

LITHIA MOTORS INC  
Form 10-Q  
July 27, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-14733

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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.)

150 N. Bartlett Street, Medford, Oregon  
(Address of principal executive offices)

97501  
(Zip Code)

Registrant's telephone number, including area code: 541-776-6401

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

Indicate by check mark whether the registrant has submitted electronically 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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

|   |   |
|---|---|
| Class A common stock without par value            | 21,839,324                                  |
| Class B common stock without par value<br>(Class) | 3,512,231<br>(Outstanding at July 27, 2012) |

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LITHIA MOTORS, INC.  
FORM 10-Q  
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PART I - FINANCIAL INFORMATION  
Item 1. Financial Statements  
LITHIA MOTORS, INC. AND SUBSIDIARIES  
Consolidated Balance Sheets  
(In thousands)  
(Unaudited)

|  | June 30,<br>2012   | December 31,<br>2011 |
|--|--------------------|----------------------|
| <b>Assets</b>  |                    |                      |
| <b>Current Assets:</b>   |                    |                      |
| Cash and cash equivalents  | \$16,247           | \$20,851             |
| Accounts receivable, net of allowance for doubtful accounts of \$292 and \$261                           | 117,747            | 99,407               |
| Inventories, net   | 617,568            | 506,484              |
| Deferred income taxes  | 3,976              | 4,730                |
| Other current assets   | 10,588             | 16,719               |
| <b>Total Current Assets</b>  | <b>766,126</b>     | <b>648,191</b>       |
| Property and equipment, net of accumulated depreciation of \$104,328 and \$99,115                        |                    |                      |
|  | 387,652            | 373,779              |
| Goodwill   | 22,608             | 18,958               |
| Franchise value  | 59,319             | 59,095               |
| Deferred income taxes  | 29,849             | 29,270               |
| Other non-current assets   | 18,021             | 16,840               |
| <b>Total Assets</b>  | <b>\$1,283,575</b> | <b>\$1,146,133</b>   |
| <b>Liabilities and Stockholders' Equity</b>  |                    |                      |
| <b>Current Liabilities:</b>  |                    |                      |
| Floor plan notes payable   | \$13,743           | \$114,760            |
| Floor plan notes payable: non-trade  | 482,390            | 229,180              |
| Current maturities of long-term debt   | 7,718              | 8,221                |
| Trade payables   | 40,196             | 31,712               |
| Accrued liabilities  | 79,758             | 72,711               |
| <b>Total Current Liabilities</b>   | <b>623,805</b>     | <b>456,584</b>       |
| Long-term debt, less current maturities  | 224,746            | 278,653              |
| Deferred revenue   | 30,110             | 25,146               |
| Other long-term liabilities  | 19,921             | 18,629               |
| <b>Total Liabilities</b>   | <b>898,582</b>     | <b>779,012</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 21,861 and 22,195 | 263,559            | 279,366              |
| Class B common stock - no par value; authorized 25,000 shares; issued and outstanding 3,512 and 3,762    | 437                | 468                  |
| Additional paid-in capital   | 10,949             | 10,918               |
| Accumulated other comprehensive loss   | (3,718)            | (4,508)              |
| Retained earnings  | 113,766            | 80,877               |
| <b>Total Stockholders' Equity</b>  | <b>384,993</b>     | <b>367,121</b>       |

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|  |             |             |
|--|-------------|-------------|
| Total Liabilities and Stockholders' Equity | \$1,283,575 | \$1,146,133 |
|--|-------------|-------------|

See accompanying condensed notes to consolidated financial statements.

## LITHIA MOTORS, INC. AND SUBSIDIARIES

## Consolidated Statements of Operations

(In thousands, except share amounts)

(Unaudited)

|  | Three Months Ended June<br>30, |           | Six Months Ended June<br>30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
|  | 2012                           | 2011      | 2012                         | 2011      |
| <b>Revenues:</b>   |                                |           |                              |           |
| New vehicle  | \$470,424                      | \$347,727 | \$874,712                    | \$648,367 |
| Used vehicle retail  | 212,767                        | 176,591   | 408,188                      | 333,069   |
| Used vehicle wholesale                                       | 36,083                         | 29,153    | 70,419                       | 58,690    |
| Finance and insurance  | 27,870                         | 20,886    | 53,290                       | 40,185    |
| Service, body and parts                                      | 88,585                         | 80,937    | 175,033                      | 154,698   |
| Fleet and other  | 11,394                         | 17,193    | 24,375                       | 20,335    |
| Total revenues   | 847,123                        | 672,487   | 1,606,017                    | 1,255,344 |
| <b>Cost of sales:</b>  |                                |           |                              |           |
| New vehicle  | 435,785                        | 319,726   | 808,947                      | 597,760   |
| Used vehicle retail  | 181,023                        | 149,590   | 347,530                      | 283,084   |
| Used vehicle wholesale                                       | 35,779                         | 28,885    | 69,697                       | 58,023    |
| Service, body and parts                                      | 45,343                         | 41,242    | 90,198                       | 79,242    |
| Fleet and other  | 11,004                         | 15,907    | 23,585                       | 18,502    |
| Total cost of sales  | 708,934                        | 555,350   | 1,339,957                    | 1,036,611 |
| Gross profit   | 138,189                        | 117,137   | 266,060                      | 218,733   |
| Asset impairments  | -                              | 490       | 115                          | 872       |
| Selling, general and administrative                          | 96,167                         | 82,768    | 187,757                      | 159,902   |
| Depreciation and amortization                                | 4,261                          | 4,217     | 8,460                        | 8,309     |
| Operating income   | 37,761                         | 29,662    | 69,728                       | 49,650    |
| Floor plan interest expense                                  | (3,119 )                       | (3,359 )  | (6,069 )                     | (5,821 )  |
| Other interest expense                                       | (2,549 )                       | (3,011 )  | (5,296 )                     | (6,303 )  |
| Other income, net  | 820                            | 171       | 1,319                        | 248       |
| Income from continuing operations before income taxes        | 32,913                         | 23,463    | 59,682                       | 37,774    |
| Income tax provision   | (12,422 )                      | (8,777 )  | (22,395 )                    | (14,700 ) |
| Income from continuing operations, net of income tax         | 20,491                         | 14,686    | 37,287                       | 23,074    |
| Income from discontinued operations, net of income tax       | -                              | 140       | -                            | 457       |
| Net income   | \$20,491                       | \$14,826  | \$37,287                     | \$23,531  |
| <b>Basic income per share from continuing operations</b>     |                                |           |                              |           |
| Basic income per share from continuing operations            | \$0.80                         | \$0.56    | \$1.44                       | \$0.87    |
| <b>Basic income per share from discontinued operations</b>   |                                |           |                              |           |
| Basic income per share from discontinued operations          | -                              | -         | -                            | 0.02      |
| <b>Basic net income per share</b>                            |                                |           |                              |           |
| Basic net income per share                                   | \$0.80                         | \$0.56    | \$1.44                       | \$0.89    |
| <b>Shares used in basic per share calculations</b>           |                                |           |                              |           |
| Shares used in basic per share calculations                  | 25,730                         | 26,437    | 25,860                       | 26,389    |
| <b>Diluted income per share from continuing operations</b>   |                                |           |                              |           |
| Diluted income per share from continuing operations          | \$0.78                         | \$0.55    | \$1.42                       | \$0.86    |
| <b>Diluted income per share from discontinued operations</b> |                                |           |                              |           |
| Diluted income per share from discontinued operations        | -                              | -         | -                            | 0.02      |
| <b>Diluted net income per share</b>                          |                                |           |                              |           |
| Diluted net income per share                                 | \$0.78                         | \$0.55    | \$1.42                       | \$0.88    |
| <b>Shares used in diluted per share calculations</b>         |                                |           |                              |           |
| Shares used in diluted per share calculations                | 26,185                         | 26,860    | 26,331                       | 26,779    |

See accompanying condensed notes to consolidated financial statements.

LITHIA MOTORS, INC. AND SUBSIDIARIES  
 Consolidated Statements of Comprehensive Income  
 (In thousands)  
 (Unaudited)

|  | Three Months Ended June<br>30, |          | Six Months Ended June<br>30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2012                           | 2011     | 2012                         | 2011     |
| Net income   | \$20,491                       | \$14,826 | \$37,287                     | \$23,531 |
| Other comprehensive income (loss), net of tax:   |                                |          |                              |          |
| Gain (loss) on cash flow hedges, net of tax expense (benefit)<br>of \$225, (\$35), \$490 and \$285, respectively | 364                            | (56 )    | 790                          | 506      |
| Comprehensive income   | \$20,855                       | \$14,770 | \$38,077                     | \$24,037 |

See accompanying condensed notes to consolidated financial statements.



LITHIA MOTORS, INC. AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
(In thousands)  
(Unaudited)

|  | Six Months Ended June 30, |          |
|--|---------------------------|----------|
|  | 2012                      | 2011     |
| <b>Cash flows from operating activities:</b>   |                           |          |
| Net income   | \$37,287                  | \$23,531 |
| <b>Adjustments to reconcile net income to net cash used in operating activities:</b> |                           |          |
| Asset impairments  | 115                       | 872      |
| Depreciation and amortization  | 8,460                     | 8,309    |
| Depreciation and amortization within discontinued operations                         | -                         | 197      |
| Stock-based compensation   | 1,512                     | 1,034    |
| Gain on disposal of other assets   | (983)                     | (190)    |
| Loss from disposal activities within discontinued operations                         | -                         | 53       |
| Deferred income taxes  | 302                       | 2,060    |
| Excess tax benefit from share-based payment arrangements                             | (1,026)                   | (278)    |
| <b>(Increase) decrease (net of acquisitions and dispositions):</b>                   |                           |          |
| Trade receivables, net   | (18,305)                  | (6,579)  |
| Inventories  | (109,592)                 | (60,498) |
| Other current assets   | 4,680                     | (461)    |
| Other non-current assets   | (1,847)                   | (884)    |
| <b>Increase (decrease) (net of acquisitions and dispositions):</b>                   |                           |          |
| Floor plan notes payable   | (94,305)                  | 1,744    |
| Trade payables   | 7,289                     | 4,679    |
| Accrued liabilities  | 7,671                     | 7,757    |
| Other long-term liabilities and deferred revenue                                     | 6,700                     | 1,418    |
| Net cash used in operating activities  | (152,042)                 | (17,236) |
| <b>Cash flows from investing activities:</b>   |                           |          |
| Principal payments received on notes receivable                                      | 50                        | 72       |
| Capital expenditures   | (22,693)                  | (7,855)  |
| Proceeds from sales of assets  | 4,940                     | 11,358   |
| Cash paid for acquisitions, net of cash acquired                                     | (12,782)                  | (53,302) |
| Payments for life insurance policies   | (1,934)                   | (1,001)  |
| Proceeds from sales of stores  | 2,901                     | 412      |
| Net cash used in investing activities  | (29,518)                  | (50,316) |
| <b>Cash flows from financing activities:</b>   |                           |          |
| Borrowings on floor plan notes payable: non-trade                                    | 251,844                   | 65,789   |
| Borrowings on lines of credit  | 177,623                   | 34,000   |
| Repayments on lines of credit  | (212,623)                 | (9,000)  |
| Principal payments on long-term debt, scheduled                                      | (4,000)                   | (4,405)  |
| Principal payments on long-term debt and capital leases, other                       | (32,049)                  | (21,865) |
| Proceeds from issuance of long-term debt   | 14,169                    | 6,664    |
| Proceeds from issuance of common stock   | 2,671                     | 1,833    |
| Repurchase of common stock   | (20,607)                  | (142)    |
| Excess tax benefit from share-based payment arrangements                             | 1,026                     | 278      |

