This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
✓ **Accounting**: Quality of Earnings Issues
Governance: Corporate Governance Issues
✓ **Fundamentals:** Analysis of fundamentals
Deception: Deception detection analysis

The Champion of "Cash for Clunkers" Dumps Shares AutoNation Inc. (NYSE:AN)

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Contact: Bob Gabele (954) 779-3974 or bgabele@3DAdvisors.com

Business Description

AutoNation Inc., through its subsidiaries, operates as an automotive retailer in the United States. It offers various automotive products and services, including new vehicles, used vehicles, parts and automotive services, and automotive finance and insurance products, as well as provides a range of vehicle maintenance, repair, paint, and collision repair services, including warranty work. As of July 31, 2009, AutoNation owned and operated 264 new vehicle franchises from 210 stores located in major metropolitan markets, primarily in the Sunbelt region of the United States. The Company was founded in 1991 and is headquartered in Fort Lauderdale, Florida.

Key Statistics

Sector:	Last Close:	Market Cap:	Avg Vol (3m):
Services	**$18.30**	**$3.26B**	**2,996,530**
Industry:	52 Wk Range:	Trailing P/E:	Shrs Out:
Auto Dealerships	**$3.97-$21.33**	**N/A**	**178.02M**
F/T Employees:	FYE:	Forward P/E:	Short % of Float:
20,000	**31-Dec**	**14.10**	**11.50%**

Summary of 3DAdvisors Findings for AN

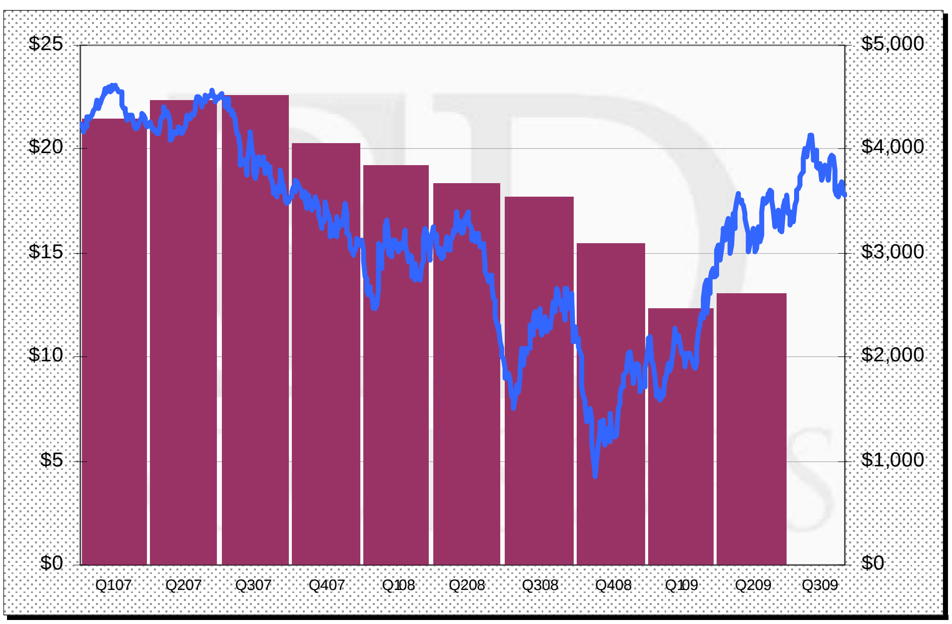
- **Fundamentals:** Revenue and gross margin have been deteriorating since 3Q07
- **Fundamentals:** Revenue growth has lagged peers due to location of stores
- **Fundamentals:** Reports of a "Clunkers hangover" grow here and abroad
- **Insider Trading:** CEO, ever present in the media hyping recovery, dumps shares
- **Accounting:** Big debt and declining sales force focus on covenants, use of cash
- **Accounting:** SEC industry scrutiny leads to write off of goodwill; more coming?

Discussion of 3DAdvisors Findings for AN

In the immediate wake of the $2.9 billion "Cash for Clunkers" program and in the midst of an unsteady but persistent rally in equities, AutoNation Inc. (NYSE:AN) CEO **Michael Jackson** was busy once again adding to the media fixation on Clunkers, sounding ever more confident that the "worst was over" and that a recovery for the auto industry was at hand. In an interview he gave on 09/02/09 on CNBC, Jackson proclaimed Cash for Clunkers as "one of the most successful stimulus programs off all time", that it was the necessary "shot in the arm" the industry needed, and that "we are on our way to a gradual recovery". When asked if he was concerned that the program may have simply brought forward sales that would have taken place anyway, he denied that was the case. He said that the buyers under the program were "very smart and sophisticated consumers" who had been waiting for the program to be put in place since late last year and as a result it would have no impact on future sales.

This was not the first time Mr. Jackson has acted as cheerleader. And his hyping of Clunkers and an industry recovery in the media certainly contributed to the rally in AutoNation shares which broke above $20 a share for the first time since July 2007 just as the frenzy over the program was heating up in late July and early August. But what caught our attention was the fact that despite his publicly professed enthusiasm in the media, Jackson chose to sell off approximately 50% of his actionable holdings between April and August, by far his largest holdings reduction from sales taking place within a relatively short time frame. Also selling aggressively during this period was President and COO **Michael Maroone**, and to a lesser degree General Counsel **Jonathan Ferrando**, who is also a named executive officer, and Director **Rick Burdick**.

Figure 1. AN Daily Stock Price, 01/03/07 through 09/14/09 (Blue Line and Left Scale) and Quarterly Total Revenue (Red Bars and Right Scale). Source: AN SEC Filings.



As we began looking in to AutoNation further as a result of this disconnect between management's words and actions, we quickly realized that the shares, which are up over 300% from the 52-week low of $3.97 reached in October of last year, had really outrun any concrete evidence of substantial improvement in its financial performance (see Figure 1 above) in a fashion not dissimilar to many retail stocks in the current and ongoing rally in equities. But what is more interesting is the fact that the Company's revenues and gross margins had begun to deteriorate in the 3Q07, nearly a year before auto sales hit the skids nationally, and the Company's sales growth throughout this period significantly trailed that of its publicly traded peers.

