

AUTONATION, INC.
Form 10-Q
July 17, 2014

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

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from _____ to _____

Commission File Number: 1-13107

AutoNation, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

73-1105145
(I.R.S. Employer Identification No.)

200 SW 1st Avenue, Fort Lauderdale, Florida
(Address of principal executive offices)
(954) 769-6000
(Registrant's telephone number, including area code)

33301
(Zip Code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

As of July 16, 2014, the registrant had 118,539,221 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AUTONATION, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except share and per share data)

	June 30, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$68.5	\$69.2
Receivables, net	691.3	740.9
Inventory	2,776.6	2,827.2
Other current assets	191.6	192.7
Total Current Assets	3,728.0	3,830.0
PROPERTY AND EQUIPMENT, net of accumulated depreciation of \$925.8 million and \$883.7 million, respectively	2,272.9	2,235.3
GOODWILL	1,257.8	1,259.6
OTHER INTANGIBLE ASSETS, NET	335.0	335.1
OTHER ASSETS	277.9	254.1
Total Assets	\$7,871.6	\$7,914.1
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Vehicle floorplan payable - trade	\$1,977.7	\$2,130.1
Vehicle floorplan payable - non-trade	891.4	898.9
Accounts payable	249.4	263.0
Current maturities of long-term debt	17.5	30.1
Other current liabilities	432.9	429.7
Total Current Liabilities	3,568.9	3,751.8
LONG-TERM DEBT, NET OF CURRENT MATURITIES	1,865.7	1,809.8
DEFERRED INCOME TAXES	124.2	116.5
OTHER LIABILITIES	187.7	174.3
COMMITMENTS AND CONTINGENCIES (Note 12)		
SHAREHOLDERS' EQUITY:		
Preferred stock, par value \$0.01 per share; 5,000,000 shares authorized; none issued	—	—
Common stock, par value \$0.01 per share; 1,500,000,000 shares authorized; 163,562,149 shares issued at June 30, 2014, and December 31, 2013, including shares held in treasury	1.6	1.6
Additional paid-in capital	53.8	42.8
Retained earnings	3,533.4	3,337.9
Treasury stock, at cost; 45,025,078 and 42,646,753 shares held, respectively	(1,463.7	) (1,320.6
Total Shareholders' Equity	2,125.1	2,061.7
Total Liabilities and Shareholders' Equity	\$7,871.6	\$7,914.1

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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AUTONATION, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Revenue:				
New vehicle	\$2,736.9	\$2,493.6	\$5,165.5	\$4,751.3
Used vehicle	1,082.3	1,056.5	2,132.0	2,066.2
Parts and service	704.8	655.9	1,375.8	1,292.5
Finance and insurance, net	185.4	173.9	357.8	329.5
Other	79.1	46.6	120.9	83.4
TOTAL REVENUE	4,788.5	4,426.5	9,152.0	8,522.9
Cost of sales:				
New vehicle	2,575.3	2,344.4	4,858.0	4,460.4
Used vehicle	993.0	972.4	1,948.4	1,896.1
Parts and service	404.0	375.7	788.3	740.0
Other	71.3	37.9	105.0	66.3
TOTAL COST OF SALES (excluding depreciation shown below)	4,043.6	3,730.4	7,699.7	7,162.8
Gross Profit:				
New vehicle	161.6	149.2	307.5	290.9
Used vehicle	89.3	84.1	183.6	170.1
Parts and service	300.8	280.2	587.5	552.5
Finance and insurance	185.4	173.9	357.8	329.5
Other	7.8	8.7	15.9	17.1
TOTAL GROSS PROFIT	744.9	696.1	1,452.3	1,360.1
Selling, general, and administrative expenses	524.6	494.1	1,025.3	967.4
Depreciation and amortization	26.2	23.3	51.8	46.0
Other income, net	(3.7)	(2.2)	(11.7)	(3.6)
OPERATING INCOME	197.8	180.9	386.9	350.3
Non-operating income (expense) items:				
Floorplan interest expense	(13.3)	(13.6)	(26.5)	(26.5)
Other interest expense	(21.3)	(22.0)	(42.9)	(44.3)
Interest income	0.1	—	0.1	0.1
Other income, net	0.9	1.3	2.4	2.9
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	164.2	146.6	320.0	282.5
Income tax provision	63.5	56.5	123.8	109.2
NET INCOME FROM CONTINUING OPERATIONS	100.7	90.1	196.2	173.3
Loss from discontinued operations, net of income taxes	(0.3)	(0.2)	(0.7)	(0.4)
NET INCOME	\$100.4	\$89.9	\$195.5	\$172.9
BASIC EARNINGS (LOSS) PER SHARE:				
Continuing operations	\$0.85	\$0.74	\$1.64	\$1.43
Discontinued operations	\$—	\$—	\$(0.01)	\$—
Net income	\$0.84	\$0.74	\$1.64	\$1.43
Weighted average common shares outstanding	119.1	121.4	119.3	121.2
DILUTED EARNINGS (LOSS) PER SHARE:				