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|  |          |          |
|--|----------|----------|
| Decrease in restricted cash                      | 3,300    | -        |
| Dividends paid                                   | (4,398   | ) (3,168 |
| Net cash provided by financing activities        | 176,956  | 69,984   |
| Increase (decrease) in cash and cash equivalents | (4,604   | ) 2,432  |
| Cash and cash equivalents at beginning of period | 20,851   | 9,306    |
| Cash and cash equivalents at end of period       | \$16,247 | \$11,738 |

Supplemental disclosure of cash flow information:

|   |          |          |
|---|----------|----------|
| Cash paid during the period for interest          | \$11,690 | \$12,276 |
| Cash paid during the period for income taxes, net | 14,217   | 9,788    |

Supplemental schedule of non-cash activities:

|  |       |          |
|--|-------|----------|
| Floor plan debt acquired in connection with acquisitions | \$-   | \$18,553 |
| Acquisition of assets with capital leases                | 2,470 | -        |
| Floor plan debt paid in connection with store disposals  | 6,712 | -        |

See accompanying condensed notes to consolidated financial statements.

LITHIA MOTORS, INC. AND SUBSIDIARIES  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1. Interim Financial Statements

Basis of Presentation

These condensed Consolidated Financial Statements contain unaudited information as of June 30, 2012 and for the three- and six-month periods ended June 30, 2012 and 2011. The unaudited interim financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by accounting principles generally accepted in the United States of America for annual financial statements are not included herein. In management's opinion, these unaudited financial statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the information when read in conjunction with our 2011 audited Consolidated Financial Statements and the related notes thereto. The financial information as of December 31, 2011 is derived from our 2011 Annual Report on Form 10-K. The interim condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in our 2011 Annual Report on Form 10-K. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

Reclassifications

Certain reclassifications of amounts previously reported have been made to the accompanying consolidated financial statements to maintain consistency and comparability between periods presented. These reclassifications had no impact on previously reported net income.

Note 2. Inventories

The components of inventory consisted of the following (in thousands):

|                       | June 30,<br>2012 | December 31,<br>2011 |
|-----------------------|------------------|----------------------|
| New vehicles          | \$ 456,551       | \$ 372,838           |
| Used vehicles         | 132,534          | 106,622              |
| Parts and accessories | 28,483           | 27,024               |
| Total inventories     | \$ 617,568       | \$ 506,484           |

Note 3. Goodwill

The changes in the carrying amounts of goodwill are as follows (in thousands):

|   | Goodwill   |
|---|------------|
| Balance as of December, 31, 2010, gross | \$ 305,452 |
| Accumulated impairment loss             | (299,266 ) |
| Balance as of December 31, 2010, net    | 6,186      |
| Additions through acquisitions          | 12,869     |
| Goodwill allocated to dispositions      | (97 )      |
| Balance as of December 31, 2011, net    | 18,958     |
| Additions through acquisitions          | 3,881      |
| Goodwill allocated to dispositions      | (231 )     |
| Balance as of June 30, 2012, net        | \$ 22,608  |



#### Note 4. Credit Facility

On April 17, 2012, we executed a new \$650 million credit facility, which is comprised of 10 financial institutions, including four manufacturer-affiliated finance companies. This credit facility provides a \$500 million new vehicle floor plan commitment, \$100 million in used vehicle inventory financing and a \$50 million revolving line of credit for general corporate use including working capital and acquisitions. We have the ability to expand the credit facility to \$800 million total availability upon credit approval. The credit facility expires on April 16, 2017. All borrowings from, and repayments to, our syndicated lending group are presented in the Consolidated Statements of Cash Flows as financing activities. The interest rate on the credit facility varies based on the type of debt with the rate ranging from the 1-month LIBOR plus 1.50% to the 1-month LIBOR plus 2.50%. Our financial covenants related to this credit facility include maintaining a current ratio of not less than 1.20x, a fixed charge coverage ratio of not less than 1.20x and a leverage ratio of not more than 5.0x. As of June 30, 2012, \$482.4 million was outstanding on our new vehicle floor plan commitment, \$52.0 million was outstanding on our used vehicle inventory financing facility and our revolving line of credit was undrawn.

#### Note 5. Commitments and Contingencies

##### 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.

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 July 5, 2011, we participated in a mediation of the McClintic case and subsequently entered into a settlement agreement with the plaintiffs, which is subject to final 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. On June 11, 2012, the court preliminarily approved the settlement. The court set a final approval hearing for October 11, 2012. No assurances can be given that the court will grant final approval of the settlement.

On 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). Subsequently, the complaint was amended to include claims against the vendor. The class representative in the McLaren case attempted to intervene in the McClintic case. This intervention motion was denied on October 19, 2011.

The McLaren case was stayed pending the outcome of the McClintic matter by order of the court on or about October 11, 2011; the stay was lifted on or about June 19, 2012, following with the preliminary settlement approval in the McClintic case. Now that McClintic has been granted preliminary approval, the defendants have moved the court to dismiss the McLaren case. No assurances can be given that the court will dismiss the McLaren case.

#### 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 (i) for 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 Trial Court granted Plaintiffs’ motion to certify a class without addressing either the merits of the claims or the size of the 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.

#### Note 6. Stockholders’ Equity

##### Share Repurchases

In August 2011, our Board of Directors authorized the repurchase of up to 2,000,000 shares of our Class A common stock. Through June 30, 2012 we have repurchased 1,120,147 shares, of which 823,092 were purchased in 2012 at an average price of \$24.17 per share. At June 30, 2012, 879,853 shares remained available for repurchase. This plan does not have an expiration date and we may continue to repurchase shares from time to time in the future as conditions warrant.

##### Dividends

During 2012, we paid dividends of \$0.07 per share on our Class A and Class B common stock, or a total of \$1.8 million, related to our fourth quarter 2011 financial results, and of \$0.10 per share, or a total of \$2.6 million, related to our first quarter 2012 financial results. See Note 17 for a discussion of a dividend related to our second quarter 2012 financial results.

#### Note 7. Asset Impairment Charges

Long-lived assets classified as held and used are reviewed for impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. An estimate of future undiscounted net cash flows associated with the long-lived assets is used to determine if the carrying value of the assets is recoverable. An impairment charge is recorded if the asset is determined to not be recoverable and the carrying value of the asset

exceeds its fair value.

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Triggering events were determined to have occurred related to certain properties due to changes in the expected future use. We evaluated the future undiscounted net cash flows for each property and determined the carrying value was not recoverable. We concluded the carrying value of the assets exceeded the fair value. As a result, asset impairments were recorded as a component of continuing operations as follows (in thousands):

|                   | Three Months Ended |        | Six Months Ended |        |
|-------------------|--------------------|--------|------------------|--------|
|                   | June 30,           |        | June 30,         |        |
|                   | 2012               | 2011   | 2012             | 2011   |
| Long-lived assets | \$ -               | \$ 490 | \$ 115           | \$ 872 |

#### Note 8. Stock-Based Compensation

In the first quarter of 2012, we issued restricted stock units (“RSUs”) covering 168,000 shares of our Class A common stock to certain employees. The RSUs are not participating securities and fully vest on the fourth anniversary of the grant date.

Our executives and other key employees received 89,000 of the 168,000 issued. These shares are subject to forfeiture, in whole or in part, based upon minimum performance measures and continuation of employment. If minimum performance measures are met, the number of RSUs ultimately received under these awards is subject to attainment of specific earnings per share thresholds. Each earnings per share threshold specifies an attainment level ranging from 75% to 150% of the base number of units identified in the award. Therefore, at the 150% maximum attainment level, the number of shares awarded to executive officers and other key employees would increase by 44,500 shares for a total award of 133,500 shares. Failure to achieve the minimum performance threshold in 2012 will result in forfeiture of the entire award. The final attainment will be calculated using the 2012 adjusted net income per share from continuing operations with the attainment percentage determined on a pro-rata basis ranging between 75% and 150%.

We estimated compensation expense, based on a fair value methodology, of \$4.2 million related to the RSUs, which will be recognized over the vesting period. Of this amount, approximately \$0.9 million is expected to be recognized in 2012.

In the second quarter of 2012, we issued RSUs covering 12,870 shares of our Class A common stock to members of our Board of Directors. All of these awards will vest 25% on the first day of the month following our quarterly board meetings. We estimated compensation expense, based on a fair value methodology, of \$0.4 million related to these RSUs, which will be recognized over the vesting period. Of this amount, approximately \$0.3 million is expected to be recognized in 2012.

#### Note 9. Deferred Compensation and Long-term Incentive Plan

We offer 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. We may make discretionary contributions to the Plan. Discretionary contributions vest between one and seven years based on the employee’s age and position. Additionally, participants may defer a portion of their compensation and are fully vested in their respective deferrals.

In March 2012, we made a discretionary contribution of \$1.9 million to the Plan. Participants will receive a guaranteed return of 5.9% in 2012. We recognized compensation expense related to the Plan of \$0.3 million and \$0.6 million, respectively, for the three and six months ended June 30, 2012 and \$0.3 million for both the three and six months ended June 30, 2011.

#### Note 10. 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 and 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 borrowings, 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.

There were no changes to our valuation techniques during the six-month period ended June 30, 2012.

#### 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 June 30, 2012    | Level 1 | Level 2     | Level 3 |
|--------------------------------|---------|-------------|---------|
| Measured on a recurring basis: |         |             |         |
| Derivative contracts, net      | \$ -    | \$ (6,362 ) | \$ -    |



| 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:   |         |             |          |
| Certain buildings and improvements | \$ -    | \$ -        | \$ 2,500 |

See Note 11 for more details regarding our derivative contracts.

#### Fair Value Disclosures for Financial Assets and Liabilities

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

We have fixed rate debt and 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 (Level 2), the fixed cash flows are discounted and summed to compute the fair value of the debt. As of June 30, 2012, this debt had maturity dates between October 2014 and May 2031. A summary of the aggregate carrying values and fair values of our long-term fixed interest rate debt is as follows (in thousands):

|                | June 30,<br>2012 | December 31,<br>2011 |
|----------------|------------------|----------------------|
| Carrying value | \$ 94,201        | \$ 64,463            |
| Fair value     | 98,634           | 73,551               |

#### Note 11. Derivative 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 to fluctuations in the one-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 comprehensive income rather than net income until the underlying hedged transaction affects net income. If a swap is no longer designated 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 loss 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.

