

AUTONATION INC /FL  
Form 10-Q  
July 27, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

(Mark One)

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

**For the Quarterly Period Ended June 30, 2007**

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 OF INCORPORATION)**

**73-1105145  
(IRS EMPLOYER IDENTIFICATION NO.)**

**110 S.E. 6TH STREET  
FT. LAUDERDALE, FLORIDA  
(ADDRESS OF PRINCIPAL EXECUTIVE  
OFFICES)**

**33301  
(ZIP CODE)**

**REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (954) 769-6000**

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

On July 23, 2007 the registrant had 202,064,138 outstanding shares of common stock, par value \$.01 per share.

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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)

|  | <b>June 30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|--|--------------------------|----------------------------------|
| <b>ASSETS</b>  |                          |                                  |
| <b>CURRENT ASSETS:</b>   |                          |                                  |
| Cash and cash equivalents  | \$ 31.2                  | \$ 52.6                          |
| Receivables, net   | 672.6                    | 805.0                            |
| Inventory  | 2,346.6                  | 2,320.3                          |
| Other current assets   | 177.6                    | 252.0                            |
| <b>Total Current Assets</b>  | <b>3,228.0</b>           | <b>3,429.9</b>                   |
| <b>PROPERTY AND EQUIPMENT</b> , net of accumulated depreciation of \$574.7 million and \$532.1 million, respectively                                 | 1,946.1                  | 1,904.7                          |
| <b>GOODWILL, NET</b>   | 2,783.0                  | 2,780.8                          |
| <b>OTHER INTANGIBLE ASSETS, NET</b>  | 315.6                    | 317.2                            |
| <b>OTHER ASSETS</b>  | 179.7                    | 174.4                            |
| <b>Total Assets</b>  | <b>\$ 8,452.4</b>        | <b>\$ 8,607.0</b>                |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                          |                                  |
| <b>CURRENT LIABILITIES:</b>  |                          |                                  |
| Vehicle floorplan payable trade  | \$ 1,643.8               | \$ 1,999.4                       |
| Vehicle floorplan payable non-trade  | 456.0                    | 228.9                            |
| Accounts payable   | 231.3                    | 209.7                            |
| Notes payable and current maturities of long-term obligations  | 66.0                     | 13.6                             |
| Other current liabilities  | 492.0                    | 578.9                            |
| <b>Total Current Liabilities</b>   | <b>2,889.1</b>           | <b>3,030.5</b>                   |
| <b>LONG-TERM DEBT, NET OF CURRENT MATURITIES</b>   | 1,462.6                  | 1,557.9                          |
| <b>DEFERRED INCOME TAXES</b>   | 203.2                    | 225.4                            |
| <b>OTHER LIABILITIES</b>   | 159.4                    | 80.5                             |
| <b>COMMITMENTS AND CONTINGENCIES (Note 12)</b>   |                          |                                  |
| <b>SHAREHOLDERS EQUITY:</b>  |                          |                                  |
| Preferred stock, par value \$.01 per share; 5,000,000 shares authorized; none issued   |                          |                                  |
| Common stock, par value \$.01 per share; 1,500,000,000 shares authorized; 223,562,149 shares issued in each period including shares held in treasury | 2.2                      | 2.2                              |
| Additional paid-in capital   | 1,068.5                  | 1,092.0                          |
| Retained earnings (Note 6)   | 3,142.3                  | 2,989.4                          |

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|  |            |            |
|--|------------|------------|
| Accumulated other comprehensive income (loss)                                | (.3)       | (.4)       |
| Treasury stock, at cost; 21,638,304 and 16,809,630 shares held, respectively | (474.6)    | (370.5)    |
| Total Shareholders' Equity   | 3,738.1    | 3,712.7    |
| Total Liabilities and Shareholders' Equity                                   | \$ 8,452.4 | \$ 8,607.0 |

The accompanying notes are an integral part of these statements.

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**AUTONATION, INC.**  
**UNAUDITED CONDENSED CONSOLIDATED INCOME STATEMENTS**  
(In millions, except per share data)

|  | Three Months Ended June<br>30, |                | Six Months Ended June<br>30, |                |
|--|--------------------------------|----------------|------------------------------|----------------|
|  | 2007                           | 2006           | 2007                         | 2006           |
| Revenue:   |                                |                |                              |                |
| New vehicle  | \$ 2,631.5                     | \$ 2,884.9     | \$ 5,094.7                   | \$ 5,513.8     |
| Used vehicle   | 1,104.5                        | 1,171.3        | 2,193.1                      | 2,282.8        |
| Parts and service  | 653.8                          | 648.2          | 1,310.4                      | 1,289.9        |
| Finance and insurance, net                                       | 152.3                          | 167.6          | 300.6                        | 316.4          |
| Other  | 17.2                           | 20.7           | 34.3                         | 39.5           |
| <b>TOTAL REVENUE</b>   | <b>4,559.3</b>                 | <b>4,892.7</b> | <b>8,933.1</b>               | <b>9,442.4</b> |
| Cost of Sales:   |                                |                |                              |                |
| New vehicle  | 2,450.1                        | 2,674.2        | 4,734.1                      | 5,106.9        |
| Used vehicle   | 1,010.2                        | 1,067.8        | 1,994.1                      | 2,067.4        |
| Parts and service  | 366.8                          | 360.5          | 736.9                        | 720.0          |
| Other  | 6.5                            | 8.9            | 13.1                         | 16.7           |
| <b>TOTAL COST OF SALES</b>                                       | <b>3,833.6</b>                 | <b>4,111.4</b> | <b>7,478.2</b>               | <b>7,911.0</b> |
| Gross Profit:  |                                |                |                              |                |
| New vehicle  | 181.4                          | 210.7          | 360.6                        | 406.9          |
| Used vehicle   | 94.3                           | 103.5          | 199.0                        | 215.4          |
| Parts and service  | 287.0                          | 287.7          | 573.5                        | 569.9          |
| Finance and insurance  | 152.3                          | 167.6          | 300.6                        | 316.4          |
| Other  | 10.7                           | 11.8           | 21.2                         | 22.8           |
| <b>TOTAL GROSS PROFIT</b>  | <b>725.7</b>                   | <b>781.3</b>   | <b>1,454.9</b>               | <b>1,531.4</b> |
| Selling, general and administration expenses                     | 517.7                          | 548.4          | 1,038.9                      | 1,077.5        |
| Depreciation and amortization                                    | 21.6                           | 20.7           | 42.8                         | 40.0           |
| Other expenses, net  | 1.6                            | .2             | 1.6                          | .2             |
| <b>OPERATING INCOME</b>  | <b>184.8</b>                   | <b>212.0</b>   | <b>371.6</b>                 | <b>413.7</b>   |
| Floorplan interest expense                                       | (33.5)                         | (36.1)         | (66.0)                       | (67.0)         |
| Other interest expense   | (26.5)                         | (25.2)         | (53.0)                       | (37.2)         |
| Other interest expense    Sr. Note Repurchases                   |                                | (34.5)         |                              | (34.5)         |
| Interest income  | .9                             | 3.1            | 1.8                          | 6.6            |
| Other gains, net   | .8                             | .7             | 1.0                          | .7             |
| <b>INCOME FROM CONTINUING OPERATIONS<br/>BEFORE INCOME TAXES</b> | <b>126.5</b>                   | <b>120.0</b>   | <b>255.4</b>                 | <b>282.3</b>   |
| <b>PROVISION FOR INCOME TAXES</b>                                | <b>47.2</b>                    | <b>46.1</b>    | <b>93.4</b>                  | <b>110.6</b>   |
|  | <b>79.3</b>                    | <b>73.9</b>    | <b>162.0</b>                 | <b>171.7</b>   |

NET INCOME FROM CONTINUING OPERATIONS

|  |       |       |       |        |
|--|-------|-------|-------|--------|
| Loss from discontinued operations, net of income taxes | (2.0) | (1.2) | (7.1) | (11.8) |
|--|-------|-------|-------|--------|

|            |         |         |          |          |
|------------|---------|---------|----------|----------|
| NET INCOME | \$ 77.3 | \$ 72.7 | \$ 154.9 | \$ 159.9 |
|------------|---------|---------|----------|----------|

BASIC EARNINGS (LOSS) PER SHARE:

|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Continuing operations                      | \$ .38   | \$ .34   | \$ .78   | \$ .71   |
| Discontinued operations                    | \$ (.01) | \$ (.01) | \$ (.03) | \$ (.05) |
| Net income                                 | \$ .37   | \$ .33   | \$ .75   | \$ .66   |
| Weighted average common shares outstanding | 206.8    | 220.4    | 207.4    | 241.5    |

DILUTED EARNINGS (LOSS) PER SHARE:

|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Continuing operations                      | \$ .38   | \$ .33   | \$ .77   | \$ .70   |
| Discontinued operations                    | \$ (.01) | \$ (.01) | \$ (.03) | \$ (.05) |
| Net income                                 | \$ .37   | \$ .32   | \$ .74   | \$ .65   |
| Weighted average common shares outstanding | 208.6    | 225.2    | 209.7    | 246.5    |

|  |       |       |       |       |
|--|-------|-------|-------|-------|
| COMMON SHARES OUTSTANDING, net of treasury stock | 201.9 | 213.0 | 201.9 | 213.0 |
|--|-------|-------|-------|-------|

The accompanying notes are an integral part of these statements.

**AUTONATION, INC.**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
(In millions, except share data)

|  | <b>Common Stock</b> | <b>Additional</b> |                | <b>Accumulated</b>     |              |                 |                |
|--|---------------------|-------------------|----------------|------------------------|--------------|-----------------|----------------|
|  | <b>Shares</b>       | <b>Amount</b>     | <b>Paid-In</b> | <b>Retained</b>        | <b>Other</b> | <b>Treasury</b> | <b>Total</b>   |
|  |                     |                   | <b>Capital</b> | <b>Earnings (Loss)</b> |              | <b>Stock</b>    |                |
| BALANCE AT DECEMBER 31, 2006   | 223,562,149         | \$ 2.2            | \$ 1,092.0     | \$ 2,989.4             | \$ (.4)      | \$ (370.5)      | \$ 3,712.7     |
| Cumulative effect of change in accounting for<br>uncertainties in income taxes (FIN 48 Note 6) |                     |                   |                | (2.0)                  |              |                 | (2.0)          |
| Exercise of stock options, including income tax<br>benefit of \$15.7 million                   |                     |                   | (31.5)         |                        |              | 135.8           | 104.3          |
| Stock option expense   |                     |                   | 8.0            |                        |              |                 | 8.0            |
| Other comprehensive income   |                     |                   |                |                        | .1           |                 | .1             |
| Purchases of treasury stock  |                     |                   |                |                        |              | (239.9)         | (239.9)        |
| Net income   |                     |                   |                | 154.9                  |              |                 | 154.9          |
| <br>BALANCE AT JUNE 30, 2007   | <br>223,562,149     | <br>\$ 2.2        | <br>\$ 1,068.5 | <br>\$ 3,142.3         | <br>\$ (.3)  | <br>\$ (474.6)  | <br>\$ 3,738.1 |

The accompanying notes are an integral part of these statements.



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

|  | <b>Six Months Ended</b> |             |
|--|-------------------------|-------------|
|  | <b>June 30,</b>         |             |
|  | <b>2007</b>             | <b>2006</b> |
| <b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:</b>  |                         |             |
| Net income   | \$ 154.9                | \$ 159.9    |
| Adjustments to reconcile net income to net cash provided by operating activities:              |                         |             |
| Loss from discontinued operations  | 7.1                     | 11.8        |
| Depreciation and amortization  | 42.8                    | 40.0        |
| Amortization of debt issue costs and discounts   | 1.7                     | 2.0         |
| Stock option expense   | 8.0                     | 8.7         |
| Interest expense on bond repurchase  |                         | 34.5        |
| Income taxes   | 79.4                    | 95.9        |
| Other  | .1                      | (.3)        |
| Changes in assets and liabilities, net of effects from business combinations and divestitures: |                         |             |
| Receivables  | 124.3                   | 92.9        |
| Inventory  | (24.8)                  | (148.3)     |
| Other assets   | (13.6)                  | (15.5)      |
| Vehicle floorplan payable, trade net   | (357.0)                 | 39.3        |
| Accounts payable   | 21.6                    | 17.0        |
| Other liabilities  | (75.3)                  | (184.8)     |
| Net cash provided by (used in) continuing operations   | (30.8)                  | 153.1       |
| Net cash provided by discontinued operations   | 1.1                     |             |
| Net cash provided by (used in) operating activities  | (29.7)                  | 153.1       |
| <b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES:</b>  |                         |             |
| Purchases of property and equipment  | (79.2)                  | (48.9)      |
| Proceeds from the sale of property and equipment   | 2.0                     | .6          |
| Proceeds from assets held for sale   | 2.6                     |             |
| Cash used in business acquisitions, net of cash acquired                                       | (.8)                    | (67.4)      |
| Net change in restricted cash  | 1.5                     | (1.1)       |
| Purchases of restricted investments  | (8.8)                   | (5.5)       |
| Proceeds from the sale of restricted investments   | 9.2                     | 8.1         |
| Cash received from business divestitures, net of cash relinquished                             | 36.1                    | 16.3        |
| Other  | (.2)                    | (.3)        |
| Net cash used in continuing operations   | (37.6)                  | (98.2)      |
| Net cash used in discontinued operations   | (.8)                    | (.3)        |
| Net cash used in investing activities  | (38.4)                  | (98.5)      |

The accompanying notes are an integral part of these statements.



