244) | \$ (8,237)  |
| <br>   |                                |             |             |
| Total revenues   | \$ 587,801                     | \$ 294,390  | \$ 55,077   |

Loss from discontinued operations has declined from 2008 levels due to the disposal of under-performing franchises which incurred significant operating losses in the periods prior to their disposal. For a description of the impairment and other charges taken for the years ended December 31 2010, 2009 and 2008, see the discussion under the previous heading *Impairments and Other Charges*.

***Adjusted Results of Operations***

Along with the evaluation of our performance presented on a basis consistent with GAAP, we believe there is benefit in evaluating our results of operations exclusive of certain significant items which affect the comparability of results between periods. The *As Adjusted* columns below are not measures of financial performance under GAAP. Accordingly, they should not be considered as substitutes for their *As Reported* GAAP counterparts, which are prepared in accordance with GAAP. Although we find these non-GAAP results useful in evaluating the performance of our business, our reliance on these measures is limited because the adjustments often have a material impact on our financial statements presented in accordance with GAAP. Therefore, we typically use these *As Adjusted* amounts in conjunction with our GAAP results to address these limitations. See the previous discussion in this section under the heading *Impairments and Other Charges* for discussion of the adjustments in

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the table below, which reconciles adjusted results of operations (a non-GAAP measure) to the results of operations presented in the accompanying Consolidated Statements of Income in accordance with GAAP.

|  | 2008           |             | Year Ended December 31,<br>2009  |                |             | 2010           |                | As<br>Adjusted |             |
|--|----------------|-------------|--|----------------|-------------|----------------|----------------|----------------|-------------|
|  | As<br>Reported | Adjustments | As<br>Adjusted<br>(\$ in millions,<br>shares in thousands,<br>except per share data) | As<br>Reported | Adjustments | As<br>Adjusted | As<br>Reported |                | Adjustments |
| Revenues   | \$ 6,900.2     | \$          | \$ 6,900.2   | \$ 6,055.3     | \$          | \$ 6,055.3     | \$ 6,880.8     | \$             | \$ 6,880.8  |
| Operating profit   | 1,107.2        |             | 1,107.2  | 1,032.7        |             | 1,032.7        | 1,114.7        |                | 1,114.7     |
| Expenses, general and administrative   |                |             |  |                |             |                |                |                |             |
| Depreciation and amortization  | (906.3)        | 21.5        | (884.8)  | (829.2)        | 4.0         | (825.2)        | (896.8)        | 0.6            | (896.2)     |
| Restructuring charges  | (812.0)        | 812.0       |  | (23.5)         | 23.5        |                | (0.2)          | 0.2            |             |
| Goodwill impairment  |                |             |  |                |             |                |                |                |             |
| Provision for doubtful accounts  | (32.7)         |             | (32.7)   | (34.9)         |             | (34.9)         | (35.1)         |                | (35.1)      |
| Operating income   | (643.8)        | 833.5       | 189.7  | 145.1          | 27.5        | 172.6          | 182.6          | 0.8            | 183.4       |
| Other income (expense):  |                |             |  |                |             |                |                |                |             |
| Restructuring expense, plan  | (43.4)         |             | (43.4)   | (19.8)         |             | (19.8)         | (21.5)         |                | (21.5)      |
| Restructuring expense, net   | (59.0)         |             | (59.0)   | (78.3)         | 12.0        | (66.3)         | (63.3)         | 1.5            | (64.8)      |
| Restructuring expense, cash  | (10.7)         |             | (10.7)   | (12.5)         | 0.5         | (12.0)         | (11.8)         | 4.9            | (7.9)       |
| Restructuring income (expense), net  | 0.8            |             | 0.8  | (6.6)          | 6.7         | 0.1            | (7.6)          | 7.7            | (7.5)       |
| Other expense  | (112.3)        |             | (112.3)  | (117.2)        | 19.2        | (98.0)         | (104.2)        | 14.1           | (90.1)      |
| Income (loss) from continuing operations before income tax benefit (expense) | (756.1)        | 833.5       | 77.4   | 27.9           | 46.7        | 74.6           | 78.4           | 14.9           | 93.3        |
| Income tax benefit (expense)   | 122.3          | (146.3)(1)  | (24.0)   | 29.3           | (61.5)(3)   | (32.2)         | 17.5           | (54.0)(5)      | (36.5)      |
| Income (loss) from continuing operations                                     | (633.8)        | 687.2       | 53.4   | 57.2           | (14.8)      | 42.4           | 95.9           | (39.1)         | 56.8        |
| Income (loss) from discontinued operations                                   | (58.5)         | 46.9(2)     | (11.6)   | (25.7)         | 15.5(4)     | (10.2)         | (6.0)          | 0.7(6)         | (5.5)       |
| Income (loss)  | \$ (692.3)     | \$ 734.1    | \$ 41.8  | \$ 31.5        | \$ 0.7      | \$ 32.2        | \$ 89.9        | \$ (38.4)      | \$ 51.3     |



|                     |            |          |         |         |           |         |         |           |        |        |
|---------------------|------------|----------|---------|---------|-----------|---------|---------|-----------|--------|--------|
| earnings (loss)     |            |          |         |         |           |         |         |           |        |        |
| Common share:       |            |          |         |         |           |         |         |           |        |        |
| Earnings (loss) per |            |          |         |         |           |         |         |           |        |        |
| share from          |            |          |         |         |           |         |         |           |        |        |
| continuing          | \$ (15.70) | \$ 17.01 | \$ 1.31 | \$ 1.29 | \$ (0.33) | \$ 0.96 | \$ 1.82 | \$ (0.74) | \$     |        |
| Operations          |            |          |         |         |           |         |         |           |        |        |
| per share from      |            |          |         |         |           |         |         |           |        |        |
| discontinued        | (1.46)     | 1.17     | (0.29)  | (0.58)  | 0.35      | (0.23)  | (0.12)  | 0.02      | (0.02) |        |
| Operations          |            |          |         |         |           |         |         |           |        |        |
| Earnings (loss) per | \$ (17.16) | \$ 18.18 | \$ 1.02 | \$ 0.71 | \$ 0.02   | \$ 0.73 | \$ 1.70 | \$ (0.72) | \$     |        |
| Common share        |            |          |         |         |           |         |         |           |        |        |
| Weighted average    |            |          |         |         |           |         |         |           |        |        |
| Shares outstanding  | 40,356     |          | 40,356  | 43,836  |           | 43,836  | 52,214  |           |        | 52,214 |
| Adjusted earnings   |            |          |         |         |           |         |         |           |        |        |
| per common          |            |          |         |         |           |         |         |           |        |        |
| share:              |            |          |         |         |           |         |         |           |        |        |
| Earnings (loss) per |            |          |         |         |           |         |         |           |        |        |
| share from          |            |          |         |         |           |         |         |           |        |        |
| continuing          | \$ (15.70) | \$ 17.01 | \$ 1.31 | \$ 1.07 | \$ (0.26) | \$ 0.81 | \$ 1.58 | \$ (0.59) | \$     |        |
| Operations          |            |          |         |         |           |         |         |           |        |        |
| per share from      |            |          |         |         |           |         |         |           |        |        |
| discontinued        | (1.46)     | 1.17     | (0.29)  | (0.45)  | 0.27      | (0.18)  | (0.09)  | 0.01      | (0.02) |        |
| Operations          |            |          |         |         |           |         |         |           |        |        |
| Earnings (loss) per | \$ (17.16) | \$ 18.18 | \$ 1.02 | \$ 0.62 | \$ 0.01   | \$ 0.63 | \$ 1.49 | \$ (0.58) | \$     |        |
| Common share        |            |          |         |         |           |         |         |           |        |        |
| Weighted average    |            |          |         |         |           |         |         |           |        |        |
| Shares outstanding  | 40,356     |          | 40,556  | 55,832  |           | 55,832  | 65,794  |           |        | 65,794 |

- (1) Tax effect of the pre-tax adjustments above in addition to expense of \$111.6 million related to valuation allowance and other tax adjustments.
- (2) Tax-effected adjustments to discontinued operations in addition to expense of \$3.4 million related to valuation allowance and other tax adjustments.
- (3) Tax effect of the pre-tax adjustments above in addition to a benefit of \$41.3 million related to valuation allowance and other tax adjustments.

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- (4) Tax-effected adjustments to discontinued operations in addition to a benefit of \$6.1 million related to valuation allowance and other tax adjustments.
- (5) Tax effect of the pre-tax adjustments above in addition to a benefit of \$48.2 million related to valuation allowance and other tax adjustments.
- (6) Tax-effected adjustments to discontinued operations.

## **Liquidity and Capital Resources**

We require cash to fund debt service, operating lease obligations, working capital requirements and to finance acquisitions. We rely on cash flows from operations, borrowings under our revolving credit and floor plan borrowing arrangements, real estate mortgage financing, asset sales and offerings of debt and equity securities to meet these requirements. Our liquidity could be negatively affected if we fail to comply with the financial covenants in our existing debt or lease arrangements. Cash flows provided by our dealerships are derived from various sources. The primary sources include individual consumers, automobile manufacturers, automobile manufacturers captive finance subsidiaries and finance companies. Disruptions in these cash flows can have a material and adverse impact on our operations and overall liquidity.

Because the majority of our consolidated assets are held by our dealership subsidiaries, the majority of our cash flows from operations are generated by these subsidiaries. As a result, our cash flows and ability to service our obligations depends to a substantial degree on the cash generated from the operations of these dealership subsidiaries.

In 2010, our overall debt maturity position improved as a result of the refinancing of our credit facilities in January 2010 and the issuance of our 9.0% Notes in March 2010. During 2010, we also redeemed \$232.1 million in aggregate principal amount of our 8.625% Notes and the remaining \$17.0 million in aggregate principal amount of our 4.25% Convertible Notes.

In 2010, our operational performance began to rebound as the economy and the automotive retail industry environment improved coming out of the economic crisis that began in the fourth quarter of 2008. Average industry expectations for new vehicle sales volume in 2011 are between 12.0 million and 13.0 million vehicles which, if realized, would be an increase of 3.4% to 12.1% from the 2010 level. This suggests a steady improvement in automotive retailing in 2011. We believe our current capital structure and the expected results of our operating activities will enable us to continue to service our liquidity requirements.

### ***Long-Term Debt and Credit Facilities***

#### ***2010 Credit Facilities***

Our 2010 Credit Facilities, executed on January 15, 2010, provide a total of up to \$521.0 million in combined revolving credit and floor plan financing.

Under the terms of the 2010 Credit Facilities, up to \$321.0 million is available for new vehicle inventory floor plan financing (the 2010 New Vehicle Floor Plan Sub-Facility ), up to \$50.0 million is available for used vehicle inventory floor plan financing (the 2010 Used Vehicle Floor Plan Sub-Facility ) and up to \$150.0 million is available for working capital and general corporate purposes (the 2010 Revolving Credit Facility ). The 2010 Credit Facilities mature on August 15, 2012. We also have capacity to finance new and used vehicle inventory purchases under bilateral floor plan agreements with various manufacturer-affiliated finance companies and other lending institutions (the Silo Floor

Plan Facilities ).

Availability under our 2010 Revolving Credit Facility is calculated as the lesser of \$150.0 million or a borrowing base calculated based on certain eligible assets plus 50% of the fair market value of 5,000,000 shares of common stock of Speedway Motorsports, Inc. that are pledged as collateral (the 2010 Revolving Borrowing Base ). The 2010 Revolving Credit Facility may be expanded up to \$215.0 million upon satisfaction of certain conditions. A withdrawal of this pledge by Sonic Financial Corporation ( SFC ), which holds the 5,000,000 shares of common stock of Speedway Motorsports, Inc., or a significant decline in the value of Speedway Motorsports, Inc. common stock, could reduce the amount we can borrow under the 2010 Revolving Credit Facility.

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The 2010 Revolving Borrowing Base was approximately \$145.6 million at December 31, 2010. The amount available to be borrowed under the 2010 Revolving Credit Facility is calculated by subtracting the sum of (1) any outstanding borrowings plus (2) the cumulative face amount of any outstanding letters of credit from the 2010 Revolving Borrowing Base. At December 31, 2010, we had no outstanding borrowings and \$47.7 million in outstanding letters of credit resulting in total borrowing availability of \$97.9 million.

Under the 2010 Revolving Credit Facility, the amounts outstanding bear interest at a specified percentage above LIBOR, ranging from 2.50% per annum to 4.00% per annum, (but, in any case, not less than 3.50% per annum through the end of the first quarter of 2011) according to a performance-based pricing grid determined by our Consolidated Total Debt to EBITDA Ratio as of the last day of the immediately preceding fiscal quarter (the Performance Grid ).

Under the 2010 New Vehicle Floor Plan Sub-Facility, amounts outstanding bear interest at a specified percentage above LIBOR, ranging from 1.50% per annum to 2.25% per annum (but, in any case, not less than 2.00% per annum through the end of the first quarter of 2011), according to the Performance Grid. Under the 2010 Used Vehicle Floor Plan Sub-Facility, amounts outstanding bear interest at a specified percentage above LIBOR, ranging from 1.75% per annum to 2.50% per annum (but, in any case, not less than 2.25% per annum through the end of the first quarter of 2011), according to the Performance Grid.

Availability under our 2010 Used Vehicle Floor Plan Sub-Facility is calculated as the lesser of \$50.0 million or a borrowing base calculated based on certain eligible inventory, net of any liens or reserves (the 2010 Used Vehicle Borrowing Base ). At December 31, 2010, the 2010 Used Vehicle Borrowing Base was approximately \$27.9 million and we had \$10.0 million in outstanding borrowings, resulting in total availability of approximately \$17.9 million.

The Silo Floor Plan Facilities provide financing for new and used vehicle inventory and bear interest at variable rates based on prime or LIBOR. Our obligations under the Silo Floor Plan Facilities are guaranteed by us and are secured by liens on substantially all of the assets of our respective dealership franchise subsidiaries that receive financing under these arrangements.

All amounts outstanding (including any outstanding letters of credit) under the 2010 Credit Facilities are secured by a pledge of substantially all of our assets and the assets of substantially all of our dealership franchise subsidiaries, in addition to the pledge of 5,000,000 shares of Speedway Motorsports, Inc. Common Stock owned by SFC. The collateral for the 2010 Credit Facilities also includes the pledge of the stock or equity interests of our dealership franchise subsidiaries, except where such a pledge is prohibited by the applicable vehicle manufacturer.

We agreed under the 2010 Credit Facilities not to pledge any assets to any third party, subject to certain stated exceptions, including floor plan financing arrangements. In addition, the 2010 Credit Facilities contain certain negative covenants, including covenants which could restrict or prohibit indebtedness, liens, the payment of dividends, capital expenditures and material dispositions of assets as well as other customary covenants and default provisions. Specifically, the 2010 Credit Facilities permit cash dividends on our Class A and Class B common stock so long as no event of default (as defined in the 2010 Credit Facilities) has occurred and is continuing and provided that we remain in compliance with all financial covenants under the 2010 Credit Facilities.

The 2010 Credit Facilities contain events of default, including cross-defaults to other material indebtedness, change of control events and events of default customary for syndicated commercial credit facilities. Upon the occurrence of an event of default, we could be required to immediately repay all outstanding amounts under the 2010 Credit Facilities. See Note 6, Long-Term Debt, in the accompanying Consolidated Financial Statements for further discussion of the 2010 Credit Facilities.

*9.0% Notes*

On March 12, 2010, we issued \$210.0 million in aggregate principal amount of 9.0% Notes which mature on March 15, 2018. On April 12, 2010, we used the net proceeds, together with cash on hand, to redeem \$200.0 million in aggregate principal amount of our 8.625% Notes due 2013. The 9.0% Notes are unsecured senior subordinated obligations and are guaranteed by our domestic operating subsidiaries and rank equal in right of payment to all of our and the subsidiary guarantors' existing and future senior subordinated indebtedness. Interest is payable semi-annually on March 15 and September 15 each year. We may redeem the 9.0% Notes in whole or in part at any time.

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after March 15, 2014 at the redemption prices in the following table, which are expressed as percentages of the principal amount. See Note 6, Long-Term Debt, in the accompanying Consolidated Financial Statements for further discussion of the 9.0% Notes.

|  | <b>Redemption</b> |
|--|-------------------|
| Beginning on March 15, 2014                | 104.50%           |
| Beginning on March 15, 2015                | 102.25%           |
| Beginning on March 15, 2016 and thereafter | 100.00%           |

*8.625% Notes*

As discussed above, during 2010 we redeemed \$200.0 million in aggregate principal amount of our 8.625% Notes using proceeds from the issuance of the 9.0% Notes. We also redeemed an additional \$32.1 million in aggregate principal amount of our 8.625% Notes using cash on hand. At December 31, 2010, we had \$42.9 million outstanding under the 8.625% Notes. Our obligations under the 8.625% Notes are guaranteed by our operating domestic subsidiaries. The 8.625% Notes are unsecured obligations that rank equal in right of payment to all of our and the subsidiary guarantors' existing and future senior subordinated indebtedness, mature on August 15, 2013 and are currently redeemable at our option. The redemption premiums for the twelve-month periods beginning August 15 of the years 2010 and 2011 are 101.438% and 100.000%, respectively. See Note 6, Long-Term Debt, in the accompanying Consolidated Financial Statements for further discussion of the 8.625% Notes.

*5.0% Convertible Notes*

On September 23, 2009, we issued \$172.5 million in principal of 5.0% Convertible Notes and 10,350,000 shares of Class A common stock. Net proceeds from these issuances were used to repurchase \$143.0 million in aggregate principal amount of our 4.25% Convertible Notes, \$85.6 million in aggregate principal amount of our 6.0% Convertible Notes and to repay amounts outstanding under the 2006 Credit Facility.

The 5.0% Convertible Notes bear interest at a rate of 5.0% per year, payable semiannually on April 1 and October 1 of each year and mature on October 1, 2029. We may redeem some or all of the 5.0% Convertible Notes for cash at any time subsequent to October 1, 2014 at a repurchase price equal to 100% of the principal amount of the Notes. Holders have the right to require us to purchase the 5.0% Convertible Notes on each of October 1, 2014, October 1, 2019 and October 1, 2024 or in the event of a change in control for cash at a purchase price equal to 100% of the principal amount of the notes.

Holders of the 5.0% Convertible Notes may convert their notes at their option prior to the close of business on the business day immediately preceding July 1, 2029 only under the following circumstances: (1) during any fiscal quarter commencing after December 31, 2009, if the last reported sale price of the Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the measurement period) in which the trading price (as defined below) per \$1,000 principal amount of notes for each day of that measurement period was less than 98% of the product of the last reported sale price of our Class A common stock and the applicable conversion rate on each such day; (3) if we call any or all of the notes for redemption, the notes so called for redemption at any time prior to the close of business on the third scheduled trading day prior to the redemption date; or (4) upon the occurrence of specified corporate events. On and after July 1, 2029 to (and including) the close of business on the third scheduled trading day immediately preceding the maturity date, holders may convert

their notes at any time, regardless of the foregoing circumstances. The conversion rate is 74.7245 shares of Class A common stock per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$13.38 per share of Class A common stock. The 5.0% Convertible Notes were not convertible at any time in 2010.

To recognize the equity component of a convertible borrowing instrument, upon issuance of the 5.0% Convertible Notes in September 2009, we recorded a debt discount of \$31.0 million and a corresponding amount (net of taxes of \$12.8 million) to equity. The debt discount will be amortized to interest expense through October 2014, the

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earliest redemption date. See Note 6, *Long-Term Debt*, in the accompanying Consolidated Financial Statements for further discussion of the 5.0% Convertible Notes.

### *4.25% Convertible Notes*

As discussed above, \$143.0 million in aggregate principal amount of the 4.25% Convertible Notes were repurchased in 2009, resulting in a gain of \$0.1 million recorded in other income (expense), net, in the accompanying Consolidated Statements of Income. In addition, the repurchase required the write-off of approximately \$7.1 million of unamortized debt discount, which was offset by a \$4.3 million adjustment to paid-in capital and a \$2.9 million adjustment to deferred income tax assets.

We repurchased approximately \$1.0 million in aggregate principal amount of the 4.25% Convertible Notes during the second quarter of 2010 at amounts close to par. In November 2010, we used cash on hand to extinguish the remaining \$16.0 million in aggregate principal amount of 4.25% Convertible Notes at the applicable redemption price (100.00% of principal redeemed) plus accrued but unpaid interest. The 4.25% Convertible Notes were not convertible at any time in 2010. See Note 6, *Long-Term Debt*, in the accompanying Consolidated Financial Statements for further discussion of the 4.25% Convertible Notes.

### *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 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%. 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.

### *Mortgage Notes*

During 2010, we obtained \$21.2 million in mortgage financing related to four of our properties. During 2009, we obtained \$6.3 million in mortgage financing for capital construction projects on our dealership facilities. Since implementing our strategy of owning more of our dealership properties in late 2007, we have added \$142.7 million in mortgage financing to our capital structure on 14 of our dealership properties. These mortgage notes require monthly payments of principal and interest through maturity, are secured by the underlying properties and contain certain cross-default provisions. Maturity dates range between June 2013 and December 2029. At December 31, 2010, the weighted average interest rate was 4.91% and the total outstanding balance of our mortgages was \$133.9 million.

### *Operating Leases*

We lease facilities for the majority of our dealership operations under operating lease arrangements. These facility lease arrangements normally have fifteen to twenty year terms with one or two ten year renewal options and do not contain provisions for contingent rent related to dealership operations. Many of the leases are subject to the provisions of a guaranty and subordination agreement that contains financial and affirmative covenants. Approximately 20% of these facility leases are based on capitalization rates with payments that vary based on interest rates. We also lease certain equipment for use in dealership operations. These equipment lease arrangements normally have three to five year terms with one or two year renewal options. See the table under the heading *Future Liquidity Outlook* below for our future minimum lease payment obligations, net of sublease proceeds.

### *Floor Plan Facilities*



We finance our new and certain of our used vehicle inventory through standardized floor plan facilities which are due on demand. These floor plan facilities bear interest at variable rates based on LIBOR and prime. The weighted average interest rate for our floor plan facilities for continuing and discontinued operations was 2.54% for 2009 and 2.71% for 2010. We receive floor plan assistance from certain manufacturers. Floor plan assistance received is capitalized in inventory and charged against cost of sales when the associated inventory is sold. We

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received approximately \$30.8 million, \$19.4 million and \$24.6 million in 2008, 2009 and 2010, respectively, and recognized in cost of sales for continuing operations and discontinued operations approximately \$30.1 million, \$22.6 million and \$24.0 million in 2008, 2009 and 2010, respectively, in manufacturer assistance. Interest payments under each of our floor plan facilities are due monthly and we are not required to make principal repayments prior to the sale of the vehicles.

*Covenants and Default Provisions*

Non-compliance with covenants, including a failure to make any payment when due, under our 2010 Credit Facilities, Silo Floor Plan Facilities, operating lease agreements, mortgage notes, 9.0% Notes, 8.625% Notes and 5.0% Convertible Notes (collectively, our Significant Debt Agreements ) could result in a default and an acceleration of our repayment obligation under our 2010 Credit Facilities. A default under our 2010 Credit Facilities would constitute a default under our Silo Floor Plan Facilities and could entitle these lenders to accelerate our repayment obligations under the one or more of the floor plan facilities. Certain defaults under our 2010 Credit Facilities and one or more Silo Floor Plan Facilities, or certain other debt obligations would not result in a default under our 9.0% Notes, 8.625% Notes or 5.0% Convertible Notes unless our repayment obligations under the 2010 Credit Facilities and/or one or more of the Silo Floor Plan Facilities or such other debt obligations were accelerated. An acceleration of our repayment obligation under any of our Significant Debt Agreements could result in an acceleration of our repayment obligations under our other Significant Debt Agreements. The failure to repay principal amounts of the Significant Debt Agreements when due would create cross-default situations related to other indebtedness. The 2010 Credit Facilities include the following financial covenants:

|   | <b>Consolidated<br/>Liquidity<br/>Ratio</b> | <b>Covenant<br/>Consolidated<br/>Fixed Charge<br/>Coverage<br/>Ratio</b> | <b>Consolidated<br/>Total Senior<br/>Secured Debt to<br/>EBITDA Ratio</b> |
|---|---|--|---|
| Through March 30, 2011                              | <sup>3</sup> 1.00                           | <sup>3</sup> 1.10  | £2.25   |
| March 31, 2011 through and including March 30, 2012 | <sup>3</sup> 1.05                           | <sup>3</sup> 1.15  | £2.25   |
| March 31, 2012 and thereafter                       | <sup>3</sup> 1.10                           | <sup>3</sup> 1.20  | £2.25   |
| December 31, 2010 actual                            | 1.17  | 1.40   | 1.22  |

In addition, many of our facility leases are governed by a guarantee agreement between the landlord and us that contains financial and operating covenants. The financial covenants are identical to those under the 2010 Credit Facilities with the exception of one financial covenant related to the ratio of EBTDAR to Rent with a required ratio of no less than 1.5 to 1.0. At December 31, 2010, the ratio was 2.11 to 1.00.

We were in compliance with all of the restrictive and financial covenants on all of our floor plan, long-term debt facilities and lease agreements as of December 31, 2010. We expect to be in compliance with all of our long-term debt agreements for the foreseeable future.

*Acquisitions and Dispositions*

During 2010, we did not acquire any franchises. Under the 2010 Credit Facilities, we are restricted from making dealership franchise acquisitions in any fiscal year if the aggregate cost of all such acquisitions occurring in any fiscal year is in excess of \$25.0 million, without the written consent of the Required Lenders (as that term is defined in the 2010 Credit Facilities). Currently, we have no plans to pursue any significant dealership franchise acquisition activity

in 2011. Although we believe growth through acquisitions will be a significant source of growth for us in the future, we do not see this being a significant source of growth in the near-term.

During 2010, we disposed of 13 franchises, of which three were General Motors terminations. These disposals generated cash of \$24.7 million. In addition, as of December 31, 2010, we had no additional franchises classified as held for sale.

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### ***Capital Expenditures***

Our capital expenditures include the purchase of land, construction of new dealerships and collision repair centers, building improvements and equipment purchased for use in our dealerships. We selectively construct new dealership facilities to maintain compliance with manufacturers' image requirements. We often finance these projects first through new mortgages and secondly through cash flow from operations and availability under our credit facilities.

Capital expenditures in 2010 were approximately \$88.3 million. Of this amount, \$43.7 million was related to facility construction projects, \$29.1 million was related to real estate acquisitions and \$15.5 million was for fixed assets utilized in our dealership operations. Of the 2010 capital expenditures, \$21.2 million was funded through mortgage financing and \$67.1 million was funded through cash from operations and use of our credit facilities. See the previous discussion in this section under the heading "Mortgage Notes". As of December 31, 2010, commitments for facilities construction projects totaled approximately \$17.3 million. We expect investments related to capital expenditures to be dependent upon the availability of mortgage financing to fund significant capital projects.

Subsequent to December 31, 2010, we purchased five dealership properties which we were previously leasing through long-term operating leases for \$75.2 million, utilizing cash on hand and borrowings under our 2010 Credit Facilities.

### ***Stock Repurchase Program***

Our Board of Directors has authorized us to repurchase shares of our Class A common stock or redeem securities convertible into Class A common stock. Historically, we have used our share repurchase authorization to offset dilution caused by the exercise of stock options or the vesting of restricted stock awards and to maintain our desired capital structure. At the end of 2010, our remaining repurchase authorization was approximately \$43.5 million. Under our 2010 Credit Facilities, share repurchases are permitted to the extent that no event of default exists and we are in compliance with the financial covenants contained therein.

Our share repurchase activity is subject to the business judgment of management and our Board of Directors, taking into consideration our historical and projected results of operations, financial condition, cash flows, capital requirements, covenant compliance and economic and other factors considered relevant. These factors are considered each quarter and will be scrutinized as management and our Board of Directors determines our share repurchase policy throughout 2011.

### ***Dividends***

Our Board of Directors approved a cash dividend on all outstanding shares of Class A and Class B common stock of \$0.025 per share in the fourth quarter of 2010. Subsequent to December 31, 2010, our Board of Directors approved a cash dividend on all outstanding shares of common stock of \$0.025 per share for shareholders of record on March 15, 2011 to be paid on April 15, 2011. Under our 2010 Credit Facilities, dividends are permitted to the extent that no event of default exists and we are in compliance with the financial covenants contained therein. The indentures governing our outstanding 8.625% Notes and 9.0% Notes contain restrictions on our ability to pay dividends. The payment of any future dividend is subject to the business judgment of our Board of Directors, taking into consideration our historic and projected results of operations, financial condition, cash flows, capital requirements, covenant compliance, share repurchases, current economic environment and other factors considered relevant. These factors are considered each quarter and will be scrutinized as our Board of Directors determines our dividend policy throughout 2011. There is no guarantee that additional dividends will be declared and paid at any time in the future. See Note 6, "Long-Term Debt," in the accompanying Consolidated Financial Statements for a description of restrictions on the payment of dividends.

***Cash Flows***

*Cash Flows from Operating Activities* Net cash provided by operating activities was \$120.6 million, \$403.6 million and \$255.0 million for the years ended December 31, 2008, 2009 and 2010, respectively.

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We arrange our inventory floor plan financing through both manufacturer captive finance companies and a syndicate of manufacturer-affiliated finance companies and commercial banks. Our floor plan financed with manufacturer captives is recorded as trade floor plan liabilities (with the resulting change being reflected as an operating cash flow). Our dealerships that obtain floor plan financing from a syndicate of manufacturer-affiliated finance companies and commercial banks record their obligation as non-trade floor plan liabilities (with the resulting change being reflected as a financing cash flow).

Due to the presentation differences for changes in trade floor plan and non-trade floor plan in the Consolidated Statements of Cash Flows, decisions made by us to move dealership floor plan financing arrangements from one finance source to another may cause significant variations in operating and financing cash flows without affecting our overall liquidity, working capital, or cash flow.

Net cash used in combined trade and non-trade floor plan financing was \$53.8 million for the year ended December 31, 2008 and \$353.8 million for the year ended December 31, 2009. The significant reduction of floor plan liabilities in 2009 was mostly offset by a corresponding \$307.8 million decrease in inventory. Net cash provided by combined trade and non-trade floor plan financing was \$95.3 million for the year ended December 31, 2010. Had all floor plan financing changes been included in cash flow from operations, adjusted cash provided by operations would have been \$116.5 million, \$108.8 million and \$86.4 million for the years ended December 31, 2008, 2009 and 2010, respectively.

Inventory levels were reduced in 2009 due to the struggling economy, but in 2010 Sonic began to build up inventory levels as economic conditions improved. The primary factor increasing cash provided from operations during 2010 was the inflow of cash provided by notes payable floor plan - trade of \$264.0 million as a result of the floor plan refinancing that occurred in the first half of 2010, under which notes payable floor plan trade replaced a significant amount of notes payable floor plan non-trade. During 2009, the reduction of inventory levels generated cash of \$307.8 million, and in 2008, reductions of accounts receivable generated cash of \$101.1 million.

*Cash Flows from Investing Activities* Cash used in investing activities during 2008, 2009 and 2010 was \$115.3 million, \$9.7 million, and \$58.7 million, respectively. During 2010, the majority of the investing activities cash outflow is related to capital expenditures partially offset by proceeds received from the disposition of franchises. During 2008 and 2009, cash used in investing activities was primarily related to capital expenditures partially offset by proceeds received from dealership dispositions and the sales of property and equipment. Dealership franchise acquisitions, net of cash acquired, used \$22.9 million for the year ended December 31, 2008, whereas there were no dealership franchise acquisitions in the years ended December 31, 2009 and 2010. We do not expect to complete any significant dealership franchise acquisitions in 2011.

The significant components of capital expenditures relate primarily to dealership renovations and the purchase of certain existing dealership facilities which had previously been financed under long-term operating leases. During 2008, 2009 and 2010, we used proceeds from mortgage financing in the amount of \$56.9 million, \$6.3 million and \$21.2 million, respectively, to purchase certain existing dealership facilities and to fund certain capital expenditures.

*Cash Flows from Financing Activities* Net cash used in financing activities was \$14.8 million for the year ended December 31, 2008, \$370.8 million for the year ended December 31, 2009, and \$204.6 million for the year ended December 31, 2010. For the year ended December 31, 2010, excluding the effect of changes in notes payable floor plan, non-trade, cash flow used in financing activities is comprised primarily of repurchases of debt securities, payments on long-term debt and debt issuance costs, partially offset by new borrowings.

During the year ended December 31, 2009, cash used in financing activities was comprised primarily of payments on long-term debt partially offset by new borrowings and issuance of common stock. During 2009, we repurchased the

remaining balances of our 5.25% Convertible Notes for \$15.7 million and a portion of our 4.25% Convertible Notes for \$143.0 million. During 2009, we also issued common stock of \$101.3 million and paid cash of \$16.5 million for the settlement of two swaps.

*Cash Flows from Discontinued Operations* Our Consolidated Statement of Cash Flows includes both continuing and discontinued operations. Net cash used in operating activities associated with discontinued

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operations for the year ended December 31, 2010 was approximately \$25.6 million. This was substantially comprised of changes in assets and liabilities that relate to dealership operations. In our Consolidated Statement of Cash Flows, cash flows from investing activities includes the line item Proceeds from sale of franchises which is entirely related to discontinued operations. With the exception of Proceeds from sale of franchises in the amount of \$24.7 million and Net payments on notes payable floor plan non-trade in the amount of \$6.7 million, 2010 cash flows from investing and financing activities represent an immaterial amount of total cash flows from discontinued operations.

**Guarantees and Indemnification Obligations**

See discussion under heading Off-Balance Sheet Arrangements Guarantees and Indemnification Obligations below.

**Future Liquidity Outlook**

Our future contractual obligations are as follows:

|   | 2011                | 2012              | 2013              | 2014              | 2015              | Thereafter        | Total               |
|---|---------------------|-------------------|-------------------|-------------------|-------------------|-------------------|---------------------|
|   | (In thousands)      |                   |                   |                   |                   |                   |                     |
| Floor Plan Facilities                                   | \$ 861,985          | \$                | \$                | \$                | \$                | \$                | \$ 861,985          |
| Long-Term Debt(1)                                       | 8,449               | 8,991             | 58,103            | 184,923           | 15,383            | 305,084           | 580,933             |
| Letters of Credit                                       | 47,657              |                   |                   |                   |                   |                   | 47,657              |
| Estimated Interest Payments on Floor Plan Facilities(2) | 3,980               |                   |                   |                   |                   |                   | 3,980               |
| Estimated Interest Payments on Long-Term Debt(3)        | 62,586              | 49,250            | 38,039            | 32,701            | 25,471            | 64,750            | 272,797             |
| Operating Leases (Net of Sublease Rentals)              | 107,191             | 97,935            | 93,465            | 90,004            | 85,609            | 385,844           | 860,048             |
| Construction Contracts                                  | 17,331              |                   |                   |                   |                   |                   | 17,331              |
| Other Purchase Obligations(4)                           | 80,836              | 4,135             | 3,500             | 3,500             |                   |                   | 91,971              |
| FIN 48 Liability(5)                                     | 500                 |                   |                   |                   |                   | 27,099            | 27,599              |
| <b>Total</b>  | <b>\$ 1,190,515</b> | <b>\$ 160,311</b> | <b>\$ 193,107</b> | <b>\$ 311,128</b> | <b>\$ 126,463</b> | <b>\$ 782,777</b> | <b>\$ 2,764,301</b> |

(1) Amounts outstanding under the 8.625% Notes are redeemable at our option but have been classified in this schedule according to contractual maturity. The 5.0% Convertible Notes are redeemable before the stated maturities at both our option and the option of the respective holders. The assumed maturities of these securities are based on these earlier redemption date, which is October 2014 for the 5.0% Convertible Notes. All amounts represent outstanding principal only.

