

LITHIA MOTORS INC  
Form 10-Q  
July 29, 2016  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

---

FORM 10-Q

---

(Mark One)

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

For the quarterly period ended **June 30, 2016**

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**

---

**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**

**97501**

Edgar Filing: LITHIA MOTORS INC - Form 10-Q

(Address of principal executive offices)

(Zip Code)

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

---

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

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.

<b>Class A common stock without par value</b>	<b>23,401,321</b>
<b>Class B common stock without par value</b>	<b>1,762,231</b>
(Class)	Outstanding at July 29, 2016

---

**LITHIA MOTORS, INC.**

**FORM 10-Q**

**INDEX**

<u>PART I - FINANCIAL INFORMATION</u>		<u>Page</u>
Item 1.	Financial Statements	2
	Consolidated Balance Sheets (Unaudited) - June 30, 2016 and December 31, 2015	2
	Consolidated Statements of Operations (Unaudited) – Three and Six Months Ended June 30, 2016 and 2015	3
	Consolidated Statements of Comprehensive Income (Unaudited) – Three and Six Months Ended June 30, 2016 and 2015	4
	Consolidated Statements of Cash Flows (Unaudited) – Six Months Ended June 30, 2016 and 2015	5
	Condensed Notes to Consolidated Financial Statements (Unaudited)	6
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	44
Item 4.	Controls and Procedures	44
<u>PART II - OTHER INFORMATION</u>		44
Item 1A.	Risk Factors	44
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	44
Item 6.	Exhibits	45
	Signatures	46

**LITHIA MOTORS, INC. AND SUBSIDIARIES****Consolidated Balance Sheets****(In thousands)****(Unaudited)**

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 15,044	\$45,008
Accounts receivable, net of allowance for doubtful accounts of \$3,972 and \$2,243	305,293	308,462
Inventories, net	1,582,274	1,470,987
Other current assets	38,192	54,408
Total Current Assets	1,940,803	1,878,865
Property and equipment, net of accumulated depreciation of \$152,048 and \$137,853	898,239	876,660
Goodwill	214,444	213,220
Franchise value	162,296	157,699
Other non-current assets	106,288	100,855
Total Assets	\$3,322,070	\$3,227,299
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities:		
Floor plan notes payable	\$56,767	\$48,083
Floor plan notes payable: non-trade	1,316,747	1,265,872
Current maturities of long-term debt	28,053	38,891
Trade payables	77,979	70,871
Accrued liabilities	184,160	167,108
Total Current Liabilities	1,663,706	1,590,825
Long-term debt, less current maturities	626,543	606,463
Deferred revenue	73,540	66,734
Deferred income taxes	54,647	53,129
Other long-term liabilities	86,173	81,984
Total Liabilities	2,504,609	2,399,135
Stockholders' Equity:		
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 23,416 and 23,676	168,950	258,410
	219	316

Edgar Filing: LITHIA MOTORS INC - Form 10-Q

Class B common stock - no par value; authorized 25,000 shares; issued and outstanding  
1,762 and 2,542

Additional paid-in capital	37,230	38,822
Accumulated other comprehensive loss	—	(277 )
Retained earnings	611,062	530,893
Total Stockholders' Equity	817,461	828,164
Total Liabilities and Stockholders' Equity	\$3,322,070	\$3,227,299

See accompanying condensed notes to consolidated financial statements.

**LITHIA MOTORS, INC. AND SUBSIDIARIES****Consolidated Statements of Operations****(In thousands, except per share amounts)****(Unaudited)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Revenues:				
New vehicle	\$ 1,209,037	\$ 1,149,512	\$ 2,305,092	\$ 2,157,328
Used vehicle retail	553,647	488,801	1,086,373	951,732
Used vehicle wholesale	66,714	66,796	131,860	129,004
Finance and insurance	81,043	72,463	158,681	137,067
Service, body and parts	202,265	182,695	398,940	356,170
Fleet and other	20,633	36,680	35,254	54,824
Total revenues	2,133,339	1,996,947	4,116,200	3,786,125
Cost of sales:				
New vehicle	1,136,175	1,080,170	2,165,464	2,026,212
Used vehicle retail	486,422	426,108	954,871	829,597
Used vehicle wholesale	65,228	65,390	128,544	125,437
Service, body and parts	103,666	91,946	204,222	180,982
Fleet and other	19,812	35,684	33,881	52,873
Total cost of sales	1,811,303	1,699,298	3,486,982	3,215,101
Gross profit	322,036	297,649	629,218	571,024
Asset impairments	3,498	6,130	6,996	10,260
Selling, general and administrative	215,526	195,610	434,632	387,228
Depreciation and amortization	12,503	10,287	24,166	20,013
Operating income	90,509	85,622	163,424	153,523
Floor plan interest expense	(6,209 )	(4,655 )	(12,118 )	(9,304 )
Other interest expense, net	(5,502 )	(4,972 )	(10,961 )	(9,800 )
Other expense, net	(1,495 )	(356 )	(3,021 )	(724 )
Income before income taxes	77,303	75,639	137,324	133,695
Income tax provision	(25,875 )	(24,416 )	(45,626 )	(41,819 )
Net income	\$51,428	\$51,223	\$91,698	\$91,876
Basic net income per share	\$2.02	\$1.95	\$3.58	\$3.49
Shares used in basic per share calculations	25,462	26,332	25,639	26,310
Diluted net income per share	\$2.01	\$1.93	\$3.56	\$3.47
Shares used in diluted per share calculations	25,534	26,496	25,754	26,509

See accompanying condensed notes to consolidated financial statements.

3

---

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Net income	\$51,428	\$51,223	\$91,698	\$91,876
Other comprehensive income, net of tax:				
Gain on cash flow hedges, net of tax expense of \$72, \$94, \$175 and \$181, respectively	114	165	277	304
Comprehensive income	\$51,542	\$51,388	\$91,975	\$92,180

See accompanying condensed notes to consolidated financial statements.

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

	<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
Net income	\$91,698	\$91,876
Adjustments to reconcile net income to net cash provided by operating activities:		
Asset impairments	6,996	10,260
Depreciation and amortization	24,166	20,013
Stock-based compensation	6,018	5,822
(Gain) loss on disposal of other assets	(4,512 )	44
Gain on disposal of franchise	(1,102 )	(5,919 )
Deferred income taxes	5,704	(1,145 )
Excess tax benefit from share-based payment arrangements	(4,384 )	(4,865 )
(Increase) decrease (net of acquisitions and dispositions):		
Trade receivables, net	6,564	7,570
Inventories	(114,052)	(122,660)
Other assets	5,688	(3,815 )
Increase (decrease) (net of acquisitions and dispositions):		
Floor plan notes payable	8,685	4,417
Trade payables	6,678	8,854
Accrued liabilities	17,595	7,717
Other long-term liabilities and deferred revenue	10,668	11,161
<b>Net cash provided by operating activities</b>	<b>66,410</b>	<b>29,330</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(43,247 )	(48,008 )
Proceeds from sales of assets	197	145
Cash paid for other investments	(16,690 )	(15,222 )
Cash paid for acquisitions, net of cash acquired	(18,807 )	(87 )
Proceeds from sales of stores	11,837	12,966
<b>Net cash used in investing activities</b>	<b>(66,710 )</b>	<b>(50,206 )</b>
<b>Cash flows from financing activities:</b>		
Borrowings on floor plan notes payable, net: non-trade	58,622	35,685
Borrowings on lines of credit	487,623	557,394
Repayments on lines of credit	(468,955)	(602,818)
Principal payments on long-term debt, scheduled	(8,062 )	(7,324 )
Principal payments on long-term debt and capital leases, other	(2,303 )	(9,189 )