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

|   | <b>Six Months Ended</b> |                |
|---|-------------------------|----------------|
|   | <b>June 30,</b>         |                |
|   | <b>2007</b>             | <b>2006</b>    |
| <b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES:</b> |                         |                |
| Purchases of treasury stock                             | (239.9)                 | (1,218.6)      |
| Proceeds from senior unsecured notes issued             |                         | 600.0          |
| Proceeds from term loan                                 |                         | 600.0          |
| Proceeds from revolving credit facility                 | 436.0                   | 318.0          |
| Payment of revolving credit facility                    | (475.0)                 | (238.0)        |
| Net proceeds (payments) of vehicle floor plan non-trade | 227.0                   | (34.1)         |
| Payments of mortgage facilities                         | (2.2)                   | (2.8)          |
| Payments of notes payable and long-term debt            | (2.1)                   | (1.6)          |
| Proceeds from the exercise of stock options             | 88.6                    | 51.6           |
| Tax benefit from stock options                          | 15.7                    | 12.8           |
| Repurchases of 9% senior unsecured notes                |                         | (334.2)        |
| Other   | .1                      | (16.1)         |
| Net cash provided by (used in) continuing operations    | 48.2                    | (263.0)        |
| Net cash used in discontinued operations                | (1.5)                   | (.8)           |
| Net cash provided by (used in) financing activities     | 46.7                    | (263.8)        |
| <b>DECREASE IN CASH AND CASH EQUIVALENTS</b>            | <b>(21.4)</b>           | <b>(209.2)</b> |
| CASH AND CASH EQUIVALENTS at beginning of period        | 52.6                    | 246.4          |
| CASH AND CASH EQUIVALENTS at end of period              | \$ 31.2                 | \$ 37.2        |

The accompanying notes are an integral part of these statements.

**AUTONATION, INC.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(In millions, except share and per share data.)**

**1. Interim Financial Statements**

**Business and Basis of Presentation**

AutoNation, Inc. (the Company), through its subsidiaries, is the largest automotive retailer in the United States. As of June 30, 2007, the Company owned and operated 321 new vehicle franchises from 249 stores located in major metropolitan markets, predominantly in the Sunbelt region of the United States. The Company offers a diversified range of automotive products and services, including new vehicles, used vehicles, vehicle maintenance and repair services, vehicle parts, extended service contracts, vehicle protection products and other aftermarket products. The Company also arranges financing for vehicle purchases through third-party finance sources.

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 the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information related to the Company's organization, significant accounting policies and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States has 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, the financial position and the results of operations of the Company for the periods presented.

The preparation of financial statements 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. Significant estimates made by the Company in the accompanying Unaudited Condensed Consolidated Financial Statements include allowances for doubtful accounts, accruals for chargebacks against revenue recognized from the sale of finance and insurance products, certain assumptions related to goodwill and other intangible, long-lived assets and accruals related to self-insurance programs, certain legal proceedings, estimated tax liabilities, estimated losses from disposals of discontinued operations and certain assumptions related to stock option 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 the Company's audited consolidated financial statements and notes thereto included in the Company's most recent Annual Report on Form 10-K.

Certain amounts have been reclassified from the previously reported financial statements to conform with the income statement presentation of the current period.

**New Accounting Pronouncements**

As of January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN 48). See Note 6, Income Taxes, of Notes to Unaudited Condensed Consolidated Financial Statements for discussion.

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

In September 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements. SFAS No. 157 defines fair value and applies to other accounting pronouncements that require or permit fair value measurements and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting SFAS No. 157 on its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115 . SFAS No. 159 permits entities to choose to measure certain financial assets and liabilities at fair value. Unrealized gains and losses, arising subsequent to adoption, are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS No. 159, if elected, on its Consolidated Financial Statements.

**2. Receivables, Net**

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

|  | <b>June 30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|--|--------------------------|----------------------------------|
| Trade receivables                            | \$ 89.1                  | \$ 88.8                          |
| Manufacturer receivables                     | 138.3                    | 159.4                            |
| Other  | 84.6                     | 102.3                            |
|  | 312.0                    | 350.5                            |
| Less: Allowances                             | (4.8)                    | (6.3)                            |
|  | 307.2                    | 344.2                            |
| Contracts-in-transit and vehicle receivables | 344.6                    | 431.9                            |
| Income tax refundable (See Note 6)           | 20.8                     | 28.9                             |
| Receivables, net                             | \$ 672.6                 | \$ 805.0                         |

Contracts-in-transit and vehicle receivables primarily represent receivables from financial institutions for the portion of the vehicle sales price financed by the Company's customers.

**3. Inventory and Vehicle Floorplan Payable**

The components of inventory are as follows:

|                              | <b>June 30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|------------------------------|--------------------------|----------------------------------|
| New vehicles                 | \$ 1,830.0               | \$ 1,868.5                       |
| Used vehicles                | 372.6                    | 301.9                            |
| Parts, accessories and other | 144.0                    | 149.9                            |
|                              | \$ 2,346.6               | \$ 2,320.3                       |

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

At June 30, 2007 and December 31, 2006, vehicle floorplan payable-trade totaled \$1.6 billion and \$2.0 billion, respectively. Vehicle floorplan payable-trade reflects amounts borrowed to finance the purchase of specific vehicle inventories with the corresponding manufacturers' captive finance subsidiaries ( "trade lenders" ). Vehicle floorplan payable-non-trade totaled \$456.0 million and \$228.9 million at June 30, 2007 and December 31, 2006, respectively, and represents amounts borrowed to finance the purchase of specific vehicle inventories with non-trade lenders. On November 30, 2006, General Motors ( "GM" ) completed the sale of a majority stake in General Motors Acceptance Corporation ( "GMAC" ), which was GM's wholly-owned captive finance subsidiary prior to this transaction. GMAC will remain the exclusive provider of GM-sponsored auto finance programs and is expected to continue to provide GM dealers and their customers with the same financial products and services which were in place with the Company before the sale. As a result of this sale, the Company has treated new vehicles financed after the change in GMAC control (totaling \$389.0 million and \$134.3 million at June 30, 2007 and December 31, 2006, respectively) as vehicle floorplan non-trade. Vehicles financed by GMAC prior to this transaction continue to be classified as vehicle floorplan-trade. Changes in vehicle floorplan payable-trade are reported as operating cash flows and changes in vehicle floorplan-non-trade are reported as financing cash flows in the accompanying Unaudited Condensed Consolidated Statements of Cash Flows.

The Company's floorplan facilities, which utilize LIBOR-based interest rates, averaged 6.3% and 5.9% for the six months ended June 30, 2007 and 2006, respectively. Floorplan facilities are used to finance new vehicle inventories and the amounts outstanding thereunder are due on demand, but are generally paid within several business days after the related vehicles are sold. Floorplan facilities are primarily collateralized by new vehicle inventories and related receivables. The Company's manufacturer agreements generally require the manufacturer to have the ability to draft against the floorplan facilities so the floorplan lender directly funds the manufacturer for the purchase of inventory. The floorplan facilities contain certain operational covenants. At June 30, 2007, the Company was in compliance with such covenants in all material respects. At June 30, 2007, aggregate capacity under the floorplan credit facilities to finance new vehicles was approximately \$3.6 billion, of which \$2.1 billion total was outstanding.

**4. Goodwill and Intangible Assets**

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

|                                     | <b>June 30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|-------------------------------------|--------------------------|----------------------------------|
| Goodwill                            | \$ 3,048.8               | \$ 3,046.6                       |
| Less: accumulated amortization      | (265.8)                  | (265.8)                          |
| Goodwill, net                       | \$ 2,783.0               | \$ 2,780.8                       |
| Franchise rights - indefinite-lived | \$ 311.6                 | \$ 312.4                         |
| Other intangibles                   | 7.9                      | 7.9                              |
|                                     | 319.5                    | 320.3                            |
| Less: accumulated amortization      | (3.9)                    | (3.1)                            |
| Other intangibles, net              | \$ 315.6                 | \$ 317.2                         |

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

Goodwill and intangibles with indefinite lives are tested for impairment annually at June 30 or more frequently when events or circumstances indicate that an impairment may have occurred. The Company completed its annual impairment tests as of June 30, 2007 for goodwill and intangibles with indefinite lives. The goodwill test includes determining the estimated fair value of the Company's single reporting unit and comparing it to the carrying value of the net assets allocated to the reporting unit. No goodwill impairment charges resulted from the required goodwill impairment test. The Company's principal identifiable intangible assets are individual store rights under franchise agreements with vehicle manufacturers. The test for intangibles with indefinite lives requires the comparison of estimated fair value to its carrying value by store. Fair values of rights under franchise agreements are estimated by discounting expected future cash flows of the store. The Company recorded \$1.0 million (\$.6 million, net of tax) of impairment charges related to rights under a Jaguar store's franchise agreement to reduce the carrying value of that store's franchise agreement to estimated fair value. The decline in the fair value of rights under this store's franchise agreement reflects the negative impact of historical performance of the store since the Company's acquisition of it, as well as the Company's expectations for the store's future prospects. These factors resulted in a reduction in forecasted cash flows and growth rates used to estimate fair value. This non-cash impairment charge is classified as other expenses, net in the accompanying Unaudited Condensed Consolidated Income Statement.

**5. Notes Payable and Long-term Debt**

Notes payable and long-term debt consist of the following:

|   | <b>June 30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|---|--------------------------|----------------------------------|
| Floating rate senior unsecured notes      | \$ 300.0                 | \$ 300.0                         |
| 7% senior unsecured notes                 | 300.0                    | 300.0                            |
| Term loan facility                        | 600.0                    | 600.0                            |
| Revolving credit facility                 | 156.0                    | 195.0                            |
| 9% senior unsecured notes                 | 14.1                     | 14.1                             |
| Mortgage facility                         | 113.8                    | 116.0                            |
| Other debt                                | 44.7                     | 46.4                             |
|   | 1,528.6                  | 1,571.5                          |
| Less: current maturities                  | (66.0)                   | (13.6)                           |
| Long-term debt, net of current maturities | \$ 1,462.6               | \$ 1,557.9                       |

In April 2006, the Company sold \$300.0 million of floating rate senior unsecured notes due April 15, 2013 and \$300.0 million of 7% senior unsecured notes due April 15, 2014, in each case at par. The floating rate senior unsecured notes bear interest at a rate equal to three-month LIBOR plus 2.0% per annum, adjusted quarterly, and may be redeemed by the Company on or after April 15, 2008 at 103% of principal, on or after April 15, 2009 at 102% of principal, on or after April 15, 2010 at 101% of principal and on or after April 15, 2011 at 100% of principal. The 7% senior unsecured notes may be redeemed by the Company on or after April 15, 2009 at 105.25% of principal, on or after April 15, 2010 at 103.5% of principal, on or after April 15, 2011 at 101.75% of principal and on or after April 15, 2012 at 100% of principal.

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

In connection with the issuance of the new senior unsecured notes, the Company amended its existing credit agreement in April 2006 to provide: (1) a \$675.0 million revolving credit facility that provided for various interest rates on borrowings generally at LIBOR plus .80%, and (2) a \$600.0 million term loan facility that provided for interest at a rate equal to LIBOR plus 1.25%. In December 2006, the borrowing capacity of the revolving credit facility was increased to \$700.0 million under the amended credit agreement. The amended credit agreement, which includes the new term loan facility, was set to terminate on July 14, 2010, and is guaranteed by substantially all of the Company's subsidiaries.

The credit spread charged for the revolving credit facility is impacted by the Company's senior unsecured credit ratings. The Company has negotiated a letter of credit sublimit as part of its 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 totaled \$91.0 million at June 30, 2007.

In April 2006, the proceeds of the new senior unsecured notes and term loan facility, together with cash on hand and borrowings of \$80.0 million under the amended revolving credit facility, were used to: (1) purchase 50 million shares of the Company's common stock at \$23 per share for an aggregate purchase price of \$1.15 billion pursuant to the Company's equity tender offer, (2) purchase \$309.4 million aggregate principal of the Company's 9% senior unsecured notes for an aggregate total consideration of \$339.8 million pursuant to the Company's debt tender offer and consent solicitation, and (3) pay related financing costs. Approximately \$34.5 million of tender premium and other financing costs related to the Company's debt tender offer was expensed during the six months ended June 30, 2006.

In July 2007, the Company completed a second amendment of the credit agreement. Under the terms of the second amendment, the interest rate on the term loan facility decreased from LIBOR plus 1.25% to LIBOR plus .875% and the interest rate on the revolving credit facility decreased from LIBOR plus .80% to LIBOR plus .725%. The credit spread charged for the revolving credit facility will continue to be based upon the Company's senior unsecured credit ratings. Additionally, the credit agreement termination date was extended to July 2012 and certain other terms and conditions were modified as a result of this amendment.

