

SONIC AUTOMOTIVE INC

Form 10-Q

April 26, 2019

SONIC AUTOMOTIVE INC Large Accelerated

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**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 March 31, 2019

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: 1-13395

SONIC AUTOMOTIVE, INC.

(Exact name of registrant as specified in its charter)

Delaware 56-2010790

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

4401 Colwick Road Charlotte, North Carolina 28211

(Address of principal executive offices) (Zip Code)

(704) 566-2400

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No
As of April 23, 2019, there were 31,051,431 shares of the registrant’s Class A Common Stock and 12,029,375 shares of the registrant’s Class B Common Stock outstanding.

UNCERTAINTY OF FORWARD-LOOKING STATEMENTS AND INFORMATION

This Quarterly Report on Form 10-Q contains, and written or oral statements made from time to time by us or by our authorized officers may contain, “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address our future objectives, plans and goals, as well as our intent, beliefs and current expectations regarding future operating performance, results and events, and can generally be identified by words such as “may,” “will,” “should,” “believe,” “expect,” “estimate,” “anticipate,” “intend,” “plan,” “foresee” or similar words or phrases.

These forward-looking statements are based on our current estimates and assumptions and involve various risks and uncertainties. As a result, you are cautioned that these forward-looking statements are not guarantees of future performance, and that actual results could differ materially from those projected in these forward-looking statements. Factors which may cause actual results to differ materially from our projections include those risks described in “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2018 and in “Item 1A. Risk Factors” of this report and elsewhere herein, as well as:

- the number of new and used vehicles sold in the United States as compared to our expectations and the expectations of the market;
- our ability to generate sufficient cash flows or to obtain additional financing to fund our EchoPark expansion, capital expenditures, our share repurchase program, dividends on our common stock, acquisitions and general operating activities;
- our business and growth strategies, including, but not limited to, our EchoPark store operations;
- the reputation and financial condition of vehicle manufacturers whose brands we represent, the financial incentives vehicle manufacturers offer and their ability to design, manufacture, deliver and market their vehicles successfully;
- our relationships with manufacturers, which may affect our ability to obtain desirable new vehicle models in inventory or to complete additional acquisitions;
- the adverse resolution of one or more significant legal proceedings against us or our franchised dealerships or EchoPark stores;
- changes in laws and regulations governing the operation of automobile franchises, accounting standards, taxation requirements and environmental laws;
- changes in vehicle and parts import quotas, duties, tariffs or other restrictions;
- general economic conditions in the markets in which we operate, including fluctuations in interest rates, employment levels, the level of consumer spending and consumer credit availability;
- high competition in the retail automotive industry, which not only creates pricing pressures on the products and services we offer, but also on businesses we may seek to acquire;
- our ability to successfully integrate potential future acquisitions; and
- the rate and timing of overall economic recovery or decline.

These forward-looking statements speak only as of the date of this report or when made, and we undertake no obligation to revise or update these statements to reflect subsequent events or circumstances, except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission.

**SONIC AUTOMOTIVE, INC.
 QUARTERLY REPORT ON FORM 10-Q
 FOR THE THREE MONTHS ENDED MARCH 31, 2019**

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PART I – FINANCIAL INFORMATION**Item 1. Financial Statements.****SONIC AUTOMOTIVE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	Three Months Ended March 31,	
	2019	2018
	(Dollars and shares in thousands, except per share amounts)	
Revenues:		
New vehicles	\$ 1,066,334	\$ 1,180,846
Used vehicles	820,366	709,046
Wholesale vehicles	54,770	65,398
Total vehicles	1,941,470	1,955,290
Parts, service and collision repair	341,430	351,758
Finance, insurance and other, net	106,238	93,725
Total revenues	2,389,138	2,400,773
Cost of Sales:		
New vehicles	(1,012,538)	(1,124,046)
Used vehicles	(783,358)	(672,275)
Wholesale vehicles	(56,037)	(69,823)
Total vehicles	(1,851,933)	(1,866,144)
Parts, service and collision repair	(178,194)	(182,130)
Total cost of sales	(2,030,127)	(2,048,274)
Gross profit	359,011	352,499
Selling, general and administrative expenses	(247,095)	(304,925)
Impairment charges	(1,952)	(3,643)
Depreciation and amortization	(22,649)	(23,743)
Operating income (loss)	87,315	20,188
Other income (expense):		
Interest expense, floor plan	(13,226)	(10,677)
Interest expense, other, net	(12,853)	(13,456)
Other income (expense), net	100	89
Total other income (expense)	(25,979)	(24,044)
Income (loss) from continuing	61,336	(3,856)