As it turns out, AutoNation likely felt the effects of the recession earlier and more deeply than its peers because it is geographically more concentrated in areas of the country where the collapse of the housing market hurt the most, hitting employment and consumer spending on autos the hardest. Nearly half of the 264 franchises it operated as of 06/30/09 were located in Florida, California and Nevada, where unemployment averaged 11.7% in July, versus the national rate of 9.4%. State level data is not yet available, but the national rate jumped to 9.7% in August and is still not expected to peak until sometime late this year or early next year at over 10%.

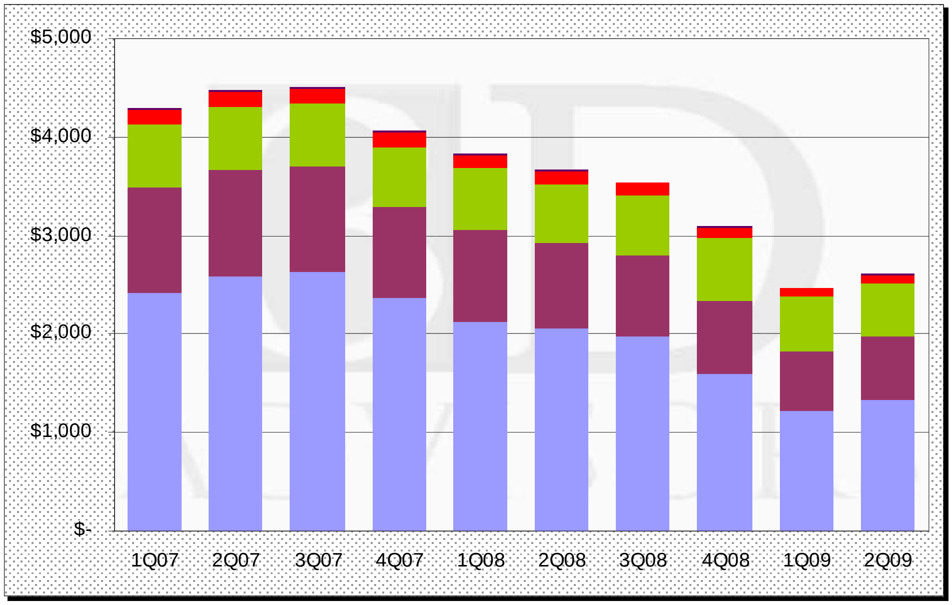
To its credit, the Company appears to have done a good job managing the consolidation forced on it by the bankruptcies of Chrysler and GM, reducing inventories and shedding $200 million of costs, all of which have allowed it stay in the black through the worst of the industry downturn. It has even managed to find enough cash to pay down debt to remain in compliance with various covenants. But real questions remain about the near-term sales outlook and if a significant and sustainable recovery is really around the corner, especially since more recent information suggests that Cash for Clunkers may have in fact impacted future sales. And then there is the question of whether or not the Company will continue to trail its peers given its geographic exposure to areas hardest hit by the recession. On these final points, it's not too hard for us to argue that Mr. Jackson has voted with his feet, despite his gushing about Clunkers.

We begin with an overview of sales and gross margin trends for the Company, followed by a discussion of its sales growth underperformance as a result of the geographic concentration of its stores in areas most impacted by the recession.

<u>Fundamentals: Revenue and gross margin have been deteriorating since 3Q07</u>

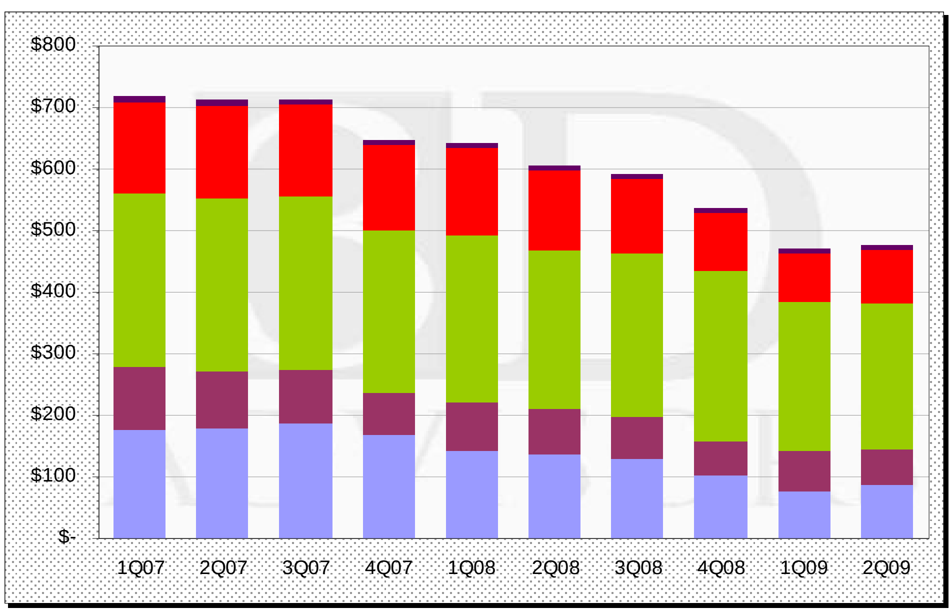
The first thing that struck us as we began looking more closely at simple measures of growth and financial performance was that AutoNation seems to have been in a fairly steady decline since the 3Q07, nearly a year before things really got ugly for the rest of the retail auto business. The downward trend in total revenue from the 3Q07 is pronounced, as shown in Figure 2 below, which shows the four major components of revenue including new vehicles (blue), used vehicles (plum), parts and service (green) and finance and insurance (red). The steepest decline, as one might expect, has been in new vehicle revenue, which declined from $2.634 billion in the 3Q07 to $1.339 billion in the 2Q09, a drop of 49%. The other components of total revenue have declined significantly as well, but not as steeply, with total revenue falling from $4.513 billion to $2.610 billion, a 42% contraction over the eight quarter period. In the 3Q07 new vehicle revenue accounted for 58% of total revenue, and by the 2Q09, new vehicles were 51% of the total picture. Again, the thing that obviously sticks out is that the AutoNation top line has been trending down for two years, a much longer period of contraction than the auto business overall. Though there was a sequential uptick of 5.5% in total revenue in the 2Q09, it was still off nearly 30% from the year ago period.

