

LITHIA MOTORS INC  
Form 10-K  
February 24, 2012

---

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

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended: December 31, 2011  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-14733

LITHIA MOTORS, INC.  
(Exact name of registrant as specified in its charter)

Oregon  
(State or other jurisdiction of incorporation or organization)

93-0572810  
(I.R.S. Employer Identification  
No.)

360 E. Jackson Street, Medford, Oregon  
(Address of principal executive offices)

97501  
(Zip Code)

541-776-6899  
(Registrant's telephone number including area code)  
Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
Class A common stock, without par value

Name of each exchange on which registered  
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None  
(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:  
Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the  
Act:

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

Edgar Filing: LITHIA MOTORS INC - Form 10-K

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately \$445,604,000 computed by reference to the last sales price (\$19.63) as reported by the New York Stock Exchange for the Registrant's Class A common stock, as of the last business day of the Registrant's most recently completed second fiscal quarter (June 30, 2011).

The number of shares outstanding of the Registrant's common stock as of February 24, 2012 was: Class A: 22,235,942 shares and Class B: 3,762,231 shares.

Documents Incorporated by Reference

The Registrant has incorporated into Part III of Form 10-K, by reference, portions of its Proxy Statement for its 2012 Annual Meeting of Shareholders.

---

---

---

LITHIA MOTORS, INC.  
2011 FORM 10-K ANNUAL REPORT  
TABLE OF CONTENTS

	Page
<b>PART I</b>	
Item 1. Business	2
Item 1A. Risk Factors	11
Item 1B. Unresolved Staff Comments	24
Item 2. Properties	25
Item 3. Legal Proceedings	25
Item 4. Reserved	26
<b>PART II</b>	
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	27
Item 6. Selected Financial Data	29
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	30
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	52
Item 8. Financial Statements and Supplementary Data	54
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	54
Item 9A. Controls and Procedures	54
Item 9B. Other Information	55
<b>PART III</b>	
Item 10. Directors, Executive Officers and Corporate Governance	55
Item 11. Executive Compensation	55
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	56
Item 13. Certain Relationships and Related Transactions, and Director Independence	56
Item 14. Principal Accountant Fees and Services	56

PART IV

Item 15. Exhibits and Financial Statement Schedules	56
---	----

Signatures	61
------------	----

## PART I

## Item 1. Business

## Forward Looking Statements

Certain statements under the sections entitled “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business” and elsewhere in this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Generally, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “expect,” “plan,” “intend,” “forecast,” “anticipate,” “estimate,” “predict,” “potential,” and “continue” or the negative of these terms or other comparable terminology. The forward-looking statements contained in this Form 10-K involve known and unknown risks, uncertainties and situations that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. Some of the important factors that could cause actual results to differ from our expectations are discussed in Item 1A. of this Form 10-K.

While we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements. Any forward looking statement speaks only as of the date on which it is made. We assume no obligation to update or revise any forward looking statement.

## Overview

We are a leading operator of automotive franchises and a retailer of new and used vehicles and services. As of February 24, 2012, we offered 25 brands of new vehicles and all brands of used vehicles in 86 stores in the United States and online at Lithia.com. We sell new and used cars and light trucks and replacement parts; provide vehicle maintenance, warranty, paint and repair services; and arrange related financing, service contracts, protection products and credit insurance.

Our dealerships are primarily located throughout the Western and Midwestern regions of the United States. We target mid-sized regional markets for domestic and import franchises and metropolitan markets for luxury franchises. We believe this strategy enables brand exclusivity with minimal competition from other dealerships with the same franchise in the market.

The following table sets forth information about stores that were part of our continuing operations as of December 31, 2011:

State	Number of Stores	Percent of 2011 Revenue
Texas	14	24%
Oregon	20	20
California	11	10
Washington	8	10
Alaska	7	9
Montana	7	8
Idaho	5	6
Iowa	5	5
Nevada	4	5
North Dakota	3	2
New Mexico	1	1

Total

85

100%

2

---

### Business Strategy and Operations

Our mission statement is: “Driven by our employees and preferred by our customers, Lithia is the leading automotive retailer in each of our markets.” We offer customers personal, convenient, flexible hometown service combined with the large company advantages of selection, competitive pricing, broad access to financing, consistent service, competence and guarantees. We strive for diversification in our products, services, brands and geographic locations to insulate us from market risk and to maintain profitability. We have developed a centralized support structure to reduce store level administrative functions. This allows store personnel to focus on providing a positive customer experience. With our management information systems, our emphasis on standardized operating practices and administrative functions performed centrally in Medford, Oregon, we seek to gain economies of scale from our dealership network.

Our overall strategy is to target mid-sized and rural markets for domestic and import brands and metropolitan markets for luxury brands. We offer a variety of luxury, import and domestic new vehicle brands and models, reducing our dependence on any one manufacturer and our susceptibility to changing consumer preferences. Encompassing economy and luxury cars, sports utility vehicles (SUVs), crossovers, minivans and light trucks, we believe our brand mix is well-suited to what people want in the markets we serve. For example, in the rural, agricultural markets, as opposed to metropolitan markets, we believe more consumers prefer trucks or SUVs, and a larger percentage of customers choose domestic vehicles.

We have centralized many administrative functions to streamline store level operations. Accounts payable, accounts receivable, credit and collections, accounting and taxes, payroll and benefits, information technology, legal, human resources, personnel development, treasury, cash management, advertising and marketing are all centralized at our corporate headquarters. The reduction of administrative functions at our stores allows our local managers to focus on customer-facing opportunities to generate increased revenues and gross profit. Our operations are supported by our dedicated training and personnel development program, which shares best practices across our dealership network and seeks to develop our store management talent.

Operations are structured to promote an entrepreneurial environment at the dealership level. Each store’s general manager and department managers, with assistance from regional and corporate management, are responsible for developing retail models that perform in their communities. They are the leaders in driving dealership operations, personnel development, manufacturer relationships, store culture and financial performance.

During 2011, we focused on the following areas to achieve our mission:

- increasing revenues in all business lines;
- capturing a greater percentage of overall new vehicle sales in our local markets;
- increasing sales of manufacturer certified pre-owned used vehicles; three to seven years old, lower-mileage vehicles; and value autos to reach additional customers;
- diversifying our franchise mix through acquisitions;
- increasing our return to investors through dividends and strategic share buy backs;
- utilizing prudent cash management, including investing capital to produce accretive returns; and
- reducing our exposure to pending debt maturities by renewing and extending debt instruments.

We believe our cost structure is aligned with current industry sales levels and is positioned to be leveraged as vehicle sales levels continue to improve. Our selling, general and administrative (“SG&A”) expense as a percentage of gross profit improved to 71.6% in 2011 compared to 78.6% in 2010. The 2011 results included a \$6.3 million gain on the sale of property in California. Adjusting for this gain and other pro forma items, our adjusted SG&A expense as a percentage of gross profit in 2011 was 72.9%.





We also measure the leverage of our cost structure by evaluating throughput, which is calculated as the incremental percentage of gross profit retained after deducting SG&A expense. For the years ended December 31, 2011 and 2010, our incremental throughput was 58.1% and 42.9%, respectively. Adjusting for the gain on the sale of property in California and other non-core items, our adjusted throughput in 2011 was 49.3%.

We believe we are well positioned to improve our SG&A expense leverage as vehicle sales levels continue to improve. As sales volume increases and we gain leverage in our cost structure, we anticipate achieving metrics of SG&A as a percentage of gross profit in the low 70% range and incremental throughput of approximately 50%.

We continuously evaluate our portfolio of franchises, divesting stores that are not expected to meet our financial return requirements while selectively acquiring attractive stores in our target markets. In the past three years, we generated \$52.5 million in cash by divesting stores that did not meet our financial return expectations. Additionally, in 2011 and 2010, we spent \$84.2 million in cash on acquisitions which increase revenue and diversify our portfolio.

#### New Vehicles

In 2011, we sold 43,273 new vehicles, generating 24% of our gross profit for the year. New vehicle sales also have the potential to create incremental profit opportunities through manufacturer incentives, resale of trade-in vehicles, sale of third-party financing, vehicle service and insurance contracts, and future service and repair work.

In 2011, we represented 26 domestic and import brands ranging from economy to luxury cars, sport utility vehicles, crossovers, minivans and light trucks.

Manufacturer	Percent of 2011 Total Revenue	Percent of 2011 New Vehicle Revenue	Percent of 2011 New Vehicle Gross Profit
Chrysler, Jeep, Dodge	17.1%	32.4%	29.9%
Chevrolet, Cadillac, Saab	8.9	16.8	15.8
Toyota, Scion	5.6	10.5	10.4
BMW, Mini	5.3	10.1	9.3
Honda, Acura	2.9	5.6	7.1
Ford, Lincoln	3.3	6.2	5.0
Subaru	2.2	4.2	3.7
Hyundai	2.1	3.9	6.1
Volkswagen, Audi	1.1	2.1	2.6
Nissan	1.4	2.7	3.1
Mercedes, smart	2.0	3.7	4.7
Kia	0.4	0.8	0.9
Porsche	0.4	0.7	0.9
Mazda	0.2	0.3	0.5
Suzuki	*	*	*
Mitsubishi	*	*	*
Total	52.9%	100.0%	100.0%

\* Less than 0.1%

We purchase our new car inventory directly from manufacturers, who generally allocate new vehicles to stores based on availability, monthly sales and market area. Accordingly, we rely on the manufacturers to provide us with vehicles that meet consumer demand at suitable locations, with appropriate quantities and prices. However, high demand

vehicles are often in short supply. We exchange vehicles with other automotive retailers and between our own stores to accommodate customer demand and to balance inventory.

### Used Vehicles

At each new vehicle store, we also sell used vehicles. In 2011, retail used vehicle sales generated 22% of our gross profit.

Our used vehicle operations give us an opportunity to:

- generate sales to customers financially unable or unwilling to purchase a new vehicle;
- generate sales of vehicle brands other than the store's new vehicle franchise;
- increase new and used vehicle sales by aggressively pursuing customer trade-ins; and
- increase finance and insurance revenues and service and parts sales.

Our longer-term strategy is to maintain a ratio of one retail used vehicle sale to one retail new vehicle sale. As of December 31, 2011 and 2010, we had a ratio of 0.9:1 and 1.0:1, respectively. In addition, our stores currently sell an average of 40 retail used vehicle units per month and our longer-term strategy is to increase monthly sales to an average of 60 units. In 2011, we experienced stronger growth in new vehicle sales compared to 2010, resulting in performance slightly below our goal.

We strive to achieve this strategy through offering three categories of used vehicles: manufacturer certified pre-owned used vehicles; three to seven years old, lower-mileage vehicles; and value autos. We offer manufacturer certified pre-owned used vehicles at most of our franchised dealerships. These vehicles undergo additional reconditioning and receive an extended factory-provided warranty. Late model, lower-mileage vehicles are highly reconditioned and offer a Lithia certified warranty. Value autos are older, higher mileage vehicles that undergo a safety check and a lesser degree of reconditioning. Value autos are offered to customers who require a less expensive vehicle with lower monthly payments.

We acquire our used vehicles through customer trade-ins and at closed auctions. We also purchase vehicles directly from customers visiting our stores, private parties advertising through local newspapers, competing dealers and online.

In addition, as a complement to our ongoing used vehicle operation at each store, and in response to customer demand, we use personnel in our support services group to identify and communicate the optimal mix of used vehicles that are most attractive to our markets. We conduct our own internal used vehicle auctions, and often centrally manage the sale of used vehicles at public auctions at the corporate level.

Wholesale transactions result from vehicles we have purchased from customers or vehicles we have attempted to sell via retail that we elect to dispose of due to inventory age or other factors. As part of our used vehicle strategy, we have concentrated on directing more lower-priced, older vehicles to retail sale rather than wholesale disposal.

### Vehicle Financing, Service Contracts and Other Products

As part of the vehicle sales process, we offer our customers financing options as well as extended warranties, insurance contracts and vehicle and theft protection products. The sale of these items generated 19% of our gross profit.

We believe that arranging financing is an important part of our ability to sell vehicles and related products and services. Our sales personnel and finance and insurance managers receive training in securing customer financing and possess extensive knowledge of available financing alternatives. We attempt to arrange financing for every vehicle we sell and we offer customers financing on a "same day" basis, giving us an advantage, particularly over smaller competitors who do not generate enough sales to attract our breadth of finance sources.



We earn a commission on each finance, service and insurance contract we write and subsequently sell to a third-party. We normally arrange financing for customers by selling the contracts to outside sources on a non-recourse basis to avoid the risk of default.

We were able to arrange financing on 73% of the vehicles we sold during 2011, compared to 72% in 2010. Our presence in multiple markets and changes in technology surrounding the credit application process have allowed us to utilize a larger network of lenders across a broader geographic area. Additionally, credit markets improved throughout 2010 and 2011, as the asset-backed securities market for automotive paper improved and banks increased the volume of automotive loans initiated. Sub-prime customers, who comprised approximately 13% of the financing we completed in 2011, continue to experience constraints in obtaining automotive financing. In 2011, we increased the number of vehicles sold to customers visiting our dealerships with credit scores of 620 or lower by 2.2% compared to the prior year. Over our entire customer base, the average credit score in 2011 was 723. While the market for sub-prime customers improved in 2011, we believe vehicle sales will increase as these customers are able to obtain loans at more attractive terms.

We also market third-party extended warranty contracts, insurance contracts and vehicle and theft protection products to our customers. These products and services yield higher profit margins than vehicle sales and contribute significantly to our profitability. Extended warranty contracts for new vehicles provide additional coverage beyond the duration or scope of the manufacturer's warranty. We also sell service contracts, which provide coverage for certain major repairs. We believe the sale of extended warranties and service contracts increases our service and parts business as well, linking future repair work to our locations.

When customers finance an automobile purchase, we offer them guaranteed auto protection ("gap") coverage that provides protection from loss incurred by the difference in the amount owed and the amount received under a comprehensive insurance claim. We receive a commission on each gap policy sold.

We offer a lifetime lube, oil and filter ("LOF") service, which, in 2011, was purchased by 36% of our total new and used vehicle buyers. This service helps us retain customers by building customer loyalty and it provides opportunities for selling additional routine maintenance items and generating repeat service and parts business. In 2011, we sold approximately \$48 of additional maintenance on each lifetime LOF service we performed.

#### Service, Body and Parts

In 2011, our service, body and parts operations generated 34% of our gross profit. Our service, body and parts operations are an integral part of establishing customer loyalty and contribute significantly to our overall revenue and profits. We provide parts and service primarily for the new vehicle brands sold by our stores, but we also service most other makes and models.

The service and parts business provides important repeat revenues to our stores. We market our parts and service products by notifying owners when their vehicles are due for periodic service. This encourages preventive maintenance rather than post-breakdown repairs. The number of customers who purchase our lifetime LOF service helps to improve customer loyalty and provides opportunities for repeat parts and service business.

Revenues from the service and parts departments are particularly important during economic downturns, as owners tend to repair their existing vehicles rather than buy new vehicles during such periods. This partially mitigates the effects of a drop in new vehicle sales that may occur in a recessionary economic environment.

Our service, body and parts operations provide us an opportunity to build the Lithia Automotive brand independent of new vehicle franchises. We have branded our service processes as “Assured Service.” Assured Service provides customer benefits such as same day service, upfront price guarantees and a three-year/50,000 mile warranty on repairs. We have also launched “Assured Automotive Products” on various commodity items such as tires, filters and batteries. These branded parts provide improved margins as we procure in bulk directly from the manufacturer.

The number of vehicles in operation has been declining over the past several years as the extended challenging economic environment has curtailed vehicle purchases. We believe that this presents a challenge to our service, body and parts business in the foreseeable future as there are near-term impacts to warranty work, as well as an overall decrease in the number of vehicles requiring service.

To counteract the impact of fewer units in operation, we have increased marketing efforts and lowered prices on routine maintenance items. We have also focused on offering more commodity products, such as wiper blades and tires, with the goal of being a full service provider for all of our customers’ vehicle needs. We believe offering ‘one-stop shopping’ will be an important point of differentiation, particularly to take advantage of additional sales opportunities with customers purchasing a lifetime LOF service. These return customers provide an opportunity to offer more diversified services, and will help to offset the impact from the decline in the number of vehicles in operation.

We believe body shops provide an attractive opportunity to grow our business, and we continue to evaluate potential locations to expand. We currently operate 14 collision repair centers: four in Texas; three in Oregon; two in Idaho; and one each in Alaska, Washington, Montana, Iowa and Nevada.

#### Marketing

We market ourselves as Lithia Auto Stores-Serving our Communities since 1946. In most markets, except where prohibited by franchise requirements, our stores are identified as Lithia Auto Stores.

We emphasize customer satisfaction and we realize that customer retention is critical to our success. We want our customers’ experiences to be satisfying so that they refer us to their families and friends. We utilize an owner marketing strategy, consisting of email, traditional mail and phone contact, to maintain regular communication and solicit feedback.

To increase awareness and traffic at our stores, we employ a combination of traditional, digital and social media to reach potential customers. Total advertising expense, net of manufacturer credits, was \$25.1 million in 2011, \$26.2 million in 2010 and \$17.8 million in 2009. In 2011, approximately 48% of those funds were spent in traditional media and 52% were spent in digital and owner communications. In all of our communications, we seek to differentiate ourselves from competitors by conveying price, selection and finance benefits unique to Lithia.

Certain advertising and marketing expenditures are offset by manufacturer co-op programs. Advertising credits not tied to specific vehicles are earned as requests for reimbursement are submitted to manufacturers for qualifying advertising expenditures. These reimbursements are recognized as a reduction of advertising expense upon manufacturer confirmation of submitted expenditures. Manufacturer cooperative advertising credits were \$7.9 million in 2011, \$2.6 million in 2010 and \$3.7 million in 2009.

Many people now shop online before visiting our stores. We maintain websites for all of our stores and a corporate site (Lithia.com) dedicated to generating customer leads for our stores. Today, our websites enable our customers to:

- locate our stores and identify the new vehicle brands sold at each store;
- search new and pre-owned vehicle inventory;



- - view current pricing and specials;
- obtain a value for their vehicle to trade or sell to us;
  - submit credit applications;
- shop for and order manufacturers' vehicle parts;
  - schedule service appointments; and
- provide feedback about their Lithia experience.

We also maintain mobile versions of our websites in anticipation of greater adoption of mobile technology.

We post our inventory on major new and used vehicle listing services (cars.com, autotrader.com, kbb.com, ebay, craigslist, etc.) to reach online shoppers. We also employ search engine optimization, search engine marketing and online display advertising to reach more online prospects.

Social influence marketing represents a very cost-effective method to enhance our corporate reputation and increase vehicle sales and service. We are deploying tools and training to our employees in ways that will help us listen to our customers and create more ambassadors for Lithia.

#### Franchise Agreements

Each of our stores operates under a separate agreement ("Franchise Agreement") with the manufacturer of the new vehicle brand it sells.

Typical automobile Franchise Agreements specify the locations within a designated market area at which the store may sell vehicles and related products and perform certain approved services. The designation of such areas and the allocation of new vehicles among stores are at the discretion of the manufacturer. Franchise Agreements do not, however, guarantee exclusivity within a specified territory.

A Franchise Agreement may impose requirements on the store with respect to:

- facilities and equipment;
- inventories of vehicles and parts;
- minimum working capital;
- training of personnel; and
- performance standards for market share and customer satisfaction.

Each manufacturer closely monitors compliance with these requirements and requires each store to submit monthly financial statements. Franchise Agreements also grant a store the right to use and display manufacturers' trademarks, service marks and designs in the manner approved by each manufacturer.

We have determined the useful life of a Franchise Agreement is indefinite, even though certain Franchise Agreements are renewed after one to five years. In our experience, agreements are routinely renewed without substantial cost and there are legal remedies to help prevent termination. Certain Franchise Agreements, including those with Ford and Chrysler, have no termination date. In addition, state franchise laws protect franchised automotive retailers. Under certain laws, a manufacturer may not terminate or fail to renew a franchise without good cause or prevent any reasonable changes in the capital structure or financing of a store.

The typical Franchise Agreement provides for early termination or non-renewal by the manufacturer upon:

- a change of management or ownership without manufacturer consent;
- insolvency or bankruptcy of the dealer;
- death or incapacity of the dealer/manager;
- conviction of a dealer/manager or owner of certain crimes;



- misrepresentation of certain sales or inventory information by the store, dealer/manager or owner to the manufacturer;

- failure to adequately operate the store;
- failure to maintain any license, permit or authorization required for the conduct of business;
- poor market share; or
- low customer satisfaction index scores.

Franchise Agreements generally provide for prior written notice before a franchise may be terminated under most circumstances. We also sign master framework agreements with most manufacturers that impose additional requirements on our stores. See Item 1A. “Risk Factors.”

### Competition

The retail automotive business is highly competitive. Currently, there are approximately 17,700 dealers in the United States, many of whom are independent operators managed by individuals, families or small retail groups. We compete primarily with other automotive retailers, both publicly and privately-held.

Vehicle manufacturers have designated specific marketing and sales areas within which only one dealer of a vehicle brand may operate. In addition, our Franchise Agreements typically limit our ability to acquire multiple dealerships of a given brand within a particular market area. Certain state franchise laws also restrict us from relocating our dealerships, or establishing new dealerships of a particular brand, within any area that is served by another dealer with the same brand. Accordingly, to the extent that a market has multiple dealers of a particular brand, as certain markets we operate in do, we are subject to significant intra-brand competition.

We are larger and have more financial resources than most private automotive retailers with which we currently compete in the majority of our regional markets. We compete directly with retailers with similar or greater resources in our metropolitan markets in Seattle, Washington and Portland, Oregon. If we enter other metropolitan markets, we may face competitors that are larger or have access to greater financial resources. We do not have any cost advantage in purchasing new vehicles from manufacturers. We rely on advertising and merchandising, pricing, our customer guarantees and sales model, our sales expertise, service reputation and the location of our stores to sell new vehicles.

### Regulation

#### Automotive and Other Laws and Regulations

We operate in a highly regulated industry. A number of state and federal laws and regulations affect our business. In every state in which we operate, we must obtain various licenses in order to operate our businesses, including dealer, sales and finance and insurance licenses issued by state regulatory authorities. Numerous laws and regulations govern our conduct of business, including those relating to our sales, operations, financing, insurance, advertising and employment practices. These laws and regulations include state franchise laws and regulations, consumer protection laws, privacy laws, escheatment laws, anti-money laundering laws and other extensive laws and regulations applicable to new and used motor vehicle dealers, as well as a variety of other laws and regulations. These laws also include federal and state wage-hour, anti-discrimination and other employment practices laws.

Our financing activities with customers are subject to numerous federal, state and local laws and regulations. Claims arising out of actual or alleged violations of law may be asserted against us or our stores by individuals, a class of individuals, or governmental entities. These claims may expose us to significant damages or other penalties, including revocation or suspension of our licenses to conduct store operations and fines.

Our operations are subject to the National Traffic and Motor Vehicle Safety Act, Federal Motor Vehicle Safety Standards promulgated by the United States Department of Transportation, and the rules and regulations of various state motor vehicle regulatory agencies.



#### Environmental, Health, and Safety Laws and Regulations

Our operations involve the use, handling, storage and contracting for recycling and/or disposal of materials such as motor oil and filters, transmission fluids, antifreeze, refrigerants, paints, thinners, batteries, cleaning products, lubricants, degreasing agents, tires and fuel. Consequently, our business is subject to a complex variety of federal, state and local requirements that regulate the environment and public health and safety.

Most of our stores utilize aboveground storage tanks, and, to a lesser extent, underground storage tanks, primarily for petroleum-based products. Storage tanks are subject to periodic testing, containment, upgrading and removal under the Resource Conservation and Recovery Act and its state law counterparts. Clean-up or other remedial action may be necessary in the event of leaks or other discharges from storage tanks or other sources. In addition, water quality protection programs under the federal Water Pollution Control Act (commonly known as the Clean Water Act), the Safe Drinking Water Act and comparable state and local programs govern certain discharges from our operations. Similarly, certain air emissions from operations, such as auto body painting, may be subject to the federal Clean Air Act and related state and local laws. Health and safety standards promulgated by the Occupational Safety and Health Administration of the United States Department of Labor and related state agencies also apply.

Certain stores may be party to proceedings under the Comprehensive Environmental Response, Compensation, and Liability Act, or CERCLA, typically in connection with materials that were sent to former recycling, treatment and/or disposal facilities owned and operated by independent businesses. The remediation or clean-up of facilities where the release of a regulated hazardous substance occurred is required under CERCLA and other laws.

We incur certain costs to comply with applicable environmental, health and safety laws and regulations in the ordinary course of our business. We do not anticipate, however, that the costs of such compliance will have a material adverse effect on our business, results of operations, cash flows or financial condition, although such outcome is possible given the nature of our operations and the extensive environmental, public health and safety regulatory framework. We are aware of minor contamination at certain of our facilities, and we are in the process of conducting investigations and/or remediation at certain properties. In certain cases, the current or prior property owner is conducting the investigation and/or remediation or we have been indemnified by either the current or prior property owner for such contamination. The current level of contamination is such that we do not expect to incur significant costs for the remediation. However, no assurances can be given that material environmental commitments or contingencies will not arise in the future, or that they do not already exist but are unknown to us.

#### Employees

As of December 31, 2011, we employed approximately 4,397 persons on a full-time equivalent basis.

#### Available Information and NYSE Compliance

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 as amended (the "Exchange Act"). You may inspect and copy our reports, proxy statements, and other information filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The SEC maintains an Internet Web site at <http://www.sec.gov> where you may access copies of our SEC filings. We also make available, on our website at [www.lithia.com](http://www.lithia.com), our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after they are filed electronically with the SEC. The information found on our website is not part of this Form 10-K. You may also obtain copies of these reports by contacting Investor Relations at 877-331-3084.



As required by the NYSE Corporate Governance Standards, we filed the appropriate certifications with the NYSE in 2011 confirming that our CEO is not aware of any violations of the NYSE Corporate Governance Standards and we also filed with the SEC, in 2011, the Chief Executive Officer and Chief Financial Officer certifications required under Section 302 of the Sarbanes-Oxley Act.

#### Item 1A. Risk Factors

You should carefully consider the risks described below before making an investment decision. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.

##### Risks related to our business

Our business will be harmed if overall consumer demand continues to suffer from a severe or sustained downturn.

Our business is heavily dependent on consumer demand and preferences. The downturn in overall levels of consumer spending has materially and adversely affected our revenues. Retail vehicle sales are cyclical and historically have experienced periodic downturns characterized by oversupply and weak demand. These cycles are often dependent on general economic conditions and consumer confidence, as well as the level of discretionary personal income and credit availability. Economic conditions may remain anemic for an extended period of time, or deteriorate in the future. This continuation would have a material adverse effect on our retail business, particularly sales of new and used automobiles.

Our business may be adversely affected by unfavorable conditions in our local markets, even if those conditions are not prominent nationally.

Our performance is subject to local economic, competitive and other conditions prevailing in our various geographic areas. Our dealerships are currently located in limited markets in 11 states, with sales in the top three states accounting for approximately 54% of our annualized revenue in 2011. Our results of operations, therefore, depend substantially on general economic conditions and consumer spending levels in those markets and could be materially adversely affected to the extent these markets experience sustained economic downturns regardless of improvements in the U.S. economy overall.

Increasing competition among automotive retailers reduces our profit margins on vehicle sales and related businesses. Further, the use of the Internet in the car purchasing process could materially adversely affect us.

Automobile retailing is a highly competitive business. Our competitors include publicly and privately-owned dealerships, of which certain competitors are larger and have greater financial and marketing resources than we have. Many of our competitors sell the same or similar makes of new and used vehicles that we offer in our markets at competitive prices. We do not have any cost advantage in purchasing new vehicles from manufacturers due to economies of scale or otherwise.

Our finance and insurance business and other related businesses, which have higher margins than sales of new and used vehicles, are subject to strong competition from various financial institutions and other third parties.

The Internet has become a significant part of the sales process in our industry. Customers are using the Internet to compare pricing for vehicles and related finance and insurance services, which may further reduce margins for new and used vehicles and profits for related finance and insurance services. If Internet new vehicle sales are allowed to be conducted without the involvement of franchised dealers, our business could be materially adversely affected. In addition, other franchise groups have aligned themselves with services offered on the Internet or are investing heavily in the development of their own Internet capabilities, which could materially adversely affect our business, results of operations, financial condition and cash flows.

Our Franchise Agreements do not grant us the exclusive right to sell a manufacturer's product within a given geographic area. Our revenues or profitability could be materially adversely affected if any of our manufacturers award franchises to others in the same markets where we operate or if existing franchised dealers increase their market share in our markets.

In addition, we may face increasingly significant competition as we strive to gain market share through acquisitions or otherwise. Our operating margins may decline over time as we expand into markets where we do not have a leading position.

Increasing fuel prices change consumer demand. Significant increases in fuel prices can be expected to reduce vehicle sales.

Historically, in times of rapid increase in crude oil and fuel prices, sales of vehicles have dropped, particularly in the short term, as the economy slows, consumer confidence wanes and fuel costs become more prominent to the consumer's buying decision. Limited supply of, and an increasing demand for, crude oil over time are expected to result in significant price increases in the future. In sustained periods of higher fuel costs, consumers who do purchase vehicles tend to prefer smaller, more fuel efficient vehicles (which typically have lower margins) or hybrid vehicles (which can be in limited supply during these periods).

Additionally, a significant portion of our new vehicle revenue and gross profit is derived from domestic manufacturers. These manufacturers have historically sold a higher percentage of trucks and SUVs than import or luxury brands. As such, they may experience a more significant decline in sales in the event that fuel prices increase.

A decline of available financing in the lending market has adversely affected, and may continue to adversely affect, our vehicle sales volume.

A significant portion of vehicle buyers finance their purchases of automobiles. Sub-prime lenders have historically provided financing for consumers who, for a variety of reasons, including poor credit histories and lack of down payment, do not have access to more traditional finance sources. Lenders have generally tightened their credit standards. In the event lenders maintain or further tighten their credit standards or there is a further decline in the availability of credit in the lending market, the ability of these consumers to purchase vehicles could be limited, which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Adverse conditions affecting one or more key manufacturers may negatively impact our business, results of operations, financial condition and cash flows.

In March 2011, an earthquake, tsunami and subsequent nuclear crisis in Japan impacted automotive manufacturers and automotive suppliers. These events damaged facilities, reduced production of vehicles and parts and destroyed inventory in Japan. Many Japanese manufacturers and suppliers were forced to halt production as they reconfigured production logistics. Many plants in Japan were inoperable or ran at limited capacity for a period of time. These events caused a global disruption to the supply of vehicles and automotive parts. As a result, new vehicle sales

volumes for these manufacturers were negatively impacted in 2011. Vehicle production levels for these automotive manufacturers began improving during the last half of 2011. We have seen inventory levels return to normal in early 2012. We depend on our manufacturers to provide a supply of vehicles which supports expected sales levels. In the event that manufacturers are unable to supply the needed level of vehicles, our financial performance may be adversely impacted. As of December 31, 2011 and 2010, we had \$372.8 million and \$305.7 million, respectively, in new vehicle inventory. We had \$27.0 million and \$22.2 million in parts and accessories inventory as of December 31, 2011 and 2010, respectively.