Edgar Filing: LITHIA MOTORS INC - Form 10-Q

Proceeds from issuance of long-term debt	12,080	59,425
Proceeds from issuance of common stock	3,329	2,589
Repurchase of common stock	(104,858)	(16,773 )
Excess tax benefit from share-based payment arrangements	4,384	4,865
Dividends paid	(11,524 )	(9,482 )
<b>Net cash used in (provided by) financing activities</b>	<b>(29,664 )</b>	<b>14,372 )</b>
<b>Decrease in cash and cash equivalents</b>	<b>(29,964 )</b>	<b>(6,504 )</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>45,008</b>	<b>29,898</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 15,044</b>	<b>\$ 23,394</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for interest	\$24,960	\$22,262
Cash paid during the period for income taxes, net	9,684	28,699
<b>Supplemental schedule of non-cash activities:</b>		
Floor plan debt paid in connection with store disposals	\$5,284	\$4,400
Non-cash consideration given in connection with acquisitions	2,637	—

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, 2016 and for the three and six months ended June 30, 2016 and 2015. 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 2015 audited Consolidated Financial Statements and the related notes thereto. The financial information as of December 31, 2015 is derived from our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 26, 2016. The interim condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in our 2015 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 condensed Consolidated Financial Statements to maintain consistency and comparability between periods presented. These reclassifications had no impact on previously reported net income.

**Note 2. Accounts Receivable**

Accounts receivable consisted of the following (in thousands):

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Contracts in transit	\$ 159,069	\$ 168,460
Trade receivables	38,524	33,749
Vehicle receivables	34,441	36,470

Edgar Filing: LITHIA MOTORS INC - Form 10-Q

Manufacturer receivables	61,109	59,215
Auto loan receivables	54,412	42,490
Other receivables	3,001	3,033
	350,556	343,417
Less: Allowances	(3,972 )	(2,243 )
Less: Long-term portion of accounts receivable, net	(41,291 )	(32,712 )
Total accounts receivable, net	\$ 305,293	\$ 308,462

Accounts receivable classifications include the following:

• Contracts in transit are receivables from various lenders for the financing of vehicles that we have arranged on behalf of the customer and are typically received approximately ten days after selling a vehicle.

• Trade receivables are comprised of amounts due from customers for open charge accounts, lenders for the commissions earned on financing and others for commissions earned on service contracts and insurance products.

• Vehicle receivables represent receivables for the portion of the vehicle sales price paid directly by the customer.

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

• Auto loan receivables include amounts due from customers related to retail sales of vehicles and certain finance and insurance products.

Interest income on auto loan receivables is recognized based on the contractual terms of each loan and is accrued until repayment, charge-off or repossession. Direct costs associated with loan originations are capitalized and expensed as an offset to interest income when recognized on the loans. All other receivables are recorded at invoice and do not bear interest until they are 60 days past due.

The allowance for doubtful accounts is estimated based on our historical write-off experience and is reviewed monthly. Consideration is given to recent delinquency trends and recovery rates. Account balances are charged against the allowance after all appropriate means of collection have been exhausted and the potential for recovery is considered remote. The annual activity for charges and subsequent recoveries is immaterial.

The long-term portion of accounts receivable was included as a component of other non-current assets in the Consolidated Balance Sheets.

### **Note 3. Inventories**

The components of inventories, net, consisted of the following (in thousands):

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
New vehicles	\$1,172,198	\$1,113,613
Used vehicles	354,420	302,911
Parts and accessories	55,656	54,463
Total inventories	\$1,582,274	\$1,470,987

### **Note 4. Goodwill and Franchise Value**

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

	<b>Domestic</b>	<b>Import</b>	<b>Luxury</b>	<b>Consolidated</b>
<b>Balance as of December 31, 2014</b> <sup>1</sup>	\$ 91,011	\$79,601	\$28,763	\$ 199,375
Additions through acquisitions	6,892	5,029	2,170	14,091
Reduction related to divestiture	—	(246 )	—	(246 )
<b>Balance as of December 31, 2015</b> <sup>1</sup>	97,903	84,384	30,933	213,220
Additions through acquisitions	966	1,283	193	2,442
Reduction related to divestiture	(1,218 )	—	—	(1,218 )
<b>Balance as of June 30, 2016</b> <sup>1</sup>	\$ 97,651	\$85,667	\$31,126	\$ 214,444

<sup>1</sup> Net of accumulated impairment losses of \$299.3 million recorded during the year ended December 31, 2008.

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

	<b>Franchise Value</b>
<b>Balance as of December 31, 2014</b>	\$ 150,892
Additions through acquisitions	6,843
Reduction related to divestiture	(36 )

<b>Balance as of December 31, 2015</b>	157,699
Additions through acquisitions	5,115
Reduction related to divestiture	(518 )
<b>Balance as of June 30, 2016</b>	\$ 162,296

**Note 5. Stockholders' Equity**

***Repurchases of Class A Common Stock***

Repurchases of our Class A Common Stock occurred under repurchase authorizations granted by our Board of Directors and related to shares withheld as part of the vesting of restricted stock units ("RSUs").

In August 2011, our Board of Directors authorized the repurchase of up to 2 million shares of our Class A common stock and, on July 20, 2012, our Board of Directors authorized the repurchase of 1 million additional shares of our Class A common stock. Effective February 29, 2016, our Board of Directors authorized the repurchase of up to \$250 million of our Class A common stock. This authorization replaced the existing authorizations, increasing the total and establishing a maximum dollar rather than share amount.

Share repurchases under our authorizations were as follows:

	<b>Repurchases Occurring in the Six Months Ended June 30, 2016</b>		<b>Cumulative Repurchases as of June 30, 2016</b>	
	<b>Shares</b>	<b>Average Price</b>	<b>Shares</b>	<b>Average Price</b>
2011 Share Repurchase Authorization	599,123	\$ 79.21	2,327,636	\$ 51.09
2016 Share Repurchase Authorization	622,225	\$ 78.52	622,225	\$ 78.52

As of June 30, 2016, we had \$201.1 million available for repurchases pursuant to our 2016 share repurchase authorization.

In addition, during the first six months of 2016, we repurchased 94,363 shares at an average price of \$90.48 per share, for a total of \$8.5 million, related to tax withholdings associated with the vesting of RSUs. The repurchase of shares related to tax withholdings associated with stock awards does not reduce the number of shares available for repurchase as approved by our Board of Directors.