Figure 2. AN Quarterly Total Revenue, Millions of $, by Major Category. New Vehicles, Blue; Used Vehicles, Plum; Parts and Service, Green; Finance and Insurance, Red. Source: AN SEC Filings.



Considering a similar presentation by category for gross margin, there are few surprises but there are a couple of points worth mentioning in looking at the data in Figure 3 below. As would be expected given the decline in revenue for new and used vehicles, gross margin from vehicle sales has shrunk correspondingly, but what sticks out is the growing extent to which parts and service and finance and insurance contribute to the total gross margin picture.

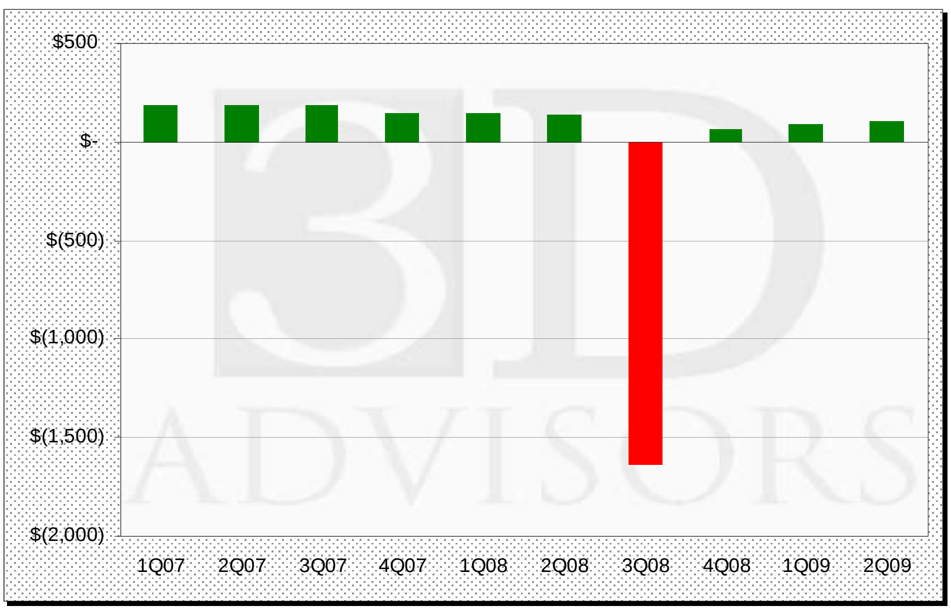
Figure 3. AN Quarterly Gross Margin, Millions of $, by Major Category. New Vehicles, Blue; Used Vehicles, Plum; Parts and Service, Green; Finance and Insurance, Red. Source: AN SEC Filings.



In the 3Q07, gross margin for parts and service and finance and insurance together accounted for about 60% of total gross margin; by the 2Q09 their share had grown to 68% of total gross margin. Gross margin from parts and service and finance and insurance have, over the last two consecutive quarters, each exceeded the gross margin from new vehicle sales for the first time. Though not necessarily a surprise since customers need to spend more on parts and service the longer they put off new vehicle purchases, you have to sell a car before you can service it, and so ongoing weak sales will likely put pressure on the Company's ability to maintain parts and service profits.

Despite a two-year long decline in total revenue and gross margin, the Company has for the most part been able to maintain a meager level of operating income as shown in Figure 4 below, largely as a result of aggressively cutting costs by $200 million. The large negative number shown in the 3Q08 reflects a $1.61 billion write down of goodwill assets associated with dealership acquisitions that were deemed impaired as revenue and gross margin continued to trend downward in the quarter, especially at stores selling domestic vehicles that were hit especially hard by $4 gasoline since they relied heavily on truck and SUV sales (more on these impairment charges below and whether or not more are likely in the future).

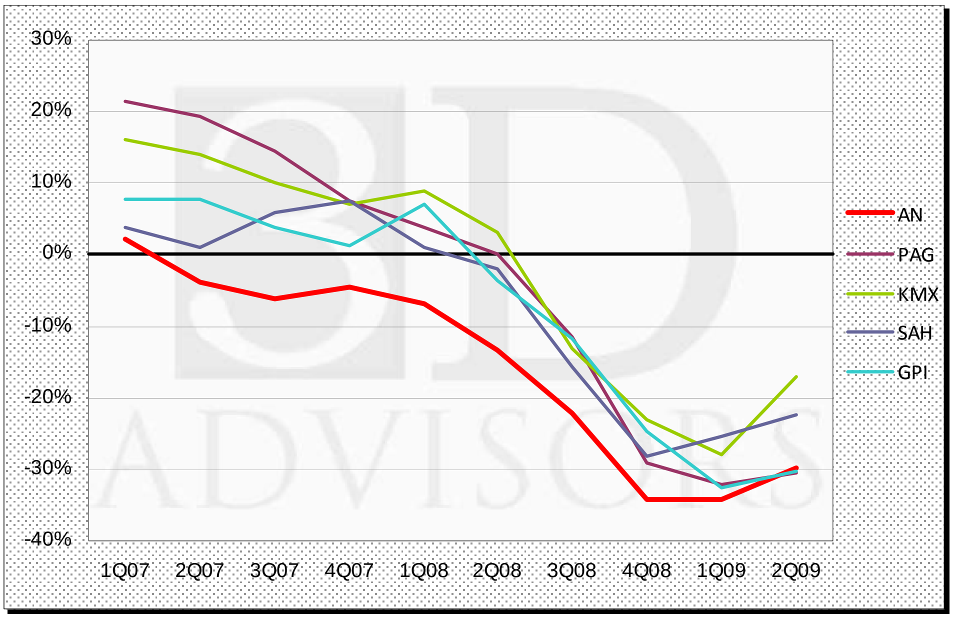
Figure 4. AN Operating Income, Millions of $. Source: AN SEC Filings.



