

AUTONATION, INC.  
Form 10-Q  
October 28, 2016

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 September 30, 2016

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)

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 October 26, 2016, the registrant had 101,044,098 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)

	September 30, 2016	December 31, 2015
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 62.2	\$ 74.1
Receivables, net	788.3	908.2
Inventory	3,448.0	3,612.0
Other current assets	123.4	115.4
Total Current Assets	4,421.9	4,709.7
PROPERTY AND EQUIPMENT, net of accumulated depreciation of \$1.1 billion and \$1.0 billion, respectively	2,807.6	2,667.4
GOODWILL	1,492.4	1,394.5
OTHER INTANGIBLE ASSETS, NET	581.0	439.9
OTHER ASSETS	384.1	336.7
Total Assets	\$ 9,687.0	\$ 9,548.2
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Vehicle floorplan payable - trade	\$ 2,096.6	\$ 2,565.8
Vehicle floorplan payable - non-trade	1,442.9	1,161.3
Accounts payable	304.0	299.9
Commercial paper	975.0	599.5
Current maturities of long-term debt	13.3	11.7
Other current liabilities	566.1	529.2
Total Current Liabilities	5,397.9	5,167.4
LONG-TERM DEBT, NET OF CURRENT MATURITIES	1,769.5	1,745.3
DEFERRED INCOME TAXES	89.3	78.6
OTHER LIABILITIES	209.5	207.6
<b>COMMITMENTS AND CONTINGENCIES (Note 11)</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
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; 120,562,149 shares issued at September 30, 2016, and December 31, 2015, including shares held in treasury	1.2	1.2
Additional paid-in capital	18.0	5.2
Retained earnings	3,018.0	2,702.8
Treasury stock, at cost; 19,323,697 and 9,758,091 shares held, respectively	(816.4)	(359.9)
Total Shareholders' Equity	2,220.8	2,349.3
Total Liabilities and Shareholders' Equity	\$ 9,687.0	\$ 9,548.2

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		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Revenue:				
New vehicle	\$3,195.9	\$3,113.6	\$9,068.0	\$8,851.0
Used vehicle	1,276.8	1,205.4	3,777.8	3,614.9
Parts and service	843.8	783.3	2,498.9	2,304.5
Finance and insurance, net	229.6	227.1	678.1	652.4
Other	21.4	24.3	105.7	99.4
<b>TOTAL REVENUE</b>	<b>5,567.5</b>	<b>5,353.7</b>	<b>16,128.5</b>	<b>15,522.2</b>
Cost of sales:				
New vehicle	3,037.7	2,942.8	8,597.8	8,352.6
Used vehicle	1,199.6	1,122.2	3,525.6	3,336.9
Parts and service	480.0	441.1	1,418.8	1,305.1
Other	13.8	17.3	82.2	78.3
<b>TOTAL COST OF SALES (excluding depreciation shown below)</b>	<b>4,731.1</b>	<b>4,523.4</b>	<b>13,624.4</b>	<b>13,072.9</b>
Gross Profit:				
New vehicle	158.2	170.8	470.2	498.4
Used vehicle	77.2	83.2	252.2	278.0
Parts and service	363.8	342.2	1,080.1	999.4
Finance and insurance	229.6	227.1	678.1	652.4
Other	7.6	7.0	23.5	21.1
<b>TOTAL GROSS PROFIT</b>	<b>836.4</b>	<b>830.3</b>	<b>2,504.1</b>	<b>2,449.3</b>
Selling, general, and administrative expenses	591.3	568.7	1,765.2	1,695.0
Depreciation and amortization	36.3	32.9	107.0	93.7
Other income, net	(10.2)	(7.0)	(21.0)	(12.1)
<b>OPERATING INCOME</b>	<b>219.0</b>	<b>235.7</b>	<b>652.9</b>	<b>672.7</b>
Non-operating income (expense) items:				
Floorplan interest expense	(18.2)	(14.7)	(56.4)	(42.1)
Other interest expense	(28.9)	(21.4)	(85.9)	(64.4)
Interest income	0.3	—	0.8	0.1
Other income (loss), net	2.6	(4.3)	3.4	(2.7)
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>174.8</b>	<b>195.3</b>	<b>514.8</b>	<b>563.6</b>
Income tax provision	67.0	76.3	198.7	217.7
<b>NET INCOME FROM CONTINUING OPERATIONS</b>	<b>107.8</b>	<b>119.0</b>	<b>316.1</b>	<b>345.9</b>
Loss from discontinued operations, net of income taxes	(0.5)	(0.5)	(0.9)	(0.8)
<b>NET INCOME</b>	<b>\$107.3</b>	<b>\$118.5</b>	<b>\$315.2</b>	<b>\$345.1</b>
<b>BASIC EARNINGS (LOSS) PER SHARE:</b>				
Continuing operations	\$1.06	\$1.06	\$3.05	\$3.05
Discontinued operations	\$—	\$—	\$(0.01)	\$(0.01)
Net income	\$1.05	\$1.05	\$3.04	\$3.05
Weighted average common shares outstanding	101.9	112.4	103.8	113.3
<b>DILUTED EARNINGS (LOSS) PER SHARE:</b>				
Continuing operations	\$1.05	\$1.05	\$3.02	\$3.02