(2) Floor plan facilities balances 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, 2010 floor plan facilities balance, the weighted average interest rate for the fourth quarter of 2010 of 2.78% and the assumption that floor plan facilities balances at December 31, 2010 would be relieved within 60 days in connection with the



sale of the associated vehicle inventory.

- (3) Estimated interest payments calculated based on assumed or stated maturities consistent discussion in (1) above. Estimated interest payments include payments related to interest rate swaps.
- (4) Other Purchase Obligations include contracts for office supplies, utilities, and various other items or services. The \$75.2 million of dealership property discussed under the previous heading **Capital Expenditures** is included in the amount for 2011.
- (5) Amount represents recorded liability, including interest and penalties, related to FIN 48. See Notes 1 and 7 to the accompanying Consolidated Financial Statements.

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We believe our best source of liquidity for operations and debt service remains cash flows generated from operations combined with our availability of borrowings under our floor plan facilities (or any replacements thereof), our 2010 Credit Facilities, selected dealership and other asset sales and our ability to raise funds in the capital markets. Because the majority of our consolidated assets are held by our dealership subsidiaries, the majority of our cash flows from operations are generated by these 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.

### ***Seasonality***

Our operations are subject to seasonal variations. The first quarter normally contributes less operating profit than the second, third and fourth quarters. Weather conditions, the timing of manufacturer incentive programs and model changeovers cause seasonality, and may adversely affect vehicle demand, and consequently, our profitability. Comparatively, parts and service demand remains more stable throughout the year.

### **Off-Balance Sheet Arrangements**

#### ***Guarantees and Indemnification Obligations***

In connection with the operation and disposition of dealership franchises, we have entered into various guarantees and indemnification obligations. When we sell dealership franchises, we attempt to assign any related lease to the buyer of the franchise to eliminate any future liability. However, if we are unable to assign the related leases to the buyer, we will attempt to sublease the leased properties to the buyer at a rate equal to the terms of the original leases. In the event we are unable to sublease the properties to the buyer with terms at least equal to our lease, we may be required to record lease exit accruals. We expect the aggregate amount of the obligations we guarantee to increase as we dispose of additional franchises. See Note 12, Commitments and Contingencies, to the accompanying Consolidated Financial Statements for a discussion regarding these guarantees and indemnification obligations. Past performance under these guarantees and indemnification obligations and their estimated fair value has been immaterial to our liquidity and capital resources. Although we seek to mitigate our exposure in connection with these matters, these guarantees and indemnification obligations, including environmental exposures and the financial performance of lease assignees and sub-lessees, cannot be predicted with certainty. An unfavorable resolution of one or more of these matters could have a material adverse effect on our liquidity and capital resources. At December 31, 2010, our future gross minimum lease payments related to properties subleased to buyers of sold franchises totaled approximately \$119.1 million. Future sublease payments expected to be received related to these lease payments were \$94.3 million at December 31, 2010.

#### ***5.0% Convertible Notes***

The 5.0% Convertible Notes are convertible into shares of our Class A common stock, at the option of the holder, based on certain conditions. See Note 6, Long-Term Debt, to the accompanying Consolidated Financial Statements for a discussion regarding these conversion conditions, which are primarily linked to the per share price of our Class A common stock and the relationship between the trading values of our Class A common stock and the 5.0% Convertible Notes.

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

#### **Interest Rate Risk**

Our variable rate floor plan facilities, revolving credit 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 \$408.0 million at December 31, 2009 and approximately \$504.9 million at December 31, 2010. A change of 100 basis points in the underlying interest rate would have caused a change in interest expense of approximately \$5.1 million in 2009 and approximately \$4.6 million in 2010. Of the total change in interest expense, approximately \$4.5 million in both 2009 and 2010 would have resulted from the floor plan facilities.

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In addition to our variable rate debt, as of December 31, 2009 and 2010 approximately 20% of our dealership lease facilities have monthly lease payments that fluctuate based on LIBOR interest rates. An increase in interest rates of 100 basis points would not have had a significant impact on rent expense in 2010 due to the leases containing LIBOR floors which were above the LIBOR rate during 2010.

We also have the Fixed Swaps to effectively convert a portion of our LIBOR based variable rate debt to a fixed rate. Under the terms of the Fixed Swaps interest rates reset monthly. The fair value of these swap positions at December 31, 2010 was a liability of \$32.7 million included in Other Long-Term Liabilities in the accompanying Consolidated Balance Sheets. See the previous discussion of Interest Expense/Amortization, Non-Cash, Cash Flow Swaps in Item 7: *Management's Discussion and Analysis of Financial Condition and Results of Operations*. We will receive and pay interest based on the following:

| Notional<br>(In millions) | Pay Rate | Receive Rate(1) | Maturing Date      |
|---------------------------|----------|-----------------|--------------------|
| \$ 200.0                  | 4.935%   | one-month LIBOR | May 1, 2012        |
| \$ 100.0                  | 5.265%   | one-month LIBOR | June 1, 2012       |
| \$ 3.6                    | 7.100%   | one-month LIBOR | July 10, 2017      |
| \$ 25.0(2)                | 5.160%   | one-month LIBOR | September 1, 2012  |
| \$ 15.0(2)                | 4.965%   | one-month LIBOR | September 1, 2012  |
| \$ 25.0(2)                | 4.885%   | one-month LIBOR | October 1, 2012    |
| \$ 11.3                   | 4.655%   | one-month LIBOR | December 10, 2017  |
| \$ 8.7                    | 6.860%   | one-month LIBOR | August 1, 2017     |
| \$ 6.9                    | 4.330%   | one-month LIBOR | July 1, 2013       |
| \$ 100.0(3)               | 3.280%   | one-month LIBOR | July 1, 2015       |
| \$ 100.0(3)               | 3.300%   | one-month LIBOR | July 1, 2015       |
| \$ 7.3                    | 6.410%   | one-month LIBOR | September 12, 2017 |

(1) The one-month LIBOR rate was 0.261% at December 31, 2010.

(2) After December 31, 2009 changes in fair value are recorded through earnings.

(3) The effective date of these forward-starting swaps is July 2, 2012.

During the second quarter of 2010, we entered into two \$100.0 million notional forward-starting interest rate swap agreements which become effective in July 2012 and terminate in July 2015. These interest rate swaps have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of these swaps are recorded in other comprehensive income (loss), net of related income taxes, in the Consolidated Statements of Stockholders Equity.

During the first quarter of 2009, we settled our \$100.0 million notional, pay 5.002% and \$100.0 million notional, pay 5.319% swaps above with a payment to the counterparty for approximately \$16.5 million.

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Absent the acceleration of payments of principal that may result from non-compliance with financial and operational covenants under our various indebtedness, future principal maturities of variable and fixed rate debt and related interest rate swaps are as follows:

|          | 2011       | 2012       | 2013       | 2014<br>(\$ in thousands) | 2015       | Thereafter | Total      |
|----------|------------|------------|------------|---------------------------|------------|------------|------------|
| Debt:    |            |            |            |                           |            |            |            |
|          | \$ 5,623   | \$ 6,180   | \$ 49,542  | \$ 182,469                | \$ 7,003   | \$ 284,477 | \$ 535,294 |
| Interest | \$ 535,294 | \$ 529,671 | \$ 523,491 | \$ 473,949                | \$ 291,480 | \$ 284,477 |            |
| Debt     | 7.27%      | 7.27%      | 7.26%      | 7.12%                     | 8.36%      | 8.37%      |            |
| Debt     | \$ 2,826   | \$ 2,811   | \$ 8,561   | \$ 2,454                  | \$ 8,380   | \$ 20,607  | \$ 45,639  |
| Interest | \$ 45,639  | \$ 42,813  | \$ 40,002  | \$ 31,441                 | \$ 28,987  | \$ 20,607  |            |
| Debt     | 2.34%      | 2.35%      | 2.36%      | 2.27%                     | 2.28%      | 1.88%      |            |
| Fixed    | \$ 1,791   | \$ 366,836 | \$ 7,621   | \$ 1,536                  | \$ 1,597   | \$ 223,380 | \$ 602,761 |
| Fixed    | \$ 402,761 | \$ 35,946  | \$ 28,008  | \$ 26,513                 | \$ 24,977  | \$ 223,380 |            |
|          | 5.10%      | 5.69%      | 6.00%      | 6.00%                     | 6.01%      | 3.58%      |            |
|          | 1M LIBOR   | 1M LIBOR   | 1M LIBOR   | 1M LIBOR                  | 1M LIBOR   | 1M LIBOR   |            |

**Foreign Currency Risk**

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.

**Item 8. Financial Statements and Supplementary Data.**

See Consolidated Financial Statements and Notes that appears on page F-1 herein.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. *Controls and Procedures.***

**Controls and Procedures**

Our management, under the supervision and with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our principal executive officer and principal financial officer have concluded that the design and operation of our disclosure controls and procedures were effective as of the end of the period covered by this Annual Report on Form 10-K. During our last fiscal quarter, there were no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

**Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Our internal control over financial reporting is a process designed to provide a reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

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Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control – Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2010.

The effectiveness of our internal control over financial reporting as of December 31, 2010 has been attested to by Ernst & Young LLP, the independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, as stated in their report which is included herein.

**Item 9B. *Other Information.***

None.

**PART III**

**Item 10. *Directors, Executive Officers and Corporate Governance.***

Information required by this item is furnished by incorporation by reference to the information under the captions entitled Election of Directors, Election of Directors Board Meetings and Committees of the Board Audit Committee, Section 16(a) Beneficial Ownership Reporting Compliance, and Additional Corporate Governance and Other Information Corporate Governance Guidelines, Code of Business Conduct and Ethics and Committee Charters in the Proxy Statement (to be filed hereafter) for our Annual Meeting of the Stockholders to be held on April 21, 2011 (the Proxy Statement ). The information required by this item with respect to our executive officers appears in Part I of this Annual Report on Form 10-K under the caption Executive Officers of the Registrant.

**Item 11. *Executive Compensation.***

The information required by this item is furnished by incorporation by reference to the information under the captions entitled Executive Compensation and Director Compensation for 2010 in the Proxy Statement.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this item is furnished by incorporation by reference to the information under the caption General Ownership of Voting Stock and Equity Compensation Plan Information in the Proxy Statement.

**Item 13. *Certain Relationships and Related Transactions and Director Independence***

The information required by this item is furnished by incorporation by reference to all information under the captions Certain Transactions and Election of Directors Board and Committee Member Independence in the Proxy Statement.

**Item 14. *Principal Accountant Fees and Services.***

The information required by this item is furnished by incorporation by reference to the information under the caption Selection of Independent Registered Public Accounting Firm in the Proxy Statement.

**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedules.**

The exhibits and other documents filed as a part of this Annual Report on Form 10-K, including those exhibits that are incorporated by reference herein, are:

(a) (1) Financial Statements: Consolidated Balance Sheets as of December 31, 2009 and 2010. Consolidated Statements of Income for the Years Ended December 31, 2008, 2009 and 2010. Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2008, 2009 and 2010. Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2009 and 2010.

(2) Financial Statement Schedules: No financial statement schedules are required to be filed (no respective financial statement captions) as part of this Annual Report on Form 10-K.

(3) Exhibits: Exhibits required in connection with this Annual Report on Form 10-K are listed below. Certain of such exhibits, indicated by an asterisk, are hereby incorporated by reference to other documents on file with the SEC with which they are physically filed, to be a part hereof as of their respective dates.

**Exhibit****No.****Description**

- | <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 3.1*               | Amended and Restated Certificate of Incorporation of Sonic (incorporated by reference to Exhibit 3.1 to Sonic's Registration Statement on Form S-1 (Reg. No. 333-33295) (the "Form S-1")).  |
| 3.2*               | Certificate of Amendment to Sonic's Amended and Restated Certificate of Incorporation effective June 18, 1999 (incorporated by reference to Exhibit 3.2 to Sonic's Annual Report on Form 10-K for the year ended December 31, 1999 (the "1999 Form 10-K")).   |
| 3.3*               | Certificate of Designation, Preferences and Rights of Class A Convertible Preferred Stock (incorporated by reference to Exhibit 4.1 to Sonic's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998).   |
| 3.4*               | Amended and Restated Bylaws of Sonic (as amended February 9, 2006) (incorporated by reference to Exhibit 3.1 to Sonic's Current Report on Form 8-K filed February 13, 2006)).   |
| 4.1*               | Specimen Certificate representing Class A Common Stock (incorporated by reference to Exhibit 4.1 to the Form S-1)   |
| 4.2*               | Form of 85/8% Senior Subordinated Note due 2013, Series B (incorporated by reference to Exhibit 4.3 to Sonic's Registration Statement on Form S-4 (Reg. Nos. 333-109426 and 333-109426-1 through 109426-261) (the "2003 Exchange Offer Form S-4")).   |
| 4.3*               | Indenture dated as of August 12, 2003 among Sonic Automotive, Inc., as issuer, the subsidiaries of Sonic named therein, as guarantors, and U.S. Bank National Association, as trustee (the "Trustee"), relating to the 85/8% Senior Subordinated Notes due 2013 (incorporated by reference to Exhibit 4.4 to the 2003 Exchange Offer Form S-4). |
| 4.4*               | Form of 5.0% Convertible Senior Note due October 2029 (included in Exhibit 4.2 to the Current Report on Form 8-K filed September 25, 2009 (the "September 25, 2009 Form 8-K")).   |
| 4.5*               | Indenture dated as of September 23, 2009 (the "Base Indenture") by and among Sonic Automotive, Inc, the guarantors named therein, and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the September 25, 2009 Form 8-K).   |



- 4.6\* First Supplemental Indenture dated as of September 23, 2009 to the Base Indenture (incorporated by reference to Exhibit 4.2 to the September 2009 Form 8-K).
- 4.7\* Registration Rights Agreement dated as of March 12, 2010 by and among Sonic Automotive, Inc. the guarantors set forth on the signature page thereto and Banc of America Securities LLC, as representative of the several initial purchasers named on Schedule A to the Purchase Agreement (incorporated by reference to Exhibit 4.2 to the March 2010 Form 8-K).
- 4.8\* Indenture dated as of March 12, 2010 by and among Sonic Automotive, Inc, as issuer, the guarantors named therein, and U.S. Bank National Association, as trustee, relating to the 9.0% Senior Subordinated Notes due 2018 (incorporated by reference to Exhibit 4.2 to the March 2010 Form 8-K).
- 4.9\* Form of 9.0% Senior Subordinated Note due 2018 (included in Exhibit 4.2) to Exhibit 4.2 to the March 2010 Form 8-K).

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| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 10.1*              | Sonic Automotive, Inc. 2004 Stock Incentive Plan, Amended and Restated as of February 11, 2009 (incorporated by reference to Exhibit 4 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-159674))(1)  |
| 10.2*              | Sonic Automotive, Inc. 1997 Stock Option Plan, Amended and Restated as of April 22, 2003 (incorporated by reference to Exhibit 10.10 to Sonic's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003).(1)   |
| 10.3*              | Sonic Automotive, Inc. Employee Stock Purchase Plan, Amended and Restated as of May 8, 2002 (incorporated by reference to Exhibit 10.15 to the 2002 Annual Report).(1)  |
| 10.4*              | Sonic Automotive, Inc. Nonqualified Employee Stock Purchase Plan, Amended and Restated as of October 23, 2002 (incorporated by reference to Exhibit 10.16 to the 2002 Annual Report).(1)  |
| 10.5*              | Sonic Automotive, Inc. 2005 Formula Restricted Stock Plan for Non-Employee Directors, Amended and Restated as of May 11, 2009 (incorporated by reference to Exhibit 4 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-159675))(1)   |
| 10.6*              | Employment Agreement dated January 30, 2006 between Sonic and Mr. David P. Cosper (incorporated by reference to Exhibit 10.1 to Sonic's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the March 2006 Form 10-Q)).(1)  |
| 10.7*              | First Amendment to Employment Agreement dated January 30, 2006 between Sonic and Mr. David P. Cosper. (incorporated by reference to Exhibit 10.12 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).(1)   |
| 10.8*              | Sonic Automotive, Inc. 2004 Stock Incentive Plan Form of Performance-Based Restricted Stock Unit Award Agreement.(1)  |
| 10.9*              | Sonic Automotive, Inc. 2004 Stock Incentive Plan Form of Performance-Based Restricted Stock Award Agreement.(1)   |
| 10.10*             | Sonic Automotive, Inc. Incentive Compensation Plan, Amended and Restated as of December 4, 2008.(1)   |
| 10.11*             | Standard form of lease executed with Capital Automotive, L.P. or its affiliates (incorporated by reference to Exhibit 10.38 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).  |
| 10.12*             | Standard form of guaranty executed with Capital Automotive, L.P. or its affiliates (incorporated by reference to Exhibit 10.39 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).   |
| 10.13*             | Amendment to Guaranty and Subordination Agreements, dated as of January 1, 2005, by Sonic as Guarantor, to Capital Automotive, L.P. and affiliates, as Landlord (incorporated by reference to Exhibit 10.40 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).                      |
| 10.14*             | Second Amendment to Guaranty and Subordination Agreements, dated as of March 11, 2009, by Sonic as Guarantor, to Capital Automotive, L.P. and affiliates, as Landlord. (incorporated by reference to Exhibit 10.41 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).               |
| 10.15*             | Side letter to Second Amendment to Guaranty and Subordination Agreements, dated as of March 11, 2009, by Sonic as Guarantor, to Capital Automotive, L.P. and affiliates, as Landlord. (incorporated by reference to Exhibit 10.42 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008) |
| 10.16*             | Sonic Automotive, Inc. 2004 Stock Incentive Plan, Amended and Restated as of February 11, 2009 (incorporated by reference to Exhibit 4 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-159674))(1)  |
| 10.17*             |   |

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Underwriting Agreement (Class A common stock) dated as of September 17, 2009 by and among Sonic Automotive, Inc. and J.P. Morgan Securities, Inc. and Merrill Lynch, Pierce, Fenner & Smith, Incorporated, as representatives of the several underwriters named therein (incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K filed September 23, 2009 (the September 23, 2009 Form 8-K )).

- 10.18\* Underwriting Agreement (convertible senior notes) dated as of September 17, 2009 by and among Sonic Automotive, Inc. and J.P. Morgan Securities, Inc. and Merrill Lynch, Pierce, Fenner & Smith, Incorporated, as representatives of the several underwriters named therein (incorporated by reference to Exhibit 1.2 to the September 23, 2009 Form 8-K).

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| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 10.19*             | Amendment No. 1 to Sonic Automotive, Inc. Formula Stock Option Plan for Independent Directors.(1)  |
| 10.20*             | Sonic Automotive, Inc. Incentive Compensation Plan Amended and Restated as of December 4, 2008.(1)   |
| 10.21*             | Amended and Restated Credit Agreement, dated as of January 15, 2010, among Sonic Automotive, Inc.; each lender; Bank of America, N.A, as Administrative Agent, Swing Line Lender and an L/C Issuer;; and Wells Fargo Bank, National Association, as an L/C Issuer.   |
| 10.22*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Bank of America, N.A., pursuant to the Credit Agreement.  |
| 10.23*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of DCFS USA LLC, pursuant to the Credit Agreement.   |
| 10.24*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of BMW Financial Services NA, LLC, pursuant to the Credit Agreement.   |
| 10.25*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Toyota Motor Credit Corporation, pursuant to the Credit Agreement.  |
| 10.26*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of JPMorgan Chase Bank, N.A., pursuant to the Credit Agreement.  |
| 10.27*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Wachovia Bank, National Association, pursuant to the Credit Agreement.  |
| 10.28*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Comerica Bank, pursuant to the Credit Agreement.  |
| 10.29*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of World Omni Financial Corp., pursuant to the Credit Agreement.   |
| 10.30*             | Amended and Restated Subsidiary Guaranty Agreement, dated as of January 15, 2010, by the Revolving Subsidiary Guarantor, as Guarantors, to Bank of America, N.A, as administrative agent for the lenders.  |
| 10.31*             | Amended and Restated Securities Pledge Agreement, dated as of January 15, 2010, by Sonic Automotive, Inc., the subsidiaries of Sonic named therein and Bank of America, N.A., as administrative agent for the lenders.   |
| 10.32*             | Amended and Restated Escrow and Security Agreement, dated as of January 15, 2010, by Sonic Automotive, Inc., the subsidiaries of Sonic named therein and Bank of America, N.A., as administrative agent for the lenders.   |
| 10.33*             | Amended and Restated Securities Pledge Agreement, dated as of January 15, 2010, by Sonic Financial Corporation and Bank of America, N.A., as administrative agent for the lenders.   |
| 10.34*             | Amended and Restated Security Agreement, dated as of January 15, 2010, by Sonic Automotive, Inc., the subsidiaries of Sonic named therein and Bank of America, N.A., as administrative agent for the lenders.  |
| 10.35*             | Syndicated New and Used Vehicle Floor Plan Credit Agreement, dated January 15, 2010, among Sonic Automotive, Inc.; certain subsidiaries of the Company; each lender; Bank of America, N.A., as Administrative Agent, New Vehicle Swing Line Lender and Used Vehicle Swing Line Lender; and Bank of America, N.A., as Revolving Administrative Agent. |
| 10.36*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Bank of America, N.A., pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.   |
| 10.37*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of JPMorgan Chase Bank, N.A., pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.   |
| 10.38*             |  |

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- Promissory Note, dated January 15, 2010, executed by Sonic in favor of Wachovia Bank, National Association, pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.
- 10.39\* Promissory Note, dated January 15, 2010, executed by Sonic in favor of Comerica Bank, pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.
- 10.40\* Company Guaranty Agreement, dated January 15, 2010, by Sonic Automotive, Inc. and Bank of America, N.A., as administrative agent for the lenders.
- 10.41\* Subsidiary Guaranty Agreement, dated as of January 15, 2010, by the Floor Plan Subsidiary Guarantor, as Guarantors, to Bank of America, N.A, as administrative agent for the lenders.

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| <b>Exhibit<br/>No.</b> | <b>Description</b>  |
|------------------------|---|
| 10.42*                 | Promissory Note, dated August 12, 2010, executed by Sonic in favor of VW Credit, Inc., pursuant to the Credit Agreement.  |
| 10.43*                 | Purchase Agreement (the Purchase Agreement ) dated as of March 9, 2010 by and among Sonic Automotive, Inc., the guarantors named therein and Banc of America Securities LLC on behalf of itself and as representative of the initial purchasers named therein (incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K filed March 15, 2010 (the March 2010 Form 8-K )). |
| 10.44*                 | Amendment No. 1 to Amended and Restated Credit Agreement dated as of February 25, 2010 by and among Sonic Automotive, Inc., Bank of America, N.A. and each of the Subsidiary Guarantors signatory thereto (incorporated by reference to Exhibit 10.22 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 (the March 2010 Form 10-Q )).                               |
| 10.45*                 | Amendment No. 1 to the Syndicated New and Used Vehicle Floorplan Credit Agreement dated February 25, 2010 by and among Sonic Automotive, Inc., certain of its subsidiaries party to the Credit Agreement and Bank of America, N.A. (incorporated by reference to Exhibit 10.23 to the March 2010 Form 10-Q).  |
| 10.46                  | Sonic Automotive, Inc. Supplemental Executive Retirement Plan effective January 1, 2010.(1)   |
| 10.47                  | First Amendment to Sonic Automotive, Inc. Supplemental Executive Retirement Plan effective December 29, 2010.(1)  |
| 12.1                   | Computation of Ratio of Earnings to Fixed Charges.  |
| 21.1                   | Subsidiaries of Sonic.  |
| 23.1                   | Consent of Ernst & Young LLP.   |
| 31.1                   | Certification of Mr. David P. Cospers pursuant to Rule 13a-14(a).   |
| 31.2                   | Certification of Mr. O. Bruton Smith pursuant to Rule 13a-14(a).  |
| 32.1                   | Certification of Mr. David P. Cospers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2                   | Certification of Mr. O. Bruton Smith pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |

\* Filed Previously

(1) Indicates a management contract or compensatory plan or arrangement.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**SONIC AUTOMOTIVE, INC.**

BY /s/ DAVID P. COSPER

Mr. David P. Cosper  
Vice Chairman and Chief Financial Officer  
Date: February 24, 2011

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b><u>Signature</u></b>                    | <b><u>Title</u></b>  | <b><u>Date</u></b> |
|--|--|--------------------|
| /s/ O. BRUTON SMITH<br>O. Bruton Smith     | Chairman, Chief Executive Officer<br>(principal executive officer) and Director                                | February 24, 2011  |
| /s/ B. SCOTT SMITH<br>B. Scott Smith       | President, Chief Strategic Officer and<br>Director   | February 24, 2011  |
| /s/ DAVID P. COSPER<br>David P. Cosper     | Vice Chairman and Chief Financial Officer<br>(principal financial officer and principal<br>accounting officer) | February 24, 2011  |
| /s/ DAVID B. SMITH<br>David B. Smith       | Executive Vice President and Director  | February 24, 2011  |
| /s/ WILLIAM R. BROOKS<br>William R. Brooks | Director   | February 24, 2011  |
| /s/ WILLIAM I. BELK<br>William I. Belk     | Director   | February 24, 2011  |
| /s/ ROBERT HELLER<br>Robert Heller         | Director   | February 12, 2011  |

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|                      |          |                   |
|----------------------|----------|-------------------|
| /s/ ROBERT L. REWEY  | Director | February 24, 2011 |
| Robert L. Rewey      |          |                   |
| /s/ VICTOR H. DOOLAN | Director | February 24, 2011 |
| Victor H. Doolan     |          |                   |
| /s/ DAVID C. VORHOFF | Director | February 24, 2011 |
| David C. Vorhoff     |          |                   |



**Table of Contents****EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 3.1*               | Amended and Restated Certificate of Incorporation of Sonic (incorporated by reference to Exhibit 3.1 to Sonic's Registration Statement on Form S-1 (Reg. No. 333-33295) (the Form S-1)).   |
| 3.2*               | Certificate of Amendment to Sonic's Amended and Restated Certificate of Incorporation effective June 18, 1999 (incorporated by reference to Exhibit 3.2 to Sonic's Annual Report on Form 10-K for the year ended December 31, 1999 (the 1999 Form 10-K)).  |
| 3.3*               | Certificate of Designation, Preferences and Rights of Class A Convertible Preferred Stock (incorporated by reference to Exhibit 4.1 to Sonic's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998).  |
| 3.4*               | Amended and Restated Bylaws of Sonic (as amended February 9, 2006) (incorporated by reference to Exhibit 3.1 to Sonic's Current Report on Form 8-K filed February 13, 2006)).  |
| 4.1*               | Specimen Certificate representing Class A Common Stock (incorporated by reference to Exhibit 4.1 to the Form S-1)  |
| 4.2*               | Form of 85/8% Senior Subordinated Note due 2013, Series B (incorporated by reference to Exhibit 4.3 to Sonic's Registration Statement on Form S-4 (Reg. Nos. 333-109426 and 333-109426-1 through 109426-261) (the 2003 Exchange Offer Form S-4)).  |
| 4.3*               | Indenture dated as of August 12, 2003 among Sonic Automotive, Inc., as issuer, the subsidiaries of Sonic named therein, as guarantors, and U.S. Bank National Association, as trustee (the Trustee), relating to the 85/8% Senior Subordinated Notes due 2013 (incorporated by reference to Exhibit 4.4 to the 2003 Exchange Offer Form S-4).                    |
| 4.4*               | Form of 5.0% Convertible Senior Note due October 2029 (included in Exhibit 4.2 to the Current Report on Form 8-K filed September 25, 2009 (the September 25, 2009 Form 8-K)).  |
| 4.5*               | Indenture dated as of September 23, 2009 (the Base Indenture) by and among Sonic Automotive, Inc, the guarantors named therein, and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the September 25, 2009 Form 8-K).  |
| 4.6*               | First Supplemental Indenture dated as of September 23, 2009 to the Base Indenture (incorporated by reference to Exhibit 4.2 to the September 2009 Form 8-K).   |
| 4.7*               | Registration Rights Agreement dated as of March 12, 2010 by and among Sonic Automotive, Inc. the guarantors set forth on the signature page thereto and Banc of America Securities LLC, as representative of the several initial purchasers named on Schedule A to the Purchase Agreement (incorporated by reference to Exhibit 4.2 to the March 2010 Form 8-K). |
| 4.8*               | Indenture dated as of March 12, 2010 by and among Sonic Automotive, Inc, as issuer, the guarantors named therein, and U.S. Bank National Association, as trustee, relating to the 9.0% Senior Subordinated Notes due 2018 (incorporated by reference to Exhibit 4.2 to the March 2010 Form 8-K).   |
| 4.9*               | Form of 9.0% Senior Subordinated Note due 2018 (included in Exhibit 4.2) to Exhibit 4.2 to the March 2010 Form 8-K).   |
| 10.1*              | Sonic Automotive, Inc. 2004 Stock Incentive Plan, Amended and Restated as of February 11, 2009 (incorporated by reference to Exhibit 4 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-159674))(1)   |
| 10.2*              | Sonic Automotive, Inc. 1997 Stock Option Plan, Amended and Restated as of April 22, 2003 (incorporated by reference to Exhibit 10.10 to Sonic's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003).(1)  |
| 10.3*              | Sonic Automotive, Inc. Employee Stock Purchase Plan, Amended and Restated as of May 8, 2002 (incorporated by reference to Exhibit 10.15 to the 2002 Annual Report).(1)   |

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- 10.4\* Sonic Automotive, Inc. Nonqualified Employee Stock Purchase Plan, Amended and Restated as of October 23, 2002 (incorporated by reference to Exhibit 10.16 to the 2002 Annual Report).(1)
- 10.5\* Sonic Automotive, Inc. 2005 Formula Restricted Stock Plan for Non-Employee Directors, Amended and Restated as of May 11, 2009 (incorporated by reference to Exhibit 4 to Sonic s Registration Statement on Form S-8 (Reg. No. 333-159675))(1)

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| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 10.6*              | Employment Agreement dated January 30, 2006 between Sonic and Mr. David P. Cospers (incorporated by reference to Exhibit 10.1 to Sonic's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the March 2006 Form 10-Q)).(1)  |
| 10.7*              | First Amendment to Employment Agreement dated January 30, 2006 between Sonic and Mr. David P. Cospers. (incorporated by reference to Exhibit 10.12 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008)(1)  |
| 10.8*              | Sonic Automotive, Inc. 2004 Stock Incentive Plan Form of Performance-Based Restricted Stock Unit Award Agreement.(1)   |
| 10.9*              | Sonic Automotive, Inc. 2004 Stock Incentive Plan Form of Performance-Based Restricted Stock Award Agreement.(1)  |
| 10.10*             | Sonic Automotive, Inc. Incentive Compensation Plan, Amended and Restated as of December 4, 2008.(1)  |
| 10.11*             | Standard form of lease executed with Capital Automotive, L.P. or its affiliates (incorporated by reference to Exhibit 10.38 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).   |
| 10.12*             | Standard form of guaranty executed with Capital Automotive, L.P. or its affiliates (incorporated by reference to Exhibit 10.39 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).  |
| 10.13*             | Amendment to Guaranty and Subordination Agreements, dated as of January 1, 2005, by Sonic as Guarantor, to Capital Automotive, L.P. and affiliates, as Landlord (incorporated by reference to Exhibit 10.40 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).   |
| 10.14*             | Second Amendment to Guaranty and Subordination Agreements, dated as of March 11, 2009, by Sonic as Guarantor, to Capital Automotive, L.P. and affiliates, as Landlord. (incorporated by reference to Exhibit 10.41 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008).  |
| 10.15*             | Side letter to Second Amendment to Guaranty and Subordination Agreements, dated as of March 11, 2009, by Sonic as Guarantor, to Capital Automotive, L.P. and affiliates, as Landlord. (incorporated by reference to Exhibit 10.42 to Sonic's Annual Report on Form 10-K for the year ended December 31, 2008)  |
| 10.16*             | Sonic Automotive, Inc. 2004 Stock Incentive Plan, Amended and Restated as of February 11, 2009 (incorporated by reference to Exhibit 4 to Sonic's Registration Statement on Form S-8 (Reg. No. 333-159674)).(1)  |
| 10.17*             | Underwriting Agreement (Class A common stock) dated as of September 17, 2009 by and among Sonic Automotive, Inc. and J.P. Morgan Securities, Inc. and Merrill Lynch, Pierce, Fenner & Smith, Incorporated, as representatives of the several underwriters named therein (incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K filed September 17, 2009 (the September 23, 2009 Form 8-K)). |
| 10.18*             | Underwriting Agreement (convertible senior notes) dated as of September 17, 2009 by and among Sonic Automotive, Inc. and J.P. Morgan Securities, Inc. and Merrill Lynch, Pierce, Fenner & Smith, Incorporated, as representatives of the several underwriters named therein (incorporated by reference to Exhibit 1.2 to the September 23, 2009 Form 8-K).   |
| 10.19*             | Amendment No. 1 to Sonic Automotive, Inc. Formula Stock Option Plan for Independent Directors.(1)  |
| 10.20*             | Sonic Automotive, Inc. Incentive Compensation Plan Amended and Restated as of December 4, 2008.(1)   |
| 10.21*             | Amended and Restated Credit Agreement, dated as of January 15, 2010, among Sonic Automotive, Inc.; each lender; Bank of America, N.A, as Administrative Agent, Swing Line Lender and an L/C Issuer;  |

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and Wells Fargo Bank, National Association, as an L/C Issuer.

- 10.22\* Promissory Note, dated January 15, 2010, executed by Sonic in favor of Bank of America, N.A., pursuant to the Credit Agreement.
- 10.23\* Promissory Note, dated January 15, 2010, executed by Sonic in favor of DCFS USA LLC, pursuant to the Credit Agreement.
- 10.24\* Promissory Note, dated January 15, 2010, executed by Sonic in favor of BMW Financial Services NA, LLC, pursuant to the Credit Agreement.
- 10.25\* Promissory Note, dated January 15, 2010, executed by Sonic in favor of Toyota Motor Credit Corporation, pursuant to the Credit Agreement.