Fundamentals: Revenue growth has lagged peers due to location of stores

As mentioned above, we were immediately struck by the fact that revenue and gross margin had begun deteriorating in the 3Q07, long before analysts were talking about a significant recession and nearly a year before auto sales nationally fell into the abyss. In looking at sales growth over this period for the Company and its publicly traded peers, it was very evident that AutoNation had in fact significantly underperformed as shown in Figure 5 below. The peers include Penske Automotive Group Inc. (NYSE:PAG), CarMax Inc. (NYSE:KMX), Sonic Automotive Inc. (NYSE:SAH) and Group 1 Automotive Inc. (NYSE:GPI).

Figure 5. Quarterly Year-Over-Year Percentage Growth in Total Revenue for AN and Industry Peers. Source: Respective Company SEC Filings.



As early as 2Q07, AN began showing declines in year-over-year sales growth while the peer group, though showing slower growth, managed to keep positive growth going until at least 1Q08 and even the 2Q08. Once sales growth started to decline sharply for everyone in the group in the 3Q08, the AutoNation rate of decline was significantly greater than the peers.

The explanation for this underperformance is found in the location of the Company's stores compared to its peers. AutoNation describes its stores as "being located primarily in Sunbelt states" and provides few additional details on store location in its filings, but a simple check of the corporate website reveals that the actual locations of its various franchises are concentrated in those states that have been hit hardest by the meltdown of the real estate market and subsequent recession, causing unemployment in those states to be higher than the national average. The table below shows that of the 277 franchise locations on the Company's web site[1], 135 or nearly half are in Florida, California and Nevada, where the unemployment rate averaged 11.7% in July, versus a national rate of 9.4%. About 60% of the franchises are located in states where the unemployment rate in July was significantly higher than the national average. The additional states besides Florida, California and Nevada are Tennessee (10 franchises, 10.7% unemployment), Georgia (8, 10.3%), Illinois (7, 10.4%), Ohio (4, 11.2%), and Alabama (2, 10.2%).

[1] The corporate website lists 277 franchise locations, but in the 2Q09 conference call it was disclosed there are 246 franchises. The website shows franchises that are no longer included in continuing operations and are in the process of being either closed or sold.

Franchise Location	Number of Franchises	State Unemployment Rate[2]
Florida	65	10.7%
California	52	11.9%
Texas	46	7.9%
Colorado	25	7.8%
Nevada	18	12.5%
Washington	16	9.1%
Arizona	14	9.2%
Tennessee	10	10.7%
Georgia	8	10.3%
Illinois	7	10.4%
Maryland	6	7.3%
Ohio	4	11.2%
Virginia	3	6.9%
Alabama	2	10.2%
Minnesota	1	8.1%
Total	277	

In contrast to the 49% concentration that the Company has in Florida, California and Nevada, the peer group has significantly less of its business in these same states: PAG 23%; KMX 25%; SAH 33%; GPI 16%. With so many of its franchises in these hard hit states, it is clear to us why AutoNation revenue growth suffered earlier and more deeply than its peers. This also begs the question as to whether or not AutoNation will experience a slower recovery as the economy improves and car sales begin to pick up nationally. It also reminds us that the assertion by CEO Jackson that the Clunkers program will not impact future sales is particularly important in the case of AutoNation as it seeks new sales in coming months in states still suffering the effects of higher unemployment.

Fundamentals: Reports of a "Clunker hangover" grow both here and abroad

In his last CNBC interview, Mr. Jackson maintained that the Clunkers program did not "pull forward" future sales, but rather "clawed back" sales that had been put off by "smart and sophisticated consumers" who had been waiting eight months for the program to start, and so future sales would not be impacted at all. He then gushed that the program has prompted AutoNation and its peers to place huge increases (50% for

[2] Preliminary state level data for July 2009 from the U.S. Department of Commerce, Bureau of Labor Statistics. See http://www.bls.gov/lau/ for more information.

AN) in their forward factory orders for new vehicles, which is exactly what the government intended to happen. Of course he did not mention the fact that inventories industry wide were at record low levels, and that the bump in sales created by Clunkers left some dealers with little or no product to sell in coming months. But that little detail would not have left the impression he was trying to leave with viewers.

Despite Mr. Jackson's assertions, there seems to be growing evidence that a Clunkers "hangover" is developing in the wake of the program, and dealers are beginning to worry that sales in coming months will pay the price. In an article that appeared in *The Wall Street Journal* on 09/01/09[3], it was reported that estimates of the seasonally adjusted annual rate of new car sales, or SAAR, had dropped down to 8 million units the final week of August just after the program ended, and the article quoted a sell-side analyst as saying he expected sales for the remainder of the year to drop well below the level reached in August. In a more recent article published in *Edmund's AutoObserver* on 09/16/09[4], the author states that the Clunkers program did what it was supposed to by generating a surge in auto sales, "But now automakers, unsure of how much buy-ahead Cash for Clunkers stole, could face the lowest annualized sales rate of the year when they post September sales." Edmunds.com now forecasts a SAAR of sales of under 9.5 million in September, possibly the lowest of the year.

In Europe, where programs similar to Clunkers, called "scrappage" programs, have been in place for some time, a similar pattern seems to be developing. This is especially true in Germany, where the government has spent $7.1 billion on its plan since mid-January, which resulted in the sale of 2 million vehicles. In the same Edmond's article mentioned above, the author refers to Germany as the "poster child for severe hangover", and that the successful program, which ended on 09/02/09, has led some analysts to estimate that year-over-year sales could decline by 60% or more for the remainder of the year.

As we suggested above, the point here is that if the Clunker program was successful for AutoNation at the expense of sales in future months, they could suffer more than most retailers because it is already dealing with economic conditions significantly worse than most car dealers.

