AUTONATION, INC.
Form 10-Q
October 28, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 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	73-1105145
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 SW 1st Avenue, Fort Lauderdale, Florida	33301
(Address of principal executive offices)	(Zip Code)

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

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

As of October 27, 2014, the registrant had 113,143,813 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, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$67.5	$69.2
Receivables, net	651.8	740.9
Inventory	2,691.4	2,827.2
Other current assets	196.2	192.7
Total Current Assets	3,606.9	3,830.0
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $942.3 million and $883.7 million, respectively	2,293.4	2,235.3
GOODWILL	1,265.3	1,259.6
OTHER INTANGIBLE ASSETS, NET	339.1	335.1
OTHER ASSETS	289.0	254.1
Total Assets	$7,793.7	$7,914.1
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Vehicle floorplan payable - trade	$1,912.6	$2,130.1
Vehicle floorplan payable - non-trade	862.1	898.9
Accounts payable	251.1	263.0
Current maturities of long-term debt	17.5	30.1
Other current liabilities	499.2	429.7
Total Current Liabilities	3,542.5	3,751.8
LONG-TERM DEBT, NET OF CURRENT MATURITIES	1,915.5	1,809.8
DEFERRED INCOME TAXES	129.4	116.5
OTHER LIABILITIES	194.3	174.3
COMMITMENTS AND CONTINGENCIES (Note 11)		
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 September 30, 2014, and December 31, 2013, including shares held in treasury	1.6	1.6
Additional paid-in capital	55.6	42.8
Retained earnings	3,639.9	3,337.9
Treasury stock, at cost; 49,033,894 and 42,646,753 shares held, respectively	(1,685.1)	(1,320.6)
Total Shareholders' Equity	2,012.0	2,061.7
Total Liabilities and Shareholders' Equity	$7,793.7	$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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue:				
New vehicle	$2,823.6	$2,561.6	$7,989.1	$7,312.9
Used vehicle	1,148.5	1,044.7	3,280.5	3,110.9
Parts and service	717.4	653.8	2,093.2	1,946.3
Finance and insurance, net	196.5	174.9	554.3	504.4
Other	23.0	35.8	143.9	119.2
TOTAL REVENUE	4,909.0	4,470.8	14,061.0	12,993.7
Cost of sales:				
New vehicle	2,666.5	2,406.2	7,524.5	6,866.6
Used vehicle	1,060.1	964.2	3,008.5	2,860.3
Parts and service	413.7	376.7	1,202.0	1,116.7
Other	15.8	27.1	120.8	93.4
TOTAL COST OF SALES (excluding depreciation shown below)	4,156.1	3,774.2	11,855.8	10,937.0
Gross Profit:				
New vehicle	157.1	155.4	464.6	446.3
Used vehicle	88.4	80.5	272.0	250.6
Parts and service	303.7	277.1	891.2	829.6
Finance and insurance	196.5	174.9	554.3	504.4
Other	7.2	8.7	23.1	25.8
TOTAL GROSS PROFIT	752.9	696.6	2,205.2	2,056.7
Selling, general, and administrative expenses	522.3	485.1	1,547.6	1,452.5
Depreciation and amortization	27.2	24.1	79.0	70.1
Other expenses (income), net	(4.0)	0.2	(15.7)	(3.4)
OPERATING INCOME	207.4	187.2	594.3	537.5
Non-operating income (expense) items:				
Floorplan interest expense	(13.1)	(12.7)	(39.6)	(39.2)
Other interest expense	(21.7)	(22.3)	(64.6)	(66.6)
Interest income	0.1	0.1	0.2	0.2
Other income (loss), net	1.1	(0.7)	3.5	2.2
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	173.8	151.6	493.8	434.1
Income tax provision	67.1	58.8	190.9	168.0
NET INCOME FROM CONTINUING OPERATIONS	106.7	92.8	302.9	266.1
Loss from discontinued operations, net of income taxes	(0.2)	(0.2)	(0.9)	(0.6)
NET INCOME	$106.5	$92.6	$302.0	$265.5
BASIC EARNINGS (LOSS) PER SHARE:				
Continuing operations	$0.91	$0.76	$2.56	$2.19
Discontinued operations	$—	$—	$(0.01)	$—
Net income	$0.91	$0.76	$2.55	$2.19
Weighted average common shares outstanding	117.0	121.5	118.5	121.3
DILUTED EARNINGS (LOSS) PER SHARE:				