At June 30, 2007, the Company also had \$14.1 million of 9% senior unsecured notes, due August 1, 2008 at par, which are guaranteed by substantially all of the Company's subsidiaries. As discussed above, in April 2006 the Company purchased \$309.4 million aggregate principal amount of the 9% senior notes. As of April 12, 2006, covenants related to the 9% senior unsecured notes were substantially eliminated as a result of the successful completion of the consent solicitation. The remaining aggregate principal amount of 9% senior unsecured notes was not tendered for purchase and, accordingly, remains outstanding.

At June 30, 2007, the Company had \$113.8 million outstanding under a mortgage facility with an automotive manufacturer's captive finance subsidiary. The facility, which utilizes LIBOR-based interest rates, averaged 6.7% and 6.1% for the six months ended June 30, 2007 and 2006, respectively. The mortgage facility is secured by mortgages on certain of the Company's store properties.



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

The Company's new senior unsecured notes, credit agreement and mortgage facility contain numerous customary financial and operating covenants that place significant restrictions on the Company, including the Company's ability to incur additional indebtedness or prepay existing indebtedness, to create liens or other encumbrances, to sell (or otherwise dispose of) assets and merge or consolidate with other entities. The indenture for the Company's new senior unsecured notes restricts the Company's ability to make payments in connection with share repurchases, dividends, debt retirement, investments and similar matters to a cumulative aggregate amount that is limited to \$500 million plus 50% of the Company's cumulative consolidated net income (as defined in the indenture), subject to certain exceptions and conditions set forth in the indenture. As of June 30, 2007, the credit agreement requires the Company to meet certain financial ratios, including financial covenants, as defined, requiring the maintenance of a maximum consolidated cash flow leverage ratio (2.75 times), as defined, and a maximum capitalization ratio (65%), as defined. The July 2007 amendment to the credit agreement resulted in a revision to the consolidated cash flow leverage ratio (to 3.0 times) through September 30, 2009, after which it will revert to 2.75 times. In addition, the indenture for the new senior unsecured notes contains a debt incurrence restriction based on a minimum fixed charge coverage ratio (2:1), and the mortgage facility contains covenants regarding maximum cash flow leverage and minimum interest coverage.

In the event that the Company were to default in the observance or performance of any of the financial covenants in the credit agreement or mortgage facility and such default were to continue beyond any cure period or waiver, the lender under the respective facility could elect to terminate the facilities and declare all outstanding obligations under such facilities immediately payable. The Company's credit agreement, the indenture for the Company's senior unsecured notes, vehicle floorplan payable facilities and mortgage facility have cross-default provisions that trigger a default in the event of an uncured default under other material indebtedness of the Company. As of June 30, 2007, the Company was in compliance with the requirements of all applicable financial and operating covenants.

The Company's senior unsecured notes and borrowings under the credit agreement are guaranteed by substantially all of the Company's 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.

In the event of a downgrade in the Company's credit ratings, none of the covenants described above would be impacted. In addition, availability under the credit agreement described above would not be impacted should a downgrade in the senior unsecured debt credit ratings occur. Certain covenants in the indenture for the senior unsecured notes would be eliminated with an upgrade of the Company's senior unsecured notes to investment grade by either Standard & Poor's or Moody's Investors Service.

**6. Income Taxes**

At June 30, 2007, and December 31, 2006, income taxes refundable included in Accounts Receivable totaled \$20.8 million and \$28.9 million, respectively.

The Company files 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 the Company. Currently, the IRS is auditing the tax years from 2002 to 2004. These audits may result in proposed assessments where the ultimate resolution may result in the Company owing additional taxes. The Company believes that its tax positions comply with applicable tax law and that it has adequately provided for these matters. Generally, the Company is no longer subject to income tax examinations by tax authorities for tax years beginning before 2002 in most major taxing jurisdictions.

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

The Company adopted the provisions of FIN 48 on January 1, 2007. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. As a result of the implementation of FIN 48, the Company recognized an increase of approximately \$2.0 million (net of tax effect) in the liability for unrecognized tax benefits which was accounted for as a reduction to the January 1, 2007 balance of retained earnings.

As of June 30, 2007, the Company had \$74.1 million of unrecognized tax benefits, of which \$51.7 million (net of tax effect) could ultimately reduce the Company's effective tax rate.

During the twelve months beginning July 1, 2007, the Company expects to reduce its unrecognized tax benefits by less than \$1.0 million (net of tax effect) as a result of settlements reached with certain state tax authorities and/or the expiration of certain statutes of limitations. During the six months ended June 30, 2007, the Company recognized \$8.6 million (net of tax effect) related to the resolution of certain tax matters, changes in certain state tax laws and other adjustments.

It is the Company's continuing policy to account for interest and penalties associated with income tax obligations as a component of income tax expense. The Company recognized \$1.7 million (net of tax effect) of interest and no penalties as provision for income taxes in the Unaudited Condensed Consolidated Income Statements during the six months ended June 30, 2007.

**7. Shareholders' Equity**

In April 2007, the Company's Board of Directors authorized an additional \$500.0 million share repurchase program. The Company repurchased 11.0 million shares of its common stock for an aggregate purchase price of \$239.9 million (average purchase price per share of \$21.77) during the six months ended June 30, 2007. As of June 30, 2007, there was approximately \$352.5 million available for share repurchases authorized by the Company's Board of Directors. Future share repurchases are subject to limitations contained in the indenture relating to the Company's senior unsecured notes.

During the six months ended June 30, 2007 and 2006, the Company issued 6.2 million and 3.8 million shares of common stock in connection with the exercise of stock options, the proceeds from which were \$88.6 million (average per share \$14.31) and \$51.6 million (average per share \$13.41), respectively.

**8. Earnings (Loss) Per Share**

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) per share are based on the combined weighted-average number of common shares and common share equivalents outstanding, which includes, where appropriate, the assumed exercise of dilutive options.

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

The computation of weighted-average common and common equivalent shares used in the calculation of basic and diluted earnings per share is as follows:

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
| Weighted average shares outstanding used in calculating basic earnings per share                    | 206.8                     | 220.4       | 207.4                   | 241.5       |
| Effect of dilutive options  | 1.8                       | 4.8         | 2.3                     | 5.0         |
| Weighted average common and common equivalent shares used in calculating diluted earnings per share | 208.6                     | 225.2       | 209.7                   | 246.5       |

In April 2006, the Company purchased 50 million shares of its common stock at \$23 per share for an aggregate purchase price of \$1.15 billion pursuant to the equity tender offer discussed in Note 5 to the Notes to the Unaudited Condensed Consolidated Financial Statements.

At June 30, 2007 and 2006, the Company had approximately 13.2 million and 23.8 million stock options outstanding, respectively.

**9. Stock Options**

The Company has stock option plans under which options to purchase shares of common stock may be granted to key employees and directors of the Company. Upon exercise, shares of common stock are issued from the Company's treasury stock. Options granted under the plans are non-qualified and are granted at a price equal to or above the closing price of the common stock on the trading day immediately prior to the date of grant. Generally, employee stock options have a term of 10 years from the date of grant and vest in increments of 25% per year over a four-year period on the yearly anniversary of the grant date. Director stock options have a term of 10 years from the date of grant and vest immediately upon grant.

The following table summarizes the impact to compensation expense (included in Selling, General and Administrative expenses in the 2007 and 2006 Unaudited Condensed Consolidated Income Statement) attributable to stock options granted or vested subsequent to December 31, 2005:

|                   | <b>Three Months</b>   |             | <b>Six Months</b>     |             |
|-------------------|-----------------------|-------------|-----------------------|-------------|
|                   | <b>Ended June 30,</b> |             | <b>Ended June 30,</b> |             |
|                   | <b>2007</b>           | <b>2006</b> | <b>2007</b>           | <b>2006</b> |
| Pre-tax expense   | \$ 5.0                | \$ 4.2      | \$ 8.0                | \$ 8.7      |
| After-tax expense | \$ 3.1                | \$ 2.6      | \$ 5.1                | \$ 5.3      |

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

A summary of stock option activity is as follows for the six months ended June 30, 2007:

|  | Shares<br>(in<br>millions) | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term<br>(Years) | Aggregate<br>Intrinsic<br>Value<br>(in<br>millions) |
|--|----------------------------|---|---|---|
| Options outstanding at beginning of period | 22.5                       | \$ 17.01                                  |   |   |
| Granted                                    | .4                         | \$ 21.19                                  |   |   |
| Exercised                                  | (6.2)                      | \$ 14.31                                  |   |   |
| Forfeited                                  | (.2)                       | \$ 19.45                                  |   |   |
| Expired                                    | (3.3)                      | \$ 25.76                                  |   |   |
| Options outstanding at end of period       | 13.2                       | \$ 16.17                                  | 5.8   | \$ 82.5   |
| Options exercisable at end of period       | 8.0                        | \$ 13.92                                  | 4.3   | \$ 68.5   |
| Options available for future grants        | 15.9                       |   |   |   |

In February 2007, the Company's Board of Directors approved a new director stock option plan for its non-employee directors. The new plan replaces the Company's 1995 non-employee director stock option plan, which has terminated (except with respect to previously granted stock options). The new plan, under which options to purchase up to 2.0 million shares of common stock may be granted, was approved at the Company's annual meeting of stockholders held in May 2007. Under the plan, an aggregate of 176,768 options were granted to non-employee directors on the date the plan was approved by stockholders. In future years, annual automatic grants of 20,000 options to each non-employee director will be made on the first business day of each calendar year that the plan is in effect.

The total intrinsic value (which equals the spread between the market value of the stock and the exercise price) of stock options exercised was \$48.0 million and \$33.6 million during the six months ended June 30, 2007 and 2006, respectively. As of June 30, 2007, there was \$24.9 million of total unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a period of four years.

#### 10. Comprehensive Income

Comprehensive income (loss) is as follows:

|                                 | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |          |
|---------------------------------|--------------------------------|---------|------------------------------|----------|
|                                 | 2007                           | 2006    | 2007                         | 2006     |
| Net Income                      | \$ 77.3                        | \$ 72.7 | \$ 154.9                     | \$ 159.9 |
| Other comprehensive gain (loss) | (.1)                           | (.7)    | .1                           | (1.0)    |
| Comprehensive income            | \$ 77.2                        | \$ 72.0 | \$ 155.0                     | \$ 158.9 |

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

**11. Acquisitions**

The Company acquired one automotive retail franchise and other related assets during each of the six months ended June 30, 2007 and 2006. Additionally, the Company also signed a separate agreement in January 2006 to acquire certain rights to establish a new Mercedes-Benz dealership. Acquisitions are included in the Unaudited Condensed Consolidated Financial Statements from the date of acquisition.

During the six months ended June 30, 2007 and 2006, the Company paid \$.8 million and \$67.2 million, respectively, for acquisitions. Additionally, during the six months ended June 30, 2006, the Company paid \$.2 million in cash for the deferred purchase price for certain prior year automotive retail acquisitions. Purchase price allocations for business combinations for the six months ended June 30, 2007 are tentative and subject to final adjustment.

Responsibility for the vehicle floorplan payable is assumed by the Company in acquisition transactions. Typically, the Company refinances the vehicle floorplan payable in which case the initial refinancing is accounted for as a vehicle floorplan payable-non-trade.

**12. Commitments and Contingencies**

**Legal Proceedings**

The Company is involved, and will continue to be involved, in numerous legal proceedings arising out of the conduct of its business, including litigation with customers, employment related lawsuits, class actions, purported class actions and actions brought by governmental authorities.

The Company does not believe that the ultimate resolution of these matters will have a material adverse effect on its 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 its financial condition, results of operations and cash flows.

**Other Matters**

The Company, acting through its subsidiaries, is the lessee under many real estate leases that provide for the use by the Company's subsidiaries of their respective dealership premises. Pursuant to these leases, the Company's 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, the Company enters into agreements with third parties in connection with the sale of assets or businesses in which it agrees 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, the Company enters into agreements that may contain indemnification provisions. In the event that an indemnification claim is asserted, liability would be limited by the terms of the applicable agreement.

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

From time to time, primarily in connection with dispositions of automotive stores, the Company's subsidiaries assign or sublet to the dealership purchaser the subsidiaries' interests in any real property leases associated with such stores. In general, the Company's 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, the Company and its subsidiaries generally remain subject to the terms of any guarantees made by the Company and its subsidiaries in connection with such leases. Although the Company generally has indemnification rights against the assignee or sublessee in the event of non-performance under these leases, as well as certain defenses, and the Company presently has no reason to believe that it or its subsidiaries will be called on to perform under any such assigned leases or subleases, the Company estimates that lessee rental payment obligations during the remaining terms of these leases are approximately \$89 million at June 30, 2007. The Company and its subsidiaries also may be called on to perform other obligations under these leases, such as environmental remediation of the leased premises or repair of the leased premises upon termination of the lease, although the Company presently has no reason to believe that it or its subsidiaries will be called on to so perform and such obligations cannot be quantified at this time. The Company's exposure under these leases is difficult to estimate and there can be no assurance that any performance of the Company or its subsidiaries required under these leases would not have a material adverse effect on the Company's business, financial condition and cash flows.