Insider Trading: CEO, ever present in the media hyping recovery, dumps shares

In a pattern similar to many stocks we have looked at during the current rally in equities, the pace of insider selling at AutoNation picked up substantially in the first half of the year as the shares have rallied impressively along with the rest of the market, even though there is scant evidence of any actual improvement in the Company's financial performance or fundamentals. Upon closely scrutiny, however, we began to appreciate that the AutoNation trading profile was in fact much more unique when viewed in the context of historical trading patterns. What follows is a detailed analysis of what some might consider subtle changes in the trading behavior of key insiders.

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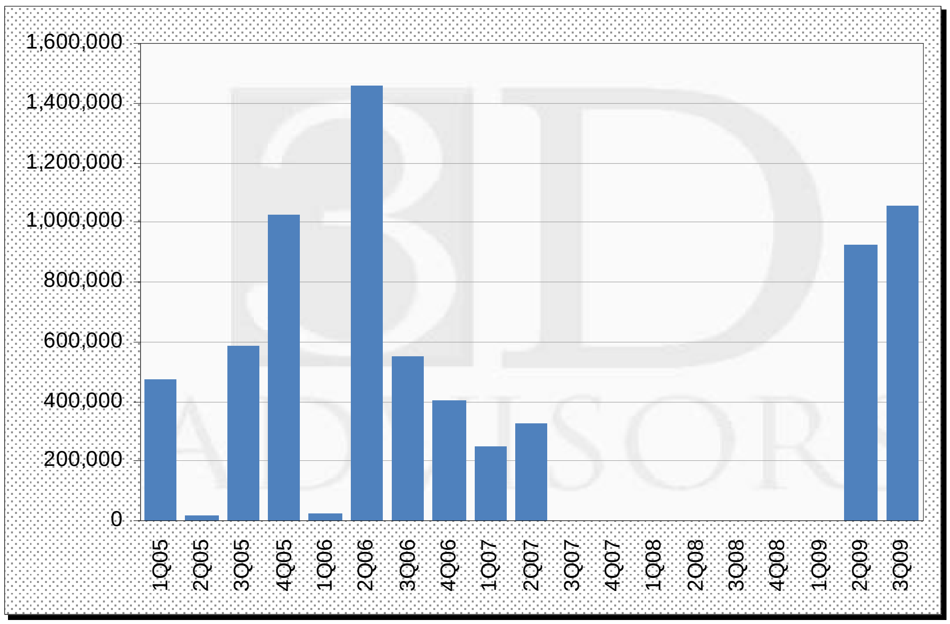
[3] Rappaport, Liz, "Next for Auto Sector, Post-Clunker Hangover", *The Wall Street Journal*, September 1, 2009, page C1.
[4] Krebs, Michelle, "Fearing Clunker Hangover, Europeans Plead for Renewed Scrappage Plans", *Edmund's AutoObserver*, September 16, 2009.

Though the analysis may seem tedious at times, we think the changes in behavior are in fact quite significant and should not be ignored by investors.

Prior to the middle of 2007 when the shares regularly traded above $20, insiders routinely took profits. But when revenue growth dipped into negative territory by the middle of the year and the shares slid below $20 in July, insiders ceased selling altogether and there was virtually no activity for 22 months, the longest such stretch of inactivity in Company history. The lull in trading ended in April of this year, when insiders surfaced after the release of 1Q09 earnings, but for the first time they were pulling the trigger before the shares returned to the $20 price level which for years appeared to be their minimum exit point.

Figure 6. AN Quarterly Insider Selling Volume. Source: AN SEC Filings.

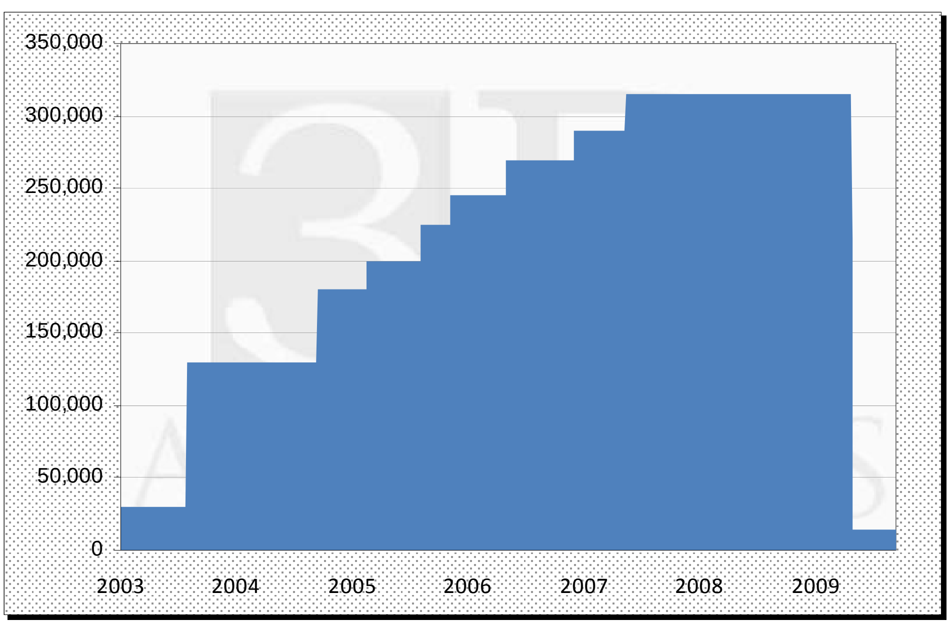


On April 23rd AutoNation shares traded 10% higher when the Company posted better-than-expected sales and earnings for the 1Q09. Chairman and Chief Executive Michael Jackson talked up the shares, saying his outlook for the auto industry was that the first quarter would prove to be the bottom of the "difficult period" and he was quite optimistic sales would pick up in the second half of the year. But those upbeat comments seemed hollow to us when over the next few days Jackson, along with President, COO and Director Michael Maroone would together sell almost 1 million shares at an average price of $17. You have to go back to April and May of 2006 to find the last time Jackson and Maroone sold shares at the same time. At that time the two executives acted just after the Company reported a solid first quarter and the shares traded back to an all-time high of $23. The next quarter failed to live up to expectations with sales increasing just 1% and profits falling 18% year over year. Their actions proved quite timely as the issue, which had been building momentum, reversed course almost immediately after their sales and would bottom at $19 in August.