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Discontinued operations	\$—	\$—	\$(0.01 )	\$(0.01 )
Net income	\$1.05	\$1.04	\$3.02	\$3.01
Weighted average common shares outstanding	102.6	113.6	104.5	114.6
COMMON SHARES OUTSTANDING, net of treasury stock, at period end	101.2	111.0	101.2	111.0

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	Retained	Treasury	Total
	Shares	Amount	Paid-In Capital	Earnings	Stock	
BALANCE AT DECEMBER 31, 2015	120,562,149	\$ 1.2	\$ 5.2	\$2,702.8	\$(359.9)	\$2,349.3
Net income	—	—	—	315.2	—	315.2
Repurchases of common stock	—	—	—	—	(472.5 )	(472.5 )
Stock-based compensation expense	—	—	22.5	—	—	22.5
Shares awarded under stock-based compensation plans, including income tax benefit of \$0.7	—	—	(7.5 )	—	16.0	8.5
Other	—	—	(2.2 )	—	—	(2.2 )
BALANCE AT SEPTEMBER 30, 2016	120,562,149	\$ 1.2	\$ 18.0	\$3,018.0	\$(816.4)	\$2,220.8

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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AUTONATION, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Nine Months Ended September 30,	
	2016	2015
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:</b>		
Net income	\$315.2	\$345.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations	0.9	0.8
Depreciation and amortization	107.0	93.7
Amortization of debt issuance costs and accretion of debt discounts	4.0	3.4
Stock-based compensation expense	22.5	21.2
Deferred income tax provision	2.6	23.1
Net gain related to business/property dispositions	(29.7 )	(16.8 )
Non-cash impairment charges	14.0	4.5
Excess tax benefit from stock-based awards	(0.7 )	(13.7 )
Other	(2.4 )	3.1
(Increase) decrease, net of effects from business combinations and divestitures:		
Receivables	137.5	59.4
Inventory	320.4	(270.5 )
Other assets	(38.2 )	(9.9 )
Increase (decrease), net of effects from business combinations and divestitures:		
Vehicle floorplan payable - trade, net	(418.2 )	168.6
Accounts payable	(3.9 )	16.8
Other liabilities	48.6	47.3
Net cash provided by continuing operations	479.6	476.1
Net cash used in discontinued operations	(0.8 )	(0.8 )
Net cash provided by operating activities	478.8	475.3
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(187.6 )	(179.5 )
Property operating lease buy-outs	(5.0 )	(8.5 )
Proceeds from the sale of property and equipment	7.2	21.9
Proceeds from assets held for sale	—	10.1
Cash received from business divestitures, net of cash relinquished	87.5	36.2
Cash used in business acquisitions, net of cash acquired	(362.5 )	(123.8 )
Net change in restricted cash	3.8	(3.8 )
Other	(0.2 )	(5.5 )
Net cash used in continuing operations	(456.8 )	(252.9 )
Net cash used in discontinued operations	—	—
Net cash used in investing activities	(456.8 )	(252.9 )

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)

	Nine Months Ended September 30, 2016 2015	
<b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES:</b>		
Repurchases of common stock	(470.6)	(211.3 )
Proceeds from 3.35% Senior Notes due 2021	—	300.0
Proceeds from 4.5% Senior Notes due 2025	—	448.5
Proceeds from revolving credit facility	1,050.0	1,310.0
Payments of revolving credit facility	(1,050.0)	(2,420.0)
Net proceeds from commercial paper	375.5	435.0
Payment of debt issuance costs	—	(5.5 )
Net proceeds from (payments of) vehicle floorplan payable - non-trade	78.7	(112.9 )
Purchase of subsidiary shares	(15.2 )	—
Payments of mortgage facility	(7.7 )	(7.3 )
Payments of capital leases and other debt obligations	(3.1 )	(8.2 )
Proceeds from the exercise of stock options	7.8	24.1
Excess tax benefit from stock-based awards	0.7	13.7
Net cash used in continuing operations	(33.9 )	(233.9 )
Net cash used in discontinued operations	—	—
Net cash used in financing activities	(33.9 )	(233.9 )
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(11.9 )</b>	<b>(11.5 )</b>
CASH AND CASH EQUIVALENTS at beginning of period	74.1	75.4
CASH AND CASH EQUIVALENTS at end of period	\$62.2	\$63.9