At June 30, 2007, surety bonds, letters of credit and cash deposits totaled \$121.9 million, including \$91.0 million of letters of credit. In the ordinary course of business, the Company is required to post performance and surety bonds, letters of credit, and/or cash deposits as financial guarantees of the Company's performance. The Company does not currently provide cash collateral for outstanding letters of credit.

In the ordinary course of business, the Company is subject to numerous laws and regulations, including automotive, environmental, health and safety and other laws and regulations. The Company does not anticipate that the costs of such compliance will have a material adverse effect on its business, consolidated results of operations, cash flows or financial condition, although such outcome is possible given the nature of the Company's operations and the extensive legal and regulatory framework applicable to its business. The Company does not have any material known environmental commitments or contingencies.

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

**13. Discontinued Operations**

Discontinued operations are related to stores that were sold, that the Company has entered into an agreement to sell or for which the Company otherwise deems a proposed sales transaction to be probable, with no material changes expected. Generally, the sale of a store is completed within 60 to 90 days after the date of a sale agreement. The accompanying Unaudited Condensed Consolidated Financial Statements for all the periods presented have been adjusted to classify these stores as discontinued operations. Selected income statement data for the Company's discontinued operations is as follows:

|  | <b>Three Months Ended June</b> |             | <b>Six Months Ended June</b> |             |
|--|--------------------------------|-------------|------------------------------|-------------|
|  | <b>2007</b>                    | <b>2006</b> | <b>2007</b>                  | <b>2006</b> |
| Total revenue  | \$ 52.2                        | \$ 164.5    | \$ 128.5                     | \$ 339.8    |
| Pre-tax loss from discontinued operations              | \$ (2.0)                       | \$ (3.5)    | \$ (3.3)                     | \$ (6.4)    |
| Pre-tax loss on disposal of discontinued operations    | (0.3)                          | (1.6)       | (1.8)                        | (10.2)      |
| Income tax expense (benefit)                           | (2.3)                          | (5.1)       | (5.1)                        | (16.6)      |
|  | (0.3)                          | (3.9)       | 2.0                          | (4.8)       |
| Loss from discontinued operations, net of income taxes | \$ (2.0)                       | \$ (1.2)    | \$ (7.1)                     | \$ (11.8)   |

A summary of the total assets and liabilities of discontinued operations included in Other Current Assets and Other Current Liabilities is as follows:

|                                     | <b>June</b> | <b>December</b> |
|-------------------------------------|-------------|-----------------|
|                                     | <b>30,</b>  | <b>31,</b>      |
|                                     | <b>2007</b> | <b>2006</b>     |
| Inventory                           | \$ 22.5     | \$ 62.4         |
| Other current assets                | 7.9         | 16.3            |
| Property and equipment, net         | 9.8         | 29.0            |
| Goodwill                            | 7.2         | 22.9            |
| Other non-current assets            | .2          | .3              |
| Total assets                        | \$ 47.6     | \$ 130.9        |
| Vehicle floorplan payable-trade     | \$ 10.9     | \$ 46.6         |
| Vehicle floorplan payable-non-trade | 8.3         | 9.8             |
| Other current liabilities           | 6.6         | 12.3            |
| Total liabilities                   | \$ 25.8     | \$ 68.7         |

Responsibility for the Company's vehicle floorplan payable at the time of divestiture is assumed by the buyer. Cash received from business divestitures is net of vehicle floorplan payable assumed by the buyer.

**14. Subsequent Event**

As indicated in Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements, the Company completed a second amendment of its credit agreement in July 2007.



## **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 Item 1. 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 amounts have been reclassified from the previously reported financial statements to conform with the income statement presentation of the current period.

### **OVERVIEW**

AutoNation, Inc., through its subsidiaries, is the largest automotive retailer in the United States. As of June 30, 2007, we owned and operated 321 new vehicle franchises from 249 dealerships located in major metropolitan markets, predominantly in the Sunbelt region of the United States. Our stores, which we believe include some of the most recognizable and well known in our key markets, sell 37 different brands of new vehicles. The core brands of vehicles that we sell are manufactured by Ford, General Motors, Daimler Chrysler, Toyota, Nissan, Honda and BMW.

We operate in a single operating and reporting segment, automotive retailing. We offer a diversified range of automotive products and services, including new vehicles, used vehicles, vehicle maintenance and repair services, vehicle parts, extended service contracts, vehicle protection products and other aftermarket products. We also arrange 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 our market brands and advertising, improving asset management, driving common processes and increasing productivity across all of our stores.

For the six months ended June 30, 2007, new vehicle sales accounted for approximately 57% of our total revenue, but approximately 25% of our total gross margin. Our parts and service and finance and insurance operations, while comprising approximately 18% of total revenue for the six months ended June 30, 2007, contributed approximately 60% of our gross margin for the same period. We believe that many factors affect sales of new vehicles and retailers gross profit margins in the United States and in our particular geographic markets, including the economy, inflation, recession or economic slowdown, consumer confidence, housing markets, the level of manufacturers' production capacity, manufacturer incentives (and consumers' reaction to such offers), intense industry competition, interest rates, the prospects of war, other international conflicts or terrorist attacks, severe weather conditions, the level of personal discretionary spending, product quality, affordability and innovation, fuel prices, credit availability, employment/unemployment rates, the number of consumers whose vehicle leases are expiring, and the length of consumer loans on existing vehicles. Increases in interest rates could significantly impact industry new vehicle sales and vehicle affordability, due to the direct relationship between higher rates and higher monthly loan payments, a critical factor for many vehicle buyers, and the impact higher rates can have on customers' borrowing capacity and disposable income. Sales of certain new vehicles, particularly larger trucks and sports utility vehicles that historically have provided us with higher gross margins, also could be impacted adversely by significant increases in fuel prices.

For the three months ended June 30, 2007 and 2006, we had net income from continuing operations of \$79.3 million and \$73.9 million, respectively, and diluted earnings per share of \$.38 and \$.33, respectively. For the six months ended June 30, 2007 and 2006, we had net income from continuing operations of \$162.0 million and \$171.7 million, respectively, and diluted earnings per share of \$.77 and \$.70, respectively. Results for the three and six months ended June 30, 2006 reflect \$34.5 million (approximately \$21 million, net of tax) of premium and deferred financing costs recognized as Interest Expense related to the repurchase of our 9% senior unsecured notes in April 2006.

Results for the first three and six months of 2007 were adversely impacted by a decline in new vehicle sales especially in California and Florida, driven in part by continued weakness in the housing market largely due to higher interest rates. Results for the three and six months ended June 30, 2007 were favorably impacted by increased new vehicle and finance and insurance revenue per vehicle sold, the impact of 2006 acquisitions, certain tax adjustments and, for the first six months of 2007, the accretive impact of share repurchases, including the \$1.15 billion April 2006 share buyback.

To the extent that we continue to see weakness in the housing market, we anticipate that our sales trends will be adversely impacted. For 2007, we anticipate that the automotive retail market will remain challenging.

In April 2007, our Board of Directors authorized an additional \$500.0 million share repurchase program. We repurchased 11.0 million shares of our common stock for an aggregate purchase price of \$239.9 million (average purchase price per share of \$21.77) during the six months ended June 30, 2007. There was approximately \$352.5 million available for share repurchases authorized by our Board of Directors as of June 30, 2007. Future share repurchases are subject to limitations contained in the indenture relating to our senior unsecured notes. See further discussion under the heading Financial Condition. During the six months ended June 30, 2007, 6.2 million shares of our common stock were issued upon the exercise of stock options, resulting in proceeds of \$88.6 million (average per share of \$14.31).

For the three months ended June 30, 2007 and 2006, we had a loss from discontinued operations totaling \$2.0 million and \$1.2 million, respectively, net of income taxes. For the six months ended June 30, 2007 and 2006, we had a loss from discontinued operations totaling \$7.1 million and \$11.8 million, respectively, net of income taxes. Certain amounts reflected in the accompanying Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2007 and 2006, have been adjusted to classify the results of these stores as discontinued operations.

**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 June 30, |                   |                                   |               | Six Months Ended June 30, |                   |                                   |               |
|--|-----------------------------|-------------------|-----------------------------------|---------------|---------------------------|-------------------|-----------------------------------|---------------|
|  | 2007                        | 2006              | Variance Favorable/ (Unfavorable) | % Variance    | 2007                      | 2006              | Variance Favorable/ (Unfavorable) | % Variance    |
| Revenue:   |                             |                   |                                   |               |                           |                   |                                   |               |
| New vehicle  | \$ 2,631.5                  | \$ 2,884.9        | \$ (253.4)                        | (8.8)         | \$ 5,094.7                | \$ 5,513.8        | \$ (419.1)                        | (7.6)         |
| Used vehicle   | 1,104.5                     | 1,171.3           | (66.8)                            | (5.7)         | 2,193.1                   | 2,282.8           | (89.7)                            | (3.9)         |
| Parts and service  | 653.8                       | 648.2             | 5.6                               | .9            | 1,310.4                   | 1,289.9           | 20.5                              | 1.6           |
| Finance and insurance, net                                   | 152.3                       | 167.6             | (15.3)                            | (9.1)         | 300.6                     | 316.4             | (15.8)                            | (5.0)         |
| Other  | 17.2                        | 20.7              | (3.5)                             |               | 34.3                      | 39.5              | (5.2)                             |               |
| <b>Total revenue</b>   | <b>\$ 4,559.3</b>           | <b>\$ 4,892.7</b> | <b>\$ (333.4)</b>                 | <b>(6.8)</b>  | <b>\$ 8,933.1</b>         | <b>\$ 9,442.4</b> | <b>\$ (509.3)</b>                 | <b>(5.4)</b>  |
| Gross profit:  |                             |                   |                                   |               |                           |                   |                                   |               |
| New vehicle  | \$ 181.4                    | \$ 210.7          | \$ (29.3)                         | (13.9)        | \$ 360.6                  | \$ 406.9          | \$ (46.3)                         | (11.4)        |
| Used vehicle   | 94.3                        | 103.5             | (9.2)                             | (8.9)         | 199.0                     | 215.4             | (16.4)                            | (7.6)         |
| Parts and service  | 287.0                       | 287.7             | (.7)                              | (.2)          | 573.5                     | 569.9             | 3.6                               | .6            |
| Finance and insurance  | 152.3                       | 167.6             | (15.3)                            | (9.1)         | 300.6                     | 316.4             | (15.8)                            | (5.0)         |
| Other  | 10.7                        | 11.8              | (1.1)                             |               | 21.2                      | 22.8              | (1.6)                             |               |
| <b>Total gross profit</b>                                    | <b>725.7</b>                | <b>781.3</b>      | <b>(55.6)</b>                     | <b>(7.1)</b>  | <b>1,454.9</b>            | <b>1,531.4</b>    | <b>(76.5)</b>                     | <b>(5.0)</b>  |
| Selling, general and administrative expenses                 |                             |                   |                                   |               |                           |                   |                                   |               |
| Selling, general and administrative expenses                 | 517.7                       | 548.4             | 30.7                              | 5.6           | 1,038.9                   | 1,077.5           | 38.6                              | 3.6           |
| Depreciation and amortization                                | 21.6                        | 20.7              | (.9)                              |               | 42.8                      | 40.0              | (2.8)                             |               |
| Other expenses, net  | 1.6                         | .2                | (1.4)                             |               | 1.6                       | .2                | (1.4)                             |               |
| <b>Operating income</b>                                      | <b>184.8</b>                | <b>212.0</b>      | <b>(27.2)</b>                     | <b>(12.8)</b> | <b>371.6</b>              | <b>413.7</b>      | <b>(42.1)</b>                     | <b>(10.2)</b> |
| Floorplan interest expense                                   | (33.5)                      | (36.1)            | 2.6                               |               | (66.0)                    | (67.0)            | 1.0                               |               |
| Other interest expense                                       | (26.5)                      | (25.2)            | (1.3)                             |               | (53.0)                    | (37.2)            | (15.8)                            |               |
| Other interest expense - senior note repurchases             |                             | (34.5)            | 34.5                              |               |                           | (34.5)            | 34.5                              |               |
| Interest income  | .9                          | 3.1               | (2.2)                             |               | 1.8                       | 6.6               | (4.8)                             |               |
| Other gains, net   | .8                          | .7                | .1                                |               | 1.0                       | .7                | .3                                |               |
| <b>Income from continuing operations before income taxes</b> | <b>\$ 126.5</b>             | <b>\$ 120.0</b>   | <b>\$ 6.5</b>                     | <b>5.4</b>    | <b>\$ 255.4</b>           | <b>\$ 282.3</b>   | <b>\$ (26.9)</b>                  | <b>(9.5)</b>  |
| Retail vehicle unit sales:                                   |                             |                   |                                   |               |                           |                   |                                   |               |
| New vehicle  | 85,768                      | 96,932            | (11,164)                          | (11.5)        | 165,279                   | 184,045           | (18,766)                          | (10.2)        |
| Used vehicle   | 53,011                      | 57,781            | (4,770)                           | (8.3)         | 107,111                   | 114,004           | (6,893)                           | (6.0)         |
|  | 138,779                     | 154,713           | (15,934)                          | (10.3)        | 272,390                   | 298,049           | (25,659)                          | (8.6)         |
| Revenue per vehicle retailed:                                |                             |                   |                                   |               |                           |                   |                                   |               |
| New vehicle  | \$ 30,682                   | \$ 29,762         | \$ 920                            | 3.1           | \$ 30,825                 | \$ 29,959         | \$ 866                            | 2.9           |
| Used vehicle   | \$ 16,602                   | \$ 16,232         | \$ 370                            | 2.3           | \$ 16,434                 | \$ 16,107         | \$ 327                            | 2.0           |