### ***Class B Common Stock Conversion***

On March 2, 2016, Lithia Holding Company, L.L.C. (“Holding Company”), which is managed and controlled by Sidney B. DeBoer, our Chairman of the Board, notified us that it had converted 780,000 shares of our Class B Common Stock into shares of our Class A Common Stock and distributed them to certain members of Holding Company in redemption of their membership interests in Holding Company. At that time, this transaction decreased the voting power of Holding Company to 42.4% from 52.3%, but did not result in any person acquiring voting control over us.

### ***Dividends***

Dividends paid on our Class A and Class B common stock were as follows:

<b>Three Months Ended June 30,</b>	<b>Six Months Ended June 30,</b>
--	--

	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Dividend amount per share	\$0.25	\$0.20	\$0.45	\$0.36
Total amount of dividend (in thousands)	6,373	5,266	11,524	9,482

See Note 13 for a discussion of a dividend related to our second quarter 2016 financial results.

#### **Note 6. Deferred Compensation and Long-Term Incentive Plan**

We offer a deferred compensation and long-term incentive plan (the “LTIP”) to provide certain employees the ability to accumulate assets for retirement on a tax-deferred basis. We may make discretionary contributions to the LTIP. Discretionary contributions vest over one to seven years depending on the employee’s age and position. Additionally, a participant may defer a portion of his or her compensation and receive the deferred amount upon certain events, including termination or retirement. The following is a summary related to our LTIP (dollars in thousands):

	<b>Three Months Ended June 30, 2016</b>		<b>Six Months Ended June 30, 2016</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Compensation expense	\$252	\$463	\$532	\$920
Discretionary contribution	\$10	\$153	\$1,392	\$2,249
Guaranteed annual return	5.25%	5.25%	5.25%	5.25%

As of June 30, 2016 and December 31, 2015, the balance due, comprised of both amounts participants elected to defer and discretionary contributions, was \$20.1 million and \$19.7 million, respectively, and was included as a component of accrued liabilities and other long-term liabilities in the Consolidated Balance Sheets.

Assets to fund the obligations of the LTIP are held in a Rabbi Trust and must be used only for purposes of providing benefits under the plan, other than in an event of insolvency. The assets held by the Rabbi Trust are invested in corporate-owned life insurance. As of June 30, 2016 and December 31, 2015, the value of the assets held by the Rabbi trust were \$21.0 million and \$15.4 million, respectively, and are recorded as a component of other non-current assets in the Consolidated Balance Sheets.

**Note 7. Fair Value Measurements**

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

Level 1 - quoted prices in active markets for identical securities;

Level 2 - other significant observable inputs, including quoted prices for similar securities, interest rates, prepayment spreads, credit risk; and

Level 3 - significant unobservable inputs, including our own assumptions in determining fair value.

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

We estimate the value of our equity-method investment, which is recorded at fair value on a non-recurring basis, based on a market valuation approach. We use prices and other relevant information generated primarily by recent market transactions involving similar or comparable assets. Because these valuations contain unobservable inputs, we classified the measurement of fair value of our equity-method investment as Level 3.

We estimate the value of other long-lived assets that are recorded at fair value on a non-recurring basis 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. Because 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, 2016.

***Assets and Liabilities Measured at Fair Value***

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

<b>Fair Value at June 30, 2016</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Measured on a non-recurring basis:</b>			
Equity-method investment	\$ —	\$ —	\$11,157

<b>Fair Value at December 31, 2015</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Measured on a non-recurring basis:</b>			
Equity-method investment	\$ —	\$ —	\$22,284
Long-lived assets held and used:			
Certain buildings and improvements	\$ —	\$ —	\$6,559

Based on operating losses recognized by the equity-method investment, we determined that an impairment of our investment had occurred. Accordingly, we performed a fair value calculation for this investment and determined that a \$7.0 million and a \$8.3 million impairment, respectively, was required to be recorded as asset impairments in our Consolidated Statements of Operations for the six months ended June 30, 2016 and 2015, respectively. See Note 9.

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

We determined the carrying value of cash equivalents, accounts receivable, trade payables, accrued liabilities and short-term borrowings approximate their fair values because of the nature of their terms 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, 2016, this debt had maturity dates between May 1, 2018 and October 1, 2034. A summary of the aggregate carrying values and fair values of our long-term fixed interest rate debt is as follows (in thousands):

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Carrying value	\$281,886	\$297,463
Fair value	286,628	296,961

**Note 8. 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 common shares underlying equity awards that are unvested or subject to forfeiture. 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 common shares issuable upon the net exercise of stock options and unvested RSUs and 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. Under our Articles of Incorporation, the Class A and Class B common stock 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 that would adversely alter 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. Because the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis.

Following is a reconciliation of net income and weighted average shares used for our basic earnings per share (“EPS”) and diluted EPS (in thousands, except per share amounts):

<b>Three Months Ended June 30,</b>	<b>2016</b>		<b>2015</b>	
<b>Basic EPS</b>	<b>Class A</b>	<b>Class B</b>	<b>Class A</b>	<b>Class B</b>
<i>Numerator:</i>				
Net income applicable to common stockholders	\$47,869	\$3,559	\$46,239	\$4,984
Distributed net income applicable to common stockholders	(5,932)	(441)	(4,754)	(512)
Basic undistributed net income applicable to common stockholders	\$41,937	\$3,118	\$41,485	\$4,472
<i>Denominator:</i>				
Weighted average number of shares outstanding used to calculate basic net income per share	23,700	1,762	23,770	2,562

***Earnings per Share:***

Basic net income per share applicable to common stockholders	\$2.02	\$2.02	\$1.95	\$1.95
Basic distributed net income per share applicable to common stockholders	(0.25 )	(0.25 )	(0.20 )	(0.20 )
Basic undistributed net income per share applicable to common stockholders	\$1.77	\$1.77	\$1.75	\$1.75

<b>Three Months Ended June 30,</b>	<b>2016</b>		<b>2015</b>	
<b>Diluted EPS</b>	<b>Class A</b>	<b>Class B</b>	<b>Class A</b>	<b>Class B</b>
<i><b>Numerator:</b></i>				
Distributed net income applicable to common stockholders	\$5,932	\$441	\$4,754	\$512
Reallocation of distributed net income as a result of conversion of dilutive stock options	1	(1 )	3	(3 )
Reallocation of distributed net income due to conversion of Class B to Class A common shares outstanding	440	—	509	—
Diluted distributed net income applicable to common stockholders	\$6,373	\$440	\$5,266	\$509
Undistributed net income applicable to common stockholders	\$41,937	\$3,118	\$41,485	\$4,472
Reallocation of undistributed net income as a result of conversion of dilutive stock options	9	(9 )	28	(28 )
Reallocation of undistributed net income due to conversion of Class B to Class A	3,109	—	4,444	—
Diluted undistributed net income from continuing operations applicable to common stockholders	\$45,055	\$3,109	\$45,957	\$4,444
<i><b>Denominator:</b></i>				
Weighted average number of shares outstanding used to calculate basic net income per share	23,700	1,762	23,770	2,562
Weighted average number of shares from stock options	72	—	164	—
Conversion of Class B to Class A common shares outstanding	1,762	—	2,562	—
Weighted average number of shares outstanding used to calculate diluted net income per share	25,534	1,762	26,496	2,562
<i><b>Earnings per Share:</b></i>				
Diluted net income per share applicable to common stockholders	\$2.01	\$2.01	\$1.93	\$1.93
Diluted distributed net income per share applicable to common stockholders	(0.25 )	(0.25 )	(0.20 )	(0.20 )
Diluted undistributed net income per share applicable to common stockholders	\$1.76	\$1.76	\$1.73	\$1.73