At June 30, 2012 and December 31, 2011, the net fair value of all of our agreements totaled a loss of \$6.4 million and \$7.5 million, respectively, which was recorded on our Consolidated Balance Sheets as a component of accrued liabilities and other long-term liabilities. The estimated amount expected to be reclassified into earnings within the next twelve months was \$3.4 million at June 30, 2012.

As of June 30, 2012, we had outstanding the following interest rate swaps with U.S. Bank Dealer Commercial Services:

- \$25 million interest rate swap at a fixed rate of 4.495% per annum, variable rate adjusted on the 26th of each month, matures January 25, 2013;

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- \$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, matures April 30, 2013;
- \$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, matures April 30, 2013 and
- \$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, matures June 15, 2016.

We receive interest on all of the interest rate swaps at the one-month LIBOR rate. The one-month LIBOR rate at June 30, 2012 was 0.25% per annum, as reported in the Wall Street Journal.

At June 30, 2012 and December 31, 2011, the fair value of our derivative instruments was included in our Consolidated Balance Sheets as follows (in thousands):

| Balance Sheet Information                     | Fair Value of Liability Derivatives |               |
|---|-------------------------------------|---------------|
|   | Location in Balance Sheet           | June 30, 2012 |
| Derivatives Designated as Hedging Instruments |                                     |               |
| Interest Rate Swap Contracts                  | Accrued liabilities                 | \$ 3,123      |
|   | Other long-term liabilities         | 3,239         |
|   |                                     | \$ 6,362      |

| Balance Sheet Information                     | Fair Value of Liability Derivatives |                   |
|---|-------------------------------------|-------------------|
|   | Location in Balance Sheet           | December 31, 2011 |
| Derivatives Designated as Hedging Instruments |                                     |                   |
| Interest Rate Swap Contracts                  | Accrued liabilities                 | \$ 3,522          |
|   | Other long-term liabilities         | 4,008             |
|   |                                     | \$ 7,530          |

The effect of derivative instruments on our Consolidated Statements of Operations for the three- and six-month periods ended June 30, 2012 and 2011 was as follows (in thousands):

| Derivatives in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in Accumulated OCI (Effective Portion) | Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion) | Location of Loss Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) | Amount of Loss Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) |
|--|---|---|--|--|--|
|  |   |   |  |  |  |
| Interest Rate Swap Contracts                   | \$ 239  | Floor plan interest expense   | \$ (350 )  | Floor plan interest expense  | \$ (730 )  |

Three Months Ended

June 30, 2011

|                    |    |        |            |        |            |
|--------------------|----|--------|------------|--------|------------|
| Interest Rate Swap |    |        | Floor plan |        | Floor plan |
| Contracts          | \$ | (508 ) | interest   | \$     | interest   |
|                    |    |        | expense    | (416 ) | expense    |
|                    |    |        |            |        | \$ (861 )  |

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|  | Amount of<br>Gain (Loss)<br>Recognized<br>in<br>Accumulated<br>OCI<br>(Effective<br>Portion) | Location of<br>Gain (Loss)<br>Reclassified<br>from<br>Accumulated<br>OCI into<br>Income<br>(Effective Portion) | Amount of<br>Loss<br>Reclassified<br>from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) | Location of<br>Loss<br>Recognized in<br>Income on<br>Derivative<br>(Ineffective<br>Portion and<br>Amount<br>Excluded from<br>Effectiveness<br>Testing) | Amount of<br>Loss<br>Recognized<br>in<br>Income on<br>Derivative<br>(Ineffective<br>Portion and<br>Amount<br>Excluded<br>from<br>Effectiveness<br>Testing) |
|--|--|--|--|--|--|
| Derivatives in Cash<br>Flow Hedging<br>Relationships |  |  |  |  |  |

Six Months Ended  
June 30, 2012

|                                 |        |                                   |           |                                   |             |
|---------------------------------|--------|-----------------------------------|-----------|-----------------------------------|-------------|
| Interest Rate Swap<br>Contracts | \$ 522 | Floor plan<br>Interest<br>expense | \$ (758 ) | Floor plan<br>Interest<br>expense | \$ (1,384 ) |
|---------------------------------|--------|-----------------------------------|-----------|-----------------------------------|-------------|

Six Months Ended  
June 30, 2011

|                                 |           |                                   |           |                                   |             |
|---------------------------------|-----------|-----------------------------------|-----------|-----------------------------------|-------------|
| Interest Rate Swap<br>Contracts | \$ (119 ) | Floor plan<br>Interest<br>expense | \$ (910 ) | Floor plan<br>Interest<br>expense | \$ (1,273 ) |
|---------------------------------|-----------|-----------------------------------|-----------|-----------------------------------|-------------|

See also Note 10.

#### Note 12. Related Party Transactions

On March 27, 2012, we completed the sale of an 80% interest in our Nissan, Volkswagen and BMW stores in Medford, Oregon to our Vice Chairman, Dick Heimann. The price of the intangible assets of the Nissan, Volkswagen and BMW stores was \$1.2 million. We received proceeds of \$9.6 million, of which \$2.9 million was received in cash and \$6.7 million was received through the payoff of floor plan financing. The sale of the 80% interest in the stores resulted in a gain of \$0.7 million and was recorded as a component of selling, general and administrative expense on our Consolidated Statements of Operations.

The Nissan and Volkswagen stores were purchased for the book value of the inventory as defined by the original terms of an option agreement provided to Mr. Heimann in 2009. The price of the intangible assets of \$1.2 million was based on the fair value of the intangible assets related to the BMW store. We corroborated the fair value of the BMW store's intangible assets with independent third party broker opinions and financial projections using a fair value income approach.

Concurrent to the sale of the interest in the three stores, we entered into a shared service agreement with the stores. This agreement allows the stores to lease our employees, use the Lithia name, utilize accounting support functions and receive consulting services.

We retained a 20% interest in the stores as of the transition date. We determined that we are not the primary beneficiary of the stores and the risk and rewards associated with our investment are based on ownership percentages. We determined we maintained significant influence over the operations. As a result, the stores do not qualify for



consolidation and our 20% interest is accounted for under the equity method. We recorded the equity investment at fair value of \$0.8 million as of the transition date which resulted in a gain of \$0.2 million, which was recorded as a component of other income on our Consolidated Statements of Operations. We determined the fair value of our equity investment based on independent third party broker opinions and financial projections using a fair value income approach.

As of June 30, 2012, our equity investment increased by \$0.1 million to \$0.9 million and was recorded as a component of other non-current assets in our Consolidated Balance Sheets.

## Note 13. Acquisitions

On April 30, 2012, we acquired the inventory, equipment and intangible assets and assumed certain liabilities of Bellingham Chevrolet and Cadillac in Bellingham, Washington from Jerry Chambers Chevrolet.

On June 12, 2012, we acquired the inventory, equipment and intangible assets and assumed certain liabilities of Fairbanks GMC Buick from Gene's GMC, LLC.

Consideration paid for the acquisitions totaled \$12.8 million and was paid in cash. 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 of operations are not materially different than actual results of operations.

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 the three or six months ended June 30, 2012.

## Note 14. Discontinued Operations

In 2011, we sold three stores: a Chrysler Jeep Dodge FIAT store in Concord, California; a Volkswagen store in Thornton, Colorado; and a GMC Buick and Kia store in Cedar Rapids, Iowa. The associated results of operations for these locations are classified as discontinued operations as follows (in thousands):

|  | Three Months Ended |           | Six Months Ended |           |
|--|--------------------|-----------|------------------|-----------|
|  | June 30,           |           | June 30,         |           |
|  | 2012               | 2011      | 2012             | 2011      |
| Revenue  | \$ -               | \$ 20,141 | \$ -             | \$ 40,281 |
| Pre-tax gain from discontinued operations                      | \$ -               | \$ 280    | \$ -             | \$ 797    |
| Loss on disposal activities                                    | -                  | (53 )     | -                | (53 )     |
|  | -                  | 227       | -                | 744       |
| Income tax expense   | -                  | (87 )     | -                | (287 )    |
| Income from discontinued operations, net of income tax expense | \$ -               | \$ 140    | \$ -             | \$ 457    |

## Note 15. 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.

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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 three- and six-month periods ended June 30, 2012 and 2011 (in thousands, except per share amounts):

| Three Months Ended June 30,<br>Basic EPS from Continuing Operations   | 2012      |          | 2011      |          |
|---|-----------|----------|-----------|----------|
|   | Class A   | Class B  | Class A   | Class B  |
| <b>Numerator:</b>   |           |          |           |          |
| Income from continuing operations applicable to common stockholders   | \$ 17,681 | \$ 2,810 | \$ 12,596 | \$ 2,090 |
| Distributed income applicable to common stockholders  | (2,230 )  | (354 )   | (1,588 )  | (264 )   |
| Basic undistributed income from continuing operations applicable to common stockholders                           | \$ 15,451 | \$ 2,456 | \$ 11,008 | \$ 1,826 |
| <b>Denominator:</b>   |           |          |           |          |
| Weighted average number of shares outstanding used to calculate basic income per share                            | 22,201    | 3,529    | 22,675    | 3,762    |
| Basic income per share from continuing operations applicable to common stockholders                               | \$ 0.80   | \$ 0.80  | \$ 0.56   | \$ 0.56  |
| Basic distributed income per share from continuing operations applicable to common stockholders                   | (0.10 )   | (0.10 )  | (0.07 )   | (0.07 )  |
| Basic undistributed income per share from continuing operations applicable to common stockholders                 | \$ 0.70   | \$ 0.70  | \$ 0.49   | \$ 0.49  |
| <b>Three Months Ended June 30,<br/>Diluted EPS from Continuing Operations</b>                                     |           |          |           |          |
| <b>Numerator:</b>   |           |          |           |          |
| Distributed income applicable to common stockholders  | \$ 2,230  | \$ 354   | \$ 1,588  | \$ 264   |
| Reallocation of distributed income as a result of conversion of dilutive stock options                            | 6         | (6 )     | (5 )      | 5        |
| Reallocation of distributed income due to conversion of Class B to Class A common shares outstanding              | 348       | -        | 269       | -        |
| Diluted distributed income applicable to common stockholders  | \$ 2,584  | \$ 348   | \$ 1,852  | \$ 269   |
| Undistributed income from continuing operations applicable to common stockholders                                 | \$ 15,451 | \$ 2,456 | \$ 11,008 | \$ 1,826 |
| Reallocation of undistributed income as a result of conversion of dilutive stock options                          | 43        | (43 )    | 28        | (28 )    |
| Reallocation of undistributed income due to conversion of Class B to Class A                                      | 2,413     | -        | 1,798     | -        |
| Diluted undistributed income from continuing operations applicable to common stockholders                         | \$ 17,907 | \$ 2,413 | \$ 12,834 | \$ 1,798 |
| <b>Denominator:</b>   |           |          |           |          |
| Weighted average number of shares outstanding used to calculate basic income per share from continuing operations | 22,201    | 3,529    | 22,675    | 3,762    |
| Weighted average number of shares from stock options  | 455       | -        | 423       | -        |
| Conversion of Class B to Class A common shares outstanding  | 3,529     | -        | 3,762     | -        |