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| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 10.26*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of JPMorgan Chase Bank, N.A., pursuant to the Credit Agreement.   |
| 10.27*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Wachovia Bank, National Association, pursuant to the Credit Agreement.   |
| 10.28*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Comerica Bank, pursuant to the Credit Agreement.   |
| 10.29*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of World Omni Financial Corp., pursuant to the Credit Agreement.  |
| 10.30*             | Amended and Restated Subsidiary Guaranty Agreement, dated as of January 15, 2010, by the Revolving Subsidiary Guarantor, as Guarantors, to Bank of America, N.A, as administrative agent for the lenders.   |
| 10.31*             | Amended and Restated Securities Pledge Agreement, dated as of January 15, 2010, by Sonic Automotive, Inc., the subsidiaries of Sonic named therein and Bank of America, N.A., as administrative agent for the lenders.  |
| 10.32*             | Amended and Restated Escrow and Security Agreement, dated as of January 15, 2010, by Sonic Automotive, Inc., the subsidiaries of Sonic named therein and Bank of America, N.A., as administrative agent for the lenders.  |
| 10.33*             | Amended and Restated Securities Pledge Agreement, dated as of January 15, 2010, by Sonic Financial Corporation and Bank of America, N.A., as administrative agent for the lenders.  |
| 10.34*             | Amended and Restated Security Agreement, dated as of January 15, 2010, by Sonic Automotive, Inc., the subsidiaries of Sonic named therein and Bank of America, N.A., as administrative agent for the lenders.   |
| 10.35*             | Syndicated New and Used Vehicle Floor Plan Credit Agreement, dated January 15, 2010, among Sonic Automotive, Inc.; certain subsidiaries of the Company; each lender; Bank of America, N.A., as Administrative Agent, New Vehicle Swing Line Lender and Used Vehicle Swing Line Lender; and Bank of America, N.A., as Revolving Administrative Agent.  |
| 10.36*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Bank of America, N.A., pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.  |
| 10.37*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of JPMorgan Chase Bank, N.A., pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.  |
| 10.38*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Wachovia Bank, National Association, pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.  |
| 10.39*             | Promissory Note, dated January 15, 2010, executed by Sonic in favor of Comerica Bank, pursuant to the Syndicated New and Used Vehicle Floor Plan Credit Agreement.  |
| 10.40*             | Company Guaranty Agreement, dated January 15, 2010, by Sonic Automotive, Inc. and Bank of America, N.A., as administrative agent for the lenders.   |
| 10.41*             | Subsidiary Guaranty Agreement, dated as of January 15, 2010, by the Floor Plan Subsidiary Guarantor, as Guarantors, to Bank of America, N.A, as administrative agent for the lenders.   |
| 10.42*             | Promissory Note, dated August 12, 2010, executed by Sonic in favor of VW Credit, Inc., pursuant to the Credit Agreement.  |
| 10.43*             | Purchase Agreement (the Purchase Agreement ) dated as of March 9, 2010 by and among Sonic Automotive, Inc., the guarantors named therein and Banc of America Securities LLC on behalf of itself and as representative of the initial purchasers named therein (incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K filed March 15, 2010 (the March 2010 Form 8-K )). |
| 10.44*             |   |

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Amendment No. 1 to Amended and Restated Credit Agreement dated as of February 25, 2010 by and among Sonic Automotive, Inc., Bank of America, N.A. and each of the Subsidiary Guarantors signatory thereto (incorporated by reference to Exhibit 10.22 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 (the March 2010 Form 10-Q ).

10.45\* Amendment No. 1 to the Syndicated New and Used Vehicle Floorplan Credit Agreement dated February 25, 2010 by and among Sonic Automotive, Inc., certain of its subsidiaries party to the Credit Agreement and Bank of America, N.A. (incorporated by reference to Exhibit 10.23 to the March 2010 Form 10-Q).

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| <b>Exhibit<br/>No.</b> | <b>Description</b>  |
|------------------------|---|
| 10.46                  | Sonic Automotive, Inc. Supplemental Executive Retirement Plan effective January 1, 2010.(1)   |
| 10.47                  | First Amendment to Sonic Automotive, Inc. Supplemental Executive Retirement Plan effective December 29, 2010.(1)                                |
| 12.1                   | Computation of Ratio of Earnings to Fixed Charges.  |
| 21.1                   | Subsidiaries of Sonic.  |
| 23.1                   | Consent of Ernst & Young LLP.   |
| 31.1                   | Certification of Mr. David P. Cospers pursuant to Rule 13a-14(a).   |
| 31.2                   | Certification of Mr. O. Bruton Smith pursuant to Rule 13a-14(a).  |
| 32.1                   | Certification of Mr. David P. Cospers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2                   | Certification of Mr. O. Bruton Smith pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |

\* Filed Previously

(1) Indicates a management contract or compensatory plan or arrangement.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders of Sonic Automotive, Inc.

We have audited the accompanying consolidated balance sheets of Sonic Automotive, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. 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, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sonic Automotive, Inc. and subsidiaries at December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Sonic Automotive, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2011 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Charlotte, North Carolina  
February 24, 2011



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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders of Sonic Automotive, Inc. and subsidiaries

We have audited Sonic Automotive, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Sonic Automotive, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Sonic Automotive, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Sonic Automotive, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010, and our report dated February 24, 2011 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Charlotte, North Carolina  
February 24, 2011



**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****December 31, 2009 and 2010**

|  | <b>December 31,</b>           |              |
|--|-------------------------------|--------------|
|  | <b>2009</b>                   | <b>2010</b>  |
|  | <b>(Dollars in thousands)</b> |              |
| <b>ASSETS</b>  |                               |              |
| Current Assets:  |                               |              |
| Cash and cash equivalents  | \$ 30,035                     | \$ 21,842    |
| Receivables, net   | 232,969                       | 239,634      |
| Inventories  | 795,275                       | 903,221      |
| Assets held for sale   | 12,167                        | 2,020        |
| Other current assets   | 14,937                        | 23,633       |
| Total current assets   | 1,085,383                     | 1,190,350    |
| Property and Equipment, net  | 382,085                       | 436,260      |
| Goodwill   | 469,482                       | 468,516      |
| Other Intangible Assets, net   | 80,806                        | 79,149       |
| Other Assets   | 51,099                        | 76,489       |
| Total Assets   | \$ 2,068,855                  | \$ 2,250,764 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                               |              |
| Current Liabilities:   |                               |              |
| Notes payable floor plan trade   | \$ 214,871                    | \$ 478,834   |
| Notes payable floor plan non-trade   | 548,493                       | 383,151      |
| Trade accounts payable   | 55,345                        | 59,719       |
| Accrued interest   | 16,146                        | 14,070       |
| Other accrued liabilities  | 144,709                       | 160,763      |
| Liabilities associated with assets held for sale non-trade   | 3,346                         |              |
| Current maturities of long-term debt   | 23,991                        | 9,050        |
| Total current liabilities  | 1,006,901                     | 1,105,587    |
| Long-Term Debt   | 552,150                       | 546,401      |
| Other Long-Term Liabilities  | 141,052                       | 134,081      |
| Commitments and Contingencies  |                               |              |
| Stockholders Equity:   |                               |              |
| Class A convertible preferred stock, none issued   |                               |              |
| Class A common stock, \$.01 par value; 100,000,000 shares authorized;<br>54,986,875 shares issued and 40,099,559 shares outstanding at December 31, 2009;<br>55,738,639 shares issued and 40,757,999 shares outstanding at December 31, 2010 | 550                           | 557          |
| Class B common stock; \$.01 par value; 30,000,000 shares authorized;<br>12,029,375 shares issued and outstanding at December 31, 2009 and December 31,<br>2010   | 121                           | 121          |

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|   |              |              |
|---|--------------|--------------|
| Paid-in capital   | 662,186      | 666,961      |
| Retained earnings (accumulated deficit)   | (35,180)     | 53,427       |
| Accumulated other comprehensive loss  | (22,350)     | (18,683)     |
| Treasury stock, at cost (14,887,316 Class A shares held at December 31, 2009 and 14,980,640 Class A shares held at December 31, 2010) | (236,575)    | (237,688)    |
| Total stockholders' equity  | 368,752      | 464,695      |
| Total Liabilities and Stockholders' Equity  | \$ 2,068,855 | \$ 2,250,764 |

See notes to Consolidated Financial Statements.

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****Years Ended December 31, 2008, 2009 and 2010**

|  | <b>Year Ended December 31,</b>   |                 |                 |
|--|--|-----------------|-----------------|
|  | <b>2008</b>  | <b>2009</b>     | <b>2010</b>     |
|  | <b>(Dollars and shares in thousands,<br/>except per share amounts)</b> |                 |                 |
| Revenues:  |  |                 |                 |
| New vehicles   | \$ 4,009,496   | \$ 3,229,948    | \$ 3,646,200    |
| Used vehicles  | 1,342,486  | 1,451,870       | 1,776,581       |
| Wholesale vehicles   | 272,172  | 147,002         | 149,041         |
| <br>Total vehicles   | <br>5,624,154  | <br>4,828,820   | <br>5,571,822   |
| Parts, service and collision repair                        | 1,095,774  | 1,071,825       | 1,128,054       |
| Finance, insurance and other                               | 180,274  | 154,696         | 180,968         |
| <br>Total revenues   | <br>6,900,202  | <br>6,055,341   | <br>6,880,844   |
| Cost of Sales:   |  |                 |                 |
| New vehicles   | (3,744,533)  | (3,010,790)     | (3,409,129)     |
| Used vehicles  | (1,223,409)  | (1,327,878)     | (1,636,961)     |
| Wholesale vehicles   | (278,364)  | (152,487)       | (154,082)       |
| <br>Total vehicles   | <br>(5,246,306)  | <br>(4,491,155) | <br>(5,200,172) |
| Parts, service and collision repair                        | (546,698)  | (531,514)       | (565,994)       |
| <br>Total cost of sales                                    | <br>(5,793,004)  | <br>(5,022,669) | <br>(5,766,166) |
| Gross profit   | 1,107,198  | 1,032,672       | 1,114,678       |
| Selling, general and administrative expenses               | (906,243)  | (829,220)       | (896,697)       |
| Impairment charges   | (812,004)  | (23,460)        | (249)           |
| Depreciation and amortization                              | (32,734)   | (34,879)        | (35,110)        |
| <br>Operating income (loss)                                | <br>(643,783)  | <br>145,113     | <br>182,622     |
| Other income (expense):                                    |  |                 |                 |
| Interest expense, floor plan                               | (43,392)   | (19,812)        | (21,536)        |
| Interest expense, other, net                               | (58,980)   | (78,284)        | (63,343)        |
| Interest expense, non-cash, convertible debt               | (10,704)   | (679)           | (6,914)         |
| Interest expense / amortization, non-cash, cash flow swaps |  | (11,769)        | (4,883)         |
| Other income (expense), net                                | 742  | (6,677)         | (7,525)         |
| <br>Total other expense                                    | <br>(112,334)  | <br>(117,221)   | <br>(104,201)   |
| <br>Income (loss) from continuing operations before taxes  | <br>(756,117)  | <br>27,892      | <br>78,421      |
| Provision for income taxes benefit (expense)               | 122,340  | 29,275          | 17,504          |
| <br>Income (loss) from continuing operations               | <br>(633,777)  | <br>57,167      | <br>95,925      |

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|  |              |           |           |
|--|--------------|-----------|-----------|
| Discontinued operations:                                     |              |           |           |
| Loss from operations and the sale of discontinued franchises | (75,515)     | (50,244)  | (8,237)   |
| Income tax benefit   | 16,943       | 24,625    | 2,241     |
| Loss from discontinued operations                            | (58,572)     | (25,619)  | (5,996)   |
| Net income (loss)  | \$ (692,349) | \$ 31,548 | \$ 89,929 |
| Basic earnings (loss) per common share:                      |              |           |           |
| Earnings (loss) per share from continuing operations         | \$ (15.70)   | \$ 1.29   | \$ 1.82   |
| Loss per share from discontinued operations                  | (1.46)       | (0.58)    | (0.12)    |
| Earnings (loss) per common share                             | \$ (17.16)   | \$ 0.71   | \$ 1.70   |
| Weighted average common shares outstanding                   | 40,356       | 43,836    | 52,214    |
| Diluted earnings (loss) per common share:                    |              |           |           |
| Earnings (loss) per share from continuing operations         | \$ (15.70)   | \$ 1.07   | \$ 1.58   |
| Loss per share from discontinued operations                  | (1.46)       | (0.45)    | (0.09)    |
| Earnings (loss) per common share                             | \$ (17.16)   | \$ 0.62   | \$ 1.49   |
| Weighted average common shares outstanding                   | 40,356       | 55,832    | 65,794    |
| Dividends declared per common share                          | \$ 0.48      | \$        | \$ 0.025  |

See notes to Consolidated Financial Statements

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

Years Ended December 31, 2008, 2009 and 2010

|  | Class A                |        | Class B                |        | Paid-In<br>Capital | Retained<br>Earnings /<br>(Deficit) | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensiv<br>(Loss)/Income | Total<br>Stockholders'<br>Equity | Con<br>her<br>Inc<br>(L |
|--|------------------------|--------|------------------------|--------|--------------------|-------------------------------------|-------------------|---|----------------------------------|-------------------------|
|  | Common Stock<br>Shares | Amount | Common Stock<br>Shares | Amount |                    |                                     |                   |   |                                  |                         |
| ANCE AT<br>MBER 31,  | 42,414                 | \$ 424 | 12,029                 | \$ 121 | \$ 523,020         | \$ 644,399                          | \$ (207,866)      | \$ (15,114)   | \$ 944,984                       | \$                      |
| warded<br>ock<br>sation  | 509                    | 5      |                        |        | 5,144              |                                     |                   |   | 5,149                            |                         |
| es of<br>stock<br>tax benefit<br>ed with                                 |                        |        |                        |        |                    |                                     | (28,648)          |   | (28,648)                         |                         |
| sation   |                        |        |                        |        | 607                |                                     |                   |   | 607                              |                         |
| tax benefit<br>ed with<br>ble note                                       |                        |        |                        |        | 2,120              |                                     |                   |   | 2,120                            |                         |
| ue of<br>rate swap<br>ents, net of<br>fit of                             |                        |        |                        |        |                    |                                     |                   | (21,835)  | (21,835)                         | (                       |
| zed gain on<br>e-for-sale<br>s, net of<br>fit of \$193<br>ased<br>sation |                        |        |                        |        |                    |                                     |                   | 314   | 314                              |                         |
| ed stock<br>ation  |                        |        |                        |        | 2,211              |                                     |                   |   | 2,211                            |                         |
| ds (\$0.48<br>e)   |                        |        |                        |        | 3,920              | (692,349)                           |                   |   | 3,920<br>(692,349)               | (6                      |
|  |                        |        |                        |        |                    | (18,950)                            |                   |   | (18,950)                         |                         |





|  |        |        |        |        |            |    |        |              |             |         |         |    |         |
|--|--------|--------|--------|--------|------------|----|--------|--------------|-------------|---------|---------|----|---------|
| awarded<br>stock<br>sation                         |        |        |        |        |            |    |        |              |             |         |         |    |         |
| es of<br>stock<br>tax benefit<br>ed with<br>sation |        |        |        |        |            |    |        |              |             | (1,113) |         |    | (1,113) |
| tax benefit<br>ed with<br>ble note                 |        |        |        |        |            |    |        |              |             |         |         |    | (12)    |
| ue of<br>rate swap<br>ents, net of<br>nse of       |        |        |        |        |            |    |        |              |             |         |         |    | 239     |
| ased<br>sation                                     |        |        |        |        |            |    |        |              |             |         |         |    | 3,667   |
| ed stock<br>ation                                  |        |        |        |        |            |    |        |              |             |         |         |    | 513     |
| ome<br>ds (\$0.025<br>e)                           | 356    | 3      |        |        |            |    |        |              |             |         |         |    | 2,301   |
|  |        |        |        |        |            |    |        |              |             |         |         |    | (3)     |
|  |        |        |        |        |            |    |        |              |             |         |         |    | 89,929  |
|  |        |        |        |        |            |    |        |              |             |         |         |    | (1,322) |
| CE AT<br>MBER 31,                                  | 55,739 | \$ 557 | 12,029 | \$ 121 | \$ 666,961 | \$ | 53,427 | \$ (237,688) | \$ (18,683) | \$      | 464,695 | \$ | 9       |

See notes to Consolidated Financial Statements

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | <b>Year Ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2008</b>                    | <b>2009</b> | <b>2010</b> |
|   | <b>(Dollars in thousands)</b>  |             |             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                                |             |             |
| Net (loss) income   | \$ (692,349)                   | \$ 31,548   | \$ 89,929   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |             |             |
| Depreciation and amortization of property, plant and equipment                    | 36,378                         | 36,091      | 35,292      |
| Provision for bad debt expense  | 2,488                          | 1,491       | 1,449       |
| Other amortization  | 1,912                          | 1,656       | 1,656       |
| Debt issuance cost amortization   | 1,256                          | 13,435      | 3,685       |
| Debt discount amortization, net of premium amortization                           | 11,712                         | 11,755      | 5,195       |
| Stock based compensation expense  | 2,211                          | 603         | 513         |
| Amortization of restricted stock  | 5,280                          | 1,511       | 2,301       |
| Restricted stock forfeiture   | (1,360)                        | (182)       |             |
| Deferred income taxes   | (253,846)                      | 23,153      | 22,057      |
| Valuation allowance deferred income taxes   | 108,421                        | (53,743)    | (50,388)    |
| Equity interest in earnings of investees  | (399)                          | (713)       | (752)       |
| Asset impairment charges  | 851,655                        | 30,038      | 249         |
| Loss (gain) on disposal of franchises and property and equipment                  | 1,604                          | (804)       | (1,249)     |
| Loss on exit of leased dealerships  | 18,037                         | 33,013      | 4,266       |
| (Gain) loss on retirement of debt   | (647)                          | 6,745       | 7,665       |
| Derivative liability fair value adjustments                                       |                                | (11,300)    |             |
| Non-cash adjustments cash flow swaps  |                                | 11,769      | 4,883       |
| Changes in assets and liabilities that relate to operations:                      |                                |             |             |
| Receivables   | 101,126                        | 23,424      | (8,114)     |
| Inventories   | 5,204                          | 307,803     | (121,935)   |
| Other assets  | 9,909                          | (1,393)     | (21,315)    |
| Notes payable floor plan trade  | (49,590)                       | (58,972)    | 263,963     |
| Trade accounts payable and other liabilities                                      | (38,363)                       | (3,347)     | 15,689      |
| Total adjustments   | 812,988                        | 372,033     | 165,110     |
| Net cash provided by operating activities   | 120,639                        | 403,581     | 255,039     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                                |             |             |
| Purchase of businesses, net of cash acquired                                      | (22,945)                       |             |             |
| Purchases of land, property and equipment   | (137,094)                      | (43,277)    | (85,194)    |
| Proceeds from sales of property and equipment                                     | 6,295                          | 6,018       | 1,214       |
| Proceeds from sale of franchises  | 37,803                         | 27,276      | 24,720      |
| Distributions from equity investees   | 600                            | 300         | 600         |
| Net cash used in investing activities   | (115,341)                      | (9,683)     | (58,660)    |

**CASH FLOWS FROM FINANCING ACTIVITIES:**

|   |           |           |           |
|---|-----------|-----------|-----------|
| Net (repayments) borrowings on notes payable floor plan non-trade | (4,167)   | (294,823) | (168,688) |
| Borrowings on revolving credit facilities                         | 890,838   | 558,011   | 40,000    |
| Repayments on revolving credit facilities                         | (889,996) | (628,853) | (40,000)  |
| Proceeds from issuance of long-term debt                          | 56,913    | 178,751   | 229,775   |
| Debt issuance costs   |           | (18,387)  | (10,962)  |
| Principal payments on long-term debt                              | (4,348)   | (5,458)   | (6,362)   |
| Settlement of cash flow swaps                                     |           | (16,454)  |           |
| Repurchase of debt securities                                     | (24,203)  | (244,258) | (249,190) |
| Purchases of treasury stock                                       | (28,648)  | (61)      | (1,113)   |
| Income tax benefit associated with stock compensation plans       | 607       |           | (12)      |
| Income tax benefit associated with convertible hedge              | 2,120     | 4,293     | 239       |
| Issuance of shares under stock compensation plans                 | 5,149     |           | 1,741     |
| Issuance of common stock  |           | 101,265   |           |
| Dividends paid  | (19,106)  | (4,860)   |           |
| Net cash provided by (used in) financing activities               | (14,841)  | (370,834) | (204,572) |

**NET INCREASE (DECREASE) IN CASH AND CASH**

|   |         |        |         |
|---|---------|--------|---------|
| <b>EQUIVALENTS</b>                                  | (9,543) | 23,064 | (8,193) |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b> | 16,514  | 6,971  | 30,035  |

|   |          |           |           |
|---|----------|-----------|-----------|
| <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b> | \$ 6,971 | \$ 30,035 | \$ 21,842 |
|---|----------|-----------|-----------|

**SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING ACTIVITIES:**

|   |             |           |          |
|---|-------------|-----------|----------|
| Change in fair value of cash flow hedging instruments<br>(net of tax benefit of \$13,383, and tax expense of \$7,045 and \$2,247 in<br>2008, 2009 and 2010, respectively) | \$ (21,835) | \$ 11,494 | \$ 3,667 |
|---|-------------|-----------|----------|

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

|   |            |             |             |
|---|------------|-------------|-------------|
| Cash paid (received) during the year for: |            |             |             |
| Interest, net of amount capitalized       | \$ 114,003 | \$ 110,420  | \$ 93,598   |
| Income taxes                              | \$ 13,351  | \$ (23,507) | \$ (17,098) |

See notes to Consolidated Financial Statements

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**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 135 dealership franchises and 25 collision repair centers throughout the United States as of December 31, 2010. Sonic sells new and used cars and light trucks, sells replacement parts, provides vehicle maintenance, warranty, paint and repair services, and arranges related financing and insurance for its automotive customers. As of December 31, 2010, Sonic sold a total of 29 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 one fifty-percent owned dealership that is accounted for under the equity method. All material intercompany balances and transactions have been eliminated in the accompanying Consolidated Financial Statements.

*Reclassifications* Individual franchises sold, terminated or classified as held for sale are reported as discontinued operations. During 2010, Sonic completed the disposal of 13 automobile franchises, and had no franchises classified as held for sale at December 31, 2010. The results of operations of these franchises for the years ended December 31, 2008, 2009 and 2010 are reported as discontinued operations for all periods presented. Sonic decided to retain and operate one franchise which was held for sale as of December 31, 2009 due to strategic considerations. This dealership was reclassified into continuing operations during 2010 as a result of Sonic s asset management strategy. Determining whether a franchise will be reported as continuing or discontinued operations involves judgments such as 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.

*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, lease exit accruals and certain accrued expenses.

*Cash and Cash Equivalents* Sonic classifies cash and all highly liquid investments with a maturity of three months or less at the date of purchase, including short-term time deposits and government agency and corporate obligations, as cash and cash equivalents.

*Revenue Recognition* Sonic records revenue when vehicles are delivered to customers, when vehicle service work is performed and when parts are delivered. Conditions to completing a sale include having an agreement with the customer, including pricing, and the sales price must be reasonably expected to be collected.

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.

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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, 2009 and 2010, the amounts recorded as allowances for commission chargeback reserves were \$11.7 million and \$11.3 million, respectively, and were classified as other accrued liabilities and other long-term liabilities in the accompanying Consolidated Balance Sheets.

*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 recognized as a reduction of cost of sales for continuing operations were \$26.6 million, \$21.0 million and \$23.6 million for the years ended December 31, 2008, 2009 and 2010, respectively. There was an additional \$3.5 million, \$1.6 million and \$0.4 million in floor plan assistance related to discontinued operations for the years ended December 31, 2008, 2009 and 2010, 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 \$90.8 million at December 31, 2009 and \$109.0 million at December 31, 2010.

*Accounts Receivable* In addition to contracts in transit, Sonic's accounts receivable consist 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 evaluates 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 vehicles, recorded 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 usually be returned to the manufacturer. Recorded inventory reserves are not significant.

*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

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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                       | 10-30 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 and franchise assets) 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. See Note 4, Property and Equipment, for a discussion of impairment charges.

*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. Commonly, 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. As of December 31, 2010, Sonic only utilizes interest rate swap agreements to effectively convert a portion of its LIBOR-based variable rate debt to a fixed rate. See Note 6, Long-Term Debt, for further discussion of derivative instruments and hedging activities.

*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. An exception to the annual impairment test is provided by Intangibles Goodwill and Other in the ASC, wherein a detailed determination of the fair value of a reporting unit may be carried forward from one year to the next if the following criteria have been met: (i) the assets and liabilities that make up the reporting unit have not changed significantly since the most recent fair value determination; (ii) the most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin; and (iii) based on the analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote. Based on criteria established by the applicable accounting pronouncements, Sonic has one reporting unit.

In evaluating goodwill for impairment, if the fair value of the reporting unit is less than its carrying value, 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 and liabilities of the reporting unit as if the calculated fair value was the purchase price in a business combination. This allocation would include assigning value to any previously unrecognized identifiable assets (including franchise assets) which means the remaining fair value that would be allocated to goodwill would be significantly reduced. See discussion regarding franchise agreements acquired prior to July 1, 2001 in Other Intangible Assets below. Sonic would then compare the fair value of the goodwill resulting from this allocation process to the carrying value of the goodwill with the difference representing the amount of impairment. The purpose of this second step is only to determine the amount of goodwill that should be recorded on the balance sheet. The recorded amounts of other items on the balance sheet are not adjusted.

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Sonic uses a discounted cash flow model to estimate its reporting unit's fair value in evaluating goodwill for impairment. The significant assumptions include projected earnings, weighted average cost of capital (and estimates in the weighted average cost of capital inputs) and residual growth rates. Sonic also considers a control premium that represents the estimated amount an investor would pay for Sonic's equity securities to obtain a controlling interest and other factors. See Note 5, *Intangible Assets and Goodwill*, for further discussion.

*Other Intangible Assets* The principal identifiable intangible assets other than goodwill acquired in an acquisition are rights under franchise agreements with manufacturers. Sonic classifies franchise agreements as indefinite lived intangible assets as it has been Sonic's experience that renewals have occurred without substantial cost or material modifications to the underlying agreements. 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. 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. See Note 5, *Intangible Assets and Goodwill*, regarding impairment charges on franchise agreements.

*Insurance Reserves* Sonic has various self-insured and high deductible casualty and other 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, 2009 and 2010, Sonic had \$19.4 million and \$21.0 million, respectively, reserved for such programs.

*Lease Exit Accruals* The majority of Sonic's dealership properties are leased under long-term operating lease arrangements. When situations arise where the leased properties are no longer utilized in operations, Sonic records accruals for the present value of the lease payments, net of estimated sublease rentals, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord. These situations could include the relocation of an existing facility or the sale of a franchise whereby the buyer will not be subleasing the property for either the remaining term of the lease or for an amount of rent equal to Sonic's obligation under the lease. See Note 12, *Commitments and Contingencies*, for further discussion.

*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 with applicable tax law and that the Company has adequately provided for any reasonably foreseeable outcome related to these matters.

From time to time, Sonic engages in transactions in which the tax consequences may be subject to uncertainty. Significant judgment is required in assessing and estimating the tax consequences of these transactions. Sonic determines whether it is more likely than not that a tax position will be sustained upon examination, including

resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, Sonic presumes that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. A tax position that does not meet the more-likely-than-not recognition threshold is measured to determine the amount of benefit to be recognized in the financial statements. The tax position is measured at the largest amount of benefit that is likely of being realized upon ultimate settlement. Sonic adjusts its estimates periodically because of ongoing

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

examinations by and settlements with the various taxing authorities, as well as changes in tax laws, regulations and precedent. See Note 7, *Income Taxes*, for further discussion of Sonic's uncertain tax positions.

*Concentrations of Credit and Business 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 exceed FDIC insurance limits. Concentrations of credit risk with respect to receivables are limited primarily to automobile manufacturers and financial institutions. Credit risk arising from trade receivables from commercial customers is reduced by the large number of customers comprising the trade receivables balances.

The counterparties to Sonic's swap transactions consist of four large financial institutions. Sonic could be exposed to loss in the event of non-performance by any of these counterparties.

*Financial Instruments and Market Risks* As of December 31, 2009 and 2010 the fair values of Sonic's financial instruments including receivables, notes receivable from finance contracts, notes payable-floor plan, trade accounts payable, borrowings under the revolving credit facilities and certain mortgage notes approximate their carrying values due either to length of maturity or existence of variable interest rates that approximate prevailing market rates. See Note 11, *Fair Value Measurements*, for further discussion of the fair value and carrying value of Sonic's fixed rate long-term debt.

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 \$805.0 million at December 31, 2009 and \$907.6 million at December 31, 2010.

*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 \$56.8 million, \$44.7 million and \$46.9 million for the years ended December 31, 2008, 2009 and 2010, respectively, and has been classified as selling, general and administrative expense in the accompanying Consolidated Statements of Income.

Sonic has cooperative advertising reimbursement agreements with certain automobile manufacturers it represents. Usually, 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 expenses were \$13.6 million, \$9.2 million and \$13.7 million in 2008, 2009 and 2010, respectively.

*Segment Information* Sonic has determined it has a single segment for purposes of reporting financial condition and results of operations.

**2. Business Acquisitions and Dispositions**

***Acquisitions***

Sonic's growth strategy is focused on metropolitan markets, predominantly in the Southeast, Southwest, Midwest and California. Where practicable, Sonic also seeks to acquire stable franchises that Sonic believes have above average sales prospects. Under the 2010 Credit Facilities (see Note 6 for discussion of the 2010 Credit Facilities), Sonic is restricted from making dealership franchise acquisitions in any fiscal year if the aggregate cost of all such acquisitions occurring in any fiscal year is in excess of \$25.0 million, without the written consent of the Required Lenders (as that term is defined in the 2010 Credit Facilities). With this restriction on Sonic's ability to make dealership franchise acquisitions, its acquisition growth strategy may be limited. Sonic was awarded two franchises from manufacturers in 2010.

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During 2008, Sonic acquired or was awarded five franchises located in its Tennessee and Houston markets, for an aggregate purchase price of approximately \$22.4 million in cash, net of cash acquired, funded by cash from operations and borrowing under the 2006 Credit Facility.

**Dispositions**

During 2010, Sonic disposed of 13 franchises. These disposals generated cash of \$24.7 million. During 2008 and 2009, Sonic completed 10 and 18 franchise dispositions, respectively. The dispositions in 2008 and 2009 generated cash of \$37.8 million and \$27.3 million, respectively. The operating gains or losses associated with these disposed franchises are included in the amounts shown in the table below.

In conjunction with franchise dispositions, Sonic has agreed 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. See Note 12, Commitments and Contingencies, for further discussion.

At December 31, 2010, Sonic had no franchises held for sale. Assets which have been classified in assets held for sale in the accompanying Consolidated Balance Sheets include dealership franchises not yet sold as of December 31, 2009 and real estate held for sale by non-dealership entities at December 31, 2010 and consist of the following:

|                             | <b>December 31,<br/>2009</b> | <b>December 31,<br/>2010</b> |
|-----------------------------|------------------------------|------------------------------|
|                             | <b>(In thousands)</b>        |                              |
| Inventories                 | \$ 4,528                     | \$                           |
| Property and equipment, net | 2,073                        |                              |
| Land                        | 2,765                        | 2,020                        |
| Goodwill                    | 2,801                        |                              |
| Franchise assets            |                              |                              |
| Assets held for sale        | \$ 12,167                    | \$ 2,020                     |

Liabilities associated with assets held for sale are comprised entirely of notes payable floor plan and are classified as such on the accompanying Consolidated Balance Sheets at December 31, 2009. Results associated with franchises classified as discontinued operations were as follows:

|                                       | <b>Year Ended December 31,</b> |             |             |
|---------------------------------------|--------------------------------|-------------|-------------|
|                                       | <b>2008</b>                    | <b>2009</b> | <b>2010</b> |
|                                       | <b>(In thousands)</b>          |             |             |
| Loss from operations                  | \$ (20,103)                    | \$ (12,579) | \$ (6,634)  |
| Gain (loss) on disposal of franchises | (2,325)                        | (293)       | 2,629       |

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|  |             |             |            |
|--|-------------|-------------|------------|
| Lease exit charges                                     | (13,747)    | (30,794)    | (4,232)    |
| Property impairment charges                            | (14,912)    | (4,992)     |            |
| Goodwill impairment charges                            | (2,025)     | (1,586)     |            |
| Franchise agreement and other asset impairment charges | (20,500)    |             |            |
| Favorable lease asset impairment charges               | (1,903)     |             |            |
| Pre-tax loss   | \$ (75,515) | \$ (50,244) | \$ (8,237) |
| Total revenues   | \$ 587,801  | \$ 294,390  | \$ 55,077  |

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Sonic allocates corporate-level interest to discontinued operations based on the net assets of the discontinued operations group. Interest allocated to discontinued operations for the years ended December 31, 2008, 2009 and 2010 was \$3.1 million, \$2.0 million and \$0.2 million, respectively.

**3. Inventories and Related Notes Payable Floor Plan**

Inventories consist of the following:

|   | <b>December 31,</b>   |             |
|---|-----------------------|-------------|
|   | <b>2009</b>           | <b>2010</b> |
|   | <b>(In thousands)</b> |             |
| New vehicles  | \$ 557,319            | \$ 628,939  |
| Used vehicles                                       | 138,401               | 165,039     |
| Parts and accessories                               | 51,956                | 50,854      |
| Other   | 52,127                | 58,389      |
|   | \$ 799,803            | \$ 903,221  |
| Less inventories classified as assets held for sale | (4,528)               |             |
| Inventories   | \$ 795,275            | \$ 903,221  |

Sonic finances all of its new and certain of its used vehicle inventory through standardized floor plan facilities with a syndicate of financial institutions and manufacturer-affiliated finance companies. The new and used floor plan facilities bear interest at variable rates based on prime and LIBOR. The weighted average interest rate for Sonic's new vehicle floor plan facilities, for continuing operations and discontinued operations, was 2.54% and 2.71% for the years ended December 31, 2009 and 2010, respectively. Sonic's floor plan interest expense related to the new vehicle floor plan arrangements is partially 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. For the years ended December 31, 2008, 2009 and 2010, for continuing operations and discontinued operations, Sonic recognized a reduction in cost of sales of approximately \$30.1 million, \$22.6 million and \$24.0 million, respectively, related to manufacturer floor plan assistance.

The average interest rate for Sonic's used vehicle floor plan facility was 2.31% and 2.88% for the years ended December 31, 2009 and 2010, respectively.

The new and used floor plan facilities are collateralized by vehicle inventories and other assets, excluding franchise agreements, of the relevant dealership subsidiary. The new and used 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 of these restrictive covenants as of December 31, 2010.





**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Property and Equipment**

Property and equipment consists of the following:

|                               | <b>December 31,</b>   |             |
|-------------------------------|-----------------------|-------------|
|                               | <b>2009</b>           | <b>2010</b> |
|                               | <b>(In thousands)</b> |             |
| Land                          | \$ 61,886             | \$ 76,357   |
| Building and improvements     | 322,632               | 353,088     |
| Office equipment and fixtures | 75,801                | 77,654      |
| Parts and service equipment   | 54,981                | 56,651      |
| Company vehicles              | 8,440                 | 8,137       |
| Construction in progress      | 40,000                | 48,230      |
| <br>                          |                       |             |
| Total, at cost                | 563,740               | 620,117     |
| Less accumulated depreciation | (176,817)             | (181,837)   |
| <br>                          |                       |             |
| Subtotal                      | 386,923               | 438,280     |
| Less assets held for sale     | (4,838)               | (2,020)     |
| <br>                          |                       |             |
| Property and equipment, net   | \$ 382,085            | \$ 436,260  |

Subsequent to December 31, 2010, Sonic purchased five dealership properties which it was previously leasing through long-term operating leases for \$75.2 million, utilizing cash on hand and borrowings under the 2010 Credit Facilities (see Note 6 for discussion of the 2010 Credit Facilities).