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Gross profit per vehicle retailed:

|                       |          |          |         |       |          |          |         |       |
|-----------------------|----------|----------|---------|-------|----------|----------|---------|-------|
| New vehicle           | \$ 2,115 | \$ 2,174 | \$ (59) | (2.7) | \$ 2,182 | \$ 2,211 | \$ (29) | (1.3) |
| Used vehicle          | \$ 1,766 | \$ 1,786 | \$ (20) | (1.1) | \$ 1,825 | \$ 1,864 | \$ (39) | (2.1) |
| Finance and insurance | \$ 1,097 | \$ 1,083 | \$ 14   | 1.3   | \$ 1,104 | \$ 1,062 | \$ 42   | 4.0   |

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|  | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|--|--------------------------------|--------|------------------------------|--------|
|  | %<br>2007                      | % 2006 | %<br>2007                    | % 2006 |
| Revenue mix percentages:                               |                                |        |                              |        |
| New vehicle  | 57.7                           | 59.0   | 57.0                         | 58.4   |
| Used vehicle   | 24.2                           | 23.9   | 24.6                         | 24.2   |
| Parts and service                                      | 14.3                           | 13.2   | 14.7                         | 13.7   |
| Finance and insurance, net                             | 3.3                            | 3.4    | 3.4                          | 3.4    |
| Other  | .5                             | .5     | .3                           | .3     |
| Total  | 100.0                          | 100.0  | 100.0                        | 100.0  |
| Gross profit mix percentages:                          |                                |        |                              |        |
| New vehicle  | 25.0                           | 27.0   | 24.8                         | 26.6   |
| Used vehicle   | 13.0                           | 13.2   | 13.7                         | 14.1   |
| Parts and service                                      | 39.5                           | 36.8   | 39.4                         | 37.2   |
| Finance and insurance                                  | 21.0                           | 21.5   | 20.7                         | 20.7   |
| Other  | 1.5                            | 1.5    | 1.4                          | 1.4    |
| Total  | 100.0                          | 100.0  | 100.0                        | 100.0  |
| Operating items as a percentage of revenue:            |                                |        |                              |        |
| Gross profit:  |                                |        |                              |        |
| New vehicle  | 6.9                            | 7.3    | 7.1                          | 7.4    |
| Used vehicle retail                                    | 10.6                           | 11.0   | 11.1                         | 11.6   |
| Parts and service                                      | 43.9                           | 44.4   | 43.8                         | 44.2   |
| Total  | 15.9                           | 16.0   | 16.3                         | 16.2   |
| Selling, general and administrative expenses           | 11.4                           | 11.2   | 11.6                         | 11.4   |
| Operating income                                       | 4.1                            | 4.3    | 4.2                          | 4.4    |
| Operating items as a percentage of total gross profit: |                                |        |                              |        |
| Selling, general and administrative expenses           | 71.3                           | 70.2   | 71.4                         | 70.4   |
| Operating income                                       | 25.5                           | 27.1   | 25.5                         | 27.0   |

|  | June<br>30,<br>2007 | June<br>30,<br>2006 |
|--|---------------------|---------------------|
| Days supply:   |                     |                     |
| New vehicle (industry standard of selling days, including fleet) | 56 days             | 60 days             |
| Used vehicle (trailing 30 days)                                  | 44 days             | 43 days             |

The following table details net inventory carrying cost, consisting of floorplan interest expense, net of floorplan assistance earned (amounts received from manufacturers specifically to support store financing of inventory). Floorplan assistance is accounted for as a component of new vehicle gross profit.

| (\$ in millions)     | Three Months Ended June 30, |         |          | Six Months Ended June 30, |         |          |
|----------------------|-----------------------------|---------|----------|---------------------------|---------|----------|
|                      | 2007                        | 2006    | Variance | 2007                      | 2006    | Variance |
| Floorplan assistance | \$ 24.8                     | \$ 29.3 | \$ (4.5) | \$ 49.5                   | \$ 55.4 | \$ (5.9) |

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|                             |          |          |          |           |           |          |
|-----------------------------|----------|----------|----------|-----------|-----------|----------|
| Floorplan interest expense  | (33.5)   | (36.1)   | 2.6      | (66.0)    | (67.0)    | 1.0      |
| Net inventory carrying cost | \$ (8.7) | \$ (6.8) | \$ (1.9) | \$ (16.5) | \$ (11.6) | \$ (4.9) |

**Same Store Operating Data**

We have presented below our operating results on a same store basis to reflect our internal performance. Same store operating results include the results of stores for identical months in both years included in the comparison, starting with the first month of ownership or operation.

| (\$ in millions, except per vehicle data) | Three Months Ended June 30, |                   |                                   |              | Six Months Ended June 30, |                   |                                   |              |
|---|-----------------------------|-------------------|-----------------------------------|--------------|---------------------------|-------------------|-----------------------------------|--------------|
|   | 2007                        | 2006              | Variance Favorable/ (Unfavorable) | % Variance   | 2007                      | 2006              | Variance Favorable/ (Unfavorable) | % Variance   |
| Revenue:                                  |                             |                   |                                   |              |                           |                   |                                   |              |
| New vehicle                               | \$ 2,610.1                  | \$ 2,884.9        | \$ (274.8)                        | (9.5)        | \$ 5,038.4                | \$ 5,513.8        | \$ (475.4)                        | (8.6)        |
| Used vehicle                              | 1,096.7                     | 1,170.6           | (73.9)                            | (6.3)        | 2,169.3                   | 2,281.6           | (112.3)                           | (4.9)        |
| Parts and service                         | 647.3                       | 648.2             | (.9)                              | (.1)         | 1,293.7                   | 1,289.9           | 3.8                               | .3           |
| Finance and insurance, net                | 152.7                       | 167.9             | (15.2)                            | (9.1)        | 301.2                     | 316.7             | (15.5)                            | (4.9)        |
| Other                                     | 6.6                         | 8.4               | (1.8)                             |              | 13.5                      | 15.5              | (2.0)                             |              |
| <b>Total revenue</b>                      | <b>\$ 4,513.4</b>           | <b>\$ 4,880.0</b> | <b>\$ (366.6)</b>                 | <b>(7.5)</b> | <b>\$ 8,816.1</b>         | <b>\$ 9,417.5</b> | <b>\$ (601.4)</b>                 | <b>(6.4)</b> |
| Gross profit:                             |                             |                   |                                   |              |                           |                   |                                   |              |
| New vehicle                               | \$ 179.5                    | \$ 210.7          | \$ (31.2)                         | (14.8)       | \$ 355.5                  | \$ 406.9          | \$ (51.4)                         | (12.6)       |
| Used vehicle                              | 93.4                        | 102.9             | (9.5)                             | (9.2)        | 196.6                     | 214.2             | (17.6)                            | (8.2)        |
| Parts and service                         | 283.4                       | 287.1             | (3.7)                             | (1.3)        | 564.5                     | 568.7             | (4.2)                             | (.7)         |
| Finance and insurance                     | 152.7                       | 167.9             | (15.2)                            | (9.1)        | 301.2                     | 316.7             | (15.5)                            | (4.9)        |
| Other                                     | 6.9                         | 6.7               | .2                                |              | 13.6                      | 13.3              | .3                                |              |
| <b>Total gross profit</b>                 | <b>715.9</b>                | <b>775.3</b>      | <b>(59.4)</b>                     | <b>(7.7)</b> | <b>1,431.4</b>            | <b>1,519.8</b>    | <b>(88.4)</b>                     | <b>(5.8)</b> |
| Retail vehicle unit sales:                |                             |                   |                                   |              |                           |                   |                                   |              |
| New vehicle                               | 85,372                      | 96,932            | (11,560)                          | (11.9)       | 164,282                   | 184,045           | (19,763)                          | (10.7)       |
| Used vehicle                              | 52,875                      | 57,781            | (4,906)                           | (8.5)        | 106,736                   | 114,004           | (7,268)                           | (6.4)        |
|   | 138,247                     | 154,713           | (16,466)                          | (10.6)       | 271,018                   | 298,049           | (27,031)                          | (9.1)        |
| Revenue per vehicle retailed:             |                             |                   |                                   |              |                           |                   |                                   |              |
| New vehicle                               | \$ 30,573                   | \$ 29,762         | \$ 811                            | 2.7          | \$ 30,669                 | \$ 29,959         | \$ 710                            | 2.4          |
| Used vehicle                              | \$ 16,554                   | \$ 16,232         | \$ 322                            | 2.0          | \$ 16,360                 | \$ 16,108         | \$ 252                            | 1.6          |
| Gross profit per vehicle retailed:        |                             |                   |                                   |              |                           |                   |                                   |              |
| New vehicle                               | \$ 2,103                    | \$ 2,174          | \$ (71)                           | (3.3)        | \$ 2,164                  | \$ 2,211          | \$ (47)                           | (2.1)        |
| Used vehicle                              | \$ 1,765                    | \$ 1,788          | \$ (23)                           | (1.3)        | \$ 1,820                  | \$ 1,865          | \$ (45)                           | (2.4)        |
| Finance and insurance                     | \$ 1,105                    | \$ 1,085          | \$ 20                             | 1.8          | \$ 1,111                  | \$ 1,063          | \$ 48                             | 4.5          |

| Revenue mix percentages: | Three Months Ended June 30, |        | Six Months Ended June 30, |        |
|--------------------------|-----------------------------|--------|---------------------------|--------|
|                          | % 2007                      | % 2006 | % 2007                    | % 2006 |
| New vehicle              | 57.8                        | 59.1   | 57.1                      | 58.5   |

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|                            |       |       |       |       |
|----------------------------|-------|-------|-------|-------|
| Used vehicle               | 24.3  | 24.0  | 24.6  | 24.2  |
| Parts and service          | 14.3  | 13.3  | 14.7  | 13.7  |
| Finance and insurance, net | 3.4   | 3.4   | 3.4   | 3.4   |
| Other                      | .2    | .2    | .2    | .2    |
| Total                      | 100.0 | 100.0 | 100.0 | 100.0 |

Gross profit mix percentages:

|                       |       |       |       |       |
|-----------------------|-------|-------|-------|-------|
| New vehicle           | 25.1  | 27.2  | 24.8  | 26.8  |
| Used vehicle          | 13.0  | 13.3  | 13.7  | 14.1  |
| Parts and service     | 39.6  | 37.0  | 39.4  | 37.4  |
| Finance and insurance | 21.3  | 21.7  | 21.0  | 20.8  |
| Other                 | 1.0   | .8    | 1.1   | .9    |
| Total                 | 100.0 | 100.0 | 100.0 | 100.0 |

Operating items as a percentage of revenue:

|                     |      |      |      |      |
|---------------------|------|------|------|------|
| Gross profit:       |      |      |      |      |
| New vehicle         | 6.9  | 7.3  | 7.1  | 7.4  |
| Used vehicle retail | 10.7 | 11.0 | 11.1 | 11.6 |
| Parts and service   | 43.8 | 44.3 | 43.6 | 44.1 |
| Total               | 15.9 | 15.9 | 16.2 | 16.1 |



*New Vehicle*

| (\$ in millions, except per vehicle data)                        | Three Months Ended June 30, |            |                                   |            | Six Months Ended June 30, |            |                                   |            |
|--|-----------------------------|------------|-----------------------------------|------------|---------------------------|------------|-----------------------------------|------------|
|  | 2007                        | 2006       | Variance Favorable/ (Unfavorable) | % Variance | 2007                      | 2006       | Variance Favorable/ (Unfavorable) | % Variance |
| <b>Reported:</b>   |                             |            |                                   |            |                           |            |                                   |            |
| Revenue  | \$ 2,631.5                  | \$ 2,884.9 | \$ (253.4)                        | (8.8)      | \$ 5,094.7                | \$ 5,513.8 | \$ (419.1)                        | (7.6)      |
| Gross profit   | \$ 181.4                    | \$ 210.7   | \$ (29.3)                         | (13.9)     | \$ 360.6                  | \$ 406.9   | \$ (46.3)                         | (11.4)     |
| Retail vehicle unit sales  | 85,768                      | 96,932     | (11,164)                          | (11.5)     | 165,279                   | 184,045    | (18,766)                          | (10.2)     |
| Revenue per vehicle retailed                                     | \$ 30,682                   | \$ 29,762  | \$ 920                            | 3.1        | \$ 30,825                 | \$ 29,959  | \$ 866                            | 2.9        |
| Gross profit per vehicle retailed                                | \$ 2,115                    | \$ 2,174   | \$ (59)                           | (2.7)      | \$ 2,182                  | \$ 2,211   | \$ (29)                           | (1.3)      |
| Gross profit as a percentage of revenue                          | 6.9%                        | 7.3%       |                                   |            | 7.1%                      | 7.4%       |                                   |            |
| Days supply (industry standard of selling days, including fleet) | 56 days                     | 60 days    |                                   |            |                           |            |                                   |            |
| <b>Same Store:</b>   |                             |            |                                   |            |                           |            |                                   |            |
| Revenue  | \$ 2,610.1                  | \$ 2,884.9 | \$ (274.8)                        | (9.5)      | \$ 5,038.4                | \$ 5,513.8 | \$ (475.4)                        | (8.6)      |
| Gross profit   | \$ 179.5                    | \$ 210.7   | \$ (31.2)                         | (14.8)     | \$ 355.5                  | \$ 406.9   | \$ (51.4)                         | (12.6)     |
| Retail vehicle unit sales  | 85,372                      | 96,932     | (11,560)                          | (11.9)     | 164,282                   | 184,045    | (19,763)                          | (10.7)     |
| Revenue per vehicle retailed                                     | \$ 30,573                   | \$ 29,762  | \$ 811                            | 2.7        | \$ 30,669                 | \$ 29,959  | \$ 710                            | 2.4        |
| Gross profit per vehicle retailed                                | \$ 2,103                    | \$ 2,174   | \$ (71)                           | (3.3)      | \$ 2,164                  | \$ 2,211   | \$ (47)                           | (2.1)      |
| Gross profit as a percentage of revenue                          | 6.9%                        | 7.3%       |                                   |            | 7.1%                      | 7.4%       |                                   |            |