A lack of new vehicle supply may increase demand for late-model used vehicles. In 2008, 2009 and 2010, vehicle production and sales in North America were reduced by the recessionary environment. As a result, used vehicle supply, especially late-model vehicles, may be constrained, resulting in increased supply pressures and limited availability. Our used vehicle sales volume could be adversely impacted if we are unable to maintain an adequate supply of vehicles or if we are unable to obtain the makes and models desired by our customers. As of December 31, 2011, and 2010, we had \$106.6 million and \$87.3 million, respectively, in used and program vehicle inventory. We are subject to a concentration of risk in the event of financial distress, including potential reorganization or bankruptcy, of a major vehicle manufacturer. We purchase substantially all of our new vehicles from various manufacturers or distributors at the prevailing prices available to all franchised dealers. Our sales volume could be materially adversely impacted by the manufacturers' or distributors', inability to supply the stores with an adequate supply of vehicles. Our Chrysler, General Motors ("GM") and Ford (collectively, the "Domestic Manufacturers") stores represented approximately 32%, 17% and 6% of our new vehicle sales for 2011, respectively, and approximately 30%, 17% and 6% for 2010, respectively.

In the event a manufacturer or distributor bankruptcy, we could be held liable for damages related to product liability claims, intellectual property suits or other legal actions. These legal actions are typically directed towards the vehicle manufacturer and it is customary to indemnify us from exposure related to any judgments associated with the claims. In the event that damages could not be collected from the manufacturer or distributor, we could be named in lawsuits and judgments could be levied against us.

There can be no assurance that we will be able to successfully address the risks described above or those of the current economic circumstances and sales environment.

Our success depends in large part upon the overall demand for the particular lines of vehicles that each of our stores sell and the ability of the manufacturers to continue to deliver high quality, defect-free vehicles.

Demand for our primary manufacturers' vehicles, as well as the financial condition, management, marketing, production and distribution capabilities of these manufacturers, can significantly affect our business. Events that adversely affect a manufacturer's ability to timely deliver new vehicles may adversely affect us by reducing our supply of popular new vehicles and leading to lower sales in our stores during those periods than would otherwise occur. In addition, the discontinuance of a particular brand could negatively impact our revenues and profitability.

In 2010, Toyota announced vehicle recalls for possible accelerator pedal sticking issues and also halted the sale of eight models of vehicles until potentially defective parts were replaced, both of which reduced sales at our Toyota stores and adversely affected the manufacturer's reputation for quality. We depend on our manufacturers to deliver high-quality, defect-free vehicles. In the event that manufacturers, including Toyota, experience future quality issues, our financial performance may be adversely impacted.

Many new competitors are entering the automotive industry. New companies have recently raised capital to produce fully electric vehicles or to license battery technology to existing manufacturers. Foreign manufacturers from China and India are producing significant volumes of new vehicles and are entering the U.S. and selecting partners to distribute their products. As the automotive market in the U.S. is mature and the overall level of new vehicle sales may not increase in the coming years, the success of new competitors will likely be at the expense of other, established brands. This could have a material adverse impact on our success in the future.

Vehicle manufacturers would be adversely impacted by economic downturns or recessions, adverse fluctuations in currency exchange rates, significant declines in the sales of their new vehicles, increases in interest rates, declines in their credit ratings, labor strikes or similar disruptions (including within their major suppliers), supply shortages or rising raw material costs, rising employee benefit costs, adverse publicity that may reduce consumer demand for their products, product defects, vehicle recall campaigns, litigation, poor product mix or unappealing vehicle design, or other adverse events. These and other risks could materially adversely affect any manufacturer and limit its ability to profitably design, market, produce or distribute new vehicles, which, in turn, could materially adversely affect our business, results of operations, financial condition and cash flows.

Additionally, federal and certain state laws mandate minimum levels of vehicle fuel economy and establish emission standards. These levels and standards could be increased in the future, including the required use of renewable energy sources. Such laws often increase the costs of new vehicles, which would be expected to reduce demand. Further, changes in these laws could result in fewer vehicles available for sale by manufacturers unwilling or unable to comply with the higher standards.

If manufacturers or distributors discontinue or change sales incentives, warranties and other promotional programs, our business, results of operations, financial condition and cash flows may be materially adversely affected.

We depend upon the manufacturers and distributors for sales incentives, warranties and other programs that are intended to promote new vehicle sales or support dealership profitability. Manufacturers and distributors routinely make changes to their incentive programs. Key incentive programs include:

- customer rebates;
- dealer incentives on new vehicles;
- special rates on certified, pre-owned cars;
- below-market financing on new vehicles and special leasing terms; and
- sponsorship of used vehicle sales by authorized new vehicle dealers.

Our financial condition could be materially adversely impacted by a discontinuation or change in our manufacturers' or distributors' incentive programs. In addition, certain manufacturers, including BMW and Mercedes, use a dealership's manufacturer-determined customer satisfaction index, or CSI, score as a factor governing participation in incentive programs. To the extent we cannot meet minimum score requirements, we may be precluded from receiving certain incentives, which could materially adversely affect our business, results of operations, financial condition and cash flows.

The ability of our stores to make new vehicle sales depends in large part upon the manufacturers and, therefore, any disruption or change in our relationships with manufacturers may materially and adversely affect our business, results of operations, financial condition and cash flows.

We depend on the manufacturers to provide us with a desirable mix of new vehicles. The most popular vehicles usually produce the highest profit margins and are frequently in short supply. If we cannot obtain sufficient quantities of the most popular models, our profitability may be adversely affected. Sales of less desirable models may reduce our profit margins.



Each of our stores operates pursuant to a Franchise Agreement with each of the respective manufacturers for which it serves as franchisee. These agreements are typically renewed after one to five years, but may also be granted into perpetuity. In our experience, agreements are routinely renewed without substantial cost and there are legal remedies to help prevent termination.

However, manufacturers exert significant control over our stores through the terms and conditions of their franchise agreements. Such agreements contain provisions for termination or non-renewal for a variety of causes, including CSI scores and sales and financial performance. From time to time, certain of our stores have failed to comply with certain provisions of their franchise agreements, and we cannot assure you that our stores will be able to comply with these provisions in the future. In addition, actions taken by a manufacturer to exploit its bargaining position in negotiating the terms of renewals of franchise agreements or otherwise could also have a material adverse effect on our revenues and profitability. If a manufacturer terminates or fails to renew one or more of our significant franchise agreements or a large number of our franchise agreements, such action could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Our Franchise Agreements also specify that, except in certain situations, we cannot operate a franchise by another manufacturer in the same building as the manufacturer's franchised store. This may require us to build new facilities at a significant cost. Moreover, our manufacturers generally require that the store meet defined image standards. These commitments could require us to make significant capital expenditures.

Manufacturer stock ownership restrictions may impair our ability to maintain or renew franchise agreements or issue additional equity.

Certain of our Franchise Agreements prohibit transfers of ownership interests of a store or, in selected cases, its parent. The most prohibitive restriction which could be imposed by various manufacturers, including Honda/Acura, Hyundai, Mazda and Nissan, provides that, under certain circumstances, we may lose a franchise if a person or entity acquires an ownership interest in us above a specified level (ranging from 20% to 50% depending on the particular manufacturer's restrictions and falling as low as 5% if another vehicle manufacturer is the entity acquiring the ownership interest) without the approval of the applicable manufacturer. Other restrictions in certain Franchise Agreements with manufacturers, including Ford, GM, Honda/Acura and Toyota, provide that a change in control in the Company without prior consent is a violation of our franchise or dealer framework agreement. Transactions in our stock by our shareholders or prospective shareholders are generally outside of our control and may result in the termination or non-renewal of one or more of our franchises or impair our ability to negotiate new franchise agreements for dealerships we desire to acquire in the future, which may have a material adverse effect on our business, results of operations, financial condition and cash flows. These restrictions may also prevent or deter a prospective acquirer from acquiring control of us or otherwise adversely affect the market price of our Class A common stock or limit our ability to restructure our debt obligations.

If state dealer laws are repealed or weakened, our dealerships will be more susceptible to termination, non-renewal or renegotiation of their franchise agreements. Additionally, federal bankruptcy law can override protections afforded under state dealer laws.

State dealer laws generally provide that a manufacturer may not terminate or refuse to renew a franchise agreement unless it has first provided the dealer with written notice setting forth good cause and stating the grounds for termination or non-renewal. Certain state dealer laws allow dealers to file protests or petitions or attempt to comply with the manufacturer's criteria within the notice period to avoid the termination or non-renewal. If dealer laws are repealed in the states in which we operate, manufacturers may be able to terminate our franchises without providing advance notice, an opportunity to cure or a showing of good cause. Without the protection of state dealer laws, it may also be more difficult for our dealers to renew their franchise agreements upon expiration.



In addition, these laws restrict the ability of automobile manufacturers to directly enter the retail market in the future. If manufacturers obtain the ability to directly retail vehicles and do so in our markets, such competition could have a material adverse effect on our business, results of operations, financial condition and cash flows.

As evidenced by the bankruptcy proceedings of both Chrysler and GM in 2009, state dealer laws do not afford continued protection from manufacturer terminations or non-renewal of franchise agreements. While we do not believe additional bankruptcy filings are probable, no assurances can be given that a manufacturer will not seek protection under bankruptcy laws, or that, in this event, they will not seek to terminate franchise rights held by us.

Import product restrictions and foreign trade risks may impair our ability to sell foreign vehicles profitably.

A significant portion of the vehicles we sell, as well as certain major components of such vehicles, are manufactured outside the United States. Accordingly, we are affected by import and export restrictions of various jurisdictions and are dependent, to a certain extent, on general socio-economic conditions in, and political relations with, a number of foreign countries. Additionally, fluctuations in currency exchange rates may increase the price and adversely affect our sales of vehicles produced by foreign manufacturers. Imports into the United States may also be adversely affected by increased transportation costs and tariffs, quotas or duties, any of which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Environmental, health or safety regulations could have a material adverse effect on our business, results of operations, financial condition and cash flows or cause us to incur significant expenditures.

We are subject to various federal, state and local environmental, health and safety regulations which govern items such as the generation, storage, handling, use, treatment, recycling, transportation, disposal and remediation of hazardous material and the emission and discharge of hazardous material into the environment. Under certain environmental regulations or pursuant to signed private contracts, we could be held responsible for all of the costs relating to any contamination at our present, or our previously owned, facilities, and at third party waste disposal sites. We are aware of minor contamination at certain of our facilities, and we are in the process of conducting investigations and/or remediation at certain properties. The current level of contamination is such that we do not expect to incur significant costs for the remediation. In certain cases, the current or prior property owner is conducting the investigation and/or remediation or we have been indemnified by either the current or prior property owner for such contamination. There can be no assurance that these owners will remediate, or continue to remediate, these properties or pay, or continue to pay, pursuant to these indemnities. We are also required to obtain permits from governmental authorities for certain operations. If we violate or fail to fully comply with these regulations or permits, we could be fined or otherwise sanctioned by regulators.

Environmental, health and safety regulations are becoming increasingly stringent. There can be no assurance that the cost of compliance with these regulations will not result in a material adverse effect on our results of operations or financial condition. Further, no assurances can be given that additional environmental, health or safety matters will not arise or new conditions or facts will not develop in the future at our currently or formerly owned or operated facilities, or at sites that we may acquire in the future, which will require us to incur significant expenditures.

With the breadth of our operations and volume of consumer and financing transactions, compliance with the many applicable federal and state laws and regulations cannot be assured. New regulations are enacted on an ongoing basis. These regulations may impact our profitability and require continuous training and vigilance. Fines, judgments and administrative sanctions can be severe.

We are subject to federal, state and local laws and regulations in each of the 11 states in which we have stores. New laws and regulations are enacted on an ongoing basis. With the number of stores we operate, the number of personnel we employ and the large volume of transactions we handle, it is likely that technical mistakes will be made. It is also likely that these regulations may impact our profitability and require ongoing training. Current practices in stores may become prohibited. We are responsible for ensuring that continued compliance with laws is maintained. If there are unauthorized activities of serious magnitude, the state and federal authorities have the power to impose civil penalties and sanctions, suspend or withdraw dealer licenses or take other actions. These actions could materially impair our activities or our ability to acquire new stores in those states where violations occurred. Further, private causes of action on behalf of individuals or a class of individuals could result in significant damages or injunctive relief.

Compliance with the variety of federal, state and local advertising related regulations cannot be assured. These regulations, which impact various forms of advertising including print, media, text and Internet, could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Advertising in our business is subject to numerous federal, state and local laws and regulations. These laws and regulations address unfair, deceptive and/or fraudulent trade practices. Claims arising out of actual or alleged violations of law may be asserted against us or any of our dealers by individuals, either individually or through class actions, or by governmental entities in civil or criminal investigations and proceedings. Such actions may expose us to substantial monetary damages and legal defense costs, injunctive relief and criminal and civil fines and penalties.

The seasonality of our business magnifies the importance of second and third quarter operating results.

Our business is subject to seasonal variations in revenues. In our experience, demand for automobiles is generally lower during the first and fourth quarters of each year and this variance is even more pronounced in stores located in cold-weather states. We, therefore, generally receive a disproportionate amount of revenues in the second and third quarters and expect our revenues and operating results to be generally lower in the first and fourth quarters. Consequently, if conditions surface during the second and third quarters that impair vehicle sales, such as higher fuel costs, depressed economic conditions or similar adverse conditions, our revenues for the full year could be materially adversely affected.

Our ability to increase revenues through acquisitions depends on our ability to acquire and successfully integrate additional stores.

#### General

The U.S. automobile industry is considered a mature industry in which minimal growth is expected in unit sales of new vehicles. Accordingly, a principal component of our growth in sales is to make acquisitions in our existing markets and in new geographic markets. To complete the acquisition of additional stores, we need to successfully address each of the following challenges.

#### Limitations on our capital resources

The acquisition of additional stores will require substantial capital investment. Limitations on our capital resources would restrict our ability to complete new acquisitions.

We have financed our past acquisitions from a combination of the cash flow from our operations, borrowings under our credit arrangements, issuances of our common stock and proceeds from private debt offerings. The use of any of these financing sources could have the effect of reducing our earnings per share. We may not be able to obtain financing in the future due to the market price of our Class A common stock and overall market conditions. Furthermore, using cash to complete acquisitions could substantially limit our operating or financial flexibility.

Substantially all of the assets of our dealerships are pledged to secure the indebtedness under our Credit Facility and our floor plan financing indebtedness. These pledges may limit our ability to borrow from other sources in order to fund our acquisitions.

#### Manufacturers

We are required to obtain consent from the applicable manufacturer prior to the acquisition of a franchised store. In determining whether to approve an acquisition, a manufacturer considers many factors, including our financial condition, ownership structure, the number of stores currently owned and our performance with those stores. Obtaining manufacturer approval of acquisitions also takes a significant amount of time, typically 60 to 90 days. We cannot assure you that manufacturers will approve future acquisitions timely, if at all, which could significantly impair the execution of our acquisition strategy.

Most major manufacturers have now established limitations or guidelines on the:

- number of such manufacturers' stores that may be acquired by a single owner;
- number of stores that may be acquired in any market or region;
- percentage of market share that may be controlled by one automotive retailer group;
  - ownership of stores in contiguous markets;
  - performance requirements for existing stores; and
  - frequency of acquisitions.

In addition, such manufacturers generally require that no other manufacturers' brands be sold from the same store location, and many manufacturers have site control agreements in place that limit our ability to change the use of the facility without their approval.

A manufacturer also considers our past performance as measured by the Minimum Sales Responsibility ("MSR") scores, Customer Satisfaction Index ("CSI") scores and Sales Satisfaction Index ("SSI") scores at our existing stores. At any point in time, certain stores may have scores below the manufacturers' sales zone averages or have achieved sales below the targets manufacturers have set. Our failure to maintain satisfactory scores and to achieve market share performance goals could restrict our ability to complete future acquisitions. We currently have, and at any point in the future may have, manufacturers that restrict our ability to complete future acquisitions.

#### Acquisition risks

We will face risks commonly encountered with growth through acquisitions. These risks include, without limitation:

- failing to assimilate the operations and personnel of acquired dealerships;
- failing to achieve predicted sales levels;
- incurring significantly higher capital expenditures and operating expenses;
  - entering new markets with which we are unfamiliar;
- encountering undiscovered liabilities and operational difficulties at acquired dealerships;
  - disrupting our ongoing business;





- diverting our management resources;
- failing to maintain uniform standards, controls and policies;
- impairing relationships with employees, manufacturers and customers as a result of changes in management;
  - incurring increased expenses for accounting and computer systems, as well as integration difficulties;
- failing to obtain a manufacturer's consent to the acquisition of one or more of its dealership franchises or renew the franchise agreement on terms acceptable to us; and
  - incorrectly valuing entities to be acquired.

In addition, we may not adequately anticipate all of the demands that growth will impose on our systems, procedures and structures.

#### Consummation and competition

We may not be able to consummate any future acquisitions at acceptable prices and terms or identify suitable candidates. In addition, increased competition in the future for acquisition candidates could result in fewer acquisition opportunities for us and higher acquisition prices. The magnitude, timing, pricing and nature of future acquisitions will depend upon various factors, including:

- the availability of suitable acquisition candidates;
- competition with other dealer groups for suitable acquisitions;
- the negotiation of acceptable terms with the seller and with the manufacturer;
- our financial capabilities and ability to obtain financing on acceptable terms;
  - our stock price;
- our ability to maintain required financial covenant levels after the acquisition; and
  - the availability of skilled employees to manage the acquired businesses.

#### Financial condition

The operating and financial condition of acquired businesses cannot be determined accurately until we assume control. Although we conduct what we believe to be a prudent level of investigation regarding the operating and financial condition of the businesses we purchase, in light of the circumstances of each transaction, an unavoidable level of risk remains regarding the actual operating condition of these businesses. Similarly, many of the dealerships we acquire do not have financial statements audited or prepared in accordance with U.S. generally accepted accounting principles. We may not have an accurate understanding of the historical financial condition and performance of our acquired businesses. Until we actually assume control of the business assets and their operations, we may not be able to ascertain the actual value or understand the potential liabilities of the acquired businesses and their earnings potential.

Indefinite-lived intangible assets, which consist of goodwill and franchise value, comprise a meaningful portion of our total assets (\$78.1 million at December 31, 2011). We must test our indefinite-lived intangible assets for impairment at least annually, which may result in a non-cash write-down of franchise rights or goodwill and could have a material adverse impact on our business, results of operations, financial condition and cash flows and impair our ability to comply with loan covenants.

Indefinite-lived intangible assets are subject to impairment assessments at least annually (or more frequently when events or circumstances indicate that an impairment may have occurred) by applying a fair-value based test. Our principal intangible assets are goodwill and our rights under our Franchise Agreements with vehicle manufacturers. The risk of impairment charges associated with goodwill increases if there are declines in our market capitalization, profitability or cash flows. The risk of impairment charges associated with franchise value increases if operating losses are suffered at those stores, if a manufacturer files for bankruptcy or if the stores are closed. Impairment charges result in non-cash write-downs of the affected franchise values or goodwill. Furthermore, impairment charges could have an adverse impact on our ability to satisfy the financial ratios or other covenants under our debt

agreements and could have a material adverse impact on our business, results of operations, financial condition and cash flows.

A net deferred tax asset position comprises a meaningful portion of our total assets (approximately \$34.0 million at December 31, 2011). We are required to assess the recoverability of this asset on an ongoing basis. Future negative operating performance or other unfavorable developments may result in a valuation allowance being recorded against part or all of this amount. This could have a material adverse impact on our business, results of operations, financial condition and cash flows and impair our ability to comply with loan covenants.

Deferred tax assets are evaluated periodically to determine if they are expected to be recoverable in the future. This evaluation considers positive and negative evidence in order to assess whether it is more likely than not that a portion of the asset will not be realized. The risk of a valuation allowance increases if continuing operating losses are incurred. A valuation allowance on our deferred tax asset could have an adverse impact on our ability to satisfy financial ratios or other covenants under our debt agreements and could have a material adverse impact on our business, results of operations, financial condition and cash flows.

Our indebtedness and lease obligations could materially adversely affect our financial health, limit our ability to finance future acquisitions and capital expenditures and prevent us from fulfilling our financial obligations. Much of our debt has a variable interest rate component that may significantly increase our interest costs in a rising rate environment.

As of December 31, 2011, our total outstanding indebtedness was approximately \$630.8 million, including \$343.9 million in floor plan financing, \$87.0 million in borrowings under our Credit Facility, \$194.4 million in mortgage debt and \$5.5 million in other long-term debt. Mortgage indebtedness consists primarily of real estate loans on individual properties from thirteen different banks and finance companies at fixed and variable rates.

Our floor plan financing is provided by five banks and finance companies which are, or previously were, associated with automobile manufacturers. We also have floor plan financing provided by lenders not associated with automobile manufacturers. For new vehicles and vehicles purchased at dealer auctions, advances are made at the time such vehicles are purchased and are typically required to be repaid no later than upon sale or lease of the vehicle.

Most of our floor plan financing may be terminated at any time by the lender and is due on demand.

Our indebtedness and lease obligations could have important consequences to us, including the following:

- limitations on our ability to make acquisitions;
- impaired ability to obtain additional financing for acquisitions, capital expenditures, working capital or general corporate purposes;
- reduced funds available for our operations and other purposes, as a portion of our current cash flow from operations would be dedicated to the payment of principal and interest on our indebtedness; and
- exposure to the risk of increasing interest rates as certain borrowings are, and will continue to be, at variable rates of interest.

In addition, our loan agreements contain covenants that limit our discretion with respect to business matters, including incurring additional debt or disposing of assets. Other covenants are financial in nature, including tangible net worth, vehicle equity, fixed charge coverage and liabilities to tangible net worth. A breach of any of these covenants could result in a default under the applicable agreement. In addition, a default under one agreement could result in a default and acceleration of our repayment obligations under the other agreements under the cross-default provisions in such other agreements.

Certain debt agreements contain subjective acceleration clauses based on a lender deeming itself insecure or if a “material adverse change” in our business has occurred. If these clauses are implicated, and the lender declares that an event of default has occurred, the outstanding indebtedness would likely be immediately due and owing.

If these events were to occur, we may not be able to pay our debts or borrow sufficient funds to refinance them. Even if new financing were available, it may not be on terms acceptable to us. As a result of this risk, we could be forced to take actions that we otherwise would not take, or not take actions that we otherwise might take, in order to comply with these agreements.

The global credit and capital markets are undergoing a period of substantial volatility and disruption. There can be no assurance that this credit environment will not worsen or further impact the availability and cost of debt financing, including the refinancing of our indebtedness. If we are unable to refinance or renegotiate our debt, we cannot guarantee that we will be able to generate enough cash flow from operations or that we will be able to obtain enough capital to service our debt, make acquisitions or fund our planned capital expenditures. In such an event, we could face substantial liquidity issues and might be required to issue equity securities or sell assets to meet our debt payments and other obligations. There can be no assurance that we will be able to effect refinancing of our indebtedness on terms acceptable to us, if at all.

Additionally, our real estate debt generally has a five-year term, after which the debt needs to be renewed or replaced. Over the last three years, the appraised value of commercial real estate, generally, and much of our real estate, specifically, has declined. Further, many lenders are reducing the loan-to-value lending ratios for new or renewed real estate loans. The effect of these developments could result in our inability to renew maturing real estate loans at the debt level existing at maturity, or on terms acceptable to us, requiring us to find replacement lenders or to refinance at lower loan amounts.

We have significant levels of mortgage debt maturing after 2012. Approximately \$27.9 million, \$31.9 million and \$52.6 million matures in 2013, 2014 and 2015, respectively. There can be no assurance that, if requested by us, our current lenders will be willing or able to extend these maturities, or that we will be able to find other counterparties to provide financing in the future.

As of December 31, 2011, including the effect of interest rate swaps, approximately 74% of our total debt was variable rate. The majority of our variable rate debt is indexed to the 30 day LIBOR rate. The current interest rate environment is at historically low levels, and interest rates will likely increase in the future. In the event interest rates increase, our borrowing costs may increase substantially. Additionally, fixed rate debt that matures may be renewed at interest rates significantly higher than current levels. As a result, this could have a material adverse impact on our business, results of operations, financial condition and cash flows.

We are dependent on manufacturer, manufacturer-affiliated or other financing companies to provide floor plan sources for our new vehicle inventories. If floor plan sources are eliminated or reduced, no assurance can be given that we will be able to secure additional borrowing facilities. Additionally, our floor plan debt with manufacturers, their affiliated finance companies and Ally Bank are due upon demand, and may be called at any time.

We secure real estate financing from certain lenders with a commitment that we continue to maintain associated floor plan lines at the location so long as any mortgage debt remains outstanding. Such a commitment subjects us to the prevailing floor plan line rate and terms offered by the lender, unless we are able to refinance our real estate debt placed with them.

We currently have relationships with a number of manufacturers, their affiliated finance companies or other finance companies, including Mercedes-Benz Financial Services USA, LLC, Toyota Financial Services, Ford Motor Credit Company, American Honda Finance Corporation and BMW Financial Services NA, LLC. These companies provide new vehicle floor plan financing for their respective brands. Our credit facility with U.S. Bank National Association and JPMorgan Chase Bank, N.A. as well as floor plan financing with Ally Bank serve as the primary source of financing for all other brands. Certain of these companies, including Ally Bank, have incurred significant losses and are operating under financial constraints. Other companies may incur losses in the future or undergo funding limitations. As a result, credit that has typically been extended to us by the companies may be modified with terms unacceptable to us or revoked entirely. If these events were to occur, we may not be able to pay our floor plan debts or borrow sufficient funds to refinance the vehicles. Even if new financing were available, it may not be on terms acceptable to us.

We have a significant relationship with a third-party warranty insurer and administrator. If the insurer should be unable to meet claims under our customers' policies, such events could negatively impact our business, results of operations, financial condition and cash flows.

We sell service warranty policies to our customers issued by a third-party obligor. We receive additional fee income if actual claims are less than the amounts reserved for anticipated claims and the costs of administration and administrator profit. As such, the service contracts must expire before the ultimate claims experience on the service contracts are known and the profit component can be calculated.

A decline in the financial health of the third-party insurer could jeopardize the claims reserves held by the administrator, and prevent us from collecting the experience payments anticipated to be earned in future years. While the amount we receive varies annually, the loss of this income could negatively impact our business, results of operations, financial condition and cash flows. Further, the inability of the insurer to honor service warranty claims would likely result in reputational risk to us and might result in claims to cover any default by the insurer.

The loss of key personnel or the failure to attract additional qualified management personnel could adversely affect our operations and growth.

Our success depends to a significant degree on the efforts and abilities of our senior management, particularly Sidney B. DeBoer, our Chairman and Chief Executive Officer, and Bryan B. DeBoer, our President and Chief Operating Officer. Further, we have identified Sidney B. DeBoer and/or Bryan B. DeBoer in most of our store franchise agreements as the individuals who control the franchises and upon whose financial resources and management expertise the manufacturers may rely when awarding or approving the transfer of any franchise.

In addition, as we expand, we may need to hire additional managers. The market for qualified employees in the industry and in the regions in which we operate, particularly for general managers and sales and service personnel, is highly competitive and may subject us to increased labor costs during periods of low unemployment. The loss of the services of key employees or the inability to attract additional qualified managers could have a material adverse effect on our business, results of operations, financial condition and cash flows. In addition, the lack of qualified management or employees employed by potential acquisition candidates may limit our ability to consummate future acquisitions.

The sole voting control of our company is currently held by Sidney B. DeBoer, who may have interests different from our other shareholders. Further, 3.8 million shares of our Class B common stock held by Lithia Holding Company, LLC (“Lithia Holding”) are pledged, with other assets, to secure personal indebtedness of Mr. DeBoer. The failure to repay the indebtedness could result in the sale of such shares and the loss of such control, which may violate agreements with certain manufacturers.

Lithia Holding, of which Sidney B. DeBoer, our Chairman and Chief Executive Officer, is the sole managing member, holds all of the outstanding shares of our Class B common stock. A holder of Class B common stock is entitled to ten votes for each share held, while a holder of Class A common stock is entitled to one vote per share held. On most matters, the Class A and Class B common stock vote together as a single class. As of February 24, 2012, Lithia Holding controlled approximately 63% of the aggregate number of votes eligible to be cast by shareholders for the election of directors and most other shareholder actions. In addition, because Mr. DeBoer is the managing member of Lithia Holding, he currently controls, and will continue to control, all of the outstanding Class B common stock, thereby allowing him to control the company.

Lithia Holding has pledged 3.8 million shares of our Class B common stock, together with other personal assets of Mr. DeBoer, to secure a personal loan to Mr. DeBoer from U.S. Bank National Association. Should he be unable to repay the loan, the bank could foreclose against the Class B common stock, which would result in the automatic conversion of such shares to Class A common stock. In such event, Mr. DeBoer would no longer be in control of the company and this loss of (change in) control, if not consented to by the manufacturers, would be a technical violation under most of the dealer sales and service agreements held by us. While applicable state franchise laws prohibit manufacturers from unreasonably withholding consent to a change in control or the appointment of a new individual responsible for the operations of a store should a loss of control result in the removal of both Sidney DeBoer and Bryan DeBoer, there can be no assurance that such laws will not change. In addition, the market price of our Class A common stock could decline materially if the bank foreclosed on such pledged stock and subsequently sold such stock in the open market.

#### Risks related to investing in our Class A common stock

Future sales of our Class A common stock in the public market could adversely impact the market price of our Class A common stock.

As of February 24, 2012, we had 2,863,254 shares of Class A common stock reserved for issuance under our equity plans (including our employee stock purchase plan). As of February 24, 2012, a total of 1,396,351 shares were outstanding related to outstanding restricted stock, restricted stock units and options (with the options having a weighted average exercise price of \$12.70 per share and options to purchase 403,008 shares being exercisable). In addition, we had 3,762,231 shares of Class B common stock outstanding convertible into 3,762,231 shares of Class A common stock.

In the future, we may issue additional shares of our Class A common stock to raise capital or effect acquisitions. We cannot predict the size of future sales or issuance or the effect, if any, they may have on the market price of our Class A common stock. The sale of substantial amounts of Class A common stock, or the perception that such sales may occur, could adversely affect the market price of our Class A common stock and impair our ability to raise capital through the sale of additional equity securities, or to sell equity at a price acceptable to us.



Volatility in the market price and trading volume of our Class A common stock could adversely impact the value of the shares of our Class A common stock.

The stock market in recent years has experienced significant price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies like ours. These broad market factors may materially reduce the market price of our Class A common stock, regardless of our operating performance. The market price of our Class A common stock, which has experienced large price and volume fluctuations over the last five years, could continue to fluctuate significantly for many reasons, including in response to the risks described herein or for reasons unrelated to our operations, such as:

- reports by industry analysts;
- changes in financial estimates by securities analysts or us, or our inability to meet or exceed securities analysts', investors' or our own estimates or expectations;
  - actual or anticipated sales of common stock by existing shareholders;
  - capital commitments;
  - additions or departures of key personnel;
  - developments in our business or in our industry;
  - a prolonged downturn in our industry;
- general market conditions, such as interest or foreign exchange rates, commodity and equity prices, availability of credit, asset valuations and volatility;
  - changes in global financial and economic markets;
  - armed conflict, war or terrorism;
- regulatory changes affecting our industry generally or our business and operations in particular;
  - changes in market valuations of other companies in our industry;
- the operating and securities price performance of companies that investors consider to be comparable to us; and
- announcements of strategic developments, acquisitions and other material events by us, our competitors or our suppliers.

Oregon law and our Restated Articles of Incorporation may impede or discourage a takeover, which could impair the market price of our Class A common stock.