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operations before taxes		
Provision for income taxes for continuing operations - benefit (expense)	(18,987)	1,842
Income (loss) from continuing operations	42,349	(2,014)
Discontinued operations:		
Income (loss) from discontinued operations before taxes	(180)	(248)
Provision for income taxes for discontinued operations - benefit (expense)	52	68
Income (loss) from discontinued operations	(128)	(180)
Net income (loss)	\$ 42,221	\$ (2,194)
Basic earnings (loss) per common share:		
Earnings (loss) per share from continuing operations	\$ 0.99	\$ (0.05)
Earnings (loss) per share from discontinued operations	(0.01)	—
Earnings (loss) per common share	\$ 0.98	\$ (0.05)
Weighted average common shares outstanding	42,838	42,789
Diluted earnings (loss) per common share:		
Earnings (loss) per share from continuing operations	\$ 0.99	\$ (0.05)
Earnings (loss) per share from discontinued operations	(0.01)	—
Earnings (loss) per common share	\$ 0.98	\$ (0.05)
Weighted average common	42,888	42,789

shares
outstanding

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,	
	2019	2018
	(Dollars in thousands)	
Net income (loss)	\$ 42,221	\$ (2,194)
Other comprehensive income (loss) before taxes:		
Change in fair value of interest rate swap and interest rate cap agreements	(2,349)	4,044
Amortization of terminated interest rate swap agreements	(288)	—
Total other comprehensive income (loss) before taxes	(2,637)	4,044
Provision for income tax benefit (expense) related to components of other comprehensive income (loss)	776	(1,130)
Other comprehensive income (loss)	(1,861)	2,914
Comprehensive income (loss)	\$ 40,360	\$ 720

See notes to unaudited condensed consolidated financial statements.

SONIC AUTOMOTIVE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

March 31, 2019	December 31, 2018
(Dollars in thousands)	
ASSETS	
Current Assets:	
Cash and cash equivalents	
\$ 2,722	\$ 5,854
Receivables, net	
371,768	438,186
Inventory	
1,510,261	1,528,461
Other current assets	
18,578	20,886
Total current assets	
2,008,269	1,993,387
Property and Equipment, net	
1,137,573	1,178,489
Goodwill	
487,306	509,592
Other Intangible Assets, net	
64,500	69,705
Other Assets	
43,663	45,634
Right-of-Use Assets	
382,979	—
Total Assets	
\$ 4,139,090	\$ 3,796,807

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Notes payable	
\$ 763,090	\$ 821,074
- floor plan	
-	

trade	
Notes payable	
-	
712,807	712,966
plan	
-	
non-trade	
Trade	
accounts payable	
114,263	114,263
Current	
lease liabilities	
50,594	—
Accrued interest	
13,417	13,417
Other	
accounts payable	
257,823	257,823
Current	
maturities of	
38,416	26,304
long-term debt	
Total	
current liabilities	
1,966,280	1,945,847
Long-Term Debt	
880,939	918,779
Other	
Long-Term Liabilities	
75,887	75,887
Long-Term	
Lease Liabilities	
344,922	—
Deferred	
Income Taxes	
26,178	33,178
Commitments and Contingencies	
Stockholders' Equity:	
Class A	
Convertible Preferred	
	—

Stock,
 none
 issued
 Class
 A
 Common
 Stock,
 \$0.01
 par
 value;
 100,000,000
 shares
 authorized;
 64,676,858
 shares
 issued
 and
 31,051,431
 shares
 outstanding
 at
 March
 31,
 2019;
 64,197,385
 shares
 issued
 and
 30,721,226
 shares
 outstanding
 at
 December
 31,
 2018