<b>Three Months Ended June 30,</b>	<b>2016</b>		<b>2015</b>	
<b>Diluted EPS</b>	<b>Class A</b>	<b>Class B</b>	<b>Class A</b>	<b>Class B</b>
<i><b>Antidilutive Securities</b></i>				
Shares issuable pursuant to stock options not included since they were antidilutive	—	—	17	—

<b>Six Months Ended June 30,</b>	<b>2016</b>		<b>2015</b>	
<b>Basic EPS</b>	<b>Class A</b>	<b>Class B</b>	<b>Class A</b>	<b>Class B</b>
<i>Numerator:</i>				
Net income applicable to common stockholders	\$84,445	\$7,253	\$82,929	\$8,947
Distributed net income applicable to common stockholders	(10,612)	(912 )	(8,559 )	(923 )
Basic undistributed net income applicable to common stockholders	\$73,833	\$6,341	\$74,370	\$8,024
<i>Denominator:</i>				
Weighted average number of shares outstanding used to calculate basic net income per share	23,611	2,028	23,748	2,562
<i>Earnings per Share:</i>				
Basic net income per share applicable to common stockholders	\$3.58	\$3.58	\$3.49	\$3.49
Basic distributed net income per share applicable to common stockholders	(0.45 )	(0.45 )	(0.36 )	(0.36 )
Basic undistributed net income per share applicable to common stockholders	\$3.13	\$3.13	\$3.13	\$3.13

<b>Six Months Ended June 30,</b>	<b>2016</b>		<b>2015</b>	
<b>Diluted EPS</b>	<b>Class A</b>	<b>Class B</b>	<b>Class A</b>	<b>Class B</b>
<i><b>Numerator:</b></i>				
Distributed net income applicable to common stockholders	\$10,612	\$912	\$8,559	\$923
Reallocation of distributed net income as a result of conversion of dilutive stock options	5	(5 )	7	(7 )
Reallocation of distributed net income due to conversion of Class B to Class A common shares outstanding	907	—	916	—
Diluted distributed net income applicable to common stockholders	\$11,524	\$907	\$9,482	\$916
Undistributed net income applicable to common stockholders	\$73,833	\$6,341	\$74,370	\$8,024
Reallocation of undistributed net income as a result of conversion of dilutive stock options	28	(28 )	61	(61 )
Reallocation of undistributed net income due to conversion of Class B to Class A	6,313	—	7,963	—
Diluted undistributed net income applicable to common stockholders	\$80,174	\$6,313	\$82,394	\$7,963
<i><b>Denominator:</b></i>				
Weighted average number of shares outstanding used to calculate basic net income per share	23,611	2,028	23,748	2,562
Weighted average number of shares from stock options	115	—	199	—
Conversion of Class B to Class A common shares outstanding	2,028	—	2,562	—
Weighted average number of shares outstanding used to calculate diluted net income per share	25,754	2,028	26,509	2,562
<i><b>Earnings per Share:</b></i>				
Diluted net income per share applicable to common stockholders	\$3.56	\$3.56	\$3.47	\$3.47
Diluted distributed net income per share applicable to common stockholders	(0.45 )	(0.45 )	(0.36 )	(0.36 )
Diluted undistributed net income per share applicable to common stockholders	\$3.11	\$3.11	\$3.11	\$3.11

<b>Six Months Ended June 30,</b>	<b>2016</b>		<b>2015</b>	
<b>Diluted EPS</b>	<b>Class A</b>	<b>Class B</b>	<b>Class A</b>	<b>Class B</b>
<i><b>Antidilutive Securities</b></i>				
Shares issuable pursuant to stock options not included since they were antidilutive	10	—	16	—

### **Note 9. Equity-Method Investment**

In October 2014, we acquired a 99.9% membership interest in a limited liability company managed by U.S. Bancorp Community Development Corporation with an initial equity contribution of \$4.1 million. We made additional equity contributions to the entity of \$11.4 million in the first six months of 2016 and \$22.8 million in the full year of 2015. We are obligated to make \$49.8 million of total contributions in quarterly installments to the entity over a two-year period ending October 2016, of which \$38.3 million in contributions have been made as of June 30, 2016.

This investment generates new markets tax credits under the New Markets Tax Credit Program (“NMTC Program”). The NMTC Program was established by Congress in 2000 to spur new or increased investments into operating businesses and real estate projects located in low-income communities.

While U.S. Bancorp Community Development Corporation exercises management control over the limited liability company, due to the economic interest we hold in the entity, we determined our ownership portion of the entity was appropriately accounted for using the equity method.

The following amounts related to this equity-method investment were recorded in our Consolidated Balance Sheets (in thousands):

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Carrying value, recorded as a component of other non-current assets	\$11,157	\$ 22,284
Present value of obligation associated with future equity contributions, recorded as a component of accrued liabilities and other long-term liabilities	11,317	22,511

The following amounts related to this equity-method investment were recorded in our Consolidated Statements of Operations (in thousands):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Asset impairments to write investment down to fair value	\$3,498	\$4,130	\$6,996	\$8,260
Our portion of the partnership's operating losses	2,065	1,733	4,131	3,465
Non-cash interest expense related to the amortization of the discounted fair value of future equity contributions	62	183	154	394
Tax benefits and credits generated	6,837	7,652	12,782	14,902

#### **Note 10. Segments**

While we have determined that each individual store is a reporting unit, we have aggregated our reporting units into three reportable segments based on their economic similarities: Domestic, Import and Luxury.

Our Domestic segment is comprised of retail automotive franchises that sell new vehicles manufactured by Chrysler, General Motors and Ford. Our Import segment is comprised of retail automotive franchises that sell new vehicles manufactured primarily by Honda, Toyota, Subaru, Nissan and Volkswagen. Our Luxury segment is comprised of

retail automotive franchises that sell new vehicles manufactured primarily by BMW, Mercedes-Benz and Lexus. The franchises in each segment also sell used vehicles, parts and automotive services, and automotive finance and insurance products.

Corporate and other revenue and income includes the results of operations of our stand-alone body shop offset by unallocated corporate overhead expenses, such as corporate personnel costs, and certain unallocated reserve and elimination adjustments. Additionally, certain internal corporate expense allocations increase segment income for Corporate and other while decreasing segment income for the other reportable segments. These internal corporate expense allocations are used to increase comparability of our dealerships and reflect the capital burden a stand-alone dealership would experience. Examples of these internal allocations include internal rent expense, internal floor plan financing charges, and internal fees charged to offset employees within our corporate headquarters that perform certain dealership functions.