Continuing operations	$0.90	$0.75	$2.52	$2.16
Discontinued operations	$—	$—	$(0.01)	$—
Net income	$0.90	$0.75	$2.51	$2.15
Weighted average common shares outstanding	118.5	123.5	120.2	123.3
COMMON SHARES OUTSTANDING, net of treasury stock, at period end	114.5	121.8	114.5	121.8

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	—	—	—	302.0	—	302.0
Repurchases of common stock	—	—	—	—	(418.2)	(418.2)
Stock-based compensation expense	—	—	21.5	—	—	21.5
Shares awarded under stock-based compensation plans, including income tax benefit of $15.4	—	—	(8.7)	—	53.7	45.0
BALANCE AT SEPTEMBER 30, 2014	163,562,149	$1.6	$55.6	$3,639.9	$(1,685.1)	$2,012.0

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, 2014	2013
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net income	$302.0	$265.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations	0.9	0.6
Depreciation and amortization	79.0	70.1
Amortization of debt issuance costs and accretion of debt discounts	4.3	4.3
Stock-based compensation expense	21.5	17.3
Deferred income tax provision	11.9	15.4
Net gain related to business/property dispositions	(12.4)	(2.1)
Non-cash impairment charges	0.3	—
Excess tax benefit from stock-based awards	(15.4)	(8.5)
Other	(2.6)	(3.3)
(Increase) decrease, net of effects from business combinations and divestitures:		
Receivables	84.8	95.5
Inventory	146.7	(88.7)
Other assets	(25.3)	(13.9)
Increase (decrease), net of effects from business combinations and divestitures:		
Vehicle floorplan payable-trade, net	(211.5)	47.6
Accounts payable	(3.0)	16.2
Other liabilities	72.6	46.9
Net cash provided by continuing operations	453.8	462.9
Net cash provided by (used in) discontinued operations	(0.9)	5.4
Net cash provided by operating activities	452.9	468.3
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Purchases of property and equipment	(151.9)	(110.6)
Property operating lease buy-outs	(0.4)	(41.9)
Proceeds from the sale of property and equipment	0.2	3.1
Proceeds from assets held for sale	2.6	1.8
Insurance recoveries on property and equipment	1.0	2.2
Cash received from business divestitures, net of cash relinquished	21.5	10.1
Cash used in business acquisitions, net of cash acquired	(13.3)	(72.9)
Proceeds from the sale of restricted investments	0.5	—
Other	(9.4)	(3.6)
Net cash used in continuing operations	(149.2)	(211.8)
Net cash used in discontinued operations	—	—
Net cash used in investing activities	(149.2)	(211.8)

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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AUTONATION, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Continued)

	Nine Months Ended September 30, 2014	2013
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES:		
Repurchases of common stock	(378.3)	(18.6)
Proceeds from revolving credit facility	960.0	620.0
Payments of revolving credit facility	(850.0)	(840.0)
Net payments of vehicle floorplan payable - non-trade	(53.0)	(12.2)
Payments of mortgage facility	(6.8)	(6.5)
Payments of capital leases and other debt obligations	(22.3)	(23.3)
Proceeds from the exercise of stock options	29.6	20.5
Excess tax benefit from stock-based awards	15.4	8.5
Net cash used in continuing operations	(305.4)	(251.6)
Net cash used in discontinued operations	—	(6.3)
Net cash used in financing activities	(305.4)	(257.9)
DECREASE IN CASH AND CASH EQUIVALENTS	(1.7)	(1.4)
CASH AND CASH EQUIVALENTS at beginning of period	69.2	69.7
CASH AND CASH EQUIVALENTS at end of period	$67.5	$68.3

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, 2014, we owned and operated 273 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 34 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 nine months ended September 30, 2014, are manufactured by Toyota, Ford, Honda, Nissan, General Motors, Mercedes-Benz, BMW, Chrysler, 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, and should 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 retrospective approach with the cumulative effect of initially adopting the standard recognized at

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

the date of adoption (which requires additional footnote disclosures). Early adoption is not permitted. We are currently evaluating the method of adoption and the impact of the provisions of the accounting standard update.