Regarding the most recent activity, it is the behavior of Jackson that once again sticks out. Between April 27th and May 1st of this year, he sold 300,000 of the 315,000 shares of common stock he owned, including all the shares held in a trust for which he was the sole trustee and beneficiary. This sale got our attention for a number of reasons. For one, the Proxy Statement filed in March reported all of Jackson's shares had been pledged as security. No other information was supplied and his debt obligations and lenders were not made public. What we do know is that Jackson acquired most of the stock between July 2003 and May 2007 by exercising stock options and retaining some of the exercised-for shares. Based on the pledged stock totals reported in earlier proxies and following the course of his stock acquisitions, we believe he pledged 290,000 shares at some point between December 2006 and March 2007 and then pledged an additional 25,000 shares shortly after having acquired them in May 2007. We find it highly improbable that the sale of 300,000 shares in the second quarter of this year came about as a result of any margin calls, but it is possible he voluntarily sold to cover his debt obligation. But here is the kicker. AutoNation put executive stock ownership guidelines in place back in February 2006. Jackson is required to hold shares with a fair market value equal to four times his base salary, which amounts to $4.6 million. After these sales he now holds stock valued at $291,000 and *is no longer in compliance with the guidelines*.

It is quite apparent the objective of the ownership guidelines has not been realized and we do not imagine the Compensation Committee is pleased with Jackson's behavior, particularly after having highlighted his attainment of shares in several prior Proxy Statements. Not only did he covertly use the full balance of his stock holdings to take out personal loans, but he has now dumped nearly the entire position, leaving himself with little exposure to the shares. He does have until February 2011 to comply with the executive ownership guidelines, but it will now be a very costly undertaking for him to reacquire the $4.4 million worth of shares in just 16 months, especially if so many of his options remain under water (more on this below). Keep in mind, Jackson spent more than four years building the common stock position he sold in this period.

Figure 7. CEO Michael Jackson's Common Stock Holdings. Source: AN SEC Filings.



A second round of sales took place after the Company's 2Q09 earnings release on July 31st. Even though the numbers once again topped Wall Street's consensus expectations and CEO Jackson appeared on CNBC *again* that day giving praise to the Company and the Clunkers program, investors were not as impressed as they were a quarter earlier and the shares closed the session unchanged. This did not discourage four executives and one director from cashing in 1,052,747 shares between August 4th and August 6th at prices right around $20. More shares came out in this three-day period than in any of the last 12 full quarters combined. After having sold shares in the wake of the prior earnings release, Jackson and Maroone led the second charge too.

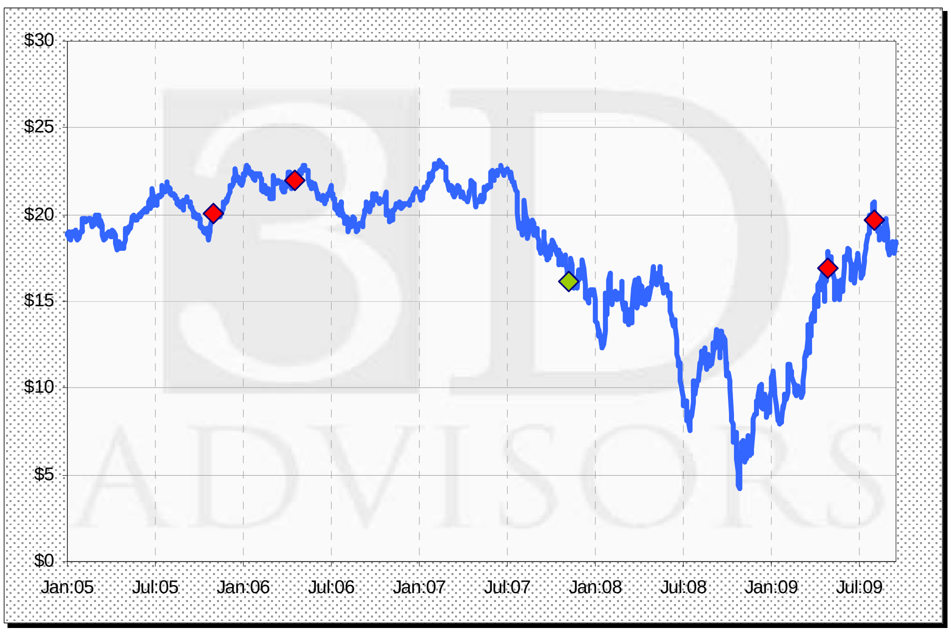
Regarding the details of Jackson's round of sales following the 2Q09 release, he wasted little time in dropping 467,766 shares as soon as the post-earnings trading window opened. Unlike the prior round of sales that exclusively involved common stock, this go around he sold only shares acquired from the exercise of options. Jackson cleared out all the options from his August 2012 series and also the vested portion of his July 2018 series which had just vested a few days earlier. Following the trades his remaining vested options total 1.26 million, but half of these are currently under water with strike prices between $19.21 and $21.59. The remainder is currently in jeopardy of slipping under water with strikes around $17. He stands to vest in only 201,000 options next year, roughly half of which will require appreciation above the current market price before they will be profitable (see Appendix A).

While throughout this period Jackson regularly appeared in the media again talking up the stock while hyping the Clunkers program and an industry recovery, he effectively liquidated 50% of his actionable holdings (common stock plus vested in-the-money options) and the percentage has increased as additional options have fallen under water since his last trade. Jackson has executed some pretty large sales over the years but never before had he ever sold more than 18% of his holdings in such a short timeframe. His recent August sales were also his largest-ever based on volume. What also stands out to us is that there have been nine distinct rounds of transactions in which Jackson exercised stock options since joining the Company in 1999. This latest round in August was the very first one where he did not retain any of the exercised-for shares. This distinct shift away from what had been ten years of consistent trading behavior is a very revealing sign to us.