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 September 30, 2016, we owned and operated 371 new vehicle franchises from 261 stores located in the United States, predominantly in major metropolitan markets in the Sunbelt region. Our stores sell 35 different new vehicle brands. The core brands of new vehicles that we sell, representing approximately 94% of the new vehicles that we sold during the nine months ended September 30, 2016, are manufactured by Toyota (including Lexus), Ford, Honda, General Motors, FCA US (formerly Chrysler), Nissan, Mercedes-Benz, BMW, and Volkswagen (including Audi and Porsche).

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; intercompany accounts and transactions have been eliminated. The accompanying Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Additionally, operating results for interim periods are not necessarily indicative of the results that can be expected for a full year. The Unaudited Condensed Consolidated Financial Statements herein should be read in conjunction with our audited Consolidated Financial Statements and notes thereto included within our most recent Annual Report on Form 10-K. 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 GAAP 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. The significant estimates made 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.

Recent Accounting Pronouncements

Presentation of Debt Issuance Costs

In April 2015, the Financial Accounting Standards Board (“FASB”) issued an accounting standard update to simplify the presentation of debt issuance costs. The amendments in this accounting standard update require debt issuance costs be presented on the balance sheet as a reduction from the carrying amount of the related debt liability. In August 2015,

the FASB issued an accounting standard update that allows the presentation of debt issuance costs related to line-of-credit arrangements to continue to be an asset on the balance sheet under the simplified guidance, regardless of whether there are any outstanding borrowings on the related arrangements. The amendments in these accounting standard updates were to be applied retrospectively and effective for interim and annual reporting periods beginning after December 15, 2015. We have reclassified all debt issuance costs, with the exception of those related to our revolving credit facility, as a reduction from the carrying amount of the related

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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

debt liability for both current and prior periods. See Note 5 of the Notes to Unaudited Condensed Consolidated Financial Statements for additional information.

Revenue Recognition

In May 2014, the 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 will be applied using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a modified retrospective approach with the cumulative effect of initially adopting the standard recognized at the date of adoption (which requires additional footnote disclosures). This accounting standard update is effective for reporting periods beginning after December 15, 2017. Earlier application is permitted only as of reporting periods beginning after December 15, 2016. We plan to adopt this accounting standard update effective January 1, 2018. While we are currently evaluating the method of adoption and the impact of the provisions of this accounting standard update, we expect similar performance obligations to result under this update as compared with deliverables and separate units of accounting currently identified. As a result, we expect the timing of our revenue recognition to generally remain the same.

Accounting for Leases

In February 2016, the FASB issued an accounting standard update that amends the accounting guidance on leases. The primary change in this accounting standard update requires lessees to recognize, in the balance sheet, a liability to make lease payments and a right-of-use asset representing the right to use the underlying asset over the lease term. The amendments in this accounting standard update are to be applied using a modified retrospective approach and are effective for fiscal years beginning after December 15, 2018. We will adopt this accounting standard update effective January 1, 2019. While we are still evaluating the impact of adopting this update on our consolidated financial statements, we expect that upon adoption the right-of-use assets and lease liabilities recorded could be material to our consolidated balance sheets. However, we do not expect a material impact to our consolidated income statements.

Improvements to Employee Share-Based Payment Accounting

In March 2016, the FASB issued an accounting standard update that amends several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification within the statement of cash flows. Certain of the amendments in this accounting standard update are to be applied using a modified retrospective approach by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted, while other amendments can be applied prospectively or retrospectively. The amendments in this accounting standard update are effective for periods beginning after December 15, 2016. We will adopt this accounting standard update effective January 1, 2017, and are currently evaluating the impact of the provisions of this update, however, we do not expect any potential cumulative-effect adjustment to equity to be material.

Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued an accounting standard update that provides classification guidance on eight specific cash flow issues, for which guidance previously did not exist or was unclear. The amendments in this accounting standard update are effective for periods beginning after December 15, 2017. Early adoption is permitted for any entity in any interim or annual period. We plan to adopt this accounting standard update effective January 1, 2018. We do not expect the impact of the provisions of this accounting standard update to have a material impact on our consolidated statements of cash flows.



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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 2. RECEIVABLES, NET

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

	September 30, December 31,	
	2016	2015
Trade receivables	\$ 139.8	\$ 133.6
Manufacturer receivables	213.2	221.4
Other	65.3	38.0
	418.3	393.0
Less: allowances for doubtful accounts	(5.3 )	(4.5 )
	413.0	388.5
Contracts-in-transit and vehicle receivables	364.8	508.0
Income taxes receivable (see Note 6)	10.5	11.7
Receivables, net	\$ 788.3	\$ 908.2

Trade receivables represent amounts due for parts and services that have been delivered or sold, excluding amounts due from manufacturers, as well as receivables from finance organizations for commissions on the sale of financing products. Manufacturer receivables represent amounts due from manufacturers 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:

	September 30, December 31,	
	2016	2015
New vehicles	\$ 2,645.2	\$ 2,888.1
Used vehicles	606.3	539.7
Parts, accessories, and other	196.5	184.2
Inventory	\$ 3,448.0	\$ 3,612.0

The components of vehicle floorplan payable are as follows:

	September 30, December 31,	
	2016	2015
Vehicle floorplan payable - trade	\$ 2,096.6	\$ 2,565.8
Vehicle floorplan payable - non-trade	1,442.9	1,161.3
Vehicle floorplan payable	\$ 3,539.5	\$ 3,727.1

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 vehicle floorplan facilities. 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, floorplan assistance, and non-reimbursement-based manufacturer advertising rebates, 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.

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AUTONATION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

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 allow the manufacturer to draft against new vehicle floorplan facilities so the lender funds the manufacturer directly for the purchase of new vehicle inventory. Vehicle floorplan facilities are primarily collateralized by vehicle inventories and related receivables.

Our new vehicle floorplan facilities utilize LIBOR-based interest rates, which averaged 2.0% for the nine months ended September 30, 2016, and 1.7% for the nine months ended September 30, 2015. At September 30, 2016, the aggregate capacity under our new vehicle floorplan facilities to finance our new vehicle inventory was approximately \$4.6 billion, of which \$3.2 billion had been borrowed.

Our used vehicle floorplan facilities utilize LIBOR-based interest rates, which averaged 2.0% for the nine months ended September 30, 2016, and 1.7% for the nine months ended September 30, 2015. At September 30, 2016, the aggregate capacity under our used vehicle floorplan facilities with various lenders to finance a portion of our used vehicle inventory was \$395.0 million, of which \$373.1 million had been borrowed. The remaining borrowing capacity of \$21.9 million was limited to \$0.3 million based on the eligible used vehicle inventory that could have been pledged as collateral.

## 4. GOODWILL AND INTANGIBLE ASSETS, NET

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

	September 30, December 31,	
	2016	2015
Goodwill	\$ 1,492.4	\$ 1,394.5
Franchise rights - indefinite-lived	\$ 572.7	\$ 432.4
Other intangibles	15.6	14.3
	588.3	446.7
Less: accumulated amortization	(7.3	) (6.8
Other intangible assets, net	\$ 581.0	\$ 439.9

See Note 14 of the Notes to Unaudited Condensed Consolidated Financial Statements for information about our annual impairment tests of goodwill and franchise rights.

## 5. LONG-TERM DEBT AND COMMERCIAL PAPER

Long-term debt, net of debt issuance costs, consists of the following:

	September 30, December 31,	
	2016	2015
6.75% Senior Notes due 2018	\$ 398.3	\$ 397.5
5.5% Senior Notes due 2020	347.1	346.5
3.35% Senior Notes due 2021	297.9	297.6
4.5% Senior Notes due 2025	445.1	444.7
Revolving credit facility due 2019	—	—
Mortgage facility <sup>(1)</sup>	168.0	175.7
Capital leases and other debt	126.4	95.0
	1,782.8	1,757.0
Less: current maturities	(13.3	) (11.7
Long-term debt, net of current maturities	\$ 1,769.5	\$ 1,745.3

<sup>(1)</sup> 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.