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, and during the third quarter of 2014, we divested an Import store. See Note 9 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:

	September 30, 2014	December 31, 2013
Trade receivables	$117.7	$110.9
Manufacturer receivables	151.9	172.9
Other	46.5	36.9
	316.1	320.7
Less: Allowances	(3.6)	(4.0)
	312.5	316.7
Contracts-in-transit and vehicle receivables	330.2	424.2
Income tax refundable (see Note 6)	9.1	—
Receivables, net	$651.8	$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.

AUTONATION, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

3. INVENTORY AND VEHICLE FLOORPLAN PAYABLE

The components of inventory are as follows:

	September 30, 2014	December 31, 2013
New vehicles	$2,139.6	$2,330.8
Used vehicles	394.7	346.5
Parts, accessories, and other	157.1	149.9
Inventory	$2,691.4	$2,827.2

The components of vehicle floorplan payable are as follows:

	September 30, 2014	December 31, 2013
Vehicle floorplan payable - trade	$1,912.6	$2,130.1
Vehicle floorplan payable - non-trade	862.1	898.9
Vehicle floorplan payable	$2,774.7	$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 nine months ended September 30, 2014, and 1.8% for the nine months ended September 30, 2013. At September 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 $189.1 million had been borrowed. The remaining borrowing capacity of $85.9 million was limited to $50.2 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 nine months ended September 30, 2014, and 2.0% for the nine months ended September 30, 2013. At September 30, 2014, the aggregate capacity under our new vehicle floorplan facilities to finance our new vehicle inventory was approximately $3.5 billion, of which $2.6 billion had been borrowed.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

4. GOODWILL AND INTANGIBLE ASSETS

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

	September 30, 2014	December 31, 2013
Goodwill	$1,265.3	$1,259.6
Franchise rights - indefinite-lived	$332.3	$329.3
Other intangibles	12.6	11.1
	344.9	340.4
Less: accumulated amortization	(5.8)	(5.3)
Other intangible assets, net	$339.1	$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 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:

	September 30, 2014	December 31, 2013
6.75% Senior Notes due 2018	$396.9	$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	410.0	300.0
Mortgage facility [1]	187.8	194.7
Capital leases and other debt	88.3	98.9
	1,933.0	1,839.9
Less: current maturities	(17.5)	(30.1)
Long-term debt, net of current maturities	$1,915.5	$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 September 30, 2014, we had outstanding $396.9 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 September 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 September 30, 2014, we had borrowings outstanding of $410.0 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 dollar-for-dollar basis by the cumulative amount of any outstanding letters of credit, which was $45.6 million at September 30, 2014, leaving an additional borrowing capacity under the revolving credit facility of $744.4 million at September 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 September 30, 2014, we had $187.8 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

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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, 2014, we had capital lease and other debt obligations of $88.3 million, which are due at various dates through 2034.

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 September 30, 2014, our leverage ratio and capitalization ratio were as follows:

	September 30, 2014	
	Requirement	Actual
Leverage ratio	≤ 3.75x	2.19x
Capitalization ratio	≤ 65.0%	57.1%

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 $9.1 million at September 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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Shares repurchased	4.4	—	8.0	0.1
Aggregate purchase price	$235.9	$—	$415.7	$4.9
Average purchase price per share	$53.15	$—	$51.98	$40.81

From October 1, 2014 through October 27, 2014, we repurchased an additional 1.4 million shares for an aggregate purchase price of $68.5 million (average purchase price per share of $49.29). In October 2014, our Board of Directors authorized an additional $250 million under our existing share repurchase program. As of October 27, 2014, $281.5 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,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Shares issued	0.4	0.5	1.5	1.0
Proceeds from the exercise of stock options	$7.5	$9.9	$29.6	$20.5
Average exercise price per share	$17.54	$20.32	$19.59	$20.46

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,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Shares issued	4,020	—	153,900	137,144
Shares surrendered to AutoNation to satisfy tax withholding obligations in connection with the vesting of restricted stock	1,788	516	46,265	42,822

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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income from continuing operations	$106.7	$92.8	$302.9	$266.1
Loss from discontinued operations, net of income taxes	(0.2)	(0.2)	(0.9)	(0.6)
Net income	$106.5	$92.6	$302.0	$265.5
Weighted average common shares outstanding used in calculating basic EPS	117.0	121.5	118.5	121.3
Effect of dilutive stock options	1.5	2.0	1.7	2.0
Weighted average common shares outstanding used in calculating diluted EPS	118.5	123.5	120.2	123.3
Basic EPS amounts:				
Continuing operations	$0.91	$0.76	$2.56	$2.19
Discontinued operations	$—	$—	$(0.01)	$—
Net income	$0.91	$0.76	$2.55	$2.19
Diluted EPS amounts:				
Continuing operations	$0.90	$0.75	$2.52	$2.16
Discontinued operations	$—	$—	$(0.01)	$—
Net income	$0.90	$0.75	$2.51	$2.15

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Anti-dilutive options excluded from the computation of diluted earnings per share	0.7	0.6	0.5	0.7

9. DIVESTITURES

As discussed in Note 1 above, 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. We adopted this accounting standard update effective January 1, 2014.