We are an Oregon corporation, and certain provisions of Oregon law and our Restated Articles of Incorporation may have anti-takeover effects. These provisions could delay, defer or prevent a tender offer or takeover attempt that a shareholder might consider to be in his or her best interest. These provisions may also affect attempts that might result in a premium over the market price for the shares held by shareholders, and may make removal of the incumbent management and directors more difficult, which, under certain circumstances, could reduce the market price of our Class A common stock.

Our issuance of preferred stock could adversely affect holders of Class A common stock.

Our Board of Directors is authorized to issue a series of preferred stock without any action on the part of our holders of Class A common stock. Our Board of Directors also has the power, without shareholder approval, to set the terms of any such series of preferred stock that may be issued, including voting powers, preferences over our Class A common stock with respect to dividends or if we voluntarily or involuntarily dissolve or distribute our assets, and other terms. If we issue preferred stock in the future that has preference over our Class A common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our Class A common stock, the rights of holders of our Class A common stock or the price of our Class A common stock could be adversely affected.

Item 1B. Unresolved Staff Comments

None.

24

---

## Item 2. Properties

Our stores and other facilities consist primarily of automobile showrooms, display lots, service facilities, collision repair and paint shops, supply facilities, automobile storage lots, parking lots and offices. We believe our facilities are currently adequate for our needs and are in good repair. Some of our facilities do not currently meet manufacturer image or size requirements and we are actively working to find a mutually acceptable outcome in terms of timing and overall cost. We own certain properties, but also lease certain properties, providing future flexibility to relocate our retail stores as demographics, economics, traffic patterns or sales methods change. Most leases provide us the option to renew the lease for one or more lease extension periods. We also hold certain vacant dealerships and undeveloped land for future expansion.

## Item 3. Legal Proceedings

We are party to numerous legal proceedings arising in the normal course of our business. While we cannot predict with certainty the outcomes of these matters, we do not anticipate that the resolution of legal proceedings arising in the normal course of business or the proceedings described below will have a material adverse effect on our business, results of operations, financial condition, or cash flows.

### Text Messaging Claims

In April 2011, a third party vendor assisted us in promoting a targeted “0% financing on used vehicles” advertising campaign during a limited sale period. The marketing included sending a “Short Message Service” communication to cell phones (a “text message”) of our previous customers. The message was sent to over 50,000 cell phones in 14 states. The message indicated that the recipients could “Opt-Out” of receiving any further messages by replying “STOP,” but, due to a technical error, some recipients who responded requesting to be unsubscribed nonetheless may have received a follow-on message.

On or about April 21, 2011, a Complaint for Damages, Injunctive and Declaratory Relief was filed against us (Kevin McClintic vs. Lithia Motors, 11-2-14632-4 SEA, Superior Court of the State of Washington for King County) alleging the text messaging activity violated State of Washington anti-texting and consumer protection laws and the federal Telephone Consumer Protection Act, and seeking statutory damages of \$500 for each violation, trebled, plus injunctive relief and attorney fees. The suit seeks class action designation for all similarly situated entities and individuals. The suit has been removed to the United States District Court for the Western District of Washington at Seattle.

On or about July 5, 2011, a complaint was filed alleging nearly identical claims, also seeking class action designation (Dan McLaren vs. Lithia Motors, Civil # 11-810, United States District Court of Oregon, Portland Division). This case was stayed pending the outcome of the McClintic matter by order of the court on or about October 11, 2011. The class representative in the McLaren case also attempted to intervene in the McClintic case. This intervention motion was denied on October 19, 2011.

We participated in a mediation of the McClintic case and have entered into a settlement agreement with the plaintiffs, which is subject to court approval. Under this settlement agreement, we agreed to pay a total of \$2.5 million, all of which such amounts will be reimbursed by the vendor pursuant to contractual indemnification. No assurances can be given that the court will approve the settlement.

#### Alaska Consumer Protection Act Claims

In December 2006, a suit was filed against us (Jackie Neese, et al vs. Lithia Chrysler Jeep of Anchorage, Inc, et al, Case No. 3AN-06-13341 CI, and in April, 2007, a second case (Jackie Neese, et al vs. Lithia Chrysler Jeep of Anchorage, Inc, et al, Case No. 3AN-06-4815 CI) (now consolidated)), in the Superior Court for the State of Alaska, Third Judicial District at Anchorage. In the suits, plaintiffs alleged that we, through our Alaska dealerships, engaged in three practices that purportedly violate Alaska consumer protection laws: (i) charging customers dealer fees and costs (including document preparation fees) not disclosed in the advertised price, (ii) failing to disclose the acquisition, mechanical and accident history of used vehicles or whether the vehicles were originally manufactured for sale in a foreign country, and (iii) engaging in deception, misrepresentation and fraud by providing to customers financing from third parties without disclosing that we receive a fee or discount for placing that loan (a “dealer reserve”). The suit seeks statutory damages of \$500 for each violation (or three times plaintiff’s actual damages, whichever is greater), and attorney fees and costs and the plaintiffs sought class action certification. Before and during the pendency of these suits, we engaged in settlement discussions with the State of Alaska through its Office of Attorney General with respect to the first two practices enumerated above. As a result of those discussions, we entered into a Consent Judgment subject to court approval and permitted potential class members to “opt-out” of the proposed settlement. Counsel for the plaintiffs attempted to intervene and, after various motions, hearings and an appeal to the state Court of Appeals, the Consent Judgment became final.

Plaintiffs then filed a motion in November 2010 seeking certification of a class for (i) the 339 customers who “opted-out” of the state settlement, (ii) for those customers who did not qualify for recovery under the Consent Judgment but were allegedly eligible for recovery under the Plaintiffs’ broader interpretation of the applicable statutes and (iii) arguing that since the State’s suit against our dealerships did not address the loan fee/discount (dealer reserve) claim, for those customers who arranged their vehicle financing through us. On June 14, 2011, the District Court granted Plaintiffs’ motion to certify a class without addressing either the merits of the claims or the size of the class or classes. We intend to defend the claims vigorously and do not believe the novel “dealer reserve” claim has merit.

The ultimate resolution of these matters cannot be predicted with certainty, and an unfavorable resolution of any of the matters could have a material adverse effect on our results of operations, financial condition or cash flows.

Item 4. Reserved

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Stock Prices and Dividends

Our Class A common stock trades on the New York Stock Exchange under the symbol LAD. The following table presents the high and low sale prices for our Class A common stock, as reported on the New York Stock Exchange Composite Tape for each of the quarters in 2010 and 2011:

	High	Low
2010		
First quarter	\$ 9.55	\$ 5.18
Second quarter	9.36	6.09
Third quarter	9.94	5.87
Fourth quarter	14.45	9.45
2011		
First quarter	\$ 16.07	\$ 13.28
Second quarter	20.31	14.12
Third quarter	23.84	13.80
Fourth quarter	24.85	13.57

The number of shareholders of record and approximate number of beneficial holders of Class A common stock as of February 24, 2012 was 968 and 10,165, respectively. All shares of Lithia's Class B common stock are held by Lithia Holding Company, LLC.

Dividends declared on our Class A and Class B common stock during 2010 and 2011 were as follows:

Quarter declared:	Dividend amount per share	Total amount of dividend (in thousands)
2010		
First quarter	\$ -	\$ -
Second quarter	0.05	1,300
Third quarter	0.05	1,307
Fourth quarter	0.05	1,312
2011		
First quarter	\$ 0.05	\$ 1,316
Second quarter	0.07	1,851
Third quarter	0.07	1,838
Fourth quarter	0.07	1,817

We did not declare or pay any dividends on our Class A and Class B common stock in 2009.

## Repurchases of Class A Common Stock

We repurchased the following shares of our Class A common stock during the fourth quarter of 2011:

Total number of shares purchased	Average price paid per share	Total number of shares purchased	Maximum number of shares that may
-------------------------------------	---------------------------------	-------------------------------------	--------------------------------------

Edgar Filing: LITHIA MOTORS INC - Form 10-K

				as part of publicly announced plan	yet be purchased under the plans
October 1 to October 31	43,137	\$	16.43	29,822	1,736,145
November 1 to November 30	68,650		20.73	33,200	1,702,945
December 1 to December 31	-		-	-	1,702,945
Total	111,787	(1) \$	19.07	63,022	1,702,945

(1) Includes 48,765 shares repurchased in association with tax withholdings on the exercises of stock options.

The plan to repurchase up to a total of 1.0 million shares of our Class A common stock, which was approved by our Board of Directors in June 2000 and renewed in August 2005, was fully utilized during the third quarter of 2011. In August 2011, our Board of Directors approved a plan to repurchase up to a total of 2.0 million shares of our Class A common stock. This plan does not have an expiration date.

## Equity Compensation Plan Information

Information regarding securities authorized for issuance under equity compensation plans is included in Item 12.

## Stock Performance Graph

The following line-graph shows the annual percentage change in the cumulative total returns for the past five years on an assumed \$100 initial investment and reinvestment of dividends, on (a) Lithia Motors, Inc.'s Class A common stock; (b) the Russell 2000; and (c) a peer group index composed of Penske Automotive Group, AutoNation, Sonic Automotive, Group 1 Automotive and Asbury Automotive Group, the only other comparable publicly traded automobile dealerships in the United States as of December 31, 2011. The peer group index utilizes the same methods of presentation and assumptions for the total return calculation as does Lithia Motors and the Russell 2000. All companies in the peer group index are weighted in accordance with their market capitalizations.

Company/Index	Base Period		Indexed Returns for the Year Ended			
	12/31/2006	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Lithia Motors, Inc.	\$100.00	\$48.94	\$12.42	\$31.31	\$55.34	\$85.86
Auto Peer Group	100.00	69.23	33.52	69.37	96.60	119.51
Russell 2000	100.00	98.45	65.18	82.90	105.16	100.75

## Item 6. Selected Financial Data

You should read the Selected Financial Data in conjunction with Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” our Consolidated Financial Statements and Notes thereto and other financial information contained elsewhere in this Annual Report on Form 10-K. The results of operations for stores classified as discontinued operations have been presented on a comparable basis for all periods presented.

(In thousands, except per share amounts) Consolidated Statements of Operations Data:	Year Ended December 31,				
	2011	2010	2009	2008	2007
<b>Revenues:</b>					
New vehicle	\$1,426,888	\$1,038,321	\$857,096	\$1,128,279	\$1,497,984
Used vehicle retail	695,796	566,803	465,001	451,257	538,486
Used vehicle wholesale	130,720	105,714	70,699	92,317	129,541
Finance and insurance	85,852	65,274	54,953	75,447	97,480
Service, body and parts	325,658	284,170	278,336	289,395	288,450
Fleet and other	34,446	11,706	2,544	4,846	4,626
Total revenues	\$2,699,360	\$2,071,988	\$1,728,629	\$2,041,541	\$2,556,567
<b>Gross Profit:</b>					
New vehicle	\$110,475	\$85,135	\$72,295	\$88,910	\$117,163
Used vehicle retail	100,618	80,064	65,515	51,929	75,863
Used vehicle wholesale	553	644	471	(2,978 )	2,898
Finance and insurance	85,852	65,274	54,953	75,447	97,480
Service, body and parts	157,120	137,051	132,500	138,226	137,225
Fleet and other	2,920	1,691	1,319	1,551	1,343
Total gross profit	\$457,538	\$369,859	\$327,053	\$353,085	\$431,972
Operating income (loss)(1)	\$111,991	\$46,571	\$34,907	\$(295,760 )	\$77,986
Income (loss) from continuing operations before income taxes(1)	\$89,175	\$22,120	\$11,764	\$(327,030 )	\$38,496
Income (loss) from continuing operations(1)	\$55,767	\$13,531	\$6,722	\$(221,425 )	\$22,876
Basic income (loss) per share from continuing operations	\$2.13	\$0.52	\$0.31	\$(10.96 )	\$1.16
Basic income (loss) per share from discontinued operations	0.11	0.01	0.11	(1.55 )	(0.06 )
Basic net income (loss) per share	\$2.24	\$0.53	\$0.42	\$(12.51 )	\$1.10
Shares used in basic per share	26,230	26,062	22,037	20,195	19,675
Diluted income (loss) per share from continuing operations	\$2.09	\$0.51	\$0.30	\$(10.96 )	\$1.11
Diluted income (loss) per share from discontinued operations	0.12	0.01	0.11	(1.55 )	(0.05 )
Diluted net income (loss) per share	\$2.21	\$0.52	\$0.41	\$(12.51 )	\$1.06
Shares used in diluted per share	26,664	26,279	22,176	20,195	22,204
Cash dividends declared per common share	\$0.26	\$0.15	\$-	\$0.47	\$0.56



(In thousands)	As of December 31,				
Consolidated Balance Sheets Data:	2011	2010	2009	2008	2007
Working capital	\$191,607	\$162,675	\$96,886	\$99,524	\$193,447
Inventories	506,484	415,228	333,628	428,032	606,056
Total assets	1,146,133	971,676	895,100	1,133,459	1,626,735
Floor plan notes payable	343,940	251,257	216,082	343,290	456,237
Long-term debt, including current maturities	286,874	280,774	265,773	338,229	464,175
Total stockholders' equity	367,121	320,217	307,038	248,343	508,212

(1) Includes \$1.4 million, \$15.3 million, \$8.0 million, \$333.8 million and \$0.2 million of non-cash charges related to asset impairments and terminated construction projects for the years ended 2011, 2010, 2009, 2008 and 2007, respectively. See Notes 1, 4 and 5 of Notes to Consolidated Financial Statements for additional information.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with Item 1. "Business," Item 1A. "Risk Factors" and our Consolidated Financial Statements and Notes thereto.

Overview

As discussed in Overview in Item 1, "Business" above, we are a leading operator of automotive franchises and retailer of new and used vehicles and services. As of February 24, 2012, we offered 25 brands of new vehicles and all brands of used vehicles in 86 stores in the United States and online at Lithia.com. We sell new and used cars and light trucks and replacement parts; provide vehicle maintenance, warranty, paint and repair services; and arrange related financing, service contracts, protection products and credit insurance.

We continue to believe that the fragmented nature of the automotive dealership sector provides us with the opportunity to achieve growth through consolidation. We seek exclusive franchises for acquisition, where we are the only representative of the brand within a market. We have completed over 100 acquisitions since our initial public offering in 1996. Our acquisition strategy has been to acquire underperforming dealerships and, through the application of our centralized operating structure, leverage costs and improve store profitability. We believe the current economic environment provides us with attractive acquisition opportunities.

We also believe that we can continue to improve operations at our existing stores. By promoting entrepreneurial leadership within our general managers and department managers, we strive for continual improvement to drive sales and capture market share in our local markets. Our goal is to retail approximately one used vehicle for every new vehicle sold and we believe we can make additional improvements in our used vehicle sales performance by offering lower-priced value vehicles and selling brands other than the new vehicle franchise at each location. Our service, body and parts operations provide important repeat business for our stores. We have increased our marketing efforts, lowered prices on routine maintenance items and focused on offering more commodity products to offset the impact of fewer units in operations. In 2011, we focused on organic growth through increasing market share and maintaining a lean cost structure.

We believe our cost structure is aligned with current industry sales levels and positioned to be leveraged as vehicle sales levels continue to improve. As we focus on maintaining discipline in controlling costs, we target retaining, on a same store pre-tax basis, 50% of each incremental gross profit dollar after deducting selling, general and administrative ("SG&A") expense.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and reported amounts of revenues and expenses at the date of the financial statements. Certain accounting policies require us to make difficult and subjective judgments on matters that are inherently uncertain. The following accounting policies involve critical accounting estimates because they are particularly dependent on assumptions made by management. While we have made our best estimates based on facts and circumstances available to us at the time, different estimates could have been used in the current period. Changes in the accounting estimates we used are reasonably likely to occur from period to period, which may have a material impact on the presentation of our financial condition and results of operations.

Our most critical accounting estimates include those related to goodwill and franchise value, long-lived assets, deferred tax assets, service contracts and other insurance contracts, and lifetime oil change and self insurance programs. We also have other key accounting policies for valuation of accounts receivable, expense accruals and revenue recognition. However, these policies either do not meet the definition of critical accounting estimates described above or are not currently material items in our financial statements. We review our estimates, judgments and assumptions periodically and reflect the effects of revisions in the period that they are deemed to be necessary. We believe that these estimates are reasonable. However, actual results could differ materially from these estimates.

#### Goodwill and Franchise Value

We are required to test our goodwill and franchise value for impairment at least annually, or more frequently if conditions indicate that an impairment may have occurred.

We have determined that we operate as one reporting unit for evaluating goodwill. For the goodwill impairment testing, we apply a fair value based test using the Adjusted Present Value method (“APV”) to indicate the fair value of our reporting unit. Under the APV method, future cash flows are based on recently prepared budget forecasts and business plans to estimate the future economic benefits that the reporting unit will generate. An estimate of the appropriate discount rate is utilized to convert the future economic benefits to their present value equivalent.

The goodwill impairment test is a two step process. The first step identifies potential impairments by comparing the calculated fair value of a reporting unit with its book value. If the fair value of the reporting unit exceeds the carrying amount, goodwill is not impaired and the second step is not necessary. If the carrying value exceeds the fair value, the second step includes determining the implied fair value through further market research. The implied fair value of goodwill is then compared with the carrying amount to determine if an impairment loss should be recorded.

As of December 31, 2011, we had \$19.0 million of goodwill on our balance sheet. The first step of our annual goodwill impairment analysis, which we perform as of October 1 of each year, did not result in an indication of impairment in 2011 or in 2010. We did not have any goodwill as of December 31, 2009. The fair value of the reporting unit as of December 31, 2011, using the APV method, was 42% greater than the carrying value at December 31, 2011.

We have determined the appropriate unit of accounting for testing franchise rights for impairment is on an individual store basis. For the franchise value impairment testing, we estimate the fair value of our franchise rights primarily using the Multi-Period Excess Earnings (“MPEE”) model. The forecasted cash flows used in the MPEE model contain inherent uncertainties, including significant estimates and assumptions related to growth rates, margins, general operating expenses, and cost of capital. We use primarily internally-developed forecasts and business plans to estimate the future cash flows that each franchise will generate. We have determined that only certain cash flows of the store are directly attributable to the franchise rights. We estimate the appropriate interest rate to discount future cash flows to their present value equivalent taking into consideration factors such as a risk-free rate, a beta, an equity risk premium, a small stock risk premium, and a subject-company risk premium.

We also use third-party brokers’ estimates to assist us in determining the fair value of our franchise rights, which are developed using marketplace data related to current transactions involving franchise rights.

As of December 31, 2011, we had \$59.1 million of franchise value on our balance sheet. Our impairment testing of franchise value did not indicate any impairment in 2011 or 2010. Our impairment testing of franchise value in 2009 resulted in impairment charges of \$0.3 million, primarily due to the adverse change in the business climate and our reduced earnings.

We are subject to financial statement risk to the extent that our goodwill or franchise rights become impaired due to decreases in the fair value. A future decline in performance, decreases in projected growth rates or margin assumptions or changes in discount rates could result in a potential impairment, which could have a material adverse impact on our financial position and results of operations. Furthermore, in the event that a manufacturer is unable to remain solvent, we may be required to record a partial or total impairment on the remaining franchise value related to that manufacturer.

See Notes 1 and 5 of Notes to Consolidated Financial Statements for additional information.

#### Long-Lived Assets

We estimate the depreciable lives of our property and equipment, including leasehold improvements, and review them for impairment when events or circumstances indicate that their carrying amounts may not be recoverable.

We determine a triggering event has occurred by reviewing store forecasted and historical financial performance. A store is evaluated for recoverability if it has an operating loss in the current year and two of the prior three years. Additionally, we may judgmentally evaluate a store if its financial performance indicates it may not support the carrying amount of the long-lived assets. If a store meets these criteria, we estimate the projected undiscounted cash flows for each asset group based on internally developed forecasts. If the undiscounted cash flows are lower than the carrying value of the asset group, we determine the fair value of the asset group based on additional market data, including recent experience in selling similar assets.

We hold certain property for future development or investment purposes. If a triggering event is deemed to have occurred, we evaluate the property for impairment by comparing its estimated fair value based on listing price less costs to sell and other market data, including similar property that is for sale or has been recently sold, to the current carrying value. If the carrying value is more than the estimated fair value, an impairment is recorded.

Although we believe our property and equipment and assets held and used are appropriately valued, the assumptions and estimates used may change and we may be required to record impairment charges to reduce the value of these assets. A future decline in store performance, decrease in projected growth rates or changes in other operating assumptions could result in an impairment of long-lived asset groups, which could have a material adverse impact on our financial position and results of operations. A decline in the commercial real estate market could result in a potential impairment of certain investment properties not currently used in operations. Currently, \$14.0 million of our long-lived assets are considered held for future development or investment purposes.

Due to the adverse change in the business climate and the commercial real estate market, we performed impairment testing on long-lived assets, mainly related to certain property held for future development or investment purposes in 2011, 2010 and 2009. As a result, we recorded impairments related to long-lived assets of \$1.4 million, \$15.3 million and \$9.7 million in 2011, 2010 and 2009, respectively.

See Notes 1 and 4 of Notes to Consolidated Financial Statements for additional information.

#### Deferred Tax Assets

As of December 31, 2011, we had deferred tax assets of approximately \$69.2 million and deferred tax liabilities of \$22.3 million. The principal components of our deferred tax assets are related to goodwill, allowances and accruals, deferred revenue and cancellation reserves. The principal components of our deferred tax liabilities are related to depreciation on property and equipment and inventories.

We consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected future taxable income, and tax-planning strategies in making this assessment.

Based upon the scheduled reversal of deferred tax liabilities, and our projections of future taxable income over the periods in which the deferred tax assets are deductible, we believe it is more likely than not that we will realize the benefits of these deductible differences.

At December 31, 2011, we recorded a \$12.8 million valuation allowance against our deferred tax assets. In 2011, we recorded an allowance associated with losses from the sale of corporate entities. As these amounts are characterized as capital losses, we evaluated the availability of projected capital gains and determined that it would be unlikely these amounts would be fully utilized. If we are unable to meet the projected taxable income levels utilized in our analysis, and depending on the availability of feasible tax planning strategies, we might record a valuation allowance on a portion or all of our deferred tax assets in the future. In the event that a manufacturer is unable to remain solvent, our operations may be impacted and we might record a valuation allowance on a portion or all of the deferred tax assets, which could have a material adverse impact on our financial position and results of operations.

#### Service Contracts and Other Insurance Contracts

We receive commissions from the sale of vehicle service contracts and certain other insurance contracts. The contracts are sold through unrelated third parties, but we may be charged back for a portion of the commissions in the event of early termination of the contracts by customers. We sell these contracts on a straight commission basis; in addition, we may also participate in future underwriting profit pursuant to retrospective commission arrangements, which are recognized as income upon receipt.

We record commissions at the time of sale of the vehicles, net of an estimated liability for future charge-backs. We have established a reserve for estimated future charge-backs based on an analysis of historical charge-backs in conjunction with estimated lives of the applicable contracts. If future cancellations are different than expected, we could have additional expense related to the cancellations in future periods, which could have a material adverse impact on our financial position and results of operations.

At December 31, 2011 and 2010, the reserve for future cancellations totaled \$10.4 million and \$9.4 million, respectively, and is included in accrued liabilities and other long-term liabilities on our Consolidated Balance Sheets. A 10% increase in expected cancellations would result in an additional reserve of approximately \$1.0 million.

#### Lifetime Oil Change Self-Insurance

In March 2009, we assumed from a third party the obligation to provide future lifetime oil service for a pool of existing contracts and began to self-insure the majority of the lifetime oil contracts we sell.

Payments we receive upon sale of the lifetime oil contracts are deferred and recognized in revenue over the expected life of the service agreement to best match the expected timing of the costs to be incurred to perform the service. We estimate the timing and amount of future costs for claims and cancellations related to our lifetime oil contracts using historical experience rates and estimated future costs.

If our estimates of future costs to perform under the contracts exceed the existing deferred revenue, we record a charge in the statement of operations. We perform our loss contingency analysis separately for the pool of assumed contracts and the pool of self-insured contracts sold starting in March 2009. We recorded a charge of \$1.0 million, \$1.0 million and \$1.4 million in 2011, 2010 and 2009, respectively, for expected costs in excess of revenue deferred related to the pool of assumed contracts. The analysis on our self-insured sold contracts did not indicate a loss reserve was needed in 2011, 2010 and 2009.

We believe the new vehicle purchase cycle has been delayed for many buyers. If the ownership cycle does not accelerate towards pre-recession levels, our estimate of the number of oil changes to be performed over a vehicle's life may increase, which would adversely affect our financial position and results of operations. In addition, other changes

in assumptions about future costs expected to be incurred to service contracts could result in the recognition of additional charges, which could have a material adverse impact on our financial position and results of operations.

A 10% change in expected claims costs per contract for the assumed pool of contracts would result in an additional reserve of approximately \$0.9 million. A 10% change in expected claims per contract for the self-insured sold contracts would not require any reserve. At December 31, 2011 and 2010, the remaining deferred revenue related to the assumed obligation and the self-insured sold contracts was \$5.5 million and \$7.5 million, respectively.

#### Self Insurance Programs

We self-insure a portion of our property and casualty insurance, medical insurance and workers' compensation insurance. A third-party is engaged to estimate the loss exposure related to the self-retained portion of the risk associated with these insurances. Additionally, we analyze our historical loss and claims experience to estimate the loss exposure associated with these programs. Any changes in assumptions or claim experience could result in the recognition of additional charges, which could have a material adverse impact on our financial position and results of operations.

At December 31, 2011 and 2010, the total reserve associated with these programs was \$10.4 million and \$7.3 million, respectively, and is included in accrued liabilities and other long-term liabilities on our Consolidated Balance Sheets. A 10% increase in claims experience would result in an additional reserve of approximately \$3.9 million.

#### Results of Continuing Operations

For the year ended December 31, 2011, we reported income from continuing operations, net of tax, of \$55.8 million, or \$2.09 per diluted share. For the years ended December 31, 2010 and 2009, we reported income from continuing operations, net of tax, of \$13.5 million, or \$0.51 per diluted share, and \$6.7 million, or \$0.30 per diluted share, respectively.

#### Discontinued Operations

Results for sold or closed stores, qualifying for reclassification under the applicable accounting guidance, have their results presented as discontinued operations in our Consolidated Statements of Operations. As a result, our results from continuing operations are presented on a comparable basis for all periods. Within discontinued operations, we realized a gain, net of tax, of \$3.1 million, \$0.2 million and \$2.4 million for the years ended December 31, 2011, 2010 and 2009, respectively. See Notes 1 and 17 of Notes to Consolidated Financial Statements for additional information.



Edgar Filing: LITHIA MOTORS INC - Form 10-K

Key Performance Metrics

Certain key performance metrics for revenue and gross profit were as follows for 2011, 2010 and 2009 (dollars in thousands):

	Revenues	Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
2011					
New vehicle	\$1,426,888	52.9 %	\$110,475	7.7 %	24.1 %
Used vehicle, retail	695,796	25.8	100,618	14.5	22.0
Used vehicle, wholesale	130,720	4.8	553	0.4	0.1
Finance and insurance(1)	85,852	3.2	85,852	100.0	18.8
Service, body and parts	325,658	12.0	157,120	48.2	34.3
Fleet and other	34,446	1.3	2,920	8.5	0.7
	\$2,699,360	100.0 %	\$457,538	16.9 %	100.0 %

	Revenues	Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
2010					
New vehicle	\$1,038,321	50.1 %	\$85,135	8.2 %	23.0 %
Used vehicle, retail	566,803	27.4	80,064	14.1	21.6
Used vehicle, wholesale	105,714	5.1	644	0.6	0.2
Finance and insurance(1)	65,274	3.1	65,274	100.0	17.6
Service, body and parts	284,170	13.7	137,051	48.2	37.1
Fleet and other	11,706	0.6	1,691	14.4	0.5
	\$2,071,988	100.0 %	\$369,859	17.9 %	100.0 %

	Revenues	Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
2009					
New vehicle	\$857,096	49.6 %	\$72,295	8.4 %	22.1 %
Used vehicle, retail	465,001	26.9	65,515	14.1	20.0
Used vehicle, wholesale	70,699	4.1	471	0.7	0.2
Finance and insurance(1)	54,953	3.2	54,953	100.0	16.8
Service, body and parts	278,336	16.1	132,500	47.6	40.5
Fleet and other	2,544	0.1	1,319	51.8	0.4
	\$1,728,629	100.0 %	\$327,053	18.9 %	100.0 %

(1) Commissions reported net of anticipated cancellations.

Same Store Operating Data

We believe that same store sales are a key indicator of our financial performance. Same store metrics demonstrate our ability to grow our revenue and profitability in our existing locations. As a result, same store sales have been integrated into the discussion below.

A same store basis represents stores that were operating during 2011, and only includes the months when operations occur in both comparable periods. For example, a store acquired in August 2010 would be included in same store

operating data beginning in September 2011, after its first full complete comparable month of operation. Thus, operating results for same store comparisons would include only the period of September through December of both comparable years.

## New Vehicle Revenues

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase	
	2011	2010			
<b>Reported</b>					
Revenue	\$1,426,888	\$1,038,321	\$388,567	37.4	%
Retail units sold	43,273	32,664	10,609	32.5	
Average selling price per retail unit	\$32,974	\$31,788	\$1,186	3.7	
<b>Same store</b>					
Revenue	\$1,341,171	\$1,039,886	\$301,285	29.0	%
Retail units sold	41,144	32,703	8,441	25.8	
Average selling price per retail unit	\$32,597	\$31,798	\$799	2.5	

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase	
	2010	2009			
<b>Reported</b>					
Revenue	\$1,038,321	\$857,096	\$181,225	21.1	%
Retail units sold	32,664	28,439	4,225	14.9	
Average selling price per retail unit	\$31,788	\$30,138	\$1,650	5.5	
<b>Same Store</b>					
Revenue	\$1,024,085	\$857,877	\$166,208	19.4	%
Retail units sold	32,136	28,457	3,679	12.9	
Average selling price per retail unit	\$31,867	\$30,146	\$1,721	5.7	

New vehicle sales in 2011 improved compared to 2010 as both volumes and average selling prices increased. We remain focused on increasing our share of overall new vehicle sales within our markets, and had targeted increased market share as an operational objective in 2011. As a result of this initiative, as well as improved consumer demand, domestic brand new vehicle same store sales increased 41% in 2011 compared to 2010. Import and luxury brands had a same store sales improvement of 15% in 2011 compared to 2010. The sales growth for import and luxury brands was not as robust as domestic brands as inventory constraints resulting from the events in Japan and the subsequent disruption to new vehicle supply negatively affected sales.

New vehicle sales improved throughout 2010 compared to 2009 due to a recovery in the U.S. economy and our efforts to increase our share of the new vehicles sold within each local market. Credit availability improved throughout 2010, although, within the sub-prime market, lending remained constrained. Additionally, domestic brands experienced a recovery of market share due to improved product and increased consumer confidence as Chrysler and GM emerged from their restructuring, and as Toyota lost market share due to perceived quality issues and recall campaigns.