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Continuing operations	\$0.83	\$0.73	\$1.62	\$1.41
Discontinued operations	\$—	\$—	\$(0.01)) \$—
Net income	\$0.83	\$0.73	\$1.61	\$1.40
Weighted average common shares outstanding	120.8	123.3	121.1	123.2
COMMON SHARES OUTSTANDING, net of treasury stock, at period end	118.5	121.3	118.5	121.3

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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AUTONATION, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(In millions, except share data)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total
	Shares	Amount				
BALANCE AT DECEMBER 31, 2013	163,562,149	\$1.6	\$42.8	\$3,337.9	\$(1,320.6)	\$2,061.7
Net income	—	—	—	195.5	—	195.5
Repurchases of common stock	—	—	—	—	(182.2)	(182.2)
Stock-based compensation expense	—	—	17.3	—	—	17.3
Shares awarded under stock-based compensation plans, including income tax benefit of \$10.7	—	—	(6.3)	—	39.1	32.8
BALANCE AT JUNE 30, 2014	163,562,149	\$1.6	\$53.8	\$3,533.4	\$(1,463.7)	\$2,125.1

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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AUTONATION, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Six Months Ended	
	June 30,	
	2014	2013
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net income	\$195.5	\$172.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations	0.7	0.4
Depreciation and amortization	51.8	46.0
Amortization of debt issuance costs and accretion of debt discounts	2.9	2.8
Stock-based compensation expense	17.3	12.8
Deferred income tax provision	6.6	7.8
Net gain related to business/property dispositions	(8.4	) (2.1
Non-cash impairment charges	0.3	—
Excess tax benefit from stock-based awards	(10.7	) (4.4
Other	(5.4	) (4.2
(Increase) decrease, net of effects from business combinations and divestitures:		
Receivables	50.2	75.6
Inventory	50.9	(206.9
Other assets	(19.0	) (11.2
Increase (decrease), net of effects from business combinations and divestitures:		
Vehicle floorplan payable-trade, net	(152.4	) 152.1
Accounts payable	(4.6	) 8.5
Other liabilities	35.7	23.0
Net cash provided by continuing operations	211.4	273.1
Net cash provided by (used in) discontinued operations	(0.5	) 5.7
Net cash provided by operating activities	210.9	278.8
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Purchases of property and equipment	(101.7	) (70.4
Property operating lease buy-outs	(0.4	) (0.5
Proceeds from the sale of property and equipment	0.1	3.0
Proceeds from assets held for sale	2.4	1.8
Cash received from business divestitures, net of cash relinquished	9.8	10.1
Cash used in business acquisitions, net of cash acquired	—	(72.5
Proceeds from the sale of restricted investments	0.5	—
Other	(6.0	) (2.4
Net cash used in continuing operations	(95.3	) (130.9
Net cash used in discontinued operations	—	—
Net cash used in investing activities	(95.3	) (130.9

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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AUTONATION, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Continued)