President Maroone is another individual whose trading behavior has shifted materially this year. Maroone joined AutoNation in January 1997 when the Company (then still a division of Wayne Huizenga's Republic Industries) bought his auto dealership business in an all-stock deal valued at $200 million. He has been an infrequent trader over the years, having sold only twice: 711,000 shares in November 2005 at roughly $20 and in an April 2006 when he sold 807,000 shares to the Company in a tender offer for $23 per share. Maroone's last trade in November 2007, however, involved subtly *acquiring* 250,000 shares when he exercised options that otherwise would have expired two months later. AutoNation shares had just traded down from a July 2007 high of $22 to $16 when he took action. If he had sold instead of held the exercised options, he would have netted a 45% pre-tax profit, but instead he exercised the options and retained all the stock at a personal cost of $2.9 million.

Fast forward to April 2009; AutoNation shares trade at the exact same price ($17) as they did when he was a stock *acquirer* in 2007. Maroone held another options series with a July 2009 expiration date and strikes closer to the market price (read: less profitable if sold) than the options involved with his last acquisition. Rather than acquire all of the shares or even retain some of the stock in a cashless exercise, he monetized all the options (i.e. exercised the options and then sold the shares) on April 27th and April 29th and even exercised some separate options that would not have expired for another 15 months. This round of sales covered 626,000 shares and that would prove to be the first of two diversification efforts as he would then clear out the remaining 500,000 options in his August 2010 series August 4th and August 5th, a full year before they were to expire. The 1.12 million shares he sold since April accounted for almost 25% of his actionable holdings, but this number jumps up to 35% if we exclude the 1.45 million shares he has "pledged as security" from the calculation. Maroone stands to gain access to another 186,000 options that will become actionable next year (see Appendix A), but these will replace a very small fraction of what he recently sold. To us it does not seem as though Maroone believes the same upside potential exists for the shares as he did as recently as late 2007.

Figure 8. AN Daily Closing Price, 01/03/05 through 09/16/09. Red diamonds are where President and COO Michael Maroone sold shares; Green diamond is where he acquired shares. Source: AN SEC Filings.



Other notable insiders to sell in August after the second quarter earnings release were General Counsel **Jonathan Ferrando**, a named executive officer, and Director **Rick Burdick**. Ferrando exercised 40,753 options on August 4th that had just vested a few days earlier and sold 37,753 of the shares at $20 while retaining the remainder. We do not view the stock retention as a vote of confidence in the shares; Burdick has not yet met his holdings requirement under the stock ownership guidelines. If he were in fact bullish we suspect he would have retained even more shares since this small acquisition did little to get him closer to his target. He still needs to pick up another 25,000 shares before February 2011. The sale covered only about 10% of his actionable holdings. Burdick on the other hand sold nearly 30% of his holdings on August 5th, exercising 42,157 options and selling all the underlying shares for $19 each. This was his largest sale since 2001 and his second largest sale on record (he joined the board in 1991).

What we find interesting about Burdick's behavior is that he also holds a board seat at CBIZ, Inc. (NYSE: CBZ) and has not sold any CBZ in the last ten years. In fact, he has executed a number of cashless exercises in the last three years, acquiring stock by turning in just enough shares to cover his exercise costs and the associated taxes. It certainly makes us wonder why he is selling his AutoNation shares when he has a stock holding requirement, but not the CBZ shares, of which he has a larger vested interest and no ownership requirement.

Accounting: Big debt and declining sales forces focus on covenants, use of cash

AutoNation does not have the strongest balance sheet in the world. At 06/30/09, cash and equivalents were $128.9 million while accounts payable stood at $128.5 million; total current liabilities were $1,711.2 million. The bulk of the current liability number ($1,200.7 million) is related to "vehicle floor plan payable", and reflects the short-term financing auto dealers use to finance their inventory which is repaid with the cash the Company receives as cars are sold.

Long-term debt (net of current portion) was $1,119.2 million at the end of the last quarter, and it is this number that has received at lot of attention from the Company and investors in recent quarters. Of course this is certainly no surprise given declining sales and the awful state of the auto business and the economy overall, especially in the states where the Company's business is concentrated. Even in good times, AutoNation does not exactly throw off tons of cash.

The Company's tight cash situation is evident. CapEx is expected to be about $90 million this year; in 2008 it was $117 million and $160 million in 2007. Share repurchases that were taking place as recently as the first half of 2008 have ceased; acquisitions of new dealerships have all but stopped. The Company has curtailed making 401K contributions to employee retirement plans.

A significant amount of the Company's debt has expiration dates that are out a few years, which eases the financial strain somewhat, but the need to remain in compliance with leverage covenants is mandating early retirement of large chunks of debt. The huge debt is a hindrance in numerous ways. Not only is it requiring large amounts of cash for early retirement, it also restricts the Company's activities as to acquisitions, dividend payments, mergers, assets sales, creating liens and incurring additional indebtedness, among other things.

For the six months ended 06/30/09, $65.9 million was spent on retiring senior unsecured notes, a huge number relative to the meager cash position. The maximum consolidated leverage ratio permitted under debt covenants is 3.0 and it goes to 2.75 at 12/31/09. At 06/30/09 it was 2.45, so debt repurchases will probably have to continue in order to maintain compliance.

To its credit, the Company appears to have done a good job of managing the business through a very difficult period. It has dealt with the consolidation of dealerships forced on it the by bankruptcy of GM and Chrysler, reduced inventory and cut expenses by $200 million, all of which have allowed it to stay in the black and generate at least some cash. But with only $130 million on hand and its $700 million credit facility limited to just $271 million because of debt covenants, there is not a whole lot of room for error at this point. The Cash for Clunkers program will likely give the Company at least a temporary shot in the arm, but if sales activity goes down in September and through the remainder of the year as some have suggested, it will put even more pressure on the business.