## Used Vehicle Retail Revenues

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase	
	2011	2010			
<b>Reported</b>					
Retail revenue	\$695,796	\$566,803	\$128,993	22.8	%
Retail units sold	40,457	33,869	6,588	19.5	
Average selling price per retail unit	\$17,198	\$16,735	\$463	2.8	
<b>Same store</b>					
Retail revenue	\$658,586	\$563,587	\$94,999	16.9	%
Retail units sold	38,762	33,646	5,116	15.2	
Average selling price per retail unit	\$16,991	\$16,750	\$241	1.4	

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase	
	2010	2009			
<b>Reported</b>					
Retail revenue	\$566,803	\$465,001	\$101,802	21.9	%
Retail units sold	33,869	28,577	5,292	18.5	
Average selling price per retail unit	\$16,735	\$16,272	\$463	2.8	
<b>Same store</b>					
Retail revenue	\$554,150	\$464,365	\$89,785	19.3	%
Retail units sold	33,073	28,532	4,541	15.9	
Average selling price per retail unit	\$16,755	\$16,275	\$480	2.9	

We continue to emphasize used vehicle retail sales and respond to potential supply constraints in late-model used vehicles as a result of the lower new vehicle sales in 2008, 2009 and 2010. Our strategy is to offer three categories of used vehicles: manufacturer certified pre-owned used vehicles; late model, lower-mileage vehicles; and value autos. This approach allows us to expand our target customer and increase the conversion of vehicles acquired via trade-in to retail used vehicle sales. In 2011, we continued to focus on increasing the number of lower-price, higher-margin, older used vehicles we sell and the sale of brands other than the store's new vehicle franchise. Our retail used to new vehicle sales ratio fell slightly to 0.9:1 for the year ended December 31, 2011 compared to 1.0:1 in 2010 and 1.0:1 in 2009, primarily related to stronger growth in new vehicle sales in 2011. On average, each of our stores currently sells 40 retail used vehicle units per month and we target increasing sales to 60 units per month. Our goal continues to be a retail used to new ratio of 1.0:1.

Used vehicle retail unit sales increased in 2010 compared to 2009 as consumers elected to purchase used vehicles instead of new vehicles, and as we increased the number of lower-price, higher-margin, older used vehicles we sell. We focused our store personnel on maximizing retail used vehicle sales and reducing the number of used vehicles we wholesale after acquiring them via trade-in.

## Used Vehicle Wholesale Revenues

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase	
	2011	2010			
<b>Reported</b>					
Wholesale revenue	\$130,720	\$105,714	\$25,006	23.7	%
Wholesale units sold	16,439	13,906	2,533	18.2	
Average selling price per wholesale unit	\$7,952	\$7,602	\$350	4.6	
<b>Same store</b>					
Wholesale revenue	\$125,324	\$104,292	\$21,032	20.2	%
Wholesale units sold	15,942	13,769	2,173	15.8	
Average selling price per wholesale unit	\$7,861	\$7,574	\$287	3.8	

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase	
	2010	2009			
<b>Reported</b>					
Wholesale revenue	\$105,714	\$70,699	\$35,015	49.5	%
Wholesale units sold	13,906	13,211	695	5.3	
Average selling price per wholesale unit	\$7,602	\$5,352	\$2,250	42.0	
<b>Same store</b>					
Wholesale revenue	\$103,302	\$69,970	\$33,332	47.6	%
Wholesale units sold	13,584	13,159	425	3.2	
Average selling price per wholesale unit	\$7,605	\$5,317	\$2,288	43.0	

Wholesale transactions are vehicles we have purchased from customers or vehicles we have attempted to sell via retail that we elect to dispose of due to inventory age or other factors. Since 2010, we have concentrated on directing more lower-priced, older vehicles to retail sale rather than wholesale disposal, which resulted in an increase in the average selling price per wholesale unit in 2011 compared to 2010 and in 2010 compared to 2009.

Wholesale vehicle sales are typically done at or near inventory cost and do not comprise a meaningful component of our gross profit. We generated wholesale profit of \$0.6 million, \$0.6 million and \$0.5 million in 2011, 2010 and 2009, respectively.

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Finance and Insurance

(Dollars in thousands)	Year Ended		Increase (Decrease)	% Increase (Decrease)	
	2011	December 31, 2010			
<b>Reported</b>					
Revenue	\$85,852	\$65,274	\$20,578	31.5	%
Revenue per retail unit					
Finance reserves	\$387	\$338	\$49	14.5	%
Maintenance contracts	528	535	(7)	(1.3)	)
Insurance and other	110	108	2	1.9	
Revenue per retail unit	\$1,025	\$981	\$44	4.5	%
<b>Same store</b>					
Revenue	\$81,335	\$62,433	\$18,902	30.3	%
Revenue per retail unit					
Finance reserves	\$382	\$333	\$49	14.7	%
Maintenance contracts	532	508	24	4.7	
Insurance and other	104	100	4	4.0	
Revenue per retail unit	\$1,018	\$941	\$77	8.2	%
<b>Reported</b>					
<b>Reported</b>					
Revenue	\$65,274	\$54,953	\$10,321	18.8	%
Revenue per retail unit					
Finance reserves	\$338	\$291	\$47	16.2	%
Maintenance contracts	535	560	(25)	(4.5)	)
Insurance and other	108	113	(5)	(4.4)	)
Revenue per retail unit	\$981	\$964	\$17	1.8	%
<b>Same store</b>					
Revenue	\$61,263	\$52,445	\$8,818	16.8	%
Revenue per retail unit					
Finance reserves	\$334	\$286	\$48	16.8	%
Maintenance contracts	505	530	(25)	(4.7)	)
Insurance and other	100	104	(4)	(3.8)	)
Revenue per retail unit	\$939	\$920	\$19	2.1	%

The increases in finance and insurance sales in 2011 compared to 2010, and 2010 compared to 2009 were primarily due to more vehicles sold. The availability of consumer credit has expanded and lenders have increased the loan-to-value amount available to most customers. Additionally, competition has continued to increase among lenders and we have seen an increase in finance reserves. As a result, we have experienced continued improvement in the average amount of revenue per unit. These shifts afford us the opportunity to sell additional or more comprehensive products, while remaining within a loan-to-value framework acceptable to our retail customer lenders.

In 2010, banks returned to the auto finance market and provided alternate financing options to customers that we had primarily shifted to credit unions in 2009. Banks typically pay a higher commission for arranging retail automotive financing and our revenue per retail unit increased as a result.

Penetration rates for certain products were as follows:

	2011	2010	2009
Finance and insurance	73%	72%	69%
Service contracts	40	41	41
Lifetime oil change and filter	36	34	35

## Service, Body and Parts Revenue

(Dollars in thousands)	Year Ended		Increase (Decrease)	% Increase (Decrease)	
	2011	December 31, 2010			
<b>Reported</b>					
Customer pay	\$184,335	\$160,395	\$23,940	14.9	%
Warranty	53,377	49,360	4,017	8.1	
Wholesale parts	57,734	48,342	9,392	19.4	
Body shop	30,212	26,073	4,139	15.9	
Total service, body and parts	\$325,658	\$284,170	\$41,488	14.6	%
<b>Same store</b>					
Customer pay	\$166,418	\$160,148	\$6,270	3.9	%
Warranty	47,470	49,311	(1,841)	(3.7)	)
Wholesale parts	53,078	48,137	4,941	10.3	
Body shop	29,689	26,040	3,649	14.0	
Total service, body and parts	\$296,655	\$283,636	\$13,019	4.6	%

(Dollars in thousands)	Year Ended		Increase (Decrease)	% Increase (Decrease)	
	2010	December 31, 2009			
<b>Reported</b>					
Customer pay	\$160,395	\$151,035	\$9,360	6.2	%
Warranty	49,360	53,062	(3,702)	(7.0)	)
Wholesale parts	48,342	48,075	267	0.6	
Body shop	26,073	26,164	(91)	(0.3)	)
Total service, body and parts	\$284,170	\$278,336	\$5,834	2.1	%
<b>Same store</b>					
Customer pay	\$158,052	\$151,024	\$7,028	4.7	%
Warranty	48,616	53,062	(4,446)	(8.4)	)
Wholesale parts	47,628	47,956	(328)	(0.7)	)
Body shop	25,601	26,164	(563)	(2.2)	)
Total service, body and parts	\$279,897	\$278,206	\$1,691	0.6	%

Our service, body and parts business improved in 2011 compared to 2010 as well as in 2010 compared to 2009. Our customer pay business has increased as we maintained our focus on retaining customers through competitively-priced routine maintenance offerings and increased marketing efforts. The same store customer pay service and parts business represented 56.1% and 56.5% of the total same store service, body and parts business in 2011 and 2010, respectively. As a result of our increased focus and marketing efforts, same store customer pay business increased 3.9% in 2011 compared to 2010 and 4.7% in 2010 compared to 2009.

Warranty work accounted for approximately 16.0% of our same store service, body and parts sales in 2011 compared to 17.4% in 2010, which resulted in a 3.7% decrease in same store warranty sales in 2011 compared to 2010. Domestic brand warranty work decreased by 7.7%, while import/luxury warranty work decreased by 0.7% in 2011 compared to 2010. Same store warranty work declined 8.4% in 2010 compared to 2009. The decline in warranty work in both 2011 compared to 2010 and in 2010 compared to 2009 was primarily due to declining units in operation.



We continued to grow our wholesale parts and body shop sales in 2011, which represented 27.9% of our same store service, body and parts revenue mix in 2011 and grew 11.6% on a same store basis in 2011 compared to 2010. We have implemented initiatives in both categories to aggressively pursue revenue increases. As both wholesale parts and body shop margins are lower than service work, we expect gross margins may modestly decline as these areas of the business comprise a larger portion of the total.

## Gross Profit

Gross profit increased \$87.7 million in 2011 compared to 2010 and increased \$42.8 million in 2010 compared to 2009. The increases in 2011 and 2010 were primarily due to increased revenues, partially offset by declines in our overall gross profit margin.

Our gross profit margins by business line were as follows:

	Year Ended December 31,		Basis Point Change*
	2011	2010	
New vehicle	7.7%	8.2%	(50)bp
Retail used vehicle	14.5	14.1	40
Wholesale used vehicle	0.4	0.6	(20)
Finance and insurance	100.0	100.0	-
Service, body and parts	48.2	48.2	-
Overall	16.9%	17.9%	(100)

	Year Ended December 31,		Basis Point Change*
	2010	2009	
New vehicle	8.2%	8.4%	(20)bp
Retail used vehicle	14.1	14.1	-
Wholesale used vehicle	0.6	0.7	(10)
Finance and insurance	100.0	100.0	-
Service, body and parts	48.2	47.6	60
Overall	17.9%	18.9%	(100)

\* A basis point is equal to 1/100th of one percent.

Our overall gross profit margin decreased slightly or remained flat in all lines of business except retail used vehicle in 2011 compared to 2010. New vehicle margins decreased during 2011 due to reduced manufacturer incentive programs and a shift in vehicle sales mix away from smaller vehicles and import brands which typically have a higher gross margin percentage. Used vehicle margins have increased slightly due to a scarcity of supply of late model used vehicles. Supply of these types of vehicles has been lower as a result of reduced new vehicle production in 2008, 2009 and 2010, which was exacerbated by the import brand shortages in the second and third quarters of 2011 as a result of events in Japan. Despite these recent trends, we believe our strategy of maintaining franchise exclusivity within the markets we serve protects profitability and allows us to maintain overall margin levels.

In 2010 compared to 2009, our overall gross profit margin decreased primarily due to a mix shift as we sold a greater number of new vehicles, which have lower margins than our other businesses. We have worked to maintain our gross profit margin in the face of rising product costs.

## Asset Impairment Charges

Asset impairments recorded as a component of continuing operations consist of the following (in thousands):

December 31,	2011	2010	2009
Asset Impairments			
Intangible assets	\$ -	\$ -	\$ 250
Long-lived assets	1,376	15,301	9,720

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Other assets	-	-	(1,998 )
Total asset impairments	\$ 1,376	\$ 15,301	\$ 7,972

During 2011, due to changes in the expected future uses for two of our properties and additional market data, we determined the carrying values exceeded the fair values of the properties and an asset impairment charge of \$1.4 million was recorded.

During 2010, we believed events and circumstances indicated the carrying amount of our non-operational long-lived assets may no longer be recoverable, triggering interim impairment tests. We determined a triggering event had occurred based on the following factors:

- slower industry recovery for retail vehicle sales than originally projected at the end of 2009;
- oversupply of vacant dealership properties due to the economic downturn and bankruptcy proceedings for Chrysler and GM; and
- the broader economic recovery, including the availability of credit, remained gradual, limiting the potential buyers of these types of properties.

Based on the results of those tests, we recorded asset impairment charges of \$15.3 million associated with certain properties during 2010.

In 2009, as a result of the reorganization in bankruptcy of both Chrysler and GM, and the decline in commercial real estate values, we tested our long-lived assets for recoverability. Additionally, operational results for certain locations have been retrospectively reclassified from discontinued operations to continuing operations in the Consolidated Statement of Operations, including prior period impairments. As these assets were no longer expected to be sold, a reversal of estimated costs to sell was recorded in 2009. Total asset impairment charges were \$8.0 million in 2009.

See Notes 1, 4 and 5 of Notes to Consolidated Financial Statements for additional information.

#### Selling, General and Administrative Expense (“SG&A”)

“SG&A” includes salaries and related personnel expenses, advertising (net of manufacturer cooperative advertising credits), rent, facility costs, and other general corporate expenses.

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2011	2010		
Personnel	\$ 216,653	\$ 180,356	\$ 36,297	20.1 %
Advertising	25,116	26,170	(1,054 )	(4.0 )
Rent	15,035	13,611	1,424	10.5
Facility costs	18,047	22,816	(4,769 )	(20.9 )
Other	52,694	47,880	4,814	10.1
Total SG&A	\$ 327,545	\$ 290,833	\$ 36,712	12.6

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2010	2009		
Personnel	\$ 180,356	\$ 166,085	\$ 14,271	8.6 %
Advertising	26,170	17,798	8,372	47.0
Rent	13,611	14,378	(767 )	(5.3 )
Facility costs	22,816	22,545	271	1.2
Other	47,880	45,582	2,298	5.0
Total SG&A	\$ 290,833	\$ 266,388	\$ 24,445	9.2

SG&A expense increased \$36.7 million in 2011 compared to 2010. This change was primarily driven by increased variable costs associated with improved sales. Offsetting the increased costs was a \$6.3 million gain on the sale of property in California recorded as a component of facility costs. We continue to focus on reducing or maintaining fixed costs and effectively managing variable costs.

SG&A as a percentage of gross profit was 71.6% in 2011 compared to 78.6% in 2010. Adjusting for the gain on the sale of property in California and other pro forma items, our adjusted SG&A expense as a percentage of gross profit was 72.9% in 2011. As sales volume increases and we gain leverage in our cost structure, we anticipate achieving metrics of SG&A as a percentage of gross profit in the low 70% range.

SG&A expense increased \$24.4 million in 2010 compared to 2009, primarily due to increased sales volumes and increased advertising expense to gain market share, offset by savings in other areas as we continued to focus on reducing costs. SG&A as a percentage of gross profit was 78.6% in 2010 compared to 81.5% in 2009.

We also measure the leverage of our cost structure by evaluating throughput, which is calculated as the incremental percentage of gross profit retained after deducting SG&A expense. For the years ended December 31, 2011 and 2010, our incremental throughput was 58.1% and 42.9%, respectively. Adjusting for the gain on the sale of property in California and other pro forma items, our adjusted throughput in 2011 was 49.3%. We target same store incremental throughput of approximately 50%.

#### Depreciation and Amortization

Depreciation and amortization is comprised of depreciation expense related to buildings, significant remodels or betterments, furniture, tools, equipment and signage and amortization of certain intangible assets, including customer lists and non-compete agreements.

	Year Ended December 31,			%
(Dollars in thousands)	2011	2010	Decrease	Decrease
Depreciation and amortization	\$ 16,626	\$ 17,154	\$ (528 )	(3.1 )%

	Year Ended December 31,			%
(Dollars in thousands)	2010	2009	Decrease	Decrease
Depreciation and amortization	\$ 17,154	\$ 17,786	\$ (632 )	(3.6 )%

Depreciation and amortization decreased \$0.5 million and \$0.6 million, respectively, in 2011 compared to 2010 and in 2010 compared to 2009. The decrease in 2011 compared to 2010 was due primarily to the sale of facilities in the second half of 2010 and early 2011. The decrease in 2010 compared to 2009 was primarily due to the reclassification of assets previously classified as held for sale back to assets held and used, which resulted in a \$2.0 million depreciation charge in 2009 as these assets were valued at the lower of their fair value or their net book value assuming depreciation had not been halted.

#### Operating Income

Operating income was 4.1%, 2.2% and 2.0% of revenue, respectively, in 2011, 2010 and 2009. The increases in 2011 compared to 2010, and 2010 compared to 2009 were primarily due to improved sales and continued cost control.

#### Floor Plan Interest Expense and Floor Plan Assistance

Floor plan interest expense increased \$0.3 million in 2011 compared to 2010. A decrease of \$1.4 million resulted from declines in the average benchmark interest rates on our floor plan facilities and an increase of \$2.4 million resulted from increases in the average outstanding balances of our floor plan facilities. Ineffectiveness from hedging interest rate swaps resulted in a decrease of \$0.7 million.

Floor plan interest expense decreased \$0.4 million in 2010 compared to 2009. A decrease of \$0.1 million resulted from declines in the average benchmark interest rates on our floor plan facilities and a decrease of \$1.0 million resulted from decreases in the average outstanding balances of our floor plan facilities. Ineffectiveness from hedging interest rate swaps resulted in an increase of \$0.7 million.



Floor plan assistance is provided by manufacturers to support store financing of new vehicle inventory. Under accounting standards, floor plan assistance is recorded as a component of new vehicle gross profit when the specific vehicle is sold. However, as manufacturers provide this assistance to offset inventory carrying costs, we believe a comparison of floor plan interest expense to floor plan assistance may be used to evaluate the efficiency of our new vehicle sales relative to stocking levels. The following tables detail the carrying costs for new vehicles and include new and program vehicle floor plan interest net of floor plan assistance earned.

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2011	2010		
Floor plan interest expense (new vehicles)	\$ 10,584	\$ 10,325	\$ 259	2.5 %
Floor plan assistance (included in cost of sales)	(12,812 )	(9,543 )	(3,269 )	(34.3 )
Net new vehicle carrying costs (benefit)	\$(2,228 )	\$ 782	\$(3,010 )	(384.9 )%

(Dollars in thousands)	Year Ended December 31,		Decrease	% Decrease
	2010	2009		
Floor plan interest expense (new vehicles)	\$ 10,325	\$ 10,704	\$(379 )	(3.5 )%
Floor plan assistance (included in cost of sales)	(9,543 )	(9,002 )	(541 )	(6.0 )
Net new vehicle carrying costs	\$ 782	\$ 1,702	\$(920 )	(54.1 )%

#### Other Interest Expense

Other interest expense includes interest on debt incurred related to acquisitions, real estate mortgages and our working capital, acquisition and used vehicle credit facility.

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2011	2010		
Mortgage interest	\$ 11,395	\$ 13,593	\$(2,198 )	(16.2 )%
Other interest	1,696	952	744	78.2
Capitalized interest	(163 )	-	(163 )	-
Total other interest expense	\$ 12,928	\$ 14,545	\$(1,617 )	(11.1 )%

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2010	2009		
Mortgage interest	\$ 13,593	\$ 12,439	\$ 1,154	9.3 %
Other interest	952	2,402	(1,450 )	(60.4 )
Capitalized interest	-	(916 )	916	-
Total other interest expense	\$ 14,545	\$ 13,925	\$ 620	4.5 %

For 2011 compared to 2010, other interest expense decreased \$1.6 million primarily due to decreases in outstanding real estate mortgage debt, partially offset by an increase in interest on our working capital, acquisition and used vehicle credit facility due to a higher volume of borrowing compared to 2010. Additionally, we recorded \$0.2 million in capitalized interest in 2011 associated with construction projects, further reducing our overall interest expense.



Other interest expense increased in 2010 compared to 2009 mainly related to outstanding real estate mortgage debt and \$0.9 million of capitalized interest in 2009. This increase was offset by the reduction of other interest expense associated with our convertible notes, which were repurchased in 2009.

### Other Income, net

Other income, net primarily includes interest income and gains on the retirement of debt. Other income, net was \$0.7 million, \$0.4 million and \$1.5 million for 2011, 2010 and 2009, respectively. A gain of \$0.3 million was recorded in 2009 related to the early retirement of our convertible notes. Additionally, a gain of approximately \$1.0 million in 2009 was related to the result of a binding arbitration.

### Income Tax Expense

Our effective income tax rate was 37.5% in 2011, 38.8% in 2010 and 42.9% in 2009. Our federal income tax rate is 35.0% and our state income tax rate is currently 3.4%, which varies with the mix of states where our stores are located. We also have certain non-deductible expenses and other adjustments that impact our effective rate. In 2009, the impact of non-deductible expenses was magnified by a decline in income due to the slower sales environment.

### Non-GAAP Reconciliations

We believe each of the non-GAAP financial measures below improves the transparency of our disclosures, provides a meaningful presentation of our results from the core business operations excluding adjustments for items not related to our ongoing core business operations or other non-cash adjustments, and improves the period-to-period comparability of our results from the core business operations. These presentations are not intended to provide cost of sales, SG&A expense, income from operations, income from continuing operations before income taxes, income from continuing operations or diluted income per share from continuing operations in accordance with GAAP and should not be considered an alternative to GAAP measures.

The following table reconciles certain reported GAAP amounts per the Consolidated Statements of Operations to the comparable non-GAAP amounts (dollars in thousands, except per share amounts):

	Year Ended December 31					
	2011		2010		2009	
Service, body and parts cost of sale						
As reported	\$	168,538	\$	147,119	\$	145,836
Reserve adjustments		(950 )		(1,040 )		(1,400 )
Adjusted	\$	167,588	\$	146,079	\$	144,436
Selling, general and administrative expense						
As reported	\$	327,545	\$	290,833	\$	266,388
Impairments, disposal gains and other, net		6,881		419		-
Reserve adjustments		-		(1,238 )		(454 )
Adjusted	\$	334,426	\$	290,014	\$	265,934
SG&A as a % of gross profit						
As reported		71.6 %		78.6 %		81.5 %
Adjusted		72.9		78.2		81.0
Income from operations						
As reported	\$	111,991	\$	46,571	\$	34,907
Impairments, disposal gains and other, net		(5,505 )		14,882		7,542
Reserve adjustments		950		2,278		1,854
Adjusted	\$	107,436	\$	63,731	\$	44,303

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Operating profit						
As reported	4.1	%	2.2	%	2.0	%
Adjusted	4.0		3.1		2.6	

Income from continuing operations before  
income taxes

As reported	\$ 89,175	\$ 22,120	\$ 11,764
Impairments, disposal (gains) losses and other, net	(5,505 )	14,882	7,542
Reserve adjustments	950	2,278	1,854
Gain on extinguishment of debt	-	-	(1,317 )
Adjusted	\$ 84,620	\$ 39,280	\$ 19,843

## Pre-tax margin

As reported	3.3	%	1.1	%	0.7	%
Adjusted	3.1		1.9		1.1	

## Net income from continuing operations

As reported	\$ 55,767	\$ 13,531	\$ 6,722
Impairments, disposal (gains) losses and other, net	(3,732 )	9,166	4,782
Reserve adjustments	591	1,496	1,102
Gain on extinguishment of debt	-	-	(811 )
Adjusted	\$ 52,626	\$ 24,193	\$ 11,795

Diluted net income per share from  
continuing operations

As reported	\$ 2.09	\$ 0.51	\$ 0.30
Impairments, disposal (gains) losses and other, net	(0.14 )	0.35	0.22
Reserve adjustments	0.02	0.07	0.05
Gain on extinguishment of debt	-	-	(0.04 )
Adjusted	\$ 1.97	\$ 0.93	\$ 0.53

## Liquidity and Capital Resources

We manage our liquidity and capital resources to be able to fund future capital expenditures, working capital requirements and contractual obligations. Additionally, we use capital resources to fund cash dividend payments, share repurchases and acquisitions.

## Available Sources

We have relied primarily upon internally generated cash flows from operations, borrowings under our credit agreements, financing of real estate and the proceeds from equity and debt offerings to finance operations and expansion. Based on these factors and our normal operational cash flow, we believe we have sufficient availability to accommodate both our short- and long-term capital needs.

Below is a summary and discussion of our available funds (in thousands):

	As of December 31,		Increase	Increase
	2011	2010	(Decrease)	(Decrease)
Cash and cash equivalents	\$ 20,851	\$ 9,306	\$ 11,545	124.1 %
	10,449	23,332	(12,883 )	(55.2 )

Available credit on the  
Credit Facility

Unfinanced new vehicles	65,857	65,601	256	0.4
Total available funds	\$ 97,157	\$ 98,239	\$ (1,082 )	(1.1 )%

In 2011, we invested approximately \$60.5 million for the purchase of three stores in Portland, Oregon, the opening of an awarded franchise in Klamath Falls, Oregon, and the purchase of one store in Fresno, California. We subsequently financed the real estate associated with some of these stores for \$16.1 million. We estimate the stores will provide \$213.5 million in revenues over the next twelve months.

Historically, we have raised capital through the sale of assets, sale of stores, issuance of stock and the issuance of debt. We may strategically use excess cash to reduce the amount of debt outstanding when appropriate. During 2011, 2010 and 2009, we generated \$23.5 million, \$18.3 million and \$11.4 million, respectively, through the sale of assets and stores and the issuance of long-term debt (primarily related to the financing of certain real estate), net of debt repayments in excess of scheduled amounts.

In addition to the above sources of liquidity, potential sources include the placement of subordinated debentures or loans, additional store sales or additional other asset sales. We will evaluate all of these options and may select one or more of them depending on overall capital needs and the availability and cost of capital, although no assurances can be provided that these capital sources will be available in sufficient amounts or with terms acceptable to us.

#### Summary of Outstanding Balances on Credit Facilities and Long-term Debt

Below is a summary of our outstanding balances on credit facilities and long-term debt (in thousands):

	Outstanding as of December 31, 2011	Remaining Available as of December 31, 2011	
New and program floor plan notes payable	\$ 343,940	\$ -	(1)
Credit facility	87,000	10,449	(2),(3)
Real estate mortgages	194,404	-	
Other debt	5,470	-	
<b>Total debt</b>	<b>\$ 630,814</b>	<b>\$ 10,449</b>	

- (1) We have a \$100 million credit facility for floor plan financing with U.S. Bank National Association and JPMorgan Chase Bank, N.A. Certain of our lenders do not have formal limits on the new and program vehicle lines. We had approximately \$65.9 million in unfloored new vehicles at December 31, 2011.
- (2) Reduced by \$2.6 million for outstanding letters of credit.
- (3) The amount available on the line is limited based on a borrowing base calculation and fluctuates monthly.

#### New and Program Vehicle Lines

Mercedes-Benz Financial Services USA, LLC, Toyota Financial Services, Ford Motor Credit Company, American Honda Finance Corporation and BMW Financial Services NA, LLC provide new vehicle floor plan financing for their respective brands. Our credit facility with U.S. Bank National Association and JPMorgan Chase Bank, N.A., as well as floor plan financing with Ally Bank serve as the primary source of financing for all other brands.

The new and program vehicle lines are secured by new and program vehicle inventory of the stores financed by that lender. The weighted average interest rate associated with our new and program vehicle lines, excluding the effects of our interest rate swaps, was 2.5% at December 31, 2011.

Vehicles financed by lenders not directly associated with the manufacturer are classified as floor plan notes payable: non-trade and are included as a financing activity in our Consolidated Statements of Cash Flows. Vehicles financed by lenders directly associated with the manufacturer are classified as floor plan notes payable and are included as an operating activity in our Consolidated Statements of Cash Flows.

To improve the visibility of cash flows related to vehicle financing, which is a core part of our business, the non-GAAP financial measures below demonstrate cash flows assuming all floor plan notes payable are included as an operating activity. We believe that this non-GAAP financial measure improves the transparency of our disclosure by considering all cash flows to finance our inventory.

(In thousands)	Year Ended December 31,		
	2011	2010	2009
<b>As Reported</b>			
Cash flow from (used in) operations	\$ (766 )	\$ (21,330 )	\$ 9,939
Change in floor plan notes payable: non-trade	63,145	24,090	31,417
<b>As Adjusted</b>	<b>\$ 62,379</b>	<b>\$ 2,760</b>	<b>\$ 41,356</b>
<b>As Reported</b>			
Cash flow from (used in) financing activities	\$ 51,733	\$ 37,826	\$ (29,127 )
Change in floor plan notes payable: non-trade	(63,145 )	(24,090 )	(31,417 )
<b>As Adjusted</b>	<b>\$ (11,412 )</b>	<b>\$ 13,736</b>	<b>\$ (60,544 )</b>

#### Working Capital, Acquisition and Used Vehicle Credit Facility

On September 30, 2011, we entered into a new three-year loan agreement which includes a \$100 million credit facility with U.S. Bank National Association and JPMorgan Chase Bank, N.A. The interest rate on the credit facility is the one-month LIBOR plus 2.25%, which totaled approximately 2.5% at December 31, 2011. As of December 31, 2011, approximately \$10.4 million was available on the credit facility.

#### Real Estate Mortgages and Other Debt

We have mortgages associated with our owned real estate and leasehold improvements. Interest rates related to this debt ranged from 2.5% to 7.0% at December 31, 2011. The mortgages are payable in various installments through May 2031 with no significant maturities until 2013.

Our other debt includes various notes, capital leases and obligations assumed as a result of acquisitions and other agreements and had interest rates that ranged from 3.5% to 9.0% at December 31, 2011. The other debt is due in various installments through October 2018.

#### Debt Covenants

Under the terms of our Credit Facility and other debt agreements, we are subject to certain financial and restrictive covenants. In addition, the covenants place limitations or restrictions on our incurring additional indebtedness, making investments, selling or acquiring assets and granting security interests in our assets.

Debt Covenant Ratio	Requirement	As of December 31, 2011
Current ratio	Not less than 1.20 to 1	1.44 to 1
Fixed charge coverage ratio	Not less than 1.20 to 1	1.39 to 1
Liabilities to tangible net worth ratio	Not more than 4.00 to 1	2.72 to 1
Funded debt restriction	Not to exceed \$310 million	\$199.9 million

Based on the information in the above table, we were in compliance with the financial covenants in our Credit Facility and other debt agreements as of December 31, 2011.

We expect to remain in compliance with the financial and restrictive covenants in our Credit Facility and other debt agreements. However, no assurances can be provided that we will continue to remain in compliance with the financial and restrictive covenants.

In the event that we are unable to meet the financial and restrictive covenants, we would enter into a discussion with the lender to remediate the condition. If we were unable to remediate or cure the condition, a breach would give rise to certain remedies under the agreement, the most severe of which is the termination of the agreement and acceleration of the amounts owed, including the triggering of cross-default provisions to other debt agreements.



### Inventories

We calculate days supply based on current inventory levels, excluding in-transit vehicles, and a 30-day historical cost of sales level. As of December 31, 2011, our new vehicle days supply was 62, or 12 days lower than our days supply as of December 31, 2010. Our days supply of used vehicles was 52 days as of December 31, 2011, or 1 day lower than our days supply as of December 31, 2010. We have continued to focus on managing our mix and maintaining an appropriate level of used vehicle inventory.