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As discussed in Note 1 above, the FASB issued an accounting standard update that requires debt issuance costs be presented on the balance sheet as a reduction from the carrying amount of the related debt liability. We adopted the accounting standard update retrospectively effective January 1, 2016, and have presented all debt issuance costs, with the exception of those related to our revolving credit facility, as a reduction from the carrying amount of the related debt liability for both current and prior periods. We reclassified \$10.1 million of debt issuance costs as a direct reduction from the carrying amount of debt as of December 31, 2015.

**Senior Unsecured Notes and Credit Agreement**

At September 30, 2016, we had outstanding \$398.6 million of 6.75% Senior Notes due 2018, net of debt discount. Interest is payable on April 15 and October 15 of each year. These notes will mature on April 15, 2018.

At September 30, 2016, 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. These notes will mature on February 1, 2020.

At September 30, 2016, we had outstanding \$300.0 million of 3.35% Senior Notes due 2021, net of debt discount. Interest is payable on January 15 and July 15 of each year. These notes will mature on January 15, 2021.

At September 30, 2016, we had outstanding \$448.6 million of 4.5% Senior Notes due 2025, net of debt discount. Interest on the 2025 Notes is payable on April 1 and October 1 of each year. These notes will mature on October 1, 2025.

The interest rate payable on the 2021 Notes and 2025 Notes is subject to adjustment upon the occurrence of certain credit rating events as provided in the indentures for these senior unsecured notes.

Under our credit agreement, we have a \$1.8 billion revolving credit facility that matures on December 3, 2019. The credit agreement also contains an accordion feature that allows us, subject to credit availability and certain other conditions, to increase the amount of the revolving credit facility, together with any added term loans, by up to \$500.0 million in the aggregate. As of September 30, 2016, we had no borrowings outstanding 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 dollar-for-dollar basis by the cumulative amount of any outstanding letters of credit, which was \$44.1 million at September 30, 2016, leaving a borrowing capacity under the revolving credit facility of \$1.8 billion at September 30, 2016. As of September 30, 2016, this borrowing capacity was limited under the maximum consolidated leverage ratio contained in our credit agreement to \$1.0 billion.

Our revolving credit facility provides for a commitment fee on undrawn amounts ranging from 0.175% to 0.25% and interest on borrowings at LIBOR or the base rate, in each case plus an applicable margin. The applicable margin ranges from 1.25% to 1.625% for LIBOR borrowings and 0.25% to 0.625% for base rate borrowings. The interest rate charged for our 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 12.5 basis point increase in the applicable margin.

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 Long-Term Debt**

At September 30, 2016, we had \$168.0 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 September 30, 2016, we had capital lease and other debt obligations of \$126.4 million, which are due at various dates through 2036.

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## Commercial Paper

We have a commercial paper program pursuant to which we may issue short-term, unsecured commercial paper notes on a private placement basis up to a maximum aggregate amount outstanding at any time of \$1.0 billion. The interest rate for the commercial paper notes varies based on duration and market conditions. The maturities of the commercial paper notes may vary, but may not exceed 397 days from the date of issuance. The commercial paper notes are guaranteed by substantially all of our subsidiaries. Proceeds from the issuance of commercial paper notes are used to repay borrowings under the revolving credit facility, to finance acquisitions and for working capital, capital expenditures, share repurchases, and/or other general corporate purposes. We plan to use the revolving credit facility under our credit agreement as a liquidity backstop for borrowings under the commercial paper program. A downgrade in our credit ratings could negatively impact our ability to issue, or the interest rates for, commercial paper notes. At September 30, 2016, we had \$975.0 million of commercial paper notes outstanding with a weighted-average annual interest rate of 1.31% and a weighted-average remaining term of 26 days.

## Restrictions and Covenants

Our credit agreement, the indentures for our senior unsecured notes, 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 70.0%. 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, 2014 plus \$1.53 billion.

The indentures for our senior unsecured notes 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 result in the 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 September 30, 2016, our leverage ratio and capitalization ratio were as follows:

	September 30, 2016	
	Requirement	Actual
Leverage ratio	≤ 3.75x	2.75x
Capitalization ratio	≤ 70.0%	62.6%

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.

## 6. INCOME TAXES

Income taxes receivable included in Receivables, net totaled \$10.5 million at September 30, 2016, and \$11.7 million at December 31, 2015.

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

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2009 to 2015 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.

It is our 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 September 30, 2016		Nine Months Ended September 30, 2015	
Shares repurchased	1.0	2.5	9.9	3.5
Aggregate purchase price	\$50.0	\$150.0	\$470.6	\$209.1
Average purchase price per share	\$48.62	\$59.83	\$47.48	\$60.54

In October 2016, our Board of Directors authorized the repurchase of an additional \$250.0 million of shares of our common stock. As of October 26, 2016, \$315.9 million remained available for share repurchases under the program.