The following table details net inventory carrying cost, consisting of floorplan interest expense, net of floorplan assistance earned (amounts received from manufacturers specifically to support store financing of inventory). Floorplan assistance is accounted for as a component of new vehicle gross profit.

| (\$ in millions)            | Three Months Ended June 30, |          |          | Six Months Ended June 30, |           |          |
|-----------------------------|-----------------------------|----------|----------|---------------------------|-----------|----------|
|                             | 2007                        | 2006     | Variance | 2007                      | 2006      | Variance |
| Floorplan assistance        | \$ 24.8                     | \$ 29.3  | \$ (4.5) | \$ 49.5                   | \$ 55.4   | \$ (5.9) |
| Floorplan interest expense  | (33.5)                      | (36.1)   | 2.6      | (66.0)                    | (67.0)    | 1.0      |
| Net inventory carrying cost | \$ (8.7)                    | \$ (6.8) | \$ (1.9) | \$ (16.5)                 | \$ (11.6) | \$ (4.9) |

Reported new vehicle performance for the three and six months ended June 30, 2007 benefited from the impact of acquisitions when compared to same store performance.

Same store new vehicle revenue for the three and six months ended June 30, 2007 decreased compared to the same period in 2006 primarily as a result of a decrease in same store unit volume, particularly in California and Florida, driven in part by continued weakness in the housing market. To the extent that we continue to see weakness in the housing market, we anticipate that our sales trends will be adversely impacted. Additionally, we continued to see a decline in sales of domestic brands in our markets, which we expect to continue. These volume decreases were partially offset by an increase in same store average revenue per unit retailed, primarily as a result of the continued shift in our brand mix to premium luxury brands.

Same store gross profit per vehicle retailed and gross profit as a percentage of revenue decreased as a result of a challenging retail environment, partially offset by the shift in our sales mix to more premium luxury brands.

At June 30, 2007, our new vehicle inventories were at \$1.8 billion or 56 days compared to new vehicle inventories of \$1.9 billion or 51 days supply at December 31, 2006 and \$2.2 billion or 60 days at June 30, 2006.

The net inventory carrying cost (floorplan interest expense net of floorplan assistance from manufacturers) for the three and six months ended June 30, 2007 was \$8.7 million and \$16.5 million, respectively, an increase of \$1.9 million and \$4.9 million, respectively, compared to the same periods in 2006.

*Used Vehicle*

| (\$ in millions, except per vehicle data) | Three Months Ended June 30, |            |                                   |            | Six Months Ended June 30, |            |                                   |            |
|---|-----------------------------|------------|-----------------------------------|------------|---------------------------|------------|-----------------------------------|------------|
|   | 2007                        | 2006       | Variance Favorable/ (Unfavorable) | % Variance | 2007                      | 2006       | Variance Favorable/ (Unfavorable) | % Variance |
| <b>Reported:</b>                          |                             |            |                                   |            |                           |            |                                   |            |
| Retail revenue                            | \$ 880.1                    | \$ 937.9   | \$ (57.8)                         | (6.2)      | \$ 1,760.3                | \$ 1,836.3 | \$ (76.0)                         | (4.1)      |
| Wholesale revenue                         | 224.4                       | 233.4      | (9.0)                             | (3.9)      | 432.8                     | 446.5      | (13.7)                            | (3.1)      |
| Total revenue                             | \$ 1,104.5                  | \$ 1,171.3 | \$ (66.8)                         | (5.7)      | \$ 2,193.1                | \$ 2,282.8 | \$ (89.7)                         | (3.9)      |
| Retail gross profit                       | \$ 93.6                     | \$ 103.2   | \$ (9.6)                          | (9.3)      | \$ 195.5                  | \$ 212.5   | \$ (17.0)                         | (8.0)      |
| Wholesale gross profit                    | 0.7                         | 0.3        | 0.4                               |            | 3.5                       | 2.9        | 0.6                               |            |
| Total gross profit                        | \$ 94.3                     | \$ 103.5   | \$ (9.2)                          | (8.9)      | \$ 199.0                  | \$ 215.4   | \$ (16.4)                         | (7.6)      |
| Retail vehicle unit sales                 | 53,011                      | 57,781     | (4,770)                           | (8.3)      | 107,111                   | 114,004    | (6,893)                           | (6.0)      |
| Revenue per vehicle retailed              | \$ 16,602                   | \$ 16,232  | \$ 370                            | 2.3        | \$ 16,434                 | \$ 16,107  | \$ 327                            | 2.0        |
| Gross profit per vehicle retailed         | \$ 1,766                    | \$ 1,786   | \$ (20)                           | (1.1)      | \$ 1,825                  | \$ 1,864   | \$ (39)                           | (2.1)      |
| Gross profit as a percentage of revenue   | 10.6%                       | 11.0%      |                                   |            | 11.1%                     | 11.6%      |                                   |            |
| Days supply (trailing 30 days)            | 44 days                     | 43 days    |                                   |            |                           |            |                                   |            |
| <b>Same Store:</b>                        |                             |            |                                   |            |                           |            |                                   |            |
| Retail revenue                            | \$ 875.3                    | \$ 937.9   | \$ (62.6)                         | (6.7)      | \$ 1,746.2                | \$ 1,836.4 | \$ (90.2)                         | (4.9)      |
| Wholesale revenue                         | 221.4                       | 232.7      | (11.3)                            | (4.9)      | 423.1                     | 445.2      | (22.1)                            | (5.0)      |
| Total revenue                             | \$ 1,096.7                  | \$ 1,170.6 | \$ (73.9)                         | (6.3)      | \$ 2,169.3                | \$ 2,281.6 | \$ (112.3)                        | (4.9)      |
| Retail gross profit                       | \$ 93.3                     | \$ 103.3   | \$ (10.0)                         | (9.7)      | \$ 194.3                  | \$ 212.6   | \$ (18.3)                         | (8.6)      |
| Wholesale gross profit                    | .1                          | (.4)       | .5                                |            | 2.3                       | 1.6        | .7                                |            |
| Total gross profit                        | \$ 93.4                     | \$ 102.9   | \$ (9.5)                          | (9.2)      | \$ 196.6                  | \$ 214.2   | \$ (17.6)                         | (8.2)      |
| Retail vehicle unit sales                 | 52,875                      | 57,781     | (4,906)                           | (8.5)      | 106,736                   | 114,004    | (7,268)                           | (6.4)      |
| Revenue per vehicle retailed              | \$ 16,554                   | \$ 16,232  | \$ 322                            | 2.0        | \$ 16,360                 | \$ 16,108  | \$ 252                            | 1.6        |
| Gross profit per vehicle retailed         | \$ 1,765                    | \$ 1,788   | \$ (23)                           | (1.3)      | \$ 1,820                  | \$ 1,865   | \$ (45)                           | (2.4)      |
| Gross profit as a percentage of revenue   | 10.7%                       | 11.0%      |                                   |            | 11.1%                     | 11.6%      |                                   |            |

Reported used vehicle performance for the three and six months ended June 30, 2007 benefited from the impact of acquisitions when compared to same store performance.

Same store retail used vehicle revenue for the three and six months ended June 30, 2007 decreased compared to the same period in 2006 primarily as a result of a decrease in same store unit volume, partially offset by an increase in same store average revenue per unit retailed. Same store unit volume decreased as a result of a challenging retail environment, particularly in Florida. To the extent that we continue to see weakness in the housing market, we anticipate that our sales trends will be adversely impacted. We also saw a decrease in used vehicle sales volumes in our domestic brand stores in our markets. Same store revenue per vehicle retailed for the three and six months ended June 30, 2007 increased due to a shift in our sales mix to import luxury vehicles. Same store retail gross profit per vehicle retailed for the three and six months ended June 30, 2007 decreased primarily as a result of an increase in the average cost of our used vehicle inventory.

Used vehicle inventories were at \$372.6 million or 44 days supply at June 30, 2007 compared to \$301.9 million or 42 days supply at December 31, 2006 and \$372.9 million or 43 days at June 30, 2006.

*Parts and Service*

| (\$ in millions, except per vehicle data) | Three Months Ended June 30, |          |                                   |            | Six Months Ended June 30, |            |                                   |            |
|---|-----------------------------|----------|-----------------------------------|------------|---------------------------|------------|-----------------------------------|------------|
|   | 2007                        | 2006     | Variance Favorable/ (Unfavorable) | % Variance | 2007                      | 2006       | Variance Favorable/ (Unfavorable) | % Variance |
| <b>Reported:</b>                          |                             |          |                                   |            |                           |            |                                   |            |
| Revenue                                   | \$ 653.8                    | \$ 648.2 | \$ 5.6                            | .9         | \$ 1,310.4                | \$ 1,289.9 | \$ 20.5                           | 1.6        |
| Gross profit                              | \$ 287.0                    | \$ 287.7 | \$ (0.7)                          | (.2)       | \$ 573.5                  | \$ 569.9   | \$ 3.6                            | .6         |
| Gross profit as a percentage of revenue   | 43.9%                       | 44.4%    |                                   |            | 43.8%                     | 44.2%      |                                   |            |
| <b>Same Store:</b>                        |                             |          |                                   |            |                           |            |                                   |            |
| Revenue                                   | \$ 647.3                    | \$ 648.2 | \$ (0.9)                          | (.1)       | \$ 1,293.7                | \$ 1,289.9 | \$ 3.8                            | .3         |
| Gross profit                              | \$ 283.4                    | \$ 287.1 | \$ (3.7)                          | (1.3)      | \$ 564.5                  | \$ 568.7   | \$ (4.2)                          | (.7)       |
| Gross profit as a percentage of revenue   | 43.8%                       | 44.3%    |                                   |            | 43.6%                     | 44.1%      |                                   |            |

Parts and service revenue is primarily derived from vehicle repairs paid directly by customers or via reimbursement from manufacturers and others under warranty programs. Reported parts and service revenue and gross profit for the three and six months ended June 30, 2007 benefited from the impact of acquisitions when compared to same store performance.

Same store parts and service revenue decreased slightly in the three months ended June 30, 2007 due primarily to a decrease in warranty business, partially offset by increases in customer-paid work for parts and service and wholesale parts sales. Same store parts and service revenue increased during the six months ended June 30, 2007 due to increases in customer-paid work for parts and service and wholesale parts sales, partially offset by a decrease in warranty business. Warranty declines were driven in part by improved quality of vehicles manufactured in recent years, as well as changes to certain manufacturers' warranty and prepaid service programs and lower vehicle sales volume.

Same store parts and service gross profit and gross profit as a percentage of revenue decreased during the three and six months ended June 30, 2007, primarily as a result of the greater percentage of revenue from lower-margin wholesale parts sales.

*Finance and Insurance*

| (\$ in millions, except per vehicle data) | Three Months Ended June 30, |          |   |               | Six Months Ended June 30, |          |   |               |
|---|-----------------------------|----------|---|---------------|---------------------------|----------|---|---------------|
|   | 2007                        | 2006     | Variance<br>Favorable/<br>(Unfavorable) | %<br>Variance | 2007                      | 2006     | Variance<br>Favorable/<br>(Unfavorable) | %<br>Variance |
| <b>Reported:</b>                          |                             |          |   |               |                           |          |   |               |
| Revenue and gross profit                  | \$ 152.3                    | \$ 167.6 | \$ (15.3)                               | (9.1)         | \$ 300.6                  | \$ 316.4 | \$ (15.8)                               | (5.0)         |
| Gross profit per vehicle<br>retailed      | \$ 1,097                    | \$ 1,083 | \$ 14                                   | 1.3           | \$ 1,104                  | \$ 1,062 | \$ 42                                   | 4.0           |
| <b>Same Store:</b>                        |                             |          |   |               |                           |          |   |               |
| Revenue and gross profit                  | \$ 152.7                    | \$ 167.9 | \$ (15.2)                               | (9.1)         | \$ 301.2                  | \$ 316.7 | \$ (15.5)                               | (4.9)         |
| Gross profit per vehicle<br>retailed      | \$ 1,105                    | \$ 1,085 | \$ 20                                   | 1.8           | \$ 1,111                  | \$ 1,063 | \$ 48                                   | 4.5           |

Reported and same store finance and insurance revenue and gross profit decreased during the three and six months ended June 30, 2007, primarily as a result of the adverse impact of lower new and used sales volumes. Reported and same store finance and insurance revenue and gross profit per vehicle retailed benefited from higher new and used vehicle prices and an increase in finance and insurance product sales per customer. Improvements were also driven by our continued emphasis on training and certification of store associates, particularly in third and fourth quartile stores and on maximizing our preferred lender relationships.