We define our chief operating decision maker (“CODM”) to be certain members of our executive management group. Historical and forecasted operational performance is evaluated on a store-by-store basis and on a consolidated basis by the CODM. We derive the operating results of the segments directly from our internal management reporting system. The accounting policies used to derive segment results are substantially the same as those used to determine our consolidated results, except for the internal allocation within Corporate and other discussed above. Our CODM measures the performance of each operating segment based on several metrics, including earnings from operations, and uses these results, in part, to evaluate the performance of, and to allocate resources to, each of the operating segments.

Certain financial information on a segment basis is as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>Revenues:</b>				
Domestic	\$826,709	\$768,170	\$1,595,611	\$1,458,853
Import	934,018	855,305	1,799,761	1,615,385
Luxury	371,866	372,500	718,679	709,493
	2,132,593	1,995,975	4,114,051	3,783,731
Corporate and other	746	972	2,149	2,394
	\$2,133,339	\$1,996,947	\$4,116,200	\$3,786,125
<b>Segment income*:</b>				
Domestic	\$27,614	\$31,320	\$49,344	\$58,613
Import	28,228	28,149	50,861	45,212
Luxury	9,398	10,801	13,633	17,446
	65,240	70,270	113,838	121,271
Corporate and other	31,563	20,984	61,634	42,961
Depreciation and amortization	(12,503 )	(10,287 )	(24,166 )	(20,013 )
Other interest expense	(5,502 )	(4,972 )	(10,961 )	(9,800 )
Other expense, net	(1,495 )	(356 )	(3,021 )	(724 )
Income before income taxes	\$77,303	\$75,639	\$137,324	\$133,695

\*Segment income for each of the segments is defined as income before income taxes, depreciation and amortization, other interest expense and other expense, net.

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>Floor plan interest expense:</b>				
Domestic	\$6,183	\$4,920	\$12,615	\$9,642
Import	4,443	3,736	8,742	7,448
Luxury	2,650	2,308	5,308	4,370
	13,276	10,964	26,665	21,460
Corporate and other	(7,067 )	(6,309 )	(14,547 )	(12,156 )
	\$6,209	\$4,655	\$12,118	\$9,304

	<b>June 30, 2016</b>	<b>December 31, 2015</b>
<b>Total assets:</b>		
Domestic	\$1,018,942	\$985,374

Import	825,692	725,011
Luxury	472,475	475,305
Corporate and other	1,004,961	1,041,609
	\$3,322,070	\$3,227,299

**Note 11. Contingencies**

***Litigation***

We are party to numerous legal proceedings arising in the normal course of our business. Although 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, we cannot predict this with certainty.

*In Re Lithia Motors Derivative Litigation*

On December 14, 2015, Shiva Y. Stein, a Lithia shareholder, filed derivative claims on behalf of Lithia against its Board of Directors, listing Lithia as a nominal defendant. The case, Stein v. DeBoer, et al., Case No. 15CV33696, is pending in the Circuit Court of the State of Oregon for Marion County. Ms. Stein's claims relate to the adoption of a transition agreement between Lithia and Sidney B. DeBoer, as disclosed in a Current Report on Form 8-K filed September 16, 2015. Ms. Stein alleges that Lithia's directors breached their fiduciary duties of loyalty and due care, and wasted corporate assets, when they approved the agreement with Mr. DeBoer. Ms. Stein also alleges a claim against Sidney B. DeBoer, asserting that he has been unjustly enriched by the agreement. Ms. Stein is seeking relief in the amount of damages allegedly sustained by Lithia as a result of the alleged breaches of fiduciary duty and alleged corporate waste, disgorgement and imposition of a constructive trust on all property and profits Sidney B. DeBoer received as a result of the alleged wrongful conduct, and an award of the costs and disbursements of the lawsuit, including reasonable attorney fees, costs, and expenses. The Board and Mr. DeBoer filed Motions to Dismiss the Stein suit on February 26, 2016.

On February 12, 2016, Marty A. Jessos, a Lithia shareholder, also filed derivative claims on behalf of Lithia against its Board of Directors, listing Lithia as a nominal defendant. The case, Jessos v. DeBoer, et al., Case No. 16CV04181, was filed in the Circuit Court of the State of Oregon for Multnomah County. The Jessos suit involves the same subject matter and alleges substantially the same facts, claims, and causes of action as the Stein suit. On March 22, 2016, the Jessos suit was transferred to Marion County Circuit Court. On April 4, 2016, the parties filed a Stipulation and [Proposed] Order of Consolidation in the Stein suit to consolidate both Stein and Jessos under the Stein suit, Case No. 15CV33696. On April 4, 2016, the Court signed the consolidation order. The case is now known as *In re Lithia Motors Derivative Litigation*, Case No. 15CV33696. Plaintiffs filed their consolidated complaint on April 15, 2016.

On May 10, 2016, the Board filed its Motion to Dismiss the consolidated complaint. Mr. DeBoer filed his Motion to Dismiss on May 12, 2016. These Motions supersede the Motions filed in February, prior to the consolidation of the two cases. At this juncture, the parties have fully briefed the pending Motions. A hearing on the Motions to Dismiss the consolidated complaint will be held on Thursday, July 21, 2016.

*California Wage and Hour Litigations*

In June 2012 Mr. Robles and Mr. Laredo brought claims against DCH Tustin Acura (Robles vs. Tustin Motors, Inc., Case No. 30-2012-00579414, filed in the Superior Court of California, Orange County) alleging that the employer underpaid technicians in light of California Wage Order provisions that require an employer to pay at least two times the minimum wage for each hour worked if the employee is required to bring his or her own tools. The complaint was amended in late 2013 to include allegations that the employer failed to pay technicians for non-productive time and/or time spent performing tasks not compensated by the flat-rate compensation system; off-the-clock time worked; and wages due at termination. The amended complaint also alleged that the employer failed to provide technicians accurate and complete wage statements; and statutory meal and rest periods. Plaintiffs are now seeking relief on behalf of all employees at all DCH Auto Group dealerships in California. Plaintiffs also seek attorney fees and costs. These Plaintiffs (and several other former technicians in separate-but-partially-overlapping actions) also seek relief under California's Private Attorney General Action (PAGA) provisions, which allow private plaintiffs to recover civil

penalties on behalf of the State of California. DCH successfully compelled arbitration based on arbitration agreements between these claimants and the employer, although certain representative claims were excluded and stayed pending arbitration.

DCH and these claimants settled their individual claims in arbitration in 2015. In April 2016, DCH and plaintiffs agreed in principle to settle the representative claims, although this settlement has not yet been approved by either an independent arbitrator or the California courts as expressly contemplated by the parties and required by applicable law as a condition of the agreed release of claims. DCH Auto Group (USA) Limited must indemnify Lithia Motors, Inc. for losses related to this claim pursuant to the stock purchase agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014. As a result, we believe the exposure related to this lawsuit, when considered in relation to the terms of the stock purchase agreement, is immaterial to our financial statements.