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Shares issued	0.1	0.2	0.3	1.1
Proceeds from the exercise of stock options	\$4.6	\$5.4	\$7.8	\$24.1
Average exercise price per share	\$35.55	\$26.94	\$30.93	\$22.55

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 (in actual number of shares):

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Shares issued	—	2,360	138,424	159,442
Shares surrendered to AutoNation to satisfy tax withholding obligations in connection with the vesting of restricted stock	4,788	500	37,673	36,427

**8. EARNINGS PER SHARE**

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are to be included in the computation of earnings per share ("EPS") under the two-class method. Our restricted stock awards are considered participating securities because they contain non-forfeitable rights to dividends. As the number of shares granted under such awards is immaterial, all earnings per share amounts reflect such shares as if they were fully vested shares and the disclosures associated with the two-class method are not presented.

Basic 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, noted above, adjusted for the dilutive effect of stock options.

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Net income from continuing operations	\$107.8	\$119.0	\$316.1	\$345.9
Loss from discontinued operations, net of income taxes	(0.5 )	(0.5 )	(0.9 )	(0.8 )
Net income	\$107.3	\$118.5	\$315.2	\$345.1
Weighted average common shares outstanding used in calculating basic EPS	101.9	112.4	103.8	113.3
Effect of dilutive stock options	0.7	1.2	0.7	1.3
Weighted average common shares outstanding used in calculating diluted EPS	102.6	113.6	104.5	114.6
Basic EPS amounts <sup>(1)</sup> :				
Continuing operations	\$1.06	\$1.06	\$3.05	\$3.05
Discontinued operations	\$—	\$—	\$(0.01 )	\$(0.01 )
Net income	\$1.05	\$1.05	\$3.04	\$3.05
Diluted EPS amounts <sup>(1)</sup> :				
Continuing operations	\$1.05	\$1.05	\$3.02	\$3.02
Discontinued operations	\$—	\$—	\$(0.01 )	\$(0.01 )
Net income	\$1.05	\$1.04	\$3.02	\$3.01

<sup>(1)</sup> Earnings per share amounts are calculated discretely and therefore may not add up to the total due to rounding.

A summary of anti-dilutive options excluded from the computation of diluted earnings per share is as follows:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Anti-dilutive options excluded from the computation of diluted earnings per share	3.0	0.9	2.9	0.7

**9. DIVESTITURES**

During the third quarter of 2016, we divested one Domestic store and one Import store and recorded a net gain and other related adjustments of \$11.8 million. During the second quarter of 2016, we divested one Domestic store and six Import stores and recorded a net gain and other related adjustments of \$11.5 million. During the first quarter of 2016, we divested two Import stores and recorded a gain of \$6.2 million. During the first quarter of 2015, we divested two Import stores and recorded a gain of \$1.4 million.

The gains on these divestitures are included in Other Income, Net (within Operating Income) in our Unaudited Condensed Consolidated Statements of Income. The financial condition and results of operations of these businesses were not material to our consolidated financial statements.

**10. ACQUISITIONS**



During the nine months ended September 30, 2016, we purchased 18 stores located in Texas, New York, Colorado, and California, which include Chrysler, Dodge, Jeep, Ram, Chevrolet, Hyundai, Mercedes-Benz, Sprinter, Jaguar, Land Rover, and BMW franchises. Acquisitions are included in the Unaudited Condensed Consolidated Financial Statements from the date of acquisition. The purchase price allocation for these business combinations are preliminary and subject to final adjustment. We purchased eight stores during the nine months ended September 30, 2015.

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The acquisitions that occurred during the nine months ended September 30, 2016 were not material to our financial condition or results of operations. Additionally, on a pro forma basis as if the results of these acquisitions had been included in our consolidated results for the entire nine month periods ended September 30, 2016 and 2015, revenue and net income would not have been materially different from our reported revenue and net income for these periods. In October 2016, we purchased a BMW store in the San Diego, California market, and a collision center in the Chicago, Illinois market.