	Six Months Ended		
	June 30,		
	2014	2013	
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES:			
Repurchases of common stock	(182.2	) (18.5)
Proceeds from revolving credit facility	610.0	375.0	
Payment of revolving credit facility	(545.0	) (515.0)
Net proceeds from (payments of) vehicle floorplan payable - non-trade	(7.8	) 28.9	
Payments of mortgage facility	(4.5	) (4.3)
Payments of capital leases and other debt obligations	(19.6	) (22.7)
Proceeds from the exercise of stock options	22.1	10.6	
Excess tax benefit from stock-based awards	10.7	4.4	
Net cash used in continuing operations	(116.3	) (141.6)
Net cash used in discontinued operations	—	(6.3)
Net cash used in financing activities	(116.3	) (147.9)
DECREASE IN CASH AND CASH EQUIVALENTS	(0.7) —	
CASH AND CASH EQUIVALENTS at beginning of period	69.2	69.7	
CASH AND CASH EQUIVALENTS at end of period	\$68.5	\$69.7	

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In millions, except per share data)

1. INTERIM FINANCIAL STATEMENTS

Business and Basis of Presentation

AutoNation, Inc., through its subsidiaries, is the largest automotive retailer in the United States. As of June 30, 2014, we owned and operated 270 new vehicle franchises from 229 stores located in the United States, predominantly in major metropolitan markets in the Sunbelt region. Our stores, which we believe include some of the most recognizable and well known in our key markets, sell 33 different new vehicle brands. The core brands of new vehicles that we sell, representing approximately 95% of the new vehicles that we sold during the six months ended June 30, 2014, are manufactured by Toyota, Ford, Honda, Nissan, General Motors, Mercedes-Benz, Chrysler, BMW, and Volkswagen. We offer a diversified range of automotive products and services, including new vehicles, used vehicles, “parts and service,” which includes automotive repair and maintenance services as well as wholesale parts and collision businesses, and automotive “finance and insurance” products, which include vehicle service and other protection products, as well as the arranging of financing for vehicle purchases through third-party finance sources. For convenience, the terms “AutoNation,” “Company,” and “we” are used to refer collectively to AutoNation, Inc. and its subsidiaries, unless otherwise required by the context. Our dealership operations are conducted by our subsidiaries. The accompanying Unaudited Condensed Consolidated Financial Statements include the accounts of AutoNation, Inc. and its subsidiaries; all significant intercompany accounts and transactions have been eliminated. The accompanying Unaudited Condensed Consolidated Financial Statements have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information related to our organization, significant accounting policies, and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These Unaudited Condensed Consolidated Financial Statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to fairly state, in all material respects, our financial position and results of operations for the periods presented.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 revenue and expenses during the reporting period. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. We base our estimates and judgments on historical experience and other assumptions that we believe are reasonable. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ materially from these estimates. We periodically evaluate estimates and assumptions used in the preparation of the financial statements and make changes on a prospective basis when adjustments are necessary. Significant estimates made by AutoNation in the accompanying Unaudited Condensed Consolidated Financial Statements include certain assumptions related to goodwill, intangible assets, long-lived assets, assets held for sale, accruals for chargebacks against revenue recognized from the sale of finance and insurance products, accruals related to self-insurance programs, certain legal proceedings, estimated tax liabilities, and certain assumptions related to stock-based compensation.

Operating results for interim periods are not necessarily indicative of the results that can be expected for a full year. These interim financial statements should be read in conjunction with our audited Consolidated Financial Statements and notes thereto included in our most recent Annual Report on Form 10-K.

Recent Accounting Pronouncements

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (“FASB”) issued an accounting standard update that amends the accounting guidance on revenue recognition. The amendments in this accounting standard update are intended to provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition

practices, and improve disclosure requirements. The amendments in this accounting standard update are effective for interim and annual reporting periods beginning after December 15, 2016. We are currently evaluating the impact of the provisions of the accounting standard update.