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|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Weighted average number of shares outstanding used to calculate diluted income per share from continuing operations | 26,185  | 3,529   | 26,860  | 3,762   |
| Diluted income per share from continuing operations applicable to common stockholders                               | \$0.78  | \$0.78  | \$0.55  | \$0.55  |
| Diluted distributed income per share from continuing operations applicable to common stockholders                   | (0.10 ) | (0.10 ) | (0.07 ) | (0.07 ) |
| Diluted undistributed income per share from continuing operations applicable to common stockholders                 | \$0.68  | \$0.68  | \$0.48  | \$0.48  |

| Three Months Ended June 30,<br>Diluted EPS   | 2012     |         | 2011     |         |
|--|----------|---------|----------|---------|
|  | Class A  | Class B | Class A  | Class B |
| <b>Antidilutive Securities</b>   |          |         |          |         |
| Shares issuable pursuant to stock options not included since they were antidilutive                      | 45       | -       | 142      | -       |
| <b>Six Months Ended June 30,<br/>Basic EPS from Continuing Operations</b>                                |          |         |          |         |
|  | 2012     |         | 2011     |         |
|  | Class A  | Class B | Class A  | Class B |
| <b>Numerator:</b>  |          |         |          |         |
| Income from continuing operations applicable to common stockholders                                      | \$32,040 | \$5,247 | \$19,785 | \$3,289 |
| Distributed income applicable to common stockholders   | (3,779 ) | (619 )  | (2,716 ) | (452 )  |
| Basic undistributed income from continuing operations applicable to common stockholders                  | \$28,261 | \$4,628 | \$17,069 | \$2,837 |
| <b>Denominator:</b>  |          |         |          |         |
| Weighted average number of shares outstanding used to calculate basic income per share                   | 22,221   | 3,639   | 22,627   | 3,762   |
| <b>Basic income per share from continuing operations applicable to common stockholders</b>               |          |         |          |         |
|  | \$1.44   | \$1.44  | \$0.87   | \$0.87  |
| <b>Basic distributed income per share from continuing operations applicable to common stockholders</b>   |          |         |          |         |
|  | (0.17 )  | (0.17 ) | (0.12 )  | (0.12 ) |
| <b>Basic undistributed income per share from continuing operations applicable to common stockholders</b> |          |         |          |         |
|  | \$1.27   | \$1.27  | \$0.75   | \$0.75  |

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| Six Months Ended June 30,<br>Diluted EPS from Continuing Operations   | 2012     |         | 2011     |         |
|---|----------|---------|----------|---------|
|   | Class A  | Class B | Class A  | Class B |
| <b>Numerator:</b>   |          |         |          |         |
| Distributed income applicable to common stockholders  | \$3,779  | \$619   | \$2,716  | \$452   |
| Reallocation of distributed income as a result of conversion of dilutive stock options                              | 11       | (11 )   | 7        | (7 )    |
| Reallocation of distributed income due to conversion of Class B to Class A common shares outstanding                | 608      | -       | 445      | -       |
| Diluted distributed income applicable to common stockholders  | \$4,398  | \$608   | \$3,168  | \$445   |
| Undistributed income from continuing operations applicable to common stockholders                                   | \$28,261 | \$4,628 | \$17,069 | \$2,837 |
| Reallocation of undistributed income as a result of conversion of dilutive stock options                            | 83       | (83 )   | 41       | (41 )   |
| Reallocation of undistributed income due to conversion of Class B to Class A  | 4,545    | -       | 2,796    | -       |
| Diluted undistributed income from continuing operations applicable to common stockholders                           | \$32,889 | \$4,545 | \$19,906 | \$2,796 |
| <b>Denominator:</b>   |          |         |          |         |
| Weighted average number of shares outstanding used to calculate basic income per share from continuing operations   | 22,221   | 3,639   | 22,627   | 3,762   |
| Weighted average number of shares from stock options  | 471      | -       | 390      | -       |
| Conversion of Class B to Class A common shares outstanding  | 3,639    | -       | 3,762    | -       |
| Weighted average number of shares outstanding used to calculate diluted income per share from continuing operations | 26,331   | 3,639   | 26,779   | 3,762   |
| Diluted income per share from continuing operations applicable to common stockholders                               | \$1.42   | \$1.42  | \$0.86   | \$0.86  |
| Diluted distributed income per share from continuing operations applicable to common stockholders                   | (0.17 )  | (0.17 ) | (0.12 )  | (0.12 ) |
| Diluted undistributed income per share from continuing operations applicable to common stockholders                 | \$1.25   | \$1.25  | \$0.74   | \$0.74  |
| <b>Antidilutive Securities</b>  |          |         |          |         |
| Shares issuable pursuant to stock options not included since they were antidilutive                                 | 90       | -       | 334      | -       |

#### Note 16. 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.

#### Note 17. Subsequent Events

##### Common Stock Dividend

On July 25, 2012, we announced that our Board of Directors approved a dividend of \$0.10 per share on our Class A and Class B Common stock related to our second quarter 2012 financial results. The dividend will total approximately \$2.6 million and will be paid on August 24, 2012 to shareholders of record on August 10, 2012.

##### Share Repurchase Plan

On July 20, 2012 our Board of Directors increased our existing authorization allowing the repurchase of 1,000,000 additional shares of our Class A common stock. This brings the total remaining repurchase authorization to 1,879,853 shares as of July 27, 2012.

#### Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

##### Forward-Looking Statements and Risk Factors

Certain statements under the sections entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risk Factors” and elsewhere in this Form 10-Q 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,” “believe,” “estimate,” “potential,” and “continue” or the negative of these terms or other comparable terminology. The forward-looking statements contained in this Form 10-Q 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. Important factors that could cause actual results to differ from our expectations are discussed in Part II - Other Information, Item 1A. in this Form 10-Q and in the Risk Factors section of our Annual Report on Form 10-K, as supplemented and amended from time to time in Quarterly Reports on Form 10-Q and our other filings with the Securities and Exchange Commission (“SEC”).

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 July 27, 2012, we offered 27 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.

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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 our 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.

#### Results of Continuing Operations

For the three months ended June 30, 2012 and 2011, we reported income from continuing operations, net of tax, of \$20.5 million, or \$0.78 per diluted share, and \$14.7 million, or \$0.55 per diluted share, respectively.

For the six months ended June 30, 2012 and 2011, we reported income from continuing operations, net of tax, of \$37.3 million, or \$1.42 per diluted share, and \$23.1 million, or \$0.86 per diluted share, respectively.

#### Discontinued Operations

Results for sold or closed stores qualifying for reclassification under the applicable accounting guidance are 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. We did not have any stores classified as discontinued operations during the three and six months ended June 30, 2012. Income from discontinued operations, net of tax, for the three and six months ended June 30, 2011 totaled \$0.1 million and \$0.5 million, respectively.

#### Key Performance Metrics

Key performance metrics for revenue and gross profit were as follows for the three and six months ended June 30, 2012 and 2011 (dollars in thousands):

| Three months ended<br>June 30, 2012 | Revenues   | Percent of<br>Total<br>Revenues | Gross<br>Profit | Gross<br>Profit<br>Margin | Percent of<br>Total<br>Gross<br>Profit |
|-------------------------------------|------------|---------------------------------|-----------------|---------------------------|--|
| New vehicle                         | \$ 470,424 | 55.5 %                          | \$ 34,639       | 7.4 %                     | 25.0 %                                 |
| Used vehicle retail                 | 212,767    | 25.1                            | 31,744          | 14.9                      | 23.0                                   |
| Used vehicle wholesale              | 36,083     | 4.3                             | 304             | 0.8                       | 0.2                                    |
| Finance and insurance(1)            | 27,870     | 3.3                             | 27,870          | 100.0                     | 20.2                                   |
| Service, body and parts             | 88,585     | 10.5                            | 43,242          | 48.8                      | 31.3                                   |
| Fleet and other                     | 11,394     | 1.3                             | 390             | 3.4                       | 0.3                                    |
|                                     | \$ 847,123 | 100.0 %                         | \$ 138,189      | 16.3 %                    | 100.0 %                                |

| Three months ended<br>June 30, 2011 | Revenues   | Percent of<br>Total<br>Revenues | Gross<br>Profit | Gross<br>Profit<br>Margin | Percent of<br>Total<br>Gross<br>Profit |
|-------------------------------------|------------|---------------------------------|-----------------|---------------------------|--|
| New vehicle                         | \$ 347,727 | 51.7 %                          | \$ 28,001       | 8.1 %                     | 23.9 %                                 |
| Used vehicle retail                 | 176,591    | 26.3                            | 27,001          | 15.3                      | 23.1                                   |
| Used vehicle wholesale              | 29,153     | 4.3                             | 268             | 0.9                       | 0.2                                    |
| Finance and insurance(1)            | 20,886     | 3.1                             | 20,886          | 100.0                     | 17.8                                   |
| Service, body and parts             | 80,937     | 12.0                            | 39,695          | 49.0                      | 33.9                                   |
| Fleet and other                     | 17,193     | 2.6                             | 1,286           | 7.5                       | 1.1                                    |

|    |         |       |   |    |         |      |   |       |   |
|----|---------|-------|---|----|---------|------|---|-------|---|
| \$ | 672,487 | 100.0 | % | \$ | 117,137 | 17.4 | % | 100.0 | % |
|----|---------|-------|---|----|---------|------|---|-------|---|

| Six months ended         |              | Percent of |   | Gross      | Gross  | Percent of |       |
|--------------------------|--------------|------------|---|------------|--------|------------|-------|
| June 30, 2012            | Revenues     | Total      |   | Profit     | Profit | Total      |       |
|                          |              | Revenues   | % | Margin     | Margin | Gross      |       |
|                          |              |            |   |            |        | Profit     |       |
| New vehicle              | \$ 874,712   | 54.5       | % | \$ 65,765  | 7.5    | %          | 24.7  |
| Used vehicle retail      | 408,188      | 25.4       |   | 60,658     | 14.9   |            | 22.8  |
| Used vehicle wholesale   | 70,419       | 4.4        |   | 722        | 1.0    |            | 0.3   |
| Finance and insurance(1) | 53,290       | 3.3        |   | 53,290     | 100.0  |            | 20.0  |
| Service, body and parts  | 175,033      | 10.9       |   | 84,835     | 48.5   |            | 31.9  |
| Fleet and other          | 24,375       | 1.5        |   | 790        | 3.2    |            | 0.3   |
|                          | \$ 1,606,017 | 100.0      | % | \$ 266,060 | 16.6   | %          | 100.0 |

| Six months ended         |              | Percent of |   | Gross      | Gross  | Percent of |       |
|--------------------------|--------------|------------|---|------------|--------|------------|-------|
| June 30, 2011            | Revenues     | Total      |   | Profit     | Profit | Total      |       |
|                          |              | Revenues   | % | Margin     | Margin | Gross      |       |
|                          |              |            |   |            |        | Profit     |       |
| New vehicle              | \$ 648,367   | 51.6       | % | \$ 50,607  | 7.8    | %          | 23.1  |
| Used vehicle retail      | 333,069      | 26.5       |   | 49,985     | 15.0   |            | 22.9  |
| Used vehicle wholesale   | 58,690       | 4.8        |   | 667        | 1.1    |            | 0.3   |
| Finance and insurance(1) | 40,185       | 3.2        |   | 40,185     | 100.0  |            | 18.4  |
| Service, body and parts  | 154,698      | 12.3       |   | 75,456     | 48.8   |            | 34.5  |
| Fleet and other          | 20,335       | 1.6        |   | 1,833      | 9.0    |            | 0.8   |
|                          | \$ 1,255,344 | 100.0      | % | \$ 218,733 | 17.4   | %          | 100.0 |

(1) Commissions reported net of anticipated cancellations.