Interest capitalized in conjunction with construction projects was approximately \$1.5 million, \$0.7 million and \$2.3 million for the years ended December 31, 2008, 2009 and 2010, respectively. As of December 31, 2010, commitments for facility construction projects totaled approximately \$17.3 million.

During the years ended December 31, 2008, 2009 and 2010, property and equipment impairment charges were recorded as noted in the following table.

| <b>Year Ended December 31,</b> | <b>Continuing<br/>Operations</b> | <b>Discontinued<br/>Operations</b> |
|--------------------------------|----------------------------------|------------------------------------|
|                                | <b>(In millions)</b>             |                                    |
| 2010                           | \$ 0.2                           | \$                                 |
| 2009                           | \$ 18.1                          | \$ 5.0                             |
| 2008                           | \$ 10.0                          | \$ 14.9                            |

Impairment charges related to continuing operations were related to the abandonment of construction projects, the abandonment and disposal of dealership equipment or Sonic's estimate that based on historical and projected operating losses for certain dealerships, these dealerships would not be able to recover recorded property and equipment asset balances.

Impairment charges related to assets held for sale were recorded in discontinued operations based on the estimated fair value of the property and equipment to be sold in connection with the disposal of the associated franchises. During 2009, \$3.8 million of the impairment charge in discontinued operations was related to Sonic's General Motors dealerships that were terminated in 2009.

Table of Contents**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Intangible Assets and Goodwill**

The changes in the carrying amount of franchise agreements and goodwill for the years ended December 31, 2009 and 2010 were as follows:

|   | <b>Franchise</b>      | <b>Gross</b>    | <b>Accumulated</b> | <b>Net</b>      |
|---|-----------------------|-----------------|--------------------|-----------------|
|   | <b>Agreements</b>     | <b>Goodwill</b> | <b>Impairment</b>  | <b>Goodwill</b> |
|   | <b>(In thousands)</b> |                 |                    |                 |
| Balance, December 31, 2008                      | \$ 64,701             | \$ 1,124,332    | \$ (797,325)       | \$ 327,007      |
| Impairment of domestic dealerships              | (500)                 |                 | (929)              | (929)           |
| Impairment of import dealerships                | (3,800)               |                 | (1,751)            | (1,751)         |
| Reductions from sales of franchises             | (800)                 | (10,264)        | 3,280              | (6,984)         |
| Reclassification from assets held for sale, net | 5,234                 | 152,139         |                    | 152,139         |
| Balance, December 31, 2009                      | \$ 64,835             | \$ 1,266,207    | \$ (796,725)       | \$ 469,482      |
| Reductions from sales of franchises             |                       | (3,767)         |                    | (3,767)         |
| Reclassification from assets held for sale, net |                       | 2,801           |                    | 2,801           |
| Balance, December 31, 2010                      | \$ 64,835             | \$ 1,265,241    | \$ (796,725)       | \$ 468,516      |

Pursuant to applicable accounting pronouncements, Sonic tests 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. If Sonic determines that the amount of its goodwill is impaired at any point in time, Sonic is required to reduce goodwill on its balance sheet. In completing step one of the impairment analyses, Sonic used a discounted cash flow model in order to estimate its reporting unit's fair value. The result from this model was then analyzed to determine if an indicator of impairment exists.

Based on the results of Sonic's step one test as of December 31, 2009, Sonic was not required to complete step two of the impairment evaluation. Pursuant to an exception to the annual goodwill impairment test provided by Intangibles Goodwill and Other in the ASC, Sonic was allowed to carry forward its estimate of the reporting unit's fair value from 2009, resulting in no goodwill impairment in 2010. See the discussion under the heading Goodwill in Note 1 for the criteria prescribed by this exception. For the year ended December 31, 2009, Sonic recorded goodwill impairment charges of \$1.1 million within continuing operations and \$1.6 million within discontinued operations based on the determination that a portion of the goodwill was not recoverable based on estimated proceeds while dealership operations were held for sale. For the year ended December 31, 2008, Sonic recorded an impairment of \$797.3 million related to its evaluation of goodwill. Sonic recorded \$795.3 million in continuing operations and \$2.0 million in discontinued operations as a result of step two of its goodwill impairment test and based on the determination that a portion of goodwill was not recoverable from assets held for sale based on estimated proceeds.

Franchise asset impairment charges of \$17.5 million and \$6.7 million were recorded within discontinued and continuing operations in the year ended December 31, 2008, respectively. Further, Sonic incurred \$4.3 million of

franchise asset impairment charges in continuing operations in the year ended December 31, 2009. These impairment charges were recorded based on management's conclusion that the recorded values would not be recoverable either through operating cash flows or through the eventual sale of the franchises. Approximately \$2.1 million of the impairment charges recorded in 2009 relate to dealership franchises that were terminated based on notifications from General Motors.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Definite life intangible assets consist of the following:

|                                | <b>December 31,</b>   |             |
|--------------------------------|-----------------------|-------------|
|                                | <b>2009</b>           | <b>2010</b> |
|                                | <b>(In thousands)</b> |             |
| Lease agreements               | \$ 21,987             | \$ 21,987   |
| Less accumulated amortization  | (6,016)               | (7,673)     |
| Definite life intangibles, net | \$ 15,971             | \$ 14,314   |

Franchise assets 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 \$1.8 million, \$1.7 million and \$1.7 million for the years ended December 31, 2008, 2009 and 2010, respectively. The weighted-average amortization period for lease agreements and definite life intangible assets is 15 years. Future amortization expense is as follows:

| <b>Year Ending December 31,</b> | <b>(In thousands)</b> |        |
|---------------------------------|-----------------------|--------|
| 2011                            | \$                    | 1,656  |
| 2012                            |                       | 1,656  |
| 2013                            |                       | 1,656  |
| 2014                            |                       | 1,290  |
| 2015                            |                       | 924    |
| Thereafter                      |                       | 7,132  |
| Total                           | \$                    | 14,314 |

**6. Long-Term Debt**

Long-term debt consists of the following:

|                                       | <b>December 31,</b>   | <b>December 31,</b> |
|---------------------------------------|-----------------------|---------------------|
|                                       | <b>2009</b>           | <b>2010</b>         |
|                                       | <b>(In thousands)</b> |                     |
| 2010 Revolving Credit Facility(1)     | \$                    | \$                  |
| 2006 Revolving Credit Sub-Facility(1) |                       |                     |

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|   |            |            |
|---|------------|------------|
| Senior Subordinated Notes bearing interest at 9.0%  |            | 210,000    |
| Senior Subordinated Notes bearing interest at 8.625%  | 275,000    | 42,855     |
| Convertible Senior Notes bearing interest at 5.0%   | 172,500    | 172,500    |
| Convertible Senior Subordinated Notes bearing interest at 4.25%   | 17,045     |            |
| Notes payable to a finance company bearing interest from 9.52% to 10.52% (with a weighted average of 10.19)%                | 17,778     | 15,618     |
| Mortgage notes to finance companies-fixed rate, bearing interest from 4.50% to 7.03%  | 78,424     | 88,262     |
| Mortgage notes to finance companies-variable rate, bearing interest at 1.25 to 3.50 percentage points above one-month LIBOR | 38,251     | 45,639     |
| Net debt discount and premium(2)  | (29,199)   | (25,482)   |
| Other   | 6,342      | 6,059      |
|   | \$ 576,141 | \$ 555,451 |
| Less current maturities(3)  | (23,991)   | (9,050)    |
| Long-term debt  | \$ 552,150 | \$ 546,401 |

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

- (1) Sonic replaced its 2006 Revolving Credit Sub-Facility with the 2010 Revolving Credit Facility on January 15, 2010. Interest rate on the revolving credit facility was 3.5% above LIBOR at December 31, 2009 and December 31, 2010.
- (2) December 31, 2009 includes \$1.5 million discount associated with the 8.625% Notes, \$29.8 million discount associated with the 5.0% Convertible Notes, \$0.6 million discount associated with the 4.25% Convertible Notes, \$2.5 million premium associated with notes payable to a finance company and \$0.2 million premium associated with mortgage notes payable. December 31, 2010 includes \$1.4 million discount associated with the 9.0% Notes, \$0.2 million discount associated with the 8.625% Notes, \$24.7 million discount associated with the 5.0% Convertible Notes, \$1.8 million premium associated with notes payable to a finance company and \$1.0 million discount associated with mortgage notes payable.
- (3) At December 31, 2009, current maturities included amounts outstanding related to the 4.25% Convertible Notes as a result of these obligations maturing or expected to be extinguished within one year of the balance sheet date.

Future maturities of long-term debt are as follows:

| <b>Year Ending December 31,</b> | <b>Principal</b>      | <b>Net</b> |
|---------------------------------|-----------------------|------------|
|                                 | <b>(In thousands)</b> |            |
| 2011                            | \$ 8,449              | \$ 9,050   |
| 2012                            | 8,991                 | 9,337      |
| 2013                            | 58,103                | 58,154     |
| 2014                            | 184,923               | 160,348    |
| 2015                            | 15,383                | 15,330     |
| Thereafter                      | 305,084               | 303,232    |
| Total                           | \$ 580,933            | \$ 555,451 |

**2006 Credit Facility**

The 2006 Revolving Credit Sub-Facility, the 2006 New Vehicle Floor Plan Sub-Facility and the 2006 Used Vehicle Floor Plan Sub-Facility (collectively the 2006 Credit Facility ) would have matured on February 17, 2010. The 2006 Credit Facility was refinanced on January 15, 2010. See 2010 Credit Facilities discussion below.

**2010 Credit Facilities**

On January 15, 2010, Sonic entered into an amended and restated syndicated revolving credit agreement (the 2010 Revolving Credit Facility ) and a syndicated floor plan credit facility (the 2010 Floor Plan Facility ). The 2010 Revolving Credit Facility and 2010 Floor Plan Facility (collectively the 2010 Credit Facilities ) mature on August 15, 2012.



Availability under the 2010 Revolving Credit Facility is calculated as the lesser of \$150.0 million or a borrowing base calculated based on certain eligible assets plus 50% of the fair market value of 5,000,000 shares of common stock of Speedway Motorsports, Inc. ( SMI ) that are pledged as collateral, less the aggregate face amount of any outstanding letters of credit under the 2010 Revolving Credit Facility (the 2010 Revolving Borrowing Base ). The 2010 Revolving Credit Facility may be expanded up to \$215.0 million upon satisfaction of certain conditions. A withdrawal of this pledge by Sonic Financial Corporation ( SFC ), which holds the 5,000,000 shares of common stock of Speedway Motorsports, Inc., or a significant decline in the value of Speedway Motorsports, Inc. common stock, could reduce the amount Sonic can borrow under the 2010 Revolving Credit Facility. See Note 8 for further discussion of related-party transactions with SMI and SFC.

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The 2010 Revolving Borrowing Base was approximately \$145.6 million at December 31, 2010. At December 31, 2010, Sonic had no outstanding borrowings and \$47.7 million in outstanding letters of credit resulting in total borrowing availability of \$97.9 million under the 2010 Revolving Credit Facility.

Outstanding obligations under the 2010 Revolving Credit Facility are secured by a pledge of substantially all of the assets of Sonic and its subsidiaries, and by the pledge of 5,000,000 shares of common stock of SMI by SFC. The collateral also provides for the pledge of the franchise agreements and stock or equity interests of Sonic's dealership franchise subsidiaries, except for those dealership franchise subsidiaries where the applicable manufacturer prohibits such a pledge, in which cases the stock or equity interests of the dealership franchise subsidiary is subject to an escrow arrangement with the administrative agent. Substantially all of Sonic's subsidiaries also guarantee its obligations under the 2010 Revolving Credit Facility.

The 2010 Floor Plan Facility is comprised of a new vehicle revolving floor plan facility in an amount up to \$321.0 million (the 2010 New Vehicle Floor Plan Facility) and a used vehicle revolving floor plan facility in an amount up to \$50.0 million, subject to a borrowing base (the 2010 Used Vehicle Floor Plan Facility). Sonic may, under certain conditions, request an increase in the 2010 Floor Plan Facility by up to \$125.0 million, which shall be allocated between the 2010 New Vehicle Floor Plan Facility and the 2010 Used Vehicle Floor Plan Facility as Sonic requests, with no more than 15% of the aggregate commitments allocated to the commitments under the 2010 Used Vehicle Floor Plan Facility. Outstanding obligations under the 2010 Floor Plan Facility are guaranteed by Sonic and certain of its subsidiaries and are secured by a pledge of substantially all of the assets of Sonic and its subsidiaries.

The amounts outstanding under the 2010 Credit Facilities bear interest at variable rates based on specified percentages above LIBOR according to a performance-based pricing grid determined by Sonic's Consolidated Total Debt to EBITDA Ratio (as defined in the 2010 Credit Facilities agreement) as of the last day of the immediately preceding fiscal quarter.

Sonic agreed under the 2010 Credit Facilities not to pledge any assets to any third party, subject to certain stated exceptions, including floor plan financing arrangements. In addition, the 2010 Credit Facilities contain certain negative covenants, including covenants which could restrict or prohibit indebtedness, liens, the payment of dividends, capital expenditures and material dispositions and acquisitions of assets as well as other customary covenants and default provisions. Specifically, the 2010 Credit Facilities permit cash dividends on Sonic's Class A and Class B common stock so long as no event of default (as defined in the 2010 Credit Facilities) has occurred and is continuing and provided that Sonic remains in compliance with all financial covenants under the 2010 Credit Facilities.

The 2010 Credit Facilities contain events of default, including cross-defaults to other material indebtedness, change of control events and events of default customary for syndicated commercial credit facilities. Upon the occurrence of an event of default, Sonic could be required to immediately repay all outstanding amounts under the 2010 Credit Facilities. Sonic was in compliance with all required covenants as of December 31, 2010.

***9.0% Senior Subordinated Notes ( 9.0% Notes )***

On March 12, 2010, Sonic issued \$210.0 million in aggregate principal amount of 9.0% Notes which mature on March 15, 2018. On April 12, 2010, Sonic used the net proceeds, together with cash on hand, to redeem \$200.0 million in aggregate principal amount of its 8.625% Notes due 2013. The 9.0% Notes are unsecured senior

subordinated obligations of Sonic and are guaranteed by Sonic's domestic operating subsidiaries. Interest is payable semi-annually on March 15 and September 15 each year. Sonic may redeem the 9.0% Notes in whole or in

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part at any time after March 15, 2014 at the following redemption prices, which are expressed as percentages of the principal amount:

|  | <b>Redemption</b> |
|--|-------------------|
| Beginning on March 15, 2014                | 104.50%           |
| Beginning on March 15, 2015                | 102.25%           |
| Beginning on March 15, 2016 and thereafter | 100.00%           |

In addition, on or before March 15, 2013, Sonic may redeem up to 35% of the aggregate principal amount of the 9.0% Notes at par value plus accrued interest with proceeds from certain equity offerings. The Indenture also provides that holders of 9.0% Notes may require Sonic to repurchase the 9.0% Notes at 101% of the par value of the 9.0% Notes, plus accrued interest if Sonic undergoes a change of control as defined in the Indenture.

The indenture governing the 9.0% Notes contains certain specified restrictive covenants. Sonic has agreed not to pledge any assets to any third party lender of senior subordinated debt except under certain limited circumstances. Sonic also has agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, capital stock, guarantees, asset sales, investments, cash dividends to stockholders, distributions and redemptions. Specifically, the indenture governing Sonic's 9.0% Notes limits Sonic's ability to pay quarterly cash dividends on Sonic's Class A and B common stock in excess of \$0.10 per share. Sonic may only pay quarterly cash dividends on Sonic's Class A and B common stock if Sonic complies with the terms of the indenture governing the 9.0% Notes. Sonic was in compliance with all restrictive covenants as of December 31, 2010.

Balances outstanding under Sonic's 9.0% Notes are guaranteed by all of Sonic's operating domestic subsidiaries. These guarantees are full and unconditional and joint and several. The parent company has no independent assets or operations. The non-domestic and non-operating subsidiaries that are not guarantors are considered to be minor.

Sonic's obligations under the 9.0% Notes may be accelerated by the holders of 25% of the outstanding principal amount of the 9.0% Notes then outstanding if certain events of default occur, including: (1) defaults in the payment of principal or interest when due; (2) defaults in the performance, or breach, of Sonic's covenants under the 9.0% Notes; and (3) certain defaults under other agreements under which Sonic or its subsidiaries have outstanding indebtedness in excess of \$35.0 million.

***8.625% Senior Subordinated Notes ( 8.625% Notes )***

Sonic has \$42.9 million in aggregate principal amount outstanding of the 8.625% Notes at December 31, 2010. 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.

On April 12, 2010, Sonic used the net proceeds obtained from the issuance of the 9.0% Notes, together with cash on hand, to redeem \$200.0 million in aggregate principal amount of the outstanding 8.625% Notes at the then applicable redemption price (102.875% of principal redeemed) plus accrued but unpaid interest. Sonic recorded a loss on extinguishment of debt of approximately \$7.0 million related to the redemption which was recognized in the second quarter of 2010. During the second quarter of 2010, Sonic repurchased approximately \$12.1 million in additional

aggregate principal amount of the 8.625% Notes and recorded an additional loss on extinguishment of debt of approximately \$0.3 million related to these repurchases. During the third quarter of 2010, Sonic redeemed an additional \$20.0 million in aggregate principal amount of the outstanding 8.625% Notes and recorded a loss on extinguishment of debt of approximately \$0.4 million related to the redemption.

The total loss on extinguishment of debt related to repurchases and redemptions of the 8.625% Notes of \$7.7 million for the year ended December 31, 2010 is recorded in other income (expense), net, in the Consolidated Statements of Income.

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The indenture governing the 8.625% Notes contains certain specified restrictive covenants. Sonic has agreed not to pledge any assets to any third party lender of senior subordinated debt except under certain limited capital stock, guarantees, asset sales, investments, cash dividends to shareholders, distributions and circumstances. Sonic also has agreed to certain other limitations or prohibitions concerning the incurrence of other indebtedness, 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 the terms of the indenture governing the 8.625% Notes. Sonic was in compliance with all restrictive covenants as of December 31, 2010.

Balances outstanding under Sonic's 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.

***5.25% Convertible Senior Subordinated Notes ( 5.25% Convertible Notes ) and 6.0% Senior Secured Convertible Notes ( 6.0% Convertible Notes )***

On May 7, 2009, Sonic paid the holders of its 5.25% Convertible Senior Subordinated Notes due 2009 (the 5.25% Convertible Notes) \$15.7 million in cash, issued \$85.6 million in aggregate principal of 6.0% Senior Secured Convertible Notes due 2012 (the 6.0% Convertible Notes) and issued 860,723 shares of its Class A common stock in private placements exempt from registration requirements in full satisfaction of its obligations under certain of the 5.25% Convertible Notes. The issuance of the 6.0% Convertible Notes with the redemption of the 5.25% Convertible Notes was accounted for as a debt modification which required the 6.0% Convertible Notes to be recorded at fair value of \$74.3 million (\$85.6 million, less a discount of \$11.3 million). In addition, an \$11.3 million derivative liability was also recorded which represents the fair value of the embedded derivatives (put and conversion features) contained in the 6.0% Convertible Notes.

In accordance with the provisions of *Debt with Conversion and Other Options* in the ASC, Sonic estimated the non-convertible borrowing rate related to the 5.25% Convertible Notes to be 10.0%. Accordingly, the fair value of the equity component of the 5.25% Convertible Notes was \$31.6 million (\$19.0 million, net of tax) at the date of the issuance. As of December 31, 2009, the debt discount associated with the 5.25% Convertible Notes had been fully amortized.

Sonic incurred interest expense related to the 5.25% Convertible Notes of \$7.1 million and \$2.1 million for the years ended December 31, 2008 and 2009, respectively, recorded to interest expense, other, net, in the accompanying Consolidated Statements of Income. In addition, Sonic recorded interest expense associated with the amortization of debt discount on the 5.25% Convertible Notes of \$5.7 million and \$2.1 million for the years ended December 31, 2008 and 2009, respectively, recorded to interest expense, non-cash, convertible debt in the accompanying Consolidated Statements of Income.

As a result of Sonic's redemption of the 6.0% Convertible Notes in 2009 (see discussion below), the derivative liability associated with the 6.0% Convertible Notes was extinguished, resulting in a gain which was recognized in interest expense, non-cash, convertible debt of \$11.3 million in the accompanying Consolidated Statements of Income. Sonic also recorded a loss on the repurchase of the 6.0% Convertible Notes of approximately \$7.2 million in 2009 related to the redemption of these notes. This loss represents the write-off of the remaining unamortized discount at the redemption date, and is presented in the other income (expense), net, line in the accompanying Consolidated

Statements of Income.

***5.0% Convertible Senior Notes ( 5.0% Convertible Notes )***

On September 23, 2009, Sonic issued \$172.5 million in principal of 5.0% Convertible Senior Notes (the 5.0% Convertible Notes ) and 10,350,000 shares of Class A common stock generating net proceeds of

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\$266.4 million. Net proceeds from these issuances were used to repurchase \$143.0 million of 4.25% Convertible Senior Subordinated Notes due 2010 (the 4.25% Convertible Notes), plus accrued interest, \$85.6 million of 6.0% Convertible Notes, plus accrued interest, and to repay amounts outstanding under the 2006 Credit Facility.

The 5.0% Convertible Notes bear interest at a rate of 5.0% per year, payable semiannually on April 1 and October 1 of each year, beginning on April 1, 2010. The 5.0% Convertible Notes mature on October 1, 2029. Sonic may redeem some or all of the 5.0% Convertible Notes for cash at any time subsequent to October 1, 2014 at a repurchase price equal to 100% of the principal amount of the Notes. Holders have the right to require Sonic to purchase the 5.0% Convertible Notes on each of October 1, 2014, October 1, 2019 and October 1, 2024 or in the event of a change in control for cash at a purchase price equal to 100% of the principal amount of the notes.

Holders of the 5.0% Convertible Notes may convert their notes at their option prior to the close of business on the business day immediately preceding July 1, 2029 only under the following circumstances: (1) during any fiscal quarter commencing after December 31, 2009, if the last reported sale price of the Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the measurement period) in which the trading price (as defined below) per \$1,000 principal amount of notes for each day of that measurement period was less than 98% of the product of the last reported sale price of Sonic's Class A common stock and the applicable conversion rate on each such day; (3) if Sonic calls any or all of the notes for redemption, at any time prior to the close of business on the third scheduled trading day prior to the redemption date; or (4) upon the occurrence of specified corporate events. On and after July 1, 2029 to (and including) the close of business on the third scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of the foregoing circumstances. The conversion rate is 74.7245 shares of Class A common stock per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$13.38 per share of Class A common stock.

To recognize the equity component of a convertible borrowing instrument, upon issuance of the 5.0% Convertible Notes in September 2009, Sonic recorded a debt discount of \$31.0 million and a corresponding amount (net of taxes of \$12.8 million) to equity, based on an estimated non-convertible borrowing rate of 10.5%. The debt discount is being amortized to interest expense through October 2014, the earliest redemption date. The unamortized debt discount was \$29.8 million and \$24.7 million at December 31, 2009 and 2010, respectively.

Sonic incurred interest expense related to the 5.0% Convertible Notes of approximately \$2.3 million and \$8.7 million for the years ended December 31, 2009 and 2010, respectively, recorded to interest expense, other, net, in the accompanying Consolidated Statements of Income. In addition, Sonic recorded interest expense associated with the amortization of debt discount on the 5.0% Convertible Notes of \$1.2 million and \$5.1 million for the years ended December 31, 2009 and 2010, respectively, recorded to interest expense, non-cash, convertible debt in the accompanying Consolidated Statements of Income.

***4.25% Convertible Senior Subordinated Notes ( 4.25% Convertible Notes )***

In September 2009, Sonic repurchased \$143.0 million in aggregate principal amount of the 4.25% Convertible Notes using proceeds from the issuance of the 5.0% Convertible Notes and shares of Class A common stock discussed above. The remaining outstanding aggregate principal amount of the 4.25% Convertible Notes was \$17.0 million at



December 31, 2009. The repurchase of \$143.0 million in aggregate principal amount of the 4.25% Convertible Notes resulted in a gain of \$0.1 million recorded in other income (expense), net, in the accompanying Consolidated Statements of Income. In addition, the repurchase required the write-off of approximately \$7.1 million of unamortized debt discount, which was offset by a \$4.3 million adjustment to paid-in capital and a \$2.9 million adjustment to deferred income tax assets.

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During 2010 Sonic extinguished the remaining \$17.0 million in aggregate principal amount of the 4.25% Convertible Notes. Sonic repurchased approximately \$1.0 million in aggregate principal amount of the 4.25% Convertible Notes during the second quarter of 2010 at amounts close to par. On November 30, 2010, Sonic used cash on hand to repurchase \$16.0 million in aggregate principal amount of 4.25% Convertible Notes at the applicable redemption price (100.00% of principal redeemed) plus accrued but unpaid interest.

In accordance with the provisions of *Debt with Conversion and Other Options* in the ASC, Sonic estimated the non-convertible borrowing rate related to the 4.25% Convertible Notes to be 8.0%. Accordingly, the fair value of the equity component of the 4.25% Convertible Notes was \$25.1 million (\$15.1 million, net of tax) at the date of issuance. As of December 31, 2009, the unamortized debt discount associated with these provisions related to the 4.25% Convertible Notes was \$0.5 million and as of December 31, 2010 the debt discount related to the 4.25% Convertible Notes had been fully amortized.

Sonic incurred interest expense related to the 4.25% Convertible Notes of \$7.4 million, \$5.8 million and \$0.7 million for the years ended December 31, 2008, 2009 and 2010, respectively, recorded to interest expense, other, net, in the accompanying Consolidated Statements of Income. In addition, Sonic recorded interest expense associated with the amortization of debt discount on the 4.25% Convertible Notes of \$5.0 million, \$4.1 million and \$0.5 million for the years ended December 31, 2008, 2009 and 2010, respectively, recorded to interest expense, non-cash, convertible debt in the accompanying Consolidated Statements of Income.

***Notes Payable to a Finance Company***

Three notes payable (due October 2015 and August 2016) were assumed in connection with an acquisition in 2005 (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, 2010, the outstanding principal balance on the Assumed Notes was \$15.6 million with a remaining unamortized premium balance of \$1.8 million.

***Mortgage Notes***

Sonic has mortgage financing totaling \$133.9 million in aggregate, related to several of its dealership properties. These mortgage notes require monthly payments of principal and interest through maturity and are secured by the underlying properties. Maturity dates range between June 2013 and December 2029. The weighted average interest rate was 4.91% at December 31, 2010.

***Covenants***

Sonic agreed under the 2010 Credit Facilities not to pledge any assets to any third party (other than those explicitly allowed under the amended terms of the facility), including other lenders, subject to certain stated exceptions, including floor plan financing arrangements. In addition, the 2010 Credit Facilities 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.



**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Financial covenants related to outstanding indebtedness and certain operating leases include required specified ratios of:

|   | <b>Consolidated<br/>Liquidity<br/>Ratio</b> | <b>Covenant<br/>Consolidated<br/>Fixed Charge<br/>Coverage<br/>Ratio</b> | <b>Consolidated<br/>Total Senior<br/>Secured Debt to<br/>EBITDA Ratio</b> |
|---|---|--|---|
| Through March 30, 2011                              | <sup>3</sup> 1.00                           | <sup>3</sup> 1.10  | £2.25   |
| March 31, 2011 through and including March 30, 2012 | <sup>3</sup> 1.05                           | <sup>3</sup> 1.15  | £2.25   |
| March 31, 2012 and thereafter                       | <sup>3</sup> 1.10                           | <sup>3</sup> 1.20  | £2.25   |
| December 31, 2010 actual                            | 1.17  | 1.40   | 1.22  |

***Derivative Instruments and Hedging Activities***

At December 31, 2010 Sonic had interest rate swap agreements (the Fixed Swaps ) to effectively convert a portion of its LIBOR-based variable rate debt to a fixed rate. The fair value of these swap positions at December 31, 2010 was a liability of \$32.7 million included in Other Long-Term Liabilities in the accompanying Consolidated Balance Sheets. Under the terms of the Fixed Swaps, Sonic will receive and pay interest based on the following:

| <b>Notional<br/>(In millions)</b> | <b>Pay Rate</b> | <b>Receive Rate(1)</b> | <b>Maturing Date</b>  |
|-----------------------------------|-----------------|------------------------|-----------------------|
| \$ 200.0                          | 4.935%          | one-month LIBOR        | May 1, 2012           |
| \$ 100.0                          | 5.265%          | one-month LIBOR        | June 1, 2012          |
| \$ 3.6                            | 7.100%          | one-month LIBOR        | July 10, 2017         |
| \$ 25.0(2)                        | 5.160%          | one-month LIBOR        | September 1, 2012     |
| \$ 15.0(2)                        | 4.965%          | one-month LIBOR        | September 1, 2012     |
| \$ 25.0(2)                        | 4.885%          | one-month LIBOR        | October 1, 2012       |
| \$ 11.3                           | 4.655%          | one-month LIBOR        | December 10, 2017     |
| \$ 8.7                            | 6.860%          | one-month LIBOR        | August 1, 2017        |
| \$ 6.9                            | 4.330%          | one-month LIBOR        | July 1, 2013          |
| \$ 100.0(3)                       | 3.280%          | one-month LIBOR        | July 1, 2015          |
| \$ 100.0(3)                       | 3.300%          | one-month LIBOR        | July 1, 2015          |
| \$ 7.3                            | 6.410%          | one-month LIBOR        | September 12,<br>2017 |

(1) The one-month LIBOR rate was 0.261% at December 31, 2010.

(2) After December 31, 2009 changes in fair value are recorded through earnings.

(3) The effective date of these forward-starting swaps is July 2, 2012.

During the second quarter ended June 30, 2010, Sonic entered into two \$100.0 million notional forward-starting interest rate swap agreements which become effective in July 2012 and terminate in July 2015. These interest rate swaps have been designated and qualify as cash flow hedges and, as a result, changes in the fair value of these swaps are recorded in other comprehensive income (loss), net of related income taxes, in the Consolidated Statements of Stockholders' Equity.

As a result of the refinancing of Sonic's 2006 Credit Facility and the new terms of the 2010 Credit Facilities, it is no longer probable that Sonic will incur interest payments that match the terms of certain Fixed Swaps that previously were designated and qualified as cash flow hedges. Of the Fixed Swaps (including the two \$100.0 million notional swaps which were settled in 2009), \$565.0 million of the notional amount had previously been documented

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

as hedges against the variability of cash flows related to interest payments on certain debt obligations. At December 31, 2010, Sonic estimates that under the new 2010 Credit Facilities and other facilities with matching terms, it is probable that the expected debt balance with interest payments that match the terms of the Fixed Swaps will be \$400.0 million. During the first quarter ended March 31, 2009, Sonic settled its \$100.0 million notional, pay 5.002% and \$100.0 million notional, pay 5.319% swaps for a payment of approximately \$16.5 million. These payments are being amortized into earnings over the original life of the swaps.

As a result of the above, for the years ended December 31, 2009 and 2010, non-cash charges of approximately \$11.8 million and \$4.9 million, respectively, related to the Fixed Swaps not designated as hedges and amortization of amounts in accumulated other comprehensive income (loss) related to terminated cash flow swaps were included in interest expense/amortization, non-cash, cash flow swaps in the accompanying Consolidated Statements of Income.

For the Fixed Swaps which qualify as cash flow hedges, the changes in the fair value of these swaps have been recorded in other comprehensive income (loss), net of related income taxes, in the Consolidated Statements of Stockholders' Equity. The incremental interest expense (the difference between interest paid and interest received) related to the Fixed Swaps was \$12.4 million, \$18.5 million and \$17.6 million for the years ended December 31, 2008, 2009 and 2010, respectively. This expense is included in interest expense, other, net, in the accompanying Consolidated Statements of Income. The estimated net expense expected to be reclassified out of other comprehensive income (loss) into results of operations during the next twelve months is approximately \$10.8 million.

**7. Income Taxes**

The provision for income tax (benefit) expense from continuing operations consists of the following:

|  | <b>2008</b>           | <b>2009</b> | <b>2010</b> |
|--|-----------------------|-------------|-------------|
|  | <b>(In thousands)</b> |             |             |
| Current:   |                       |             |             |
| Federal  | \$ (13,834)           | \$ 929      | \$ 8,789    |
| State  | 3,246                 | 6,865       | 3,345       |
| Deferred   | (10,588)              | 7,794       | 12,134      |
|  | (111,752)             | (37,069)    | (29,638)    |
| Total provision for income taxes (benefit) expense | \$ (122,340)          | \$ (29,275) | \$ (17,504) |

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:

|                        | <b>2008</b> | <b>2009</b> | <b>2010</b> |
|------------------------|-------------|-------------|-------------|
| Statutory federal rate | 35.00%      | 35.00%      | 35.00%      |

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|   |         |           |          |
|---|---------|-----------|----------|
| Effective state income tax rate                   | 3.21    | 4.83      | 4.85     |
| Valuation allowance and other account adjustments | (13.99) | (148.12)  | (62.18)  |
| Non-deductible goodwill                           | (8.35)  |           | 0.29     |
| Other   | 0.31    | 3.34      | (0.28)   |
| Effective tax rate                                | 16.18%  | (104.96%) | (22.32%) |

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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:

|   | <b>2009</b>           | <b>2010</b>      |
|---|-----------------------|------------------|
|   | <b>(In thousands)</b> |                  |
| Deferred tax assets:  |                       |                  |
| Allowance for bad debts   | \$ 158                | \$ 180           |
| Accruals and reserves   | 49,524                | 48,497           |
| Basis difference in property and equipment  |                       | 217              |
| Basis difference in goodwill  | 30,266                | 5,721            |
| Net operating loss carryforwards  | 15,869                | 13,638           |
| Fair value of Fixed Swaps   | 13,698                | 9,761            |
| Interest and state taxes associated with Accounting for Uncertain Income Tax Positions in the ASC liability | 7,777                 | 6,694            |
| Other   | 3                     | 3                |
| <b>Total deferred tax assets</b>  | <b>117,295</b>        | <b>84,711</b>    |
| Deferred tax liabilities:   |                       |                  |
| Basis difference in inventory   | (3,340)               | (2,105)          |
| Basis difference in property and equipment  | (3,938)               |                  |
| Basis difference in debt  | (11,748)              | (9,749)          |
| Other   | (4,396)               | (4,849)          |
| <b>Total deferred tax liability</b>   | <b>(23,422)</b>       | <b>(16,703)</b>  |
| Valuation allowance   | (61,868)              | (10,875)         |
| <b>Net deferred tax asset (liability)</b>   | <b>\$ 32,005</b>      | <b>\$ 57,133</b> |

Net long-term deferred tax balances are recorded in other assets and net short-term deferred tax balances are recorded in other current assets on the accompanying Consolidated Balance Sheets.