## **Operating Expenses**

### *Selling, General and Administrative Expenses*

During the three months ended June 30, 2007, selling, general and administrative expenses decreased \$30.7 million or 5.6%. During the six months ended June 30, 2007, selling, general and administrative expenses decreased \$38.6 million or 3.6%. As a percentage of total gross profit, selling, general and administrative expenses increased to 71.3% for the three months ended June 30, 2007 from 70.2% for the three months ended June 30, 2006. Selling, general and administrative expenses as a percentage of total gross profit increased to 71.4% for the six months ended June 30, 2007 from 70.4% for the six months ended June 30, 2006. These increases are primarily due to a de-leveraging of our cost structure, attributable to the decrease in total vehicle gross profit.

## **Non-Operating Income (Expense)**

### *Floorplan Interest Expense*

Floorplan interest expense was \$33.5 million and \$36.1 million for the three months ended June 30, 2007 and 2006, respectively. Floorplan interest expense was \$66.0 million and \$67.0 million for the six months ended June 30, 2007 and 2006, respectively. The decrease in 2007 compared to 2006 is primarily the result of lower inventory levels, partially offset by higher interest rates.

### *Other Interest Expense*

Other interest expense was incurred primarily on borrowings under our term loan facility, mortgage facility, revolving credit facility and outstanding senior unsecured notes. Other interest expense was \$26.5 million and \$25.2 million for the three months ended June 30, 2007 and 2006, respectively. Other interest expense was \$53.0 million and \$37.2 million for the six months ended June 30, 2007 and 2006, respectively.

The increase in other interest expense in the first six months of 2007 compared to 2006 is primarily due to additional debt incurred in connection with our April 2006 share buyback, which was accretive to earnings per share, partially offset by the repurchase of our 9% senior unsecured notes and repayments of mortgage facilities during 2006.

### *Other Interest Expense - Senior Note Repurchases*

In April 2006, we purchased \$309.4 million aggregate principal of our 9% senior unsecured notes for an aggregate total consideration of \$339.8 million pursuant to our debt tender offer and consent solicitation. Approximately \$34.5 million of tender premium and other financing costs related to our debt tender offer was expensed during the three months ended June 30, 2006.

### *Provision for (Benefit from) Income Taxes*

Our effective income tax rate was 37.3% and 38.4% for the three months ended June 30, 2007 and 2006, respectively, and 36.6% and 39.2% for the six months ended June 30, 2007 and 2006, respectively. Income taxes are provided based upon our anticipated underlying annual blended federal and state income tax rates adjusted, as necessary, for any other tax matters occurring during the period. As we operate in various states, our effective tax rate is also dependent upon our geographic revenue mix.

As of June 30, 2007, the Company had \$74.1 million of unrecognized tax benefits recorded in accordance with Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109, Accounting for Income Taxes ( FIN 48 ). As a result of the high level of uncertainty regarding the timing of cash flows related to these unrecognized benefits, the settlement periods and amounts cannot be determined. See Note 6, Income Taxes of Notes to Unaudited Condensed Consolidated Financial Statements for additional discussion of income taxes, including the adoption of FIN 48.

#### **Financial Condition**

At June 30, 2007, we had \$31.2 million of unrestricted cash and cash equivalents. 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. At June 30, 2007, surety bonds, letters of credit and cash deposits totaled \$121.9 million, including \$91.0 million of letters of credit. We do not currently provide cash collateral for outstanding letters of credit.

In April 2006, we sold \$300.0 million of floating rate senior unsecured notes due April 15, 2013 and \$300.0 million of 7% senior unsecured notes due April 15, 2014, in each case at par. The floating rate senior unsecured notes bear interest at a rate equal to three-month LIBOR plus 2.0% per annum, adjusted quarterly, and may be redeemed by us on or after April 15, 2008 at 103% of principal, on or after April 15, 2009 at 102% of principal, on or after April 15, 2010 at 101% of principal and on or after April 15, 2011 at 100% of principal. The 7% senior unsecured notes may be redeemed by us on or after April 15, 2009 at 105.25% of principal, on or after April 15, 2010 at 103.5% of principal, on or after April 15, 2011 at 101.75% of principal and on or after April 15, 2012 at 100% of principal.

In connection with the issuance of the new senior unsecured notes, we amended our existing credit agreement in April 2006 to provide: (1) a \$675.0 million revolving credit facility that provided for various interest rates on borrowings generally at LIBOR plus .80%, and (2) a \$600.0 million term loan facility that provided for interest at a rate equal to LIBOR plus 1.25%. In December 2006, the borrowing capacity of the revolving credit facility was increased to \$700.0 million under the amended credit agreement. The amended credit agreement, which includes the new term loan facility, was set to terminate on July 14, 2010, and is guaranteed by substantially all of our subsidiaries.

The credit spread charged for the revolving credit facility is impacted by our senior unsecured credit ratings. We have negotiated a 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 totaled \$91.0 million at June 30, 2007.

In April 2006, the proceeds of the new senior unsecured notes and term loan facility, together with cash on hand and borrowings of \$80.0 million under the amended revolving credit facility, were used to: (1) purchase 50 million shares of our common stock at \$23 per share for an aggregate purchase price of \$1.15 billion pursuant to our equity tender offer, (2) purchase \$309.4 million aggregate principal of our 9% senior unsecured notes for an aggregate total consideration of \$339.8 million pursuant to our debt tender offer and consent solicitation, and (3) pay related financing costs. Approximately \$34.5 million of tender premium and other financing costs related to our debt tender offer was expensed during the six months ended June 30, 2006.



In July 2007, we completed a second amendment of the credit agreement. Under the terms of the second amendment, the interest rate on the term loan facility decreased from LIBOR plus 1.25% to LIBOR plus .875% and the interest rate on the revolving credit facility decreased from LIBOR plus .80% to LIBOR plus .725%. The credit spread charged for the revolving credit facility will continue to be based upon our senior unsecured credit ratings. Additionally, the credit agreement termination date was extended to July 2012 and certain other terms and conditions were modified as a result of this amendment.

At June 30, 2007, we also had \$14.1 million of 9% senior unsecured notes due August 1, 2008 at par, which are guaranteed by substantially all of our subsidiaries.

At June 30, 2007, we had \$113.8 million outstanding under a mortgage facility with an automotive manufacturer's captive finance subsidiary. The facility, which utilizes LIBOR-based interest rates, averaged 6.7% and 6.1% for the six months ended June 30, 2007 and 2006, respectively. The mortgage facility is secured by mortgages on certain of our store properties.

During the first six months of 2007, we repurchased 11.0 million shares of our common stock for an aggregate purchase price of \$239.9 million (average purchase price per share of \$21.77). There was approximately \$352.5 million available for share repurchases authorized by our Board of Directors as of June 30, 2007.

Future share repurchases are subject to limitations contained in the indenture relating to our new senior unsecured notes. While we expect to continue repurchasing shares in the future, the decision to make additional share repurchases will be based on such factors as the market price of our common stock, the potential impact on our capital structure and the expected return on competing uses of capital such as strategic store acquisitions and capital investments in our current businesses.

At June 30, 2007 and December 31, 2006, vehicle floorplan payable-trade totaled \$1.6 billion and \$2.0 billion, respectively. Vehicle floorplan payable-trade reflects amounts borrowed to finance the purchase of specific vehicle inventories with manufacturers' captive finance subsidiaries. Vehicle floorplan payable-non-trade totaled \$456.0 million and \$228.9 million, at June 30, 2007 and December 31, 2006, respectively, and represents amounts payable borrowed to finance the purchase of specific vehicle inventories with non-trade lenders. Our floorplan facilities are at LIBOR-based rates of interest. Floorplan facilities are used to finance new vehicle inventories and the amounts outstanding thereunder are due on demand, but are generally paid within several business days after the related vehicles are sold. Floorplan facilities are primarily collateralized by new vehicle inventories and related receivables. Our manufacturer agreements generally require the manufacturer to have the ability to draft against the floorplan facilities so the floorplan lender directly funds the manufacturer for the purchase of inventory. The floorplan facilities contain certain operational covenants. At June 30, 2007, we were in compliance with such covenants in all material respects. At June 30, 2007, aggregate capacity under the floorplan credit facilities to finance new vehicles was approximately \$3.6 billion, of which \$2.1 billion total was outstanding.

#### **Cash Flows**

Cash and cash equivalents decreased by \$21.4 million during the six months ended June 30, 2007 and decreased by \$209.2 million during the six months ended June 30, 2006. The major components of these changes are discussed below.

**Cash Flows Operating Activities**

Cash provided by (used in) operating activities was \$(29.7) million and \$153.1 million during the six months ended June 30, 2007 and 2006, respectively.

Cash flows from operating activities include net income adjusted for non-cash items and the effects of changes in working capital including changes in vehicle floorplan payable-trade (vehicle floorplan payables with the automotive manufacturers captive finance subsidiary for the related franchise), which directly relates to changes in new vehicle inventory for those franchises. On November 30, 2006, General Motors ( GM ) completed the sale of a majority stake in General Motors Acceptance Corporation ( GMAC ), which was GM s wholly-owned captive finance subsidiary prior to this transaction. GMAC will remain the exclusive provider of GM-sponsored auto finance programs and is expected to continue to provide GM dealers and their customers with the same financial products and services which were in place with us before the sale. However, as a result of this sale, we have treated new vehicles financed after this change in GMAC ownership control (totaling \$389.0 million and \$134.3 million at June 30, 2007 and December 31, 2006, respectively) as vehicle floorplan non-trade, with related changes as financing cash flows. Vehicles financed by GMAC prior to this transaction (totaling \$35.0 million at June 30, 2007) continue to be classified as floorplan-trade with related changes as operating cash flows.

In February 2006, we made estimated state tax and federal tax payments totaling approximately \$100 million, primarily related to provisions for the third and fourth quarter of 2005, payment for which had been deferred as allowed for filers impacted by hurricanes in 2005.

**Cash Flows Investing Activities**

Cash flows from investing activities consist primarily of cash used in capital additions, activity from business acquisitions, property dispositions, purchases and sales of investments and other transactions as further described below.

Capital expenditures were \$79.2 million and \$48.9 million during the six months ended June 30, 2007 and 2006, respectively. We project that 2007 full year capital expenditures will be approximately \$140.0 million, excluding acquisition related spending, lease buyouts, and land purchases for future sites.

Total cash used in business acquisitions, net of cash acquired, was \$.8 million and \$67.2 million for the six months ended June 30, 2007 and 2006, respectively, when we acquired one automotive retail franchise and related assets in each period. Additionally, during the six months ended June 30, 2006, we paid \$.2 million in cash for the deferred purchase price for certain prior year automotive retail acquisitions.

**Cash Flows Financing Activities**

Cash flows from financing activities primarily include treasury stock purchases, stock option exercises, debt activity and changes in vehicle floorplan payable-non-trade.

We repurchased 11.0 million shares of our common stock for an aggregate purchase price of \$239.9 million during the six months ended June 30, 2007 (average purchase price per share of \$21.77). There was approximately \$352.5 million available for share repurchases authorized by the Company s Board of Directors as of June 30, 2007. Future share repurchases are subject to limitations contained in the indenture relating to the Company s senior unsecured notes.

During the six months ended June 30, 2007 and 2006, proceeds from the exercise of stock options were \$88.6 million (average per share of \$14.31) and \$51.6 million (average per share of \$13.41), respectively.

In April 2006, we sold \$300.0 million of floating rate senior unsecured notes due April 15, 2013 and \$300.0 million of 7% senior unsecured notes due April 15, 2014, in each case at par. In connection with the issuance of the new senior unsecured notes, we amended our existing credit agreement to provide: (1) a \$675 million revolving credit facility and (2) a \$600.0 million term loan. In December 2006, the borrowing capacity of the revolving credit facility was increased to \$700.0 million under the amended credit agreement.

The proceeds of the new senior unsecured notes and term loan borrowings, together with cash on hand and borrowings of \$80.0 million under the amended revolving credit facility, were used to: (1) purchase 50 million shares of our common stock at \$23 per share for an aggregate purchase price of \$1.15 billion pursuant to our equity tender offer, (2) purchase \$309.4 million aggregate principal of our 9% senior unsecured notes for aggregate total consideration of \$339.8 million (\$334.2 million of principal and tender premium and \$5.6 million of accrued interest) pursuant to our debt tender offer and consent solicitation, and (3) pay related financing costs. Approximately \$34.5 million of tender premium (\$24.8 million) and other debt financing costs (\$9.7 million) related to our debt tender offer was expensed during the three months ended June 30, 2006. During the six months ended June 30, 2006, we repurchased 3.1 million additional shares of our common stock for a purchase price of \$67.0 million.