647
 642

Class

121

B
 Common
 Stock,
 \$0.01
 par
 value;
 30,000,000
 shares
 authorized;
 12,029,375
 shares
 issued
 and
 outstanding

at March 31, 2019 and December 31, 2018		
Paid-in capital	747,920	745,052
Retained earnings	701,182	670,691
Accumulated other comprehensive income (loss)	2,372	4,233
Treasury stock, at cost; 33,625,427 Class A Common Stock shares held at March 31, 2019 and 33,476,159 Class A Common Stock shares held at December 31, 2018		
	(599,956)	(597,623)
Total Stockholders' Equity	852,186	823,116
Total Liabilities	4,139,090	\$ 3,796,807

and
Stockholders'
Equity

See notes to unaudited condensed consolidated financial statements.

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SONIC AUTOMOTIVE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Class A Common Stock		Class A Treasury Stock		Class B Common Stock		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Share Amount	Shares	Amount	Shares	Amount	Shares	Amount	Amount	Amount	Amount
(Dollars and shares in thousands, except per share amounts)										
Balance at December 31, 2017	1,455	635	(32,290)	1,029	\$ 121	\$ 732,856	625,356	1,307	\$ 786,760	
Shares awarded under stock compensation plans	628	6	—	—	—	345	—	—	351	
Purchases of treasury stock	—	—	(1,153)	(23,449)	—	—	—	—	(23,449)	
Change in fair value of interest rate swap and interest rate cap agreements, net of tax expense of \$1,130	—	—	—	—	—	—	—	2,914	2,914	
Restricted stock amortization	—	—	—	—	—	2,962	—	—	2,962	
Net income (loss)	—	—	—	—	—	—	(2,194)	—	(2,194)	
Cumulative effect of change in accounting principle	—	—	—	—	—	—	3,918	—	3,918	
Class A dividends declared (\$0.06)	—	—	—	—	—	—	(1,823)	—	(1,823)	

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Class B dividends declared (\$0.06)	—	—	—	—	—	—	(722)	—	(722)
Balance at March 31, 2018	64,085	641	(33,443)	\$ (596,962)	2,029	\$ 121	\$ 736,165	624,535	4,221 \$ 768,717

	Class A Common Stock	Class A Treasury Stock	Class A Common Stock	Class A Treasury Stock	Class B Common Stock	Paid-In Capital	Retained Earnings	Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Share Amount	Shares	Amount	Shares	Amount				
(Dollars and shares in thousands, except per share amounts)									
Balance at December 31, 2018	64,085	642	(33,476)	\$ (597,622)	2,029	\$ 121	\$ 745,055	670,695	4,233 \$ 823,116
Shares awarded under stock compensation plans	480	5	—	—	—	—	54	—	59
Purchases of treasury stock	—	—	(149)	(2,333)	—	—	—	—	(2,333)
Change in fair value of interest rate swap and interest rate cap agreements, net of tax benefit of \$776	—	—	—	—	—	—	—	(1,861)	(1,861)
Restricted stock amortization	—	—	—	—	—	2,814	—	—	2,814
Net income (loss)	—	—	—	—	—	—	42,221	—	42,221
Cumulative effect of change in accounting principle	—	—	—	—	—	—	(7,428)	—	(7,428)
Class A	—	—	—	—	—	(3,099)	—	—	(3,099)

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dividends
declared
(\$0.10)

Class

B

dividends	—	—	—	—	—	—	(1,203)	—	(1,203)
-----------	---	---	---	---	---	---	---------	---	---------

declared

(\$0.10)

Balance

at

March	64,673	647	(33,625)	(599,956)	3,029	\$	121	\$	747,926	701,183	2,372	\$	852,286
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31,

2019

(1) See Note 1, "Summary of Significant Accounting Policies," for further discussion.

See notes to unaudited condensed consolidated financial statements.