During the third quarter of 2014, we divested an Import store and recorded a gain of $4.0 million ($2.5 million after-tax). During the first quarter of 2014, we divested our customer lead distribution business and recorded a gain of $8.4 million ($5.2 million after-tax). This business is reported in the "Corporate and other" category of our segment information.

The gains on these divestitures are included in Other Expenses (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

On July 10, 2014, we purchased one store and related assets in the Mobile, Alabama market. This acquisition was not material to our financial condition or results of operations for the three and nine months ended September 30, 2014. Acquisitions are included in the Unaudited Condensed Consolidated Financial Statements from the date of acquisition. The purchase price allocation for this business combination is tentative and subject to final adjustment. On October 22, 2014, we purchased four stores and related assets in the Seattle-Bellevue, Washington market.

On a pro forma basis as if the results of these acquisitions that were completed in 2014 had been included in our consolidated results for the entire three and nine month periods ended September 30, 2014 and 2013, revenue and net income would not have been materially different from our reported revenue and net income for these periods.

We purchased three stores and related assets during the nine months ended September 30, 2013.

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 are currently defending several purported class action lawsuits in California arising out of alleged violations of state wage and hour laws relating to compensation of automotive technicians. 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.

We believe we have adequately 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 financial condition, results of operations, and 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 2015 to 2034 are approximately

$35 million at September 30, 2014. 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, 2014. Our exposure under these leases is difficult to estimate and 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.

At September 30, 2014, surety bonds, letters of credit, and cash deposits totaled $91.8 million, including $45.6 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. The Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law on July 21, 2010, established the Consumer Financial Protection Bureau (the “CFPB”), a new independent federal agency funded by the United States Federal Reserve with broad regulatory powers and limited oversight from the United States Congress. Although automotive dealers are generally excluded, the Dodd-Frank Act could lead to additional, indirect regulation of automotive dealers, in particular, their sale and marketing of finance and insurance products, through its regulation of automotive finance companies and other financial institutions. The Dodd-Frank Act also provided the Federal Trade Commission (the “FTC”) with new and expanded authority regarding automotive dealers, and the FTC has implemented an enforcement initiative relating to the advertising practices of automotive dealers.

In addition, the Patient Protection and Affordable Care Act, which was signed into law on March 23, 2010, is expected to increase our annual employee health care costs that we fund, with the most significant increases commencing in 2015, and significantly increase our cost of compliance and compliance risk related to offering health care benefits.

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, 2014 and 2013, 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 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 collision centers, a customer lead distribution business (which was divested in January 2014), 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.

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Reportable segment revenue and segment income are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue:				
Domestic	$1,660.7	$1,491.2	$4,738.6	$4,384.5
Import	1,787.8	1,695.5	5,055.0	4,828.5
Premium Luxury	1,422.9	1,247.4	4,161.2	3,662.7
Total	4,871.4	4,434.1	13,954.8	12,875.7
Corporate and other	37.6	36.7	106.2	118.0
Total consolidated revenue	$4,909.0	$4,470.8	$14,061.0	$12,993.7

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Segment income[(1)]:				
Domestic	$76.7	$64.2	$211.0	$188.9
Import	77.1	72.7	220.0	216.6
Premium Luxury	84.0	74.2	253.1	218.7
Total	237.8	211.1	684.1	624.2
Corporate and other	(43.5)	(36.6)	(129.4)	(125.9)
Other interest expense	(21.7)	(22.3)	(64.6)	(66.6)
Interest income	0.1	0.1	0.2	0.2
Other income (loss), net	1.1	(0.7)	3.5	2.2
Income from continuing operations before income taxes	$173.8	$151.6	$493.8	$434.1

(1) 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. The core brands of vehicles that we sell are manufactured by Toyota, Ford, Honda, Nissan, General Motors, Mercedes-Benz, BMW, Chrysler, and Volkswagen. Our business could be materially adversely impacted by a bankruptcy of or other adverse event related to a major vehicle manufacturer or related lender.