### Contractual Payment Obligations

A summary of our contractual commitments and obligations as of December 31, 2011, was as follows (in thousands):

Contractual Obligation	Total	Payments Due By Period			
		2012	2013 and 2014	2015 and 2016	2017 and beyond
Floor plan notes payable(1)	\$ 343,940	\$ 343,940	\$ -	\$ -	\$ -
Credit Facility(1)	87,000	-	87,000	-	-
Real estate debt, including interest	228,948	16,151	81,845	78,026	52,926
Other debt, including capital leases and interest	7,416	1,771	1,299	4,306	40
Charge-backs on various contracts	10,361	5,752	4,106	489	14
Operating leases(2)	166,558	19,522	34,574	29,405	83,057
Fixed rate payments on interest rate swaps	9,850	4,339	8,655	(2,318 )	(826 )
	\$ 854,073	\$ 391,475	\$ 217,479	\$ 109,908	\$ 135,211

(1) Amounts for floor plan notes payable and the Credit Facility do not include estimated interest payments. See Notes 1, 6 and 7 in the Notes to Consolidated Financial Statements.

(2) Amounts for operating lease commitments do not include sublease income, and certain operating expenses such as maintenance, insurance and real estate taxes. See Note 8 in the Notes to Consolidated Financial Statements.

### Capital Expenditures

Capital expenditures were \$31.7 million, \$7.6 million and \$21.1 million for 2011, 2010 and 2009, respectively. The increase in capital expenditures in 2011 compared to 2010 was related to improvements at certain of our store facilities, the purchase of new store locations, replacement of equipment and construction of a new headquarters building. The decrease in capital expenditures in 2010 compared to 2009 reflected our cash management efforts and our desire to reduce the aggregate level of debt outstanding.

Many manufacturers provide assistance in the form of additional vehicle incentives if facilities meet image standards and requirements. Accordingly, we believe it is an attractive time to invest in certain facility upgrades and remodels that will generate additional manufacturer incentive payments. Also, recently enacted tax law changes that accelerate deductions for capital expenditures have accelerated project timelines to ensure completion before the law expires.

In the event we undertake a significant capital commitment in the future, we expect to pay for the construction out of existing cash balances, construction financing and borrowings on our Credit Facility. Upon completion of the projects, we would anticipate securing long-term financing and general borrowings from third party lenders for 70% to 90% of the amounts expended, although no assurances can be provided that these financings will be available to us in

sufficient amounts or on terms acceptable to us.

## Dividends

Our Board of Directors paid dividends on our Class A and Class B common stock for 2011 as follows:

Dividend paid:	Dividend amount per share	Total amount of dividend (in thousands)
March 2011	\$ 0.05	\$ 1,316
May 2011	0.07	1,851
August 2011	0.07	1,838
November 2011	0.07	1,817

Management evaluates performance and makes a recommendation to the Board of Directors on dividend payments on a quarterly basis.

## Share Repurchase Program

In June 2000, our Board of Directors authorized the repurchase of up to 1,000,000 shares of our Class A common stock. As of December 31, 2011, we have purchased all available shares under this program, 419,376 of which were purchased during 2011 at an average price of \$17.92 per share.

In August 2011, our Board of Directors authorized the repurchase of up to an additional 2,000,000 shares of our Class A common stock. Through December 31, 2011, we have purchased 297,055 shares under this program at an average price of \$16.41 per share.

As of December 31, 2011, 1,702,945 shares remained available for purchase pursuant to this program. We may continue to purchase shares from time to time in the future as conditions warrant.

## Selected Consolidated Quarterly Financial Data

The following tables set forth our unaudited quarterly financial data(1) (2).

2011 (in thousands, except per share data )	Three Months Ended,			
	March 31	June 30	September 30	December 31
<b>Revenues:</b>				
New vehicle	\$300,640	\$347,727	\$383,951	\$394,570
Used vehicle retail	156,478	176,591	187,443	175,284
Used vehicle wholesale	29,537	29,153	36,105	35,925
Finance and insurance	19,299	20,886	22,747	22,920
Service, body and parts	73,761	80,937	86,161	84,799
Fleet and other	3,142	17,193	10,131	3,980
Total revenues	582,857	672,487	726,538	717,478
Cost of sales	481,261	555,350	604,330	600,881
Gross profit	101,596	117,137	122,208	116,597
Asset impairments	382	490	-	504
Selling, general and administrative	77,134	82,768	86,247	81,396
Depreciation and amortization	4,092	4,217	4,161	4,156
Operating income	19,988	29,662	31,800	30,541
Floor plan interest expense	(2,462 )	(3,359 )	(2,010 )	(2,753 )
Other interest expense	(3,292 )	(3,011 )	(3,075 )	(3,550 )
Other, net	77	171	215	233
Income from continuing operations before income taxes	14,311	23,463	26,930	24,471
Income tax provision	(5,923 )	(8,777 )	(10,600 )	(8,108 )
Income before discontinued operations	8,388	14,686	16,330	16,363
Discontinued operations, net of tax	317	140	233	2,403
Net income	\$8,705	\$14,826	\$16,563	\$18,766
<b>Basic income per share from continuing operations</b>				
Basic income per share from continuing operations	\$0.32	\$0.56	\$0.62	\$0.63
Basic income per share from discontinued operations	0.01	-	0.01	0.09
Basic net income per share	\$0.33	\$0.56	\$0.63	\$0.72
<b>Diluted income per share from continuing operations</b>				
Diluted income per share from continuing operations	\$0.31	\$0.55	\$0.61	\$0.62
Diluted income per share from discontinued operations	0.02	-	0.01	0.09
Diluted net income per share	\$0.33	\$0.55	\$0.62	\$0.71

Edgar Filing: LITHIA MOTORS INC - Form 10-K

2010 (in thousands, except per share data )	Three Months Ended,			
	March 31	June 30	September 30	December 31
<b>Revenues:</b>				
New vehicle	\$210,449	\$263,014	\$284,391	\$280,467
Used vehicle retail	132,693	143,227	154,875	136,008
Used vehicle wholesale	22,782	25,166	30,204	27,562
Finance and insurance	14,268	15,863	18,367	16,776
Service, body and parts	65,960	69,227	74,799	74,184
Fleet and other	800	4,699	3,120	3,087
Total revenues	446,952	521,196	565,756	538,084
Cost of sales	363,614	428,147	464,067	446,301
Gross profit	83,338	93,049	101,689	91,783
Asset impairments	1,491	13,260	-	550
Selling, general and administrative	68,725	72,436	74,921	74,751
Depreciation and amortization	4,685	4,201	4,159	4,109
Operating income	8,437	3,152	22,609	12,373
Floor plan interest expense	(2,691 )	(2,506 )	(3,011 )	(2,117 )
Other interest expense	(3,585 )	(3,526 )	(3,715 )	(3,719 )
Other, net	67	213	74	65
Income (loss) from continuing operations before income taxes	2,228	(2,667 )	15,957	6,602
Income tax (provision) benefit	(860 )	1,119	(6,485 )	(2,363 )
Income (loss) before discontinued operations	1,368	(1,548 )	9,472	4,239
Discontinued operations, net of tax	(101 )	(171 )	320	140
Net income (loss)	\$1,267	\$(1,719 )	\$9,792	\$4,379
<b>Basic income (loss) per share from continuing operations</b>				
	\$0.05	\$(0.06 )	\$0.36	\$0.16
<b>Basic income (loss) per share from discontinued operations</b>				
	-	(0.01 )	0.01	0.01
<b>Basic net income (loss) per share</b>				
	\$0.05	\$(0.07 )	\$0.37	\$0.17
<b>Diluted income (loss) per share from continuing operations</b>				
	\$0.05	\$(0.06 )	\$0.36	\$0.16
<b>Diluted income (loss) per share from discontinued operations</b>				
	-	(0.01 )	0.01	-
<b>Diluted net income (loss) per share</b>				
	\$0.05	\$(0.07 )	\$0.37	\$0.16

- (1) Quarterly data may not add to yearly totals due to rounding.
- (2) Certain reclassifications of amounts previously reported have been made to the quarterly financial data to maintain consistency and comparability between periods presented.

#### Seasonality and Quarterly Fluctuations

Historically, our sales have been lower in the first and fourth quarters of each year due to consumer purchasing patterns during the holiday season, inclement weather in certain of our markets and the reduced number of business days during the holiday season. As a result, financial performance is expected to be lower during the first and fourth quarters than during the second and third quarters of each fiscal year. We believe that interest rates, levels of consumer debt, consumer confidence and manufacturer sales incentives, as well as general economic conditions, also

contribute to fluctuations in sales and operating results.

#### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

#### Inflation

The effects of inflation were insignificant in the years ended December 31, 2011, 2010 and 2009.

#### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

##### Variable Rate Debt

We use variable-rate debt to finance our new and program vehicle inventory and certain real estate holdings. The interest rates on our variable rate debt are tied to either the one- or three-month LIBOR or the prime rate. These debt obligations, therefore, expose us to variability in interest payments due to changes in these rates. The floor plan debt is based on open-ended lines of credit tied to each individual store from the various manufacturer finance companies.

Our variable-rate floor plan notes payable, variable rate mortgage notes payable and other credit line borrowings subject us to market risk exposure. At December 31, 2011, we had \$566.3 million outstanding under such agreements at a weighted average interest rate of 2.8% per annum. A 10% increase in interest rates would increase annual interest expense by approximately \$0.2 million, net of tax, based on amounts outstanding at December 31, 2011.

#### Fixed Rate Debt

The fair value of our long-term fixed interest rate debt is subject to interest rate risk. Generally, the fair value of fixed interest rate debt will increase as interest rates fall because we would expect to be able to refinance for a lower rate. Conversely, the fair value of fixed interest rate debt will decrease as interest rates rise. The interest rate changes affect the fair value but do not impact earnings or cash flows.

At December 31, 2011, we had \$64.5 million of long-term fixed interest rate debt outstanding and recorded on the balance sheet, with maturity dates of between July 2012 and May 2031. Based on discounted cash flows using current interest rates for comparable debt, we have determined that the fair value of this long-term fixed interest rate debt was approximately \$73.6 million at December 31, 2011.

#### Hedging Strategies

We believe it is prudent to limit the variability of a portion of our interest payments. Accordingly, we have entered into interest rate swaps to manage the variability of our interest rate exposure, thus leveling a portion of our interest expense in a rising or falling rate environment.

We have effectively changed the variable-rate cash flow exposure on a portion of our floor plan debt to fixed-rate cash flows by entering into receive-variable, pay-fixed interest rate swaps. Under the interest rate swaps, we receive variable interest rate payments and make fixed interest rate payments, thereby creating fixed rate floor plan debt.

We do not enter into derivative instruments for any purpose other than to manage interest rate exposure. That is, we do not engage in interest rate speculation using derivative instruments. Typically, we designate all interest rate swaps as cash flow hedges.

As of December 31, 2011, we had outstanding the following interest rate swaps with U.S. Bank Dealer Commercial Services:

- effective June 16, 2006 – a ten year, \$25 million interest rate swap at a fixed rate of 5.587% per annum, variable rate adjusted on the 1st and 16th of each month;
- effective January 26, 2008 – a five year, \$25 million interest rate swap at a fixed rate of 4.495% per annum, variable rate adjusted on the 26th of each month;
- effective May 1, 2008 – a five year, \$25 million interest rate swap at a fixed rate of 3.495% per annum, variable rate adjusted on the 1st and 16th of each month; and
  - effective May 1, 2008 – a five year, \$25 million interest rate swap at a fixed rate of 3.495% per annum, variable rate adjusted on the 1st and 16th of each month.

We receive interest on all of the interest rate swaps at the one-month LIBOR rate. The one-month LIBOR rate at December 31, 2011 was 0.3% per annum as reported in the Wall Street Journal.

The fair value of our interest rate swap agreements represents the estimated receipts or payments that would be made to terminate the agreements. These amounts related to our cash flow hedges are recorded as deferred gains or losses in our Consolidated Balance Sheets with the offset recorded in accumulated other comprehensive income, net of tax. Changes to the fair value of discontinued cash flow hedges are recognized into earnings as a component of floor plan interest expense. At December 31, 2011, the fair value of all of our agreements was a liability of \$7.5 million. The estimated amount expected to be reclassified into earnings within the next twelve months was \$3.9 million at

December 31, 2011.

53

---



In 2009, we determined that the original forecasted transaction for certain of the de-designated cash flow hedges became probable of not occurring. Therefore, we reclassified into earnings a gain of approximately \$0.5 million as a reduction of floor plan interest expense at that time. Additionally, we de-designated and re-designated all of our outstanding interest rate swaps when significant changes in our underlying floor plan debt occurred with the Chrysler and GM restructuring. This de-designation and re-designation did not have an impact on earnings at the time, but may increase ineffectiveness in the future.

#### Risk Management Policies

We assess interest rate cash flow risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities.

We maintain risk management control systems to monitor interest rate cash flow attributable to both our outstanding and forecasted debt obligations, as well as our offsetting hedge positions. The risk management control systems involve the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on our future cash flows.

#### Item 8. Financial Statements and Supplementary Financial Data

The financial statements and notes thereto required by this item begin on page F-1 as listed in Item 15 of Part IV of this document. Quarterly financial data for each of the eight quarters in the two-year period ended December 31, 2011 is included in Item 7.

#### Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

#### Item 9A. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure and that such information is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

##### Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2011. In making this assessment, we used the criteria set forth in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment using those criteria, our management concluded that, as of December 31, 2011, our internal control over financial reporting was effective.

KPMG LLP, our Independent Registered Public Accounting Firm, has issued an attestation report on our internal control over financial reporting as of December 31, 2011, which is included in Item 8 of this Form 10-K.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information required by this item will be included under the captions Election of Directors, Meetings and Committees of the Board of Directors, Audit Committee Independence and Financial Expert, Code of Business Conduct and Ethics, Executive Officers and Section 16(a) Beneficial Ownership Reporting Compliance in our Proxy Statement for our 2012 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item will be included under the captions Compensation of Directors, Compensation Committee Report, Compensation Discussion and Analysis, Executive Compensation, Potential Payments Upon Termination or Change-in-Control and Compensation Committee Interlocks and Insider Participation in our Proxy Statement for our 2012 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Equity Compensation Plan Information

The following table summarizes equity securities authorized for issuance as of December 31, 2011.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a) (c))
Equity compensation plans approved by shareholders	811,176	\$12.69	1,548,414
Equity compensation plans not approved by shareholders	-	-	-
Total	811,176	\$12.69	1,548,414

(1) Includes 724,050 shares available pursuant to our 2003 Stock Incentive Plan and 824,364 shares available pursuant to our Employee Stock Purchase Plan.

The additional information required by this item will be included under the caption Security Ownership of Certain Beneficial Owners and Management in our Proxy Statement for our 2012 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item will be included under the captions Certain Relationships and Related Transactions and Director Independence in our Proxy Statement for our 2012 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information required by this item will be included under the caption Fees Paid to KPMG LLP Related to Years 2011 and 2010 and Pre-approval Policies in our Proxy Statement for our 2012 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

Financial Statements and Schedules

The Consolidated Financial Statements, together with the report thereon of KPMG LLP, Independent Registered Public Accounting Firm, are included on the pages indicated below:

	Page
Reports of Independent Registered Public Accounting Firm	F-1, F-2
Consolidated Balance Sheets as of December 31, 2011 and 2010	F-3
Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009	F-4
Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income for the years ended December 31, 2011, 2010 and 2009	F-5
Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009	F-6
Notes to Consolidated Financial Statements	F-7

There are no schedules required to be filed herewith.

Exhibits

The following exhibits are filed herewith and this list is intended to constitute the exhibit index. An asterisk (\*) beside the exhibit number indicates the exhibits containing a management contract, compensatory plan or arrangement, which are required to be identified in this report.

Exhibit	Description
3.1	(a) Restated Articles of Incorporation of Lithia Motors, Inc., as amended May 13, 1999
3.2	(l) Amended and Restated Bylaws of Lithia Motors, Inc. (Corrected)
4.1	(b) Specimen Common Stock certificate
10.1*	(i) 2009 Employee Stock Purchase Plan
10.2*	(d) Lithia Motors, Inc. 2001 Stock Option Plan
10.2.1*	(e) Form of Incentive Stock Option Agreement for 2001 Stock Option Plan
10.2.2*	(e) Form of Non-Qualified Stock Option Agreement for 2001 Stock Option Plan
10.3	(q) Lithia Motors, Inc. Amended and Restated 2003 Stock Incentive Plan
10.3.1	RSU Deferral Plan
10.4*	(f) Form of Restricted Stock Unit Agreement for Senior Executives
10.4.1*	(f) Form of Restricted Stock Unit Agreement for Non-Executive Officers
10.4.2*	(f) Form of Restricted Stock Unit Agreement for Non-Executive Directors
10.5*	(k) Summary 2011 Discretionary Support Services Bonus Program

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Exhibit	Description
10.6	(a) Chrysler Corporation Sales and Service Agreement General Provisions
10.6.1	(a) Chrysler Corporation Chrysler Sales and Service Agreement, dated September 28, 1999, between Chrysler Corporation and Lithia Chrysler Plymouth Jeep Eagle, Inc. (Additional Terms and Provisions to the Sales and Service Agreements are in Exhibit 10.9) (1)
10.7	(b) Mercury Sales and Service Agreement General Provisions
10.7.1	(c) Supplemental Terms and Conditions agreement between Ford Motor Company and Lithia Motors, Inc. dated June 12, 1997
10.7.2	(c) Mercury Sales and Service Agreement, dated June 1, 1997, between Ford Motor Company and Lithia TLM, LLC dba Lithia Lincoln Mercury (general provisions are in Exhibit 10.10) (2)
10.8	(c) Volkswagen Dealer Agreement Standard Provisions
10.8.1	(a) Volkswagen Dealer Agreement dated September 17, 1998, between Volkswagen of America, Inc. and Lithia HPI, Inc. dba Lithia Volkswagen. (standard provisions are in Exhibit 10.11) (3)
10.9	(b) General Motors Dealer Sales and Service Agreement Standard Provisions
10.9.1	(a) Supplemental Agreement to General Motors Corporation Dealer Sales and Service Agreement dated January 16, 1998
10.9.2	(g) Chevrolet Dealer Sales and Service Agreement dated October 13, 1998 between General Motors Corporation, Chevrolet Motor Division and Camp Automotive, Inc. (4)
10.10	(b) Toyota Dealer Agreement Standard Provisions
10.10.1	(a) Toyota Dealer Agreement, between Toyota Motor Sales, USA, Inc. and Lithia Motors, Inc., dba Lithia Toyota, dated February 15, 1996 (5)
10.11	(c) Nissan Standard Provisions
10.11.1	(a) Nissan Public Ownership Addendum dated August 30, 1999 (identical documents executed by each Nissan store)
10.11.2	(c) Nissan Dealer Term Sales and Service Agreement between Lithia Motors, Inc., Lithia NF, Inc., and the Nissan Division of Nissan Motor Corporation In USA dated January 2, 1998. (standard provisions are in Exhibit 10.14) (6)
10.12	(a) Lease Agreement between CAR LIT, LLC and Lithia Real Estate, Inc. relating to properties in Medford, Oregon (7)

- 10.13\* Non Employee Director Compensation Plan 2010/2011 Service Year.
- 10.14\* (h) Form of Outside Director Nonqualified Deferred Compensation Agreement
- 10.15\* (o) Form of Executive Nonqualified Deferred Compensation Plan
- 10.16 (m) Loan Agreement dated as of September 30, 2011 between Lithia Motors, Inc., and U.S. Bank National Association, as agent

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Exhibit	Description
10.17*	(j) Split Dollar Agreement dated November 7, 2006 with Sidney B. DeBoer
10.18*	(j) Split Dollar Insurance Agreement dated December 20, 2007 with Sidney B. DeBoer
10.19*	(l) Terms of Amended Employment and Change in Control Agreement between Lithia Motors, Inc. and Sidney B. DeBoer dated January 15, 2009. Substantially similar agreements exist between Lithia Motors, Inc. and each of M.L. Dick Heimann, Bryan B. DeBoer, Christopher S. Holzshu and John F. North III
10.20*	(n) Form of Indemnity Agreement for each Named Executive Officer.
10.21*	(n) Form of Indemnity Agreement for each non-management Director
10.22*	(f) Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan
10.22.1*	(f) Form of Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan – Notice of Discretionary Contribution Award for Sidney DeBoer
10.22.2*	(f) Form of Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan – Notice of Discretionary Contribution Award
10.23	(p) Acquisition and Option Termination Agreement with M.L. Dick Heimann
10.23.1	(p) Form of Membership Purchase Agreement with M.L. Dick Heimann
12	Ratio of Earnings to Combined Fixed Charges
21	Subsidiaries of Lithia Motors, Inc.
23	Consent of KPMG LLP, Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
101.INS	XBRL Instance Document.



- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

- (a) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 1999 as filed with the Securities and Exchange Commission on March 30, 2000.
- (b) Incorporated by reference from the Company's Registration Statement on Form S-1, Registration Statement No. 333-14031, as declared effective by the Securities Exchange Commission on December 18, 1996.
- (c) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 1997 as filed with the Securities and Exchange Commission on March 31, 1998.
- (d) Incorporated by reference from Appendix B to the Company's Proxy Statement for its 2001 Annual Meeting as filed with the Securities and Exchange Commission on May 8, 2001.
- (e) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 2001 as filed with the Securities and Exchange Commission on February 22, 2002.
- (f) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 7, 2011.
- (g) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 1998 as filed with the Securities and Exchange Commission on March 31, 1999.
- (h) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on March 8, 2006.
- (i) Incorporated by reference from the Company's Proxy Statement for its 2009 Annual Meeting as filed with the Securities and Exchange Commission on March 20, 2009.
- (j) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 2007 as filed with the Securities and Exchange Commission on April 11, 2008.

- (k) Incorporated by reference from the Company's Proxy Statement for its 2011 Annual Meeting as filed with the Securities and Exchange Commission on March 14, 2011.
  - (l) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission on March 16, 2009.
  - (m) Incorporated by reference from the Company's Form 8-K as filed with the Securities and Exchange Commission on October 6, 2011.
  - (n) Incorporated by reference from the Company's Form 8-K as filed with the Securities and Exchange Commission on May 28, 2009.
  - (o) Incorporated by reference from the Company's Form 8-K as filed with the Securities and Exchange Commission on January 5, 2010.
  - (p) Incorporated by reference from the Company's Form 8-K as filed with the Securities and Exchange Commission on December 22, 2011.
  - (q) Incorporated by reference from the Company's Form 10-Q as filed with the Securities and Exchange Commission on April 29, 2011.
- 
- (1) Substantially identical agreements exist between DaimlerChrysler Motor Company, LLC and those other subsidiaries operating Dodge, Chrysler, Plymouth or Jeep dealerships.
  - (2) Substantially identical agreements exist for its Ford and Lincoln-Mercury lines between Ford Motor Company and those other subsidiaries operating Ford or Lincoln-Mercury dealerships.
  - (3) Substantially identical agreements exist between Volkswagen of America, Inc. and those subsidiaries operating Volkswagen dealerships.
  - (4) Substantially identical agreements exist between Chevrolet Motor Division, GM Corporation and those other subsidiaries operating General Motors dealerships.
  - (5) Substantially identical agreements exist (except the terms are all 2 years) between Toyota Motor Sales, USA, Inc. and those other subsidiaries operating Toyota dealerships.
  - (6) Substantially identical agreements exist between Nissan Motor Corporation and those other subsidiaries operating Nissan dealerships.
  - (7) Lithia Real Estate, Inc. leases all the property in Medford, Oregon sold to CAR LIT, LLC under substantially identical leases covering six separate blocks of property.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 24, 2012

LITHIA MOTORS, INC.

By /s/ Sidney B. DeBoer  
Sidney B. DeBoer  
Chairman of the Board and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on February 24, 2012:

Signature	Title
/s/ Sidney B. DeBoer Sidney B. DeBoer	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
/s/ Christopher S. Holzshu Christopher S. Holzshu	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ John F. North III John F. North III	Vice President and Corporate Controller (Principal Accounting Officer)
/s/ Bryan B. DeBoer Bryan B. DeBoer	Director, President and Chief Operating Officer
/s/ Thomas Becker Thomas Becker	Director
/s/ Susan O. Cain Susan O. Cain	Director
/s/ William J. Young William J. Young	Director

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Lithia Motors, Inc.:

We have audited the accompanying Consolidated Balance Sheets of Lithia Motors, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related Consolidated Statements of Operations, Changes in Stockholders' Equity and Comprehensive Income, and Cash Flows for each of the years in the three-year period ended December 31, 2011. These Consolidated Financial Statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the Consolidated Financial Statements referred to above present fairly, in all material respects, the financial position of Lithia Motors, Inc. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Lithia Motors, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 24, 2012 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Portland, Oregon  
February 24, 2012

F-1

---

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Lithia Motors, Inc.:

We have audited Lithia Motors, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Lithia Motors, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Lithia Motors, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Consolidated Balance Sheets of Lithia Motors, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related Consolidated Statements of Operations, Changes in Stockholders' Equity and Comprehensive Income, and Cash Flows for each of the years in the three-year period ended December 31, 2011, and our report dated February 24, 2012 expressed an unqualified opinion on those Consolidated Financial Statements.

/s/ KPMG LLP

Portland, Oregon  
February 24, 2012

F-2

---

LITHIA MOTORS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In thousands)

	December 31, 2011	2010
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$20,851	\$9,306
Accounts receivable, net of allowance for doubtful accounts of \$261 and \$190	99,407	75,011
Inventories, net	506,484	415,228
Deferred income taxes	4,730	2,937
Other current assets	16,719	6,062
<b>Total Current Assets</b>	<b>648,191</b>	<b>508,544</b>
Property and equipment, net of accumulated depreciation of \$99,115 and \$93,745	373,779	362,433
Goodwill	18,958	6,186
Franchise value	59,095	45,193
Deferred income taxes	29,270	39,524
Other non-current assets	16,840	9,796
<b>Total Assets</b>	<b>\$1,146,133</b>	<b>\$971,676</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities:</b>		
Floor plan notes payable	\$114,760	\$84,775
Floor plan notes payable: non-trade	229,180	166,482
Current maturities of long-term debt	8,221	12,081
Trade payables	31,712	23,747
Accrued liabilities	72,711	58,784
<b>Total Current Liabilities</b>	<b>456,584</b>	<b>345,869</b>
Long-term debt, less current maturities	278,653	268,693
Deferred revenue	25,146	20,158
Other long-term liabilities	18,629	16,739
<b>Total Liabilities</b>	<b>779,012</b>	<b>651,459</b>
<b>Stockholders' Equity:</b>		
Preferred stock - no par value; authorized 15,000 shares; none outstanding	-	-
Class A common stock - no par value; authorized 100,000 shares; issued and outstanding 22,195 and 22,523	279,366	284,807
Class B common stock - no par value; authorized 25,000 shares; issued and outstanding 3,762 and 3,762	468	468
Additional paid-in capital	10,918	10,972
Accumulated other comprehensive loss	(4,508)	(4,869)
Retained earnings	80,877	28,839
<b>Total Stockholders' Equity</b>	<b>367,121</b>	<b>320,217</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$1,146,133</b>	<b>\$971,676</b>

Edgar Filing: LITHIA MOTORS INC - Form 10-K  
See accompanying notes to consolidated financial statements.

F-3

---



LITHIA MOTORS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share amounts)

	Year Ended December 31,		
	2011	2010	2009
<b>Revenues:</b>			
New vehicle	\$ 1,426,888	\$ 1,038,321	\$ 857,096
Used vehicle retail	695,796	566,803	465,001
Used vehicle wholesale	130,720	105,714	70,699
Finance and insurance	85,852	65,274	54,953
Service, body and parts	325,658	284,170	278,336
Fleet and other	34,446	11,706	2,544
Total revenues	2,699,360	2,071,988	1,728,629
<b>Cost of sales:</b>			
New vehicle	1,316,413	953,186	784,801
Used vehicle retail	595,178	486,739	399,486
Used vehicle wholesale	130,167	105,070	70,228
Service, body and parts	168,538	147,119	145,836
Fleet and other	31,526	10,015	1,225
Total cost of sales	2,241,822	1,702,129	1,401,576
Gross profit	457,538	369,859	327,053
Asset impairment	1,376	15,301	7,972
Selling, general and administrative	327,545	290,833	266,388
Depreciation and amortization	16,626	17,154	17,786
Operating income	111,991	46,571	34,907
Floor plan interest expense	(10,584 )	(10,325 )	(10,704 )
Other interest expense	(12,928 )	(14,545 )	(13,925 )
Other income, net	696	419	1,486
Income from continuing operations before income taxes	89,175	22,120	11,764
Income tax provision	(33,408 )	(8,589 )	(5,042 )
Income from continuing operations, net of income tax	55,767	13,531	6,722
Income from discontinued operations, net of income tax	3,093	188	2,429
Net income	\$ 58,860	\$ 13,719	\$ 9,151
<b>Basic income per share from continuing operations</b>			
Basic income per share from continuing operations	\$ 2.13	\$ 0.52	\$ 0.31
<b>Basic income per share from discontinued operations</b>			
Basic income per share from discontinued operations	0.11	0.01	0.11
<b>Basic net income per share</b>			
Basic net income per share	\$ 2.24	\$ 0.53	\$ 0.42
<b>Shares used in basic per share calculations</b>			
Shares used in basic per share calculations	26,230	26,062	22,037
<b>Diluted income per share from continuing operations</b>			
Diluted income per share from continuing operations	\$ 2.09	\$ 0.51	\$ 0.30
<b>Diluted income per share from discontinued operations</b>			
Diluted income per share from discontinued operations	0.12	0.01	0.11
<b>Diluted net income per share</b>			
Diluted net income per share	\$ 2.21	\$ 0.52	\$ 0.41
<b>Shares used in diluted per share calculations</b>			
Shares used in diluted per share calculations	26,664	26,279	22,176

See accompanying notes to consolidated financial statements.

F-4

---

LITHIA MOTORS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE  
INCOME

For the years ended December 31, 2009, 2010 and 2011

(In thousands)

	Common Stock Class A		Class B		Additional Paid In Capital	Accumulated Other Compre- hensive Income (Loss)	Retained Earnings	Total Stock- holders' Equity
	Shares	Amount	Shares	Amount				
Balance at December 31, 2008	16,717	\$ 234,522	3,762	\$ 468	\$ 9,275	\$ (5,810 )	\$ 9,888	\$ 248,343
Net income	-	-	-	-	-	-	9,151	9,151
Fair value of interest rate swap agreements, net of tax expense of \$1,177	-	-	-	-	-	1,960	-	1,960
Comprehensive income								11,111
Issuance of stock in connection with employee stock plans	635	2,426	-	-	-	-	-	2,426
Issuance of restricted stock to employees and directors	110	-	-	-	-	-	-	-
Shares forfeited by employees	(26 )	-	-	-	-	-	-	-
Issuance of Class A common stock	4,600	43,150	-	-	-	-	-	43,150
Repurchase of Class A common stock	-	(1 )	-	-	-	-	-	(1 )
Compensation for stock and stock option issuances and excess tax benefits from option exercises	-	783	-	-	1,226	-	-	2,009
Balance at December 31, 2009	22,036	280,880	3,762	468	10,501	(3,850 )	19,039	307,038
Net income	-	-	-	-	-	-	13,719	13,719
	-	-	-	-	-	(1,019 )	-	(1,019 )

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Fair value of interest rate swap agreements, net of tax benefit of \$626								
Comprehensive income								12,700
Issuance of stock in connection with employee stock plans	658	4,192	-	-	-	-	-	4,192
Shares forfeited by employees	(9 )	-	-	-	-	-	-	-
Repurchase of Class A common stock	(162 )	(1,626 )	-	-	-	-	-	(1,626 )
Compensation for stock and stock option issuances and excess tax benefits from option exercises	-	1,361	-	-	471	-	-	1,832
Dividends paid	-	-	-	-	-	-	(3,919 )	(3,919 )
Balance at December 31, 2010	22,523	284,807	3,762	468	10,972	(4,869 )	28,839	320,217
Net income	-	-	-	-	-	-	58,860	58,860
Fair value of interest rate swap agreements, net of tax expense of \$195	-	-	-	-	-	361	-	361
Comprehensive income								59,221
Issuance of stock in connection with employee stock plans	438	5,654	-	-	-	-	-	5,654
Issuance of restricted stock to employees	11	-	-	-	-	-	-	-
Shares forfeited by employees	(5 )	-	-	-	-	-	-	-
Repurchase of Class A common stock	(772 )	(13,568 )	-	-	-	-	-	(13,568 )
Compensation for stock and stock option issuances and excess tax benefits from	-	2,473	-	-	(54 )	-	-	2,419

Edgar Filing: LITHIA MOTORS INC - Form 10-K

option exercises

Dividends paid	-	-	-	-	-	-	(6,822 )	(6,822 )
Balance at December 31, 2011	22,195	\$ 279,366	3,762	\$ 468	\$ 10,918	\$ (4,508 )	\$ 80,877	\$ 367,121

See accompanying notes to consolidated financial statements.