At December 31, 2008, Sonic had a valuation allowance recorded totaling \$116.3 million. During the years ended December 31, 2009 and 2010, Sonic lowered the recorded valuation allowance amount by \$54.4 million (\$44.2 million in continuing operations and \$10.2 million in discontinued operations) and \$51.0 million (\$48.8 million in continuing operations and \$2.2 million in discontinued operations), respectively. These changes were the result of the use of certain state net operating loss carryforwards as well as a change in estimate that we would be able to ultimately realize the benefits of recorded deferred tax balances. These changes in estimate were primarily driven by the improvement experienced in Sonic's operating results, the overall improvement of the automotive retailing industry and the expectation that Sonic's results and those of the automotive retailing industry would continue to improve in the future.



Sonic has \$345.5 million in gross deferred tax assets related to state net operating loss carryforwards that will expire between 2014 and 2030. 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. The results of future operations, regulatory framework of the taxing authorities and other related matters cannot be predicted with certainty. Therefore, actual utilization of the losses that created these deferred tax assets that differs from the assumptions used in the development of management's judgment could occur. Accordingly, at December 31, 2010, Sonic had recorded a valuation allowance amount of \$10.9 million related to certain state net operating loss carryforward deferred tax assets

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as it was likely that Sonic would not be able to generate sufficient state taxable income in the related entities to utilize the accumulated net operating loss carryforward balances.

At January 1, 2010, Sonic had liabilities of \$31.2 million recorded related to unrecognized tax benefits. Included in the liabilities related to unrecognized tax benefits at January 1, 2010, is \$6.4 million related to interest and penalties which Sonic has estimated may be paid as a result of its tax positions. It is Sonic's policy to classify the expense related to interest and penalties to be paid on underpayments of income taxes within income tax expense. A summary of the changes in the liability related to Sonic's unrecognized tax benefits is presented below.

|  | <b>2008</b>           | <b>2009</b> | <b>2010</b> |
|--|-----------------------|-------------|-------------|
|  | <b>(In thousands)</b> |             |             |
| Unrecognized tax benefit liability, January 1(1)   | \$ 18,921             | \$ 17,131   | \$ 24,790   |
| Prior period positions:                            |                       |             |             |
| Increases  | 132                   | 8,883       | 518         |
| Decreases  | (1,766)               | (134)       | (162)       |
| Current period positions                           | 2,278                 | 1,629       | 1,212       |
| Settlements  | (33)                  | (456)       | (1,706)     |
| Lapse of statute of limitations                    | (2,401)               | (2,072)     | (1,762)     |
| Other  |                       | (191)       | (355)       |
| Unrecognized tax benefit liability, December 31(2) | \$ 17,131             | \$ 24,790   | \$ 22,535   |

(1) Excludes accrued interest and penalties of \$5.6 million at January 1, 2008, \$6.1 million at January 1, 2009 and \$6.4 million at January 1, 2010.

(2) Excludes accrued interest and penalties of \$6.1 million at December 31, 2008, \$6.4 million at December 31, 2009 and \$5.1 million at December 31, 2010.

Approximately \$12.0 million of the unrecognized tax benefits as of December 31, 2010 would ultimately affect the income tax rate if ultimately recognized. Included in the December 31, 2010 recorded liability is \$5.1 million related to interest and penalties which Sonic has estimated may be paid as a result of its tax positions. Sonic does not anticipate any significant changes in its unrecognized tax benefit liability within the next twelve months.

Sonic and its subsidiaries are subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. Sonic's 2007 through 2010 U.S. federal income tax returns remain open to examination by the Internal Revenue Service, and the 2008 and 2009 tax years are currently under review. Sonic and its subsidiaries' state income tax returns are open to examination by state taxing authorities for years ranging from 2000 to 2010.

**8. Related Parties**

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Sonic leases office space in Charlotte from a subsidiary of Sonic Financial Corporation ( SFC ), an entity controlled by Sonic s Chairman and Chief Executive Officer, Mr. O. Bruton Smith, for a majority of its headquarters personnel. Annual aggregate rent under this lease was approximately \$0.6 million in 2008, 2009 and 2010.

Sonic rents various aircraft owned by SFC, subject to their availability, for business-related travel by Sonic executives. Sonic incurred costs of approximately \$0.4 million in 2008, \$0.3 million in 2009 and \$0.4 million in 2010 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, also Sonic s Chairman and Chief Executive Officer, for resale to service customers of Sonic s dealerships in

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the ordinary course of business. Total purchases from Oil Chem by Sonic dealerships totaled approximately \$1.7 million in 2008, \$1.5 million in 2009 and \$1.4 million in 2010.

Sonic donates cash periodically to Speedway Children's Charities, a non-profit organization founded by O. Bruton Smith. O. Bruton Smith and B. Scott Smith, Sonic's President and Chief Strategic Officer, are both board members of Speedway Children's Charities. Donations to this organization amounted to \$0.2 million in 2008.

**9. Capital Structure and Per Share Data**

*Preferred Stock* Sonic has 3,000,000 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, 2009 and 2010.

*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. Sonic has also authorized 30.0 million shares of Class B common stock at a par value of \$0.01 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. The two classes of stock share equally in dividends and in the event of liquidation.

*Share Repurchases* Sonic's Board of Directors has authorized Sonic to expend up to \$295.0 million to repurchase shares of its Class A common stock or redeem securities convertible into Class A common stock. As of December 31, 2010, Sonic had repurchased a total of 14,980,640 shares of Class A common stock at an average price per share of approximately \$15.87 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, 2010, Sonic had \$43.5 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, the 5.0% Convertible Notes, 6.0% Convertible Notes, the 5.25% Convertible Notes and the 4.25% Convertible Notes (see Notes 1 and 6). Sonic's non-vested restricted stock and restricted stock units contain rights to receive non-forfeitable dividends, and thus, are considered participating securities and should be included in the two-class method of computing earnings per share. Due to the net loss in the year ended December 31, 2008, there was no dilutive impact of options, shares or warrants as their effect would be anti-dilutive on a loss per share basis. The

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following table illustrates the dilutive effect of such items on earnings per share for the years ended December 31, 2009 and 2010:

|  | <b>For the Year Ended December 31, 2009</b> |  |               |                     |               |                   |               |
|--|---|--|---------------|---------------------|---------------|-------------------|---------------|
|  | <b>Weighted</b>                             | <b>Income</b>                                  |               | <b>Loss from</b>    |               | <b>Net Income</b> |               |
|  | <b>Average</b>                              | <b>from Continuing</b>                         | <b>Per</b>    | <b>Discontinued</b> | <b>Per</b>    | <b>Per</b>        | <b>Per</b>    |
|  | <b>Shares</b>                               | <b>Operations</b>                              | <b>Share</b>  | <b>Operations</b>   | <b>Share</b>  | <b>Share</b>      | <b>Share</b>  |
|  |   | <b>Amount</b>                                  | <b>Amount</b> | <b>Amount</b>       | <b>Amount</b> | <b>Amount</b>     | <b>Amount</b> |
|  |   | <b>(In thousands except per share amounts)</b> |               |                     |               |                   |               |
| Earnings (Loss) and Shares Effect of Participating Securities: | 43,836                                      | \$ 57,167                                      | \$ 1.30       | \$ (25,619)         | \$ (0.58)     | \$ 31,548         |               |
| Unvested Restricted Stock and Stock Units                      |   | (406)  |               |                     |               | (406)             |               |
| Basic Earnings (Loss) Per Share                                | 43,836                                      | \$ 56,761                                      | \$ 1.29       | \$ (25,619)         | \$ (0.58)     | \$ 31,142         | \$ 0.71       |
| Effect of Dilutive Securities:                                 |   |  |               |                     |               |                   |               |
| Contingently Convertible Debt (6.0% Convertible Notes)         | 7,833                                       | 916  |               | 23                  |               | 939               |               |
| Contingently Convertible Debt (5.0% Convertible Notes)         | 3,496                                       | 2,225  |               | 55                  |               | 2,280             |               |
| Stock Compensation Plans                                       | 667   |  |               |                     |               |                   |               |
| Diluted Earnings (Loss) Per Share                              | 55,832                                      | \$ 59,902                                      | \$ 1.07       | \$ (25,541)         | \$ (0.45)     | \$ 34,361         | \$ 0.62       |

|  | <b>For the Year Ended December 31, 2010</b> |   |               |                     |               |                   |               |
|--|---|---|---------------|---------------------|---------------|-------------------|---------------|
|  | <b>Weighted</b>                             | <b>Income</b>                                   |               | <b>Loss from</b>    |               | <b>Net Income</b> |               |
|  | <b>Average</b>                              | <b>from Continuing</b>                          | <b>Per</b>    | <b>Discontinued</b> | <b>Per</b>    | <b>Per</b>        | <b>Per</b>    |
|  | <b>Shares</b>                               | <b>Operations</b>                               | <b>Share</b>  | <b>Operations</b>   | <b>Share</b>  | <b>Share</b>      | <b>Share</b>  |
|  |   | <b>Amount</b>                                   | <b>Amount</b> | <b>Amount</b>       | <b>Amount</b> | <b>Amount</b>     | <b>Amount</b> |
|  |   | <b>(In thousands, except per share amounts)</b> |               |                     |               |                   |               |

|  |        |            |         |            |           |           |         |  |
|--|--------|------------|---------|------------|-----------|-----------|---------|--|
| Earnings (Loss) and Shares<br>Effect of Participating<br>Securities:                           | 52,214 | \$ 95,925  | \$ 1.84 | \$ (5,996) | \$ (0.12) | \$ 89,929 |         |  |
| Unvested Restricted Stock<br>and Stock Units   |        | (921)      |         |            |           | (921)     |         |  |
| Basic Earnings (Loss) Per<br>Share   | 52,214 | \$ 95,004  | \$ 1.82 | \$ (5,996) | \$ (0.12) | \$ 89,008 | \$ 1.70 |  |
| Effect of Dilutive Securities:<br>Contingently Convertible<br>Debt (5.0% Convertible<br>Notes) | 12,890 | 9,022      |         | 31         |           | 9,053     |         |  |
| Stock Compensation Plans   | 690    |            |         |            |           |           |         |  |
| Diluted Earnings (Loss) Per<br>Share   | 65,794 | \$ 104,026 | \$ 1.58 | \$ (5,965) | \$ (0.09) | \$ 98,061 | \$ 1.49 |  |

In addition to the stock options included in the tables above, options to purchase approximately 3.3 million, 2.4 million and 2.3 million shares of Class A common stock were outstanding during the years ended December 31, 2008, 2009 and 2010, respectively, but were not included in the computation of diluted net income per share because the options were not dilutive.

#### 10. Employee Benefit Plans

Substantially all of the employees of Sonic are eligible to participate in a 401(k) plan. Contributions by Sonic to the 401(k) plan were \$5.8 million in 2008 and none in 2009 and 2010.

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Stock Compensation Plans***

Sonic currently has two stock compensation plans, the Sonic Automotive, Inc. 2004 Stock Incentive Plan (the 2004 Plan ) and the 2005 Formula Restricted Stock Plan for Non-Employee Directors (the 2005 Formula Plan ) (collectively, the Stock Plans ). During the second quarter of 2007, Sonic s stockholders approved amendments to the 2004 Plan and the 2005 Formula Plan to increase the number of shares issuable under these plans to 3,000,000 and 90,000, respectively. During the second quarter of 2009, Sonic s stockholders approved an increase in the number of shares of Sonic s Class A Common Stock authorized for issuance under the 2004 Plan and the 2005 Formula Plan to 5,000,000 and 340,000, respectively. The Sonic Automotive, Inc. 1997 Stock Option Plan (the 1997 Plan ) was terminated during the fourth quarter of 2007.

The 2004 Plan and the 1997 Plan were adopted by the Board of Directors in order to attract and retain key personnel. 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 2004 Plan also authorized the issuance of restricted stock. Restricted stock grants under the 2004 Plan vest over a three year term. The 2005 Formula Plan provides for grants of restricted stock to non-employee directors and restrictions on those shares expire on the earlier of the first anniversary of the grant date or the day before the next annual meeting of Sonic s stockholders. Individuals receiving restricted shares under both the 2005 Formula Plan and the 2004 Plan have voting rights and receive dividends on non-vested shares. Sonic issues new shares of Class A common stock to employees and directors to satisfy its option exercise and stock grant obligations. To offset the effects of these transactions, Sonic will periodically buy back shares of Class A common stock after considering cash flow, market conditions and other factors.

A summary of the status of the options related to the Stock Plans and the 1997 Plan is presented below:

|             |                   | <b>Options</b>     | <b>Exercise</b>  |   |       | <b>Weighted<br/>Average<br/>Exercise<br/>Price<br/>per<br/>Share</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|-------------|-------------------|--------------------|--|---|-------|--|--|--|
|             |                   | <b>Outstanding</b> | <b>Price per Share</b>   |   |       |  |  |  |
|             |                   |                    | <b>(\$ in thousands, except per share data, term in years)</b> |   |       |  |  |  |
| Balance     | December 31, 2009 | 4,014              | \$ 1.81  | - | 37.50 | \$ 15.48   | 5.9  | \$ 12,349                                |
| Exercised   |                   | (357)              | 1.81   | - | 11.19 | 5.18   |  |  |
| Forfeited   |                   | (228)              | 1.81   | - | 37.50 | 13.51  |  |  |
| Balance     | December 31, 2010 | 3,429              | \$ 1.81  | - | 37.50 | \$ 16.69   | 5.1  | \$ 13,193                                |
| Exercisable |                   | 2,535              | \$ 1.81  | - | 37.50 | \$ 21.93   | 4.0  | \$ 2,976                                 |

|   | <b>December 31,</b>                               |             |             |
|---|---|-------------|-------------|
|   | <b>2008</b>                                       | <b>2009</b> | <b>2010</b> |
|   | <b>(In thousands, except<br/>per option data)</b> |             |             |
| Weighted Average Grant-Date Fair Value per Option Granted | N/A   | \$ 0.99     | N/A         |
| Intrinsic Value of Options Exercised                      | \$ 3,146  | \$          | \$ 2,235    |
| Fair Value of Shares Vested                               | \$ 5,867  | \$ 395      | \$ 555      |

Sonic recognized compensation expense within selling, general and administrative expenses related to the options in the Stock Plans of \$2.2 million, \$0.6 million and \$0.5 million in the years ended December 31, 2008, 2009 and 2010, respectively. Tax benefits recognized related to the compensation expenses were \$0.8 million, \$0.2 million and \$0.2 million for the years ended December 31, 2008, 2009 and 2010, respectively. The total compensation cost related to non-vested options not yet recognized at December 31, 2010 was \$0.5 million and is expected to be recognized over a weighted average period of 1.3 years.



**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Black-Scholes Assumptions***

The weighted average fair value of options granted in the year ended December 31, 2009 (no options were granted in 2008 or 2010) was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

|                           | <b>2009</b> |
|---------------------------|-------------|
| <b>Stock Option Plans</b> |             |
| Dividend yield            | 0.00%       |
| Risk free interest rates  | 1.67-1.87%  |
| Expected lives            | 5 years     |
| Volatility                | 64.13%      |

Sonic used an expected term of five years for option grants based on several facts associated with past grants and exercises. First, the historical exercise experience indicated that the expected term was at least three years (consistent with the three year graded vesting period attached to the majority of these options) and the majority of Sonic's grants were in the early to middle stages of their contractual terms of ten years; secondly, the contractual term of all of Sonic's options was ten years. Expected volatility was estimated based on historical experience.

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

|           |                   | <b>Unvested Restricted</b> |    | <b>Weighted</b>        |
|-----------|-------------------|----------------------------|----|------------------------|
|           |                   | <b>Stock and</b>           |    | <b>Average</b>         |
|           |                   | <b>Restricted Stock</b>    |    | <b>Grant Date Fair</b> |
|           |                   | <b>Units</b>               |    | <b>Value</b>           |
|           |                   | <b>(Shares in</b>          |    |                        |
|           |                   | <b>thousands)</b>          |    |                        |
| Balance   | December 31, 2009 | 313                        | \$ | 17.45                  |
| Granted   |                   | 502                        |    | 10.30                  |
| Forfeited |                   | (4)                        |    | 10.30                  |
| Vested    |                   | (305)                      |    | 17.47                  |
| Balance   | December 31, 2010 | 506                        | \$ | 10.58                  |

During the year ended December 31, 2010, approximately 472,000 restricted shares of Class A common stock and restricted stock units were awarded to Sonic's executive officers and other key associates under the 2004 Plan. These awards were made in connection with establishing the objective performance criteria for 2010 incentive compensation and vest one-third annually over three years. The shares and units awarded to executive officers and other key

associates are subject to forfeiture, in whole or in part, based upon specified measures of Sonic's earnings per share performance for the 2010 fiscal year, continuation of employment and compliance with any restrictive covenants contained in any agreement between Sonic and the respective officer and other key associates. Also in 2010, 30,000 restricted shares of Class A common stock were awarded to Sonic's Board of Directors pursuant to the 2005 Formula Plan and vest on the earlier of the first anniversary of the grant date or the day before the next annual meeting of Sonic's stockholders. Sonic recognized compensation expense within selling, general and administrative expenses related to non-vested restricted stock and restricted stock units of \$3.9 million, \$2.2 million and \$2.3 million in the years ended December 31, 2008, 2009 and 2010, respectively. Tax benefits recognized related to the compensation expenses were \$1.5 million, \$0.8 million and \$0.9 million for the years ended December 31, 2008, 2009 and 2010, respectively. Total compensation cost related to non-vested restricted stock not yet recognized at December 31, 2010 was \$3.6 million and is expected to be recognized over a weighted average period of 2.1 years.

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Supplemental Executive Retirement Plan***

On December 7, 2009, the Compensation Committee of Sonic's Board of Directors approved and adopted the Sonic Automotive, Inc. Supplemental Executive Retirement Plan (the "SERP") to be effective as of January 1, 2010. The SERP is a nonqualified deferred compensation plan that is unfunded for federal tax purposes. The SERP includes 11 members of senior management at December 31, 2010. The purpose of the SERP is to attract and retain key members of management by providing a retirement benefit in addition to the benefits provided by Sonic's tax-qualified and other nonqualified deferred compensation plans. As of December 31, 2010, Sonic had recorded a liability of \$1.0 million and assets of \$1.7 million in the Consolidated Balance Sheets related to the SERP. Service cost recognized for the year ended December 31, 2010 was \$1.0 million and is recorded in selling, general and administrative expenses in the Consolidated Statements of Income.

**11. Fair Value Measurements**

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

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

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

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

*Level 3* Valuations based on inputs that are unobservable and significant to the overall fair value measurement. Asset and liability measurements utilizing Level 3 inputs include those used in estimating fair value of non-financial assets and non-financial liabilities in purchase acquisitions, those used in assessing impairment of property, plant and equipment and other intangibles and those used in the reporting unit valuation in the first step of the annual goodwill impairment evaluation. For instance, certain assets held for sale in the accompanying Consolidated Balance Sheets are valued based on estimated proceeds to be received in connection with the disposal of those assets.

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

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

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Assets or liabilities recorded at fair value in the accompanying balance sheet as of December 31, 2009 and 2010 are as follows:

|  | <b>Total</b>         |                  | <b>Fair Value at December 31,<br/>Quoted Prices<br/>in Active<br/>Markets for<br/>Identical<br/>Assets (Level 1)</b> |             | <b>Significant Other<br/>Observable<br/>Inputs (Level 2)</b> |                  | <b>Significant<br/>Unobservable<br/>Inputs (Level 3)</b> |             |
|--|----------------------|------------------|--|-------------|--|------------------|--|-------------|
|  | <b>2009</b>          | <b>2010</b>      | <b>2009</b>  | <b>2010</b> | <b>2009</b>  | <b>2010</b>      | <b>2009</b>  | <b>2010</b> |
|  | <b>(In millions)</b> |                  |  |             |  |                  |  |             |
| Cash Flow Swaps Designated<br>as Hedges(1)     | \$ (25.9)            | \$ (25.3)        | \$   | \$          | \$ (25.9)  | \$ (25.3)        | \$   | \$          |
| Cash Flow Swaps not<br>Designated as Hedges(1) | (6.6)                | (7.4)            |  |             | (6.6)  | (7.4)            |  |             |
| <b>Total</b>                                   | <b>\$ (32.5)</b>     | <b>\$ (32.7)</b> | <b>\$</b>  | <b>\$</b>   | <b>\$ (32.5)</b>   | <b>\$ (32.7)</b> | <b>\$</b>  | <b>\$</b>   |

(1) - Included in Other Long-Term Liabilities in the accompanying Consolidated Balance Sheets.

Assets or liabilities measured at fair value on a non-recurring basis in the accompanying balance sheet as of December 31, 2010 are as follows:

|                                    | <b>Year Ended<br/>12/31/2010</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)<br/>(In millions)</b> | <b>Total<br/>Gains / (Losses)</b> |
|------------------------------------|----------------------------------|--|-----------------------------------|
| Long-lived assets held and used(1) | \$ 436.3                         | \$ 436.3   | \$ (0.2)                          |
| Goodwill(2)                        | 468.5                            | 468.5  |                                   |
| Franchise assets(2)                | 64.8                             | 64.8   |                                   |
| Long-lived assets held for sale(3) | 2.0                              | 2.0  |                                   |

(1) See Note 4 for discussion.

(2) See Note 5 for discussion.

(3) Includes real estate property. See Note 4 for discussion.

As of December 31, 2009 and December 31, 2010, the fair values of Sonic's financial instruments including receivables, notes receivable from finance contracts, notes payable-floor plan, trade accounts payable, borrowings under the revolving credit facilities and certain mortgage notes approximate their carrying values due either to length of maturity or existence of variable interest rates that approximate prevailing market rates.

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

|  | December 31, 2009 |                | December 31, 2010 |                |
|--|-------------------|----------------|-------------------|----------------|
|  | Fair Value        | Carrying Value | Fair Value        | Carrying Value |
|  | (In thousands)    |                |                   |                |
| 9.0% Convertible Senior Subordinated Notes(1)  | \$                | \$             | \$ 220,836        | \$ 208,630     |
| 8.625% Senior Subordinated Notes(1)            | \$ 266,750        | \$ 273,455     | \$ 43,498         | \$ 42,673      |
| 5.0% Convertible Senior Notes(1)               | \$ 188,072        | \$ 142,743     | \$ 215,453        | \$ 147,824     |
| 4.25% Convertible Senior Subordinated Notes(1) | \$ 16,363         | \$ 16,423      | \$                | \$             |
| Mortgage Notes(2)                              | \$ 78,333         | \$ 78,424      | \$ 88,119         | \$ 88,262      |
| Notes Payable to a Finance Company(2)          | \$ 17,859         | \$ 20,260      | \$ 15,676         | \$ 17,427      |
| Other(2)                                       | \$ 5,349          | \$ 5,931       | \$ 5,311          | \$ 5,751       |

(1) As determined by market quotations as of December 31, 2010 (Level 1).

(2) As determined by discounted cash flows (Level 3).

**12. Commitments and Contingencies*****Facility and Equipment Leases***

During 2010, Sonic's management decided to cease using one dealership property which is leased under an operating lease. Of the \$4.3 million of lease exit expense recorded for the year ended December 31, 2010, \$0.1 million related to lease exit accruals established in 2010 and adjustments to lease exit accruals recorded in prior years for the present value of the lease payments, net of estimated sublease rentals, for the remaining life of the operating leases and other accruals necessary to satisfy the lease commitment to the landlord. The remaining \$4.2 million lease exit expense was related to interest charges for dealerships for which lease exit accruals exist. A summary of the activity of these operating lease accruals consists of the following:

|                            | (In thousands) |
|----------------------------|----------------|
| Balance, December 31, 2009 | \$ 47,825      |
| Lease exit expense(1)      | 4,266          |
| Payments(2)                | (8,557)        |
| Reversals                  |                |

Balance, December 31, 2010 \$ 43,534

- (1) Approximately \$4.2 million is recorded in interest expense, other, net, and the remaining \$0.1 million is recorded in selling, general and administrative expenses in the accompanying Consolidated Statements of Income.
- (2) Amount is recorded as reduction of rent expense in selling, general and administrative expenses in the accompanying Consolidated Statements of Income.

Sonic leases facilities for the majority of its dealership operations under operating lease arrangements. These facility lease arrangements normally have fifteen to twenty year terms with one or two ten year renewal options and do not contain provisions for contingent rent related to dealership's operations. Many of the leases are subject to the

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**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

provisions of a guaranty and subordination agreement that contains financial and affirmative covenants. Sonic was in compliance with these covenants at December 31, 2010. Approximately 20% of these facility leases are based on capitalization rates with payments that vary based on interest rates. Sonic also leases certain equipment for use in dealership operations. These equipment lease arrangements normally 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 non-cancelable operating leases for both continuing and discontinued operations based on interest rates as of the inception of each lease are as follows:

| <b>Year Ending December 31,</b> | <b>Future<br/>Minimum<br/>Lease<br/>Payments, Net<br/>(In thousands)</b> | <b>Receipts<br/>from Future<br/>Subleases</b> |
|---------------------------------|--|---|
| 2011                            | \$ 107,191   | \$ (14,291)                                   |
| 2012                            | 97,935   | (13,759)                                      |
| 2013                            | 93,465   | (12,763)                                      |
| 2014                            | 90,004   | (12,793)                                      |
| 2015                            | 85,609   | (10,805)                                      |
| Thereafter                      | 385,844  | (41,830)                                      |

Total lease expense for continuing operations in 2008, 2009 and 2010 was approximately \$122.5 million, \$113.9 million and \$113.8 million, respectively. Total lease expense for discontinued operations in 2008, 2009 and 2010 was approximately \$28.2 million, \$39.5 million and \$1.7 million, respectively. The total net contingent rent benefit in 2008 relating to a decrease in interest rates since the underlying leases commenced for continuing and discontinued operations was \$1.9 million and \$0.2 million, respectively. The total net contingent benefit in each of 2009 and 2010 relating to a decrease in interest rates since the underlying leases commenced for continuing and discontinued operations was \$2.5 million and \$0.4 million, respectively.

Many of Sonic's facility operating leases are subject to affirmative and financial covenant provisions related to a subordination and guaranty agreement executed with the landlord of many of its facility properties. On March 12, 2009, Sonic amended this guaranty and subordination agreement with the landlord. This amendment adjusted the calculation of the consolidated fixed charge coverage ratio covenant contained in the original guaranty and subordination agreement and added two additional financial covenants: a consolidated liquidity ratio covenant and a consolidated total senior secured debt to EBITDA ratio covenant. The required financial covenants related to the amended subordination and guaranty agreement are as follows:

|                     | <b>Covenant</b>                          |   |               |
|---------------------|--|---|---------------|
| <b>Consolidated</b> | <b>Consolidated<br/>Fixed<br/>Charge</b> | <b>Consolidated<br/>Total Senior<br/>Secured Debt</b> | <b>EBTDAR</b> |
| <b>Liquidity</b>    | <b>Coverage</b>                          | <b>to</b>   | <b>to</b>     |

|   | <b>Ratio</b>      | <b>Ratio</b>      | <b>EBITDA Ratio</b> | <b>Rent Ratio</b> |
|---|-------------------|-------------------|---------------------|-------------------|
| Through March 30, 2011                              | <sup>3</sup> 1.00 | <sup>3</sup> 1.10 | £2.25               | <sup>3</sup> 1.50 |
| March 31, 2011 through and including March 30, 2012 | <sup>3</sup> 1.05 | <sup>3</sup> 1.15 | £2.25               | <sup>3</sup> 1.50 |
| March 31, 2012 and thereafter                       | <sup>3</sup> 1.10 | <sup>3</sup> 1.20 | £2.25               | <sup>3</sup> 1.50 |
| December 31, 2010 actual                            | 1.17              | 1.40              | 1.22                | 2.11              |

### ***Guarantees and Indemnifications***

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.

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 sub-lessee does not perform. These obligations are included within the future minimum lease payments, net, in the table above. In the event the sub-lessees do not perform under their obligations Sonic remains liable for the lease payments. The total amount relating to this risk is approximately \$106.2 million, which is the total of the receipts from future subleases in the table under Facility and Equipment Leases above. However, there are situations where Sonic has assigned a lease to the buyer and Sonic was not able to obtain a release from the landlord. In these situations, although Sonic is no longer the primary obligor, Sonic is contingently liable if the buyer does not perform under the lease terms. The total estimated minimum lease payments remaining related to these leases totaled \$13.6 million at December 31, 2010. However, in accordance with the terms of the assignment and sublease agreements, the assignees and sub-lessees 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 sub-lessees in the event of non-performance.

In accordance with the terms of agreements entered into for the sale of Sonic's franchises, Sonic generally agrees to indemnify the buyer from certain 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 maximum exposure associated with these general indemnifications was \$17.3 million at December 31, 2010. 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 and the amount recorded for this contingency was not significant at December 31, 2010.

One of the dealership acquisitions Sonic completed in 2007 provides for additional cash consideration of up to \$3.0 million to be paid if the dealership acquired achieves a prescribed level of earnings over a continuous twelve-month period within the five years following the acquisition. As of December 31, 2010, the acquired dealership had not achieved the level of earnings which would result in additional consideration to be paid.

***Legal Matters***

Sonic is a defendant in the matter of Galura, et al. v. Sonic Automotive, Inc., a private civil action filed in the Circuit Court of Hillsborough County, Florida. In this action, originally filed on December 30, 2002, the plaintiffs allege that Sonic and its Florida dealerships sold an antitheft protection product in a deceptive or otherwise illegal manner, and further sought representation on behalf of any customer of any of 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. In April 2007, the Florida Court of Appeals affirmed a portion of the trial court's class certification, and overruled a portion of the trial court's class certification. In November 2009, the Florida trial court granted Summary Judgment in Sonic's favor against Plaintiff Enrique Galura, and his claim has been dismissed. Marisa Hazelton's claim is still pending. Sonic currently intends to continue its vigorous appeal and defense of this lawsuit and to assert available defenses. However, an adverse resolution of this lawsuit could result in the payment of significant costs and damages, which

could have a material adverse effect on Sonic's future results of operations, financial condition and cash flows. At a mediation held February 4, 2011, Sonic reached an agreement in principle with the plaintiffs to settle this class action lawsuit. This agreement in principle remains conditioned upon execution

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**SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

of a definitive settlement agreement and subsequent approval by the Florida state court. In the event that a definitive settlement of this lawsuit is finalized upon terms and conditions consistent with the agreement in principle, such a settlement would not have a material adverse affect on Sonic's future results of operations, financial condition and cash flows.

Several private civil actions have been filed against Sonic Automotive, Inc. and several of its dealership subsidiaries that purport to represent classes of customers as potential plaintiffs and made 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 was filed on November 15, 2004 in South Carolina state court, York County Court of Common Pleas, against Sonic Automotive, Inc. and 10 of Sonic's South Carolina subsidiaries. The plaintiffs in that lawsuit were Misty J. Owens, James B. Wright, Vincent J. Astey and Joseph Lee Williams, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The group of plaintiffs' attorneys representing the plaintiffs in the South Carolina lawsuit also filed another private civil class action lawsuit against Sonic Automotive, Inc. and 3 of its subsidiaries on February 14, 2005 in state court in North Carolina, Lincoln County Superior Court, which similarly sought certification of a multi-state class of plaintiffs and alleged that certain products sold in the finance and insurance departments were done so in a deceptive or otherwise illegal manner. The plaintiffs in this North Carolina lawsuit were Robert Price, Carolyn Price, Marcus Cappelletti and Kathy Cappelletti, on behalf of themselves and all other persons similarly situated, with plaintiffs seeking monetary damages and injunctive relief on behalf of the purported class. The South Carolina state court action and the North Carolina state court action have since been consolidated into a single proceeding in private arbitration before the American Arbitration Association. On November 12, 2008, claimants in the consolidated arbitration filed a Motion for Class Certification as a national class action including all of the states in which Sonic operates dealerships. Claimants are seeking monetary damages and injunctive relief on behalf of this class of customers. The parties have briefed and argued the issue of class certification.

On July 19, 2010, the Arbitrator issued a Partial Final Award on Class Certification, certifying a class which includes all customers who, on or after November 15, 2000, purchased or leased from a Sonic dealership a vehicle with the Etch product as part of the transaction, but not including customers who purchased or leased such vehicles from a Sonic dealership in Florida. The Partial Final Award on Class Certification is not a final decision on the merits of the action. The merits of Claimants' assertions and potential damages will still have to be proven through the remainder of the arbitration. The Arbitrator stayed the Arbitration for thirty days to allow either party to petition a court of competent jurisdiction to confirm or vacate the award. Sonic will seek review of the class certification ruling by a court of competent jurisdiction and will continue to press its argument that this action is not suitable for a class-based arbitration. On July 22, 2010, the plaintiffs in this consolidated arbitration filed a Motion to Confirm the Arbitrator's Partial Final Award on Class Certification in state court in North Carolina, Lincoln County Superior Court. On August 17, 2010, Sonic filed to remove this North Carolina state court action to federal court, and simultaneously filed a Petition to Vacate the Arbitrator's Partial Final Award on Class Certification, with both filings made in the United States District Court for the Western District of North Carolina. Sonic intends to continue its vigorous defense of this arbitration and to assert all available defenses. However, an adverse resolution of this arbitration could result in the payment of significant costs and damages, which could have a material adverse effect on Sonic's future results of operations, financial condition and cash flows.

Sonic is involved, and expects to continue to be involved, in numerous legal and administrative proceedings arising out of the conduct of its business, including regulatory investigations and private civil actions brought by plaintiffs purporting to represent a potential class or for which a class has been certified. Although Sonic vigorously defends

itself in all legal and administrative proceedings, the outcomes of pending and future proceedings arising out of the conduct of Sonic's business, including litigation with customers, employment related lawsuits, contractual disputes, class actions, purported class actions and actions brought by governmental authorities, cannot be predicted with certainty. An unfavorable resolution of one or more of these matters could have a material adverse effect on Sonic's business, financial condition, results of operations, cash flows or prospects. Included in other

**Table of Contents****SONIC AUTOMOTIVE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

accrued liabilities at December 31, 2009 and 2010 were \$9.2 million and \$9.1 million, respectively, in reserves that Sonic has provided for pending proceedings.

**13. 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 2009 and 2010.

|  | <b>First<br/>Quarter</b>                     | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |  |
|--|--|---------------------------|--------------------------|---------------------------|--|
|  | <b>(In thousands, except per share data)</b> |                           |                          |                           |  |

Year Ended  
December 31,  
2009

|                |              |              |              |              |    |                                    |
|----------------|--------------|--------------|--------------|--------------|----|------------------------------------|
| Total revenues | \$ 1,363,074 | \$ 1,485,685 | \$ 1,629,897 | \$ 1,576,685 | 17 | <u>FIRPTA Company Certificate.</u> |
|----------------|--------------|--------------|--------------|--------------|----|------------------------------------|

Prior to the Effective Time, the Company shall execute and deliver to Parent and Sub a certificate (in a form reasonably acceptable to Parent and Sub) conforming to the requirements of Treasury Regulations Sections 1.1445-2(c)(3) and 1.897-2(h).