During the six months ended June 30, 2007, we borrowed \$436 million and repaid \$475 million outstanding under our revolving credit facility, for net repayments of \$39 million. During the six months ended June 30, 2007 and 2006, we also repaid \$2.2 million and \$2.8 million, respectively, of amounts outstanding under our mortgage facilities.

Cash flows from financing activities include changes in vehicle floorplan payable-non-trade (vehicle floorplan payables with lenders other than the automotive manufacturers captive finance subsidiaries for that franchise) totaling \$227.0 million and \$(34.1) million for the six months ended June 30, 2007 and 2006, respectively. A portion of the change in vehicle floorplan payable-non-trade in the six months ended June 30, 2007 relates to the reclassification of GMAC-financed vehicles from floorplan-trade to floorplan-non-trade, as a result of GM's sale of a majority stake in GMAC, effective November 30, 2006, as described above and in Note 3 to the Notes to the Unaudited Condensed Consolidated Financial Statements.

### **Liquidity**

We believe that our funds generated through future operations and availability of borrowings under our secured floorplan facilities (for new vehicles) and revolving credit facility will be sufficient to service our debt and fund our working capital requirements, pay our tax obligations, commitments and contingencies and meet any seasonal operating requirements for the foreseeable future. We expect to remain in compliance with covenants of our various financing agreements. At June 30, 2007, unused availability under our revolving credit facility totaled \$453.0 million.

We have not declared or paid any cash dividends on our common stock during our three most recent fiscal years. We do not anticipate paying cash dividends in the foreseeable future. The indenture for our new senior unsecured notes restricts our ability to declare cash dividends.

### **Seasonality**

Our operations generally experience higher volumes of vehicle sales and service in the second and third quarters of each year due in part to consumer buying trends and the introduction of new vehicle models. Also, demand for vehicles and light trucks is generally lower during the winter months than in other seasons, particularly in regions of the United States where stores may be subject to adverse winter conditions. Accordingly, we expect our revenue and operating results to be generally lower in the first and fourth quarters as compared to the second and third quarters. However, revenue may be impacted significantly from quarter to quarter by actual or threatened severe weather events, and by other factors unrelated to weather conditions, such as changing economic conditions and automotive manufacturer incentive programs.

### **New Accounting Pronouncements**

See Notes 1 and 6 of the Notes to Unaudited Condensed Consolidated Financial Statements.

### **Forward-Looking Statements**

Our business, financial condition, results of operations, cash flows and prospects, and the prevailing market price and performance of our common stock, may be adversely affected by a number of factors, including the matters discussed below. Certain statements and information set forth herein in this Form 10-Q, as well as other written or oral statements made from time to time by us or our authorized executive officers on our behalf, constitute

forward-looking statements within the meaning of the Federal Private Securities Litigation Reform Act of 1995. We intend for our forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we set forth this statement and these risk factors in order to comply with such safe harbor provisions. It should be noted that our forward-looking statements speak only as of the date of this Form 10-Q or when made and we undertake no duty or obligation to update or revise our forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that the expectations, plans, intentions and projections reflected in our forward-looking statements are reasonable, such statements are subject to known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. The risks, uncertainties and other factors that our shareholders and prospective investors should consider include, but are not limited to, the following:

We are dependent upon the success and continued financial viability of the vehicle manufacturers and distributors with which we hold franchises.

The automotive retailing industry is sensitive to changing economic conditions and various other factors. Our business and results of operations are substantially dependent on new vehicle sales levels in the United States and in our particular geographic markets and the level of gross profit margins that we can achieve on our sales of new vehicles, all of which are very difficult to predict.

Our new vehicle sales are impacted by the consumer incentive and marketing programs of vehicle manufacturers.

Natural disasters and adverse weather events can disrupt our business.

We are subject to restrictions imposed by, and significant influence from, vehicle manufacturers that may adversely impact our business, financial condition, results of operations, cash flows and prospects, including our ability to acquire additional stores.

We are subject to numerous legal and administrative proceedings, which, if the outcomes are adverse to us, could materially adversely affect our business, results of operations, financial condition, cash flows and prospects.

Our operations, including, without limitation, our sales of finance and insurance and vehicle protection products, are subject to extensive governmental laws, regulation and scrutiny. If we are found to be in violation of, or subject to liabilities under, any of these laws or regulations, or if new laws or regulations are enacted that adversely affect our operations, our business, operating results and prospects could suffer.

Our ability to grow our business may be limited by our ability to acquire automotive stores on favorable terms or at all.

We are subject to interest rate risk in connection with our floorplan notes payable, revolving credit facility, term loan facility, mortgage facility and floating rate senior unsecured notes that could have a material adverse effect on our profitability.

Our revolving credit facility, term loan facility, mortgage facility and the indenture relating to our new senior unsecured notes contain certain restrictions on our ability to conduct our business.

Our substantial indebtedness could adversely affect our financial conditions and operations and prevent us from fulfilling our debt service obligations. We may still be able to incur more debt, intensifying these risks.

Goodwill and other intangible assets comprise a significant portion of our total assets. We must test our intangible assets for impairment at least annually, which may result in a material, non-cash write-down of goodwill or franchise rights and could have a material adverse impact on our results of operations and shareholders' equity.

Please refer to our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, and to our subsequent filings with the SEC for additional discussion of the foregoing risk factors.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our primary market risk exposure is changing LIBOR-based interest rates. At June 30, 2007 and December 31, 2006, fixed rate debt, primarily consisting of amounts outstanding under senior unsecured notes, totaled \$358.8 million and \$360.5 million, respectively, and had a fair value of \$355.5 million and \$363.4 million, respectively. Interest rate derivatives may be used to hedge a portion of our variable rate debt when appropriate based on market conditions.

**Interest Rate Risk**

At June 30, 2007 and December 31, 2006, we had total variable rate vehicle floorplan payable totaling \$2.1 billion and \$2.2 billion, respectively. Based on these amounts at June 30, 2007 and December 31, 2006, a 100 basis point change in interest rates would result in an approximate \$21.0 million and \$22.3 million, respectively, change to our annual floorplan interest expense. Our exposure to changes in interest rates with respect to vehicle floorplan payable is partially mitigated by manufacturers' floorplan assistance, which in some cases is based on variable interest rates.

At both June 30, 2007 and December 31, 2006, we had other variable rate debt outstanding totaling \$1.2 billion. Based on the amounts outstanding at June 30, 2007 and December 31, 2006, a 100 basis point change in interest rates would result in an approximate \$11.7 million and \$12.1 million, respectively, change to interest expense.

Reference is made to our quantitative disclosures about market risk in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**ITEM 4. CONTROLS AND PROCEDURES**

We evaluated, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report.

There was no change in our internal control over financial reporting during our last fiscal quarter identified in connection with the evaluation referred to above that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

We continue to centralize certain key store-level accounting and administrative activities in our operating regions, which we expect will streamline our internal control over financial reporting. The initial or core phase consists of implementing a standard data processing platform in the stores and centralizing in a shared services center certain key accounting processes (non-inventory accounts payable, bank account reconciliations and certain accounts receivable). We have substantially implemented the core phase in 161 of our 249 stores as of June 30, 2007.

**PART II. OTHER INFORMATION****ITEM 1A. RISK FACTORS**

There were no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The table below sets forth information with respect to shares of common stock repurchased by AutoNation, Inc. during the three months ended June 30, 2007. See Note 7 of our Notes to Unaudited Condensed Consolidated Financial Statements for additional information regarding our stock repurchase programs.

| <b>Period</b>                      | <b>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>Avg.<br/>Price<br/>Paid Per<br/>Share</b> | <b>Total Number<br/>of Shares<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced<br/>Programs</b> | <b>Maximum Dollar<br/>Value of Shares That<br/>May Yet Be<br/>Purchased<br/>Under The<br/>Programs<br/>(in millions)<sup>(1)(2)</sup></b> |
|------------------------------------|---|--|--|---|
| April 1, 2007 to<br>April 30, 2007 | 100,000   | \$20.61                                      | 100,000  | \$ 540.0  |
| May 1, 2007 to<br>May 31, 2007     | 5,165,000   | \$21.23                                      | 5,165,000  | \$ 430.4  |
| June 1, 2007 to<br>June 30, 2007   | 3,458,600   | \$22.53                                      | 3,458,600  | \$ 352.5  |
|                                    | 8,723,600   |  | 8,723,600  |   |

(1) Future share repurchases are subject to limitations contained in the indenture for the Company's senior unsecured notes.

(2) Shares are repurchased under our stock repurchase program approved by the Company's Board of Directors, which



in June 2006  
authorized the  
Company to  
repurchase up to  
\$250.0 million  
of shares.

During the  
quarter ended  
June 30, 2007,  
the repurchases  
under this  
program were  
completed. In  
April 2007, the  
Company's  
Board of  
Directors  
authorized an  
additional  
\$500.0 million  
share repurchase  
program, which  
does not have an  
expiration date.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

At the Company's annual meeting of shareholders held on May 9, 2007, the shareholders of the Company voted on the following matters:

1. The election of eight directors, each for a term expiring at the next Annual Meeting or until their successors are duly elected and qualified.
2. The ratification of the appointment of KPMG LLP as our independent registered public accounting firm for 2007.
3. The adoption of the AutoNation, Inc. 2007 Non-Employee Director Stock Option Plan.
4. The adoption of the AutoNation, Inc. Senior Executive Incentive Bonus Plan.
5. The adoption of a stockholder proposal asking our Board of Directors to amend AutoNation's bylaws to provide holders of at least 10% of our outstanding common stock the right to call a special meeting.

All of the director nominees were elected based on the following votes:

| <b>Director Nominee</b> | <b>Votes Cast For</b> | <b>Votes Withheld</b> |
|-------------------------|-----------------------|-----------------------|
| Robert J. Brown         | 195,559,659           | 1,773,268             |
| Rick L. Burdick         | 188,076,169           | 9,256,758             |
| William C. Crowley      | 189,400,001           | 7,932,926             |
| Kim C. Goodman          | 196,375,542           | 957,385               |
| Robert R. Grusky        | 196,374,675           | 958,252               |
| Mike Jackson            | 194,072,066           | 3,260,861             |
| Michael E. Maroone      | 195,054,125           | 2,278,802             |
| Carlos A. Migoya        | 196,374,676           | 958,251               |

The appointment of KPMG LLP as the Company's independent registered public accounting firm for 2007 was ratified based on the following votes:

| <b>Votes Cast For</b> | <b>Votes Cast Against</b> | <b>Votes Abstained</b> |
|-----------------------|---------------------------|------------------------|
| 195,301,172           | 1,320,801                 | 710,954                |

The adoption of the AutoNation, Inc. 2007 Non-Employee Director Stock Option Plan was approved based on the following votes:

| <b>Votes Cast For</b> | <b>Votes Cast Against</b> | <b>Votes Abstained</b> |
|-----------------------|---------------------------|------------------------|
| 156,415,126           | 17,053,866                | 889,369                |

The adoption of the AutoNation, Inc. Senior Executive Bonus Plan was approved based on the following votes:

| <b>Votes Cast For</b> | <b>Votes Cast Against</b> | <b>Votes Abstained</b> |
|-----------------------|---------------------------|------------------------|
| 191,075,637           | 5,393,278                 | 864,012                |

The adoption of the stockholder proposal asking our Board of Directors to amend AutoNation's bylaws to provide holders of at least 10% of our outstanding common stock the right to call a special meeting was not approved based on the following votes:

| <b>Votes Cast For</b> | <b>Votes Cast Against</b> | <b>Votes Abstained</b> | <b>Broker Non-Votes</b> |
|-----------------------|---------------------------|------------------------|-------------------------|
| 57,921,195            | 115,497,195               | 939,971                | 22,974,566              |

**ITEM 6. EXHIBITS**

(a) Exhibits:

- 10.1 AutoNation, Inc. 2007 Non-Employee Director Stock Option Plan (adopted by AutoNation's Board of Directors on February 5, 2007 and stockholders on May 9, 2007) (incorporated by reference to Exhibit 10.17 of AutoNation's Annual Report on Form 10-K for the year ended December 31, 2006 filed on February 27, 2007)
  - 10.2 AutoNation, Inc. 2007 Senior Executive Bonus Plan (adopted by AutoNation's Board of Directors on February 5, 2007 and stockholders on May 9, 2007) (incorporated by reference to Exhibit 10.18 of AutoNation's Annual Report on Form 10-K for the year ended December 31, 2006 filed on February 27, 2007)
  - 31.1 Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer
  - 31.2 Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer
  - 32.1 Section 1350 Certification of Principal Executive Officer
  - 32.2 Section 1350 Certification of Principal Financial Officer
- Exhibits 10.1 and 10.2 are management contracts or compensatory plans, contracts or arrangements.

**SIGNATURE**

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

AUTONATION, INC.

By: /s/ Michael J. Stephan  
Michael J. Stephan  
Vice President Corporate Controller

(DULY AUTHORIZED OFFICER  
AND PRINCIPAL ACCOUNTING  
OFFICER)

Date: July 26, 2007