F-5

---

LITHIA MOTORS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

	Year Ended December 31,		
	2011	2010	2009
<b>Cash flows from operating activities:</b>			
Net income	\$58,860	\$13,719	\$9,151
<b>Adjustments to reconcile net income to net cash provided by (used in) operating activities:</b>			
Asset impairments	1,376	15,301	7,972
Depreciation and amortization	16,626	17,154	17,786
Depreciation and amortization within discontinued operations	322	432	1,035
Amortization of debt discount	-	-	48
Stock-based compensation	2,001	2,419	2,054
Gain on early extinguishment of debt	-	-	(1,317 )
Gain on disposal of other assets	(6,495 )	(107 )	(476 )
(Gain) loss from disposal activities within discontinued operations	(4,396 )	301	(9,910 )
Deferred income taxes	8,093	(2,131 )	5,627
Excess tax deficit (benefit) from share-based payment arrangements	(525 )	(264 )	45
<b>(Increase) decrease, net of effect of acquisitions and divestitures:</b>			
Accounts receivables, net	(22,503 )	(22,881 )	17,780
Inventories	(78,202 )	(68,305 )	120,785
Other current assets	(13,111 )	(1,633 )	15,992
Other non-current assets	(1,108 )	(2,029 )	(4,347 )
<b>Increase (decrease), net of effect of acquisitions and divestitures:</b>			
Floor plan notes payable	13,510	10,550	(179,893 )
Trade payables	5,998	4,960	(2,789 )
Accrued liabilities	11,605	10,029	(4,318 )
Other long-term liabilities and deferred revenue	7,183	1,155	14,714
Net cash provided by (used in) operating activities	(766 )	(21,330 )	9,939
<b>Cash flows from investing activities:</b>			
Principal payments received on notes receivable	121	85	-
Capital expenditures	(31,673 )	(7,589 )	(21,131 )
Proceeds from sales of assets	29,677	10,288	14,524
Payments for life insurance proceeds, net of proceeds received	(900 )	-	-
Cash paid for acquisitions, net of cash acquired	(60,485 )	(23,691 )	-
Proceeds from sales of stores	23,838	941	27,697
Net cash provided by (used in) investing activities	(39,422 )	(19,966 )	21,090
<b>Cash flows from financing activities:</b>			
Net borrowings on floor plan notes payable: non-trade	63,145	24,090	31,417
Borrowings on lines of credit	56,000	40,000	48,000
Repayments on lines of credit	(9,000 )	(24,000 )	(110,000 )
Principal payments on long-term debt and capital leases, scheduled	(10,909 )	(8,248 )	(13,260 )
Principal payments on long-term debt and capital leases, other	(55,666 )	(40,146 )	(78,652 )
Proceeds from issuance of long-term debt	25,674	47,219	47,838
Proceeds from issuance of common stock	5,654	4,192	45,576

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Repurchase of common stock	(13,568 )	(1,626 )	(1 )
Excess tax (deficit) benefit from share-based payment arrangements	525	264	(45 )
Dividends paid	(6,822 )	(3,919 )	-
Increase in restricted cash	(3,300 )	-	-
Net cash provided by (used in) financing activities	51,733	37,826	(29,127 )
Increase (decrease) in cash and cash equivalents	11,545	(3,470 )	1,902
Cash and cash equivalents at beginning of year	9,306	12,776	10,874
Cash and cash equivalents at end of year	\$20,851	\$9,306	\$12,776

Supplemental disclosure of cash flow information:

Cash paid during the period for interest	\$24,961	\$25,357	\$29,741
Cash paid (refunded) during the period for income taxes, net	33,722	8,000	(14,996 )

See accompanying notes to consolidated financial statements.

LITHIA MOTORS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Organization and Business

We are a leading operator of automotive franchises and a retailer of new and used vehicles and services. As of December 31, 2011, we offered 26 brands of new vehicles and all brands of used vehicles in 85 stores in the United States and online at Lithia.com. We sell new and used cars and light trucks and replacement parts; provide vehicle maintenance, warranty, paint and repair services; and arrange related financing, service contracts, protection products and credit insurance.

Our dealerships are primarily located throughout the Western and Midwestern regions of the United States. We target mid-sized regional markets for domestic and import franchises and metropolitan markets for luxury franchises. We believe this strategy enables brand exclusivity with minimal competition from other dealership with the same franchise in the market.

Basis of Presentation

The accompanying Consolidated Financial Statements reflect the results of operations, the financial position and the cash flows for Lithia Motors, Inc. and its directly and indirectly wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. The results of operations of stores classified as discontinued operations have been presented on a comparable basis for all periods presented in the accompanying Consolidated Statements of Operations. See Note 17.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand and cash in bank accounts without restrictions.

Accounts Receivable

Accounts receivable include amounts due from the following:

- various lenders for the financing of vehicles sold;
- customers for vehicles sold and service and parts sales;
- manufacturers for factory rebates, dealer incentives and warranty reimbursement; and
- insurance companies, finance companies, and other miscellaneous receivables.

Receivables are recorded at invoice and do not bear interest until such time as they are 60 days past due. The allowance for doubtful accounts is estimated based on our historical write-off experience and is reviewed on a monthly basis. Account balances are charged off against the allowance after all appropriate means of collection have been exhausted and the potential for recovery is considered remote. See Note 2.

Inventories

Inventories are valued at the lower of market value or cost, using a pooled approach for vehicles and the specific identification method for parts. The cost of new and used vehicle inventories includes the cost of any equipment added, reconditioning and transportation.

Manufacturers reimburse us for holdbacks, floor plan interest and advertising credits, which are reflected as a reduction in the carrying value of each vehicle purchased by us. We recognize advertising credits, floor plan interest credits, holdbacks, cash incentives and other rebates received from manufacturers that are tied to specific vehicles as a reduction to cost of sales as the related vehicles are sold.



Parts purchase discounts that we receive from the manufacturer are reflected as a reduction in the carrying value of the parts purchased from the manufacturer and are recognized as a reduction to cost of goods sold as the related inventory is sold. See Note 3.

F-7

---

### Property and Equipment

Property and equipment are stated at cost and are depreciated over their estimated useful lives on the straight-line basis. Leasehold improvements made at the inception of the lease or during the term of the lease are amortized on a straight-line basis over the shorter of the life of the improvement or the remaining term of the lease.

The range of estimated useful lives is as follows:

Buildings and improvements	5 to 40 years
Service equipment	5 to 15 years
Furniture, signs and fixtures	5 to 10 years

The cost for maintenance, repairs and minor renewals is expensed as incurred, while significant remodels and betterments are capitalized. In addition, interest on borrowings for major capital projects, significant remodels and betterments are capitalized. Capitalized interest becomes a part of the cost of the depreciable asset and is depreciated according to the estimated useful lives as previously stated. For the years ended December 31, 2011 and 2009, we recorded capitalized interest of \$0.2 million and \$0.9 million, respectively. We recorded no capitalized interest in 2010.

When an asset is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss is credited or charged to income from continuing operations.

Leased property meeting certain criteria is capitalized and the present value of the related lease payments is recorded as a liability. Amortization of capitalized leased assets is computed on a straight-line basis over the term of the lease, unless the lease transfers title or it contains a bargain purchase option, in which case, it is amortized over the asset's useful life, and is included in depreciation expense.

Long-lived assets held and used by us are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. We consider several factors when evaluating whether there are indications of potential impairment related to our long-lived assets, including store profitability, overall macroeconomic factors and impact of our strategic management decisions. If recoverability testing is performed, we evaluate assets to be held and used by comparing the carrying amount of an asset to future net undiscounted cash flows associated with the asset, including its disposition. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. See Note 4.

### Goodwill

Goodwill represents the excess purchase price over the fair value of net assets acquired which is not allocable to separately identifiable intangible assets. Other identifiable intangible assets, such as franchise rights, are separately recognized if the intangible asset is obtained through contractual or other legal right or if the intangible asset can be sold, transferred, licensed or exchanged.

Goodwill is not amortized but tested for impairment at least annually, and more frequently if events or circumstances indicate the carrying value of the reporting unit more likely than not exceeds fair value. We have determined that we operate as one reporting unit for the goodwill impairment test.

We test our goodwill for impairment on October 1 of each year by applying a fair-value based test using the Adjusted Present Value ("APV") method to indicate the fair value of our reporting unit. Under the APV method, future cash flows

are based on recently prepared operating forecasts and business plans to estimate the future economic benefits that the reporting unit will generate. Operating forecasts and cash flows include, among other things, revenue growth rates that are based on management's forecasted sales projections and on U.S. Department of Labor, Bureau of Labor Statistics for historical consumer price index data. A discount rate is utilized to convert the forecasted cash flows to their present value equivalent representing the indicated fair value of our reporting unit. The discount rate applied to the future cash flows factors is a subject-company risk premium, an equity market risk premium, small stock risk premium, a beta and a risk-free rate. We compare the indicated fair value of our reporting unit to our market capitalization, including consideration of a control premium. The control premium represents the estimated amount an investor would pay to obtain a controlling interest. We believe this reconciliation is consistent with a market participant perspective.

F-8

---

The impairment test of goodwill is a two step process. The first step identifies potential impairment by comparing the estimated fair value of a reporting unit with its book value. If the fair value of the reporting unit exceeds the carrying amount, goodwill is not impaired and the second step is not necessary. If the carrying value exceeds the fair value, the second step includes determining the implied fair value in the same manner as the amount of goodwill recognized in a business combination is determined. The implied fair value of goodwill is then compared with the carrying amount of goodwill to determine if an impairment loss is necessary. See Note 5.

#### Franchise Value

We enter into agreements (“Franchise Agreements”) with the manufacturers. Franchise value represents a right received under Franchise Agreements with manufacturers and is identified on an individual store basis.

We evaluated the useful lives of our Franchise Agreements based on the following factors:

- certain of our Franchise Agreements continue indefinitely by their terms;
- certain of our Franchise Agreements have limited terms, but are routinely renewed without substantial cost to us;
- other than franchise terminations related to the unprecedented reorganizations of Chrysler and General Motors, and allowed by bankruptcy law, we are not aware of manufacturers terminating Franchise Agreements against the wishes of the franchise owners under the ordinary course of business. A manufacturer may pressure a franchise owner to sell a franchise when they are in breach of the franchise agreement over an extended period of time;
  - state dealership franchise laws typically limit the rights of the manufacturer to terminate or not renew a franchise;
- we are not aware of any legislation or other factors that would materially change the retail automotive franchise system; and
  - as evidenced by our acquisition and disposition history, there is an active market for most automotive dealership franchises within the United States. We attribute value to the Franchise Agreements acquired with the dealerships we purchase based on the understanding and industry practice that the Franchise Agreements will be renewed indefinitely by the manufacturer.

Accordingly, we have determined that our Franchise Agreements will continue to contribute to our cash flows indefinitely and, therefore, have indefinite lives.

As an indefinite lived intangible asset, franchise value is tested for impairment at least annually, and more frequently if events or circumstances indicate the carrying value may exceed fair value. The impairment test for indefinite lived intangible assets requires the comparison of estimated fair value to carrying value, and an impairment charge is recorded to the extent the fair value is less than the carrying value. We have determined the appropriate unit of accounting for testing franchise value for impairment is on an individual store basis.

We perform our impairment tests on October 1 of each year using a multi-period excess earnings (“MPEE”) model to estimate the fair value of our franchises. We have determined that only certain cash flows of the store are directly attributable to franchise rights. Future cash flows are based on recently prepared operating forecasts and business plans to estimate the future economic benefits that the store will generate. Operating forecasts and cash flows include, among other things, revenue growth rates that are calculated based on management’s forecasted sales projections and on the U.S. Department of Labor, Bureau of Labor Statistics for historical consumer price index data. Additionally, we use a contributory asset charge to represent working capital, personal property and assembled workforce costs.

A discount rate is utilized to convert the forecasted cash flows to their present value equivalent. The discount rate applied to the future cash flows factors is a subject-company risk premium, an equity market risk premium, small stock risk premium, a beta and a risk-free rate. See Note 5.

#### Advertising

We expense production and other costs of advertising as incurred as a component of selling, general and administrative expense. Additionally, advertising credits that are not tied to specific vehicles are earned from the manufacturer when we submit for reimbursement of qualifying advertising expenditures and are recognized as a reduction of advertising expense upon manufacturer confirmation that our submitted expenditures qualify for such credits.

Advertising expense, net of manufacturer cooperative advertising credits, was \$25.1 million, \$26.2 million and \$17.8 million for the years ended December 31, 2011, 2010 and 2009, respectively. Manufacturer cooperative advertising credits were \$7.9 million in 2011, \$2.6 million in 2010 and \$3.7 million in 2009.

#### Income and Other Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance, if needed, reduces deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized.

When there are situations with uncertainty as to the timing of the deduction, the amount of the deduction, or the validity of the deduction, we adjust our financial statements to reflect only those tax positions that are more-likely-than-not to be sustained. Positions that meet this criterion are measured using the largest benefit that is more than 50% likely to be realized. Interest and penalties are recorded in the period incurred or accrued when related to an uncertain tax position. See Note 15.

We account for all taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction (i.e., sales, use, value-added) on a net (excluded from revenues) basis.

#### Concentration of Risk and Uncertainties

We purchase substantially all of our new vehicles and inventory from various manufacturers at the prevailing prices charged by auto makers to all franchised dealers. Our overall sales could be impacted by the auto manufacturers' inability or unwillingness to supply the dealership with an adequate supply of popular models.

In March 2011, an earthquake, tsunami and subsequent nuclear crisis in Japan impacted automotive manufacturers and automotive suppliers. These events damaged facilities, reduced production of vehicles and parts and destroyed inventory in Japan. Many Japanese manufacturers and suppliers were forced to halt production as they reconfigured production logistics. Many plants in Japan were inoperable or ran at limited capacity for a period of time. These events caused a global disruption to the supply of vehicles and automotive parts. As a result, new vehicle sales volumes for these manufacturers were negatively impacted in 2011. Vehicle production levels for these automotive manufacturers began improving during the last half of 2011. We have seen inventory levels return to normal in early 2012. We depend on our manufacturers to provide a supply of vehicles which supports expected sales levels. In the event that manufacturers are unable to supply the needed level of vehicles, our financial performance may be adversely impacted. As of December 31, 2011 and 2010, we had \$372.8 million and \$305.7 million, respectively, in

new vehicle inventory. We had \$27.0 million and \$22.2 million in parts and accessories inventory as of December 31, 2011 and 2010, respectively.

F-10

---

A lack of new vehicle supply may increase demand for late-model used vehicles. In 2008, 2009 and 2010, vehicle production and sales in North America were reduced by the recessionary environment. As a result, used vehicle supply, especially late-model vehicles, may be constrained, resulting in increased supply pressures and limited availability. Our used vehicle sales volume could be adversely impacted if we are unable to maintain an adequate supply of vehicles or if we are unable to obtain the makes and models desired by our customers. As of December 31, 2011, and 2010, we had \$106.6 million and \$87.3 million, respectively, in used and program vehicle inventory.

In 2010, Toyota announced vehicle recalls for possible accelerator pedal sticking issues and also halted the sale of eight models of vehicles until potentially defective parts were replaced, both of which reduced sales at our Toyota stores and adversely affected the manufacturer's reputation for quality. We depend on our manufacturers to deliver high-quality, defect-free vehicles. In the event that manufacturers, including Toyota, experience future quality issues, our financial performance may be adversely impacted.

We are subject to a concentration of risk in the event of financial distress, including potential reorganization or bankruptcy, of a major vehicle manufacturer. We purchase substantially all of our new vehicles from various manufacturers or distributors at the prevailing prices available to all franchised dealers. Our sales volume could be materially adversely impacted by the manufacturers' or distributors', inability to supply the stores with an adequate supply of vehicles. Our Chrysler, General Motors ("GM") and Ford (collectively, the "Domestic Manufacturers") stores represented approximately 32%, 17% and 6% of our new vehicle sales for 2011, respectively, and approximately 30%, 17% and 6% for 2010, respectively.

We receive incentives and rebates from our manufacturers, including cash allowances, financing programs, discounts, holdbacks and other incentives. These incentives are recorded as receivables on our Consolidated Balance Sheets until payment is received. Our financial condition could be materially adversely impacted by the manufacturers' or distributors' inability to continue to offer these incentives and rebates at substantially similar terms, or to pay our outstanding receivables. Total receivables from Domestic Manufacturers were \$11.6 million and \$8.4 million as of December 31, 2011 and 2010, respectively.

We enter into Franchise Agreements with the manufacturers. The Franchise Agreements generally limit the location of the dealership and provide the auto manufacturer approval rights over changes in dealership management and ownership. The auto manufacturers are also entitled to terminate the Franchise Agreements if the dealership is in material breach of the terms. Our ability to expand operations depends, in part, on obtaining consents of the manufacturers for the acquisition of additional dealerships. See also "Goodwill" and "Franchise Value" above.

We obtain new vehicle floor plan financing from a number of manufacturers or their affiliated finance companies. Amounts financed by lenders directly associated with the vehicle manufacturer or their affiliated finance company are classified as floor plan notes payable. These lenders include Mercedes-Benz Financial Services USA, LLC, Toyota Financial Services, Ford Motor Credit Company, American Honda Finance Corporation and BMW Financial Services NA, LLC. Several of these companies also provide mortgage financing.

We also obtain mortgage and new vehicle floor plan financing from certain lenders not directly affiliated with new vehicle manufacturers. Amounts financed for vehicles by these lenders are classified as floor plan notes payable: non-trade. Ally Bank and the credit facility with U.S. Bank National Association and JPMorgan Chase Bank, N.A. are the primary sources of floor plan financing for our General Motors, Chrysler, Subaru, Nissan and Hyundai brands.

At December 31, 2011 and 2010, Ally Bank was the floor plan provider on approximately 37% and 65%, respectively, of our total floor plan amount outstanding and the provider of approximately 33% and 28%, respectively, of our outstanding mortgage financing.





Certain floor plan and mortgage financing providers have incurred significant losses and are operating under financial constraints. Other providers may incur losses in the future or undergo funding limitations. As a result, credit that has typically been extended to us by these companies may be modified with terms unacceptable to us or revoked entirely. If these events were to occur, we may not be able to pay our debts or borrow sufficient funds to refinance the vehicles or real estate. Even if new financing were available, it may not be on terms acceptable to us.

The European Union is currently responding to a sovereign debt crisis involving Portugal, Ireland, Italy, Spain and Greece. The resolution of this crisis remains uncertain at this time. Many European and other banks have significant exposure to this sovereign debt and may be negatively affected in the event of restructuring or default. In 2008, with the significant disruption to financial markets, automotive sales were severely impacted due to the lack of available commercial and consumer credit. There can be no assurance that events in Europe will not cause a similar reduction in the availability of credit or otherwise negatively impact new vehicle sales.

#### Financial Instruments, Fair Value and Market Risks

The carrying amounts of cash equivalents, accounts receivables, trade payables, accrued liabilities and short-term borrowings approximate fair value because of the short-term nature and current market rates of these instruments.

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates. See Note 14.

We have variable rate floor plan notes payable, mortgages and other credit line borrowings that subject us to market risk exposure. At December 31, 2011, we had \$566.3 million outstanding under such facilities, with interest rates ranging from 2.1% to 5.0% per annum. An increase or decrease in the interest rates would affect interest expense for the period accordingly.

The fair value of long-term, fixed interest rate debt is subject to interest rate risk. Generally, the fair value of fixed interest rate debt will increase as interest rates fall because we could refinance for a lower rate. Conversely, the fair value of fixed interest rate debt will decrease as interest rates rise. The interest rate changes affect the fair value, but do not impact earnings or cash flows. We monitor our fixed interest rate debt regularly, refinancing debt that is materially above market rates if permitted. See Note 14.

We are also subject to credit risk and market risk by entering into interest rate swaps. See below and Note 13. We are generally exposed to credit or repayment risk based on our relationship with the counterparty to the transaction. We minimize the credit or repayment risk on our derivative instruments by entering into transactions with institutions whose credit rating is Aa or higher.

#### Derivative Financial Instruments

We enter into interest rate swap agreements to reduce our exposure to market risks from changing interest rates on our new vehicle floor plan lines of credit. All derivative instruments are recorded on the Consolidated Balance Sheets as an asset or liability at fair value. The related gains and losses on these instruments are deferred as a component of stockholders' equity, provided specific hedge accounting criteria are met. Recognition of the deferred gains and losses occur in the period the related cash flow item hedged is recognized as a component of floor plan interest expense. To the extent the derivative contract is determined to be ineffective, the ineffective portion is immediately recognized in earnings. See Note 13.

#### Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and related notes to financial statements. Changes in such estimates may affect amounts reported in future periods.

F-12

---

Estimates are used in the calculation of certain reserves maintained for charge-backs on estimated cancellations of service contracts; life, accident and disability insurance policies; and finance fees from customer financing contracts. We also use estimates in the calculation of various expenses, accruals and reserves, including anticipated workers compensation premium expenses related to a retrospective cost policy, anticipated losses related to self-insurance components of our property and casualty and medical insurance, self-insured lifetime lube, oil and filter service contracts, discretionary employee bonuses, warranties provided on certain products and services and stock-based compensation. We also make certain estimates regarding the assessment of the recoverability of long-lived assets, indefinite lived intangible assets and deferred tax assets.

#### Revenue Recognition

Revenue from the sale of a vehicle is recognized when a contract is signed by the customer, financing has been arranged or collectability is reasonably assured and the delivery of the vehicle to the customer is made. We do not allow the return of new or used vehicles, except where mandated by state law.

Revenue from parts and service is recognized upon delivery of the parts or service to the customer. We allow for customer returns on sales of our parts inventory up to 30 days after the sale. Most parts returns generally occur within one to two weeks from the time of sale, and are not significant.

Finance fees earned for notes placed with financial institutions in connection with customer vehicle financing are recognized, net of estimated charge-backs, as finance and insurance revenue upon acceptance of the credit by the financial institution.

Insurance income from third party insurance companies for commissions earned on credit life, accident and disability insurance policies sold in connection with the sale of a vehicle are recognized, net of anticipated cancellations, as finance and insurance revenue upon execution of the insurance contract.

Commissions from third party service contracts are recognized, net of anticipated cancellations, as finance and insurance revenue upon sale of the contracts. We also participate in future underwriting profit, pursuant to retrospective commission arrangements, which is recognized in income as earned.

Revenue related to self-insured lifetime lube, oil and filter service contracts is deferred and recognized based on expected future claims for service. The expected future claims experience is evaluated periodically to ensure it remains appropriate given actual claims history.

#### Asset Impairments

We perform periodic impairment tests for goodwill and franchise value and recoverability tests for long-lived assets.

As a result of these tests, we recorded asset impairments totaling \$1.4 million, \$15.3 million and \$8.0 million, respectively, in 2011, 2010 and 2009, as detailed below. Results for certain locations were retrospectively reclassified from discontinued operations to continuing operations for 2009 in the Consolidated Statements of Operations, including prior period impairments.

Asset impairments recorded in the Consolidated Statements of Operations consist of the following (in thousands):

Year Ended December 31,	2011	2010	2009
Intangible assets	\$ -	\$ -	\$ 250
Long-lived assets	1,376	15,301	9,720
Other assets	-	-	(1,998)
Total asset impairments	\$ 1,376	\$ 15,301	\$ 7,972

See Notes 4 and 17.

F-13

---

### Stock-Based Compensation

Compensation costs associated with equity instruments exchanged for employee and director services are measured at the grant date, based on the fair value of the award, and recognized as an expense over the individual's requisite service period (generally the vesting period of the equity award). See Note 12.

### Legal Costs

We are a party to numerous legal proceedings arising in the normal course of business. We accrue for certain legal costs, including attorney fees, and potential settlement claims related to various legal proceedings that are estimable and probable. See Note 8.

### Contract Origination Costs

Contract origination commissions paid to our employees directly related to the sale of our self-insured lifetime lube, oil and filter service contracts are deferred and charged to expense in proportion to the associated revenue to be recognized.

### Segment Reporting

We define an operating segment as a component of an enterprise that meets the following criteria:

- engages in business activities from which it may earn revenues and incur expenses;
- operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and
  - discrete financial information is available.

Based on this definition, we believe we operate as a single operating and reporting segment, automotive retailing. Our chief operating decision maker ("CODM"), defined to be our executive management group, evaluates our performance on a consolidated basis. Historical and forecasted operational performance is evaluated on a consolidated basis by the CODM. Additionally, allocation of future resources is evaluated on a consolidated basis as several of our functions are centralized.

### Warranty

We offer a 60-day, 3,000 mile limited warranty on the sale of most retail used vehicles. We also offer a 3-year, 50,000 mile warranty on parts used in our service repair work and a 2-year warranty on tire purchases. The cost that may be incurred for these warranties is estimated at the time the related revenue is recorded. A reserve for these warranty liabilities is estimated based on current sales levels, warranty experience rates and estimated costs per claim. As of December 31, 2011 and 2010, the accrued warranty balance was \$0.5 million and \$0.1 million, respectively.

### (2) Accounts Receivable

Accounts receivable consisted of the following (in thousands):

December 31,	2011	2010
Contracts in transit	\$ 47,867	\$ 34,365
Trade receivables	16,418	13,166
Vehicle receivables	15,930	13,439
Manufacturer receivables	19,453	14,231
	99,668	75,201
Less: Allowance	(261 )	(190 )
Total accounts receivables, net	\$ 99,407	\$ 75,011

Contracts in transit are receivables from various lenders for the financing of vehicles that we have arranged on behalf of the customer and are typically received within five days of selling a vehicle. Trade receivables are comprised of amounts due from customers, lenders for the commissions earned on financing and third parties for commissions earned on service contracts and insurance products. Vehicle receivables represent receivables for the portion of the vehicle sales price paid directly by the customer.

F-14

---

Manufacturer receivables represent amounts due from manufacturers including holdbacks, rebates, incentives and warranty claims.

(3) Inventories

Inventories consisted of the following (in thousands):

December 31,	2011	2010
New vehicles	\$ 372,838	\$ 305,721
Used and program vehicles	106,622	87,349
Parts and accessories	27,024	22,158
Total inventories	\$ 506,484	\$ 415,228

The new vehicle inventory cost is generally reduced by manufacturer holdbacks and incentives, while the related floor plan notes payable are reflective of the gross cost of the vehicle. As of December 31, 2011 and 2010, the carrying value of inventory had been reduced by \$3.2 million and \$2.9 million, respectively, for assistance received from manufacturers as discussed in Note 1.

We evaluate our vehicles at the lower of market value or cost under the pooled approach. We did not record any impairment charges on used vehicle inventories in 2011 or 2010. If the book value of our used vehicles is more than fair value, we could experience losses on our used vehicles in future periods.

(4) Property and Equipment

Property and equipment consisted of the following (in thousands):

December 31,	2011	2010
Land	\$ 120,092	\$ 117,083
Building and improvements	232,478	225,331
Service equipment	36,895	36,905
Furniture, signs and fixtures	71,313	73,925
	460,778	453,244
Less accumulated depreciation	(99,115 )	(93,745 )
	361,663	359,499
Construction in progress	12,116	2,934
	\$ 373,779	\$ 362,433

Description of Economic Factors Affecting Undeveloped Land and Vacant Facilities

Our portfolio of land, building and improvements includes properties held for future development, comprised of undeveloped land and vacant facilities. The undeveloped land was purchased in connection with our planned development of stand-alone used vehicle stores or to relocate existing new vehicle stores in certain markets. In 2008, our plans to develop the land were placed on hold until economic conditions improved. The vacant facilities are a result of the bankruptcy reorganization of Chrysler and GM, which terminated certain stores we operated, or through our election to close certain underperforming locations. We believe many of these locations are best utilized for retail automotive purposes reflective of our intended use and construction specifications.

In the fourth quarter of 2009, we completed an equity offering. One of the intended uses of the proceeds was, and remains, to fund potential acquisitions. Following the equity offering, we considered various strategies to convert our properties held for future development into operational assets. We ultimately concluded the best alternative was to

seek new vehicle franchises that could be acquired and located in our properties. We began an exhaustive search to identify and ultimately acquire franchises in these markets.

F-15

---



During 2010, we evaluated the results of our comprehensive search and we determined that we would be unable to acquire franchises at reasonable prices to mitigate the continued holding costs of the facilities. We also determined that development opportunities for our undeveloped land would not be realizable within a short to medium-term time period. In addition, through the first half of 2010, we experienced various macroeconomic and industry specific factors which influenced our decision to modify our disposition strategy.

At the end of 2009, the projected rate of annualized new vehicle sales in the United States was forecasted to recover from the extremely low levels experienced in 2009 to a more robust level in 2010, with some analysts projecting as many as 13 million new vehicles sold in the year. However, by the middle of 2010, the annualized new vehicle sales levels were revised down to approximately an 11.5 million unit range, and projections available at that time for the year 2011 and beyond were more uncertain with respect to the pace at which a return to the higher sales levels experienced through 2007 would occur.

The closure of a number of automotive retail locations in 2009, due both to the economic downturn and as a result of the termination of franchises by major domestic manufacturers in connection with their bankruptcy proceedings, created an oversupply of vacant dealership properties across the United States. Sales levels created significant idle capacity in existing automotive dealership network, which reduced the need for additional retail space provided by vacant dealership sites or by developing new sites. In 2010, it became apparent that this oversupply of dealer capacity may take a significantly longer period to be absorbed than previously thought.

Additionally, improvement in the demand for properties held for future development is tied to a broader economic recovery. Retailers and other commercial users who are willing and able to make the often significant capital investment these properties require must feel more optimistic about the outlook for the future. While the economy improved from the unprecedented depressed levels experienced in 2009, the longer-term outlook remained cautious. Anemic growth of economic activity out of the recession, a reduction in outlook for GDP growth by economists, persistently high unemployment rates, and the European credit crisis impacted consumer confidence and delayed the expected rebound of the U.S. economy.

Also, the relative financial condition of regional banks, many of which carry significant quantities of non-performing assets or other owned real estate, remained tenuous. As a result, their inability or unwillingness to finance the purchase of commercial properties for potential buyers significantly reduced the demand and opportunities for us to sell our holdings at reasonable prices. Overall, availability of credit for prospective buyers remained tight compared to historical levels, reducing the potential pool of buyers to only the most creditworthy market participants.