SONIC AUTOMOTIVE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2019	2018
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 42,221	\$ (2,194)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	22,197	23,741
Provision for bad debt expense	159	111
Other amortization	1	156
Debt issuance cost amortization	591	598
Stock-based compensation expense	2,814	2,962
Deferred income taxes	(2,816)	(1,069)
Net distributions from equity investee	379	(168)
Asset impairment charges	1,952	3,643
Loss (gain) on disposal of dealerships and property and equipment	(46,785)	(1,216)
Loss (gain) on exit of leased dealerships	(170)	5,070
Changes in assets and liabilities that relate to operations:		
Receivables	66,814	120,792
Inventories	(40,210)	(42,836)
Other assets	(66,967)	(3,774)
Notes payable - floor plan - trade	(57,984)	(28,951)
Trade accounts payable and other liabilities	(16,525)	(22,043)
Total adjustments	(136,550)	57,016
Net cash provided by (used in) operating activities	(94,329)	54,822

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CASH FLOWS
FROM INVESTING
ACTIVITIES:

Purchases of land, property and equipment	(30,619)	(65,713)
Proceeds from sales of property and equipment	1,125	2,178
Proceeds from sales of dealerships	121,700	7,461
Net cash provided by (used in) investing activities	92,206	(56,074)

CASH FLOWS
FROM
FINANCING
ACTIVITIES:

Net (repayments) borrowings on notes payable - floor plan - non-trade	9,841	(3,991)
Borrowings on revolving credit facilities	126,185	301,803
Repayments on revolving credit facilities	(126,185)	(276,803)
Proceeds from issuance of long-term debt	—	20,960
Debt issuance costs	—	(159)
Principal payments and repurchase of long-term debt	(6,011)	(12,489)
Purchases of treasury stock	(2,333)	(23,449)
Issuance of shares under stock compensation plans	59	351
Dividends paid	(2,565)	(2,160)
Net cash provided by (used in) financing activities	(1,009)	4,063

NET INCREASE
(DECREASE) IN
CASH AND CASH
EQUIVALENTS

	(3,132)	2,811
--	---------	-------

CASH AND CASH
EQUIVALENTS,
BEGINNING OF
YEAR

	5,854	6,352
--	-------	-------

CASH AND CASH
EQUIVALENTS,
END OF PERIOD

\$	2,722	\$	9,163
----	-------	----	-------

SUPPLEMENTAL
SCHEDULE OF
NON-CASH
FINANCING
ACTIVITIES:

Change in fair value of interest rate swap	\$	(1,861)	\$	2,914
---	----	---------	----	-------

and interest rate cap agreements (net of tax benefit of \$776 in the three months ended March 31, 2019 and net of tax expense of \$1,130 in the three months ended March 31, 2018)

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid (received) during the period for:

Interest, including amount capitalized	\$	26,945	\$	23,360
Income taxes	\$	10,277	\$	—

See notes to unaudited condensed consolidated financial statements.

SONIC AUTOMOTIVE, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. Summary of Significant Accounting Policies**

Basis of Presentation –The accompanying condensed consolidated financial statements of Sonic Automotive, Inc. and its wholly owned subsidiaries (“Sonic,” the “Company,” “we,” “us” and “our”) for the three months ended March 31, 2019 and 2018 are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and applicable rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The accompanying unaudited condensed consolidated financial statements reflect, in the opinion of management, all material normal recurring adjustments necessary to fairly state the financial position, results of operations and cash flows for the periods presented. The operating results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year or future interim periods, because the first quarter historically has contributed less operating profit than the second, third and fourth quarters. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in Sonic’s Annual Report on Form 10-K for the year ended December 31, 2018.