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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

Reporting Discontinued Operations

In April 2014, the FASB issued an accounting standard update that changes the definition of a discontinued operation to include only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The amendments in this accounting standard update should be applied prospectively and are effective for annual periods, and interim periods within those years, beginning on or after December 15, 2014. Early adoption is permitted for disposals that have not been reported in financial statements previously issued. We adopted this accounting standard update effective January 1, 2014. During the first quarter of 2014, we divested our customer lead distribution business. See Note 10 of the Notes to Unaudited Condensed Consolidated Financial Statements for more information.

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss, a Similar Tax Loss, or a Tax Credit Carryforward Exists

In July 2013, the FASB issued an accounting standard update to reduce the diversity in practice regarding the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this accounting standard update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this accounting standard update did not have a material impact on our consolidated financial position, results of operations, or cash flows.

2. RECEIVABLES, NET

The components of receivables, net of allowance for doubtful accounts, are as follows:

	June 30, 2014	December 31, 2013
Trade receivables	\$109.0	\$110.9
Manufacturer receivables	153.2	172.9
Other	35.4	36.9
	297.6	320.7
Less: Allowances	(3.3	) (4.0
	294.3	316.7
Contracts-in-transit and vehicle receivables	370.6	424.2
Income tax refundable (see Note 6)	26.4	—
Receivables, net	\$691.3	\$740.9

Trade receivables represent amounts due for parts and services that have been sold or delivered, excluding amounts due from manufacturers, as well as receivables from finance organizations for commissions on the sale of financing products. Manufacturer receivables represent receivables from manufacturers including amounts due for holdbacks, rebates, incentives, floorplan assistance, and warranty claims. Contracts-in-transit and vehicle receivables primarily represent receivables from financial institutions for the portion of the vehicle sales price financed by our customers. We evaluate our receivables for collectability based on the age of receivables and past collection experience.

3. INVENTORY AND VEHICLE FLOORPLAN PAYABLE

The components of inventory are as follows:

	June 30, 2014	December 31, 2013
New vehicles	\$2,202.5	\$2,330.8
Used vehicles	420.3	346.5
Parts, accessories, and other	153.8	149.9
Inventory	\$2,776.6	\$2,827.2

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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

The components of vehicle floorplan payable are as follows:

	June 30, 2014	December 31, 2013
Vehicle floorplan payable - trade	\$1,977.7	\$2,130.1
Vehicle floorplan payable - non-trade	891.4	898.9
Vehicle floorplan payable	\$2,869.1	\$3,029.0

Vehicle floorplan payable-trade reflects amounts borrowed to finance the purchase of specific new vehicle inventories with the corresponding manufacturers' captive finance subsidiaries ("trade lenders"). Vehicle floorplan payable - non-trade represents amounts borrowed to finance the purchase of specific new and, to a lesser extent, used vehicle inventories with non-trade lenders, as well as amounts borrowed under our secured used floorplan facilities, which are primarily collateralized by used vehicle inventories and related receivables. Changes in vehicle floorplan payable-trade are reported as operating cash flows and changes in vehicle floorplan payable-non-trade are reported as financing cash flows in the accompanying Unaudited Condensed Consolidated Statements of Cash Flows.

Our inventory costs are generally reduced by manufacturer holdbacks, incentives, and floorplan assistance, while the related vehicle floorplan payables are reflective of the gross cost of the vehicle. The vehicle floorplan payables, as shown in the above table, will generally also be higher than the inventory cost due to the timing of the sale of a vehicle and payment of the related liability.

Vehicle floorplan facilities are due on demand, but in the case of new vehicle inventories, are generally paid within several business days after the related vehicles are sold. Our manufacturer agreements generally require that the manufacturer have the ability to draft against new vehicle floorplan facilities so the lender directly funds the manufacturer for the purchase of new vehicle inventory. Vehicle floorplan facilities are primarily collateralized by vehicle inventories and related receivables.