In August 2014 Ms. Holzer filed a complaint in the Central District of California (Holzer vs. DCH Auto Group (USA) Inc., Case No. BC558869) alleging that her employer, an affiliate of DCH Auto Group (USA) Inc., failed to provide vehicle finance and sales persons, service advisors, and other clerical and hourly workers accurate and complete wage statements; and statutory meal and rest periods. The complaint also alleges that the employer failed to pay these employees for off-the-clock time worked; and wages due at termination. Plaintiffs also seek attorney fees and costs. DCH has sought to compel arbitration based on Plaintiffs' arbitration agreements. Plaintiffs (and several other employees in separate actions) are seeking relief under California's PAGA provisions. DCH is defending itself against these claims, and DCH Auto Group (USA) Limited must indemnify Lithia Motors, Inc. for losses related to this claim pursuant to the stock purchase agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014. As a result, we believe the exposure related to this lawsuit, when considered in relation to the terms of the stock purchase agreement, is not material.

**Note 12. Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (“FASB”) issued accounting standards update (“ASU”) 2014-09, “Revenue from Contracts with Customers”, which amends the accounting guidance related to revenues. This amendment will replace most of the existing revenue recognition guidance when it becomes effective. The new standard, as amended in July 2015, is effective for fiscal years beginning after December 15, 2017 and entities are allowed to adopt the standard as early as annual periods beginning after December 15, 2016, and interim periods therein. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect this amendment will have on our consolidated financial statements and related disclosures and believe the financial impact is not material. We have not yet selected a transition method.

In July 2015, the FASB issued ASU 2015-11, “Simplifying the Measurement of Inventory (Topic 330)”. ASU 2015-11 simplifies the accounting for the valuation of all inventory not accounted for using the last-in, first-out method by prescribing inventory be valued at the lower of cost and net realizable value. ASU 2015-11 is effective for public companies' annual periods, including interim periods within those fiscal years, beginning after December 15, 2016 on a prospective basis. Early adoption is permitted. We do not expect the adoption of ASU 2015-11 to have a material effect on our financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU 2016-02, "Leases". ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requires disclosing key information about leasing arrangements. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We are evaluating the effect this pronouncement will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation - Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies the accounting for several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. We are evaluating the effect this pronouncement will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method.

**Note 13. Subsequent Events**

***Common Stock Dividend***

On July 25, 2016, our Board of Directors approved a dividend of \$0.25 per share on our Class A and Class B common stock related to our second quarter 2016 financial results. The dividend will total approximately \$6.4 million and will

be paid on August 26, 2016 to shareholders of record on August 12, 2016.

***Credit Facility***

On July 27, 2016, we amended our existing credit facility to increase the total financing commitment by \$300 million to \$2.05 billion and extend the maturity to July 2021. This syndicated credit facility is comprised of 18 financial institutions, including eight manufacturer-affiliated finance companies. Under our credit facility we are permitted to allocate the total financing commitment among floor plan financing for new vehicle inventory, floor plan financing for used vehicles (up to a maximum of \$350 million) and revolving financing for general corporate purposes, including acquisitions and working capital (up to a maximum of \$400 million). Our credit facility may be expanded to \$2.4 billion total availability, subject to lender approval. All borrowings from, and repayments to, our lending group are presented in the Consolidated Statements of Cash Flows as financing activities.

## **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 “project”, “outlook,” “target”, “may,” “will,” “would,” “should,” “seek,” “expect,” “plan,” “intend” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “likely,” “goal,” “strategy,” “future,” “maintain,” and “continue” or these terms or other comparable terms. Examples of forward-looking statements in this Form 10-Q include, among others, statements we make regarding:

• Future market conditions;

• Expected operating results, such as improved store performance; continued improvement of SG&A as a percentage of gross profit and all projections;

• Anticipated continued success and growth of DCH Auto Group;

• Anticipated ability to capture additional market share;

• Anticipated ability to find accretive acquisitions;

• Anticipated additions of dealership locations to our portfolio in the future;

• Anticipated availability of liquidity from our unfinanced operating real estate; and

• Anticipated levels of capital expenditures in the future.

The forward-looking statements contained in this Form 10-Q involve known and unknown risks, uncertainties and situations that may cause our actual results to materially differ from the results expressed or implied by these statements. Certain 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 2015 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.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events that depend on circumstances that may or may not occur in the future. 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 related services. As of July 29, 2016, we offered 31 brands of new vehicles and all brands of used vehicles in 139 stores in the United States and online at Lithia.com and DCHauto.com. We sell new and used cars and replacement parts, provide vehicle maintenance, warranty, paint and repair services, arrange related financing, and sell service contracts, vehicle protection products and credit insurance.

Our dealerships are located across the United States. We seek domestic, import and luxury franchises in cities ranging from mid-sized regional markets to metropolitan markets. We evaluate all brands for expansion opportunities provided the market is large enough to support adequate new vehicle sales to justify the required capital investment.

Our mission statement is: “Driven by our employees and preferred by our customers, Lithia is the leading automotive retailer in each of our markets.” We offer customers convenient, flexible personalized service combined with the large company advantages of selection, competitive pricing, broad access to financing, and warranties. We strive for diversification in our products, services, brands and geographic locations to manage 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 and centrally-performed administrative functions in Medford, Oregon, and regional accounting processing centers, we seek to gain economies of scale from our dealership network.

### **Results of Operations**

For the three months ended June 30, 2016 and 2015, we reported net income of \$51.4 million, or \$2.01 per diluted share, and \$51.2 million, or \$1.93 per diluted share, respectively.

For the six months ended June 30, 2016 and 2015, we reported net income of \$91.7 million, or \$3.56 per diluted share, and \$91.9 million, or \$3.47 per diluted share, respectively.

**Key Revenue and Gross Profit Metrics**

Key performance metrics for revenue and gross profit were as follows (dollars in thousands):

<b>Three Months Ended June 30, 2016</b>	<b>Revenues</b>	<b>Percent of</b>		<b>Gross Profit</b>	<b>Percent of</b>			
		<b>Total</b>			<b>Total</b>			
		<b>Revenues</b>			<b>Gross Profit</b>			
New vehicle	\$1,209,037	56.7	%	\$72,862	6.0	%	22.6	%
Used vehicle retail	553,647	26.0		67,225	12.1		20.9	
Used vehicle wholesale	66,714	3.1		1,486	2.2		0.5	
Finance and insurance <sup>(1)</sup>	81,043	3.8		81,043	100.0		25.2	
Service, body and parts	202,265	9.5		98,599	48.7		30.6	
Fleet and other	20,633	0.9		821	4.0		0.2	
	\$2,133,339	100.0	%	\$322,036	15.1	%	100.0	%

<b>Three Months Ended June 30, 2015</b>	<b>Revenues</b>	<b>Percent of</b>		<b>Gross Profit</b>	<b>Percent of</b>			
		<b>Total</b>			<b>Total</b>			
		<b>Revenues</b>			<b>Gross Profit</b>			
New vehicle	\$1,149,512	57.6	%	\$69,342	6.0	%	23.3	%
Used vehicle retail	488,801	24.5		62,693	12.8		21.1	
Used vehicle wholesale	66,796	3.3		1,406	2.1		0.5	
Finance and insurance <sup>(1)</sup>	72,463	3.6		72,463	100.0		24.3	
Service, body and parts	182,695	9.1		90,749	49.7		30.5	
Fleet and other	36,680	1.9		996	2.7		0.3	
	\$1,996,947	100.0	%	\$297,649	14.9	%	100.0	%

(1)Commissions reported net of anticipated cancellations.