#### Same Store Operating Data

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

A same store metric represents stores that were operating during the three- and six-month periods ended June 30, 2012, and only includes the months when operations occur in both comparable periods. For example, a store acquired in May 2011 would be included in same store operating data beginning in June 2012, after its first full complete comparable month of operation. Thus, operating results for same store comparisons would include only the period of June for both comparable periods.

#### New Vehicle Revenues

|   | Three Months Ended |           |           |            |
|---|--------------------|-----------|-----------|------------|
|   | June 30,           |           |           |            |
|   | 2012               | 2011      | Increase  | % Increase |
| (Dollars in thousands, except per unit amounts) |                    |           |           |            |
| Reported  |                    |           |           |            |
| Revenue   | \$470,424          | \$347,727 | \$122,697 | 35.3       |
| Retail units sold                               | 14,406             | 10,725    | 3,681     | 34.3       |
| Average selling price per retail unit           | \$32,655           | \$32,422  | \$233     | 0.7        |
| Same store                                      |                    |           |           |            |

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|                                       |           |           |           |      |   |
|---------------------------------------|-----------|-----------|-----------|------|---|
| Revenue                               | \$454,445 | \$339,427 | \$115,018 | 33.9 | % |
| Retail units sold                     | 13,939    | 10,486    | 3,453     | 32.9 |   |
| Average selling price per retail unit | \$32,602  | \$32,370  | \$232     | 0.7  |   |

Six Months Ended  
June 30,

|      |      |          |               |
|------|------|----------|---------------|
| 2012 | 2011 | Increase | %<br>Increase |
|------|------|----------|---------------|

(Dollars in thousands, except per unit amounts)

Reported

|                                       |           |           |           |      |   |
|---------------------------------------|-----------|-----------|-----------|------|---|
| Revenue                               | \$874,712 | \$648,367 | \$226,345 | 34.9 | % |
| Retail units sold                     | 26,875    | 20,250    | 6,625     | 32.7 |   |
| Average selling price per retail unit | \$32,547  | \$32,018  | \$529     | 1.7  |   |

Same store

|                                       |           |           |           |      |   |
|---------------------------------------|-----------|-----------|-----------|------|---|
| Revenue                               | \$825,948 | \$636,106 | \$189,842 | 29.8 | % |
| Retail units sold                     | 25,570    | 19,877    | 5,693     | 28.6 |   |
| Average selling price per retail unit | \$32,301  | \$32,002  | \$299     | 0.9  |   |

New vehicle sales in the second quarter of 2012 improved compared to the second quarter of 2011 driven by increased volume. Demand for new vehicles continues to be strong as same store sales volume increased 33% and 29%, respectively, in the three- and six-month periods ended June 30, 2012 compared to the same periods in 2011. We remain focused on increasing our share of overall new vehicle sales within our markets and continue to have an operational objective of increasing market share.

## Used Vehicle Retail Revenues

|   | Three Months Ended<br>June 30, |           |          | %<br>Increase |
|---|--------------------------------|-----------|----------|---------------|
|   | 2012                           | 2011      | Increase |               |
| (Dollars in thousands, except per unit amounts) |                                |           |          |               |
| <b>Reported</b>                                 |                                |           |          |               |
| Retail revenue                                  | \$212,767                      | \$176,591 | \$36,176 | 20.5 %        |
| Retail units sold                               | 11,923                         | 10,085    | 1,838    | 18.2          |
| Average selling price per retail unit           | \$17,845                       | \$17,510  | \$335    | 1.9           |
| <b>Same store</b>                               |                                |           |          |               |
| Retail revenue                                  | \$205,794                      | \$171,768 | \$34,026 | 19.8 %        |
| Retail units sold                               | 11,546                         | 9,847     | 1,699    | 17.3          |
| Average selling price per retail unit           | \$17,824                       | \$17,444  | \$380    | 2.2           |
|   | Six Months Ended<br>June 30,   |           |          | %             |
|   | 2012                           | 2011      | Increase | Increase      |
| (Dollars in thousands, except per unit amounts) |                                |           |          |               |
| <b>Reported</b>                                 |                                |           |          |               |
| Retail revenue                                  | \$408,188                      | \$333,069 | \$75,119 | 22.6 %        |
| Retail units sold                               | 23,431                         | 19,591    | 3,840    | 19.6          |
| Average selling price per retail unit           | \$17,421                       | \$17,001  | \$420    | 2.5           |
| <b>Same store</b>                               |                                |           |          |               |
| Retail revenue                                  | \$388,771                      | \$325,676 | \$63,095 | 19.4 %        |
| Retail units sold                               | 22,403                         | 19,197    | 3,206    | 16.7          |
| Average selling price per retail unit           | \$17,354                       | \$16,965  | \$389    | 2.3           |

Used vehicle retail sales continue to be a strategic focus as we strive for organic growth 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, vehicles over 80,000 miles. This approach allows us to expand our target customer base and increase the conversion of vehicles acquired via trade-in to retail used vehicle sales.

During the three- and six-month periods ended June 30, 2012, sales increased in all three categories of used vehicles compared to the same periods of 2011. Our retail used to new vehicle sales ratio was 0.8:1 for the three-month period ended June 30, 2012 compared to 0.9:1 in the same period in 2011. For the six months ended June 30, 2012 and 2011, our retail used to new vehicle sales ratio was 0.9:1 and 1.0:1, respectively. We continue to experience growth in our new vehicle sales that outpaces our used retail vehicle sales in 2012. On average, each of our stores currently sells approximately 47 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 Wholesale Revenues

|   | Three Months Ended<br>June 30, |          | Increase | % Increase |   |
|---|--------------------------------|----------|----------|------------|---|
|   | 2012                           | 2011     |          |            |   |
| (Dollars in thousands, except per unit amounts) |                                |          |          |            |   |
| <b>Reported</b>                                 |                                |          |          |            |   |
| Wholesale revenue                               | \$36,083                       | \$29,153 | \$6,930  | 23.8       | % |
| Wholesale units sold                            | 4,621                          | 3,767    | 854      | 22.7       |   |
| Average selling price per wholesale unit        | \$7,808                        | \$7,739  | \$69     | 0.9        |   |
| <b>Same store</b>                               |                                |          |          |            |   |
| Wholesale revenue                               | \$34,828                       | \$28,209 | \$6,619  | 23.5       | % |
| Wholesale units sold                            | 4,497                          | 3,683    | 814      | 22.1       |   |
| Average selling price per wholesale unit        | \$7,745                        | \$7,659  | \$86     | 1.1        |   |

|   | Six Months Ended<br>June 30, |          | Increase<br>(Decrease) | % Increase<br>(Decrease) |   |
|---|------------------------------|----------|------------------------|--------------------------|---|
|   | 2012                         | 2011     |                        |                          |   |
| (Dollars in thousands, except per unit amounts) |                              |          |                        |                          |   |
| <b>Reported</b>                                 |                              |          |                        |                          |   |
| Wholesale revenue                               | \$70,419                     | \$58,690 | \$11,729               | 20.0                     | % |
| Wholesale units sold                            | 9,214                        | 7,509    | 1,705                  | 22.7                     |   |
| Average selling price per wholesale unit        | \$7,643                      | \$7,816  | \$(173)                | (2.2)                    | ) |
| <b>Same store</b>                               |                              |          |                        |                          |   |
| Wholesale revenue                               | \$66,789                     | \$56,944 | \$9,845                | 17.3                     | % |
| Wholesale units sold                            | 8,809                        | 7,354    | 1,455                  | 19.8                     |   |
| Average selling price per wholesale unit        | \$7,582                      | \$7,743  | \$(161)                | (2.1)                    | ) |

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. Wholesale vehicle sales are typically sold at or near inventory cost and do not comprise a meaningful component of our gross profit. The increases in wholesale revenues are primarily due to increased volume.

## Finance and Insurance

|   | Three Months Ended<br>June 30, |          | Increase | % Increase |   |
|---|--------------------------------|----------|----------|------------|---|
|   | 2012                           | 2011     |          |            |   |
| (Dollars in thousands, except per unit amounts) |                                |          |          |            |   |
| <b>Reported</b>                                 |                                |          |          |            |   |
| Revenue   | \$27,870                       | \$20,886 | \$6,984  | 33.4       | % |
| <b>Revenue per retail unit</b>                  |                                |          |          |            |   |
| Finance reserves                                | \$410                          | \$378    | \$32     | 8.5        |   |
| Maintenance contracts                           | 527                            | 520      | 7        | 1.3        |   |
| Insurance and other                             | 122                            | 106      | 16       | 15.1       |   |



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|                                |          |          |         |        |
|--------------------------------|----------|----------|---------|--------|
| Revenue per retail unit        | \$ 1,059 | \$ 1,004 | \$ 55   | 5.5    |
| <b>Same store</b>              |          |          |         |        |
| Revenue                        | \$27,086 | \$20,163 | \$6,923 | 34.3 % |
| <b>Revenue per retail unit</b> |          |          |         |        |
| Finance reserves               | \$408    | \$373    | \$35    | 9.4    |
| Maintenance contracts          | 539      | 519      | 20      | 3.9    |
| Insurance and other            | 116      | 100      | 16      | 16.0   |
| Revenue per retail unit        | \$ 1,063 | \$ 992   | \$ 71   | 7.2    |

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Six Months Ended  
June 30,

2012      2011      Increase      %  
Increase

(Dollars in thousands, except per unit amounts)

| Reported                |          |          |          |      |   |
|-------------------------|----------|----------|----------|------|---|
| Revenue                 | \$53,290 | \$40,185 | \$13,105 | 32.6 | % |
| Revenue per retail unit |          |          |          |      |   |
| Finance reserves        | \$402    | \$372    | \$30     | 8.1  |   |
| Maintenance contracts   | 537      | 530      | 7        | 1.3  |   |
| Insurance and other     | 120      | 107      | 13       | 12.1 |   |
| Revenue per retail unit | \$1,059  | \$1,009  | \$50     | 5.0  |   |
| Same store              |          |          |          |      |   |
| Revenue                 | \$50,825 | \$38,627 | \$12,198 | 31.6 | % |
| Revenue per retail unit |          |          |          |      |   |
| Finance reserves        | \$400    | \$367    | \$33     | 9.0  |   |
| Maintenance contracts   | 545      | 521      | 24       | 4.6  |   |
| Insurance and other     | 114      | 101      | 13       | 12.9 |   |
| Revenue per retail unit | \$1,059  | \$989    | \$70     | 7.1  |   |

The increases in finance and insurance sales are driven by increased vehicle sales volume in the three- and six-month periods ended June 30, 2012 compared to the same periods of 2011. The availability of consumer credit has expanded and lenders have increased the loan-to-value amount available to most customers. 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. Additionally, we continue to diversify our product offerings and seek more accommodating financing terms.