Our used vehicle floorplan facilities utilize LIBOR-based interest rates, which averaged 1.7% for the six months ended June 30, 2014, and 1.8% for the six months ended June 30, 2013. At June 30, 2014, the aggregate capacity under our used vehicle floorplan facilities with various lenders to finance a portion of our used vehicle inventory was \$275.0 million, of which \$199.2 million had been borrowed. The remaining borrowing capacity of \$75.8 million was limited to \$50.6 million based on the eligible used vehicle inventory that could have been pledged as collateral.

Our new vehicle floorplan facilities utilize LIBOR-based interest rates, which averaged 1.8% for the six months ended June 30, 2014, and 2.0% for the six months ended June 30, 2013. At June 30, 2014, the aggregate capacity under our new vehicle floorplan facilities to finance our new vehicle inventory was approximately \$3.4 billion, of which \$2.7 billion had been borrowed.

4. GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets, net, consist of the following:

	June 30, 2014	December 31, 2013
Goodwill	\$1,257.8	\$1,259.6
Franchise rights - indefinite-lived	\$328.7	\$329.3
Other intangibles	11.9	11.1
	340.6	340.4
Less: accumulated amortization	(5.6	) (5.3
Other intangible assets, net	\$335.0	\$335.1
Goodwill)

We test goodwill of our Domestic, Import, and Premium Luxury reporting units for impairment annually as of April 30 or more frequently when events or changes in circumstances indicate that the carrying value of a reporting unit more likely than

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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

not exceeds its fair value. Under accounting standards, an entity is permitted to first make a qualitative assessment of any potential goodwill impairment to determine whether it is necessary to calculate the fair value of a reporting unit under the quantitative two-step goodwill impairment test.

We completed our qualitative assessment of any potential goodwill impairment as of April 30, 2014. Based on our qualitative assessment, we determined that it was not more likely than not that the fair values of our reporting units were less than their carrying amounts and we were therefore not required to perform the two-step goodwill impairment test for any of our reporting units.

Intangible Assets

Our principal identifiable intangible assets are individual store rights under franchise agreements with vehicle manufacturers, which have indefinite lives and are tested at least annually as of April 30 for impairment. Under accounting standards, an entity is permitted to first make a qualitative evaluation about the likelihood that an indefinite-lived intangible asset is impaired to determine whether it is necessary to perform a quantitative impairment test.

We completed our qualitative assessment of any potential franchise rights impairment as of April 30, 2014. Based on our qualitative assessment, we determined that we should perform a quantitative test for franchise rights related to one store, and no impairment charges resulted from this quantitative test. For the remainder of our franchise rights, we determined that it was not more likely than not that the fair values of our franchise rights were less than their carrying amounts based on our qualitative assessment and we were therefore not required to perform a quantitative test.

5. LONG-TERM DEBT

Long-term debt consists of the following:

	June 30, 2014	December 31, 2013
6.75% Senior Notes due 2018	\$396.7	\$396.3
5.5% Senior Notes due 2020	350.0	350.0
Term loan facility due 2016	500.0	500.0
Revolving credit facility due 2016	365.0	300.0
Mortgage facility ⁽¹⁾	190.1	194.7
Capital leases and other debt	81.4	98.9
	1,883.2	1,839.9
Less: current maturities	(17.5	) (30.1
Long-term debt, net of current maturities	\$1,865.7	\$1,809.8

⁽¹⁾ The mortgage facility requires monthly principal and interest payments of \$1.7 million based on a fixed amortization schedule with a balloon payment of \$155.4 million due November 2017.

Senior Unsecured Notes and Credit Agreement

At June 30, 2014, we had outstanding \$396.7 million of 6.75% Senior Notes due 2018, net of debt discount. Interest on the 6.75% Senior Notes due 2018 is payable on April 15 and October 15 of each year. These notes will mature on April 15, 2018.

At June 30, 2014, we had outstanding \$350.0 million of 5.5% Senior Notes due 2020. Interest is payable on February 1 and August 1 of each year. At any time prior to February 1, 2015, we may redeem up to 35% of the principal amount of these notes with the net cash proceeds of one or more public equity offerings of our common stock at 105.5% of principal. These notes will mature on February 1, 2020.