<b>Six Months Ended June 30, 2016</b>	<b>Revenues</b>	<b>Percent of</b>		<b>Gross Profit</b>	<b>Percent of</b>	
		<b>Total</b>			<b>Total</b>	
					<b>Margin</b>	

Edgar Filing: LITHIA MOTORS INC - Form 10-Q

	<b>Revenues</b>				<b>Gross Profit</b>			
New vehicle	\$2,305,092	56.0	%	\$139,628	6.1	%	22.2	%
Used vehicle retail	1,086,373	26.4		131,502	12.1		20.9	
Used vehicle wholesale	131,860	3.2		3,316	2.5		0.5	
Finance and insurance <sup>(1)</sup>	158,681	3.9		158,681	100.0		25.2	
Service, body and parts	398,940	9.7		194,718	48.8		30.9	
Fleet and other	35,254	0.8		1,373	3.9		0.3	
	\$4,116,200	100.0	%	\$629,218	15.3	%	100.0	%

<b>Six Months Ended June 30, 2015</b>	<b>Revenues</b>	<b>Percent of</b>	<b>Gross Profit</b>	<b>Gross Profit</b>	<b>Percent of</b>			
		<b>Total</b>		<b>Margin</b>	<b>Total</b>			
						<b>Revenues</b>	<b>Gross Profit</b>	
New vehicle	\$2,157,328	57.0	%	\$131,116	6.1	%	23.0	%
Used vehicle retail	951,732	25.1		122,135	12.8		21.4	
Used vehicle wholesale	129,004	3.4		3,567	2.8		0.6	
Finance and insurance <sup>(1)</sup>	137,067	3.6		137,067	100.0		24.0	
Service, body and parts	356,170	9.4		175,188	49.2		30.7	
Fleet and other	54,824	1.5		1,951	3.6		0.3	
	\$3,786,125	100.0	%	\$571,024	15.1	%	100.0	%

(1)Commissions reported net of anticipated cancellations.

**Same Store Operating Data**

In the first six months of 2016, we acquired two stores and one franchise and, in the full year of 2015 we acquired six stores and opened one store. We believe that same store comparisons are an important indicator of our financial performance. Same store measures demonstrate our ability to grow revenues in our existing locations. As a result, same store measures have been integrated into the discussion below.

Same store measures reflect results for stores that were operating in each comparison period and only include the months when operations occurred in both periods. For example, a store acquired in May 2015 would be included in same store operating data beginning in June 2016, after its first full complete comparable month of operation. The second quarter operating results for the same store comparisons would include results for that store in only the period of June for both comparable periods.

***New Vehicle Revenue and Gross Profit***

<b>(Dollars in thousands, except per unit amounts)</b>	<b>Three Months Ended</b>		<b>Increase (Decrease)</b>	<b>% Increase (Decrease)</b>	
	<b>June 30, 2016</b>	<b>2015</b>			
<b>Reported</b>					
Revenue	\$1,209,037	\$1,149,512	\$ 59,525	5.2	%
Gross profit	\$72,862	\$69,342	\$ 3,520	5.1	
Gross margin	6.0	% 6.0	—	bp	(1 )
Retail units sold	36,059	35,112	947	2.7	
Average selling price per retail unit	\$33,529	\$32,738	\$ 791	2.4	
Average gross profit per retail unit	\$2,021	\$1,975	\$ 46	2.3	
<b>Same store</b>					
Revenue	\$1,172,249	\$1,145,910	\$ 26,339	2.3	
Gross profit	\$70,532	\$69,178	\$ 1,354	2.0	
Gross margin	6.0	% 6.0	—	bp	
Retail units sold	34,995	35,017	(22 )	(0.1 )	
Average selling price per retail unit	\$33,498	\$32,724	\$ 774	2.4	
Average gross profit per retail unit	\$2,015	\$1,976	\$ 39	2.0	

(1) A basis point is equal to 1/100<sup>th</sup> of one percent



(Dollars in thousands, except per unit amounts)	Six Months Ended June 30,		Increase	% Increase	
	2016	2015			
<b>Reported</b>					
Revenue	\$2,305,092	\$2,157,328	\$147,764	6.8	%
Gross profit	\$139,628	\$131,116	\$8,512	6.5	
Gross margin	6.1	% 6.1	% —		
Retail units sold	68,808	65,735	3,073	4.7	
Average selling price per retail unit	\$33,500	\$32,819	\$681	2.1	
Average gross profit per retail unit	\$2,029	\$1,995	\$34	1.7	
<b>Same store</b>					
Revenue	\$2,234,584	\$2,146,678	\$87,906	4.1	
Gross profit	\$135,350	\$130,456	\$4,894	3.8	
Gross margin	6.1	% 6.1	% —		
Retail units sold	66,774	65,408	1,366	2.1	
Average selling price per retail unit	\$33,465	\$32,820	\$645	2.0	
Average gross profit per retail unit	\$2,027	\$1,994	\$33	1.7	

New vehicle sales increased 5.2% and 6.8%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015, primarily driven by increases in volume related to acquisitions. On a same store basis, new vehicle sales increased 2.3% and 4.1%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015 as average selling prices increased.

Same store new vehicle unit sales decreased 0.1% and increased 2.1%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015. Our stores, on a same store basis, slightly out-performed the national new vehicle sales levels, which decreased 0.4% and increased 1.3%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015.

Same store unit sales increased (decreased) as follows:

Three months  ended June 30,	National growth  in the three	Six months  ended June 30,	National growth  in the six
--	---	--	--------------------------------------

	<b>2016 compared to the same period of 2015</b>	<b>months ended June 30, 2016</b>	<b>2016 compared to the same period of 2015</b>	<b>months ended June 30, 2016</b>	<b>2016 compared to the same period of 2015<sup>1</sup></b>	<b>months ended June 30, 2016</b>	<b>2016 compared to the same period of 2015<sup>1</sup></b>
Domestic brand same store unit sales change	(1.8 )%	(1.8 )%	0.2 %	1.4 %			
Import brand same store unit sales change	1.8	1.0	4.1	1.4			
Luxury brand same store unit sales change	(3.9 )	(0.2 )	(1.4 )	0.3			
Overall	(0.1 )	(0.4 )	2.1	1.3			

<sup>1</sup> National auto unit sales and SAAR data obtained from Stephens Auto Unit Sales and SAAR report as of June 2016.