We had receivables from manufacturers or distributors of $151.9 million at September 30, 2014, and $172.9 million at December 31, 2013. 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, 2014, 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 significant judgment, and therefore cannot be determined with precision. The assumptions used have a significant effect on the estimated amounts reported.

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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
Level 2	Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted 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

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, 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 debt: Our fixed rate 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 debt is as follows:

	September 30, 2014	December 31, 2013
Carrying value	$1,023.0	$1,039.9
Fair value	$1,130.2	$1,135.2

Nonfinancial assets such as goodwill, other intangible assets, and long-lived assets held and used are measured at fair value when there is an indicator of impairment and recorded at fair value only when impairment is recognized or for a business combination. The fair values less costs to sell of long-lived assets held for sale are assessed each reporting period they remain classified as held for sale. Subsequent changes in the held for sale long-lived asset’s fair value less cost to sell (increase or decrease) is reported as an adjustment to its carrying amount, except that the adjusted carrying amount cannot exceed the carrying amount of the long-lived asset at the time it was initially classified as held for sale.

Goodwill and Other Intangible Assets

Goodwill for our Domestic, Import, and Premium Luxury reporting units is tested 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 not exceeds its fair value.

Under accounting standards, we chose to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it was necessary to calculate the fair values of our reporting units under the two-step goodwill impairment test. We completed our qualitative assessment of potential goodwill impairment as of April 30, 2014 and 2013, and we determined that it was not more likely than not that the fair values of our reporting units were less than their carrying amounts. Accordingly, no impairment charges were recorded for the carrying value of goodwill during the three and nine months ended September 30, 2014 and 2013.

Our principal identifiable intangible assets are individual store rights under franchise agreements with vehicle manufacturers, which have indefinite lives and are tested for impairment annually as of April 30 or more frequently when events or changes in circumstances indicate that impairment may have occurred.

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Under accounting standards, we chose to make a qualitative evaluation about the likelihood of franchise rights impairment to determine whether it was 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.

The quantitative impairment test for franchise rights requires the comparison of the franchise rights' estimated fair value to carrying value by store. Fair values of rights under franchise agreements are estimated using Level 3 inputs by discounting expected future cash flows of the store. The forecasted cash flows contain inherent uncertainties, including significant estimates and assumptions related to growth rates, margins, working capital requirements, capital expenditures, and cost of capital, for which we utilize certain market participant-based assumptions, using third-party industry projections, economic projections, and other marketplace data we believe to be reasonable. The development of the assumptions used in our annual impairment tests are coordinated by our financial planning and analysis group, and the assumptions are reviewed by management.

We completed our qualitative assessment of franchise rights impairment as of April 30, 2013 and we determined that it was not more likely than not that the fair values of our franchise rights were less than their carrying amounts. Accordingly, no impairment charges were recorded for the carrying value of franchise rights during the three and nine months ended September 30, 2013.

Long-Lived Assets

The fair value measurement valuation process for our long-lived assets is established by our corporate real estate services group, which reports to the Company's President and Chief Operating Officer. Fair value measurements, which are based on Level 3 inputs, and changes in fair value measurements are reviewed and assessed each quarter for properties classified as held for sale, or when an indicator of impairment exists for properties classified as held and used, by the corporate real estate services group. Our corporate real estate services group utilizes its knowledge of the automotive industry and historical experience in real estate markets and transactions in establishing the valuation process, which is generally based on a combination of the market and replacement cost approaches.

In a market approach, the corporate real estate services group uses transaction prices for comparable properties that have recently been sold. These transaction prices are adjusted for factors related to a specific property. The corporate real estate services group also evaluates changes in local real estate markets, and/or recent market interest or negotiations related to a specific property. In a replacement cost approach, the cost to replace a specific long-lived asset is considered, which is adjusted for depreciation from physical deterioration, as well as functional and economic obsolescence, if present and measurable.

To validate the fair values determined under the valuation process noted above, our corporate real estate services group also obtains independent third-party appraisals for our properties and/or third-party brokers' opinions of value, which are generally developed using the same valuation approaches described above, and evaluates any recent negotiations or discussions with third-party real estate brokers related to a specific long-lived asset or market.