Recent Accounting Pronouncements – In February 2016, the Financial Accounting Standards Board (the “FASB”) established Accounting Standards Codification (“ASC”) 842, “Leases,” by issuing Accounting Standards Update (“ASU”) 2016-02 (and subsequent amendments via ASU 2018-01, ASU 2018-10 and ASU 2018-11) in order to increase transparency and comparability among organizations by recognizing operating lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Prior to adoption of the new lease standard, only leases classified as capital leases under ASC 840 were recorded in the consolidated balance sheets. Under ASC 842, “Leases,” an entity must classify leases as either finance leases (formerly capital leases) or operating leases, and a right-of-use asset (“ROU asset”) and lease liability are required to be recognized in the consolidated balance sheets for both finance and operating leases with a term longer than 12 months. The new lease standard requires a modified retrospective transition approach and provides an optional transition method to either (1) record current existing leases as of the effective date; or (2) record leases existing as of the earliest comparative period presented in the financial statements by recasting comparative period financial statements. We adopted the new lease standard as of January 1, 2019 using the effective date as our date of application. As such, financial statement information and disclosures required under the new lease standard have not been provided for dates and periods prior to January 1, 2019. The new lease standard provides for a number of optional practical expedients in transition, which include: (1) not requiring an entity to reassess prior conclusions about lease identification, lease classification or initial direct costs; (2) allowing an entity to use a portfolio approach for similar lease assets; (3) allowing an entity to elect an accounting policy to choose not to separate non-lease components of an agreement from lease components (by asset class); (4) allowing the use of hindsight in estimating lease term or assessing impairment of ROU assets; and (5) not requiring an entity to reassess prior conclusions about land easements. We have elected all of the practical expedients permitted under the transition guidance within the new lease standard. The new lease standard also provides practical expedients for ongoing accounting. We have elected the short-term lease recognition exemption for our real estate and equipment leases, which means that for those leases that qualify (less than 1-year term), we will not recognize ROU assets or lease liabilities. We have also elected not to separate non-lease components of an agreement from lease components (by asset class).

The cumulative effect of the adoption of ASC 842, “Leases,” on our unaudited condensed consolidated balance sheet as of January 1, 2019 was the recognition of ROU assets of approximately \$406.9 million (including approximately \$18.9 million related to capital leases that was reclassified from property and equipment, net in the accompanying unaudited condensed consolidated balance sheet as of December 31, 2018) and lease liabilities of approximately \$419.5 million (including approximately \$20.6 million related to capital leases that was reclassified from current maturities of long-term debt and long-term debt in the accompanying unaudited condensed consolidated balance sheet as of December 31, 2018). Upon adoption of ASC 842, “Leases,” we evaluated ROU assets for impairment and determined that approximately \$10.5 million of impairment was required related to newly recognized ROU assets that would have been impaired in previous periods. This impairment of the ROU asset as of January 1, 2019 was recorded, net of related income tax effects, as a \$7.4 million reduction of beginning retained earnings. The

adoption of ASC 842 did not have a material affect on our unaudited condensed consolidated statements of income or unaudited condensed consolidated statements of cash flows. The effect of the adoption of ASC 842, "Leases," on our unaudited condensed consolidated balance sheet as of January 1, 2019 and March 31, 2019 was as follows:

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SONIC AUTOMOTIVE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Before Impact of ASC 842 December 31, 2018	Effects of Adoption of ASC 842	After Impact of ASC 842	January 1, 2019	
Balance Sheet					
Assets:					
Property and Equipment, net	\$ 1,178,489	\$ (18,948)	\$ 1,159,541		
Other Intangible Assets, net	69,705	(4,005)	65,700		
Right-of-Use Assets	—	406,918	406,918		
Liabilities:					
Current lease liabilities	\$ —	\$ 48,832	\$ 48,832		
Other accrued liabilities	257,823	(1,987)	255,836		
Long-Term Debt	918,779	(20,557)	898,222		
Long-Term Lease Liabilities	—	370,647	370,647		
Other Long-Term Liabilities	75,887	(2,508)	73,379		
Deferred Income Taxes	33,178	(3,034)	30,144		
Stockholders' Equity:					
Retained earnings	\$ 670,691	\$ (7,428)	\$ 663,263		
	Adoption of ASC 842 as of January 1, 2019	New Leases	Modifications (1)	Amortization	As Reported March 31, 2019
	(In thousands)				
Right-of-Use Assets:					
Finance Leases	\$ 18,948	\$ —	\$ 21,520	\$ (709)	\$ 39,759
Operating Leases	387,970	—	(33,697)	(11,052)	343,221
Total Right-of-Use Assets	\$ 406,918	\$ —	\$ (12,177)	\$ (11,761)	\$ 382,980
Current Lease Liabilities:					
Finance Leases	\$ 728	\$ —	\$ 4,510	\$ —	\$ 5,238
Operating Leases	48,104	21	(1,473)	(1,295)	45,357
Total Current Lease Liabilities	\$ 48,832	\$			