In the markets where our undeveloped or vacant properties are located, we experienced a large supply of vacant dealership sites, commercial real estate in general and available land for commercial and retail development, which allowed prospective buyers a number of choices and increased price pressure. In evaluating broader commercial real estate trends, the supply of commercial real estate failed to decrease in the first half of 2010 and continued to significantly outstrip current demand. Sales activity remained limited given diverging price expectations by buyers and sellers. When sales do occur, the realized prices were often lower than in prior periods, reflecting the financially distressed nature of the seller and/or the leveraged negotiating position of the buyer.

As a result of these various considerations, we changed our strategy in the middle of 2010 regarding our real estate held for development. Previously, we contemplated disposition in the normal course of business under a highest and best use scenario allowing for a "market reasonable" marketing period. As a result, we adopted a strategy focused on a more immediate disposition to potential buyers meeting broader needs and characteristics, including a different commercial retail use, allowing for the redeployment of the invested capital to higher-growth potential opportunities within our business.



We experienced an increase in sales interest by prospective buyers; although offers were made at prices significantly lower than we anticipated. In certain cases, these offers were made at amounts that we consider to be significantly lower than the value of these properties from a long-term income approach at their highest and best use. Also in some cases, the offers represented amounts less than current replacement cost. However, given the prospect of accepting these offers and effecting a quick sale, or alternatively continuing the capital investment in these non-operational properties for a longer period until we or other market participants can find a suitable operational use for these properties, we decided to accept certain offers and redeploy the capital elsewhere.

#### Long-Lived Asset Impairment Charges

As a result of the above, additional changes in expected future use and additional market data, as well as the reorganization in bankruptcy of both Chrysler and GM in 2009, we tested our long-lived assets for recovery in 2011, 2010 and 2009. Based on these tests, we recorded asset impairment charges of \$1.4 million, \$15.3 million and \$9.7 million in 2011, 2010 and 2009, respectively, on our Consolidated Statements of Operations.

We continue to focus on mitigating our exposure to vacant dealerships and undeveloped land, and have made progress towards the disposal of these non-operating assets. We place the highest priority on disposing of vacant dealerships, due to their significantly higher carrying costs and more restrictive commercial use. As additional market information becomes available and negotiations with prospective buyers continue, estimated fair market values of our properties may change. These changes may result in recognition of additional impairment charges in future periods. As of December 31, 2011, we had \$14.0 million of our long-lived assets held for future development or investment purposes.

#### (5) Goodwill and Franchise Value

The following is a roll-forward of goodwill (in thousands):

	Goodwill
Gross balance as of December 31, 2009	\$ 299,266
Accumulated impairment losses	(299,266 )
Net balance as of December 31, 2009	-
Additions through acquisitions	6,186
Net balance as of December 31, 2010	6,186
Additions through acquisitions	12,869
Transfers to discontinued operations	(97 )
Net balance as of December 31, 2011	\$ 18,958

During 2011 and 2010, we concluded that there were no impairments to the carrying value of goodwill. We did not have any goodwill on our Consolidated Balance Sheets during 2009.

The following is a roll-forward of franchise value (in thousands):

	Franchise Value
Balance as of December 31, 2009	\$ 42,428
Additions through acquisitions	2,615
Transfers from discontinued operations	150
Balance as of December 31, 2010	45,193
Additions through acquisitions	14,517
Transfers to discontinued operations	(615 )
Balance as of December 31, 2011	\$ 59,095

We concluded that there were no impairments to the carrying value of franchise value in 2011 or 2010. The \$0.3 million impairment charge recorded in 2009 was related to an impairment associated with a location that was retrospectively reclassified from discontinued operations to continuing operations in the Consolidated Statements of Operations.

F-17

---

## (6) Floor Plan Notes Payable

We obtain new vehicle floor plan financing from a number of manufacturers, manufacturer affiliated finance companies and lenders. All new vehicles are pledged to collateralize floor plan notes payable. Floor plan notes are payable on demand and are typically paid upon the sale of the related vehicle. As such, these floor plan notes payable are classified as current liabilities on the Consolidated Balance Sheets. These notes bear interest, payable monthly on the outstanding balance, at a rate of interest that varies by provider. The weighted average interest rate on our floor plan facilities was 2.5% as of December 31, 2011.

We maintain deposit relationships with certain floor plan providers. As of December 31, 2011 and 2010, \$0.5 million and \$7.7 million, respectively, was recorded as a reduction to floor plan notes payable related to these amounts, reflecting the legal right of offset held by the floor plan provider.

## (7) Long-Term Debt

Our long-term debt consists of the following (in thousands):

December 31,	2011	2010
Working capital, acquisition and used vehicle credit facility	\$87,000	\$40,000
Real estate mortgages	194,404	234,850
Other debt	5,470	5,924
Total long-term debt	286,874	280,774
Less current maturities	(8,221)	(12,081)
Long-term debt	\$278,653	\$268,693

## Working Capital, Acquisition and Used Vehicle Credit Facility

On September 30, 2011, we entered into a new three-year \$200 million credit facility with U.S. Bank National Association and JPMorgan Chase, N.A. (the "Credit Facility"). This Credit Facility provides us with a \$100 million floor plan commitment and up to a \$100 million revolving line of credit.

The interest rate on the revolving line of credit is the 1-month LIBOR plus 2.25%. Our financial covenants related to this Credit Facility include maintaining a current ratio not less than 1.20:1.0, a fixed charge coverage ratio not less than 1.20:1.0 and a liabilities to tangible net worth ratio not more than 4.0:1.0. We are also limited in the amount of total funded debt we may carry to \$310 million, excluding subordinated debt. As of December 31, 2011, we had \$87.0 million outstanding under the Credit Facility and we were in compliance with all financial covenants.

Loans are guaranteed by all of our subsidiaries and are secured by new vehicle inventory, used vehicle and parts inventory, equipment other than fixtures, deposit accounts, accounts receivable, investment property, other intangible personal property and a portion of our real property Lithia Real Estate grants as a security interest to U.S. Bank. Capital stock and other equity interests of our subsidiary stores and certain other subsidiaries are excluded. The lenders' security interest in new vehicle inventory is subordinated to the interests of floor plan financing lenders, including Ally Bank, Mercedes-Benz Financial Services USA, LLC, Toyota Financial Services, Ford Motor Credit Company, American Honda Finance Corporation and BMW Financial Services NA, LLC. The Credit Facility agreement provides for events of default that include nonpayment, breach of covenants, a change of control and certain cross-defaults with other indebtedness. The Credit Facility provides for events of default that include nonpayment and certain cross-defaults with other indebtedness. In the event of a default, the Credit Facility provides that the lenders may declare the entire principal balance and floor plan balance immediately due, foreclose on collateral and increase the applicable interest rate to the revolving loan rate plus 3% per annum, among other remedies.

Real Estate Mortgages

Associated with our owned real estate and leaseholds, we have mortgages with interest rates ranging from 2.5% to 7.0% per annum. These mortgages are payable in various installments through May 2031 and are secured by the associated real estate.

F-18

---

### Other Debt

Other long-term debt includes various notes, capital leases and obligations assumed as a result of acquisitions and other agreements. The interest rates associated with this debt range from 3.5% to 9.0% per annum and are payable in various installments through October 2018.

### Future Principal Payments

The schedule of future principal payments on long-term debt as of December 31, 2011 was as follows (in thousands):

Year Ending December 31,	
2012	\$ 8,221
2013	34,318
2014	122,821
2015	46,187
2016	29,498
Thereafter	45,829
<b>Total principal payments</b>	<b>\$ 286,874</b>

### (8) Commitments and Contingencies

#### Leases

We lease certain of our facilities under non-cancelable operating and capital leases. These leases expire at various dates through 2066. Certain lease commitments contain fixed payment increases at predetermined intervals over the life of the lease, while other lease commitments are subject to escalation clauses of an amount equal to the increase in the cost of living based on the "Consumer Price Index - U.S. Cities Average - All Items for all Urban Consumers" published by the U.S. Department of Labor, or a substantially equivalent regional index. Lease expense related to operating leases is recognized on a straight-line basis over the life of the lease.

The minimum lease payments under our operating and capital leases after December 31, 2011 are as follows (in thousands):

Year Ending December 31,	
2012	\$ 19,584
2013	18,182
2014	16,499
2015	15,344
2016	14,142
Thereafter	83,097
<b>Total minimum lease payments</b>	<b>166,848</b>
Less: sublease rentals	(8,819 )
	<b>\$ 158,029</b>

Rental expense, net of sublease income, for all operating leases was \$15.0 million, \$13.6 million and \$14.4 million for the years ended December 31, 2011, 2010 and 2009, respectively. These amounts are included as a component of selling, general and administrative expenses in our Consolidated Statements of Operations.

In connection with dispositions of dealerships, we occasionally assign or sublet our interests in any real property leases associated with such dealerships to the purchaser. We often retain responsibility for the performance of certain obligations under such leases to the extent that the assignee or sublessee does not perform. Additionally, we may remain subject to the terms of any guarantees and have correlating indemnification rights against the assignee or

sublessee in the event of non-performance, as well as certain other defenses. We may also be called upon to perform other obligations under these leases, such as environmental remediation of the premises or repairs upon termination of the lease. We currently have no reason to believe that we will be called upon to perform any such services; however, there can be no assurance that any future performance required by us under these leases will not have a material adverse effect on our financial condition or results of operations.

F-19

---



Certain of our facilities where a lease obligation still exists have been vacated for business reasons. In these instances, we make efforts to find qualified tenants to sublease the facilities and assume financial responsibility. However, due to the specific nature and size of the facilities used in our dealerships, tenants are not always available. Liabilities have been accrued to reflect our estimate of future lease obligations. These amounts were not material to our Consolidated Statements of Operations during 2011, 2010 and 2009 and the amounts accrued at December 31, 2011 and 2010 were not material.

#### Capital Commitments

Capital expenditures were \$31.7 million, \$7.6 million and \$21.1 million for 2011, 2010 and 2009, respectively. The increase in capital expenditures in 2011 was related to improvements at certain of our store facilities, the purchase of new store locations, replacement of equipment and construction of a new headquarters building.

Many manufacturers provide assistance in the form of additional vehicle incentives if facilities meet image standards and requirements. We believe it is an attractive time to invest in certain internal initiatives that will generate additional manufacturer incentive payments, particularly from our domestic partners. Also, recently enacted tax law changes that accelerate deductions for capital expenditures have accelerated project timelines to ensure completion before the law expires.

In the event we undertake a significant capital commitment in the future, we expect to pay for the construction out of existing cash balances, construction financing and borrowings on our Credit Facility. Upon completion of the projects, we would anticipate securing long-term financing and general borrowings from third party lenders for 70% to 90% of the amounts expended, although no assurances can be provided that these financings will be available to us in sufficient amounts or on terms acceptable to us.

#### Charge-Backs for Various Contracts

We have recorded a liability of \$10.4 million as of December 31, 2011 for our estimated contractual obligations related to potential charge-backs for vehicle service contracts, lifetime oil change contracts and other various insurance contracts that are terminated early by the customer. We estimate that the charge-backs will be paid out as follows (in thousands):

Year Ending December 31,	
2012	\$ 5,752
2013	2,889
2014	1,217
2015	402
2016	87
Thereafter	14
<b>Total</b>	<b>\$ 10,361</b>

#### Lifetime Lube, Oil and Filter Contracts

In March 2009, we entered into a transaction related to existing lifetime lube, oil and filter contracts, in which we assumed the obligation to provide future services under the purchased contracts. As of December 31, 2011, we had a remaining balance of \$5.5 million. We estimate the deferred revenue associated with this assumed obligation will be recognized as follows (in thousands):

Year Ending December 31,	
2012	\$ 1,530
2013	1,163
2014	888

2015	660
2016	473
Thereafter	799
Total	\$ 5,513

We periodically evaluate the estimated future costs of these contracts and record a charge if future expected claim and cancellation costs exceed the deferred revenue to be recognized. In 2011, 2010 and 2009, our analysis indicated expected costs had increased as experience rates changed due to customers retaining their cars for longer periods of time compared to our historical experience at that time. Additionally, in 2011 we experienced an increase in the costs related to increased oil prices. As a result, we recorded increases to our liability of \$1.0 million, \$1.0 million and \$1.4 million, respectively, as a charge to cost of sales in our Consolidated Statements of Operations in 2011, 2010 and 2009.

We retain the obligation for lifetime lube, oil and filter service contracts sold to our customers and record deferred revenues related to these contracts. At the time of sale, we defer the full sale price and recognize the revenue based on the rate we expect future costs to be incurred. As of December 31, 2011, we had a deferred revenue balance of \$22.8 million associated with these contracts and estimate the deferred revenue will be recognized as follows (in thousands):

Year Ending December 31,	
2012	\$ 5,493
2013	4,258
2014	3,206
2015	2,433
2016	1,921
Thereafter	5,509
Total	\$ 22,820

#### Self-insurance Programs

We self-insure a portion of our property and casualty insurance, medical insurance and workers' compensation insurance. A third-party is engaged to assist in estimating the loss exposure related to the self-retained portion of the risk associated with these insurances. Additionally, we analyze our historical loss and claims experience to estimate the loss exposure associated with these programs. As of December 31, 2011 and 2010, we had liabilities associated with these programs of \$10.4 million and \$7.3 million, respectively, recorded as a component of accrued liabilities and other long-term liabilities on our Consolidated Balance Sheets.

#### Regulatory Compliance

We are subject to numerous state and federal regulations common in the automotive sector that cover retail transactions with customers and employment and trade practices. We do not anticipate that compliance with these regulations will have an adverse effect on our business, consolidated results of operations, financial condition or cash flows, although such outcome is possible given the nature of our operations and the legal and regulatory environment affecting our business.

#### Severance Agreement

In the second quarter of 2010, we entered into an agreement with Jeffrey DeBoer, former Senior Vice President and Chief Financial Officer, stipulating a one-time cash payment associated with the acceptance of his resignation no later than October 31, 2010. Under the terms of the agreement, we would also provide out-placement consulting services for a maximum of two years, the option to purchase two vehicles leased from us and a pro-rated portion of his variable compensation. Mr. DeBoer will also provide his services as a consultant for up to two years.

As a result of this agreement, we recorded a liability totaling \$0.7 million in the second quarter of 2010 as a component of selling, general and administrative expense in our Consolidated Statements of Operations. As of December 31, 2010, we had paid out all of this liability.

#### Litigation

We are party to numerous legal proceedings arising in the normal course of our business. While we cannot predict with certainty the outcomes of these matters, we do not anticipate that the resolution of legal proceedings arising in the normal course of business or the proceedings described below will have a material adverse effect on our business, results of operations, financial condition, or cash flows.

#### Text Messaging Claims

In April 2011, a third party vendor assisted us in promoting a targeted "0% financing on used vehicles" advertising campaign during a limited sale period. The marketing included sending a "Short Message Service" communication to

cell phones (a “text message”) of our previous customers. The message was sent to over 50,000 cell phones in 14 states. The message indicated that the recipients could “Opt-Out” of receiving any further messages by replying “STOP,” but, due to a technical error, some recipients who responded requesting to be unsubscribed nonetheless may have received a follow-on message.

F-21

---

On or about April 21, 2011, a Complaint for Damages, Injunctive and Declaratory Relief was filed against us (Kevin McClintic vs. Lithia Motors, 11-2-14632-4 SEA, Superior Court of the State of Washington for King County) alleging the text messaging activity violated State of Washington anti-texting and consumer protection laws and the federal Telephone Consumer Protection Act, and seeking statutory damages of \$500 for each violation, trebled, plus injunctive relief and attorney fees. The suit seeks class action designation for all similarly situated entities and individuals. The suit has been removed to the United States District Court for the Western District of Washington at Seattle.

On or about July 5, 2011, a complaint was filed alleging nearly identical claims, also seeking class action designation (Dan McLaren vs. Lithia Motors, Civil # 11-810, United States District Court of Oregon, Portland Division). This case was stayed pending the outcome of the McClintic matter by order of the court on or about October 11, 2011. The class representative in the McLaren case also attempted to intervene in the McClintic case. This intervention motion was denied on October 19, 2011.

We participated in a mediation of the McClintic case and have entered into a settlement agreement with the plaintiffs, which is subject to court approval. Under this settlement agreement, we agreed to pay a total of \$2.5 million, all of which such amounts will be reimbursed by the vendor pursuant to contractual indemnification. No assurances can be given that the court will approve the settlement.

#### Alaska Consumer Protection Act Claims

In December 2006, a suit was filed against us (Jackie Neese, et al vs. Lithia Chrysler Jeep of Anchorage, Inc, et al, Case No. 3AN-06-13341 CI, and in April, 2007, a second case (Jackie Neese, et al vs. Lithia Chrysler Jeep of Anchorage, Inc, et al, Case No. 3AN-06-4815 CI) (now consolidated)), in the Superior Court for the State of Alaska, Third Judicial District at Anchorage. In the suits, plaintiffs alleged that we, through our Alaska dealerships, engaged in three practices that purportedly violate Alaska consumer protection laws: (i) charging customers dealer fees and costs (including document preparation fees) not disclosed in the advertised price, (ii) failing to disclose the acquisition, mechanical and accident history of used vehicles or whether the vehicles were originally manufactured for sale in a foreign country, and (iii) engaging in deception, misrepresentation and fraud by providing to customers financing from third parties without disclosing that we receive a fee or discount for placing that loan (a “dealer reserve”). The suit seeks statutory damages of \$500 for each violation (or three times plaintiff’s actual damages, whichever is greater), and attorney fees and costs and the plaintiffs sought class action certification. Before and during the pendency of these suits, we engaged in settlement discussions with the State of Alaska through its Office of Attorney General with respect to the first two practices enumerated above. As a result of those discussions, we entered into a Consent Judgment subject to court approval and permitted potential class members to “opt-out” of the proposed settlement. Counsel for the plaintiffs attempted to intervene and, after various motions, hearings and an appeal to the state Court of Appeals, the Consent Judgment became final.

Plaintiffs then filed a motion in November 2010 seeking certification of a class for (i) the 339 customers who “opted-out” of the state settlement, (ii) for those customers who did not qualify for recovery under the Consent Judgment but were allegedly eligible for recovery under the Plaintiffs’ broader interpretation of the applicable statutes and (iii) arguing that since the State’s suit against our dealerships did not address the loan fee/discount (dealer reserve) claim, for those customers who arranged their vehicle financing through us. On June 14, 2011, the District Court granted Plaintiffs’ motion to certify a class without addressing either the merits of the claims or the size of the class or classes. We intend to defend the claims vigorously and do not believe the novel “dealer reserve” claim has merit.

The ultimate resolution of these matters cannot be predicted with certainty, and an unfavorable resolution of any of the matters could have a material adverse effect on our results of operations, financial condition or cash flows.



## (9) Stockholders' Equity

## Class A and Class B Common Stock

The shares of Class A common stock are not convertible into any other series or class of our securities. Each share of Class B common stock, however, is freely convertible into one share of Class A common stock at the option of the holder of the Class B common stock. All shares of Class B common stock shall automatically convert to shares of Class A common stock (on a share-for-share basis, subject to adjustment) on the earliest record date for an annual meeting of our stockholders on which the number of shares of Class B common stock outstanding is less than 1% of the total number of shares of common stock outstanding. Shares of Class B common stock may not be transferred to third parties, except for transfers to certain family members and in other limited circumstances.

Holders of Class A common stock are entitled to one vote for each share held of record and holders of Class B common stock are entitled to ten votes for each share held of record. The Class A common stock and Class B common stock vote together as a single class on all matters submitted to a vote of stockholders.

## Sale of Class A Common Stock

On October 15, 2009, we sold 4,000,000 shares of our Class A common stock in a public offering at a price of \$10.00 per share for gross proceeds of \$40.0 million and net proceeds, after underwriting commissions, of \$37.9 million. We also granted to the underwriters of the public offering a 30-day option to purchase up to an additional 600,000 shares to cover over-allotments, if any. The option to purchase the shares was exercised by the underwriters in its entirety, resulting in total gross proceeds of \$46.0 million and net proceeds, after underwriting commissions and other expenses, of \$43.2 million.

## Repurchases of Class A Common Stock

In June 2000, our Board of Directors authorized the repurchase of up to 1,000,000 shares of our Class A common stock. Through December 31, 2011, we have purchased all available shares under this program. In August 2011, our Board of Directors authorized the repurchase of up to 2,000,000 additional shares of our Class A common stock. This plan does not have an expiration date. As of December 31, 2011, 1,702,945 shares remained available for purchase pursuant to this program.

The following is a summary of our repurchases in the years ended December 31, 2011 and 2010. We did not repurchase shares under this program in 2009.

	Year Ended December 31,	
	2011	2010
Shares repurchased	716,431	100,893
Total purchase price (in thousands)	\$ 12,389	\$ 795
Average purchase price per share	\$ 17.29	\$ 7.88

We may continue to purchase shares from time to time in the future as conditions warrant.

## Dividends

For the period January 1, 2009 through December 31, 2011, we declared and paid dividends on our Class A and Class B Common Stock as follows:

Quarter declared:	Dividend amount per Class A and Class B share	Total amount of dividend (in thousands)
<b>2009</b>		
First quarter	\$ --	\$ --
Second quarter	--	--
Third quarter	--	--
Fourth quarter	--	--
<b>2010</b>		
First quarter	\$ --	\$ --
Second quarter	0.05	1,300
Third quarter	0.05	1,307
Fourth quarter	0.05	1,312
<b>2011</b>		
First quarter	\$ 0.05	\$ 1,316
Second quarter	0.07	1,851
Third quarter	0.07	1,838
Fourth quarter	0.07	1,817

## (10) Net Income Per Share of Class A and Class B Common Stock

We compute net income per share of Class A and Class B common stock using the two-class method. Under this method, basic net income per share is computed using the weighted average number of common shares outstanding during the period excluding unvested common shares subject to repurchase or cancellation. Diluted net income per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options and unvested restricted shares subject to repurchase or cancellation. The dilutive effect of outstanding stock options and other grants is reflected in diluted earnings per share by application of the treasury stock method. The computation of the diluted net income per share of Class A common stock assumes the conversion of Class B common stock, while the diluted net income per share of Class B common stock does not assume the conversion of those shares.

Except with respect to voting and transfer rights, the rights of the holders of our Class A and Class B common stock are identical. Our Restated Articles of Incorporation require that the Class A and Class B common stock must share equally in any dividends, liquidation proceeds or other distribution with respect to our common stock and the Articles of Incorporation can only be amended by a vote of the shareholders. Additionally, Oregon law provides that amendments to our Articles of Incorporation, which would have the effect of adversely altering the rights, powers or preferences of a given class of stock, must be approved by the class of stock adversely affected by the proposed amendment. As a result, the undistributed earnings for each year are allocated based on the contractual participation rights of the Class A and Class B common shares as if the earnings for the year had been distributed. As the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis. Further, as we assume the conversion of Class B common stock in the computation of the diluted net income per share of Class A common stock, the undistributed earnings are equal to net income for that computation.





Following is a reconciliation of the income from continuing operations and weighted average shares used for our basic earnings per share (“EPS”) and diluted EPS for the years ended December 31, 2011, 2010 and 2009 (in thousands, except per share amounts):

Year Ended December 31, Basic EPS	2011		2010		2009	
	Class A	Class B	Class A	Class B	Class A	Class B
<b>Numerator:</b>						
Income from continuing operations applicable to common stockholders	\$47,769	\$7,998	\$11,578	\$1,953	\$5,574	\$1,148
Distributed income applicable to common stockholders	(5,844 )	(978 )	(3,353 )	(566 )	-	-
Basic undistributed income from continuing operations applicable to common stockholders	\$41,925	\$7,020	\$8,225	\$1,387	\$5,574	\$1,148
<b>Denominator:</b>						
Weighted average number of shares out-standing used to calculate basic income per share	22,468	3,762	22,300	3,762	18,275	3,762
Basic income from continuing operations per share applicable to common stockholders	\$2.13	\$2.13	\$0.52	\$0.52	\$0.31	\$0.31
Basic distributed income per share applicable to common stockholders	(0.26 )	(0.26 )	(0.15 )	(0.15 )	-	-
Basic undistributed income from continuing operations per share applicable to common stockholders	\$1.87	\$1.87	\$0.37	\$0.37	\$0.31	\$0.31

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Year Ended December 31, Diluted EPS	2011		2010		2009	
	Class A	Class B	Class A	Class B	Class A	Class B
<b>Numerator:</b>						
Distributed income applicable to common stockholders	\$5,844	\$978	\$3,353	\$566	\$-	\$-
Reallocation of distributed income as a result of conversion of dilutive stock options	15	(15 )	5	(5 )	-	-
Reallocation of distributed income due to conversion of Class B to Class A	963	-	561	-	-	-
Diluted distributed income applicable to common stockholders	\$6,822	\$963	\$3,919	\$561	\$-	\$-
Undistributed income from continuing operations applicable to common stockholders	\$41,925	\$7,020	\$8,225	\$1,387	\$5,574	\$1,148
Reallocation of undistributed income as a result of conversion of dilutive stock options	114	(114 )	11	(11 )	8	(8 )
Reallocation of undistributed income due to conversion of Class B to Class A	6,906	-	1,376	-	1,140	-
Diluted undistributed income from continuing operations applicable to common stockholders	\$48,945	\$6,906	\$9,612	\$1,376	\$6,722	\$1,140

**Denominator:**

Weighted average number of shares outstanding used to calculate basic income per share	22,468	3,762	22,300	3,762	18,275	3,762
Weighted average number of shares from stock options	434	-	217	-	139	-
Conversion of Class B to Class A	3,762	-	3,762	-	3,762	-
Weighted average number of shares outstanding used to calculate diluted income per share	26,664	3,762	26,279	3,762	22,176	3,762

Year Ended December 31, Diluted EPS	2011		2010		2009	
	Class A	Class B	Class A	Class B	Class A	Class B
Diluted income from continuing operations per share available to common stockholders	\$2.09	\$2.09	\$0.51	\$0.51	\$0.30	\$0.30
	(0.26 )	(0.26 )	(0.15 )	(0.15 )	-	-

Diluted distributed income from  
 continuing operations per share  
 applicable to common  
 stockholders

Diluted undistributed income from continuing operations per share applicable to common stockholders	\$1.83	\$1.83	\$0.36	\$0.36	\$0.30	\$0.30
--	--------	--------	--------	--------	--------	--------

Antidilutive Securities:

2 7/8% convertible senior subordinated notes	-	-	-	-	321	-
---	---	---	---	---	-----	---

Shares issuable pursuant to stock options not included since they were antidilutive	280	-	661	-	1,338	-
---	-----	---	-----	---	-------	---

F-26

---

## (11) 401(k) Profit Sharing, Deferred Compensation and Long-term Incentive Plans

We have a defined contribution 401(k) plan and trust covering substantially all full-time employees. The annual contribution to the plan is at the discretion of our Board of Directors. Contributions of \$1.7 million, \$0.6 million and \$0.4 million were recognized for the years ended December 31, 2011, 2010 and 2009, respectively. Employees may contribute to the plan if they meet certain eligibility requirements.

Beginning in March 2011, we offered a deferred compensation and long-term incentive plan (the "Plan") to provide certain employees the ability to accumulate assets for retirement on a tax deferred basis. Participants are allowed to defer a portion of their compensation and are 100% vested in their respective deferrals and earnings. We may also make discretionary contributions to the Plan. The vesting terms of the discretionary contribution are determined at the time of contribution. Participants receive a guaranteed return on vested deferrals and earnings. We retain discretion to set the guaranteed rate each year. We also have existing deferred compensation plans for our Board of Directors and selected executives.

In March 2011, we made a discretionary contribution of \$1.3 million to the Plan. The vesting terms range between one and seven years, based on the employee's position. Participants received a guaranteed return of 6% in 2011. As of December 31, 2011, the balance due to participants was \$1.4 million and was included as a component of other long-term liabilities in the Consolidated Balance Sheets.

## (12) Stock Incentive Plans

## 2003 Stock Incentive Plan

Our 2003 Stock Incentive Plan, as amended, (the "2003 Plan") allows for the granting of up to a total of 2.8 million nonqualified stock options and shares of restricted stock to our officers, key employees, directors and consultants. We also have grants outstanding and options exercisable pursuant to prior plans. Grants canceled under prior plans do not return to the pool available for grant under the 2003 Plan. All of our plans are administered by the Compensation Committee of the Board of Directors and permit accelerated vesting of outstanding awards upon the occurrence of certain changes in control. Options become exercisable over a period of up to five years from the date of grant with expiration dates up to ten years from the date of grant and at exercise prices of not less than market value, as determined by the Board of Directors. Restricted stock grants vest over a period up to five years from the date of grant. Beginning in 2004, the expiration date of options granted was reduced to six years.

At December 31, 2011, 724,050 shares of Class A common stock were available for future grants.

Activity under our stock incentive plans was as follows:

	Shares Subject to Options	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term
Balance, December 31, 2010	1,185,241	\$ 13.56		
Granted	-	-		
Forfeited	(58,066 )	9.62		
Expired	(84,773 )	27.28		
Exercised	(231,226 )	12.57		
			\$8.9	
Balance, December 31, 2011	811,176	\$ 12.69	million	2.0 years

Exercisable, December 31, 2011	407,133	\$ 13.25	\$4.4 million	1.8 years
--------------------------------	---------	----------	---------------	-----------

	Non-Vested Stock Grants	Weighted Average Grant Date Fair Value
Balance, December 31, 2010	458,529	\$ 8.12
Granted	191,450	13.58
Vested	(43,498 )	23.56
Forfeited	(15,931 )	9.39
Balance, December 31, 2011	590,550	\$ 8.72

As of December 31, 2011, unrecognized stock-based compensation related to outstanding, but unvested stock option and stock awards was \$2.6 million, which will be recognized over the remaining weighted average vesting period of 1.3 years.

#### 2009 Employee Stock Purchase Plan

In May 2009, our shareholders approved the 2009 Employee Stock Purchase Plan (the "2009 ESPP") and the reservation of 1,500,000 shares of our Class A common stock there under. The 2009 ESPP replaced the 1998 Employee Stock Purchase Plan, which was terminated. The 2009 ESPP is intended to qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986, as amended, and is administered by the Compensation Committee of the Board of Directors.

Eligible employees are entitled to defer up to 10% of their base pay for the purchase of stock, up to \$25,000 of fair market value of our Class A common stock annually. The purchase price is equal to 85% of the fair market value at the end of the purchase period. During 2011, a total of 197,815 shares were purchased under the 2009 ESPP at a weighted average price of \$14.52 per share, which represented a weighted average discount from the fair market value of \$2.56 per share. As of December 31, 2011, 824,364 shares remained available for purchase under the 2009 ESPP.

#### Stock-Based Compensation

Compensation expense related to our 2009 ESPP is calculated based on the 15% discount from the per share market price on the date of grant. Compensation expense related to non-vested stock is based on the intrinsic value on the date of grant as if the stock is vested.