Long-lived Assets Held and Used in Continuing Operations

During the three and nine months ended September 30, 2014 and 2013, there were no significant impairment charges recorded for the carrying value of long-lived assets held and used in continuing operations.

Long-lived Assets Held for Sale in Continuing Operations

During the nine months ended September 30, 2014, long-lived assets held for sale in continuing operations with a carrying value of $0.6 million were written down to their fair value of $0.3 million, resulting in a non-cash impairment charge of $0.3 million. The non-cash impairment charge was included in Other Expenses (Income), Net (within Operating Income) in our Unaudited Condensed Consolidated Statements of Income and was reported in the "Corporate and other" category of our segment information. We recorded no impairment charges during the three months ended September 30, 2014.

During the three and nine months ended September 30, 2013, no impairment charges were recorded for the carrying value of long-lived assets held for sale in continuing operations.

Long-lived Assets Held for Sale in Discontinued Operations

During the nine months ended September 30, 2014, long-lived assets held for sale in discontinued operations with a carrying value of $7.1 million were written down to their fair value of $6.9 million, resulting in a non-cash impairment charge of $0.2 million. The non-cash impairment charge was included in Loss from Discontinued Operations in our Unaudited Condensed Consolidated Statements of Income. We recorded no impairment charges during the three months ended September 30, 2014.

During the three and nine months ended September 30, 2013, no impairment charges were recorded for the carrying value of long-lived assets held for sale in discontinued operations.

As of September 30, 2014, we had long-lived assets held for sale of $65.4 million in continuing operations and $34.3 million in discontinued operations. Long-lived assets held for sale are included in Other Current Assets in our Unaudited Condensed Consolidated Balance Sheets.

15. CASH FLOW INFORMATION

We consider all highly liquid investments with a maturity of three months or less as of the date of purchase to be cash equivalents unless the investments are legally or contractually restricted for more than three months. We had non-cash investing and financing activities primarily related to increases in property acquired under capital leases of $11.6 million for the nine months ended September 30, 2014, and $9.5 million for the nine months ended September 30, 2013. We also had accrued purchases of property and equipment of $15.7 million at September 30, 2014 and $11.0 million at September 30, 2013. The effect of non-cash transactions is excluded from the accompanying Unaudited Condensed Consolidated Statements of Cash Flows.

We made interest payments of $99.7 million during the nine months ended September 30, 2014, and $100.4 million during the nine months ended September 30, 2013. We made income tax payments, net of income tax refunds, of $180.4 million during the nine months ended September 30, 2014, and $155.3 million during the nine months ended September 30, 2013.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Unaudited Condensed Consolidated Financial Statements and notes thereto included under Part I, Item 1 of this Quarterly Report on Form 10-Q. In addition, reference should be made to our audited Consolidated Financial Statements and notes thereto and related "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our most recent Annual Report on Form 10-K. Certain reclassifications of amounts previously reported have been made in order to maintain consistency and comparability between periods presented.

Overview

AutoNation, Inc., through its subsidiaries, is the largest automotive retailer in the United States. As of September 30, 2014, we owned and operated 273 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 34 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 nine months ended September 30, 2014, are manufactured by Toyota, Ford, Honda, Nissan, General Motors, Mercedes-Benz, BMW, Chrysler, and Volkswagen.

On January 31, 2013, we announced that we would be marketing our Domestic and Import stores under the AutoNation retail brand. The rebranding of these stores, which previously operated under various local market retail brands, commenced in the first quarter of 2013 and was completed in the second quarter of 2013. We are investing significantly to enhance our ability to generate our own digital traffic and to build an end-to-end customer experience in-store and through our digital channels. We expect that these investments, which may exceed $100 million in the aggregate, will continue for the next several years.

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. We believe that the significant scale of our operations and the quality of our managerial talent allow us to achieve efficiencies in our key markets by, among other things, leveraging the AutoNation retail brand and advertising, implementing standardized processes, and increasing productivity across all of our stores.

At September 30, 2014, 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 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.

For the nine months ended September 30, 2014, new vehicle sales accounted for approximately 57% of our total revenue, but approximately 21% of our total gross profit. Used vehicle sales accounted for approximately 23% of our total revenue, and approximately 12% of our total gross profit. Our parts and service and finance and insurance operations, while comprising approximately 19% of our total revenue for the nine months ended September 30, 2014, contributed approximately 66% of our total gross profit for the same period.