Penetration rates were as follows:

|                                | Three Months Ended<br>June 30, |   |      |   | Six Months Ended<br>June 30, |   |      |   |
|--------------------------------|--------------------------------|---|------|---|------------------------------|---|------|---|
|                                | 2012                           |   | 2011 |   | 2012                         |   | 2011 |   |
| Finance and insurance          | 76                             | % | 73   | % | 76                           | % | 73   | % |
| Service contracts              | 40                             |   | 40   |   | 40                           |   | 40   |   |
| Lifetime oil change and filter | 36                             |   | 37   |   | 36                           |   | 37   |   |

Service, Body and Parts Revenue

Three Months Ended  
June 30,

2012      2011      Increase  
(Decrease)      %  
Increase(Decrease)

(Dollars in thousands)

| Reported        |          |          |         |       |   |
|-----------------|----------|----------|---------|-------|---|
| Customer pay    | \$51,223 | \$46,150 | \$5,073 | 11.0  | % |
| Warranty        | 13,099   | 13,779   | (680)   | (4.9) | ) |
| Wholesale parts | 15,907   | 13,768   | 2,139   | 15.5  |   |

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|                               |          |          |         |        |   |
|-------------------------------|----------|----------|---------|--------|---|
| Body shop                     | 8,356    | 7,240    | 1,116   | 15.4   |   |
| Total service, body and parts | \$88,585 | \$80,937 | \$7,648 | 9.4    | % |
| Same store                    |          |          |         |        |   |
| Customer pay                  | \$48,316 | \$44,725 | \$3,591 | 8.0    | % |
| Warranty                      | 12,267   | 13,142   | (875 )  | (6.7 ) |   |
| Wholesale parts               | 15,022   | 13,491   | 1,531   | 11.3   |   |
| Body shop                     | 8,355    | 7,240    | 1,115   | 15.4   |   |
| Total service, body and parts | \$83,960 | \$78,598 | \$5,362 | 6.8    | % |

|                               | Six Months Ended<br>June 30, |           | Increase<br>(Decrease) | %<br>Increase(Decrease) |   |
|-------------------------------|------------------------------|-----------|------------------------|-------------------------|---|
|                               | 2012                         | 2011      |                        |                         |   |
| (Dollars in thousands)        |                              |           |                        |                         |   |
| <b>Reported</b>               |                              |           |                        |                         |   |
| Customer pay                  | \$99,315                     | \$86,030  | \$13,285               | 15.4                    | % |
| Warranty                      | 26,416                       | 26,756    | (340)                  | (1.3)                   | ) |
| Wholesale parts               | 32,517                       | 27,209    | 5,308                  | 19.5                    |   |
| Body shop                     | 16,785                       | 14,703    | 2,082                  | 14.2                    |   |
| Total service, body and parts | \$175,033                    | \$154,698 | \$20,335               | 13.1                    | % |
| <b>Same store</b>             |                              |           |                        |                         |   |
| Customer pay                  | \$89,994                     | \$83,879  | \$6,115                | 7.3                     | % |
| Warranty                      | 23,389                       | 25,751    | (2,362)                | (9.2)                   | ) |
| Wholesale parts               | 29,780                       | 26,789    | 2,991                  | 11.2                    |   |
| Body shop                     | 16,780                       | 14,703    | 2,077                  | 14.1                    |   |
| Total service, body and parts | \$159,943                    | \$151,122 | \$8,821                | 5.8                     | % |

Our service, body and parts business continued to experience overall growth in the second quarter of 2012. We increased our same store customer pay business 8.0% and 7.3% in the three- and six-month periods ended June 30, 2012 compared to the same periods in 2011 as we focused on retaining customers through competitively-priced routine maintenance offerings and increased marketing efforts. The same store customer pay service and parts business represented 57.5% and 56.9% of the total same store service, body and parts business in the three-month periods ended June 30, 2012 and 2011, respectively, and 56.3% and 55.5% for the six-month periods ended June 30, 2012 and 2011, respectively.

Warranty work accounted for approximately 14.6% of our same store service, body and parts sales in both the three- and six-month periods of 2012 compared to 16.7% and 17.0% in the same periods in 2011. Warranty work decreased 6.7% and 9.2% in same store sales for the three and six months ended June 30, 2012 compared to the same periods in 2011. Domestic brand warranty work decreased by 0.9% and 6.2%, respectively, while import/luxury warranty work decreased by 11.4% and 11.9%, respectively, in the three- and six-month periods of 2012 compared to the same periods in 2011. Warranty work continues to be impacted by declining units in operation from 2008, 2009 and 2010, as well as the increased warranty work in 2011 associated with the Toyota recalls.

Our wholesale parts and body shop sales grew 11.3% and 15.4%, respectively, in the second quarter of 2012, and 11.2% and 14.1%, respectively, in the first six months of 2012, on a same store basis compared to the same periods in 2011. Wholesale parts represented 17.9% and 18.6%, and body shop sales represented 10.0% and 10.5%, of our same store service, body and parts revenue mix for the three- and six-month periods ended June 30, 2012, respectively. These categories allow for incremental organic growth. 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 \$21.1 million and \$47.3 million in the three- and six-month periods ended June 30, 2012 compared to the same periods in 2011 due to increased revenues, partially offset by declines in our overall gross profit margin.

Our gross profit margin by business line was as follows:

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|                         | Three Months Ended June |   |       |   | Basis<br>Point<br>Change* |
|-------------------------|-------------------------|---|-------|---|---------------------------|
|                         | 30,<br>2012             |   | 2011  |   |                           |
| New vehicle             | 7.4                     | % | 8.1   | % | (70 ) bp                  |
| Used vehicle retail     | 14.9                    |   | 15.3  |   | (40 )                     |
| Used vehicle wholesale  | 0.8                     |   | 0.9   |   | (10 )                     |
| Finance and insurance   | 100.0                   |   | 100.0 |   | -                         |
| Service, body and parts | 48.8                    |   | 49.0  |   | (20 )                     |
| Overall                 | 16.3                    | % | 17.4  | % | (110 )                    |

|                         | Six Months Ended June |        |   |     | Basis<br>Point<br>Change* |
|-------------------------|-----------------------|--------|---|-----|---------------------------|
|                         | 30,                   |        |   |     |                           |
|                         | 2012                  | 2011   |   |     |                           |
| New vehicle             | 7.5                   | % 7.8  | % | (30 | ) bp                      |
| Used vehicle retail     | 14.9                  | 15.0   |   | (10 | )                         |
| Used vehicle wholesale  | 1.0                   | 1.1    |   | (10 | )                         |
| Finance and insurance   | 100.0                 | 100.0  |   | -   |                           |
| Service, body and parts | 48.5                  | 48.8   |   | (30 | )                         |
| Overall                 | 16.6                  | % 17.4 | % | (80 | )                         |

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

New vehicle margins decreased during the three and six months ended June 30, 2012 compared to the same periods of 2011. These decreases are due to 2011 margins being abnormally high from constrained import inventory levels as a result of the earthquake and tsunami in Japan, which returned to more normalized levels in 2012. Additionally, certain domestic vehicle margins were reduced due to the discontinuation of manufacturer incentive programs in 2012. Used vehicle retail margins also decreased in the current year periods compared to the same periods of 2011. While all three categories of used vehicles have experienced revenue growth in 2012, strong used vehicle prices have caused cost of goods sold to grow faster than revenue, resulting in margin pressure. Service, body and parts margins decreased as our wholesale parts and body shop revenue growth continues, both of which achieve lower margins than other portions of our service, body and parts business. We believe our “single-point” strategy of maintaining franchise exclusivity within the markets we serve protects profitability and supports higher overall margin levels.

#### Asset Impairment Charges

Long-lived assets classified as held and used by us and definite-lived intangible assets are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable.

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

|                   | Three Months Ended |       | Six Months Ended |       |
|-------------------|--------------------|-------|------------------|-------|
|                   | June 30,           |       | June 30,         |       |
|                   | 2012               | 2011  | 2012             | 2011  |
| Long-lived assets | \$-                | \$490 | \$115            | \$872 |

In the first half of 2012 and 2011, we recorded impairment charges associated with certain properties. As the expected future use of these facilities changed, the long-lived assets were tested for recoverability. As a result, we determined the carrying value exceeded the fair value of these properties. As additional market information becomes available and negotiations with prospective buyers continue, estimated fair values of our properties may change. These changes may result in the recognition of additional asset impairment charges in future periods.

#### 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.

|  | Three Months Ended |      | Increase | %        |
|--|--------------------|------|----------|----------|
|  | June 30,           |      |          |          |
|  | 2012               | 2011 |          |          |
|  |                    |      | Increase | Increase |

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(Dollars in thousands)

|                |           |           |           |      |   |
|----------------|-----------|-----------|-----------|------|---|
| Personnel      | \$ 62,713 | \$ 54,821 | \$ 7,892  | 14.4 | % |
| Advertising    | 8,045     | 6,419     | 1,626     | 25.3 |   |
| Rent           | 4,414     | 3,669     | 745       | 20.3 |   |
| Facility costs | 6,073     | 5,683     | 390       | 6.9  |   |
| Other          | 14,922    | 12,176    | 2,746     | 22.6 |   |
| Total SG&A     | \$ 96,167 | \$ 82,768 | \$ 13,399 | 16.2 | % |

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|                        | Six Months Ended<br>June 30, |            |           | % Increase |   |
|------------------------|------------------------------|------------|-----------|------------|---|
|                        | 2012                         | 2011       | Increase  |            |   |
| (Dollars in thousands) |                              |            |           |            |   |
| Personnel              | \$ 122,893                   | \$ 104,252 | \$ 18,641 | 17.9       | % |
| Advertising            | 14,589                       | 12,049     | 2,540     | 21.1       |   |
| Rent                   | 8,754                        | 6,966      | 1,788     | 25.7       |   |
| Facility costs         | 12,327                       | 12,240     | 87        | 0.7        |   |
| Other                  | 29,194                       | 24,395     | 4,799     | 19.7       |   |
| Total SG&A             | \$ 187,757                   | \$ 159,902 | \$ 27,855 | 17.4       | % |

SG&A expense increased \$13.4 million and \$27.9 million, respectively, in the three- and six-month periods ended June 30, 2012 compared to the same periods in 2011. These changes were primarily driven by increased variable costs associated with improved sales, offset by a continued focus to reduce or maintain fixed costs and effectively manage variable costs.