Under our credit agreement, we have a \$500.0 million term loan facility and a \$1.2 billion revolving credit facility. The term loan and revolving credit facilities under the credit agreement mature December 7, 2016. As of June 30, 2014, we had borrowings outstanding of \$365.0 million under our revolving credit facility. We have a \$200.0 million letter of credit sublimit as part of our revolving credit facility. The amount available to be borrowed under the

revolving credit facility is reduced on a

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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

dollar-for-dollar basis by the cumulative amount of any outstanding letters of credit, which was \$45.6 million at June 30, 2014, leaving an additional borrowing capacity under the revolving credit facility of \$789.4 million at June 30, 2014.

Our term loan facility provides for various interest rates generally at LIBOR plus 1.75%. Our revolving credit facility provides for a commitment fee on undrawn amounts of 0.30% and various interest rates on borrowings generally at LIBOR plus 1.75%.

The credit spread charged for both our term loan facility and revolving credit facility is affected by our leverage ratio. For instance, an increase in our leverage ratio from greater than or equal to 2.0x but less than 3.25x to greater than or equal to 3.25x would result in a 25 basis point increase in the credit spread under both our term loan facility and revolving credit facility.

Our senior unsecured notes and borrowings under our credit agreement are guaranteed by substantially all of our subsidiaries. Within the meaning of Regulation S-X, Rule 3-10, AutoNation, Inc. (the parent company) has no independent assets or operations, the guarantees of its subsidiaries are full and unconditional and joint and several, and any subsidiaries other than the guarantor subsidiaries are minor.

Other Debt

At June 30, 2014, we had \$190.1 million outstanding under a mortgage facility with an automotive manufacturer's captive finance subsidiary that matures on November 30, 2017. The mortgage facility utilizes a fixed interest rate of 5.864% and is secured by 10-year mortgages on certain of our store properties. The mortgage facility requires monthly principal and interest payments of \$1.7 million based on a fixed amortization schedule with a balloon payment of \$155.4 million due November 2017. Repayment of the mortgage facility is subject to a prepayment penalty.

At June 30, 2014, we had capital lease and other debt obligations of \$81.4 million, which are due at various dates through 2033.

Restrictions and Covenants

Our credit agreement, the indentures for our 6.75% Senior Notes due 2018 and 5.5% Senior Notes due 2020, our vehicle floorplan facilities, and our mortgage facility contain customary financial and operating covenants that place restrictions on us, including our ability to incur additional indebtedness or prepay existing indebtedness, to create liens or other encumbrances, to sell (or otherwise dispose of) assets, and to merge or consolidate with other entities.

Under our credit agreement, we are required to remain in compliance with a maximum leverage ratio and maximum capitalization ratio. The leverage ratio is a contractually defined amount principally reflecting non-vehicle debt divided by a contractually defined measure of earnings with certain adjustments. The capitalization ratio is a contractually defined amount principally reflecting vehicle floorplan payable and non-vehicle debt divided by our total capitalization including vehicle floorplan payable. Under the credit agreement, the maximum leverage ratio is 3.75x and the maximum capitalization ratio is 65.0%. In calculating our leverage and capitalization ratios, we are not required to include letters of credit in the definition of debt (except to the extent of letters of credit in excess of \$150.0 million). In addition, in calculating our capitalization ratio, we are permitted to add back to shareholders' equity all goodwill, franchise rights, and long-lived asset impairment charges subsequent to September 30, 2011 plus \$1.52 billion.

The indentures for our 6.75% Senior Notes due 2018 and 5.5% Senior Notes due 2020 contain certain limited covenants, including limitations on liens and sale and leaseback transactions. Our mortgage facility contains covenants regarding maximum cash flow leverage and minimum interest coverage.

Our failure to comply with the covenants contained in our debt agreements could permit acceleration of all of our indebtedness. Our debt agreements have cross-default provisions that trigger a default in the event of an uncured default under other material indebtedness of AutoNation.