Results of Operations

Third Quarter 2014 compared to Third Quarter 2013

During the three months ended September 30, 2014, we had net income from continuing operations of $106.7 million or $0.90 per share on a diluted basis, as compared to net income from continuing operations of $92.8 million or $0.75 per share on a diluted basis during the same period in 2013.

First Nine Months 2014 compared to First Nine Months 2013

During the nine months ended September 30, 2014, we had net income from continuing operations of $302.9 million or $2.52 per share on a diluted basis, as compared to net income from continuing operations of $266.1 million or $2.16 per share on a diluted basis during the same period in 2013.

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Results for the nine months ended September 30, 2014, were favorably impacted by a net gain related to business/property dispositions of $8.1 million ($5.0 million after-tax, or $0.04 per share), primarily related to the divestiture of our customer lead distribution business.

Market Conditions

In the third quarter of 2014, U.S. industry new vehicle unit sales increased 8% as compared to the third quarter of 2013, driven by replacement demand. Based on industry data, the average age of cars and trucks in the United States is at a record high of 11.4 years compared to an average age of 9.8 years during the period from 2002 to 2007. Attractive products and continued access to affordable credit were also supportive of a strong selling environment. We expect continued growth in new vehicle unit sales in 2015, with full-year 2015 U.S. industry new vehicle unit sales above 17 million. However, actual sales may materially differ.

During the three and nine months ended September 30, 2014, the warranty component of our parts and service business benefited from the rise of manufacturer recalls in our Domestic and Import segments. Additionally, after several years of decline, the number of recent-model-year vehicles in operation has begun to grow due to increases in the annual rate of new vehicle sales in the United States since 2009. The growth in that portion of our service base, together with our customer retention efforts, has benefited the customer-pay service and warranty components of our parts and service business, and we believe that it will continue to benefit those components for the next several years. While the number of older vehicles in operation is expected to decline over the next few years, we believe that overall our parts and service business will benefit from the mix shift in our service base toward newer vehicles.

Inventory Management

Our new and used vehicle inventories are stated at the lower of cost or market on our consolidated balance sheets. We monitor our vehicle inventory levels closely based on current economic conditions and seasonal sales trends.

We have generally not experienced losses on the sale of new vehicle inventory, in part due to incentives provided by manufacturers to promote sales of new vehicles and our inventory management practices. We had 62,831 units in new vehicle inventory at September 30, 2014, 72,095 units at December 31, 2013, and 60,035 units at September 30, 2013.

We recondition the majority of used vehicles acquired for retail sale in our parts and service departments and capitalize the related costs to the used vehicle inventory. In general, used vehicles that are not sold on a retail basis are liquidated at wholesale auctions. We record estimated losses on used vehicle inventory. Our used vehicle inventory balance was net of cumulative write-downs of $3.1 million at September 30, 2014, and $1.8 million at December 31, 2013.

Parts, accessories, and other inventory are carried at the lower of acquisition cost (first-in, first-out method) or market. We estimate the amount of potential obsolete inventory based upon past experience and market trends. Our parts, accessories, and other inventory balance was net of cumulative write-downs of $3.0 million at September 30, 2014, and $3.6 million at December 31, 2013.

Critical Accounting Policies and Estimates

We prepare our Unaudited Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States, which require us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. We evaluate our estimates on an ongoing basis, and we base our estimates on historical experience and various other assumptions we believe to be reasonable. Actual outcomes could differ materially from those estimates in a manner that could have a material effect on our Unaudited Condensed Consolidated Financial Statements. For additional discussion of our critical accounting policies and estimates, please see “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our most recent Annual Report on Form 10 K.

Goodwill

Goodwill for our Domestic, Import, and Premium Luxury reporting units is tested for impairment annually as of April 30 or more frequently when events or changes in circumstances indicate that impairment may have occurred.

Under accounting standards, we chose to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it was necessary to calculate the fair values of our reporting units under the two-step goodwill impairment test. We completed our qualitative assessment of potential goodwill impairment as of April 30, 2014, and we determined that it was not more likely than not that the fair values of our reporting units were less than their carrying amounts. The fair values of

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the Domestic, Import, and Premium Luxury reporting units were substantially in excess of their carrying values as of April 30, 2011, the date of our most recent quantitative annual impairment test.

Other Intangible Assets

Our principal identifiable intangible assets are individual store rights under franchise agreements with vehicle manufacturers, which have indefinite lives and are tested for impairment annually as of April 30 or more frequently when events or changes in circumstances indicate that impairment may have occurred.