SG&A as a percentage of gross profit was 69.6% compared to 70.7%, respectively, for the three months ended June 30, 2012 and 2011 and was 70.6% compared to 73.1%, respectively, for the six months ended June 30, 2012 and 2011. We target SG&A as a percentage of gross profit in the low 70% range with increased volume.

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.

|                         | Three Months Ended<br>June 30, |            |           | % of Change in Gross Profit |   |
|-------------------------|--------------------------------|------------|-----------|-----------------------------|---|
|                         | 2012                           | 2011       | Change    |                             |   |
| (Dollars in thousands)  |                                |            |           |                             |   |
| Gross profit            | \$ 138,189                     | \$ 117,137 | \$ 21,052 | 100.0                       | % |
| SG&A expense            | (96,167 )                      | (82,768 )  | (13,399 ) | (63.6 )                     |   |
| Throughput contribution |                                |            | \$ 7,653  | 36.4                        | % |

|                         | Three Months Ended<br>June 30, |           |           | % of Change in Gross Profit |   |
|-------------------------|--------------------------------|-----------|-----------|-----------------------------|---|
|                         | 2011                           | 2010      | Change    |                             |   |
| (Dollars in thousands)  |                                |           |           |                             |   |
| Gross profit            | \$ 117,137                     | \$ 93,049 | \$ 24,088 | 100.0                       | % |
| SG&A expense            | (82,768 )                      | (72,436 ) | (10,332 ) | (42.9 )                     |   |
| Throughput contribution |                                |           | \$ 13,756 | 57.1                        | % |

|  | Six Months Ended<br>June 30, |      |        | % of Change in Gross Profit |  |
|--|------------------------------|------|--------|-----------------------------|--|
|  | 2012                         | 2011 | Change |                             |  |



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(Dollars in thousands)

|                         |            |            |           |        |   |
|-------------------------|------------|------------|-----------|--------|---|
| Gross profit            | \$ 266,060 | \$ 218,733 | \$ 47,327 | 100.0  | % |
| SG&A expense            | (187,757)  | (159,902)  | (27,855)  | (58.9) | ) |
| Throughput contribution |            |            | \$ 19,472 | 41.1   | % |

Six Months Ended  
June 30,

|                         | 2011       | 2010       | Change    | % of<br>Change in<br>Gross Profit |   |
|-------------------------|------------|------------|-----------|-----------------------------------|---|
| (Dollars in thousands)  |            |            |           |                                   |   |
| Gross profit            | \$ 218,733 | \$ 176,387 | \$ 42,346 | 100.0                             | % |
| SG&A expense            | (159,902)  | (141,161)  | (18,741)  | (44.3)                            | ) |
| Throughput contribution |            |            | \$ 23,605 | 55.7                              | % |

Throughput contributions for newly opened or acquired stores are on a 'first dollar' basis for the first twelve months of operations. We acquired three stores and added one open point since the second quarter of 2011 and, adjusting for these locations, our throughput on a same store basis was 42.9% and 48.3% for the three- and six-month periods ended June 30, 2012, respectively. Our throughput in the second quarter of 2012 was reduced by insurance items totaling \$1.7 million. Excluding these items, our same store throughput would have been approximately 52%. We continue to target a 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.

|                               | Three Months Ended<br>June 30, |          |          |            |   |
|-------------------------------|--------------------------------|----------|----------|------------|---|
|                               | 2012                           | 2011     | Increase | % Increase |   |
| (Dollars in thousands)        |                                |          |          |            |   |
| Depreciation and amortization | \$ 4,261                       | \$ 4,217 | \$ 44    | 1.0        | % |

|                               | Six Months Ended<br>June 30, |          |          |            |   |
|-------------------------------|------------------------------|----------|----------|------------|---|
|                               | 2012                         | 2011     | Increase | % Increase |   |
| (Dollars in thousands)        |                              |          |          |            |   |
| Depreciation and amortization | \$ 8,460                     | \$ 8,309 | \$ 151   | 1.8        | % |

Depreciation and amortization for the three and six months ended June 30, 2012 increased slightly compared to the same periods of 2011 as we have increased our capital expenditures in recent periods.

### Operating Margin

Operating income in the three- and six-month periods ended June 30, 2012 was 4.5% and 4.3% of revenue compared to 4.4% and 4.0% in the comparable periods of 2011. These improvements were primarily due to improved sales and continued cost control.

### Floor Plan Interest Expense and Floor Plan Assistance

Floor plan interest expense decreased \$0.2 million and increased \$0.2 million, respectively in the three- and six-month periods ended June 30, 2012 compared to the same periods of 2011. The decrease in the current quarter mainly related to our interest rate swaps as the impact of increased volume was offset by the decrease in rate. The increase for the six months ended June 30, 2012 compared to the same period in 2011 was due to increased volume.

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 vehicle floor plan interest net of floor plan assistance earned.

|  | Three Months Ended<br>June 30, |         |         |          |    |
|--|--------------------------------|---------|---------|----------|----|
|  | 2012                           | 2011    | Change  | % Change |    |
| (Dollars in thousands)   |                                |         |         |          |    |
| Floor plan interest expense (new vehicles)                     | \$3,119                        | \$3,359 | \$(240) | (7.1)    | )% |
| Floor plan assistance (included as an offset to cost of sales) | (4,289)                        | (3,209) | 1,080   | 33.7     |    |

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|  | Six Months Ended<br>June 30, |          | Change  | %<br>Change |   |
|--|------------------------------|----------|---------|-------------|---|
|  | 2012                         | 2011     |         |             |   |
| Net new vehicle carrying costs                                 | \$(1,170 )                   | \$150    | \$1,320 | 880.0       | % |
| (Dollars in thousands)   |                              |          |         |             |   |
| Floor plan interest expense (new vehicles)                     | \$6,069                      | \$5,821  | \$248   | 4.3         | % |
| Floor plan assistance (included as an offset to cost of sales) | (7,999 )                     | (6,010 ) | 1,989   | 33.1        |   |
| Net new vehicle carrying costs                                 | \$(1,930 )                   | \$(189 ) | \$1,741 | 921.2       | % |

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### 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.

|                              | Three Months Ended<br>June 30, |         | Increase<br>(Decrease) | %<br>Increase<br>(Decrease) |
|------------------------------|--------------------------------|---------|------------------------|-----------------------------|
|                              | 2012                           | 2011    |                        |                             |
| (Dollars in thousands)       |                                |         |                        |                             |
| Mortgage interest            | \$2,245                        | \$2,670 | \$(425 )               | (15.9 )%                    |
| Other interest               | 403                            | 373     | 30                     | 8.0                         |
| Capitalized interest         | (99 )                          | (32 )   | 67                     | 209.4                       |
| Total other interest expense | \$2,549                        | \$3,011 | \$(462 )               | (15.3 )%                    |

|                              | Six Months Ended<br>June 30, |         | Increase<br>(Decrease) | %<br>Increase<br>(Decrease) |
|------------------------------|------------------------------|---------|------------------------|-----------------------------|
|                              | 2012                         | 2011    |                        |                             |
| (Dollars in thousands)       |                              |         |                        |                             |
| Mortgage interest            | \$4,463                      | \$5,625 | \$(1,162 )             | (20.7 )%                    |
| Other interest               | 1,025                        | 726     | 299                    | 41.2                        |
| Capitalized interest         | (192 )                       | (48 )   | 144                    | 300.0                       |
| Total other interest expense | \$5,296                      | \$6,303 | \$(1,007 )             | (16.0 )%                    |

For the three- and six-month periods ended June 30, 2012 compared to the same periods of 2011, other interest expense decreased \$0.5 million and \$1.0 million, respectively, primarily due to decreases in outstanding real estate mortgage debt as we retired approximately \$23 million in mortgages, offset by higher volumes of borrowing on our credit facility.

### Other Income, Net

Other income, net primarily includes interest income and, beginning in 2012, the gains related to an equity investment. Other income, net was \$0.8 million and \$0.2 million for the three-month periods ended June 30, 2012 and 2011, respectively, and \$1.3 million and \$0.2 million for the six-month periods ended June 30, 2012 and 2011, respectively.

### Income Tax Expense

Our effective income tax rate was 37.7% and 37.5% for the three- and six-month periods ended June 30, 2012, compared to 37.4% and 38.9%, respectively, in the comparable periods of 2011. We had certain tax attributes lowering our effective rate in the three and six month periods ended June 30, 2012. In the three months ended June 30, 2011, our income tax rate was decreased due to a tax shortfall associated with our stock-based compensation reversing and becoming a tax benefit.

For the full year 2012, we anticipate our income tax rate to be approximately 38.4%.

### 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.

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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):

|  | Three Months Ended June 30, 2012 |               |           |
|--|----------------------------------|---------------|-----------|
|  | As reported                      | Tax attribute | Adjusted  |
| Income from continuing operations before income taxes        | \$ 32,913                        | \$ -          | \$ 32,913 |
| Income tax expense   | (12,422 )                        | (578 )        | (13,000 ) |
| Net income from continuing operations                        | \$ 20,491                        | \$ (578 )     | \$ 19,913 |
| Diluted earnings (loss) per share from continuing operations | \$ 0.78                          | \$ (0.02 )    | \$ 0.76   |
| Diluted share count  | 26,185                           |               |           |

|   | Three Months Ended June 30, 2011 |                                    |  |          |
|---|----------------------------------|------------------------------------|--|----------|
|   | As reported                      | Asset impairment and disposal gain | Reversal of stock-based compensation tax shortfall | Adjusted |
| Asset impairments                                     | \$490                            | \$(490 )                           | \$ -   | \$-      |
| Selling, general and administrative                   | \$82,768                         | \$580                              | \$ -   | \$83,348 |
| Income from operations                                | \$29,662                         | \$(90 )                            | \$ -   | \$29,572 |
| Income from continuing operations before income taxes | \$23,463                         | \$(90 )                            | \$ -   | \$23,373 |
| Income tax expense                                    | (8,777 )                         | 37                                 | (186 )   | (8,926 ) |
| Income from continuing operations                     | \$14,686                         | \$(53 )                            | \$(186 )   | \$14,477 |
| Diluted earnings per share from continuing operations | \$0.55                           | \$-                                | \$(0.01 )  | \$0.54   |
| Diluted share count                                   | 26,860                           |                                    |  |          |

|   | Six Months Ended June 30, 2012 |                                    |                   |               |           |
|---|--------------------------------|------------------------------------|-------------------|---------------|-----------|
|   | As reported                    | Asset impairment and disposal gain | Equity investment | Tax attribute | Adjusted  |
| Asset impairments                                     | \$115                          | \$(115 )                           | \$-               | \$-           | \$-       |
| Selling, general and administrative                   | \$187,757                      | \$739                              | \$-               | \$-           | \$188,496 |
| Income from operations                                | \$69,728                       | \$(624 )                           | \$-               | \$-           | \$69,104  |
| Other income, net                                     | \$1,319                        | \$-                                | \$(244 )          | \$-           | \$1,075   |
| Income from continuing operations before income taxes | \$59,682                       | \$(624 )                           | \$(244 )          | \$-           | \$58,814  |
| Income tax expense                                    | (22,395 )                      | 244                                | 95                | (1,072 )      | (23,128 ) |