4.18 **Conduct of Parent and Sub.**

Subject to applicable Law, neither Parent nor Sub will take any action that, or fail to take any reasonable action, for which the failure to take such action, is intended to, or would reasonably be expected to, individually or in the aggregate, result in any condition to the Merger not being satisfied or prevent, delay or impede the ability of Parent and Sub or the Company to consummate the Merger or the other transactions contemplated by this Agreement.

4.19 **Section 16 Matters.**

The Board or a committee of non-employee directors thereof (as such term is defined for purposes of Rule 16b-3(d) under the Exchange Act) shall adopt a resolution in advance of the Effective Time providing that the disposition by the officers and directors of the Company of Company Common Stock, Company Options or other equity securities of the Company pursuant to the Merger or the other transactions contemplated by this Agreement is intended to be

exempt

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from liability pursuant to Rule 16b-3 under the Exchange Act and shall take all such reasonable steps as may be required to cause such dispositions to be so exempt. The board of directors of Parent or a committee of non-employee directors thereof (as such term is defined for purposes of Rule 16b-3(d) under the Exchange Act) shall adopt a resolution in advance of the Effective Time providing that the receipt by the Company Insiders (as defined below) of Parent Common Stock or other equity securities of Parent pursuant to the Merger or the other transactions contemplated by this Agreement (to the extent such equity securities are listed in the Section 16 Information, as defined below) is intended to be exempt from liability pursuant to Rule 16b-3 under the Exchange Act. For purposes of this Section 4.19, the term “Company Insiders” means those officers and directors of the Company who are currently subject to or will become subject to the reporting requirements of Section 16(a) of the Exchange Act as insiders of Parent in conjunction with the Merger, and the term “Section 16 Information” means information provided by Company that is accurate in all respects regarding Company Insiders and the number of shares of Parent Common Stock or other Parent equity securities to be acquired by each such Company Insider in connection with the Merger and other transactions contemplated by this Agreement.

4.20 Governance Matters.

The Company shall take all reasonable action to cause, effective at the Effective Time, if requested by Parent, the resignations of such directors and officers of the Company and/or the Company Subsidiaries as Parent may request.

4.21 SEC Reports.

During the period prior to the Effective Time, the Company and Parent shall each continue to timely file or furnish all forms, reports, statements, schedules and other materials with the SEC required to be filed or furnished pursuant to the Exchange Act or other federal or applicable foreign securities Laws.

4.22 Post-Closing Restructuring.

As promptly as practicable after the Effective Time, the Surviving Corporation shall merge with and into a Delaware limited liability company wholly owned by Parent (the “LLC”), in accordance with the provisions of the NJBCA and the Delaware Limited Liability Act, as amended (the “DELLC Act”), and with the effects provided in the NJBCA and the DELLC Act. At the effective time of such merger, the separate corporate existence of the Surviving Corporation shall cease, and the LLC shall continue as the surviving entity in such merger (the “Surviving Entity”) and shall be a wholly owned Subsidiary of Parent and shall be governed by the Laws of the State of Delaware. From and after the effective time of such merger, the Surviving Entity shall possess all properties, rights, privileges, powers and franchises of the

Surviving Corporation, and all of the claims, obligations, liabilities, debts and duties of the Surviving Corporation and the LLC shall become the claims, obligations, liabilities, debts and duties of the Surviving Entity.

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Article 5

Conditions Precedent to Obligations to Consummate

5.1 Conditions to Obligations of Each Party.

The obligations of the Company, Parent and Sub to effect the Merger and the other transactions contemplated hereby are subject to the satisfaction or waiver (other than the Required Company Vote, which may not be waived in any circumstance) on or prior to the Closing of the following conditions:

(a) Company Shareholder Approval. The Company shall have obtained the Required Company Vote in connection with the approval and adoption of this Agreement, the Merger and the other transactions contemplated by this Agreement.

(b) No Injunctions or Restraints, Illegality. No statute, rule, regulation, executive order, decree or ruling, shall have been adopted or promulgated, and no temporary restraining order, preliminary or permanent injunction or other order issued by a court or other U.S. Governmental Entity of competent jurisdiction shall be in effect, having the effect of making the Merger or the other transactions contemplated hereby illegal or otherwise prohibiting consummation of the Merger or the other transactions contemplated hereby; provided, that the provisions of this Section 5.1(b) shall not be available to any Party whose failure to fulfill its obligations pursuant to Section 4.9 shall have been the cause of, or shall have resulted in, such order or injunction.

(c) Antitrust and Competition Laws. The waiting period (and any extension thereof) applicable to the Merger and the other transactions contemplated pursuant to this Agreement under the HSR Act shall have been terminated or shall have expired, and all waiting period expirations or terminations, consents, clearances, waivers, licenses, orders, registrations, approvals, permits, and authorizations necessary under the Antitrust Laws of the jurisdictions set forth in Section 5.1(c) of the Company Disclosure Schedule and Section 5.1(c) of the Parent Disclosure Schedule, shall have been obtained.

(d) Consents and Approvals. All consents, waivers, authorizations and approvals of any Governmental Entity or any third party required in connection with the execution, delivery and performance of this Agreement and the other transactions contemplated hereby set forth in Section 5.1(d) of the Company Disclosure Schedule and Section 5.1(d) of the Parent Disclosure Schedule shall have been duly obtained and shall be in full force and effect on the Closing Date.

(e) Listing. The Parent Common Stock to be issued in the Merger shall have been approved for quotation or listing, as the case may be, on the New York Stock Exchange (or any successor inter-dealer quotation system or stock exchange thereto) subject to official notice of issuance.

(f) Effectiveness of the Registration Statement. The Registration Statement shall have been declared effective by the SEC under the Securities Act. No stop order

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suspending the effectiveness of the Registration Statement shall have been issued by the SEC and no proceedings for that purpose and no similar proceeding in respect of the Proxy Statement/Prospectus shall have been initiated or threatened by the SEC.

5.2 Conditions to Obligations of Parent and Sub.

The obligations of Parent and Sub to effect the Merger and the other transactions contemplated hereby are subject to the satisfaction, or waiver by Parent, on or prior to the Closing, of the following additional conditions:

(a) Representations and Warranties. The representations and warranties of the Company set forth in Article 2 of this Agreement shall be true and correct with such exceptions as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect (without giving effect to any limitation indicated therein by the words “Company Material Adverse Effect,” “in all material respects,” “in any material respect,” “material” or “materially” used with respect to the Company (each, a “Company Materiality Qualifier”)) when made and as of the Closing Date, as if made at and as of such date (except those representations and warranties that address matters only as of a particular date, which shall be true and correct in all respects only as of such date), provided, that the representations and warranties of the Company set forth (i) in Sections 2.3 (other than the last sentence of 2.3(b)), 2.4(a), 2.4(b)(i), 2.4(c)(ii), 2.4(d), 2.23, 2.25 and the first sentence of Sections 2.1(a) and 2.1(b), shall be true and correct in all respects (without giving effect to any Company Materiality Qualifier therein) other than inaccuracies that are de minimis in the context of a transaction of this magnitude, and (ii) in Section 2.7(b) shall be true and correct in all respects, in each of the foregoing cases, when made and as of the Closing Date, as if made at and as of such date (except those representations and warranties that address matters only as of a particular date, which shall be true and correct in all respects only as of that date). Parent shall have received a certificate of an executive officer of the Company to such effect. For purposes of this Section 5.2(a), “de minimis” with respect to inaccuracies in Section 2.3 shall mean inaccuracies involving, in the aggregate, an amount of shares of Company Common Stock not in excess of 69,510.

(b) Performance of Obligations of the Company. The Company shall have performed in all material respects and complied in all material respects with all agreements and covenants required to be performed or complied with by it under this Agreement at or prior to the Closing Date; provided that the failure to notify Parent in accordance with Sections 4.1(c), 4.4(a) and 4.4(b) shall not be deemed to be a failure to perform or comply with such agreements and covenants unless such notice was with respect to a fact, change, event, effect or occurrence that has had or that would reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. Parent shall have received a certificate of an executive officer of the Company to such effect.

(c) Parent Tax Opinion. Parent shall have received a written opinion of counsel from Greenberg Traurig, P.A., in form reasonably satisfactory to Parent (the “Parent Tax Opinion” and together with the Company Tax Opinion, the “Tax Opinions”), dated as of the Closing Date, to the effect that the Merger will qualify as a “reorganization” within the meaning of Section 368(a) of the Code. In rendering such Parent Tax Opinion, such counsel shall be

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entitled to rely upon representations of officers of Company and Parent reasonably satisfactory in form and substance to such counsel. If Greenberg Traurig, P.A. does not render such opinion, this condition may be satisfied if a nationally-recognized law firm (other than Davis Polk & Wardwell LLP) renders such opinion, relying upon representations of officers of the Company and Parent reasonably satisfactory in form and substance to such firm.

### 5.3 Conditions to Obligations of the Company.

The obligations of the Company to effect the Merger and the other transactions contemplated hereby are subject to the satisfaction of, or waiver by the Company, on or prior to the Closing of the following additional conditions:

(a) Representations and Warranties. The representations and warranties of Parent and Sub set forth in Article 3 of this Agreement shall be true and correct with such exceptions as would not, individually or in the aggregate, reasonably be expected to have a Parent Material Adverse Effect (without giving effect to any limitation indicated therein by the words “Parent Material Adverse Effect,” “in all material respects,” “in any material respect,” “material” or “materially” used with respect to Parent or Sub (each, a “Parent Materiality Qualifier”)) when made and as of the Closing Date, as if made at and as of such date (except those representations and warranties that address matters only as of a particular date, which shall be true and correct in all respects only as of such date), provided, that the representations and warranties of Parent and Sub set forth in (i) Sections 3.2(a), 3.2(b)(i), 3.4, 3.18 and 3.19, and the first sentence of Sections 3.1(a) and 3.1(b) shall be true and correct in all respects (without giving effect to any Parent Materiality Qualifier therein) other than inaccuracies that are de minimis in the context of a transaction of this magnitude, and (ii) Section 3.8(a) shall be true and correct in all respects, in each of the foregoing cases, when made and as of the Closing Date, as if made at and as of such date (except those representations and warranties that address matters only as of a particular date, which shall be true and correct in all respects only as of that date). The Company shall have received a certificate of an executive officer of Parent and Sub to such effect. For purposes of this Section 5.3(a), “de minimis” with respect to inaccuracies in Section 3.4(a) shall mean inaccuracies involving, in the aggregate, an amount of shares of Parent Common Stock not in excess of 1,158,229.

(b) Performance of Obligations of Parent. Parent shall have performed in all material respects and complied in all material respects with all agreements and covenants required to be performed or complied with by it under this Agreement at or prior to the Closing Date; provided that the failure to notify the Company in accordance with Section 4.4(a) shall not be deemed to be a failure to perform or comply with such agreements and covenants unless such notice was with respect to a fact, change, event, effect or occurrence that has had or that would reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect. The Company shall have received a certificate of an executive officer of Parent to such effect.

(c) Company Tax Opinion. Company shall have received a written opinion of counsel from Davis Polk & Wardwell LLP, in form reasonably satisfactory to Company (the "Company Tax Opinion"), dated as of the Closing Date, to the effect that the Merger will qualify

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as a “reorganization” within the meaning of Section 368(a) of the Code. In rendering such Company Tax Opinion, such counsel shall be entitled to rely upon representations of officers of the Company and Parent reasonably satisfactory in form and substance to such counsel. If Davis Polk & Wardwell LLP does not render such opinion, this condition may be satisfied if a nationally-recognized law firm (other than Greenberg Traurig, P.A.) renders such opinion, relying upon representations of officers of the Company and Parent reasonably satisfactory in form and substance to such firm.

## Article 6

### Termination

#### 6.1 Termination.

This Agreement may be terminated at any time prior to the Effective Time, whether before or after receipt of the Required Company Vote (except as otherwise expressly noted):

(a) by mutual written consent of Parent and the Company, by action of their respective boards of directors;

(b) by either the Company or Parent if:

(i) the Effective Time shall not have occurred on or before December 2, 2015 (the “Termination Date”); provided that the Termination Date shall be automatically extended for a period of ninety (90) days in the event that the failure of the Closing to have occurred by the initial Termination Date results primarily by the failure of any of the conditions set forth in Sections 5.1(c), 5.1(d), 5.1(e) or 5.1(f); and provided further, that the right to terminate this Agreement under this Section 6.1(b)(i) shall not be available to any Party whose failure to fulfill any obligation under this Agreement has been the principal cause of the failure of the Effective Time to occur on or before the Termination Date and such action or failure to perform constitutes a breach of this Agreement;

(ii) if any Governmental Entity of competent jurisdiction shall have issued an order, decree or ruling or taken any other action permanently restraining, enjoining or otherwise prohibiting or making illegal the transactions contemplated by this Agreement, and such order, decree, ruling or other action shall be in effect and shall have become final and nonappealable; provided that the Party seeking to terminate this Agreement pursuant to Section 6.1(b)(ii) shall have used its reasonable best efforts to resist, remove or resolve such restraint or prohibition as

required by this Agreement; and provided, further, that the right to terminate this Agreement pursuant to this Section 6.1(b)(ii) shall not be available to any Party whose material breach of any provision of this Agreement results in the imposition of such order, decree or ruling or the failure of such order, decree or ruling to be resisted, resolved or lifted; or

(iii) if the Company Shareholders' Meeting shall have been conducted and the Required Company Vote shall not have been obtained.

(c) by Parent, if:

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(i) the Company shall have breached or failed to perform in any respect any of its representations, warranties, covenants or agreements contained in this Agreement, which breach or failure to perform (A) is not capable of being, or is not, cured by the Company within ninety (90) days following receipt by the Company of written notice of such breach or failure to perform from Parent (or, if earlier, the Termination Date), and (B) would result in a failure of any condition set forth in Sections 5.1 or 5.2; provided that Parent's right to terminate this Agreement pursuant to this Section 6.1(c)(i) shall not be available if Parent or Sub is then in material breach of any of its representations, warranties, covenants or agreements hereunder that would result in the conditions to Closing set forth in Sections 5.1 or 5.3 not being satisfied;

(ii) (A)(i) the Board fails to include the Company Board Recommendation in the Proxy Statement/Prospectus or (ii) a Change in Recommendation or a Company Intervening Event Change in Recommendation shall have occurred; (B) there has been a publicly announced Company Acquisition Proposal that is not with respect to a tender offer or exchange offer, and the Board shall have failed to publicly reaffirm the Company Board Recommendation within five (5) Business Days after Parent so requests in writing; (C) the Company enters into a written agreement with respect to a Company Acquisition Agreement; or (D) the Company or the Board shall have publicly announced its intention to do any of the foregoing; or

(d) by the Company if

(i) Parent or Sub shall have breached or failed to perform in any respect any of their respective representations, warranties, covenants or agreements contained in this Agreement, which breach or failure to perform (A) is not capable of being, or is not, cured by Parent within ninety (90) days following receipt by Parent of written notice of such breach or failure to perform from the Company (or, if earlier, the Termination Date), and (B) would result in a failure of any condition set forth in Sections 5.1 or 5.3; provided, that the Company's right to terminate this Agreement pursuant to this Section 6.1(d)(i) shall not be available if the Company is then in material breach of any of its representations, warranties, covenants or agreements hereunder that would result in the conditions to Closing set forth in Sections 5.1 or 5.2 not being satisfied;

(ii) there is a Change in Recommendation (for the avoidance of doubt, but not a Company Intervening Event Change in Recommendation) after complying with Section 4.7; or

(iii) the Company enters into a Company Acquisition Agreement with respect to a Superior Proposal after complying with the requirements of Section 4.7 and concurrently with such termination the Company pays to Parent the Company Termination Fee pursuant to Section 6.2(b).



6.2 Effect of Termination.

(a) Except as provided in this Section 6.2, in the event of termination of this Agreement by either the Company or Parent as provided in Section 6.1, this Agreement (other than Section 4.8(b), 4.12, 6.2, 6.3 and Article 7) shall forthwith become void and there shall be no liability or obligation on the part of Parent, Sub or the Company or their respective Representatives; provided, that the termination of this Agreement shall not relieve any Party from any liability or damage (which the parties acknowledge and agree shall not be limited to the reimbursement of expenses or out-of-pocket costs, and may include to the extent proven the benefit of the bargain lost by a party's stockholders (taking into consideration relevant matters including other combination opportunities and the time value of money), which shall be deemed in such event to be damages of such party) as a result of any fraud or intentional and material breach of this Agreement by any party.

(b) If (x) Parent shall terminate this Agreement pursuant to Sections 6.1(c)(i) or 6.1(c)(ii)(B) or (y) Parent or the Company shall terminate this Agreement pursuant to Sections 6.1(b)(i) (provided that the Company Shareholders' Meeting has not yet been held) or 6.1(b)(iii), and, in either case (x) or (y), at any time after the date of this Agreement and prior to the termination of this Agreement a Company Acquisition Proposal shall have been publicly disclosed and not publicly withdrawn, then (A) the Company shall pay Parent the Expense Reimbursement within one (1) Business Day after Parent's demand therefor and (B) if within twelve (12) months after such termination, the Company enters into a Company Acquisition Agreement or consummates a Company Acquisition Proposal, then the Company shall pay to Parent an amount equal to \$54,000,000 (the "Company Termination Fee") by wire transfer of same day funds on the earlier of the date of entry into the Company Acquisition Agreement and such consummation.

(c) If (x) Parent shall terminate this Agreement pursuant to Sections 6.1(c)(ii)(A), (C) or (D) or (y) the Company shall terminate this Agreement pursuant to Section 6.1(d)(i) then, in either case, the Company shall pay to Parent (1), not later than two (2) Business Days following such termination, an amount equal to the Company Termination Fee and (2) the Expense Reimbursement within one (1) Business Day after Parent's demand therefor; provided, however, that if a termination under Section 6.1(c)(ii)(A) is pursuant to clause (ii) thereof because a Company Intervening Event Change in Recommendation has occurred, then in lieu of the Company Termination Fee, the Company shall pay to Parent an amount equal to \$40,500,000 (the "Company Intervening Event Termination Fee") (and, for the avoidance of doubt, the Expense Reimbursement). In addition, if Parent shall terminate this Agreement in a situation where it receives the Company Intervening Event Termination Fee and within twelve (12) months after such termination, the Company enters into a Company Acquisition Agreement or consummates a Company Acquisition Proposal, then the Company shall pay to Parent an amount equal to \$13,500,000 on the earlier of the date of entry into the Company Acquisition Agreement and such consummation. For the elimination of doubt, this amount shall be in addition to the Company Intervening Event Termination Fee and the Expense Reimbursement that the Company shall pay to Parent pursuant to this Section 6.2(c).

(d) If the Company shall terminate this Agreement pursuant to Section 6.1(d)(iii), then the Company shall pay to Parent the Company Termination Fee concurrently with such termination and the Expense Reimbursement within one (1) Business Day after Parent's demand therefor.

(e) For purposes of this Section 6.2, (A) the term "Company Acquisition Proposal" shall have the meaning assigned to such term in Section 4.7(d)(ii), except that the reference to "fifteen percent (15%)" in the definition of "Company Acquisition Proposal" shall be deemed to be a reference to "fifty percent (50%)" and (B) the term "Expense Reimbursement" shall mean Parent's documented out-of-pocket expenses incurred in connection with investigating, negotiating, documenting and implementing this Agreement and the transactions contemplated hereby not in excess of an aggregate of \$3,000,000.

(f) All payments under this Section 6.2 shall be made by wire transfer of immediately available funds to an account or accounts designated by Parent.

(g) The Company acknowledges that the agreements contained in this Section 6.2 are an integral part of the transactions contemplated by this Agreement and are not a penalty, and that, without these agreements, Parent and Sub would not enter into this Agreement. Nothing contained in this Section 6.2 shall constitute or shall be deemed to constitute liquidated damages for the intentional breach by the Company of the terms of this Agreement or otherwise limit the rights of Parent. If the Company fails to pay promptly any fees or expenses due pursuant to this Section 6.2, the Company will also pay to Parent Parent's reasonable costs and expenses (including legal fees and expenses) in connection with any action, including the filing of any lawsuit or other legal action, taken to collect payment, together with interest on the amount of the unpaid fees or expenses under this Section 6.2, accruing from its due date, at an interest rate per annum equal to two (2) percentage points in excess of the prime commercial lending rate quoted by The Wall Street Journal. Any change in the interest rate hereunder resulting from a change in such prime rate will be effective at the beginning of the date of such change in such prime rate. Under no circumstances shall the Company be obligated to pay more than one (1) Company Termination Fee. If Parent receives the Company Termination Fee pursuant to Sections 6.2(b), 6.2(c), or 6.2(d), the collection of such fee will be the sole and exclusive remedy (other than receipt of the Expense Reimbursement) of Parent and Sub in respect of (i) any breach of, or inaccuracy contained in the Company's covenants, agreements, representations or warranties in this Agreement, (ii) any loss suffered as a result of the failure of the Merger to be consummated and (iii) any other losses, damages, obligations or liabilities suffered as a result of or under this Agreement and the transactions contemplated hereby. Upon payment of the Company Termination Fee in accordance with this Section 6.2, none of the Company, or any of its shareholders, directors, Affiliates, officers or agents shall have any further liability or obligation relating to or arising under this Agreement or the transactions contemplated hereby (other than with respect to the payment of the Expense Reimbursement, if such Expense Reimbursement has not yet been paid).

6.3 Expenses. Except as otherwise provided herein, including as set forth in Section 6.2, all Expenses shall be borne by the Party incurring such Expenses, it being understood and agreed that the fee payable under the HSR Act

shall be borne equally by Parent

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and the Company and each of the Company and Parent shall pay half of any administrative filing fees required to be paid in connection with any filing made under any Foreign Antitrust Filing in connection with the transactions contemplated hereby.

## Article 7

### Miscellaneous

#### 7.1 Definitions.

(a) Except as otherwise provided herein, the capitalized terms set forth below shall have the following meanings:

“Acceptable NDA” means a confidentiality agreement containing terms at least as restrictive with respect to such Person as the terms contained in the Confidentiality Agreement are with respect to Parent (provided that such confidentiality agreement may provide that any standstill provisions shall terminate if there is a public announcement that a third party other than Parent has entered into an agreement with the Company with respect to a Company Acquisition Proposal or such third party has publicly announced that it intends to commence a tender offer with respect to the Company’s equity securities), subject, however, to the last sentence of Section 4.7(c).

“Affiliate” of a Person means (x) any other Person directly, or indirectly through one or more intermediaries, controlling, controlled by or under common control with such Person and (y) for purposes of Section 4.7 any officer or director of such Person.

“Antitrust Laws” mean the Sherman Act, as amended, the Clayton Act, as amended, the HSR Act, the Federal Trade Commission Act, as amended, and all other state, foreign, national, multinational, and supra-national Laws, if any, that are designed or intended to control mergers and acquisitions or to prohibit, restrict or regulate actions having the purpose or effect of monopolization or restraint of trade or lessening of competition through merger or acquisition.

“Assets” of a Person means all of the assets, properties, businesses and rights of such Person of every kind, nature, character and description, whether tangible or intangible, accrued or contingent, or otherwise relating to or utilized in such Person’s business, directly or indirectly, in whole or in part, whether or not carried on the books and records of such Person, and whether or not owned in the name of such Person or any Affiliate of such Person and wherever



located.

“Audit” means any audit, investigation, claim, assessment of Taxes, deficiency action, other examination by any Governmental Entity, or any administrative or judicial proceeding or appeal of such proceeding relating to Taxes.

“Business Day” means a day except a Saturday, a Sunday or other day on which the SEC or banks in the City of New York are authorized or required by Law to be closed.

“CLIA” means the Clinical Laboratory Improvement Amendments of 1988, 42 U.S.C. § 263a *et seq.* and its implementing regulations at 42 C.F.R. pts. 493 & 498.

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“CMS” means the Centers for Medicare & Medicaid Services, a non-independent agency within the United States Department of Health and Human Services

“Company Common Stock” means the common stock, par value \$0.01 per share, of the Company.

“Company Disclosure Schedule” means the written information set forth in a disclosure letter delivered as of the date of this Agreement to Parent and attached hereto describing in reasonable detail the matters contained therein and, with respect to each disclosure made therein, referencing each Section of this Agreement under which such disclosure is being made. Unless reasonably apparent from its face, information disclosed with respect to one Section shall not be deemed to be disclosed for purposes of any other Section not specifically referenced with respect thereto.

“Company Entities” means, collectively, the Company and the Company Subsidiaries.

“Company Material Adverse Effect” means any state of facts, event, change, circumstance, development, effect or occurrence which, individually or together with any other state of facts, event, change, circumstance, development, effect or occurrence, has or would reasonably be expected to have a material adverse effect on (i) the assets, properties, capitalization, condition (financial or otherwise), financial position, business or results of operations of the Company Entities, taken as a whole; provided, that “Company Material Adverse Effect” shall be deemed to exclude the impact of (A) changes after the date hereof in Laws (or interpretations thereof) of general applicability or interpretations thereof by Governmental Entities, (B) changes or modifications after the date hereof in GAAP or regulatory accounting requirements (or regulatory interpretations thereof), (C) actions and omissions of any Company Entity taken with the prior written consent of Parent or expressly permitted pursuant to this Agreement, (D) the public announcement of this Agreement, including, without limitation, any shareholder litigation related to this Agreement, (E) changes in the market price or trading volume of Company Common Stock (it being understood that any cause of any such change may be taken into consideration when determining whether a Company Material Adverse Effect has occurred or would reasonably be expected to occur, unless such cause is otherwise excluded), (F) general national or international economic, financial, political or business conditions including the engagement by the United States in hostilities, whether or not pursuant to a declaration of a national emergency or war, or the occurrence of any military or terrorist attack upon the United States or any of its territories, possession or diplomatic or consular offices or upon any military installation, equipment or personnel of the United States, or (G) any failure by the Company to meet internal projections, budgets or forecasts or third-party revenue or earnings predictions or other analyst expectations, projections, forecasts or budgets for any period (it being understood that any cause of any such failure may be taken into consideration when determining whether a Company Material Adverse Effect has occurred or would reasonably be expected to occur, unless such cause is otherwise excluded); provided, that state of facts, events, changes, circumstances, developments, effects or occurrences referred to in clauses (A), (B) and (F) above shall be considered for purposes of determining whether there has been or would

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reasonably be expected to be a Company Material Adverse Effect if and to the extent such state of facts, events, changes, circumstances, developments, effects or occurrences has had or would reasonably be expected to have a disproportionate adverse effect on the Company and the Company Subsidiaries, as compared to other companies operating in the industry or territory in which the Company and the Company Subsidiaries operate; or (ii) the ability of the Company to perform its obligations under this Agreement or to consummate the Merger or the other transactions contemplated by this Agreement.

“Company Material Contract” means any Contract that is binding upon the Company or any Company Subsidiary and that: (i) would be required to be filed by the Company as a “material contract” pursuant to Item 601(b)(10) of Regulation S-K under the Securities Act; (ii) contains covenants that limit the ability of the Company or any Company Subsidiary (or which, following the consummation of the Merger, could restrict or purport to restrict the ability of the Surviving Corporation or Parent or any of their Affiliates) to compete in any business or with any Person or in any geographic area; (iii) is required to be set forth in Section 2.15(c) of the Company Disclosure Schedule; (iv) involves the payment to or from any Company Entity of \$250,000 or more; (v) relates to indebtedness for borrowed money or any third-party financial guaranty, in each case in excess of \$1,000,000; (vi) any Lease that is required to be set forth in Section 2.17 of the Company Disclosure Schedule; (vii) involves any exchange traded or over the counter swap, forward, future, option, cap, floor or collar financial Contract, or other derivative Contract, or any other interest rate or foreign currency protection Contract, not entered into in the ordinary course of business consistent with past practice; (viii) involves the acquisition or disposition, directly or indirectly (by merger or otherwise), of a business or capital stock or other equity interest of another Person outside of the ordinary course of business consistent with past practice, which acquisition or disposition has yet to be consummated; or (ix) contains a “standstill” or similar provision that restricts the ability of the Company, the Company Subsidiaries or any of their respective Affiliates to acquire any of the securities or assets of a third party or such third party’s Affiliates.

“Company Option Plan” means, either individually or collectively, the Company’s 2000 Employee Incentive Stock Option Plan and 2003 Employee Incentive Stock Option Plan.

“Company Preferred Stock” means the preferred stock, par value \$0.10 per share, of the Company.

“Company SEC Documents” means the SEC Documents of the Company.

“Company Services” means all commercial services provided by the Company including testing of human specimens for any purpose.

“Company Shareholders’ Meeting” means the meeting of the shareholders of the Company to approve and adopt this Agreement, the Merger and the transactions contemplated hereby, including any adjournment or adjournments thereof.

“Company Subsidiaries” means the Subsidiaries of the Company, which shall include any corporation, limited liability company, limited partnership, limited liability partnership or other organization acquired as a Subsidiary of the Company in the future and held as a Subsidiary by the Company at the Effective Time.

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“Consent” means any consent, approval, authorization, clearance, exemption, waiver, or similar affirmation by any Person pursuant to any Contract, Law, Lease, Order or Permit.

“Contract” means any written or oral agreement, arrangement, authorization, commitment, contract, indenture, instrument, license, obligation, plan, practice, restriction, promise, understanding, or undertaking of any kind or character, or other document to which any Person is a party or that is binding on any Person or its capital stock, Assets or business (but specifically excluding the Leases).

“Default” means (i) any breach or violation of, default under, contravention of, or conflict with, any Contract, Lease, Law, Order, or Permit; (ii) any occurrence of any event that with the passage of time or the giving of notice or both would constitute a breach or violation of, default under, contravention of, or conflict with, any Contract, Lease, Law, Order, or Permit; or (iii) any occurrence of any event that with or without the passage of time or the giving of notice would give rise to a right of any Person to exercise any remedy or obtain any relief under, terminate or revoke, suspend, cancel, or modify or change the current terms of, or renegotiate, or to accelerate the maturity or performance of, or to increase or impose any Liability under, any Contract, Lease, Law, Order, or Permit.

“Environmental Laws” means all foreign, federal, state, or local statutes, regulations, ordinances, orders, judgments, codes, decrees or other legal requirements protecting the environment, including the ambient air, soil, surface water or groundwater or natural resources, pollution or human exposure to Materials of Environmental Concern.

“Environmental Permits” means all permits, licenses, registrations, and other authorizations of Governmental Entities required under applicable Environmental Laws.

“Equity Rights” means all binding arrangements, calls, commitments, Contracts, options, rights to subscribe to, scrip, warrants, or other binding obligations of any character whatsoever in each case by which a Person is or may be bound to issue additional shares of its capital stock or other Equity Rights, including securities or rights convertible into or exchangeable for shares of the capital stock of that Person.

“Exchange Act” means the Securities Exchange Act of 1934, as amended.

“Exhibit” means the Exhibits so marked, copies of which are attached to this Agreement. Such Exhibits are hereby incorporated by reference herein and made a part hereof, and may be referred to in this Agreement and any other

related instrument or document without being attached hereto or thereto.

“Expenses” of a Person means all fees and expenses, including all out-of-pocket expenses (including all fees and expenses of counsel, accountants, investment bankers, experts and consultants to a Party hereto and its Affiliates), incurred by or on behalf of such Person in connection with or related to the authorization, preparation, negotiation, execution and performance of this Agreement, the Confidentiality Agreement and the transactions contemplated hereby and thereby, including the preparation, printing, filing and mailing, as the

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case may be, of the Proxy Statement/Prospectus, the Registration Statement and the other Required Filings and any amendments or supplements thereto, and the solicitation of shareholder approval and all other matters related to the transactions contemplated hereby.

“FDA” means the United States Food and Drug Administration.

“GAAP” means United States generally accepted accounting principles.

“Governmental Entity” shall mean any foreign, multinational, supra-national, or domestic arbitrator, court, nation, governmental or quasi-governmental agency, government, any state or other political subdivision thereof and any entity exercising executive, legislative, judicial regulatory or administrative functions of, or pertaining to, government.

“Healthcare Regulatory Authorizations” means all approvals, clearances, authorizations, registrations, certifications, licenses and permits granted by any Healthcare Regulatory Authority, including participation agreements with governmental third-party payors, including by way of example, Medicare, Medicare Advantage, Medicaid, Tricare, FEHBP and any “federal health care program,” as that term is defined in Social Security Act § 1128B(f), and certificates of compliance and certificates of accreditation issued pursuant to CLIA.

“HSR Act” means Section 7A of the Clayton Act, as added by Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations promulgated thereunder.

“IRS” means the United States Internal Revenue Service.

“Knowledge” as used with respect to a Person (including references to such Person being aware of a particular matter) means, except as otherwise specifically provided herein, the personal knowledge after reasonable inquiry of the chairman, chief executive officer, president, chief financial officer, chief accounting officer, chief operating officer, or general counsel of such Person.

“Law” means any foreign, federal, state or local law, statute, code, ordinance, rule, regulation or other requirement.



“Leases” means all leases, subleases, licenses, concessions and other agreements (written or oral) pursuant to which the Company or any Company Subsidiary holds any Leased Real Property, including the right to all security deposits and other amounts and instruments deposited by or on behalf of the Company or any Company Subsidiary thereunder.

“Leased Real Property” means all material leasehold or subleasehold estates and other rights to use or occupy any land, buildings, structures, improvements, fixtures or other interest in real property held by the Company or any Company Subsidiary.

“Liability” means any direct or indirect, primary or secondary, liability, indebtedness, obligation, penalty, cost or expense (including costs of investigation, collection and defense), claim, deficiency, guaranty or endorsement of or by any Person (other than endorsements of

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notes, bills, checks and drafts presented for collection or deposit in the ordinary course of business) of any type, whether accrued, absolute or contingent, liquidated or unliquidated, matured or unmatured, or otherwise.

“Lien” means any conditional sale agreement, default of title, easement, encroachment, encumbrance, hypothecation, lien, mortgage, pledge, reservation, restriction, security interest, title retention or other security arrangement, or any charge of any nature whatsoever of, on, or with respect to any property or property interest, other than (i) liens reflected (or with respect to liabilities reflected) in the most recent audited financial statements of the Company or any Company Subsidiary or Parent or any of its Subsidiaries, as applicable; (ii) mechanics’, materialmen’s, workmen’s or similar liens; (iii) easements, rights of way or similar encumbrances that do not materially interfere with the operations of the business of the Company Entities or the Parent Entities, as applicable, as presently conducted; (iv) liens for Taxes and all water, sewer, utility, trash and other similar charges, in each case that are not yet due and payable or are being contested in good faith; (v) with respect to Article 4 hereof, all matters created or caused by or on behalf of, or with the written consent of, Parent; (vi) licenses to Intellectual Property granted in the ordinary course of business consistent with past practice; (vii) restrictions on transfers arising under applicable securities Laws; (viii) liens that would be set forth in a title policy, title report or survey with respect to the applicable real property; and (A) are not substantial in character, amount or extent in relation to the applicable real property and (B) do not materially and adversely impact the Company’s current or contemplated use, utility or value of the applicable real property or otherwise materially and adversely impair the Company’s present or contemplated business operations at such location, (ix) liens with respect to the Company’s amended revolving note payable loan agreement and (x) liens with respect to capital leases for equipment entered into in the ordinary course of business consistent with past practice ((i) through (x), collectively, “Permitted Liens”).