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.

Long-Lived Assets

We estimate the depreciable lives of our property and equipment, including leasehold improvements, and review them for impairment when events or changes in circumstances indicate that their carrying amounts may be impaired. Such events or changes may include a significant decrease in market value, a significant change in the business climate in a particular market, a current expectation that more-likely-than-not a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life, or a current-period operating or cash flow loss combined with historical losses or projected future losses.

When property and equipment is identified as held for sale, we reclassify the held for sale assets to Other Current Assets and cease recording depreciation. We measure each long-lived asset or disposal group at the lower of its carrying amount or fair value less cost to sell and recognize a loss for any initial adjustment of the long-lived asset’s or disposal group’s carrying amount to fair value less cost to sell in the period the “held for sale” criteria are met. We periodically evaluate the carrying value of assets held for sale to determine if, based on market conditions, the values of these assets should be adjusted.

As of September 30, 2014, we had long-lived assets held for sale of $65.4 million in continuing operations and $34.3 million in discontinued operations.

During the three and nine months ended September 30, 2014, there were no significant impairment charges recorded for the carrying value of long-lived assets held and used in continuing operations. We recorded a $0.3 million non-cash impairment charge during the nine months ended September 30, 2014, associated with assets held for sale in continuing operations to reduce the carrying value of these assets to fair value less cost to sell. This charge is recorded as a component of Other Expenses (Income), Net (within Operating Income) in the Unaudited Condensed Consolidated Statements of Income. We recorded no impairment charges during the three months ended September 30, 2014, associated with assets held for sale in continuing operations.

We recorded a $0.2 million non-cash impairment charge during the nine months ended September 30, 2014, associated with assets held for sale in discontinued operations. This charge is included in Loss from Discontinued Operations in our Unaudited Condensed Consolidated Statements of Income. We recorded no impairment charges during the three months ended September 30, 2014, associated with assets held for sale in discontinued operations.

The fair value measurements for our property and equipment and assets held for sale are based on Level 3 inputs, which considered information from third-party real estate valuation sources, or, in certain cases, pending agreements to sell the related assets. See Note 14 of the Notes to Unaudited Condensed Consolidated Financial Statements for more information on our fair value measurement valuation process. Although we believe our property and equipment and assets held for sale are appropriately valued, the assumptions and estimates used may change and we may be required to record impairment charges to reduce the value of these assets.

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Reported Operating Data
Historical operating results include the results of acquired businesses from the date of acquisition.

($ in millions, except per vehicle data)	Three Months Ended September 30, 2014	2013	Variance Favorable / (Unfavorable)	% Variance	Nine Months Ended September 30, 2014	2013	Variance Favorable / (Unfavorable)	% Variance
Revenue:								
New vehicle	$2,823.6	$2,561.6	$ 262.0	10.2	$7,989.1	$7,312.9	$ 676.2	9.2
Retail used vehicle	1,046.2	933.0	113.2	12.1	2,981.1	2,786.2	194.9	7.0
Wholesale	102.3	111.7	(9.4)	(8.4)	299.4	324.7	(25.3)	(7.8)
Used vehicle	1,148.5	1,044.7	103.8	9.9	3,280.5	3,110.9	169.6	5.5
Finance and insurance, net	196.5	174.9	21.6	12.3	554.3	504.4	49.9	9.9
Total variable operations[1]	4,168.6	3,781.2	387.4	10.2	11,823.9	10,928.2	895.7	8.2
Parts and service	717.4	653.8	63.6	9.7	2,093.2	1,946.3	146.9	7.5
Other	23.0	35.8	(12.8)		143.9	119.2	24.7	
Total revenue	$4,909.0	$4,470.8	$ 438.2	9.8	$14,061.0	$12,993.7	$ 1,067.3	8.2
Gross profit:								
New vehicle	$157.1	$155.4	$ 1.7	1.1	$464.6	$446.3	$ 18.3	4.1
Retail used vehicle	91.8	80.4	11.4	14.2	273.3	247.1	26.2	10.6
Wholesale	(3.4)	0.1	(3.5)		(1.3)	3.5	(4.8)	
Used vehicle	88.4	80.5	7.9	9.8	272.0	250.6	21.4	8.5
Finance and insurance	196.5	174.9	21.6	12.3	554.3	504.4		