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|  |          |         |   |         |   |          |   |          |
|--|----------|---------|---|---------|---|----------|---|----------|
| Income from continuing operations                            | \$37,287 | \$(380  | ) | \$(149  | ) | \$(1,072 | ) | \$35,686 |
| Diluted earnings (loss) per share from continuing operations | \$1.42   | \$(0.01 | ) | \$(0.01 | ) | \$(0.04  | ) | \$1.36   |
| Diluted share count  | 26,331   |         |   |         |   |          |   |          |

## Six Months Ended June 30, 2011

|  | As reported | Asset<br>impairment<br>and disposal<br>gain | Adjusted   |
|--|-------------|---|------------|
| Asset impairments  | \$ 872      | \$ (872 )                                   | \$ -       |
| Selling, general and administrative                      | \$ 159,902  | \$ 580                                      | \$ 160,482 |
| Income from operations                                   | \$ 49,650   | \$ 292                                      | \$ 49,942  |
| Income from continuing operations<br>before income taxes | \$ 37,774   | \$ 292                                      | \$ 38,066  |
| Income tax expense                                       | (14,700 )   | (116 )                                      | (14,816 )  |
| Net income from continuing<br>operations                 | \$ 23,074   | \$ 176                                      | \$ 23,250  |
| Diluted earnings per share from<br>continuing operations | \$ 0.86     | \$ 0.01                                     | \$ 0.87    |
| Diluted share count                                      | 26,779      |   |            |

## 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<br>June 30,<br>2012 | As of<br>December 31,<br>2011 | Increase<br>(Decrease) | %<br>Increase<br>(Decrease) |
|--|---------------------------|-------------------------------|------------------------|-----------------------------|
| Cash and cash equivalents                                  | \$16,247                  | \$20,851                      | \$(4,604 )             | (22.1 )%                    |
| Available credit on the used vehicle financing<br>facility | 28,834                    | -                             | 28,834                 | NM                          |
| Available credit on the revolving line of<br>credit        | 46,898                    | 10,449                        | 36,449                 | 348.8                       |
| Unfinanced new vehicles                                    | -                         | 65,857                        | (65,857 )              | (100.0 )                    |
| Total available funds                                      | \$91,979                  | \$97,157                      | \$(5,178 )             | (5.3 )%                     |

NM - not meaningful



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 the six months ended June 30, 2012, we used proceeds from the sale of assets and stores and the issuance of long-term debt (primarily related to the financing of certain real estate) to repay outstanding debt, resulting in a net cash usage of \$10.0 million. During the six months ended June 30, 2011, we used proceeds from the sale of assets and stores and the issuance of long-term debt to repay outstanding debt, resulting in a net cash usage of \$3.4 million.

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<br>of June 30,<br>2012 | Remaining<br>Available as of<br>June 30, 2012 |         |
|---|---------------------------------------|---|---------|
| New vehicle floor plan commitment         | \$ 482,390                            | \$ -  | (1)     |
| Floor plan notes payable                  | 13,743                                | -   |         |
| Used vehicle inventory financing facility | 52,000                                | 28,834  | (3)     |
| Revolving line of credit                  | -                                     | 46,898  | (2),(3) |
| Real estate mortgages                     | 175,153                               | -   |         |
| Other debt                                | 5,311                                 | -   |         |
| <b>Total debt</b>                         | <b>\$ 728,597</b>                     | <b>\$ 75,732</b>                              |         |

- (1) We have a \$500 million new vehicle floor plan commitment as part of our credit facility.  
(2) Available credit reduced by \$3.1 million for outstanding letters of credit.  
(3) The amount available on the credit facility is limited based on a borrowing base calculation and fluctuates monthly.

#### New Credit Facility

On April 17, 2012, we executed a new five-year \$650 million credit facility, which is comprised of 10 financial institutions, including four manufacturer-affiliated finance companies. This credit facility provides a \$500 million new vehicle floor plan commitment, \$100 million in used vehicle inventory financing and a \$50 million revolving line of credit for general corporate use, including working capital and acquisitions. This credit facility may be expanded to \$800 million total availability. All borrowings from, and repayments to, our syndicated lending group are presented in the Consolidated Statements of Cash Flows as financing activities. The interest rate on the credit facility varies based on the type of debt with the rate ranging from the 1-month LIBOR plus 1.50% to the 1-month LIBOR plus 2.50%. Our financial covenants related to this credit facility include maintaining a current ratio of not less than 1.20x, a fixed charge coverage ratio of not less than 1.20x and a leverage ratio of not more than 5.0x. As of June 30, 2012, \$482.4 million was outstanding on our new vehicle floor plan commitment, \$52.0 million was outstanding on our used vehicle inventory financing facility and our revolving line of credit was undrawn.

#### New Vehicle Floor Plan Lines

We finance substantially all of our new vehicles through the new vehicle floor plan commitment component of our credit facility mentioned above. We also have additional floor plan agreements with manufacturer-affiliated finance companies for vehicles that are designed for use as service loaners. All borrowings from, and repayments to, our syndicated lending group are presented in the Consolidated Statements of Cash Flows as financing activities. Borrowings from, and repayments to, manufacturer-affiliated finance companies are classified as operating activities on the Consolidated Statements of Cash Flows.

The interest rate associated with our new vehicle line, excluding the effects of our interest rate swaps, was 1.7% at June 30, 2012.

#### 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 3.0% to 7.0% at June 30, 2012. The mortgages are payable in various installments through May 2031. Total mortgages outstanding decreased \$19.2 million since December 31, 2011 to \$175.2 million as of June 30, 2012.

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 June 30, 2012. The other debt, which totaled \$5.3 million at June 30, 2012, is due in various installments through May 2019.

### Debt Covenants

Under the terms of our credit facility and other debt agreements, we are subject to 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.

Under the new credit facility, we are required to maintain the ratios detailed in the following table. As of June 30, 2012, our debt covenant ratios under this agreement are as follows:

| Debt Covenant Ratio         | Requirement                 | As of June 30, 2012 |
|-----------------------------|-----------------------------|---------------------|
| Current ratio               | Not less than 1.20 to 1     | 1.30 to 1           |
| Fixed charge coverage ratio | Not less than 1.20 to 1     | 1.49 to 1           |
| Leverage ratio              | Not more than 5.00 to 1     | 2.19 to 1           |
| Funded debt restriction     | Not to exceed \$375 million | \$180.5 million     |

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 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 June 30, 2012, our new vehicle days supply was 74, or 6 days higher than our days supply as of June 30, 2011. Our days supply of used vehicles was 52 days as of June 30, 2012, or 4 days lower than our days supply level as of June 30, 2011. We have continued to focus on managing our mix and maintaining an appropriate level of used vehicle inventory.

### Capital Expenditures

We anticipate approximately \$48 million in capital expenditures for all of 2012. This amount is associated with improvements to, and purchases of, store facilities, replacement of equipment and the relocation to a new headquarters building.

Capital expenditures were \$22.7 million and \$7.9 million for the six months ended June 30, 2012 and 2011, respectively. The increase in capital expenditures in 2012 compared to the same period of 2011 was related to improvements at store facilities, the purchase of new store locations, replacement of equipment and the construction of a new headquarters building.

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 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

In the first six months of 2012, we paid dividends on our Class A and Class B common stock totaling \$4.4 million. In addition, our Board of Directors approved a dividend of \$0.10 per share on our Class A and Class B common stock related to our second quarter 2012 financial results. The dividend will total approximately \$2.6 million and will be paid on August 24, 2012 to shareholders of record on August 10, 2012.

#### Share Repurchase Program

In August 2011, our Board of Directors authorized the repurchase of up to 2,000,000 shares of our Class A common stock. Through June 30, 2012, we have purchased 1,120,147 shares under this program at an average price of \$22.12 per share.

On July 20, 2012 our Board of Directors increased our existing authorization allowing the repurchase of 1,000,000 additional shares of our Class A common stock. This brings the total remaining repurchase authorization to 1,879,853 shares as of July 27, 2012. We may continue to repurchase shares from time to time in the future as conditions warrant.

#### Recent Accounting Pronouncements

See Note 16 of the Condensed Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

#### Critical Accounting Policies and Use of Estimates

There have been no material changes in our critical accounting policies and use of estimates as described in our 2011 Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 24, 2012.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in our reported market risks or risk management policies since the filing of our 2011 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 24, 2012.

#### Item 4. 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 Quarterly Report on Form 10-Q. 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.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

There have been no new proceedings or material changes to previously disclosed proceedings in our Annual Report on Form 10-K for the year ended December 31, 2011. See Note 5 of the Condensed Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q. The information in this Form 10-Q should be read in conjunction with the legal proceedings disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011, which was filed with the Securities and Exchange Commission on February 24, 2012.

### Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011. Accordingly, the information in this Form 10-Q should be read in conjunction with the risk factors and information disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011, which was filed with the Securities and Exchange Commission on February 24, 2012.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We repurchased the following shares of our Class A common stock during the second quarter of 2012:

|                     | Total number<br>of shares<br>purchased | Average<br>price paid<br>per share | Total number of<br>shares purchased<br>as part of<br>publicly<br>announced plan | Maximum<br>number<br>of shares that may<br>yet be purchased<br>under the plans |
|---------------------|--|------------------------------------|---|--|
| April 1 to April 30 | 80,341                                 | \$ 26.73                           | 80,341  | 1,540,604  |
| May 1 to May 31     | 490,324                                | 24.30                              | 490,324   | 1,050,280  |
| June 1 to June 30   | 170,427                                | 22.84                              | 170,427   | 879,853  |
| Total               | 741,092                                | 24.23                              | 741,092   | 879,853  |

In August 2011, our Board of Directors authorized the repurchase of up to 2,000,000 shares of our Class A common stock. On July 20, 2012 our Board of Directors increased our existing authorization allowing the repurchase of 1,000,000 additional shares of our Class A common stock, bringing the remaining available for repurchase to 1,879,853 as of July 27, 2012. Through June 30, 2012, we have repurchased 1,120,147 shares under this program at an average price of \$22.12 per share. This plan does not have an expiration date.

Item 6. Exhibits

The following exhibits are filed herewith and this list is intended to constitute the exhibit index:

- 3.1 Restated Articles of Incorporation of Lithia Motors, Inc., as amended May 13, 1999 (filed as Exhibit 3.1 to Form 10-K filed March 30, 2000 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws of Lithia Motors, Inc. – Corrected (filed as Exhibit 3.2 to Form 10-K filed March 16, 2009 and incorporated herein by reference).
- 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.



SIGNATURES

Pursuant to the requirements 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: July 27, 2012

LITHIA MOTORS, INC.

By: /s/ Christopher S. Holzshu  
Christopher S. Holzshu  
Senior Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

By: /s/ John F. North III  
John F. North III  
Vice President and  
Corporate Controller  
(Principal Accounting Officer)