“Litigation” means any action, arbitration, cause of action, lawsuit, claim, complaint, criminal prosecution, governmental or other examination or investigation, audit (other than regular audits of financial statements by outside auditors and review or examination of a patent or patent application by a patent office), compliance review, inspection, hearing, administrative or other proceeding relating to or affecting a Party, its business, its records, its policies, its practices, its compliance with Law, its actions, its Assets (including Contracts related to it), or the transactions contemplated by this Agreement.

“made available”, with respect to a particular document, means that such document was included in the virtual data room assembled by the Company and its Representatives and made accessible to Parent and its Representatives and included in such virtual data room prior to the date hereof and was accessible to Parent and its Representatives and included therein as of 5:00 p.m., New York City time, on the date that is two Business Days prior to the date hereof.

“Material” or “material” for purposes of this Agreement shall be determined in light of the facts and circumstances of the matter in question; provided that any specific monetary amount stated in this Agreement shall determine materiality in that instance.

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“Materials of Environmental Concern” means any pollutants or contaminants or any hazardous, acutely hazardous, radioactive or toxic substance, material or medical or other waste defined and regulated as such under Environmental Laws.

“Medicare” means the federal health insurance program administered by CMS pursuant to titles II, XI and XVIII of the Social Security Act, and includes Medicare Advantage as set forth in 42 C.F.R. pt. 422.

“Medicaid” means the federal-state health program for the categorically and medically needy administered by the states pursuant to state plans with CMS pursuant to XI and XIX of the Social Security Act.

“NASDAQ” means the NASDAQ Global Select Market.

“OIG” means the office with the United States Department of Health and Human Services charged with, among other things, combatting fraud, waste and abuse in federal health care programs.

“Order” means any administrative award, settlement, decree, injunction, judgment, quasi-judicial decision or award, ruling or writ of any Governmental Entity.

“Organizational Documents” means with respect to any entity, the certificate or articles of incorporation and bylaws of such entity or any similar charter or other organizational documents of such entity.

“Owned Intellectual Property” means all Intellectual Property that is owned by the Company or any Company Subsidiary (whether solely or jointly with a third party).

“Owned Real Property” means all land, together with all buildings, structures, improvements and fixtures located thereon, and all easements and other rights and interests appurtenant thereto, owned by the Company or any Company Subsidiary.

“Parent Common Stock” means the common stock, par value \$0.01 per share, of the Parent.

“Parent Disclosure Schedule” means the written information set forth in the disclosure letter delivered as of the date of this Agreement by Parent to the Company.

“Parent Entities” means, collectively, Parent and all Parent Subsidiaries.

“Parent Financial Statements” means the consolidated balance sheets (including related notes and schedules, if any) of Parent as of December 31, 2014 and the related statements of operations, changes in stockholders’ equity, and cash flows (including related notes and schedules, if any) for each of the three fiscal years ended December 31, 2014, 2013 and 2012, as filed by Parent in SEC Documents.

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“Parent Material Adverse Effect” means any state of facts, event, change, circumstance, development, effect or occurrence which, individually or together with any other state of facts, event, change, circumstance, development, effect or occurrence, has or would reasonably be expected to have a material adverse effect on (i) the assets, properties, capitalization, condition (financial or otherwise), financial position, business or results of operations of the Parent Entities, taken as a whole; provided, that “Parent Material Adverse Effect” shall be deemed to exclude the impact of (A) changes after the date hereof in Laws (or interpretations thereof) of general applicability or interpretations thereof by Governmental Entities, (B) changes or modifications after the date hereof in GAAP or regulatory accounting requirements (or regulatory interpretations thereof), (C) actions and omissions of Parent or any of its Subsidiaries taken with the prior written consent of the Company, (D) the public announcement of this Agreement, including, without limitation, any shareholder litigation related to this Agreement, (E) changes in the market price or trading volume of Parent Common Stock (it being understood that any cause of any such change may be taken into consideration when determining whether a Parent Material Adverse Effect has occurred or would reasonably be expected to occur, unless such cause is otherwise excluded), (F) general national or international economic, financial, political or business conditions including the engagement by the United States in hostilities, whether or not pursuant to a declaration of a national emergency or war, or the occurrence of any military or terrorist attack upon the United States or any of its territories, possession or diplomatic or consular offices or upon any military installation, equipment or personnel of the United States, or (G) any failure by Parent to meet internal projections, budgets or forecasts or third-party revenue or earnings predictions or other analyst expectations, projections, forecasts or budgets for any period (it being understood that any cause of any such failure may be taken into consideration when determining whether a Parent Material Adverse Effect has occurred or would reasonably be expected to occur, unless such cause is otherwise excluded); provided, that state of facts, events, changes, circumstances, developments, effects or occurrences referred to in clauses (A), (B) and (F) above shall be considered for purposes of determining whether there has been or would reasonably be expected to be a Parent Material Adverse Effect if and to the extent such state of facts, events, changes, circumstances, developments, effects or occurrences has had or would reasonably be expected to have a disproportionate adverse effect on the Parent Entities, as compared to other companies operating in the industry or territory in which the Parent Entities operate; or (ii) the ability of Parent to perform its obligations under this Agreement or to consummate the Merger or the other transactions contemplated by this Agreement.

“Parent Option” means an option to purchase one share of Parent Common Stock granted by Parent.

“Parent Owned Intellectual Property” means all Intellectual Property that is owned by Parent or any Parent Subsidiary (whether solely or jointly with a third party).

“Parent Products/Services” means (i) all commercial services provided by Parent or any Parent Subsidiary and (ii) all marketed products, and all compounds or devices and Product Candidates that are being evaluated or are under development, current, active or otherwise, or consideration by Parent or any Parent Subsidiary or any of their respective licensees, whether in clinical trials as to which Parent or any Parent Subsidiary holds the applicable investigational



new drug applications, or in earlier stages of development, or otherwise. Parent Products includes LDTs.

“Parent Registered Intellectual Property” means all trademarks, Copyrights, and Patents that are the subject of an application for registration or a registration issued, filed with or recorded by any Governmental Entity and included in the Parent Owned Intellectual Property.

“Parent SEC Documents” means the SEC Documents of Parent.

“Parent Stock Plan” means the OPKO Health, Inc. 2007 Equity Incentive Plan, as amended.

“Parent Subsidiaries” means the Subsidiaries of Parent, which shall include any corporation, limited liability company, limited partnership, limited liability partnership or other organization acquired as a Subsidiary of Parent in the future and held as a Subsidiary by Parent at the Effective Time.

“Parent Warrant” means a warrant to purchase one share of Parent Common Stock granted by Parent.

“Party” means any of Parent, Sub or the Company, and “Parties” means Parent, Sub and the Company.

“Permit” means any federal, state, local and foreign governmental approval, authorization, certificate, easement, filing, franchise, license, notice, permit or right to which any Person is a party or that is or may be binding upon or inure to the benefit of any Person or its securities, Assets, or business.

“Person” means a natural person or any legal, commercial or governmental entity, such as, but not limited to, a corporation, general partnership, joint venture, limited partnership, limited liability company, limited liability partnership, trust, business association, group acting in concert, or any person acting in a representative capacity.

“Proxy Statement” means the proxy statement on Schedule 14A to be prepared and filed with the SEC by the Company relating to the approval and adoption by the Company’s shareholders of this Agreement, the Merger and the other



transactions contemplated by this Agreement.

“Registration Statement” means the registration statement on Form S-4, and any amendment or supplement thereto, pursuant to which the Parent Common Stock issuable in the Merger will be registered with the SEC, in which the Proxy Statement will be included as a prospectus.

“Regulatory Authorities” means, collectively, the SEC, the New York Stock Exchange, NASDAQ, the Federal Trade Commission, the Department of Justice, any Healthcare Regulatory Authority and all other foreign, federal, state, county, local or other governmental or regulatory agencies, authorities (including taxing and self-regulatory authorities), instrumentalities (whether domestic or foreign) having jurisdiction over the Parties and their respective Subsidiaries.

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“Release” means any release, spill, emission, leaking, pumping, injection, deposit, disposal, discharge, dispersal, leaching or migration into the indoor or outdoor environment, including movement through air, soil, surface water, groundwater or real property.

“Representative” means any director, officer, employee, Affiliate, investment banker, financial advisor, attorney, accountant, consultant or other representative or agent engaged by a Person.

“Required Company Vote” means the affirmative vote at an annual or special meeting of the shareholders of the Company, at which a quorum is present in accordance with the NJBCA and the bylaws of the Company, of holders of the Company Common Stock representing at least a majority of the votes cast at such meeting.

“SEC” means the United States Securities and Exchange Commission.

“SEC Documents” means all reports, forms, schedules, agreements (oral or written), registration statements, proxy statements and other documents (in each case including all exhibits and schedules thereto and documents incorporated by reference therein) filed, or required to be filed, by a Party with the SEC pursuant to the Securities Laws.

“Securities Act” means the Securities Act of 1933, as amended.

“Securities Laws” means the Securities Act, the Exchange Act, the Investment Company Act of 1940, as amended, the Investment Advisors Act of 1940, as amended, the Trust Indenture Act of 1939, as amended, and the rules and regulations of any Regulatory Authority promulgated thereunder.

“Sub Common Stock” means the common stock, par value \$0.01 per share, of Sub.

“Subsidiaries” means all those corporations, associations or other business entities of which the entity in question either (i) owns or controls fifty percent (50%) or more of the outstanding equity securities either directly or through an unbroken chain of entities as to each of which fifty percent (50%) or more of the outstanding equity securities is owned directly or indirectly by its parent (provided, that there shall not be included any such entity the equity securities of which are owned or controlled in a fiduciary capacity); (ii) in the case of partnerships, serves as a general

partner; (iii) in the case of a limited liability company, serves as a manager or a managing member; (iv) otherwise has the ability to elect a majority of the directors, trustees, managers, or managing members thereof; or (v) under GAAP consolidates in its financial statements.

“Surviving Corporation” means the Company as the surviving corporation in the Merger.

“Tax” or “Taxes” means any federal, state, county, local, or foreign taxes, charges, fees, levies, imposts, duties or other assessments, including, without limitation, income, gross receipts, excise, employment, sales, use, transfer, recording license, payroll, franchise, severance, documentary, stamp, occupation, windfall profits, environmental, federal highway use,

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commercial rent, customs duties, capital stock, paid-up capital, profits, withholding, Social Security, single business and unemployment, disability, real property, personal property, registration, ad valorem, value added, alternative or add-on minimum, estimated or other tax or governmental fee of any kind whatsoever, imposed or required to be withheld by the United States or any state, county, local or foreign government or subdivision or agency thereof, whether imposed directly or through withholding, whether disputed or not, and including any interest, penalties and additions imposed thereon or with respect thereto, and any Liability for payment of any amounts described in above, whether as a result of transferee Liability, of being a member of an affiliated, consolidated, combined, unitary or similar group, as a result of any Tax sharing, Tax indemnity or Tax allocation Contract or any other express or implied agreement to indemnify or otherwise succeed to, assume, or bear responsibility for the Taxes of any other Person, as a withholding agent or collection agent, or otherwise through operation of Law.

“Tax Laws” means any Laws relating to Taxes.

“Tax Liability” means any Liability in respect of Taxes.

“Tax Return” means any report, return, information return or other information required to be supplied to a Regulatory Authority in connection with Taxes, including any return of an affiliated or combined or unitary group that includes a Party or the Company Subsidiaries, and any schedule, attachment or amendment to any Tax Return.

The terms set forth below shall have the meanings ascribed thereto on the referenced pages:

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Any singular term in this Agreement shall be deemed to include the plural, and any plural term the singular. Whenever the words “include,” “includes” or “including” are used in this Agreement, they shall be deemed followed by the words “but not limited to.” The word “or” is not exclusive. References to “written” or “in writing” include in visual electronic form. Words of one gender shall be construed to apply to each gender. The words “hereof”, “herein” and “hereunder” and words of like import used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. Any capitalized terms used in any Exhibit or Schedule but not otherwise defined therein, shall have the meaning as defined in this Agreement. References to any statute shall be deemed to refer to such statute as amended from time to time and to any rules or regulations promulgated thereunder (except if expressly stated otherwise). References to any agreement or contract are to that agreement or contract as amended, modified or supplemented from time to time in accordance with the terms hereof and thereof. References to any Person include the successors and permitted assigns of that Person. References from or through any date mean, unless otherwise specified, from and including or through and including, respectively.

7.2 Non-Survival of Representations, Warranties and Agreements.

None of the representations, warranties, covenants and other agreements in this Agreement or in any instrument delivered pursuant to this Agreement shall survive the Effective Time, except for Section 4.11 and those other covenants and agreements contained herein and therein that by their terms apply or are to be performed in whole or in part after the Effective Time and this Article 7.

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7.3 Disclosure Schedules.

The inclusion of any information in the disclosure schedules accompanying this Agreement will not be deemed an admission or acknowledgment, in and of itself, solely by virtue of the inclusion of such information in such disclosure schedules, that such information is required to be listed in such disclosure schedules or that such information is material to any party or the conduct of the business of any party.

7.4 Governing Law: Jurisdiction.

This Agreement shall be governed by and construed in accordance with the Laws of the State of Delaware, regardless of the Laws that might otherwise govern under applicable principles of conflicts of laws thereof, except to the extent that mandatory provisions of federal law apply or mandatory principles of law require the application of the NJBCA. Each of the Parties hereto hereby irrevocably and unconditionally submits, for itself and its property, to the exclusive jurisdiction of the courts of the State of Delaware and any appellate court thereof and any United States District Court for the State of Delaware and any appellate court thereof, in any action or proceeding arising out of or relating to this Agreement or the agreements delivered in connection herewith or the transactions contemplated hereby or thereby or for recognition or enforcement of any judgment relating thereto, and each of the Parties hereby irrevocably and unconditionally (a) agrees not to commence any such action except in such courts, (b) agrees that any claim in respect of any such action or proceeding may be heard and determined in such courts, (c) waives, to the fullest extent it may legally and effectively do so, any objection which it may now or hereafter have to venue of any such action or proceeding in any such courts, and (d) waives, to the fullest extent permitted by Law, the defense of any inconvenient forum to the maintenance of such action or proceeding in any such courts. Each of the Parties hereto agrees that a final judgment in any such action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by Law. Each of the Parties irrevocably consents to service of process in any such action or proceeding in the manner provided for notices in Section 7.13 of this Agreement; provided, that nothing in this Agreement shall affect the right of any Party to this Agreement to serve process in any other manner permitted by Law.

7.5 WAIVER OF JURY TRIAL. EACH OF THE PARTIES HEREBY WAIVES TRIAL BY JURY IN ANY JUDICIAL PROCEEDING INVOLVING, DIRECTLY, IN ANY MATTERS (WHETHER SOUNDING IN TORT, CONTRACT OR OTHERWISE) IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

7.6 Severability; Construction.

If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially

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adverse to any Party. Upon such a determination, the Parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the Parties as closely as possible in an acceptable manner in order that the transactions contemplated hereby be consummated as originally contemplated to the fullest extent possible.

7.7 Specific Performance.

The Parties agree that irreparable damage would occur for which monetary damages would not be an adequate remedy in the event that the Parties do not perform their obligations under the provisions of this Agreement in accordance with their specific terms or otherwise breach such obligations. Accordingly, the Parties agree that, if for any reason any of Parent, Sub or the Company shall have failed to perform its obligations under this Agreement or otherwise breached this Agreement, then the Party seeking to enforce this Agreement against such nonperforming Party shall be entitled to seek specific performance and the issuance of immediate injunctive and other equitable relief to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof, without the necessity of proving the inadequacy of money damages as a remedy, and the Parties further agree to waive any requirement for the securing or posting of any bond in connection with the obtaining of any such injunctive or other equitable relief, this being in addition to and not in limitation of any other remedy to which they are entitled at Law or in equity. The Parties agree that (a) by seeking the remedies provided for in this Section 7.7, a Party shall not in any respect waive its right to seek any other form of relief that may be available to a Party under the terms of this Agreement in the event that the remedies provided for in this Section 7.7 are not available or otherwise are not granted and (b) nothing contained in this Section 7.7 shall require any Party to institute any proceeding for (or limit any Party's right to institute any proceeding for) specific performance under this Section 7.7 before exercising any termination right under Article 6 (and, if applicable, pursuing damages after such termination) nor shall the commencement of any action pursuant to this Section 7.7 or anything contained in this Section 7.7 restrict or limit any Party's right to terminate this Agreement in accordance with the terms of Article 6 or pursue any other remedies under this Agreement that may be available then or thereafter.

7.8 Entire Agreement.

This Agreement and the Confidentiality Agreement contain the entire understanding among the Parties hereto with respect to the transactions contemplated hereby and supersede and replace all prior and contemporaneous agreements and understandings, oral or written, with regard to such transactions. All Exhibits and Schedules hereto and any documents and instruments delivered pursuant to any provision hereof are expressly made a part of this Agreement as fully as though completely set forth herein.

7.9 Amendments.

This Agreement may be amended by the Parties, by action taken or authorized by their respective boards of directors, at any time before or after receipt of the Required Company Vote, but, after any such approval, no amendment shall be made which by Law requires further approval by such shareholders without such further

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approval. This Agreement may not be amended except by an instrument in writing signed on behalf of each of the Parties hereto.

7.10 Extension; Waivers.

At any time prior to the Effective Time, the Parties, by action taken or authorized by their respective boards of directors, may, to the extent legally allowed, (a) extend the time for the performance of any of the obligations or other acts of the other parties hereto, (b) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto and (c) waive compliance with any of the agreements or conditions contained herein. Any agreement on the part of a Party to any such extension or waiver shall be valid only if set forth in a written instrument signed on behalf of such Party. The failure of any Party to assert any of its rights under this Agreement or otherwise shall not constitute a waiver of those rights.

7.11 Parties in Interest.

Except for (i) the rights of the Company shareholders to receive the Merger Consideration following the Effective Time in accordance with the terms of this Agreement (of which the shareholders are the intended beneficiaries following the Effective Time) and (ii) the rights to continued indemnification and insurance pursuant to Section 4.11 hereof (of which the Persons entitled to indemnification or insurance, as the case may be, are the intended beneficiaries following the Effective Time), nothing in this Agreement is intended to confer any rights or remedies under or by reason of this Agreement on any Persons other than the parties hereto and their respective successors and permitted assigns. Nothing in this Agreement is intended to relieve or discharge the obligations or liability of any third Persons to the Company or Parent.

7.12 Assignment.

Except as expressly contemplated hereby, neither this Agreement nor any of the rights, interests or obligations hereunder may be assigned by any Party hereto (whether by operation of Law or otherwise) without the prior written consent of the other Parties. Subject to the preceding sentence, this Agreement will be binding upon, inure to the benefit of and be enforceable by the Parties and their respective successors and permitted assigns.

7.13 Notices.

All notices, requests, demands and other communications in connection with this Agreement shall be in writing and shall be deemed given if (a) delivered personally, on the date of such delivery, (b) upon non-automated confirmation of receipt when transmitted via electronic mail or upon automated or non-automated confirmation when transmitted via facsimile (but only, in the case of electronic mail and facsimile, if followed by transmittal by nationally recognized overnight courier or by hand for delivery on the next Business Day), or (c) on receipt (or refusal to accept delivery) after dispatch by registered or certified mail (return receipt requested),

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postage prepaid, or by a nationally recognized overnight courier (with confirmation), addressed, in each case, as follows:

If to the Company prior to the Effective Time:

481 Edward H. Ross Drive  
Elmwood Park, New Jersey 07407

Attention: Marc D. Grodman M.D.  
Richard L. Faherty  
Facsimile: 201-791-1941  
Email: [mgrodman@bioreference.com](mailto:mgrodman@bioreference.com)  
[rfaherty@bioreference.com](mailto:rfaherty@bioreference.com)

Davis Polk & Wardwell LLP

with a copy to (which shall not constitute notice): 450 Lexington Avenue  
New York, NY 10017

Attention: David L. Caplan  
John H. Butler  
Facsimile: 212-701-5156  
Email: [david.caplan@davispolk.com](mailto:david.caplan@davispolk.com)  
[john.butler@davispolk.com](mailto:john.butler@davispolk.com)

If to Parent or Sub or, from and after the Effective Time, the Company:

4400 Biscayne Boulevard  
Miami, Florida 33137

Attention: Kate Inman  
Facsimile: 305-575-4140  
Email: [KInman@opko.com](mailto:KInman@opko.com)

Greenberg Traurig, P.A.

with a copy to (which shall not constitute notice): 333 Avenue of the Americas  
(333 S.E. 2nd Ave)  
Miami, Florida 33131

Attention: Robert L. Grossman  
Ira N. Rosner  
Facsimile: 305-961-5756  
Email: [GrossmanB@gtlaw.com](mailto:GrossmanB@gtlaw.com)  
[rosneri@gtlaw.com](mailto:rosneri@gtlaw.com)

7.14 Counterparts.

This Agreement may be executed in two or more counterparts (including by facsimile or by an electronic scan delivered by electronic mail), each of which shall be deemed to be an original, but all of which together shall constitute one and the same instrument.

7.15 Captions: Articles and Sections.

The captions contained in this Agreement are for reference purposes only and are not part of this Agreement. Unless otherwise indicated, all references to particular Articles, Sections, Exhibits and Schedules shall mean and refer to the referenced Articles, Sections,

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Exhibits and Schedules of this Agreement.

7.16 Interpretations.

Neither this Agreement nor any uncertainty or ambiguity herein shall be construed or resolved against any Party, whether under any rule of construction or otherwise. No Party to this Agreement shall be considered the drafter. The Parties acknowledge and agree that this Agreement has been reviewed, negotiated and accepted by all Parties and their attorneys and shall be construed and interpreted according to the ordinary meaning of the words used so as fairly to accomplish the purposes and intentions of all Parties hereto. This Agreement shall be interpreted and applied in a manner which is consistent with the classification of the Merger as a reorganization under Code section 368(a). If there shall be any conflict between this Agreement and the plan of merger executed and filed with the Certificate of Merger, then this Agreement shall govern.

[Signature Page Follows]

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**IN WITNESS WHEREOF**, each of the Parties has caused this Agreement to be executed on its behalf by its duly authorized officers as of the day and year first above written.

**OPKO HEALTH, INC.**

By: /s/ Adam Logal  
Name: Adam Logal  
Title: SVP, CFO, CAO & Treasurer

**BAMBOO ACQUISITION,  
INC.**

By: /s/ Adam Logal  
Name: Adam Logal  
Title: VP and Treasurer

**BIO-REFERENCE LABORATORIES, INC.**

By: /s/ Marc D. Grodman  
Name: Marc D. Grodman, M.D.  
Title: Chairman, President and Chief Executive Officer

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Annex B

[LETTERHEAD OF ALLEN & COMPANY LLC]

June 2, 2015

The Board of Directors

Bio-Reference Laboratories, Inc.

481 Edward H. Ross Drive

Elmwood Park, New Jersey 07407

The Board of Directors:

We understand that Bio-Reference Laboratories, Inc., a New Jersey Corporation ( Bio-Reference ), OPKO Health, Inc., a Delaware corporation ( OPKO ), and Bamboo Acquisition, Inc., a New Jersey corporation and wholly owned subsidiary of OPKO ( Sub ), propose to enter into an Agreement and Plan of Merger (the Agreement ) pursuant to which (i) Sub will be merged with and into Bio-Reference (the Merger ) and (ii) each outstanding share of the common stock, par value \$0.01 per share, of Bio-Reference ( Bio-Reference Common Stock ) will be converted into the right to receive 2.75 (the Exchange Ratio ) shares of the common stock, par value \$0.01 per share, of OPKO ( OPKO Common Stock ). The terms and conditions of the Merger are more fully set forth in the Agreement.

As you know, Allen & Company LLC ( Allen & Company ) has acted as financial advisor to Bio-Reference in connection with the proposed Merger and has been asked to render an opinion to the Board of Directors of Bio-Reference (the Board ) as to the fairness, from a financial point of view, to holders of Bio-Reference Common Stock of the Exchange Ratio provided for in the Merger. For such services, Bio-Reference has agreed to pay to Allen & Company separate cash fees contingent upon consummation of the Merger and upon delivery of this opinion (the Opinion Fee ). No portion of the Opinion Fee is contingent upon either the conclusion expressed in this opinion or successful consummation of the Merger. Bio-Reference also has agreed to reimburse Allen & Company's reasonable expenses and to indemnify Allen & Company against certain liabilities arising out of our engagement.

Allen & Company, as part of our investment banking business, is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, private placements and related financings, bankruptcy reorganizations and similar recapitalizations, negotiated underwritings, secondary distributions of listed and unlisted securities, and valuations for corporate and other purposes. Allen & Company in the past has provided, currently is providing and in the future may provide investment banking services to Bio-Reference unrelated to the Merger, for which services Allen & Company has received and/or may receive compensation, including during the two-year period prior to the date hereof, having acted or acting as financial advisor to Bio-Reference in connection with certain potential merger and acquisition transactions. Although Allen & Company has not provided during the two-year period prior to the date hereof, and is not currently providing, investment banking services to OPKO for which Allen & Company has received compensation, Allen & Company may provide such services to OPKO and/or its affiliates in the future, for which services Allen & Company would expect to receive compensation. In the ordinary

course, Allen & Company as a broker-dealer and market maker and certain of Allen & Company's affiliates may have long or short positions, either on a discretionary or non-discretionary basis, for Allen & Company's own account or for those of Allen & Company's clients, in the debt and equity securities (or related derivative securities) of Bio-Reference, OPKO or their respective affiliates. The issuance of this opinion has been approved by Allen & Company's fairness opinion committee.

Our opinion as expressed herein reflects and gives effect to our general familiarity with Bio-Reference as well as information which we received during the course of this assignment, including information provided by the managements of Bio-Reference and OPKO in the course of discussions relating to the Merger as more fully described below. In arriving at our opinion, we neither conducted a physical inspection of the properties or

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The Board of Directors

Bio-Reference Laboratories, Inc.

June 2, 2015

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facilities of Bio-Reference, OPKO or any other entity nor made or obtained any evaluations or appraisals of the assets or liabilities (contingent, off-balance sheet or otherwise) of Bio-Reference, OPKO or any other entity, or conducted any analysis concerning the solvency or fair value of Bio-Reference, OPKO or any other entity.

In arriving at our opinion, we have, among other things:

- (i) reviewed the financial terms and conditions of the Merger as reflected in a draft, dated June 1, 2015, of the Agreement;
- (ii) reviewed certain publicly available historical business and financial information relating to Bio-Reference and OPKO, including public filings of Bio-Reference and OPKO, historical market prices for Bio-Reference Common Stock and historical market prices and trading volumes for OPKO Common Stock;
- (iii) reviewed certain internal financial forecasts and other financial and operating data of Bio-Reference and OPKO, provided to or discussed with us by the respective managements of Bio-Reference and OPKO;
- (iv) held discussions with the managements of Bio-Reference and OPKO relating to the past and current operations and financial condition and prospects of Bio-Reference and OPKO;
- (v) reviewed and analyzed certain publicly available information, including certain stock market data and financial information, relating to selected companies with businesses that we deemed generally relevant in evaluating Bio-Reference and OPKO;
- (vi) reviewed certain publicly available financial information relating to selected transactions that we deemed generally relevant in evaluating the Merger; and
- (vii) conducted such other financial analyses and investigations as we deemed necessary or appropriate for purposes of the opinion expressed herein.

In rendering our opinion, we have relied upon and assumed, with your consent and without independent verification, the accuracy and completeness of all of the financial, legal, regulatory, tax, accounting and other information available to us from public sources, provided to or discussed with us by Bio-Reference and OPKO or their respective representatives or otherwise reviewed by us. With respect to the financial forecasts and other information and data relating to Bio-Reference that we were directed to utilize in our analyses, we have been advised by the management of Bio-Reference and we have assumed, with your consent, that such forecasts and other financial and operating data have been reasonably prepared in good faith reflecting the best currently available estimates and judgments of such management as to the future operating and financial performance of Bio-Reference and the other matters covered thereby. With respect to the financial forecasts and other information and data relating to OPKO that we were directed to utilize in our analyses, we have been advised by the management of OPKO and we have assumed, with your consent, that such forecasts and other financial and operating data have been reasonably prepared in good faith reflecting the best currently available estimates and judgments of such management as to the future operating and financial performance of OPKO and the other matters covered thereby. We further have assumed, with your consent, that the financial results reflected in the financial forecasts and other financial and operating data utilized in our analyses will be realized at the times and in the amounts projected. We assume no responsibility for and express no view or opinion as to any such financial forecasts, estimates and other financial and operating data or the assumptions on which they are based. We have relied, at your direction, upon the assessments of the managements of Bio-Reference and OPKO as to (i) the potential impact on Bio-Reference and OPKO of certain market and other trends in and prospects for, and

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The Board of Directors

Bio-Reference Laboratories, Inc.

June 2, 2015

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governmental, regulatory and legislative policies and matters relating to or affecting, the clinical laboratory testing and biopharmaceutical and diagnostics industries, (ii) the products, product candidates, technology and intellectual property of OPKO and associated risks (including, without limitation, with respect to the development and commercialization of such product candidates, use indications for such products, the validity and duration of patents and the potential for generic competition), (iii) existing and future relationships, agreements and arrangements with, and the ability to attract and retain, key employees, and (iv) the ability to integrate the businesses of Bio-Reference and OPKO. We have assumed, with your consent, that there will be no developments with respect to any such matters that would have an adverse effect on Bio-Reference, OPKO or the Merger (including the contemplated benefits thereof) or that otherwise would be meaningful in any respect to our analyses or opinion.

Further, our opinion is necessarily based on economic, monetary, market and other conditions as in effect on, and the information made available to us as of, the date hereof. It should be understood that subsequent developments may affect the conclusion expressed in this opinion and that we assume no responsibility for advising any person of any change in any matter affecting this opinion or for updating or revising our opinion based on circumstances or events occurring after the date hereof.

It is understood that this opinion is intended for the benefit and use of the Board (in its capacity as such) in connection with its evaluation of the Merger. This opinion does not constitute a recommendation as to the course of action that the Board or Bio-Reference should pursue in connection with the Merger, or otherwise address the merits of the underlying decision by Bio-Reference to engage in the Merger, including in comparison to other strategies or transactions that might be available to Bio-Reference or in which Bio-Reference might engage. In connection with our engagement, we were not requested to, and we did not, undertake a third-party solicitation process on Bio-Reference's behalf with respect to the acquisition of all or a part of Bio-Reference; however, at the direction of Bio-Reference, we held preliminary discussions with selected third parties from time to time regarding a possible acquisition of, or other strategic transaction involving, Bio-Reference. This opinion does not constitute advice or a recommendation to any stockholder as to how such stockholder should vote or act on any matter relating to the Merger or otherwise. We do not express any opinion as to the fairness, financial or otherwise, of the amount, nature or any other aspect of any compensation or consideration payable to any officers, directors or employees of any party to the Merger, or any class of such persons or any other party, relative to the Exchange Ratio or otherwise. We are not expressing any opinion as to the actual value of OPKO Common Stock when issued in the Merger or the prices at which OPKO Common Stock (or any other securities of OPKO) or Bio-Reference Common Stock may trade or otherwise be transferable at any time.

In addition, we do not express any opinion as to any tax or other consequences that might result from the Merger, nor does our opinion address any legal, regulatory, tax or accounting matters, as to which we understand that Bio-Reference obtained such advice as it deemed necessary from qualified professionals. We have assumed, with your

consent, that the Merger will be consummated in accordance with its terms and all applicable laws, documents and other requirements, without waiver, modification or amendment of any material term, condition or agreement, and that all governmental, regulatory or other consents, approvals, releases and waivers necessary for consummation of the Merger will be obtained without delay, limitation, restriction or condition, including any divestiture or other requirements, that would have an adverse effect on Bio-Reference, OPKO or the Merger (including the contemplated benefits thereof) or that otherwise would be meaningful in any respect to our analyses or opinion. We also have assumed, with your consent, that the Merger will qualify for U.S. federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended. We further have assumed, with your consent, that the final executed Agreement will not differ in any material respect from the draft reviewed by us.

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Our opinion is limited to the fairness, from a financial point of view and as of the date hereof, to holders of Bio-Reference Common Stock of the Exchange Ratio provided for in the Merger (to the extent expressly specified herein). Our opinion does not address any other term, aspect or implication of the Merger, including, without limitation, the form or structure of the Merger or any voting or other agreement, arrangement or understanding entered into in connection with the Merger or otherwise.

Based upon and subject to the foregoing, it is our opinion that, as of the date hereof, the Exchange Ratio provided for in the Merger is fair, from a financial point of view, to holders of Bio-Reference Common Stock.

Very truly yours,

ALLEN & COMPANY LLC

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Annex C

**CERTIFICATE OF MERGER**  
**OF**  
**BAMBOO ACQUISITION, INC.**  
**INTO**  
**BIO-REFERENCE LABORATORIES, INC.**

The undersigned corporations, pursuant to the provisions of Section 14A:10-4.1 of the New Jersey Business Corporation Act (the Act ), do hereby certify as follows:

**FIRST:** The names of the merging corporations are Bamboo Acquisition, Inc., a corporation organized under the laws of the State of New Jersey (Acquisition Sub ), and Bio-Reference Laboratories, Inc., a corporation organized under the laws of the State of New Jersey (BRL or the Surviving Corporation ).

**SECOND:** Acquisition Sub is to be merged with and into BRL pursuant to a Plan of Merger dated as of \_\_\_\_\_, 2015 (the Plan of Merger ). A copy of the Plan of Merger is set forth in Exhibit A attached hereto.

**THIRD:** The Certificate of Incorporation of Acquisition Sub, as in effect immediately prior to the filing of this Certificate of Merger, shall be amended and restated as set forth in Exhibit B attached hereto, and, as so amended and restated, shall be the amended and restated Certificate of Incorporation of the Surviving Corporation.

**FOURTH:** The number of shares of Acquisition Sub which was entitled to vote at the time of the approval of the Plan of Merger was \_\_\_\_\_ shares of common stock, par value \$\_\_\_\_\_ per share. The sole shareholder of Acquisition Sub entitled to vote regarding the approval of the Plan of Merger approved the Plan of Merger pursuant to its written consent without a meeting of shareholders; and the number of shares represented by such written consent was \_\_\_\_\_. The date of said written consent and approval was \_\_\_\_\_, 2015.

**FIFTH:** The number of shares of BRL which was entitled to vote at the time of the approval of the Plan of Merger was \_\_\_\_\_ shares of common stock, par value \$0.01 per share. The number of shares of BRL which were voted for the Plan of Merger was \_\_\_\_\_, and the number of shares of BRL which were voted against the Plan of Merger was \_\_\_\_\_. The date of said vote and approval was \_\_\_\_\_, 2015.