Under the terms of our credit agreement, at June 30, 2014, our leverage ratio and capitalization ratio were as follows:

June 30, 2014	
Requirement	Actual

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Leverage ratio	≤ 3.75x	2.19x
Capitalization ratio	≤ 65.0%	56.6%

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Both the leverage ratio and the capitalization ratio limit our ability to incur additional non-vehicle debt. The capitalization ratio also limits our ability to incur additional vehicle floorplan indebtedness and repurchase shares. In the event of a downgrade in our credit ratings, none of the covenants described above would be impacted. In addition, availability under our credit agreement described above would not be impacted should a downgrade in our senior unsecured debt credit ratings occur.

6. INCOME TAXES

Income taxes refundable included in Receivables, Net totaled \$26.4 million at June 30, 2014. Income taxes payable included in Other Current Liabilities totaled \$8.4 million at December 31, 2013.

We file income tax returns in the U.S. federal jurisdiction and various states. As a matter of course, various taxing authorities, including the IRS, regularly audit us. Currently, no tax years are under examination by the IRS, and tax years from 2009 to 2012 are under examination by certain U.S. state jurisdictions. These audits may result in proposed assessments where the ultimate resolution may result in our owing additional taxes. We believe that our tax positions comply with applicable tax law and that we have adequately provided for these matters.

It is our continuing policy to account for interest and penalties associated with income tax obligations as a component of Income Tax Provision in the accompanying Unaudited Condensed Consolidated Financial Statements.

7. SHAREHOLDERS' EQUITY

A summary of shares repurchased under our stock repurchase program authorized by our Board of Directors follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Shares repurchased	1.1	0.1	3.6	0.1
Aggregate purchase price	\$64.1	\$2.7	\$179.8	\$4.9
Average purchase price per share	\$56.05	\$42.01	\$50.53	\$40.81

As of June 30, 2014, \$335.9 million remained available under our stock repurchase authorization limit.

A summary of shares of common stock issued in connection with the exercise of stock options follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Shares issued	0.3	0.1	1.1	0.5
Proceeds from the exercise of stock options	\$6.8	\$2.7	\$22.1	\$10.6
Average exercise price per share	\$19.44	\$24.54	\$20.39	\$20.59

The following table presents a summary of shares of common stock issued in connection with grants of restricted stock and shares surrendered to AutoNation to satisfy tax withholding obligations in connection with the vesting of restricted stock:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Shares issued	4,692	—	149,880	137,144
Shares surrendered to AutoNation to satisfy tax withholding obligations in connection with the vesting of restricted stock	33,274	36,175	44,477	42,306

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8. EARNINGS PER SHARE

Basic earnings per share (“EPS”) is computed by dividing net income by the weighted average number of common shares outstanding for the period, including outstanding unvested restricted stock awards and vested restricted stock unit awards. Diluted EPS is computed by dividing net income by the weighted average number of shares outstanding adjusted for the dilutive effect of stock options.

The following table presents the calculation of basic and diluted EPS:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net income from continuing operations	\$100.7	\$90.1	\$196.2	\$173.3
Loss from discontinued operations, net of income taxes	(0.3	) (0.2	) (0.7	) (0.4
Net income	\$100.4	\$89.9	\$195.5	\$172.9
Weighted average common shares outstanding used in calculating basic EPS	119.1	121.4	119.3	121.2
Effect of dilutive stock options	1.7	1.9	1.8	2.0
Weighted average common shares outstanding used in calculating diluted EPS	120.8	123.3	121.1	123.2
Basic EPS amounts:				
Continuing operations	\$0.85	\$0.74	\$1.64	\$1.43
Discontinued operations	\$—	\$—	\$(0.01) \$—
Net income	\$0.84	\$0.74	\$1.64	\$1.43
Diluted EPS amounts:				
Continuing operations	\$0.83	\$0.73	\$1.62	\$1.41
Discontinued operations	\$—	\$—	\$	