Our unit volume changes for the three- and six-month periods ended June 30, 2016 were slightly better than the overall national average, mainly driven by the out-performance of our import brand stores, but offset by under-performance in our luxury stores.

Our domestic brand unit volume change was in line with the national average for the three-month period and lagged the national average for the six-month period ended June 30, 2016. Our Chrysler and General Motors stores, which comprised 27.6% of our total new vehicle unit sales in the second quarter of 2016, had same store unit sales declines of 2.9% and 0.1%, respectively. The national average increased for Chrysler 4.3% and 6.4%, respectively, and decreased for General Motors 8.1% and 4.4%. respectively, for the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015.

The period-over-period volume declines for our luxury brand unit volume exceeded the national average in the 2016 periods compared to the 2015 periods. The decline was primarily associated with our Acura and Mercedes stores, which comprised 4.0% of our total new vehicle unit sales in the second quarter of 2016. These stores had same store unit sale declines of (11.3)% and (7.0)%, respectively, compared to a national franchise average unit sales declines of (0.1)% and (0.5)%, respectively, for the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015.

An increase in average selling prices of 2.4% and 2.0%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015, contributed to the overall increase in same store new vehicle revenue. All three categories of new vehicles experienced increased average selling prices.

New vehicle gross profit increased 5.1% and 6.5%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015. On a same store basis, new vehicle gross profit increased by 2.0% and 3.8%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015. We increased the average gross profit per unit \$39 and \$33, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015.

### *Used Vehicle Retail Revenue and Gross Profit*

	<b>Three Months Ended</b>		<b>Increase (Decrease)</b>	<b>% Increase (Decrease)</b>	
	<b>June 30, 2016</b>	<b>2015</b>			
<b>(Dollars in thousands, except per unit amounts)</b>					
<b>Reported</b>					
Retail revenue	\$553,647	\$488,801	\$ 64,846	13.3	%
Retail gross profit	\$67,225	\$62,693	\$ 4,532	7.2	
Retail gross margin	12.1	% 12.8	% (70	)bp	
Retail units sold	27,716	24,689	3,027	12.3	
Average selling price per retail unit	\$19,976	\$19,798	\$ 178	0.9	
Average gross profit per retail unit	\$2,425	\$2,539	\$ (114	)	(4.5
<b>Same store</b>					
Retail revenue	\$536,454	\$486,600	\$ 49,854	10.2	
Retail gross profit	\$65,169	\$62,584	\$ 2,585	4.1	
Retail gross margin	12.1	% 12.9	% (80	)bp	
Retail units sold	26,778	24,568	2,210	9.0	
Average selling price per retail unit	\$20,033	\$19,806	\$ 227	1.1	

Average gross profit per retail unit	\$2,434	\$2,547	\$ (113 )	(4.4 )
--------------------------------------	---------	---------	-----------	--------

(Dollars in thousands, except per unit amounts)	Six Months Ended		Increase (Decrease)	% Increase (Decrease)
	June 30, 2016	2015		
<b>Reported</b>				
Retail revenue	\$1,086,373	\$951,732	\$ 134,641	14.1 %
Retail gross profit	\$131,502	\$122,135	\$ 9,367	7.7
Retail gross margin	12.1 %	12.8 %	(70 )bp	
Retail units sold	55,147	48,893	6,254	12.8
Average selling price per retail unit	\$19,700	\$19,466	\$ 234	1.2
Average gross profit per retail unit	\$2,385	\$2,498	\$ (113 )	(4.5 )
<b>Same store</b>				
Retail revenue	\$1,052,731	\$945,792	\$ 106,939	11.3
Retail gross profit	\$127,712	\$121,610	\$ 6,102	5.0
Retail gross margin	12.1 %	12.9 %	(80 )bp	
Retail units sold	53,309	48,540	4,769	9.8
Average selling price per retail unit	\$19,748	\$19,485	\$ 263	1.3
Average gross profit per retail unit	\$2,396	\$2,505	\$ (109 )	(4.4 )

Used vehicle retail sales are a strategic focus for organic growth. We offer three categories of used vehicles: manufacturer Certified Pre-Owned ("CPO") vehicles; Core Vehicles, or late-model vehicles with lower mileage; and Value Autos, or vehicles with over 80,000 miles. Additionally, our volume-based strategy for new vehicle sales increases the organic opportunity to convert vehicles acquired via trade to retail used vehicle sales.

Same store sales increased in all three categories of used vehicles as follows:

	Three months ended		Six months ended	
	June 30, 2016		June 30, 2016	
	compared to the		compared to the	
	same period of 2015		same period of 2015	
Certified pre-owned vehicles	10.8 %		13.2 %	
Core vehicles	11.4		11.7	
Value autos	2.0		2.2	

Overall	9.0	9.8
---------	-----	-----

The increases in same store sales were mainly a result of increased unit sales and a slight increase in average selling prices. We continue to see a mix shift towards certified pre-owned and core vehicle sales as the supply of late-model, off-lease vehicles increases. This increase was driven by increased new vehicle leasing and an overall increase in vehicle sales levels over the past 6 years. Because the average new lease is approximately 30 months, the supply of late model used vehicles has increased.

On an annualized average, as of June 30, 2016 and 2015, each of our stores sold 64 and 59 retail used vehicle units, respectively, per month. We continue to target increasing sales to 75 units per store per month, or approximately a 15% increase in units sold.

Used retail vehicle gross profit increased 7.2% and 7.7%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015. On a same store basis, gross profit increased 4.1% and 5.0%, respectively, in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015, driven by volume growth, partially offset by decreases in the average gross profit per unit sold.

Similar to new vehicle sales, we focus on gross profit dollars earned per unit, not on gross margin, in evaluating our sales performance. Gross profit per unit decreased in all three categories of used vehicles in the three- and six-month periods ended June 30, 2016 compared to the same periods of 2015 as our stores focused on gaining incremental sales volume. This volume-based strategy creates the ability to generate incremental future business through used vehicle trade-in opportunities, finance and insurance sales and service work.

*Used Vehicle Wholesale Revenue and Gross Profit*

(Dollars in thousands, except per unit amounts)	Three Months Ended		Increase (Decrease)	% Increase (Decrease)
	June 30, 2016	2015		
<b>Reported</b>				
Wholesale revenue	\$66,714	\$66,796	\$ (82 )	(0.1 )%
Wholesale gross profit	\$1,486	\$1,406	\$ 80	5.7
Wholesale gross margin	2.2 %	2.1 %	10 bp	
Wholesale units sold	9,774	9,439	335	3.5
Average selling price per wholesale unit	\$6,826	\$7,077	\$ (251 )	(3.5 )
Average gross profit per retail unit	\$152	\$149	\$ 3	2.0
<b>Same store</b>				
Wholesale revenue	\$64,900	\$66,356	\$ (1,456 )	(2.2 )
Wholesale gross profit	\$1,452	\$1,455	\$ (3 )	(0.2 )
Wholesale gross margin	2.2 %	2.2 %	— bp	