**SIXTH:** BRL will continue its existence as the Surviving Corporation under the name Bio-Reference Laboratories, Inc. pursuant to the provisions of the Act until amended in accordance with the terms of the Act.

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**IN WITNESS WHEREOF**, each of the undersigned corporations has caused this Certificate of Merger to be executed as of the \_\_\_\_ day of \_\_\_\_\_, 2015.

**BAMBOO ACQUISITION, INC.**

By:  
Name:  
Title: President

**BIO-REFERENCE LABORATORIES,  
INC.**

By:  
Name:  
Title: President

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**EXHIBIT A**

**PLAN OF MERGER**

This Plan of Merger dated as of this \_\_\_\_ day of \_\_\_\_\_, 2015 (this Plan of Merger ), pursuant to Chapter 10 of the New Jersey Business Corporation Act (the Act ), is entered into by and among BAMBOO ACQUISITION, INC., a corporation organized and existing under the laws of the State of New Jersey ( Acquisition Sub ), BIO-REFERENCE LABORATORIES, INC., a corporation organized and existing under the laws of the State of New Jersey (the Company, and, together with Acquisition Sub, the Constituent Corporations ), and OPKO HEALTH, INC., a corporation organized and existing under the laws of the State of Delaware ( Parent ).

**WITNESSETH:**

**WHEREAS**, Acquisition Sub has been duly organized as a corporation under the laws of the State of New Jersey and, pursuant to its certificate of incorporation (filed in the office of the Department of Treasury of the State of New Jersey on May 22, 2015), has an authorized capital stock consisting of 1,000 shares of common stock, no par value per share (the Acquisition Sub Common Stock ), of which as of the close of business on June 2, 2015, 1,000 shares were issued and outstanding and held by Parent; and

**WHEREAS**, the Company, pursuant to its certificate of incorporation, as amended to the date hereof, has an authorized capital stock consisting of (i) 35,000,000 shares of common stock, \$.01 par value per share (the Company Common Stock ), of which as of the close of business on June 1, 2015, 27,802,976 shares were issued and outstanding, and (ii) 1,666,667 shares of preferred stock, \$.10 par value per share, of which as of the close of business on June 1, 2015, no shares were issued and outstanding; and

**WHEREAS**, Parent, pursuant to its certificate of incorporation, as amended to the date hereof, has an authorized capital stock of (i) 750,000,000 shares of common stock, \$.01 par value per share (the Parent Common Stock ), of which as of the close of business on June 2, 2015, 464,411,844 shares were issued and 463,291,477 shares were outstanding and (ii) 10,000,000 shares of preferred stock of which as of the close of business on June 2, 2015, no shares were issued and outstanding; and

**WHEREAS**, the respective boards of directors of the Constituent Corporations, and of Parent, deem it advisable and in the best interests of such corporations and their shareholders, respectively, that Acquisition Sub be merged with and into the Company, so that the Company shall become a subsidiary of Parent, in accordance with the terms and conditions hereinafter set forth (the Merger ); and

**WHEREAS**, the respective boards of directors of the Constituent Corporations have, by resolutions duly adopted, approved and authorized this Plan of Merger; and

**WHEREAS**, the respective boards of directors of the Constituent Corporations have directed that this Plan of Merger be submitted to a vote of their respective shareholders, and the respective shareholders of the Constituent Corporations have, by resolutions duly adopted, approved and authorized this Plan of Merger;

**NOW, THEREFORE**, in consideration of the premises and the mutual covenants and agreements herein contained, and for the purpose of setting forth the terms and conditions of the Merger, the mode of carrying the same into effect, the manner and basis of converting the shares of Acquisition Sub into shares of the Surviving Corporation (as hereinafter defined), and the shares of the Company into shares of Parent Common Stock and

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such other rights as are set forth herein and such other details and provisions as are deemed necessary or advisable, the parties hereto have agreed and do hereby agree, subject to the conditions hereinafter set forth, as follows:

**ARTICLE I**

**MERGER AND NAME OF SURVIVING CORPORATION**

At the Effective Time (as defined in Article VI hereof), in accordance with the terms and provisions of this Plan of Merger and in accordance with the Act, Acquisition Sub shall be merged with and into the Company. As a result of the Merger, the separate corporate existence of Acquisition Sub shall cease and the Company shall continue as the surviving corporation in the Merger and shall be a wholly-owned subsidiary of Parent and shall continue to be governed by the laws of the State of New Jersey, under the corporate name it possesses immediately prior to the Effective Time. The Company, from and after the Effective Time, is hereinafter sometimes referred to as the Surviving Corporation.

**ARTICLE II**

**TERMS AND CONDITIONS OF MERGER**

The terms and conditions of the Merger (in addition to those set forth elsewhere in this Plan of Merger) are as follows:

- (a) At the Effective Time, the certificate of incorporation of the Surviving Corporation shall be the certificate of incorporation of Acquisition Sub in effect immediately prior to the Effective Time until thereafter amended in accordance with the provisions thereof and the Act provided that the certificate of incorporation shall be amended to change the name of the Company therein to Bio-Reference Laboratories, Inc.
- (b) At the Effective Time, the by-laws of the Surviving Corporation shall be the by-laws of Acquisition Sub in effect immediately prior to the Effective Time until thereafter amended in accordance with the provisions thereof and the Act provided that the by-laws shall be amended to change the name of the Company to Bio-Reference Laboratories, Inc.
- (c) At the Effective Time, the directors of Acquisition Sub in office immediately prior to the Effective Time (together with such additional persons as may be appointed or elected to become directors of the Surviving Corporation effective as of the Effective Time), shall be the directors of the Surviving Corporation at the Effective Time and shall serve in such capacity until the earlier of their resignation or removal or until their successors are duly elected and qualified in accordance with the applicable provisions of the certificate of incorporation and bylaws of the Surviving Corporation and the Act. At the Effective Time, the officers of Acquisition Sub in office immediately prior to the Effective Time (together with such additional persons as may be elected to become officers of the Surviving Corporation effective as of the Effective Time) shall be the officers of the Surviving Corporation at the Effective Time and shall serve in such capacity until the earlier of their resignation or removal or until their successors are duly elected and qualified in accordance with the applicable provisions of the certificate of incorporation and bylaws of the Surviving Corporation and the Act.

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**ARTICLE III**

**CONVERSION OF SHARES**

At the Effective Time, by virtue of the Merger and without any action on the part of Parent, the Company, Acquisition Sub or any holder of the Company Common Stock, the manner and basis of converting the outstanding shares of the Company Common Stock and the Acquisition Sub Common Stock in the Merger are as follows:

(a) Each share of Acquisition Sub Common Stock issued and outstanding immediately prior to the Effective Time shall be converted into one fully paid and nonassessable share of common stock, par value \$0.01 per share, of the Surviving Corporation (the Converted Shares ). The Converted Shares shall constitute the only outstanding shares of capital stock of the Surviving Corporation at the Effective Time. From and after the Effective Time, all certificates representing shares of Acquisition Sub Common Stock shall be deemed for all purposes to represent the Converted Shares until the board of directors of the Surviving Corporation issues new certificates in respect of such shares.

(b) Each of the shares of Company Common Stock held by the Company and any of its subsidiaries (including shares of Company Common Stock held in treasury by the Company) or by Parent or any of its subsidiaries shall be cancelled and retired at the Effective Time and no consideration shall be issued in exchange therefor.

(c) Each share of Company Common Stock (excluding shares cancelled pursuant to clause (b) immediately preceding) issued and outstanding at the Effective Time shall cease to be outstanding and shall be converted into and exchanged for the right to receive Parent Common Stock in the ratio (the Exchange Ratio ) of 2.75 shares of Parent Common Stock for such share of Company Common Stock (the Merger Consideration ). From and after the Effective Time, all such shares of Company Common Stock shall no longer be outstanding and shall automatically be cancelled and retired and shall cease to exist, and each holder of a certificate (a Company Certificate ) or book-entry share (a Book-Entry Share ) representing any such shares of Company Common Stock shall cease to have any rights with respect thereto, except the right to receive the Merger Consideration therefor, without interest thereon, upon the surrender of such Company Certificate or Book-Entry Share in accordance with Article IV of this Plan of Merger.

(d) Notwithstanding any other provision of this Plan of Merger, each holder of shares of Company Common Stock exchanged pursuant to the Merger who would otherwise have been entitled to receive a fraction of a share of Parent Common Stock (after taking into account all Company Certificates and Book-Entry Shares delivered by such holder) shall receive, in lieu of such fraction of a share of Parent Common Stock, one share of Parent Common Stock.

(e) If, between the date of this Plan of Merger and the Effective Time, the outstanding shares of Company Common Stock shall have been changed into, or exchanged for, a different number of shares or a different class, by reason of any stock dividend, subdivision, reclassification, reorganization, recapitalization, split, combination, contribution or exchange of shares, the Merger Consideration and any payments to be made under this Article III and any other number or amount contained herein which is based upon the number of shares of Company Common Stock shall be correspondingly adjusted to provide the holders of Company Common Stock, Company Options (as hereinafter defined) and other awards under the Company Option Plan (as hereinafter defined), the same economic effect as contemplated by this Plan of Merger prior to such event.

(f) Prior to the Effective Time, the board of directors of the Company shall take all necessary actions so that each option (individually, a Company Plan Option ) to purchase shares of Company Common Stock granted by the Company, whether granted pursuant to either of the Company's 2000 Employee Incentive Stock Option Plan or the 2003 Employee Incentive Stock Option Plan (collectively, the Company Option Plans ) or otherwise





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(collectively, including all options under any Company Option Plan, the Company Options ) that is outstanding immediately prior to the Effective Time, whether vested or unvested, shall be converted into and become rights with respect to Parent Common Stock, and Parent shall assume each Company Option, in accordance with the terms of the Company Option Plan and/or stock option agreement by which it is evidenced, except that from and after the Effective Time, (i) Parent and its compensation committee shall be substituted for the Company and the compensation committee of the board of directors of the Company (including, if applicable, the board itself ) administering such Company Option Plans, (ii) each Company Option assumed by Parent may be exercised solely for shares of Parent Common Stock (or cash, if so provided under the terms of such Company Option), (iii) the number of shares of Parent Common Stock subject to such Company Options shall be equal to the number of shares of Company Common Stock subject to such Company Options immediately prior to the Effective Time multiplied by the Exchange Ratio, rounded down to the nearest whole share, and (iv) the per share exercise price under each such Company Option shall be adjusted by dividing the per share exercise price under each such Company Option by the Exchange Ratio and rounding up to the nearest cent. In addition, notwithstanding the provisions of sub-clauses (iii) and (iv) of the first sentence of this clause (f), each Company Option that is an incentive stock option or a nonqualified stock option held by a U.S. taxpayer shall be adjusted as required by Section 424 of the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder (the Code ) and Section 409A of the Code and the Treasury Regulations thereunder, so as not to constitute a modification, extension or renewal of the option, within the meaning of Section 424(h) of the Code and the Treasury Regulations under Section 409A of the Code, or otherwise result in negative tax treatment or penalties under Section 424 of the Code or Section 409A of the Code. Each of the Company and Parent shall adopt any and all resolutions and take all necessary steps to effectuate the foregoing provisions of this clause (f).

(g) As soon as practicable after the Effective Time, Parent shall deliver to the participants in each Company Option Plan an appropriate notice setting forth such participant s rights pursuant thereto and the grants subject to such Company Option Plan shall continue in effect on the same terms and conditions (subject to the adjustments required by clause (f) after giving effect to the Merger), and Parent shall comply with the terms of each Company Option Plan to ensure, to the extent required by, and subject to the provisions of, such Company Option Plan, that Company Options that qualified as incentive stock options prior to the Effective Time continue to qualify as incentive stock options after the Effective Time and Company Options that qualified for exemption from application of Section 409A of the Code prior to the Effective Time continue to remain so exempt. At or prior to the Effective Time, Parent shall take all corporate action necessary to reserve for issuance sufficient shares of Parent Common Stock for delivery upon exercise of Company Options assumed by it in accordance with clause (f). As soon as practicable after the Effective Time, Parent shall file a registration statement on Form S-3 or Form S-8, as the case may be (or any successor or other appropriate forms), with respect to the shares of Parent Common Stock subject to such options and shall use its reasonable efforts to maintain the effectiveness of such registration statements (and maintain the current status of the prospectus or prospectuses contained therein) for so long as such options remain outstanding.

## ARTICLE IV

### **EXCHANGE PROCEDURES**

(a) Immediately prior to the Effective Date, Parent shall make available to Parent s transfer agent or another exchange agent selected by Parent and which is reasonably acceptable to the Company (the Exchange Agent ), for exchange in accordance with this Article IV, the shares of the Parent Common Stock issuable pursuant to this Plan of Merger. Promptly after the Effective Time, the Surviving Corporation shall instruct the Exchange Agent to mail (or in the case of the Depository Trust Company on behalf of Street holders, deliver) to each holder of record of a Company Certificate or Book-Entry Shares immediately prior to the Effective Time, appropriate transmittal materials and instructions (which shall specify that delivery shall be effected, and risk of loss and title to such Company Certificates

or Book-Entry Shares shall pass, only upon proper delivery of such Company

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Certificates or Book-Entry Shares to the Exchange Agent). Each holder of shares of Company Common Stock that have been converted into the right to receive Merger Consideration shall be entitled to receive the Merger Consideration in respect of (i) any share of Company Common Stock represented by a Company Certificate upon surrender to the Exchange Agent of such Company Certificate, together with a duly completed and validly executed letter of transmittal and duly endorsed as the Exchange Agent may require or (ii) any Book-Entry Share upon receipt of an agent's message by the Exchange Agent, together with such other evidence, if any, of the transfer as the Exchange Agent may reasonably request. In the event of a transfer of ownership of shares of Company Common Stock represented by Company Certificates or Book-Entry Shares that are not registered in the transfer records of the Company, the consideration provided in Article III may be issued to a transferee if the Company Certificates representing such shares or Book-Entry Shares are delivered to the Exchange Agent, accompanied by all documents required to evidence such transfer and by evidence satisfactory to the Exchange Agent that any applicable stock transfer taxes have been paid. If any Company Certificate shall have been lost, stolen, mislaid or destroyed, upon receipt of (i) an affidavit of that fact from the holder claiming such Company Certificate to be lost, mislaid, stolen or destroyed, (ii) such bond, security or indemnity as Parent and the Exchange Agent may reasonably require, and (iii) any other documents necessary to evidence and effect the bona fide exchange thereof, the Exchange Agent shall issue to such holder the consideration into which the shares represented by such lost, stolen, mislaid or destroyed Company Certificate shall have been converted. The Exchange Agent may establish such other reasonable and customary rules and procedures in connection with its duties as it may deem appropriate. Parent shall pay all charges and expenses, including those of the Exchange Agent, in connection with the distribution of the consideration provided in Article III. No interest will accrue or be paid to any holder of Company Common Stock.

(b) After the Effective Time, each holder of shares of Company Common Stock (other than shares to be canceled pursuant to clause (b) of Article III) shall submit a duly completed and validly executed letter of transmittal, duly endorsed as the Exchange Agent may require (or, in the case of Book-Entry Shares, such other evidence, if any, of the transfer as the Exchange Agent may reasonably request) together with (except in the case of a holder of Book-Entry Shares) the Company Certificate or Company Certificates representing such shares and shall promptly upon surrender thereof receive in exchange therefor the consideration provided in Article III in one or more shares of Parent Common Stock which shall be in uncertificated book entry form unless a physical certificate is requested, together with all undelivered dividends or distributions in respect of such shares (without interest thereon) pursuant to Article III. Parent shall not be obligated to deliver the Merger Consideration to which any former holder of Company Common Stock is entitled as a result of the Merger until such holder surrenders or transfers such holder's Company Certificate or Company Certificates or Book-Entry Shares for exchange as provided in this Article IV.

(c) Each of Parent, the Surviving Corporation and the Exchange Agent shall be entitled to deduct and withhold from the Merger Consideration otherwise payable pursuant to this Plan of Merger to any holder of shares of Company Common Stock such amounts, if any, as it is required to deduct and withhold with respect to the making of such payment under the Code or any provision of any state, local, or foreign tax Law (as hereinafter defined), unless they have been presented with documentation that eliminates the requirement to withhold, and to request any necessary tax forms, as applicable, or any other proof of exemption from withholding or similar information, from the shareholders of the Company or other recipient of payments in respect of which such deduction and withholding was made. To the extent that any amounts are so withheld by Parent, the Surviving Corporation or the Exchange Agent, as the case may be, such withheld amounts shall be treated for all purposes of this Plan of Merger as having been paid to the holder of the shares of Company Common Stock in respect of which such deduction and withholding was made by Parent, the Surviving Corporation or the Exchange Agent, as the case may be. Each of Parent, the Surviving Corporation and the Exchange Agent shall provide any documentation of such deduction or withholding as reasonably requested by the shareholders of the Company or other recipient of payments in respect of which such deduction and withholding was made.

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(d) Any portion of the aggregate Merger Consideration that remains unclaimed by the holders of Company Common Stock for one year after the Effective Time shall be returned to Parent (together with any dividends or earnings in respect thereof). Any holders of Company Common Stock who have not theretofore complied with Articles III and IV shall thereafter be entitled to look only to Parent, and only as a general creditor thereof, for payment of the consideration deliverable in respect of each share of Company Common Stock such holder holds as determined pursuant to this Plan of Merger, in each case, without any interest thereon.

(e) Any other provision of this Plan of Merger notwithstanding, none of Parent, the Surviving Corporation or the Exchange Agent shall be liable to a holder of Company Common Stock for any amounts paid or property delivered in good faith to a public official pursuant to any applicable abandoned property, escheat or similar foreign, federal, state or local law, statute, code, ordinance, rule, regulation or other requirement (collectively, Law ). Any amounts of consideration remaining unclaimed by holders of shares of Company Common Stock immediately prior to such time when the amounts would otherwise escheat to or become property of any foreign, multinational, supra-national, or domestic arbitrator, court, nation, governmental or quasi-governmental agency, government, any state or other political subdivision thereof and any entity exercising executive, legislative, judicial, regulatory or administrative functions or, or pertaining to, government shall become, to the extent permitted by Law, the property of Parent free and clear of any claims or interest of any Person previously entitled thereto.

(f) If, at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes or intent of this Plan of Merger and to vest the Surviving Corporation with full right, title and possession to all assets, property, rights, privileges, powers and franchises of the Company and Acquisition Sub, the directors and officers of Parent and the Surviving Corporation shall have the authority to take all such lawful and necessary action.

(g) At the Effective Time, the stock transfer books of the Company shall be closed as to holders of Company Common Stock immediately prior to the Effective Time and no transfer of Company Common Stock by any such holder shall thereafter be made or recognized. If, after the Effective Time, Company Certificates and Book-Entry Shares representing shares of Company Common Stock are presented to the Surviving Corporation for transfer, they shall be canceled and exchanged for the Merger Consideration as provided in Article III. Until surrendered for exchange in accordance with the provisions of Article III, each Company Certificate theretofore representing shares of Company Common Stock and each Book-Entry Share (other than shares to be canceled pursuant to clause (b) of Article III shall from and after the Effective Time represent for all purposes only the right to receive the consideration provided in Article III in exchange therefor, subject, however, to the Surviving Corporation's obligation to pay any dividends or make any other distributions with a record date prior to the Effective Time which have been declared or made by the Company in respect of such shares of Company Common Stock and which remain unpaid at the Effective Time. To the extent required by Law, former shareholders of record of the Company shall be entitled to vote after the Effective Time at any meeting of Parent stockholders the number of whole shares of Parent Common Stock into which their respective shares of Company Common Stock are converted, regardless of whether such holders have exchanged their Company Certificates or Book-Entry Shares for Parent Common Stock in accordance with the provisions of this Plan of Merger. Whenever a dividend or other distribution is declared by Parent on the Parent Common Stock, the record date for which is at or after the Effective Time, the declaration shall include dividends or other distributions on all shares of Parent Common Stock issuable pursuant to this Plan of Merger, no dividend or other distribution payable to the holders of record of Parent Common Stock as of any time subsequent to the Effective Time shall be delivered to the holder of any Company Certificates or Book-Entry Shares until such holder surrenders such Company Certificates or Book-Entry Shares for exchange as provided in this Article IV. However, upon surrender of such Company Certificates or Book-Entry Shares, both the Parent Common Stock (together with all such undelivered dividends or other distributions without interest) and any undelivered dividends and cash payments payable hereunder (without interest) shall be delivered and paid with respect to each share represented by such Company Certificates or Book-Entry Shares.

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**ARTICLE V**

**OTHER PROVISIONS WITH RESPECT TO THE MERGER**

(a) For the convenience of the parties and to facilitate the filing and recording of this Plan of Merger, any number of counterparts hereof may be executed, and each such counterpart shall be deemed to be an original instrument, but all such counterparts together shall constitute but one agreement.

(b) The Merger shall be governed by and construed in accordance with the Act.

(c) From time to time, as and when required by the Surviving Corporation or by its successors or assigns, there shall be executed and delivered on behalf of Acquisition Sub such deeds and other instruments, and there shall be taken or caused to be taken by it all such further and other action, as shall be appropriate, advisable or necessary in order to vest, perfect or confirm, of record or otherwise, in the Surviving Corporation the title to and possession of all property, interests, assets, rights, privileges, immunities, powers, franchises and authority of Acquisition Sub and otherwise to carry out the purposes of this Plan of Merger, and the officers and directors of the Surviving Corporation are fully authorized in the name and on behalf of Acquisition Sub or otherwise, to take any and all such action and to execute and deliver any and all such deeds and other instruments.

**ARTICLE VI**

**EFFECTIVE TIME**

The Merger shall become effective at the time of filing of a Certificate of Merger with respect to the Merger, setting forth the information required, in the office of the Department of the Treasury, as required by the Act. Such time is herein referred to as the Effective Time.

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**IN WITNESS WHEREOF**, the Company, Acquisition Sub and Parent, have caused this Plan of Merger to be executed and delivered as of the date first above written.

**OPKO HEALTH, INC.**

By:  
Name:  
Title: President

**BAMBOO ACQUISITION, INC.**

By:  
Name:  
Title: President

**BIO-REFERENCE LABORATORIES,  
INC.**

By:  
Name:  
Title: President

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**EXHIBIT B**

**AMENDED AND RESTATED  
CERTIFICATE  
OF  
INCORPORATION  
OF  
BIO-REFERENCE LABORATORIES, INC.**

1. Name:

Bio-Reference Laboratories, Inc.

2. Registered Agent:

Corporation Service Company

3. Registered Office:

830 Bear Tavern Road

West Trenton, New Jersey 08628

4. Business Purpose:

To engage in any activity within the purpose for which corporations may be organized under N.J.S.A. 14A:1-1 et seq.

5. Stock:

1,000 shares of common stock, \$.01 par value per share

6. Board of Directors:

Steven D. Rubin

4400 Biscayne Boulevard

Miami, Florida 33137

Adam Logal

4400 Biscayne Boulevard

Miami, Florida 33137

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**IN WITNESS WHEREOF**, Bio-Reference Laboratories, Inc. has caused this Amended and Restated Certificate of Incorporation to be signed by its duly authorized officer as of the \_\_\_\_ day of \_\_\_\_\_, 2015.

BIO-REFERENCE LABORATORIES, INC.

By:

Name:

Title:

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**PART II: INFORMATION NOT REQUIRED IN PROSPECTUS**

**Item 20. *Indemnification of Directors and Officers***

The following is a summary of the statutes, certificate of incorporation, and bylaw provisions or other arrangements under which the registrant's directors and officers are insured or indemnified against liability in their capacities as such. All the directors and officers of the registrants are covered by insurance policies maintained and held in effect by OPKO against certain liabilities for actions taken in their capacities as such, including liabilities under the Securities Act.

**Section 145 of Delaware General Corporation Law.**

OPKO is incorporated under the laws of the State of Delaware. Section 145 of the DGCL provides that a corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee, or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit, or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful.

Section 145 also provides that a corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that such person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation. However, no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery of Delaware or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery of Delaware or such other court shall deem proper.

Section 145 provides that to the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit, or proceeding referred to above, or in defense of any claim, issue, or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith, provided that indemnification provided for by Section 145 or granted pursuant thereto shall not be deemed exclusive of any other rights to which the indemnified party may be entitled.

A Delaware corporation shall have the power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity or arising out of such

person's status as such whether or not the corporation would have the power to indemnify such person against such liabilities under Section 145.

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**Certificate of Incorporation Provisions on Exculpation and Indemnification.**

OPKO's Amended and Restated Certificate of Incorporation provides that a director of OPKO shall not be personally liable to either OPKO or any of its stockholders for monetary damages for a breach of fiduciary duty except for: (i) breaches of the duty of loyalty to the corporation or its stockholders; (ii) acts or omissions not in good faith or involving intentional misconduct or knowing violation of the law; (iii) as required by Section 174 of the DGCL; or (iv) a transaction resulting in an improper personal benefit. In addition the corporation has the power to indemnify any person serving as a director, officer or agent of the corporation to the fullest extent permitted by law.

**Bylaws Provisions on Indemnification.**

OPKO's Amended and Restated Bylaws provide generally that OPKO shall indemnify its directors, officers, employees, and agents who are or were a party, or threatened to be made a party, to any threatened, pending, or contemplated action, suit or proceeding, whether civil, criminal, administrative, or investigative (other than an action by or in the right of the corporation), by reason of the fact that such person is or was the director, officer, employee, or agent of the corporation, or is or was serving in such a position at its request of any other corporation, partnership, joint venture, trust, or other enterprise.

**Other Provisions on Indemnification.**

OPKO is also a party to indemnification agreements with each of OPKO's directors and certain officers. Consistent with OPKO's Amended and Restated Bylaws, the indemnification agreements require OPKO, among other things, to (i) maintain directors' and officers' liability insurance for each indemnitee, and (ii) indemnify each indemnitee to the fullest extent permitted by law for certain expenses incurred in a proceeding arising out of indemnitee's service to OPKO or its subsidiaries. The indemnification agreements also provide for the advancement of such expenses to the indemnitee by OPKO.

The above discussion of the Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws of the registrant and the indemnification agreements is not intended to be exhaustive and is qualified in its entirety by such Amended and Restated Certificate of Incorporation, Amended and Restated Bylaws, and indemnification agreements.

**Table of Contents****Item 21. Exhibits and Financial Statement Schedules****Exhibit**

| No.  | Description  |
|------|--|
| 2.1  | Agreement and Plan of Merger, dated as of June 3, 2015, among OPKO Health, Inc., Bio-Reference, Inc. and Bamboo Acquisition, Inc. (attached as Annex A to the proxy statement/prospectus which forms part of this registration statement). <sup>1</sup>  |
| 3.1  | Amended and Restated Certificate of Incorporation of OPKO Health, Inc., filed with the Secretary of State of the State of Delaware on June 8, 2007 (incorporated by reference to Exhibit 3.1 to OPKO's Quarterly Report on Form 10-Q of OPKO, filed with the SEC on November 12, 2013)         |
| 3.2  | Amended and Restated By-Laws of By-laws of OPKO Health, Inc., effective as of March 28, 2008 (incorporated by reference to Exhibit 2.1 to OPKO's Annual Report on Form 10-K of OPKO dated March 28, 2008 and filed with the SEC on March 31, 2008).  |
| 5.1  | Opinion of Greenberg Traurig, LLP.*  |
| 8.1  | Tax opinion of Greenberg Traurig, P.A.*  |
| 8.2  | Tax opinion of Davis Polk & Wardwell LLP.*   |
| 10.1 | Employment Agreement, dated as of June 3, 2015, among Bio-Reference Laboratories, Inc., OPKO Health, Inc. and Marc D. Grodman (incorporated by reference to Exhibit 10.3 to Bio-Reference's Quarterly Report on Form 10-Q of Bio-Reference, filed with the SEC on June 9, 2015).               |
| 10.2 | Employment Agreement, dated as of June 3, 2015, between Bio-Reference Laboratories, Inc. and Nicholas Papazicos (incorporated by reference to Exhibit 10.2 to Bio-Reference's Current Report on Form 8-K of Bio-Reference, filed with the SEC on June 4, 2015).                                |
| 10.3 | Employment Agreement, dated as of February 1, 2012, by and between Bio-Reference Laboratories, Inc. and Howard Dubinett (incorporated by reference to Exhibit 99.1 to Bio-Reference's Current Report on Form 8-K of Bio-Reference, filed with the SEC on June 15, 2012).                       |
| 10.4 | First Extension Of Employment Agreement, dated as of April 23, 2015, by and between Bio-Reference Laboratories, Inc. and Mr. Howard Dubinett (incorporated by reference to Exhibit 10.1 to Bio-Reference's Current Report on Form 8-K of Bio-Reference, filed with the SEC on April 29, 2015). |
| 21.1 | Subsidiaries of OPKO Health, Inc.  |
| 23.1 | Consent of Greenberg Traurig, LLP (included in Exhibit 5.1).*  |
| 23.2 | Consent of Greenberg Traurig, P.A. (included in Exhibit 8.1).*   |
| 23.3 | Consent of Davis Polk & Wardwell LLP (included in Exhibit 8.2).*   |
| 23.4 | Consent of Ernst & Young LLP relating to OPKO Health, Inc.'s financial statements.   |
| 23.5 | Consent of MSPC Certified Public Accountants and Advisors, P.C. relating to Bio-Reference Inc.'s financial statements.   |
| 24.1 | Powers of Attorney (included on the signature page of this Registration Statement).  |

- 99.1 Form of Bio-Reference Inc. Proxy Card.\*
- 99.2 Consent of Allen & Company LLC.

\* To be filed by amendment.

<sup>1</sup> The schedules and exhibits to the Agreement and Plan of Merger have been omitted from this filing pursuant to Item 601(b)(2) of Regulation S-K. OPKO will furnish copies of any such schedules and exhibits to the U.S. Securities and Exchange Commission upon request.



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**Item 22. Undertakings**

(a) The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

to include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

to reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the SEC pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20% change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement; and

to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) That, for the purpose of determining liability under the Securities Act of 1933 to any purchaser, each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness; provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(5) That, for the purpose of determining liability of the registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities, the undersigned registrant undertakes that in a primary offering of securities of the undersigned registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

any preliminary prospectus or prospectus of the undersigned registrant relating to the offering required to be filed pursuant to Rule 424;

any free writing prospectus relating to the offering prepared by or on behalf of the undersigned registrant or used or referred to by the undersigned registrant;

the portion of any other free writing prospectus relating to the offering containing material information about the undersigned registrant or its securities provided by or on behalf of the undersigned registrant; and

any other communication that is an offer in the offering made by the undersigned registrant to the purchaser.

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(b) The undersigned registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (and, where applicable, each filing of an employee benefit plan's annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(c) The undersigned registrant hereby undertakes as follows: that prior to any public reoffering of the securities registered hereunder through use of a prospectus which is a part of this registration statement, by any person or party who is deemed to be an underwriter within the meaning of Rule 145(c), the issuer undertakes that such reoffering prospectus will contain the information called for by the applicable registration form with respect to reofferings by persons who may be deemed underwriters, in addition to the information called for by the other Items of the applicable form.

(d) The registrant undertakes that every prospectus (i) that is filed pursuant to the paragraph immediately preceding, or (ii) that purports to meet the requirements of Section 10(a)(3) of the Securities Act of 1933 and is used in connection with an offering of securities subject to Rule 415, will be filed as a part of an amendment to the registration statement and will not be used until such amendment is effective, and that, for purposes of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(e) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act of 1933 and will be governed by the final adjudication of such issue.

(f) The undersigned registrant hereby undertakes to respond to requests for information that is incorporated by reference into the prospectus pursuant to Item 4, 10(b), 11, or 13 of this Form, within one business day of receipt of such request, and to send the incorporated documents by first class mail or other equally prompt means. This includes information contained in documents filed subsequent to the effective date of the registration statement through the date of responding to the request.

(g) The undersigned registrant hereby undertakes to supply by means of a post-effective amendment all information concerning a transaction, and the company being acquired involved therein, that was not the subject of and included in the registration statement when it became effective.

Table of Contents**SIGNATURES**

Pursuant to the requirements of the Securities Act, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Miami, State of Florida, on July 2, 2015.

**OPKO HEALTH, INC.**

By: /s/ Dr. Phillip Frost, M.D.  
 Name: Dr. Phillip Frost, M.D.  
 Title: Chairman of the Board and  
 Chief Executive Officer

BE IT KNOWN BY THESE PRESENTS: That each person whose name is signed hereto has made, constituted and appointed, and does hereby make, constitute and appoint Steven D. Rubin and Adam Logal, and each of them, his or her true and lawful attorney-in-fact, for him or her and in his or her name, place and stead to affix his or her signature as director or officer or both, as the case may be, of the registrant, to any and all registration statements and amendments thereto (including post-effective amendments) and to file the same, with all exhibits thereto, and other documents in connection therewith, and to file with the Securities and Exchange Commission, granting unto each such attorney-in-fact full power and authority to do and perform every act and thing whatsoever necessary to be done in the premises, as fully as he or she might or could do if personally present, hereby ratifying and confirming all that each such attorney-in-fact shall lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities indicated below on July 2, 2015.

| <b>Signature</b>   | <b>Title</b>   |
|--|--|
| /s/ Jane H. Hsiao, Ph.D., MBA<br>Jane H. Hsiao, Ph.D., MBA | Vice Chairman of the Board and Chief Technical Officer |
| /s/ Steven D. Rubin<br>Steven D. Rubin                     | Director and Executive Vice President Administration   |
| /s/ Adam Logal<br>Adam Logal                               | Senior Vice President and Chief Financial Officer      |
| /s/ Robert A. Baron<br>Robert A. Baron                     | Director   |
| /s/ Thomas E. Beier<br>Thomas E. Beier                     | Director   |
| /s/ Dmitry Kolosov<br>Dmitry Kolosov                       | Director   |

/s/ Richard A. Lerner, M.D.  
Richard A. Lerner, M.D.

Director

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| <b>Signature</b>   | <b>Title</b> |
|--|--------------|
| /s/ John A. Paganelli<br>John A. Paganelli                             | Director     |
| /s/ Richard C. Pfenniger, Jr.<br>Richard C. Pfenniger, Jr.             | Director     |
| /s/ Alice Lin-Tsing Yu, M.D., Ph.D.<br>Alice Lin-Tsing Yu, M.D., Ph.D. | Director     |

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| 23.3 | Consent of Davis Polk & Wardwell LLP (included in Exhibit 8.2).*   |
| 23.4 | Consent of Ernst & Young LLP relating to OPKO Health, Inc.'s financial statements.   |
| 23.5 | Consent of MSPC Certified Public Accountants and Advisors, P.C. relating to Bio-Reference Inc.'s financial statements.   |
| 24.1 | Powers of Attorney (included on the signature page of this Registration Statement).  |

- 99.1 Form of Bio-Reference Inc. Proxy Card.\*
- 99.2 Consent of Allen & Company LLC.

\* To be filed by amendment.

<sup>1</sup> The schedules and exhibits to the Agreement and Plan of Merger have been omitted from this filing pursuant to Item 601(b)(2) of Regulation S-K. OPKO will furnish copies of any such schedules and exhibits to the U.S. Securities and Exchange Commission upon request.