## 11. COMMITMENTS AND CONTINGENCIES

### Legal Proceedings

We are involved, and will continue to be involved, in numerous legal proceedings arising out of the conduct of our business, including litigation with customers, wage and hour and other employment-related lawsuits, and actions brought by governmental authorities. Some of these lawsuits purport or may be determined to be class or collective actions and seek substantial damages or injunctive relief, or both, and some may remain unresolved for several years. We establish accruals for specific legal proceedings when it is considered probable that a loss has been incurred and the amount of the loss can be reasonably estimated. Our accruals for loss contingencies are reviewed quarterly and adjusted as additional information becomes available. We disclose the amount accrued if material or if such disclosure is necessary for our financial statements to not be misleading. If a loss is not both probable and reasonably estimable, or if an exposure to loss exists in excess of the amount accrued, we assess whether there is at least a reasonable possibility that a loss, or additional loss, may have been incurred. If there is a reasonable possibility that a loss, or additional loss, may have been incurred, we disclose the estimate of the possible loss or range of loss if it is material or a statement that such an estimate cannot be made. Our evaluation of whether a loss is reasonably possible or probable is based on our assessment and consultation with legal counsel regarding the ultimate outcome of the matter. As of September 30, 2016 and 2015, we have accrued for the potential impact of loss contingencies that are probable and reasonably estimable, and there was no indication of a reasonable possibility that a material loss, or additional material loss, may have been incurred. We do not believe that the ultimate resolution of these matters will have a material adverse effect on our results of operations, financial condition, or cash flows. However, the results of these matters cannot be predicted with certainty, and an unfavorable resolution of one or more of these matters could have a material adverse effect on our results of operations, financial condition, or cash flows.

### Other Matters

AutoNation, acting through its subsidiaries, is the lessee under many real estate leases that provide for the use by our subsidiaries of their respective store premises. Pursuant to these leases, our subsidiaries generally agree to indemnify the lessor and other related parties from certain liabilities arising as a result of the use of the leased premises, including environmental liabilities, or a breach of the lease by the lessee. Additionally, from time to time, we enter into agreements with third parties in connection with the sale of assets or businesses in which we agree to indemnify the purchaser or related parties from certain liabilities or costs arising in connection with the assets or business. Also, in the ordinary course of business in connection with purchases or sales of goods and services, we enter into agreements that may contain indemnification provisions. In the event that an indemnification claim is asserted, our liability would be limited by the terms of the applicable agreement.

From time to time, primarily in connection with dispositions of automotive stores, our subsidiaries assign or sublet to the store purchaser the subsidiaries' interests in any real property leases associated with such stores. In general, our subsidiaries retain responsibility for the performance of certain obligations under such leases to the extent that the assignee or sublessee does not perform, whether such performance is required prior to or following the assignment or subletting of the lease. Additionally, AutoNation and its subsidiaries generally remain subject to the terms of any guarantees made by us and our subsidiaries in connection with such leases. Although we generally have indemnification rights against the assignee or sublessee in the event of non-performance under these leases, as well as certain defenses, we estimate that lessee rental payment obligations during the remaining terms of these leases with

expirations ranging from 2017 to 2034 are approximately \$25 million at September 30, 2016. We do not have any material known commitments that we or our subsidiaries will be called on to perform under any such assigned leases or subleases at September 30, 2016. There can be no assurance that any performance by AutoNation or its subsidiaries required under these leases would not have a material adverse effect on our business, financial condition, and cash flows.

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At September 30, 2016, surety bonds, letters of credit, and cash deposits totaled \$99.2 million, including \$44.1 million of letters of credit. In the ordinary course of business, we are required to post performance and surety bonds, letters of credit, and/or cash deposits as financial guarantees of our performance. We do not currently provide cash collateral for outstanding letters of credit.

In the ordinary course of business, we are subject to numerous laws and regulations, including automotive, environmental, health and safety, and other laws and regulations. We do not anticipate that the costs of such compliance will have a material adverse effect on our business, consolidated results of operations, cash flows, or financial condition, although such outcome is possible given the nature of our operations and the extensive legal and regulatory framework applicable to our business.

Further, we expect that new laws and regulations, particularly at the federal level, in other areas may be enacted, which could also materially adversely impact our business. We do not have any material known environmental commitments or contingencies.

## 12. SEGMENT INFORMATION

At September 30, 2016 and 2015, we had three reportable segments: (1) Domestic, (2) Import, and (3) Premium Luxury. Our Domestic segment is comprised of retail automotive franchises that sell new vehicles manufactured by Ford, General Motors, and FCA US (formerly Chrysler). Our Import segment is comprised of retail automotive franchises that sell new vehicles manufactured primarily by Toyota, Honda, and Nissan. Our Premium Luxury segment is comprised of retail automotive franchises that sell new vehicles manufactured primarily by Mercedes-Benz, BMW, Lexus, and Audi. The franchises in each segment also sell used vehicles, parts and automotive repair and maintenance services, and automotive finance and insurance products.