Accounting: SEC industry scrutiny leads to goodwill impairment; more coming?

Another issue we quickly picked up on in our review of Company filings was a series of letters from and responses to the SEC concerning management structure and segment reporting, with the first communication dating back to early 2008. As it turns out, some of the Company's publicly traded peers were also receiving letters from the SEC on the same topics around the same time period.

Though it is not explicitly stated, it seems logical to us that the real interest on the part of the SEC had to do with the need for better segment reporting so as to allow the companies to do more accurate impairment testing of goodwill assets, which in the case of AutoNation were quite large; at 06/30/08, goodwill and other intangibles (mostly franchise rights) were $3.1 billion or approximately 37% of total assets and nearly $1 billion more than total shareholders equity. Though AutoNation's goodwill stands out as the largest, the figures are relatively large among most of its peers because they are all essentially doing the same thing: buying up dealerships to build their businesses while adding more and more goodwill to their balance sheets in the process.

That the SEC would be poking around in this area is not a surprise as auto sales, especially domestic auto sales, began falling. AutoNation previously provided no segment break down at all, but shortly after the SEC inquiries announced that impairment testing revealed the carrying value of its goodwill and other intangible assets exceeded fair market value. This resulted in a second stage test that led to a change in the operating segment structure. The single enterprise-wide operating segment was realigned into three brand-oriented segments: domestic, important and premium luxury segments, which in turn led the Company to record a goodwill impairment charge of $1.61 billion. The principal culprit was the domestic segment, which is by no means a surprise as sales of domestic vehicles, which relied heavily on trucks and SUVs, declined much more rapidly in the summer of 2008 as gasoline hit $4. Several of the Company's peers took similar write offs of goodwill around the same time:

	AN	PAG	SAH	GPI
Write Off Taken:	3Q08	4Q08	4Q08	3Q & 4Q08
Goodwill (Mil $)	$2,757.8	$1,384.1	$1,268.4	$653.0
Write Off (Mil $)	$1,610.0	$606.3	$786.5	$151.9
% of Goodwill	58%	44%	62%	23%
% of Total Assets	23%	22%	19%	26%

The Company's 2008 SEC Form 10-K (filed on 02/17/09) described in detail the process involved in determining the impairment charges, but it also made it clear more charges may be coming in the future [bolding is ours]:

> We are required to complete interim tests for impairment of goodwill and other intangible assets when events occur or circumstances change between annual tests that indicate that the assets might be impaired. We continue to face a challenging automotive retail environment and an uncertain economic environment in general. **As a result of these conditions, there can be no assurance that an additional material impairment charge will not occur in a future period.** We will continue to monitor events in future periods to determine if additional asset impairment testing should be performed. If we are required to apply the second step of the goodwill impairment test to the goodwill in any of our three reporting units in future periods, we believe that we could incur another significant non-cash impairment charge related to goodwill, which **could have a material adverse impact on our consolidated financial statements and on our ability to satisfy the financial ratios or other covenants under our debt and other agreements.**

At 06/30/09, goodwill and other intangible assets stood at $1.3 billion or approximately 25% of total assets. The Company indicated on the 2Q09 conference call that its last test for impairment on 04/30/09 required no further charges against these assets, and apparently sales results in May, June or July did not lead to a requirement to test for impairment again. It is unclear if there will be any further write downs in future periods.

Appendix A

Common Stock and Option Holdings for Selected AutoNation Inc. (AN) Insiders

	Actionable Position as of 09/17/09:			Derivative Equity Expected to Vest in Next 12 Months			
Name	Common	Options [1]	Total [2]	Grant Date	Strike Price [3]	Vesting Dates [4]	# Vesting
Rick Burdick Director	7,500	80,000	**87,500**	none			0
							0
Jonathan Ferrando General Counsel	32,767	252,800	**285,567**	03/02/09	$9.92	03/02/10	9,985
				06/01/09	$16.99	06/01/10	9,985
				07/30/07	$19.21	07/30/10	41,374
				07/30/08	$10.17	07/30/10	40,753
				07/31/06	$20.08	07/31/10	43,900
							145,996
Michael Jackson Chairman, CEO	15,000	613,000	**628,000**	03/02/09	$9.92	03/02/10	16,603
				06/01/09	$16.99	06/01/10	16,603
				07/30/07	$19.21	07/30/10	68,799
				07/30/08	$10.17	07/30/10	67,767
				07/31/06	$20.08	07/31/10	31,750
							201,522
Michael Maroone President, COO	2,498,159	1,210,800	**3,708,959**	03/02/09	$9.92	03/02/10	13,288
				06/01/09	$16.99	06/01/10	13,288
				07/30/07	$19.21	07/30/10	55,063
				07/30/08	$10.17	07/30/10	54,237
				07/31/06	$20.08	07/31/10	50,750
							186,625
Michael Short CFO	1,563	40,753	**42,316**	01/15/07	$21.56	01/15/10	50,000
				03/02/09	$9.92	03/02/10	9,985
				06/01/09	$16.99	06/01/10	9,985
				07/30/07	$19.21	07/30/10	41,374
				07/30/08	$10.17	07/30/10	40,753
							152,096
Kevin Westfall SVP of Sales	1,773	64,050	**65,823**	03/02/09	$9.92	03/02/10	998
				03/02/09	N/A	03/02/10	1,331
				06/01/09	$9.92	06/01/10	998
				07/30/07	$19.21	07/30/10	12,405
				07/30/08	$10.17	07/30/10	4,073
				07/30/08	N/A	07/30/10	1,358
				07/31/06	$20.08	07/31/10	16,453
							37,616

[1] Total number of vested, in-the-money options.

[2] Total actionable position includes common stock plus vested in-the-money options.

[3] Strike Price N/A indicates the series is restricted stock, not options.

[4] A range of dates indicates the options vest equally on a monthly basis. The total provided is the cumultive amount of equity scheduled to vest during the date range.

Note: Red text indicates series is currently out-of-the-money