We estimate the fair value of stock options using the Black-Scholes valuation model. This valuation model takes into account the exercise price of the award, as well as a variety of significant assumptions. We believe that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of our stock options. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

Compensation expense related to stock options for 2010 and 2009 is based on values calculated using the Black-Scholes valuation model. No stock options were issued in 2011. Below are the significant assumptions used in the Black-Scholes valuation model:

Year Ended December 31,	2010	2009
Risk-free interest rate(1)	2.53%	2.93%
Dividend yield(2)	2.54%	0.0%
Expected term(3)	4.2 years	5.9 years
Volatility(4)	81.22%	87.41%
Discount for post-vesting restrictions	0.0%	0.0%

- (1) The risk-free interest rate for each grant is based on the U.S. Treasury yield curve in effect at the time of grant for a period equal to the expected term of the stock option.
- (2) The dividend yield is calculated as a ratio of annualized expected dividends per share to the market value of our common stock on the date of grant.
- (3) The expected term is calculated based on the observed and expected time to post-vesting exercise behavior of identifiable employee groups.
- (4) The expected volatility is estimated based on a weighted average of historical volatility of our common stock.

We amortize stock-based compensation on a straight-line basis over the vesting period of the individual award with estimated forfeitures considered. Shares to be issued upon the exercise of stock options will come from newly issued shares.

Certain information regarding our stock-based compensation was as follows:

Year Ended December 31,	2011	2010	2009
Weighted average grant-date fair value per share of stock options granted	\$-	\$4.19	\$3.10
Per share intrinsic value of non-vested stock granted	13.58	6.02	2.91
Weighted average per share discount for compensation expense recognized under the 2009 ESPP	2.56	1.11	0.85

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Total intrinsic value of stock options exercised	1,521,647	1,066,000	28,000
Fair value of non-vested stock that vested during the period	664,404	357,000	267,000
Stock-based compensation recognized in results of operations, as a component of selling, general and administrative expense - excludes compensation expense related to an option granted to one of our executives. See Note 19.	2.3 million	1.8 million	2.1 million
Tax benefit recognized in statement of operations	698,000	529,000	583,000
Cash received from options exercised and shares purchased under all share-based arrangements	5.8 million	4.2 million	2.4 million
Tax deduction realized related to stock options exercised	938,000	541,000	112,000

F-28

---



(13) Derivative Financial Instruments

We enter into interest rate swaps to manage the variability of our interest rate exposure, thus fixing a portion of our interest expense in a rising or falling rate environment. We do not enter into derivative instruments for any purpose other than to manage interest rate exposure of the 1-month LIBOR benchmark. That is, we do not engage in interest rate speculation using derivative instruments.

Typically, we designate all interest rate swaps as cash flow hedges and, accordingly, we record the change in fair value for the effective portion of these interest rate swaps in other comprehensive income rather than net income until the underlying hedged transaction affects net income. If a swap is no longer accounted for as a cash flow hedge and the forecasted transaction remains probable or reasonably possible of occurring, the gain or loss recorded in accumulated other comprehensive income is recognized in income as the forecasted transaction occurs. If the forecasted transaction is probable of not occurring, the gain or loss recorded in accumulated other comprehensive loss is recognized in income immediately. See Note 14.

At December 31, 2011 and 2010, the net fair value of all of our derivative agreements totaled a loss of \$7.5 million and \$8.7 million, respectively, which was recorded on our Consolidated Balance Sheet as a component of accrued liabilities and other long-term liabilities. The estimated loss expected to be reclassified into earnings within the next twelve months was \$3.9 million at December 31, 2011.

As of December 31, 2011, we had outstanding the following interest rate swaps with U.S. Bank Dealer Commercial Services:

- effective June 16, 2006 – a ten year, \$25 million interest rate swap at a fixed rate of 5.587% per annum, variable rate adjusted on the 1st and 16th of each month;
- effective January 26, 2008 – a five year, \$25 million interest rate swap at a fixed rate of 4.495% per annum, variable rate adjusted on the 26th of each month;
- effective May 1, 2008 – a five year, \$25 million interest rate swap at a fixed rate of 3.495% per annum, variable rate adjusted on the 1st and 16th of each month; and
- effective May 1, 2008 – a five year, \$25 million interest rate swap at a fixed rate of 3.495% per annum, variable rate adjusted on the 1st and 16th of each month.

We receive interest on all of the interest rate swaps at the one-month LIBOR rate. The one-month LIBOR rate at December 31, 2011 was 0.3% per annum, as reported in the Wall Street Journal.

Edgar Filing: LITHIA MOTORS INC - Form 10-K

At December 31, 2011 and 2010, the fair value of our derivative instruments was included in our Consolidated Balance Sheets as follows:

Balance Sheet Information (in thousands)	Fair Value of Asset Derivatives		Fair Value of Liability Derivatives	
	Location in Balance Sheet	December 31, 2011	Location in Balance Sheet	December 31, 2011
Derivatives Designated as Hedging Instruments				
Interest Rate Swap Contracts	Prepaid expenses and other	\$ -	Accrued liabilities	\$ 3,522
	Other non-current assets	-	Other long-term liabilities	4,008
		\$ -		\$ 7,530

Balance Sheet Information (in thousands)	Fair Value of Asset Derivatives		Fair Value of Liability Derivatives	
	Location in Balance Sheet	December 31, 2010	Location in Balance Sheet	December 31, 2010
Derivatives Designated as Hedging Instruments				
Interest Rate Swap Contracts	Prepaid expenses and other	\$ -	Accrued liabilities	\$ 2,862
	Other non-current assets	-	Other long-term liabilities	5,830
		\$ -		\$ 8,692

The effect of derivative instruments on our Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009 was as follows (in thousands):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in OCI (Effective Portion)	Location of Gain/(Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain/(Loss) Accumulated from OCI into Income (Effective Portion)	Location of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
For the Year Ended December 31, 2011					
Interest Rate Swap Contracts	\$(1,343)	) Interest expense	\$(1,899)	) Interest expense	\$(1,587)

Edgar Filing: LITHIA MOTORS INC - Form 10-K

For the Year Ended December 31, 2010		Floor plan		Floor plan	
Interest Rate Swap Contracts	\$(4,459	)	Interest expense	\$(2,814	) Interest expense \$(1,483
For the Year Ended December 31, 2009		Floor plan		Floor plan	
Interest Rate Swap Contracts	\$(649	)	Interest expense	\$(3,786	) Interest expense \$420

F-30

---

Derivatives Not Designated as Hedging Instruments	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
For the Year Ended December 31, 2011	Floor plan interest	
Interest Rate Swap Contracts	expense	\$ -
For the Year Ended December 31, 2010	Floor plan interest	
Interest Rate Swap Contracts	expense	\$ -
For the Year Ended December 31, 2009	Floor plan interest	
Interest Rate Swap Contracts	expense	\$ (6 )

In 2009, we determined that the original forecasted transactions for certain of the de-designated cash flow hedges became probable of not occurring. Therefore, we reclassified into earnings a gain of approximately \$0.5 million as a reduction of floor plan interest expense at that time. Additionally, we de-designated and re-designated all of our outstanding interest rate swaps when significant changes in our underlying floor plan debt occurred with the Chrysler and GM restructuring. This de-designation and re-designation did not have an impact on earnings at the time, but may increase ineffectiveness in the future.

#### (14) Fair Value Measurements

Factors used in determining the fair value of our financial assets and liabilities are summarized into three broad categories:

- Level 1 – quoted prices in active markets for identical securities;
- Level 2 – other significant observable inputs, including quoted prices for similar securities, interest rates, prepayment spreads, credit risk; and
  - Level 3 – significant unobservable inputs, including our own assumptions in determining fair value.

The inputs or methodology used for valuing financial assets and liabilities are not necessarily an indication of the risk associated with investing in them.

We use the income approach to determine the fair value of our interest rate swaps using observable Level 2 market expectations at each measurement date and an income approach to convert estimated future cash flows to a single present value amount (discounted) assuming that participants are motivated, but not compelled, to transact. Level 2 inputs for the swap valuations are limited to quoted prices for similar assets or liabilities in active markets (specifically futures contracts on LIBOR for the first two years) and inputs other than quoted prices that are observable for the asset or liability (specifically LIBOR cash and swap rates and credit risk at commonly quoted intervals). Mid-market pricing is used as a practical expedient for fair value measurements. Key inputs, including the cash rates for very short term, futures rates for up to two years and LIBOR swap rates beyond the derivative maturity, are used to predict future reset rates to discount those future cash flows to present value at the measurement date.

Inputs are collected from Bloomberg on the last market day of the period. The same methodology is used to determine the rate used to discount the future cash flows. The valuation of the interest rate swaps also takes into consideration our own, as well as the counterparty's, risk of non-performance under the contract.

We estimate the value of long-lived assets that are recorded at fair value based on a market valuation approach. We use prices and other relevant information generated primarily by recent market transactions involving similar or comparable assets, as well as our historical experience in divestitures, acquisitions and real estate transactions.

Additionally, we may use a cost valuation approach to value long-lived assets when a market valuation approach is unavailable. Under this approach, we determine the cost to replace the service capacity of an asset, adjusted for physical and economic obsolescence. When available, we use valuation inputs from independent valuation experts, such as real estate appraisers and brokers, to corroborate our estimates of fair value. Real estate appraisers' and brokers' valuations are typically developed using one or more valuation techniques including market, income and replacement cost approaches. As these valuations contain unobservable inputs, we classified the measurement of fair value of long-lived assets as Level 3.

F-31

---

There were no changes to our valuation techniques during the year ended December 31, 2011.

#### Assets and Liabilities Measured at Fair Value

Following are the disclosures related to our assets and (liabilities) that are measured at fair value (in thousands):

Fair Value at December 31, 2011	Level 1	Level 2	Level 3
Measured on a recurring basis:			
Derivative contracts, net	\$ -	\$ (7,530 )	\$ -
Measured on a non-recurring basis:			
Long-lived assets held and used	\$ -	\$ -	\$ 2,500
Fair Value at December 31, 2010			
Measured on a recurring basis:			
Derivative contracts, net	\$ -	\$ (8,692 )	\$ -
Measured on a non-recurring basis:			
Long-lived assets held and used:			
Certain buildings and improvements	\$ -	\$ -	\$ 23,400
Certain parcels of land	-	-	13,511
Total	\$ -	\$ -	\$ 36,911

See Note 13 for more details regarding our derivative contracts.

#### Financial Assets and Liabilities Not Recorded at Fair Value

We had \$64.5 million and \$118.5 million of fixed interest rate debt outstanding as of December 31, 2011 and 2010, respectively. As of December 31, 2011, this debt had maturity dates between July 2012 and May 2031. We calculate the estimated fair value of our fixed rate debt using a discounted cash flow methodology. Using estimated current interest rates based on a similar risk profile and duration, the fixed cash flows are discounted and summed to compute the fair value of the debt. Based on this analysis, we have determined that the fair value of this long-term fixed interest rate debt was approximately \$73.6 million and \$127.4 million at December 31, 2011 and 2010, respectively.

We believe the carrying value of our variable rate debt approximates fair value.

#### (15) Income Taxes

Income tax provision (benefit) from continuing operations was as follows (in thousands):

Year Ended December 31,	2011	2010	2009
Current:			
Federal	\$ 22,009	\$ 9,056	\$ (5,117 )
State	3,598	1,613	(80 )
	25,607	10,669	(5,197 )
Deferred:			
Federal	7,120	(1,664 )	8,704
State	681	(416 )	1,535
	7,801	(2,080 )	10,239
Total	\$ 33,408	\$ 8,589	\$ 5,042

At December 31, 2011, we had income taxes receivable totaling \$6.2 million included as a component of other current assets on the Consolidated Balance Sheets and at December 31, 2010, we had income taxes payable totaling \$0.3 million included as a component of accrued liabilities.

F-32

---

Individually significant components of the deferred tax assets and liabilities are presented below (in thousands):

December 31,	2011	2010
<b>Deferred tax assets:</b>		
Deferred revenue and cancellation reserves	\$ 6,369	\$ 6,047
Allowances and accruals, including state tax carryforward amounts	20,234	16,324
Interest on derivatives	2,889	3,337
Goodwill	26,817	33,380
Capital loss carryforward	12,841	-
<b>Total deferred tax assets</b>	<b>69,150</b>	<b>59,088</b>
<b>Deferred tax liabilities:</b>		
Inventories	(4,351 )	(3,503 )
Property and equipment, principally due to differences in depreciation	(16,418 )	(11,653 )
Prepays and property taxes	(1,540 )	(1,471 )
<b>Total deferred tax liabilities</b>	<b>(22,309 )</b>	<b>(16,627 )</b>
<b>Valuation allowance</b>	<b>(12,841 )</b>	<b>-</b>
<b>Total</b>	<b>\$ 34,000</b>	<b>\$ 42,461</b>

We consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected future taxable income and tax-planning strategies in making this assessment.

At December 31, 2011, we had a \$12.8 million valuation allowance recorded associated with our deferred tax assets. We recorded this allowance in association with losses from the sale of corporate entities. As these amounts are characterized as capital losses, we evaluated the availability of projected capital gains and determined that it would be unlikely these amounts would be fully utilized. We will continue to evaluate if it is more likely than not that we will realize the benefits of these deductible differences. However, additional valuation allowance amounts could be recorded in the future if estimates of taxable income during the carryforward period are reduced.

At December 31, 2011, we had a number of state tax carryforward amounts totaling approximately \$1.1 million, tax effected, with expiration dates through 2029.

The reconciliation between amounts computed using the federal income tax rate of 35% and our income tax provision from continuing operations for 2011, 2010 and 2009 is shown in the following tabulation (in thousands):

Year Ended December 31,	2011	2010	2009
Federal tax provision at statutory rate	\$ 31,200	\$ 7,315	\$ 4,117
State taxes, net of federal income tax benefit	3,439	917	632
Non-deductible expenses	205	211	320
Permanent differences related to the employee stock purchase program	25	155	17
Other	(1,461 )	(9 )	(44 )
<b>Income tax provision</b>	<b>\$ 33,408</b>	<b>\$ 8,589</b>	<b>\$ 5,042</b>



We did not have any unrecognized tax benefits at December 31, 2011 or 2010. No interest or penalties were included in our results of operations during 2011, 2010 or 2009, and we had no accrued interest or penalties at December 31, 2011 or 2010.

F-33

---

Open tax years at December 31, 2011 included the following:

Federal 2007-2010  
13 states 2006-2010

(16) Acquisitions

The following acquisitions were completed in 2011:

- In April 2011, we acquired the inventory, equipment, real estate and intangible assets of, and assumed certain liabilities related to, Mercedes-Benz of Portland, Oregon, Mercedes Benz of Wilsonville, Oregon and Rasmussen BMW/MINI in Portland, Oregon from the Don Rasmussen Group.
- In October 2011 we acquired the inventory, equipment, real estate and intangible assets of Fresno Subaru from Herwaldt Automotive Group.

These acquisitions contributed revenues of \$122.0 million for the year ended December 31, 2011.

The following unaudited pro forma summary presents consolidated information as if the above acquisitions had occurred on January 1, 2010 (in thousands, except for per share amounts):

Year Ended December 31,	2011	2010
Revenue	\$ 2,753,745	\$ 2,245,439
Income from continuing operations, net of tax	56,624	14,591
Basic income per share from continuing operations, net of tax	2.16	0.56
Diluted income per share from continuing operations, net of tax	2.12	0.56

These amounts have been calculated by estimating and applying our accounting policies. The results of these stores have been adjusted to reflect depreciation on a straight-line basis over our expected lives for property, plant and equipment; accounting for inventory on a specific identification method; and recognition of interest expense for real estate financing related to stores where we purchased the facility. No nonrecurring pro forma adjustments directly attributable to these business combinations are included in the reported pro forma revenues and earnings.

The above acquisitions were all accounted for under the acquisition method of accounting. No portion of the purchase price was paid with our equity securities. The following table summarizes the consideration paid for acquisitions and the amount of identified assets acquired and liabilities assumed as of the acquisition date (in thousands):

	Consideration
Cash paid	\$ 55,368
Floor plan financing assumed	19,348
	\$ 74,716
	Assets Acquired and Liabilities Assumed
Inventories	\$ 29,268
Franchise value	14,517
Property, plant and equipment	17,351
Real estate lease reserves	325
Other assets	1,475
Reserves	(663 )

Other liabilities	(426 )
	61,847
Goodwill	12,869
	\$ 74,716

We account for franchise value as an indefinite-lived intangible asset. We expect the full amount of the goodwill recognized to be deductible for tax purposes. We did not have any material acquisition related expenses in 2011.

In July 2011, we were awarded a Ford franchise in Klamath Falls, Oregon. Consideration of \$5.1 million was paid for the inventory, equipment and associated real estate.

On July 19, 2010, we acquired the inventory, equipment and intangible assets and assumed certain liabilities related to Honda of Bend and agreed to the transfer of Chevrolet and Cadillac brands from Bob Thomas Chevrolet Cadillac, both located in Bend, Oregon. On August 9, 2010, we acquired the inventory, equipment, real estate and intangible assets and assumed certain liabilities related to Toyota of Billings from Prestige Toyota, located in Billings, Montana. Consideration paid for the acquisitions totaled \$25.6 million, of which \$23.7 million was paid in cash and \$1.9 million was financed through a floor plan credit facility. We subsequently financed the real estate purchased for \$8.1 million, for which we had paid cash in connection with the acquisition transactions. The fair values of assets acquired and liabilities assumed are not material to our Consolidated Balance Sheets. The results of operations of the acquired stores are included in our Consolidated Financial Statements from the date of acquisition. Pro forma results operations are not materially different than actual results of operations.

#### (17) Discontinued Operations

We perform an internal evaluation of our store performance, on a store-by-store basis, in the last month of each quarter. If a store does not meet certain return on investment criteria established by our management team, the location is included on a “watch list” and is considered for potential disposition. Factors we consider in reaching the conclusion to dispose of a store include: (i) actual operating results of the store over a predetermined period of time subsequent to placing the store on the “watch list” including prospects for improved financial performance; (ii) extent of capital improvements and commitments thereto necessary to optimize operational efficiencies and marketability of the associated franchise; (iii) outlook as to the economic prospects for the local market and viability of the franchise within that market; and (iv) geographic location and franchise mix of our portfolio.

Once we have reached a decision to dispose of a store, we evaluate the following criteria as required by U.S. generally accepted accounting standards:

- our management team, possessing the necessary authority, commits to a plan to sell the store;
  - the store is available for immediate sale in its present condition;
- an active program to locate buyers and other actions that are required to sell the store are initiated;
  - a market for the store exists and we believe its sale is likely to be completed within one year;
- active marketing of the store commences at a price that is reasonable in relation to the estimated fair value; and
- our management team believes it is unlikely that changes will be made to the plan or will withdraw the plan to dispose of the store.

If we determine the above criteria have been met, we classify the store assets to be disposed of, and liabilities directly associated with those assets, as held for sale in our Consolidated Balance Sheets.

We reclassify the store’s operations to discontinued operations in our Consolidated Statement of Operations, on a comparable basis for all periods presented, provided we do not expect to have any significant continuing involvement in the store’s operations after its disposal.

As of December 31, 2008, we had 18 stores classified as held for sale. During 2009, we disposed of five stores and ceased operations at three stores that had been held for sale at December 31, 2008. We identified for disposal, and subsequently sold, an additional five stores during 2009. As a result of the Chrysler and GM bankruptcies, we reclassified four additional stores to discontinued operations. Two of these locations were Chrysler franchises that ceased operations in July 2009. The other two locations were GM stores that GM agreed to repurchase through a signed commitment.



As stores remained classified as held for sale beyond one year, we continually evaluated whether (i) we had taken all necessary actions to respond to the poor market conditions during the initial one year period; (ii) we were actively marketing the store at a price that was reasonable in view of the market conditions; and (iii) we continued to meet all of the criteria discussed above to continue to classify the stores as held for sale. Throughout 2009, we believe our response of actively marketing the dealerships through brokers and lowering prices to attract potential buyers demonstrated that we (i) took necessary actions to respond to the poor market conditions; (ii) actively marketed the store at a reasonable price and (iii) continued to meet the remaining criteria stipulated above. Therefore, our decision to continue to classify certain stores as held for sale beyond the one year period was appropriate.

In the fourth quarter of 2009, our management team re-evaluated the decision to continue to classify certain stores as held for sale in light of the then current market conditions, prospects for economic recovery, improved company-wide and individual store operating performance, and overall capital needs. Specific factors taken into consideration were as follows:

- a lack of available credit continued to prove challenging to prospective purchasers of our stores. One of the primary problems was the lack of vehicle inventory floor plan financing, which is a basic requirement of the franchise agreement. Even for prospective purchasers with existing floor plan financing, obtaining mortgage financing on dealership real estate or committing to other significant capital investment proved exceedingly difficult.
- continued economic uncertainty, including increasing unemployment, resulting in low consumer confidence and a prolonged reluctance to purchase big ticket items such as automobiles.
- the dramatically decreased pool of potential purchasers further extended our store disposition time line. The absence of qualified buyers reduced expected proceeds to levels significantly below the range of what we considered to be reasonable.
- a restructuring of store operations that began in 2008 and accelerated in 2009 aligned our costs with current industry vehicle sales levels, and enhanced our liquidity position. This restructuring improved operational performance at all locations, including those slated for divestiture. Improved operating performance at the stores held for sale, even on a constant valuation multiple, increased expected selling prices, which proved unobtainable given market conditions.
- the reorganization of Chrysler and GM resulted in the closure of four domestic stores that we had not selected for divestiture. One of the original considerations for the restructuring we initiated in 2008 involved diversifying our portfolio to reduce dependence on domestic manufacturers, particularly Chrysler and GM. The unexpected closure of locations not selected for disposition accelerated this portfolio diversification and made some divestitures less critical.
- throughout 2008 and 2009, we generated cash through asset sales, mortgage financing and operational cash flows. In 2009, we retired our outstanding convertible notes as they matured. Also, in late 2009, we completed a follow-on equity offering raising approximately \$43 million. We also extended the maturity on our Credit Facility. These actions reduced the immediate need for additional liquidity to ensure our ongoing operations and eliminated the need to dispose of assets to raise cash.

Based on these factors, in the fourth quarter of 2009, circumstances previously considered unlikely were deemed to have occurred, and our management team concluded that we no longer were committed to sell certain stores. Therefore, we no longer met the criteria necessary to continue to classify the stores as held for sale. Assets and related liabilities associated with 10 stores were subsequently reclassified out of assets held for sale. Their associated results of operations were retrospectively reclassified from discontinued operations to continuing operations for all periods presented.

Certain locations we had closed in 2008 and 2009 continued to have assets, primarily real estate, classified as held for sale. Throughout 2009, the commercial real estate market continued to deteriorate as more properties became available and asking prices declined. Particularly in the automotive retail industry, with the closure of almost 2,000

GM and Chrysler stores, as well as the wind down of Pontiac, Saturn and Hummer, numerous vacant dealerships were placed on the market. Given the slow recovery forecasted for automotive dealers in 2010 and beyond, these properties had become more difficult to sell on a timely basis. These challenging conditions accelerated midway through 2009 during the bankruptcy filings of GM and Chrysler. In addition, available commercial credit became tighter in 2009.

F-36

---

Therefore, by the middle of the fourth quarter of 2009, we began to consider a significant increase in the expected time required to sell these properties, and realized it could take a prolonged period for market demand to return to a point of converting these locations to operational automotive retail outlets. After considering these facts, we reclassified seven properties where operations had ceased to held and used in the fourth quarter of 2009, as we did not believe all the criteria for a classification as held for sale were met.

In connection with the reclassification, we valued the assets of the 10 operating stores and seven properties at the lower of (i) carrying amount before classification as held for sale, adjusted for any depreciation or amortization expense that would have been recognized had the store been continuously classified as held and used; and (ii) fair value at the date of reclassification. As a result, in the fourth quarter of 2009, we recorded impairment charges totaling \$2.9 million related to certain real estate holdings. Where fair value exceeded adjusted carrying amount, we recorded depreciation expense of \$2.0 million. We also reversed certain costs to sell that had been recorded in prior periods totaling \$2.3 million.

At December 31, 2009, two operating stores and three properties were classified as held for sale. The two operating stores were under contract to sell at that time.

Based on subsequent negotiations with the buyer in the first quarter of 2010, management concluded that it was no longer probable that the sale of the remaining two stores would be effected, resulting in the determination that these two operating stores no longer met all of the criteria for classification as held for sale at March 31, 2010. Therefore, in the first quarter of 2010, assets and related liabilities associated with two stores were reclassified from assets held for sale to assets held and used. Their associated results of operations were retrospectively reclassified from discontinued operations to continuing operations for all periods presented.

In the second quarter of 2010, we classified the operating results of Fresno Dodge, which was sold during the quarter, as discontinued operations. Additionally, one of the properties classified as held for sale as of December 31, 2009 was sold. Management evaluated the remaining two properties to determine if classification remained appropriate. Based on new facts and circumstances previously considered unlikely, management no longer believed the sales were probable. As a result the properties were reclassified to assets held and used in June 2010. As of December 31, 2010, we had no stores or properties classified as held for sale.

In 2011, we sold three stores: a Chrysler Jeep Dodge store in Concord, California; a Volkswagen store in Thornton, Colorado and a GMC Buick and a Kia store in Cedar Rapids, Iowa. The associated results of operations for these locations are classified as discontinued operations. As of December 31, 2011, we had no stores and no properties classified as held for sale.

Interest expense is allocated to stores classified as discontinued operations for actual floor plan interest expense directly related to the new vehicles in the store. Interest expense related to our working capital, acquisition and used vehicle credit facility is allocated based on the amount of assets pledged towards the total borrowing base. Interest expense included as a component of discontinued operations was as follows (in thousands):

Year Ended December 31,	2011	2010	2009
Floor plan interest	\$ 301	\$ 324	\$ 749
Other interest	58	95	2,486
Total interest	\$ 359	\$ 419	\$ 3,235



Edgar Filing: LITHIA MOTORS INC - Form 10-K

Certain financial information related to discontinued operations was as follows (in thousands):

Year Ended December 31,	2011	2010	2009
Revenue	\$ 64,766	\$ 65,613	\$ 148,680
Gain (loss) from discontinued operations	\$ 611	\$ 740	\$ (6,410 )
Net gain (loss) on disposal activities	4,396	(301 )	9,910
	5,007	439	3,500
Income tax expense	(1,914 )	(251 )	(1,071 )
Income from discontinued operations, net of income taxes	\$ 3,093	\$ 188	\$ 2,429
Goodwill and other intangible assets disposed of	\$ 712	\$ -	\$ 1,037
Cash generated from disposal activities	\$ 23,838	\$ 941	\$ 27,697
Floor plan debt paid in connection with disposal activities	\$ 1,784	\$ 2,134	\$ 26,597

The net gain (loss) on disposal activities included the following charges (in thousands):

Year Ended December 31,	2011	2010	2009
Goodwill and other intangible assets	\$ 3,168	\$ -	\$ 12,146
Property, plant and equipment	1,357	(217 )	(1,972 )
Inventory	(88 )	-	1,212
Other	(41 )	(84 )	(1,476 )
	\$ 4,396	\$ (301 )	\$ 9,910

(18) Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board (“FASB”) issued an accounting standard update that amends the accounting guidance on goodwill impairment testing. The amendments in this accounting standard update are intended to reduce complexity and costs by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of a reporting unit. The amendments also improve previous guidance by expanding upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The amendments in this accounting standard update are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this accounting standard update will not have an impact on our consolidated financial position, results of operations, or cash flows, as it is intended to simplify the assessment for goodwill impairment.

In June 2011, the FASB issued an accounting standard update which requires the presentation of the components of other comprehensive income as either (1) a continuous statement of comprehensive income that contains two sections, net income and other comprehensive income, or (2) two separate but consecutive statements. Companies will no longer be allowed to present components of other comprehensive income as part of the statement of shareholders’ equity. This update is effective for interim and annual periods beginning after December 15, 2011. As this accounting standard is only related to presentation, we do not believe the adoption of this accounting standard update will have an impact on our consolidated financial position, results of operations, or cash flows.

In May 2011, the FASB issued an accounting standard update that amends the accounting standard on fair value measurements. This update clarifies the definition and measurement of fair value to increase consistency and aligns disclosure requirements between U.S. generally accepted accounting principles and International Financial Reporting

Standards. The accounting standard update changes certain fair value measurement principles, clarifies the application of existing fair value measurement, and expands the fair value measurement disclosure requirements, particularly for Level 3 fair value measurements. These changes are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. We do not expect the adoption of this accounting standard update to have a material effect on our consolidated financial statements.

F-38

---

## (19) Related Party Transactions

On December 31, 2009, we entered into an option agreement with our Vice Chairman, Dick Heimann, who is a related party. Under the terms of the option agreement, Mr. Heimann may purchase our Volkswagen and Nissan franchises in Medford, Oregon, and acquire their operations, including inventories and equipment, at valuations set forth in our standard form of agreement, which we believe approximate fair value at the time of exercise. Any purchased real estate will be priced at the then fair market value. Existing leases, if any, will be assumed at the time of exercise of the option. The purchase price for the intangible assets (manufacturers' franchise rights) is set at \$10 in the agreement. The option can be exercised by Mr. Heimann at any time prior to December 31, 2012. No consideration was received in exchange for this option.

On December 16, 2011, we agreed with Mr. Heimann to terminate the option agreement and entered into an Acquisition and Option Termination Agreement (the "Agreement"). Under the Agreement, Mr. Heimann will purchase 80% of the Nissan, Volkswagen and BMW stores in Medford, Oregon. The purchase price for the intangible assets of the Nissan and Volkswagen stores was set at \$10, based on the original terms of the option agreement. The purchase price of the BMW store's intangible assets was set at fair value at the time of the agreement based on independent third party broker opinions and corroborated by financial projections using a fair value income approach.

As Mr. Heimann terminated the option and concurrently entered into agreements to purchase the Volkswagen and Nissan franchises in Medford, Oregon, we determined the transaction should be accounted for as an option exercise. We evaluated the fair value of the option as of the date of exercise, recording a \$0.3 million reduction in the value as a component of selling, general and administrative expenses on our Consolidated Statements of Operations.

For the year ended December 31, 2009, we estimated the fair value of the option using a discounted cash flow analysis and by considering valuation inputs from independent third parties. Based on these inputs, we determined the value of the option to be insignificant as of December 31, 2009. We estimated the fair value of the option at each reporting period subsequent to December 31, 2009 and at the time of settlement using the same methodology. The fair value analysis included the use of the Black-Scholes option valuation model with the following assumptions as of December 31, 2010:

Year Ended December 31,	2010
Risk-free interest rate(1)	0.34%
Expected term(2)	2.17 years
Volatility(3)	50%

- (1) The risk-free interest rate for the option is based on the U.S. Treasury 2-year constant maturities rate for the 2010 valuation.
- (2) The expected term is calculated based on the remaining term of the option.
- (3) The expected volatility is estimated based on the historical volatilities of our and comparable public companies' common stock, as well as implied volatilities based on the prices of currently traded options of our company and the comparable public companies.

We valued the option as of the exercise date of December 16, 2011 and determined the intrinsic value based on a discounted cash flow analysis. Additionally, we corroborated this value with valuation inputs from independent third parties.

Based on our valuation analysis, we recorded (income) expense of \$(0.3) million and \$0.6 million, respectively, as a component of selling, general and administrative expenses in our Consolidated Statements of Operations in the years ended December 31, 2011 and 2010. As the option was exercised and settled through the entering into of agreements

to purchase the stores, an increase to additional paid in capital was recorded for the change in fair value of the option in 2011.

(20) Subsequent Events

On February 22, 2012, we announced that our Board of Directors approved a dividend of \$0.07 per share on our Class A and Class B common stock for the fourth quarter of 2011. The dividend will total approximately \$1.8 million and will be paid on March 23, 2012 to shareholders of record on March 9, 2012.

F-39