“Corporate and other” is comprised of our other businesses, including certain collision centers and an auction operation, each of which generates revenues, as well as unallocated corporate overhead expenses and retrospective commissions for certain financing and insurance transactions that we arrange under agreements with third parties.

The reportable segments identified above are the business activities of the Company for which discrete financial information is available and for which operating results are regularly reviewed by our chief operating decision maker to allocate resources and assess performance. Our chief operating decision maker is our Chief Executive Officer.

In the following tables of financial data, revenue and segment income of our reportable segments are reconciled to consolidated revenue and consolidated income from continuing operations before income taxes, respectively.

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Revenue:				
Domestic	\$2,044.9	\$1,869.1	\$5,888.2	\$5,299.0
Import	1,779.0	1,837.4	5,202.1	5,311.1
Premium Luxury	1,680.6	1,607.0	4,865.6	4,803.2
Total	5,504.5	5,313.5	15,955.9	15,413.3
Corporate and other	63.0	40.2	172.6	108.9
Total consolidated revenue	\$5,567.5	\$5,353.7	\$16,128.5	\$15,522.2

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	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Segment income <sup>(1)</sup> :				
Domestic	\$83.9	\$94.6	\$246.9	\$258.8
Import	79.3	85.5	230.0	240.6
Premium Luxury	80.9	85.4	256.8	273.9
Total	244.1	265.5	733.7	773.3
Corporate and other	(43.3 )	(44.5 )	(137.2 )	(142.7 )
Other interest expense	(28.9 )	(21.4 )	(85.9 )	(64.4 )
Interest income	0.3	—	0.8	0.1
Other income (loss), net	2.6	(4.3 )	3.4	(2.7 )
Income from continuing operations before income taxes	\$174.8	\$195.3	\$514.8	\$563.6

<sup>(1)</sup> Segment income represents income for each of our reportable segments and is defined as operating income less floorplan interest expense.

**13. BUSINESS AND CREDIT CONCENTRATIONS**

We are subject to a concentration of risk in the event of financial distress of or other adverse event related to a major vehicle manufacturer or related lender or supplier. The core brands of vehicles that we sell, representing approximately 94% of the new vehicles sold during the nine months ended September 30, 2016, are manufactured by Toyota (including Lexus), Ford, Honda, General Motors, FCA US (formerly Chrysler), Nissan, Mercedes-Benz, BMW, and Volkswagen (including Audi and Porsche). Our business could be materially adversely impacted by a bankruptcy of or other adverse event related to a major vehicle manufacturer or related lender or supplier.

We had receivables from manufacturers or distributors of \$213.2 million at September 30, 2016, and \$221.4 million at December 31, 2015. Additionally, a large portion of our Contracts-in-Transit included in Receivables, Net, in the accompanying Unaudited Condensed Consolidated Balance Sheets, are due from automotive manufacturers' captive finance subsidiaries, which provide financing directly to our new and used vehicle customers. Concentrations of credit risk with respect to non-manufacturer trade receivables are limited due to the wide variety of customers and markets in which our products are sold as well as their dispersion across many different geographic areas in the United States. Consequently, at September 30, 2016, we do not consider AutoNation to have any significant non-manufacturer concentrations of credit risk.

**14. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS**

The fair value of a financial instrument represents the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. Fair value estimates are made at a specific point in time based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of judgment, and therefore cannot be determined with precision.

Accounting standards define fair value as the price that would be received from selling an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Accounting standards establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value and also establishes the following three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

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Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted Level 2 market prices in markets that are not active; or model-derived valuations or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

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The following methods and assumptions were used by us in estimating fair value disclosures for financial instruments: Cash and cash equivalents, accounts receivable, other current assets, vehicle floorplan payable, accounts payable, other current liabilities, commercial paper, and variable rate debt: The amounts reported in the accompanying Unaudited Condensed Consolidated Balance Sheets approximate fair value due to their short-term nature or the existence of variable interest rates that approximate prevailing market rates.

Fixed rate long-term debt: Our fixed rate long-term debt primarily consists of amounts outstanding under our senior unsecured notes and mortgages. We estimate the fair value of our senior unsecured notes using quoted prices for the identical liability (Level 1). We estimate the fair value of our mortgages using a present value technique based on our current market interest rates for similar types of financial instruments (Level 2). A summary of the aggregate carrying values and fair values of our fixed rate long-term debt is as follows: