

LITHIA MOTORS INC  
Form 10-K  
February 25, 2019

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

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

For the Fiscal Year Ended: December 31, 2018

OR

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

Commission File Number: 001-14733

LITHIA MOTORS, INC.

(Exact name of registrant as specified in its charter)

Oregon

93-0572810

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

150 N. Bartlett Street, Medford, Oregon

97501

(Address of principal executive offices)

(Zip Code)

541-776-6401

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A common stock, without par value	New York Stock Exchange

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

(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:

Yes  No

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

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

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

Edgar Filing: LITHIA MOTORS INC - Form 10-K

submit and post such files). Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company," and "emerging growth 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  Emerging growth company

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately \$2,216,050,000 computed by reference to the last sales price (\$94.57) as reported by the New York Stock Exchange for the Registrant's Class A common stock, as of the last business day of the Registrant's most recently completed second fiscal quarter (June 30, 2018).

The number of shares outstanding of the Registrant's common stock as of February 22, 2019 was: Class A: 22,347,635 shares and Class B: 800,000 shares.

Documents Incorporated by Reference

The Registrant has incorporated into Part III of Form 10-K, by reference, portions of its Proxy Statement for its 2019 Annual Meeting of Shareholders.

---

LITHIA MOTORS, INC.  
 2018 FORM 10-K ANNUAL REPORT  
 TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>Item 1. Business</u>	<u>2</u>
<u>Item 1A. Risk Factors</u>	<u>7</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>18</u>
<u>Item 2. Properties</u>	<u>18</u>
<u>Item 3. Legal Proceedings</u>	<u>19</u>
<u>Item 4. Mine Safety Disclosure</u>	<u>19</u>
<u>PART II</u>	
<u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>20</u>
<u>Item 6. Selected Financial Data</u>	<u>22</u>
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>23</u>
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>45</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>46</u>
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>46</u>
<u>Item 9A. Controls and Procedures</u>	<u>46</u>
<u>Item 9B. Other Information</u>	<u>47</u>
<u>PART III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>48</u>
<u>Item 11. Executive Compensation</u>	<u>48</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>48</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>48</u>
<u>Item 14. Principal Accountant Fees and Services</u>	<u>48</u>
<u>PART IV</u>	

<u>Item 15. Exhibits and Financial Statement Schedules</u>	<u>49</u>
Item 16. Form 10-K Summary	<u>49</u>
<u>Signatures</u>	<u>52</u>

## PART I

### Item 1. Business

#### Forward-Looking Statements

Certain statements in this Annual Report, including in the sections entitled “Risk Factors,” Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business” constitute forward-looking statements within the meaning of the “Safe Harbor” provisions 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,” “plan,” “intend,” “forecast,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “likely,” “goal,” “strategy,” “future,” “continue” or the negative of these terms or other comparable terms. Examples of forward-looking statements in this Form 10-K include, among others, statements we make regarding:

- Future market conditions, including anticipated national new car sales levels;
- Expected operating results, such as improved store performance; continued improvement of selling, general and administrative expenses (“SG&A”) as a percentage of gross profit and all projections;
- Anticipated integration, success and growth of acquired stores;
- Anticipated ability to capture additional market share;
- Anticipated ability to find accretive acquisitions;
- Expected revenues from acquired stores;
- Anticipated synergies, ability to increase ownership and ability to monetize our investment in Shift;
- Anticipated additions of dealership locations to our portfolio in the future;
- Anticipated availability of liquidity from our unfinanced operating real estate;
- Anticipated levels of capital expenditures in the future; and
- Our strategies for customer retention, growth, market position, financial results and risk management.

Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Forward-looking statements are not guarantees of future performance, and our actual results of operations, financial condition and liquidity and development of the industry in which we operate may differ materially from those made in or suggested by the forward-looking statements in this Annual Report. Therefore, you should not rely on any of these forward-looking statements. The risks and uncertainties that could cause actual results to differ materially from estimated or projected results include, without limitation, the factors as discussed in Part I, Item 1A. Risk Factors, and in Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, and, from time to time, in our other filings we make with the Securities and Exchange Commission (SEC).

Any forward-looking statement made by us in this Annual Report is based only on information currently available to us and speaks only as of the date on which it is made. We undertake no obligation to publicly update any forward-looking statement, whether written or oral, that may be made from time to time, whether as a result of new information, future developments or otherwise.

#### Overview

Lithia Motors, Inc. is one of the largest automotive retailers and providers of personal transportation solutions in the United States, and in 2018 was ranked #294 on the Fortune 500. As of December 31, 2018, we operated 181 stores representing 28 brands in 18 states. We offer convenient, personalized service complemented by the reach and scale of a nationwide network, one of the largest online inventories and competitive pricing on vehicles and service. Our vision to create personal transportation solutions wherever, whenever and however consumers desire, combined with our mission, “Growth Powered by People,” focuses us on our customers and our teams, creating our competitive advantage.

We offer a wide range of products and services including new and used vehicles, finance and insurance products and automotive repair and maintenance. We strive for diversification in our products, services, brands and geographic locations to reduce dependence on any one manufacturer, reduce susceptibility to changing consumer preferences, manage market risk and maintain profitability. As of December 31, 2018, we had three reportable segments: Domestic, Import and Luxury. For certain financial information by segment, see Notes 1 and 18 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

Founded in 1946 and incorporated in Oregon in 1968, we completed our initial public offering in 1996.

The following table sets forth information about stores that were part of our operations as of December 31, 2018:

State	Number of Stores	Percent of 2018 Revenue
California	41	25.4 %
New Jersey	15	14.7
Oregon	26	13.1
Texas	15	10.2
New York	16	7.5
Pennsylvania	13	5.7
Montana	11	4.6
Washington	6	3.6
Alaska	9	3.3
Idaho	5	2.4
Nevada	4	2.4
Hawaii	5	2.0
Iowa	7	2.0
North Dakota	3	0.9
Vermont	2	0.6
Wyoming	1	0.6
Massachusetts	1	0.5
New Mexico	1	0.5
Total	181	100.0 %

#### Business Strategy

Our values guide us in serving our customers, developing our people, reaching our potential and growing our Company. Our stores create a welcoming and highly-responsive environment to proactively engage customers wherever, whenever and however they desire. We strive to create an omni-channel retail experience that provides our customers with freedom, selection and choice throughout the ownership life cycle.

We build long-term value for our customers, employees and shareholders through the following strategies:

#### Driving operational excellence and unlocking store potential

We remain focused on improving performance at existing locations. Operations are structured to promote an entrepreneurial environment at the dealership level. Each store's general manager and department managers, with assistance from regional and corporate management, are responsible for developing successful retail plans in their local markets. They are responsible for driving dealership operations, personnel development, manufacturer relationships, store culture and financial performance. Strong performance creates synergistic benefits such as increased vehicle trade-ins resulting in additional used vehicle sales, incremental finance and insurance sales and ultimately, increased units in operation and customer retention, which generate additional service revenues.

In order to mitigate fluctuations in vehicle sales and general economic conditions, we link compensation to performance for the majority of our management and sales personnel. We develop pay plans that are measured based upon various factors such as dealership and department profitability, customer satisfaction and individual performance metrics. These plans also serve to reward personnel for meeting their annual operating plans and achieving store potential.

We have centralized many administrative functions to drive efficiencies and streamline store-level operations. The reduction of administrative functions at our stores allows our local managers to focus on customer-facing opportunities to increase revenues and gross profit. Our operations are supported by our dedicated training and

personnel development program, which shares best practices across our dealership network and seeks to develop management talent.

**Growth through acquisition and network optimization**

Our value-based acquisition strategy targets underperforming stores with strong franchises in desirable markets. As we integrate these stores into our existing network, we focus on improving performance. Our success is measured by achieving profitability

3

---



through increasing market share and retaining customers while controlling costs. With our performance management strategy, standardized information systems and centrally- and regionally-performed administrative functions, we seek to gain economies of scale from our dealership network.

We target acquiring 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. During 2018, we acquired 17 stores, opened one store, de-dualed two stores and divested eight stores. We invested \$253.8 million, net of floor plan debt, to acquire these stores and we expect these acquisitions to add over \$1.2 billion in annual revenues. Additionally, these acquisitions allow us to maintain a diverse franchise mix and further leverage our cost structure. We focus on successfully integrating acquired stores to achieve targeted returns. Platform acquisitions may include one or more locations which do not meet our criteria. We regularly optimize and balance our network through strategic divestitures to ensure continued high performance. Approximately half of the divested stores during 2018 were from platform acquisitions. The divestiture of these underperforming stores increases availability of capital and personnel resources and reduces future capital expenditures for facility improvements. These divestitures generated approximately \$34 million in proceeds and reduced forecasted capital expenditures by approximately \$15 million to be redeployed for investment in growth and innovation. We believe our disciplined approach and the current economic environment provide us with attractive acquisition opportunities and expanded coast to coast coverage.

#### Innovation and diversification

Driving growth and achieving earnings potential generates the free cash flow that allows us to invest in innovation, diversification and digital initiatives, thereby providing more ways to meet consumers' personal transportation needs. Through innovation and technology, we strive to provide a personalized customer experience wherever, whenever and however consumers desire. During the third quarter of 2018, we entered into a strategic partnership with Shift Technologies, Inc. ("Shift"), a San Francisco-based digital retailer. Shift provides an innovative platform to consumers for a digital vehicle purchase and selling experience, providing vehicle pickup and delivery at the customer's location. We invested \$54 million in Shift, leading the series D fundraising round and becoming its largest shareholder. In addition, during the fourth quarter of 2018, we collaborated with Shift in two areas, resulting in Lithia receiving additional equity ownership in Shift. In early October 2018, we assisted in Shift securing a credit line for acquiring used vehicle inventory and, in December 2018, we entered into a lease agreement to provide Shift with use of one of our retail locations for inventory storage and reconditioning. The strategic partnership with Shift will allow both companies to share and scale technology, data, inventory and business relationships, allowing us to capture more of the approximately 40 million used vehicles sold in the United States annually.

#### Thoughtful capital allocation

We constantly evaluate how to allocate capital, including returning cash to our investors and investing in our stores. During 2018, we paid \$27.7 million in dividends, and spent \$148.9 million to repurchase 2.1 million shares, or approximately 9% of total outstanding shares. We also invested in our facilities, allocating \$158.0 million to capital expenditures. We continue to manage our liquidity and available cash to prepare for future acquisition and innovation opportunities. As of December 31, 2018, we had \$211.2 million in available funds in cash and availability on our credit facilities, with an estimated additional \$247.7 million available if we financed our unencumbered owned real estate.

#### Marketing

One of our core values is to create customer experiences so satisfying that we earn their business for life. To facilitate customer retention for service and repeat purchase, we design marketing strategies utilizing database analysis and multi-channel communications to anticipate, listen and respond to customer needs. We tailor each store's strategy to the individual store, market, brand and manufacturer partners.

We use a combination of digital, social and traditional media, as well as inventory listing sites to increase awareness and drive traffic to our websites and stores. During 2018, online traffic increased 28%. Total advertising expense, net of manufacturer credits, was \$108.7 million in 2018, \$93.3 million in 2017 and \$81.4 million in 2016. In 2018, 78% was spent on digital, social, listings and owner communications while 22% of those funds were spent in traditional media. In all of our communications, we seek to convey the promise of a positive customer experience, competitive pricing and wide selection. We expect the portion of spending in digital channels to continue to increase as traditional media evolves to online consumption models.

Certain advertising and marketing expenditures are offset by manufacturer cooperative programs, which require us to submit requests for reimbursement to manufacturers for qualifying advertising expenditures. These advertising credits are not tied to specific vehicles and are earned as qualifying expenses are incurred. These reimbursements are recognized as a reduction of advertising expense. Manufacturer cooperative advertising credits were \$25.5 million in 2018, \$22.8 million in 2017 and \$20.3 million in 2016.

Mobile traffic now accounts for over 60% of our web traffic and all of our sites utilize responsive technology to enhance the mobile and tablet experience. We are monitoring the increased use of voice search and have initiated partnerships with search engine platforms to ensure our stores' presence and to develop the tools customers desire. Our stores' websites aim to provide customers with a simple, transparent way to interact with us including: search new and used inventories, view current pricing and specials, calculate payments for purchase or lease, submit credit application, buy online, schedule service appointments and provide feedback about their experience.

We list our inventory on new and used vehicle listing services (e.g. cars.com, autotrader.com, cargurus.com, kbb.com, edmunds.com, craigslist, and local webpages) to reach more online shoppers. We also employ search engine optimization, search engine marketing, online display and re-targeting as well as video pre-roll to reach more online prospects. We also encourage our stores to dedicate a larger percentage of their advertising spend to promoting service and repair work as we focus on customer acquisition and the value of customer retention.

#### Franchise Agreements

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

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

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

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

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

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

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

- a change of management or ownership without manufacturer consent;
- insolvency or bankruptcy of the dealer;
- death or incapacity of the dealer/manager;
- conviction of a dealer/manager or owner of certain crimes;
- misrepresentation of certain sales or inventory information by the store, dealer/manager or owner to the manufacturer;
- failure to adequately operate the store;
- failure to maintain any license, permit or authorization required for the conduct of business;
- poor market share; or

low customer satisfaction index scores.

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

#### Competition

The retail automotive business is highly competitive. Currently, there are approximately 18,000 stores in the United States, many of which are independent stores managed by individuals, families or small retail groups. We compete primarily with other automotive retailers, both publicly- and privately-held and other retailers such as Carvana, Shift and Vroom.

5

---

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

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

## Regulation

### Automotive and Other Laws and Regulations

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

Our financing activities with customers are subject to numerous federal, state and local laws and regulations. In recent years, there has been an increase in activity related to oversight of consumer lending by the Consumer Financial Protection Bureau ("CFPB"), which has broad regulatory powers. The CFPB does not have direct authority over automotive dealers; however, its regulation of larger automotive finance companies and other financial institutions could affect our financing activities. Claims arising out of actual or alleged violations of law may be asserted against us or our stores by individuals, a class of individuals, or governmental entities. These claims may expose us to significant damages or other penalties, including revocation or suspension of our licenses to conduct store operations and fines.

The vehicles we sell are also subject to rules and regulations of various federal and state regulatory agencies.

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

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

Most of our stores use above ground storage tanks, and, to a lesser extent, underground storage tanks, primarily for petroleum-based products. Storage tanks are subject to periodic testing, containment, upgrading and removal under the Resource Conservation and Recovery Act and its state law counterparts. Clean-up or other remedial action may be necessary in the event of leaks or other discharges from storage tanks or other sources. In addition, water quality protection programs under the federal Water Pollution Control Act (commonly known as the Clean Water Act), the Safe Drinking Water Act and comparable state and local programs govern certain discharges from our operations. Similarly, certain air emissions from operations, such as auto body painting, may be subject to the federal Clean Air

Act and related state and local laws. Health and safety standards promulgated by the Occupational Safety and Health Administration of the United States Department of Labor and related state agencies also apply.

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

We incur certain costs to comply with environmental, health and safety laws and regulations in the ordinary course of our business. We do not anticipate, however, that the costs of such compliance will have a material adverse effect on our business, results of operations, cash flows or financial condition, although such outcome is possible given the nature of our operations and the extensive environmental, public health and safety regulatory framework. We may become aware of minor contamination at certain of our

facilities, and we conduct investigations and remediation at properties as needed. In certain cases, the current or prior property owner may conduct the investigation and/or remediation or we have been indemnified by either the current or prior property owner for such contamination. We do not currently expect to incur significant costs for remediation. However, no assurances can be given that material environmental commitments or contingencies will not arise in the future, or that they do not already exist but are unknown to us.

#### Employees

Our mission statement is "Growth Powered by People." We cultivate an entrepreneurial, high-performance culture and strive to develop leaders from within. We continue to develop tools, training and growth opportunities that accelerate the depth of our talent. One example of this is our AMP program (Accelerate My Potential), which began in 2016. This program is designed to deepen the knowledge of future leaders in all aspects of our business and develop leadership skills to better position participants for a future as a general manager in one of our stores. During 2018, we realized a 76% year-over-year increase in the number of internal management hires compared to 2017.

The U.S. economy is highly dependent upon the retail sector as a significant employer. Wages are typically low in the sector given that there are often no formal education credentials required. As of December 31, 2018, we employed approximately 13,643 persons on a full-time equivalent basis in our nationwide network of 181 retail locations. Unlike many standard retailers, employees within our dealership network earn above average wages. Employees in our retail locations earned an average wage of \$16.94 per hour during 2018 compared to the national median pay for retail workers of \$11.70 per hour, according to the 2017 survey from the Bureau of Labor Statistics. This equates to average annual earnings in excess of \$35,000 per year, 45% higher than the median pay in the retail sector. In addition, the average hourly wage for our retail locations exceeds the minimum wage in all 18 states in which we operate.

#### Seasonality and Quarterly Fluctuations

Historically, our sales have been lower during the first quarter of each year due to consumer purchasing patterns during the holiday season and inclement weather in certain of our markets. The timing of our acquisition activity, which varies, and ability to integrate stores into our existing cost structure has moderated this seasonality. However, if conditions occur that weaken automotive sales, such as severe weather in the geographic areas in which our dealerships operate, war, high fuel costs, depressed economic conditions including unemployment or weakened consumer confidence or similar adverse conditions, or if our ability to acquire stores changes, our revenues for the year may be disproportionately adversely affected.

#### Available Information and NYSE Compliance

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"). The SEC maintains an Internet Web site at <http://www.sec.gov> where you may access copies of our SEC filings. We also make available free of charge, on our website at [www.lithiainvestorrelations.com](http://www.lithiainvestorrelations.com), our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after they are filed electronically with the SEC. The information found on our website is not part of this Annual Report on Form 10-K. You may also obtain copies of these reports by contacting Investor Relations at 877-331-3084.

#### Item 1A. Risk Factors

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

#### Risks related to our business

The automotive retail industry is sensitive to changing economic conditions and various other factors. Our business and results of operations are substantially dependent on new vehicle sales levels in the United States and in our particular geographic markets and the level of gross profit margins that we can achieve on our sales of new vehicles, all of which are very difficult to predict.

Our business is heavily dependent on consumer demand and preferences. A downturn in overall levels of consumer spending may materially and adversely affect our revenues and gross profit margins. Retail vehicle sales are cyclical and historically have experienced periodic downturns characterized by weak demand. These cycles are often dependent on general economic conditions and consumer confidence, as well as the level of discretionary personal income and credit availability. Economic conditions may

7

---



be anemic for an extended period of time, or deteriorate in the future. This would have a material adverse effect on our retail business, particularly sales of new and used automobiles.

In addition, our performance is subject to local economic, competitive and other conditions prevailing in our various geographic areas. Our dealerships are currently located in limited markets in 18 states, with sales in the top three states accounting for 53% of our revenue in 2018. Our results of operations, therefore, depend substantially on general economic conditions, consumer spending levels and other factors in those markets and could be materially adversely affected to the extent these markets experience sustained economic downturns regardless of improvements in the U.S. economy overall.

Historically, in times of rapid increase in crude oil and fuel prices, sales of vehicles have dropped, particularly in the short term, as the economy slows, consumer confidence wanes and fuel costs become more prominent to the consumer's buying decision. In sustained periods of higher fuel costs, consumers who do purchase vehicles tend to prefer smaller, more fuel-efficient vehicles (which typically have lower margins) or hybrid vehicles (which can be in limited supply during these periods). A significant portion of our new vehicle revenue and gross profit is derived from domestic manufacturers. These manufacturers have historically sold a higher percentage of trucks and SUVs than import or luxury brands. They may, therefore, experience a more significant decline in sales in the event that fuel prices increase.

Approximately 17.3 million, 17.2 million, and 17.5 million new vehicles were sold in the United States in 2018, 2017, and 2016, respectively. Certain industry analysts have predicted that new vehicle sales will decline below 17 million for 2019. If new vehicle production exceeds the rate at which new vehicles are sold, our gross profit per vehicle could be adversely affected by this excess and any resulting changes in manufacturer incentive and marketing programs. See the risk factor "If manufacturers or distributors discontinue or change sales incentives, warranties and other promotional programs, our business, results of operations, financial condition and cash flows may be materially adversely affected" below. Economic conditions and the other factors described above may also materially adversely impact our sales of used vehicles, parts and repair and maintenance services, and automotive finance and insurance products.

Natural disasters and adverse weather conditions can disrupt our business.

Our dealerships are in states and regions in the U.S. in which actual or threatened natural disasters and severe weather events (such as hurricanes, earthquakes, fires, floods, landslides, wind and/or hail storms) or other extraordinary events have in the past, and may in the future, disrupt our dealership operations and impair the value of our dealership property. A disruption in our operations may adversely impact our business, results of operations, financial condition and cash flows. In addition to business interruption, the automotive retailing business is subject to substantial risk of property loss due to the significant concentration of property at dealership locations. The exposure on any single claim under our property and casualty insurance, medical insurance and workers' compensation insurance varies based upon type of coverage. Our maximum exposure on any single claim is \$5 million, subject to certain aggregate limit thresholds.

The automotive manufacturing supply chain spans the globe. As such, supply chain disruptions resulting from natural disasters and adverse weather events may affect the flow of inventory or parts to us or our manufacturing partners. Such disruptions could have a material adverse effect on our business, financial condition, results of operations, or cash flows.

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

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

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

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

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

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

Changes to the automotive industry and consumer views on car ownership could materially adversely affect our business, results of operations, financial condition and cash flows.

The automotive industry is predicted to experience rapid change in the years to come, including increases in ride-sharing services, advances in electric vehicle production and driverless technology. Ride-sharing services such as Uber and Lyft provide consumers with mobility options outside of the traditional car ownership and lease alternatives. The overall impact of these options on the automotive industry is uncertain, and may include lower levels of new vehicle sales. Manufacturers continue to invest in increasing production and quality of BEVs (battery-electric vehicles), which generally require less maintenance than traditional cars and trucks. The effects of BEVs on the automotive industry are uncertain and may include reduced parts and service revenues, as well as changes in the level of sales of certain F&I products such as extended warranty and lifetime lube, oil and filter contracts. Technological advances are also facilitating the development of driverless vehicles. The eventual timing of availability of driverless vehicles is uncertain due to regulatory requirements, technological hurdles, and uncertain consumer acceptance of these technologies. The effect of driverless vehicles on the automotive industry is uncertain and could include changes in the level of new and used vehicle sales, the price of new vehicles, and the role of franchised dealers, any of which could materially and adversely affect our business.

Changes to the retail delivery model and increased digital retailer competition could adversely affect our business, results of operations, financial condition and cash flows.

The automotive industry is beginning to experience change and disruption in the retail delivery model, including growing competition in the used vehicle market from companies with a primarily online business model. Competition in this market includes companies such as Carvana, Vroom and Shift. In addition, larger traditional automotive retailers are also moving in this direction, providing consumers with vehicle purchasing experiences outside of the traditional brick and mortar automotive dealership model.

We have certain collaborative relationships and may develop additional relationships with Shift. We continue to develop our nationwide network of service and delivery points with options for our customers to interact with us wherever, whenever and however they choose. We may face increased competition for market share with these other delivery models and digital retailers over time which could materially and adversely affect our results of operations.

A decline of available financing in the lending market may adversely affect our vehicle sales volume.

A significant portion of buyers finance their vehicle purchases. One of the primary finance sources used by consumers in connection with the purchase of a new or used vehicle is the manufacturer captive finance company. These captive finance companies rely, to a certain extent, on the public debt markets to provide the capital necessary to support their financing programs. In addition, the captive finance companies will occasionally change their loan underwriting criteria to alter the risk profile of their loan portfolio. In addition, sub-prime lenders have historically provided financing for consumers who, for a variety of reasons, including poor credit histories and lack of down payment, do not have access to more traditional finance sources. If lenders tighten their credit standards or there is a decline in the

availability of credit in the lending market, the ability of consumers to purchase vehicles could be limited, which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

We depend on our manufacturers to provide a supply of vehicles which supports expected sales levels. Events that adversely affect a manufacturer's ability to timely deliver new vehicles may adversely affect us by reducing our supply of popular new vehicles, leading to lower sales in our stores during those periods than would otherwise occur. We depend on our manufacturers to deliver high-quality, defect-free vehicles. If manufacturers experience quality issues, our financial performance may be adversely impacted. In addition, the discontinuance of a particular brand could negatively impact our revenues and profitability.

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

We are subject to a concentration of risk in the event of financial distress, including potential reorganization or bankruptcy, of a major vehicle manufacturer. We purchase substantially all of our new vehicles from various manufacturers or distributors at the prevailing prices available to all franchised dealers. Our sales volume could be materially adversely impacted by the manufacturers' or distributors' inability to supply our stores with an adequate supply of vehicles.

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

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

Federal regulations around fuel economy standards and "greenhouse gas" emissions have continued to increase. New requirements may adversely affect any manufacturer's ability to profitably design, market, produce and distribute vehicles that comply with such regulations. We could be adversely impacted in our ability to market and sell these vehicles at affordable prices and in our ability to finance these inventories. These regulations could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

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

- customer rebates;
- dealer incentives on new vehicles;
- special financing rates on certified, pre-owned cars; and
- below-market financing on new vehicles and special leasing terms.

Our financial condition could be materially adversely impacted by a discontinuation or change in our manufacturers' or distributors' incentive programs. In addition, certain manufacturers use criteria such as a dealership's manufacturer-determined customer satisfaction index ("CSI" score), facility image compliance, employee training, digital marketing and parts purchase programs as factors governing participation in incentive programs. To the extent

we do not meet minimum score requirements, we may be precluded from receiving certain incentives, which could materially adversely affect our business, results of operations, financial condition and cash flows.

Franchised automotive retailers perform factory authorized service work and sell original replacement parts on vehicles covered by warranties issued by the automotive manufacturer. For the year ended December 31, 2018, approximately 24% of our service, body and parts revenue was for work covered by manufacturer warranties or manufacturer-sponsored maintenance services. To the extent a manufacturer reduces the labor rates or markup of replacement parts for such warranty work, our service, body and parts sales volume could be adversely affected.

The ability of our stores to make new vehicle sales depends in large part upon the manufacturers and, therefore, any disruption or change in our relationships could impact our business.

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

Each of our stores operates pursuant to a Franchise Agreement with each of the respective manufacturers for which it serves as franchisee. Each of our stores may obtain new vehicles from manufacturers, service vehicles, sell new vehicles, and display vehicle manufacturers' brand only to the extent permitted under these agreements. As a result of the terms of our Franchise Agreements, manufacturers exert significant control over the day-to-day operations at our stores. Such agreements contain provisions for termination or non-renewal for a variety of causes, including service retention, facility compliance, customer satisfaction and sales and financial performance. From time to time, certain of our stores have failed to comply with certain provisions of their Franchise Agreements, and we cannot ensure that our stores will be able to comply with these provisions in the future.

Our Franchise Agreements expire at various times, and there can be no assurances that we will be able to renew these agreements on a timely basis or on acceptable terms or at all. Actions taken by a manufacturer to exploit its bargaining position in negotiating the terms of renewals of Franchise Agreements or otherwise could also have a material adverse effect on our revenues and profitability. If a manufacturer terminates or fails to renew one or more of our significant Franchise Agreements or a large number of our Franchise Agreements, such action could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

Our Franchise Agreements do not give us the exclusive right to a given geographic area. Manufacturers may be able to establish new franchises or relocate existing franchises, subject to applicable state franchise laws. The establishment of or relocation of franchises in our markets could have a material adverse effect on the business, financial condition and results of operations of our stores in the market in which the action is taken.

Manufacturer stock ownership requirements and restrictions may impair our ability to maintain or renew Franchise Agreements or issue additional equity.

Certain of our Franchise Agreements prohibit transfers of ownership interests of a store or, in some cases, the ownership interests of the store's indirect parent companies, including the Company. Agreements with various manufacturers, including, among others, Honda/Acura, Hyundai, Mazda, Volkswagen, Mercedes-Benz, Subaru, Toyota, Ford/Lincoln, GM, and Nissan, provide that, under certain circumstances, we may lose a franchise and/or be forced to sell one or more stores or their assets if there occurs a prohibited transfer of ownership interests (in some cases not defined or defined ambiguously) or a person or entity acquires an ownership interest in us above a specified level (ranging from 20% to 50% depending on the particular manufacturer's restrictions and falling as low as 5% if another vehicle manufacturer or distributor is the entity acquiring the ownership interest) without the approval of the manufacturer. Transactions in our stock by our shareholders or prospective shareholders, including transactions in our Class B common stock, are generally outside of our control and may result in the termination or non-renewal of one or more of our franchises, may result in a forced sale of one or more of our stores or their assets at a price below fair market value or may impair our ability to negotiate new Franchise Agreements for dealerships we desire to acquire in the future, which may have a material adverse effect on our business, results of operations, financial condition and

cash flows. These restrictions may also prevent or deter a prospective acquirer from acquiring control of us or otherwise adversely affect the market price of our Class A common stock or limit our ability to restructure our debt obligations.



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

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

In addition, these laws restrict the ability of automobile manufacturers to directly enter the retail market in the future. Manufacturer lobbying efforts (including those of Tesla) may lead to the repeal or revision of these laws. If manufacturers obtain the ability to directly retail vehicles and do so in our markets, such competition could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

Import product restrictions, currency valuations, and foreign trade risks may impair our ability to sell foreign vehicles or parts profitably.

A significant portion of the vehicles we sell are manufactured outside the U.S., and all of the vehicles we sell include parts manufactured outside the U.S. As a result, our operations are subject to customary risks of importing merchandise, including currency fluctuation, import duties, exchange rates, trade restrictions, work stoppages, transportation costs, natural or man-made disasters, and general political and socio economic conditions in other countries. The U.S. or the countries from which our products are imported, may, from time to time, impose new quotas, duties, tariffs or other restrictions, or adjust presently prevailing quotas, duties or tariffs, which may affect our operations and our ability to purchase imported vehicles and/or parts at reasonable prices. Changes in U.S. trade policies, including the U.S.-Mexico-Canada Agreement or policies intended to penalize foreign manufacturing or imports, and policies of foreign countries in reaction to those changes, could increase the prices we pay for some of the new vehicles and parts we sell. Any changes that increase the costs of vehicles and parts generally, to the extent passed on to customers, could negatively affect customer demand and our revenues and profitability. If not passed on to our customers, any cost increases will adversely affect our profitability. Any cost increase that disproportionately applies to manufacturers that sell to us could adversely affect our business compared to other automobile retailers.

Our operations are subject to extensive governmental laws and regulations. If we are found to be in purported violation of or subject to liabilities under any of these laws, or if new laws or regulations are enacted that adversely affect our operations, our business, operating results, and prospects could suffer.

We are subject to federal, state and local laws and regulations in the 18 states in which we operate, such as those relating to franchising, motor vehicle sales, retail installment sales, leasing, finance and insurance, marketing, licensing, consumer protection, consumer privacy, escheatment, anti-money laundering, environmental, vehicle emissions and fuel economy, and health and safety. In addition, with respect to employment practices, we are subject to various laws and regulations, including complex federal, state and local wage and hour and anti-discrimination laws. New laws and regulations are enacted on an ongoing basis. With the number of stores we operate, the number of personnel we employ and the large volume of transactions we handle, it is likely that technical mistakes will be made.

These regulations affect our profitability and require ongoing training. Current practices in stores may become prohibited. We are responsible for ensuring that continued compliance with laws is maintained. If there are unauthorized activities, the state and federal authorities have the power to impose civil penalties and sanctions, suspend or withdraw dealer licenses or take other actions. These actions could materially impair our activities or our ability to acquire new stores in those states where violations occurred. Further, private causes of action on behalf of individuals or a class of individuals could result in significant damages or injunctive relief.

We may be involved in legal proceedings arising from the conduct of our business, including litigation with customers, employee-related lawsuits, class actions, purported class actions and actions brought by governmental authorities. Claims arising out of actual or alleged violations of law may be asserted against us or any of our dealers by individuals, either individually or through class actions, or by governmental entities in civil or criminal investigations and proceedings. Such actions may expose us to substantial

monetary damages and legal defense costs, injunctive relief, criminal and civil fines and penalties and damage our reputation and sales.

Our financing activities are subject to federal truth-in-lending, consumer leasing and equal credit opportunity laws and regulations, as well as state and local motor vehicle finance laws, installment finance laws, insurance laws, usury laws and other installment sales laws and regulations. Some states regulate finance, documentation and administrative fees that may be charged in connection with vehicle sales. In recent years, private plaintiffs and state attorneys general in the U.S. have increased their scrutiny of advertising, sales, and finance and insurance activities in the sale and leasing of motor vehicles. These activities have led many lenders to limit the amounts that may be charged to customers as fee income for these activities. If these or similar activities were to significantly restrict our ability to generate revenue from arranging financing for our customers, we could be adversely affected.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was signed into law on July 21, 2010, established the Consumer Financial Protection Bureau (the "CFPB"), a new independent federal agency funded by the U.S. Federal Reserve with broad regulatory powers and limited oversight from the U.S. Congress. Although automotive dealers are generally excluded, the Dodd-Frank Act has led to additional, indirect regulation of automotive dealers, in particular, their sale and marketing of finance and insurance products, through its regulation of automotive finance companies and other financial institutions. In March 2013, the CFPB issued supervisory guidance highlighting its concern that the practice of automotive dealers being compensated for arranging customer financing through discretionary markup of wholesale rates offered by financial institutions ("dealer markup") results in a significant risk of pricing disparity in violation of The Equal Credit Opportunity Act (the "ECOA"). The CFPB recommended that financial institutions under its jurisdiction take steps to ensure compliance with the ECOA, which may include imposing controls on dealer markup, monitoring and addressing the effects of dealer markup policies, and eliminating dealer discretion to markup buy rates and fairly compensating dealers using a different mechanism that does not result in disparate impact to certain groups of consumers.

Our marketing and disclosure regarding the sale and servicing of vehicles is regulated by federal, state and local agencies including the Federal Trade Commission ("FTC") and state attorneys general. For example, in January 2016, we settled FTC allegations that we did not adequately disclose information about used vehicles with open safety recalls. Under the settlement, we did not make any payments or admit wrong-doing, but we did agree to make specified disclosures on our website and to provide that disclosure to certain customers who had previously purchased a used vehicle from us.

If we or any of our employees at any individual dealership violate or are alleged to violate laws and regulations applicable to them or protecting consumers generally, we could be subject to individual claims or consumer class actions, administrative, civil or criminal investigations or actions and adverse publicity. Such actions could expose us to substantial monetary damages and legal defense costs, injunctive relief and criminal and civil fines and penalties, including suspension or revocation of our licenses and franchises to conduct dealership operations.

Environmental laws and regulations govern, among other things, discharges into the air and water, storage of petroleum substances and chemicals, the handling and disposal of wastes and remediation of contamination arising from spills and releases. In addition, we may also have liability in connection with materials that were sent to third-party recycling, treatment and/or disposal facilities under federal and state statutes. These federal and state statutes impose liability for investigation and remediation of contamination without regard to fault or the legality of the conduct that contributed to the contamination. Similar to many of our competitors, we have incurred and expect to continue to incur capital and operating expenditures and other costs in complying with such federal and state statutes. In addition, we may be subject to broad liabilities arising out of contamination at our currently and formerly owned or operated facilities, at locations to which hazardous substances were transported from such facilities, and at such locations related to entities formerly affiliated with us. Although for some such potential liabilities we believe we are entitled to indemnification from other entities, we cannot assure you that such entities will view their obligations as

we do or will be able or willing to satisfy them. Failure to comply with applicable laws and regulations, or significant additional expenditures required to maintain compliance therewith, may have a material adverse effect on our business, results of operations, financial condition, cash flows and prospects.

Breaches in our data security systems or in systems used by our vendor partners, including cyber-attacks or unauthorized data distribution by employees or affiliated vendors, or disruptions to access and connectivity of our information systems could impact our operations or result in the loss or misuse of customers' proprietary information.

Our information technology systems are important to operating our business efficiently. We employ information technology systems, including websites, that allow for the secure handling and processing of customers' proprietary information. The failure of our information technology systems, and those of our partner software and technology vendors, to perform as we anticipate could disrupt our business and could expose us to a risk of loss or misuse of this information, litigation and potential liability.

We collect, process, and retain personally identifiable information regarding customers, associates and vendors in the normal course of our business. Our internal and third-party systems are under a moderate level of risk from hackers or other individuals with malicious intent to gain unauthorized access to our systems. Cyber-attacks are growing in number and sophistication thus presenting an ongoing threat to systems, whether internal or external, used to operate the business on a day-to-day basis. We invest in reasonable commercial security technology to protect our data and business processes against many of these risks. We also purchase insurance to mitigate the potential financial impact of many of these risks. Despite the security measures we have in place, our facilities and systems, and those of our third-party service providers, could be vulnerable to security breaches, computer viruses, lost or misplaced data, programming errors, human errors, acts of vandalism, or other events. Any security breach or event resulting in the misappropriation, loss, or other unauthorized disclosure of confidential information, or degradation of services provided by critical business systems, whether by us directly or our third-party service providers, could adversely affect our business operations, sales, reputation with current and potential customers, associates or vendors, as well as other operational and financial impacts derived from investigations, litigation, imposition of penalties or other means.

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

#### General

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

#### Manufacturers

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

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

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

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

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

#### Acquisition Risks

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

• failing to assimilate the operations and personnel of acquired dealerships;

• straining our existing systems, procedures, structures and personnel;

• failing to achieve predicted sales levels;

• incurring significantly higher capital expenditures and operating expenses, which could substantially limit our operating or financial flexibility;

• entering new, unfamiliar markets;

• encountering undiscovered liabilities and operational difficulties at acquired dealerships;

• disrupting our ongoing business;

• diverting our management resources;

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

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

#### Consummation and Competition

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

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

#### Operating and Financial Condition

Although we conduct what we believe to be a prudent level of investigation, an unavoidable level of risk remains regarding the actual operating condition of acquired stores and we may not have an accurate understanding of each acquired store's financial condition and performance. Similarly, most of the dealerships we acquire do not have financial statements audited or prepared in accordance with U.S. generally accepted accounting principles. We may not have an accurate understanding of the historical financial condition and performance of our acquired businesses. Until we assume control of the business, we may not be able to ascertain the actual value or understand the potential liabilities of the acquired businesses and their earnings potential. These risks may not be adequately mitigated by the indemnification obligations we negotiated with sellers.

#### Limitations on Our Capital Resources

We make a substantial capital investment when we acquire dealerships. Limitations on our capital resources would restrict our ability to complete new acquisitions or could limit our operating or financial flexibility.

We finance acquisitions activity with cash flows from our operations, borrowings under our credit arrangements, proceeds from our offering of senior notes, proceeds from mortgage financing and the issuance of shares of Class A common stock. The size of our acquisition activity in recent years magnifies risks associated with debt service obligations. These risks include potential lower earnings per share, our inability to pay dividends and potential negative impacts to the debt covenants we negotiated under our credit agreement.

If we fail to meet the covenants in our credit facility or our senior notes indenture, or if some other event occurs that results in a default or an acceleration of our repayment obligations under our debt instruments, we may not be able to refinance our debt on terms acceptable to us or at all. We may not be able to obtain financing in the future due to the market price of our Class A common stock and overall market conditions. Additionally, a substantial amount of assets of our dealerships are pledged to secure the indebtedness under our credit facility and our other floor plan financing indebtedness. These pledges may limit our ability to borrow from other sources in order to fund our acquisitions.

Goodwill and other intangible assets comprise a significant portion of our total assets. We must test our goodwill and other intangible assets for impairment at least annually, which could result in a material, non-cash write-down of goodwill or franchise rights and could materially adversely affect our business, results of operations, and financial condition.

Goodwill and indefinite-lived intangible assets are subject to impairment assessments at least annually (or more frequently when events or changes in circumstances indicate that an impairment may have occurred) by applying a fair-value based test. Our principal intangible assets are goodwill and our rights under our Franchise Agreements with vehicle manufacturers. A decrease in our market capitalization or profitability increases the risk of goodwill impairment. Negative or declining cash flows or a decline in actual or planned revenues for our stores increases the risk of franchise rights impairment. An impairment loss could have a



material adverse effect on our business, results of operations, financial condition and cash flows. As of December 31, 2018, our balance sheet reflected carrying amounts of \$434.9 million in goodwill, and \$288.7 million in franchise value.

We are subject to substantial risk of loss under our various self-insurance programs including property and casualty, open lot vehicle coverage, workers' compensation and employee medical coverage. Our insurance does not fully cover all of our operational risks, and changes in the cost of insurance or the availability of insurance could materially increase our insurance costs or result in a decrease in our insurance coverage.

We have a significant concentration of our property values at each dealership location, including vehicle and parts inventories and our facilities. Natural disasters and severe weather events (such as hurricanes, earthquakes, fires, floods, landslides and wind or hail storms) or other extraordinary events subject us to property loss and business interruption. Illegal or unethical conduct by employees, customers, vendors and unaffiliated third parties can also impact our business. Other potential liabilities arising out of our operations may involve claims by employees, customers or third parties for personal injury or property damage and potential fines and penalties in connection with alleged violations of regulatory requirements.

Under our self-insurance programs, we retain various levels of aggregate loss limits, per claim deductibles and claims-handling expenses. Costs in excess of these retained risks may be insured under various contracts with third-party insurance carriers. As of December 31, 2018, we had total reserve amounts associated with these programs of \$39.9 million.

The level of risk we retain may change in the future as insurance market conditions or other factors affecting the economics of our insurance purchasing change. The operation of automobile dealerships is subject to a broad variety of risks. In certain instances, our insurance may not fully cover an insured loss depending on the magnitude and nature of the claim. Accordingly, we cannot assure that we will not be exposed to uninsured or underinsured losses that could have a material adverse effect on our business, financial condition, results of operations or cash flows. Additionally, changes in the cost of insurance or the availability of insurance in the future could substantially increase our costs to maintain our current level of coverage or could cause us to reduce our insurance coverage and increase the portion of our risks that we self-insure.

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

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

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

In addition, our loan agreements and our senior note indenture contain covenants that limit our discretion with respect to business matters, including incurring additional debt, granting additional security interests in our assets, acquisition activity, disposing of assets and other business matters. Other covenants are financial in nature, including current ratio, fixed charge coverage and leverage ratio calculations. A breach of any of these covenants could result in a default under the applicable agreement. In addition, a default under one agreement could result in a default and

acceleration of our repayment obligations under the other agreements under the cross-default provisions in such other agreements.

We have granted in favor of certain of our lenders and other secured parties, including those under our \$2.6 billion revolving syndicated credit facility, a security interest in a substantial portion of our assets. If we default on our obligations under those agreements, the secured parties may be able to foreclose upon their security interests and otherwise be entitled to obtain or control those assets.

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

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

In addition, the lenders' obligations to make loans or other credit accommodations under certain credit agreements is subject to the satisfaction of certain conditions precedent including, for example, that our representations and warranties in the agreement are true and correct in all material respects as of the date of the proposed credit extension. If any of our representations and warranties in those agreements are not true and correct in all material respects as of the date of a proposed credit extension, or if other conditions precedent are not satisfied, we may not be able to request new loans or other credit accommodations under those credit facilities, which could have a material adverse impact on our business, results of operations, financial condition and cash flows.

Additionally, our real estate debt generally has a five to ten-year term, after which the debt needs to be renewed or replaced. A decline in the appraised value of real estate or a reduction in the loan-to-value lending ratios for new or renewed real estate loans could result in our inability to renew maturing real estate loans at the debt level existing at maturity, or on terms acceptable to us, requiring us to find replacement lenders or to refinance at lower loan amounts.

As of December 31, 2018, 79% of our total debt was variable rate. The majority of our variable rate debt is indexed to the one-month LIBOR rate. The current interest rate environment is at historically low levels, and interest rates will likely increase in the future. In the event interest rates increase, our borrowing costs may increase substantially. Additionally, fixed rate debt that matures may be renewed at interest rates significantly higher than current levels. As a result, this could have a material adverse impact on our business, results of operations, financial condition and cash flows.

We may not be able to satisfy our debt obligations upon the occurrence of a change in control under our debt instruments.

Upon the occurrence of a change in control as defined in our credit agreement, the agent under the credit agreement will have the right to declare all outstanding obligations immediately due and payable and to terminate the availability of future advances to us. Upon the occurrence of a change in control, as defined in our senior notes indenture, the holders of our senior notes will have the right to require us to purchase all or any part of such holders' notes at a price equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any. There can be no assurance that we would have sufficient resources available to satisfy all of our obligations under the credit agreement in the event of a change in control or fundamental change. In the event we were unable to satisfy these obligations, it could have a material adverse impact on our business and our common stock holders. A "change in control" as defined in our credit agreement includes, among other events, the acquisition by any person, or two or more persons acting in concert, in either case other than Lithia Holdings Company, L.L.C., Sid DeBoer or Bryan DeBoer, of beneficial ownership (within the meaning of Rule 13d-3 of the SEC under the Securities Exchange Act of 1934) of 20% or more of the outstanding shares of our voting stock on a fully diluted basis.

We have a significant relationship with a third-party warranty insurer and administrator. This third-party is the obligor of service warranty policies sold to our customers. Additionally, we have agreements in place that allow for future income based on the claims experience on policies sold to our customers.

We sell service warranty policies to our customers issued by a third-party obligor. We receive additional fee income if actual claims are less than the amounts reserved for anticipated claims and the costs of administration and administrator profit.

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

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

Our success depends to a significant degree on the efforts and abilities of our senior management. Further, we have identified Bryan B. DeBoer in most of our store Franchise Agreements as the individual who controls the franchises and upon whose financial resources and management expertise the manufacturers may rely when awarding or approving the transfer of any franchise. If we lose these key personnel, our business may suffer.

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

Investments in start-up companies may be risky and may negatively affect our business, results of operations, financial condition and cash flows.

We recently entered into a strategic partnership with Shift, a San Francisco-based start-up company, by investing \$54 million, leading their Series D fundraising round. Additionally, we have the ability to increase our ownership through successful execution of operational, collaborative milestones. These milestones may involve activities such as jointly participating in agreements or sharing data and technology with Shift. As a start-up company, Shift has a lack of operating history, is not subject to Sarbanes-Oxley regulations and may lack financial controls and procedures often found at public companies. There can be no guarantees that Shift will achieve profitability, raise sufficient funds for operations or continue to successfully develop their technology platform. Additionally, start-up companies often face risk from lawsuits and regulations. Our investment is subject to potential impairment if there are indications of an other-than-temporary decline in value and our strategic partnership may expose us to additional risk. There is no guarantee we will receive a return on our investment. These conditions may adversely affect our business, results of operations, financial condition and cash flow.

Risks related to investing in our Class A common stock

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

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

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our stores and other facilities consist primarily of automobile showrooms, display lots, service facilities, collision repair and paint shops, supply facilities, automobile storage lots, parking lots and offices located in the states listed under the caption Overview in Item 1. We believe our facilities are currently adequate for our needs and are in good repair. Some of our facilities do not currently meet manufacturer image or size requirements and we are actively working to find a mutually acceptable outcome in terms of timing and overall cost. We own our corporate headquarters in Medford, Oregon, and numerous other properties used in our operations. Certain of our owned properties are mortgaged. As of December 31, 2018, we had outstanding mortgage debt of \$592.3 million. We also lease certain properties, providing future flexibility to relocate our retail stores as demographics, economics, traffic patterns or sales methods change. Most leases provide us the option to renew the lease for one or more lease extension periods. We also hold certain vacant facilities and undeveloped land for future expansion.

Our corporate headquarters is LEED certified and incorporates roof-mounted solar panels to offset energy usage. Two of our stores are also LEED certified and we have completed solar projects at four others. Our stores also integrate energy-saving practices and materials. This includes practices such as recycling used tires, used engine oil and used oil filters; the use of waste oil heaters and carwash reclaim systems; using biodegradable products in our detail services; upgrading to energy efficient LED lighting and installing electric vehicle charging stations.

Item 3. Legal Proceedings

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 will have a material adverse effect on our business, results of operations, financial condition, or cash flows, we cannot predict this with certainty.

Item 4. Mine Safety Disclosure

Not applicable.

## PART II

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

Our Class A common stock trades on the New York Stock Exchange under the symbol LAD.

The number of shareholders of record and approximate number of beneficial holders of Class A common stock as of February 22, 2019 was 502 and 28,356, respectively. All shares of Lithia's Class B common stock are held by Lithia Holding Company, LLC. Sidney B. DeBoer Trust U.T.A.D. January 30, 1997 (the "Trust") is the manager of Lithia Holding Company, L.L.C., and Sidney DeBoer, as the trustee of the Trust, has the authority to vote all of the issued and outstanding shares of our Class B common stock.

At the special meeting of shareholders held on January 21, 2019, Sidney B. DeBoer and the Company executed a Class B Conversion Agreement pursuant to which Mr. DeBoer agreed to cause all of the remaining 1,000,000 shares of our class B common stock to be converted into shares of our class A common stock by December 31, 2025. The Class B Conversion Agreement will require the conversion of at least 15% of the 1,000,000 class B shares by the end of every two years, with the first 15% to be converted by December 31, 2020, a total of 30% by December 31, 2022, a total of 45% by December 31, 2024, and the balance by December 31, 2025.

## Equity Compensation Plan Information

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

## Recent Sale of Unregistered Securities

On May 1, 2017, we agreed to issue 22,446 shares of Class A common stock to Lee W. Baierl as partial consideration for the purchase of Northland Ford, Inc., an entity we acquired in connection with our acquisition of the Baierl Auto Group. Under the agreement, we issued 4,489 shares to Mr. Baierl on both May 1, 2017 and January 1, 2018. We will issue 4,489 additional shares to him on each of January 1, 2019 and 2020; on January 1, 2021, we will issue to him the final 4,490 shares. The shares were issued to Mr. Baierl, an accredited investor, in a transaction exempt from Section 4(a)(2) of the Securities Act of 1933.

## Repurchases of Equity Securities

We made the following repurchases of our common stock during the fourth quarter of 2018:

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan <sup>(1)</sup>	Maximum dollar value of shares that may yet be purchased under publicly announced plan (in thousands) <sup>(1)</sup>
October	423,863	\$ 76.85	423,863	\$ 268,318
November	165	90.06	—	268,318
December	489,329	70.96	489,250	233,603
Total <sup>(2)</sup>	913,357	73.70	913,113	233,603

<sup>(1)</sup> In February 2016, our Board of Directors authorized the repurchase of up to \$250 million of our Class A common stock. In October 2018, our Board of Directors authorized the repurchase of up to an additional \$250 million of our Class A common stock. Through December 31, 2018, we have repurchased 3,155,095 shares at an average price of



\$84.43 per share. This authority to repurchase shares does not have an expiration date.

(2) Includes 244 shares repurchased in association with tax withholdings on the vesting of RSUs.

Stock Performance Graph

The following line-graph shows the annual percentage change in the cumulative total returns for the past five years on an assumed \$100 initial investment and reinvestment of dividends, on (a) Lithia Motors, Inc.'s Class A common stock; (b) the Russell 2000; and (c) an auto peer group index composed of Penske Automotive Group, AutoNation, Sonic Automotive, Group 1 Automotive, and Asbury Automotive Group, the only other comparable publicly traded automobile dealerships in the United States as of December 31, 2018. The peer group index utilizes the same methods of presentation and assumptions for the total return calculation as does Lithia Motors and the Russell 2000. All companies in the peer group index are weighted in accordance with their market capitalizations.

Company/Index	Base Period	Indexed Returns for the Year Ended				
		12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
Lithia Motors, Inc.	\$100.00	\$ 125.90	\$ 156.02	\$ 143.26	\$ 169.83	\$ 115.54
Auto Peer Group	100.00	119.04	109.25	107.16	105.38	84.37
Russell 2000	100.00	104.90	100.27	121.63	139.45	124.09

## Item 6. Selected Financial Data

You should read the Selected Financial Data in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," our Consolidated Financial Statements and Notes thereto and other financial information contained elsewhere in this Annual Report on Form 10-K.

(In millions, except per share amounts)

	Year Ended December 31,				
Consolidated Statements of Operations Data:	2018	2017	2016	2015	2014
<b>Revenues:</b>					
New vehicle	\$6,602.8	\$5,763.6	\$4,938.4	\$4,552.3	\$3,077.7
Used vehicle retail	3,079.0	2,544.4	2,227.0	1,927.0	1,362.5
Used vehicle wholesale	331.3	277.8	276.6	261.5	195.7
Finance and insurance	454.8	385.9	330.9	283.0	190.4
Service, body and parts	1,222.3	1,015.8	844.5	739.0	512.1
Fleet and other	131.2	99.0	60.8	101.5	51.9
Total revenues	\$11,821.4	\$10,086.5	\$8,678.2	\$7,864.3	\$5,390.3
<b>Gross Profit:</b>					
New vehicle	\$385.1	\$339.8	\$289.4	\$280.4	\$198.2
Used vehicle retail	322.9	286.8	263.7	241.2	179.3
Used vehicle wholesale	5.5	4.8	4.3	4.5	3.6
Finance and insurance	454.8	385.9	330.9	283.0	190.4
Service, body and parts	600.7	493.1	410.3	363.9	249.7
Fleet and other	8.0	5.7	2.7	2.6	2.1
Total gross profit	\$1,777.0	\$1,516.1	\$1,301.3	\$1,175.6	\$823.3
Operating income <sup>(1)(2)</sup>	\$447.0	\$409.0	\$338.4	\$302.7	\$231.9
Income from continuing operations before income taxes <sup>(1)</sup>	\$337.5	\$347.1	\$283.5	\$262.7	\$210.5
Income from continuing operations <sup>(1)</sup>	\$265.7	\$245.2	\$197.1	\$183.0	\$135.5
Basic income per share from continuing operations	\$10.91	\$9.78	\$7.76	\$6.96	\$5.19
Basic income per share from discontinued operations	—	—	—	—	0.12
Basic net income per share	\$10.91	\$9.78	\$7.76	\$6.96	\$5.31
Shares used in basic per share	24.4	25.1	25.4	26.3	26.1
Diluted income per share from continuing operations	\$10.86	\$9.75	\$7.72	\$6.91	\$5.14
Diluted income per share from discontinued operations	—	—	—	—	0.12
Diluted net income per share	\$10.86	\$9.75	\$7.72	\$6.91	\$5.26
Shares used in diluted per share	24.5	25.1	25.5	26.5	26.4
Cash dividends paid per common share	\$1.14	\$1.06	\$0.95	\$0.76	\$0.61

(In millions)	As of December 31,				
	2018	2017	2016	2015	2014
Consolidated Balance Sheets Data:					
Working capital	\$497.9	\$481.8	\$365.2	\$288.0	\$172.9
Inventories	2,365.3	2,132.7	1,772.6	1,471.0	1,249.7
Total assets	5,384.0	4,683.1	3,844.2	3,225.1	2,879.1
Floor plan notes payable	2,057.7	1,919.1	1,601.5	1,314.0	1,178.6
Long-term debt, including current maturities	1,384.1	1,047.4	790.9	643.2	639.1
Total stockholders' equity	1,197.2	1,083.2	910.8	828.1	673.1

Includes \$1.3 million, \$14.0 million, \$20.1 million and \$1.9 million in non-cash charges related to asset impairments for the years ended 2018, 2016, 2015 and 2014 respectively. We did not record any non-cash charges related to asset impairments in 2017. See Notes 1, 4 and 17 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

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

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

### Overview

We are one of the largest automotive franchises in the United States and as of 2018 were ranked #294 on the Fortune 500. As of February 22, 2019, we offered 28 brands of new vehicles and all brands of used vehicles in 182 stores in the United States and online at over 200 websites. We offer a wide range of products and services including new and used vehicles, finance and insurance products and automotive repair and maintenance.

During the year ended December 31, 2018, we had net income of \$265.7 million, or \$10.86 per diluted share, compared to net income of \$245.2 million, or \$9.75 per diluted share, during 2017. We experienced growth of revenue and gross profit in all major business lines in 2018 compared to 2017, primarily driven by increases in volume related to acquisitions, complimented by organic growth in used vehicles, finance and insurance and service, body and parts sales. On a same store basis, new vehicle revenues and gross profits experienced headwinds with plateauing national new vehicle sales and declining manufacturer incentives. For the year ended December 31, 2018, new vehicle sales accounted for approximately 56% of our revenue and approximately 22% of our gross profit. Used vehicle retail sales accounted for approximately 26% of our revenue and approximately 18% of our gross profit. Our parts and service and finance and insurance operations accounted for approximately 14% of our revenue and contributed approximately 59% of our gross profit.

We had total available liquidity of \$211.2 million as of December 31, 2018, which consisted of \$31.6 million of cash and cash equivalents and \$179.6 million of availability on our credit facilities, with an estimated additional \$247.7 million available if we financed our unencumbered owned real estate. For further discussion of our liquidity, please refer to "Liquidity and Capital Resources" below.

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Results of Operations

For the year ended December 31, 2018, we reported net income of \$265.7 million, or \$10.86 per diluted share. For the years ended December 31, 2017 and 2016, we reported net income of \$245.2 million, or \$9.75 per diluted share, and \$197.1 million, or \$7.72 per diluted share, respectively.

(\$ in millions, except per vehicle data)	Years Ended December 31,							
	2018	2017	2018 vs. 2017		2016	2017 vs. 2016		
			Change	%		Change	%	
<b>Revenues</b>								
New vehicle	\$6,602.8	\$5,763.6	\$839.2	14.6 %	\$4,938.4	\$825.2	16.7 %	
Used vehicle retail	3,079.0	2,544.4	534.6	21.0	2,227.0	317.4	14.3	
Finance and insurance	454.8	385.9	68.9	17.9	330.9	55.0	16.6	
Service, body and parts	1,222.3	1,015.8	206.5	20.3	844.5	171.3	20.3	
<b>Total Revenues</b>	<b>11,821.4</b>	<b>10,086.5</b>	<b>1,734.9</b>	<b>17.2</b>	<b>8,678.2</b>	<b>1,408.3</b>	<b>16.2</b>	
<b>Gross profit</b>								
New vehicle	\$385.1	\$339.8	\$45.3	13.3 %	\$289.4	\$50.4	17.4 %	
Used vehicle retail	322.9	286.8	36.1	12.6	263.7	23.1	8.8	
Finance and insurance	454.8	385.9	68.9	17.9	330.9	55.0	16.6	
Service, body and parts	600.7	493.1	107.6	21.8	410.3	82.8	20.2	
<b>Total Gross Profit</b>	<b>1,777.0</b>	<b>1,516.1</b>	<b>260.9</b>	<b>17.2</b>	<b>1,301.3</b>	<b>214.8</b>	<b>16.5</b>	
<b>Gross profit margins</b>								
New vehicle	5.8	% 5.9	%	-10 bp	5.9	%	0 bp	
Used vehicle retail	10.5	11.3		-80 bp	11.8		-50 bp	
Finance and insurance	100.0	100.0		0 bp	100.0		0 bp	
Service, body and parts	49.1	48.5		60 bp	48.6		-10 bp	
<b>Total Gross Profit Margin</b>	<b>15.0</b>	<b>15.0</b>		<b>0 bp</b>	<b>15.0</b>		<b>0 bp</b>	
<b>Retail units sold</b>								
New vehicles	184,601	167,146	17,455	10.4 %	145,772	21,374	14.7 %	
Used vehicles	151,234	129,913	21,321	16.4	113,498	16,415	14.5	
<b>Average selling price per retail unit</b>								
New vehicles	\$35,768	\$34,482	\$1,286	3.7 %	\$33,878	\$604	1.8 %	
Used vehicles	20,359	19,585	774	4.0	19,621	(36 )	(0.2 )	
<b>Average gross profit per retail unit</b>								
New vehicles	\$2,086	\$2,033	\$53	2.6 %	\$1,985	\$48	2.4 %	
Used vehicles	2,135	2,208	(73 )	(3.3 )	2,323	(115 )	(5.0 )	
Finance and insurance	1,354	1,299	55	4.2	1,276	23	1.8	

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Same Store Operating Data

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. Therefore, we have integrated same store measures 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 November 2017 would be included in same store operating data beginning in December 2018, after its first complete comparable month of operations. The fourth quarter operating results for the same store comparisons would include results for that store in only the period of December for both comparable periods.

(\$ in millions, except per vehicle data)	Years Ended December 31,				2017 vs. 2016			
	2018	2017	Change	%	2017	2016	Change	%
<b>Revenues</b>								
New vehicle	\$5,463.5	\$5,569.4	\$(105.9)	(1.9)%	\$4,826.8	\$4,767.3	\$59.5	1.2 %
Used vehicle retail	2,639.0	2,470.7	168.3	6.8	2,243.8	2,157.7	86.1	4.0
Finance and insurance	390.7	373.6	17.1	4.6	339.1	320.5	18.6	5.8
Service, body and parts	1,021.1	985.6	35.5	3.6	861.6	820.4	41.2	5.0
<b>Total Revenues</b>	<b>9,888.7</b>	<b>9,768.2</b>	<b>120.5</b>	<b>1.2</b>	<b>8,584.6</b>	<b>8,393.7</b>	<b>190.9</b>	<b>2.3</b>
<b>Gross profit</b>								
New vehicle	\$310.9	\$326.8	\$(15.9)	(4.9)%	\$281.4	\$278.2	\$3.2	1.2 %
Used vehicle retail	289.2	280.9	8.3	3.0	261.3	257.6	3.7	1.4
Finance and insurance	390.7	373.6	17.1	4.6	339.1	320.5	18.6	5.8
Service, body and parts	504.6	478.4	26.2	5.5	420.2	398.2	22.0	5.5
<b>Total Gross Profit</b>	<b>1,507.0</b>	<b>1,469.9</b>	<b>37.1</b>	<b>2.5</b>	<b>1,310.6</b>	<b>1,261.7</b>	<b>48.9</b>	<b>3.9</b>
<b>Gross profit margins</b>								
New vehicle	5.7	% 5.9	%	-20 bp	5.8	% 5.8	%	0 bp
Used vehicle retail	11.0	11.4		-40 bp	11.6	11.9		-30 bp
Finance and insurance	100.0	100.0		0 bp	100.0	100.0		0 bp
Service, body and parts	49.4	48.5		90 bp	48.8	48.5		30 bp
<b>Total Gross Profit Margin</b>	<b>15.2</b>	<b>15.0</b>		<b>20 bp</b>	<b>15.3</b>	<b>15.0</b>		<b>30 bp</b>
<b>Retail units sold</b>								
New vehicles	153,600	160,746	(7,146)	(4.4)%	139,652	140,024	(372)	(0.3)%
Used vehicles	130,965	125,789	5,176	4.1	114,465	109,658	4,807	4.4
<b>Average selling price per retail unit</b>								
New vehicles	\$35,570	\$34,647	\$923	2.7 %	\$34,563	\$34,046	\$517	1.5 %
Used vehicles	20,150	19,642	508	2.6	19,602	19,677	(75)	(0.4)
<b>Average gross profit per retail unit</b>								
New vehicles	\$2,024	\$2,033	\$(9)	(0.4)%	\$2,015	\$1,987	\$28	1.4 %
Used vehicles	2,208	2,233	(25)	(1.1)	2,283	2,349	(66)	(2.8)
Finance and insurance	1,373	1,304	69	5.3	1,334	1,284	50	3.9



### New Vehicles

The decrease in same store new vehicle revenues for 2018 compared to 2017 was driven by a decrease in unit volume of 4.4% , partially offset by an increase in average selling prices of 2.7%. As the national new vehicle market plateaus, our stores focus on improving gross profit per new vehicle sold. On a same store basis, gross profit per new vehicle remained flat during 2018 compared to 2017. Our recently acquired stores are also focused on improving gross profit per new vehicle as total company gross profit per unit increased 2.6% during 2018 compared to 2017. Acquisitions during 2018 included six stores each in our import and luxury segments where we have experienced larger increases in gross profit per unit on a same store basis, including increases of 21.8% for Subaru, 11.0% for Mercedes and 1.5% for Toyota, offset by a decrease of 4.2% for Lexus compared to 2017.

The same store new vehicle sales increase in 2017 over 2016 of 1.2% included an increase of 1.5% in average selling prices, partially offset by a 0.3% decrease in volume.

Under our business strategy, we believe that our new vehicle sales create incremental profit opportunities through certain manufacturer incentive programs, provides used vehicle inventory through trade-ins, arranging of third party financing, vehicle service and insurance contracts, future resale of used vehicles acquired through trade-in and parts and service work.

### Used Vehicles

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. We have established a company-wide target of achieving a per store average of 85 used retail units per month. Strategies to achieve this target include reducing wholesale sales and selling the full spectrum of used units, from late model CPO models to vehicles over ten years old. During 2018, our stores sold an average of 69 used vehicles per store per month. This compares to 67 used vehicles per store per month in 2017 and 66 in 2016.

Used vehicle revenues increased 21.0% during 2018 compared to 2017 and 14.3% in 2017 compared to 2016. These increases are due to a combination of increased volume from acquisitions and organic growth in our core and value auto categories at our seasoned stores. Excluding the impact of acquisitions, on a same store basis, used vehicle revenues increased 6.8% during 2018 and included a 4.1% increase in unit volume and a 2.6% increase in average selling price per retail unit compared to 2017. These revenue increases were driven by increases in our core and value auto categories of 12.5% and 5.0%, respectively, offset by a decrease in CPO vehicle revenues of 1.9%. The increase in our core vehicle category includes a 7.9% increase in volume, complimented by a 4.4% increase in average selling price per vehicle. The increase in our value auto category is due to an increase in unit sales of 3.0% and an increase in average selling price per vehicle of 2.0%.

Used vehicle gross profits increased 12.6% during 2018 compared to 2017 and 8.8% in 2017 compared to 2016. On a same store basis, used vehicle gross profit increased 3.0% in 2018 compared to 2017, led by the performance in our core vehicle category with an increase of 10.5%, offset by decreases in our value auto and CPO vehicles of 1.3% and 9.4%, respectively. The increase in our core vehicle category is due to increased volume and increased gross profit per unit. Gross profit per unit in our core vehicle category, which accounted for 52.4% of our used vehicle unit sales in 2018, increased 2.5%, from \$2,333 in 2017 to \$2,391 in 2018. The decrease in same store gross profit in our value auto category is due to a 4.2% decrease in gross profit per unit from \$2,134 in 2017 to \$2,045 in 2018, offset by a 3.0% increase in unit sales. Our CPO category experience declines in both gross profit per unit and volume during 2018 compared to 2017. Gross profit per unit decreased 7.3%, from \$2,127 in 2017 to \$1,971 in 2018 and unit sales decreased 2.1% during the same period.

Used vehicle revenues increased in 2017 compared to 2016 on a same store basis due primarily to an increase in unit volume of 4.4%, partially offset by a decline in average selling prices of 0.4%. Our core and value auto categories



experienced increased revenues of 6.7% and 10.1%, respectively, in 2017 compared to 2016. These increases were offset by a decline in same store CPO revenues of 2.8% over the same period. Same store used vehicle gross profit increased 1.4% in 2017 compared to 2016, again led by strong performance in our core vehicle category, offset by a decline in our CPO category and relatively flat performance in our value auto category.

Our used vehicle operations provide an opportunity to generate sales to customers unable or unwilling to purchase a new vehicle, sell brands other than the store's new vehicle franchise(s), access additional used vehicle inventory through trade-ins and increase sales from finance and insurance products and parts and service.

#### Finance and Insurance

We believe that arranging timely vehicle financing is an important part of providing personal transportation solutions, and we attempt to arrange financing for every vehicle we sell. We also offer related products such as extended warranties, insurance contracts and vehicle and theft protection.

The increases in finance and insurance revenue in 2018 compared to 2017 and in 2017 compared to 2016 were primarily due to increased volume related to acquisitions, combined with expanded product offerings and increasing penetration rates. Third party extended warranty and insurance contracts yield higher profit margins than vehicle sales and contribute significantly to our profitability. During 2018, finance and insurance sales accounted for 3.8% of total revenues and 25.6% of total gross profits. On a same store basis, finance and insurance sales accounted for 4.0% of total revenues and 25.9% of total gross profits in 2018. Same store finance and insurance revenues increased 4.6% during 2018 compared to 2017 and 5.8% during 2017 compared to 2016. These increases were driven by increases in finance and insurance revenues per retail unit, combined with increases in used vehicle unit volume, offset by decreases in new vehicle unit volume. On a same store basis, our finance and insurance revenues per retail unit increased \$69 per unit to \$1,373 in 2018 compared to 2017 and \$50 per unit to \$1,334 in 2017 compared to 2016. The increase in 2018 compared to 2017 was primarily due to increases in financing and service contract penetration rates of 180 basis points each in 2018 compared to 2017, from 71.6% to 73.4% and from 44.5% to 46.3%, respectively.

We seek to increase our penetration of vehicle financing on the number of vehicles that we sell and to offer a comprehensive suite of products. We target an average F&I per retail unit of \$1,450. We believe improved performance from sales training, continued optimization of product offerings and pricing, and revised compensation plans will be critical factors in achieving this target.

#### Service, body and parts

We provide service, body and parts for the new vehicle brands sold by our stores, as well as service and repairs for most other makes and models. Our parts and service operations are an integral part of our customer retention and the largest contributor to our overall profitability. Earnings from service, body and parts have historically been more resilient during economic downturns, when owners have tended to repair their existing vehicles rather than buy new vehicles.

Our service, body and parts revenue grew in all areas in 2018 compared to 2017 and in 2017 compared to 2016 primarily due to acquisitions, combined with more late-model units in operation from 2010 to 2016 and a plateauing new vehicle market. We believe the increased number of units in operation will continue to benefit our service, body and parts revenue in the coming years as more late-model vehicles age, necessitating repairs and maintenance.

We focus on retaining customers by offering competitively-priced routine maintenance and through our marketing efforts. On a same store basis, service, body and parts revenue increased 3.6% during 2018, primarily driven by increases in customer pay and warranty revenues of 5.6% and 2.4% , respectively. Performance in parts wholesale and body shop was similar to the same period of 2017.

Same store service, body and parts gross profit increased 5.5% during 2018 compared to 2017 and 5.5% during 2017 compared to 2016. This performance was also driven by increases in customer pay and warranty work. Our gross margins continue to increase as our mix has shifted towards customer pay, which has higher margins than other service work.

#### Segments

Certain financial information by segment is as follows:

(Dollars in millions)	Year Ended December 31,							
	2018	2017	2018 vs. 2017		2016	2017 vs. 2016		
			Change	%		Change	%	
Revenues:								
Domestic	\$4,215.0	\$3,845.8	\$369.2	9.6	% \$3,381.7	\$464.1	13.7	%
Import	5,038.1	4,432.8	605.3	13.7	3,764.3	668.5	17.8	
Luxury	2,560.3	1,810.1	750.2	41.4	1,528.7	281.4	18.4	

Edgar Filing: LITHIA MOTORS INC - Form 10-K

	11,813.4	10,088.7	1,724.7	17.1	8,674.7	1,414.0	16.3
Corporate and other	8.0	(2.2 )	10.2	(463.6)	3.5	(5.7 )	(162.9)
	\$11,821.4	\$10,086.5	\$1,734.9	17.2	\$8,678.2	\$1,408.3	16.2

27

---

Edgar Filing: LITHIA MOTORS INC - Form 10-K

(Dollars in millions)	Year Ended December 31,		2018 vs. 2017		2017 vs. 2016		
	2018	2017	Change	%	2016	Change	%
Segment income*:							
Domestic	\$97.6	\$105.2	\$(7.6)	(7.2)%	\$106.2	\$(1.0)	(0.9)%
Import	116.2	117.8	(1.6)	(1.4)	110.2	7.6	6.9
Luxury	43.9	37.0	6.9	18.6	31.5	5.5	17.5
	257.7	260.0	(2.3)	(0.9)	247.9	12.1	4.9
Corporate and other	202.4	167.4	35.0	20.9	114.2	53.2	46.6
Depreciation and amortization	(75.4)	(57.7)	17.7	30.7	(49.3)	8.4	17.0
Other interest expense	(56.0)	(34.8)	21.2	60.9	(23.2)	11.6	50.0
Other (expense) income, net	8.8	12.2	(3.4)	NM	(6.1)	(18.3)	NM
Income before income taxes	\$337.5	\$347.1	\$(9.6)	(2.8)	\$283.5	\$63.6	22.4

\*Segment income for each reportable segment is defined as Income before income taxes, depreciation and amortization, other interest expense and other (expense) income, net.

NM - Not meaningful

Retail new vehicle unit sales:	Year Ended December 31,		2018 vs. 2017		2017 vs. 2016		
	2018	2017	Change	%	2016	Change	%
Domestic	55,653	53,288	2,365	4.4	47,707	5,581	11.7
Import	102,454	94,634	7,820	8.3	80,769	13,865	17.2
Luxury	26,915	19,597	7,318	37.3	17,591	2,006	11.4
	185,022	167,519	17,503	10.4	146,067	21,452	14.7
Allocated to management	(421)	(373)	(48)	(12.9)	(295)	(78)	(26.4)
	184,601	167,146	17,455	10.4	145,772	21,374	14.7

Domestic

A summary of financial information for our Domestic segment follows:

(Dollars in millions)	Year Ended December 31,		2018 vs. 2017		2017 vs. 2016		
	2018	2017	Change	%	2016	Change	%
Revenue:							
New vehicle	\$2,290.1	\$2,153.7	\$136.4	6.3	\$1,876.6	\$277.1	14.8
Used vehicle retail	1,107.4	987.4	120.0	12.2	891.6	95.8	10.7
Used vehicle wholesale	134.9	120.5	14.4	12.0	132.6	(12.1)	(9.1)
Finance and insurance	166.4	151.4	15.0	9.9	131.7	19.7	15.0
Service, body and parts	451.4	395.5	55.9	14.1	324.0	71.5	22.1
Fleet and other	64.8	37.3	27.5	73.7	25.2	12.1	48.0
	\$4,215.0	\$3,845.8	\$369.2	9.6	\$3,381.7	\$464.1	13.7
Segment income	\$97.6	\$105.2	\$(7.6)	(7.2)	\$106.2	\$(1.0)	(0.9)
Retail new vehicle unit sales	55,653	53,288	2,365	4.4	47,707	5,581	11.7

Revenues in our Domestic segment increased in all major business lines in 2018 compared to 2017, primarily related to acquiring five stores and opening one store during 2018. New vehicle unit sales increased 4.4% overall, but declined 5.2% on a same store basis. Additionally, our Domestic stores increased their used vehicle unit sales 9.4%, improved finance and insurance income per retail unit 3.0% to \$1,539 per unit and experienced strong growth in service, body and parts revenues. The acquisition of five stores



in 2017 and strong performance on a same store basis in used vehicles, finance and insurance and service, body and parts contributed to the 13.7% increase in revenue over 2016.

Our Domestic segment income decreased 7.2% in 2018 compared to 2017 due to gross profit growth of 9.7% being more than offset by an 11.2% increase in SG&A and a 40.9% increase in floor plan interest expense. The increase in floor plan interest was primarily driven by increasing rates, compounded by increased volume related to acquisitions.

The decrease in our Domestic operating results in 2017 compared to 2016 was primarily a result of increased floor plan interest expense and SG&A expenses, which offset an increase in gross profits. The increase in SG&A during 2017 was primarily driven by increased variable costs associated with increased sales volume and the acquisition of eight stores.

### Import

A summary of financial information for our Import segment follows:

(Dollars in millions)	Year Ended December 31,				2017 vs. 2016		
	2018	2017	2018 vs. 2017	2016	Change	%	Change %
<b>Revenue:</b>							
New vehicle	\$2,933.1	\$2,638.5	\$294.6	11.2 %	\$2,214.0	\$424.5	19.2 %
Used vehicle retail	1,283.4	1,073.6	209.8	19.5 %	940.6	133.0	14.1 %
Used vehicle wholesale	123.4	105.2	18.2	17.3 %	96.5	8.7	9.0 %
Finance and insurance	220.3	186.4	33.9	18.2 %	161.1	25.3	15.7 %
Service, body and parts	453.8	396.2	57.6	14.5 %	329.9	66.3	20.1 %
Fleet and other	24.1	32.9	(8.8 )	(26.7)%	22.2	10.7	48.2 %
	\$5,038.1	\$4,432.8	\$605.3	13.7 %	\$3,764.3	\$668.5	17.8 %
Segment income	\$116.2	\$117.8	\$(1.6 )	(1.4 )	\$110.2	\$7.6	6.9
Retail new vehicle unit sales	102,454	94,634	7,820	8.3	80,769	13,865	17.2

The increase in our Import segment revenue in 2018 compared to 2017 resulted from increases in all major business lines and primarily related to acquiring six stores during 2018. New vehicle unit sales in our import segment increased 8.3%, but decreased 4.3% on a same store basis primarily related to decreases in Honda and Toyota, offset by increasing unit sales with Subaru. Additionally, Import revenues benefited from improved used vehicle sales due to a 17.0% increase in volume, increases in finance and insurance revenues as a result of increased volume combined with a 5.7% increase in finance and insurance income per retail unit sold to \$1,245 per unit, and improved service, body and parts revenues.

Our segment income decreased 1.4% in 2018 compared to 2017 mainly due to increases in SG&A and floor plan interest expenses that outpaced the increase in gross profit. Gross profit for our import segment increased 13.6% in 2018 compared to 2017, in line with our revenues. Our Import segment experienced a 15.4% increase in SG&A, primarily driven by increases in personnel, rent, and other miscellaneous costs. Floor plan interest expense increased 43.2% during 2018 and was a significant contributor to lower segment income growth compared to 2017. This increase was driven by a combination of increased volume due to the acquisition of six stores during 2018 and increasing interest rates.

Improvements in our Import operating results in 2017 compared to 2016 were primarily a result of increased revenues in all major business lines and a slight increase in gross margins, offset by increases in SG&A and floor plan expenses.



Luxury

A summary of financial information for our Luxury segment follows:

(Dollars in millions)	Year Ended December 31,				2017 vs. 2016	
	2018	2017	2018 vs. 2017 Change %	2016	Change %	
Revenue:						
New vehicle	\$1,397.8	\$991.5	\$406.3 41.0%	\$857.9	\$133.6	15.6 %
Used vehicle retail	688.1	483.1	205.0 42.4%	394.9	88.2	22.3 %
Used vehicle wholesale	72.9	51.9	21.0 40.5%	47.7	4.2	8.8 %
Finance and insurance	62.0	40.8	21.2 52.0%	33.8	7.0	20.7 %
Service, body and parts	298.9	215.0	83.9 39.0%	182.0	33.0	18.1 %
Fleet and other	40.6	27.8	12.8 46.0%	12.4	15.4	124.2%
	\$2,560.3	\$1,810.1	\$750.2 41.4%	\$1,528.7	\$281.4	18.4 %
Segment income	\$43.9	\$37.0	\$6.9 18.6	\$31.5	\$5.5	17.5
Retail new vehicle unit sales	26,915	19,597	7,318 37.3	17,591	2,006	11.4

Our Luxury segment revenue increased in 2018 compared to 2017 primarily due to our acquisition of six stores and improvements in finance and insurance and service, body and parts revenues. Overall, new vehicle unit sales increased 37.3% but declined 2.9% on a same store basis mainly related to our BMW and Audi franchises. Our luxury segment revenues also benefited from a 38.4% increase in used vehicle unit sales, a 10.2% increase in finance and insurance revenues per retail unit to \$1,212 per unit and growth in service, body and parts during 2018 compared to 2017.

Our Luxury segment income increased 18.6% in 2018 compared to 2017. This increase was due to gross profit growth of 42.2%, offset by an increase in SG&A of 44.9%, primarily related to acquisition activity, as well as increases in personnel expense, rent and facility expenses and other miscellaneous expense and an increase in floor plan interest expense of 62.6%. As a percentage of gross profit, SG&A increased 150 basis points in 2018 compared to 2017. The 62.6% increase in floor plan interest expense during 2018 compared to 2017 was due to a combination of increased volume from acquisitions and rising interest rates.

Our Luxury segment revenue increased in 2017 compared to 2016 primarily due to our acquisition of four stores and improvements in finance and insurance and service body and parts revenues. New vehicle unit sales declined on a same store basis mainly related to our BMW and Mercedes franchises. Our Luxury segment income increased in 2017 compared to 2016 primarily due to gross profits growth of 17.6% that outpaced an increase in SG&A of 16.0%.

Corporate and Other

Revenue attributable to Corporate and other includes the results of operations of our stand-alone collision centers, offset by certain unallocated reserve and elimination adjustments.

(Dollars in millions)	Year Ended December 31,				2017 vs. 2016	
	2018	2017	2018 vs. 2017 Change%	2016	Change %	
Revenue, net	\$8.0	\$(2.2 )	\$10.2 NM	\$3.5	\$(5.7 )	NM
Segment income	\$202.4	\$167.4	\$35.0 20.9	\$114.2	\$53.2	46.6
NM - not meaningful						

The increase in Corporate and other revenues in 2018 compared to 2017 was primarily related to the addition of two stand-alone body shops, changes in certain reserves that are not specifically identified with our domestic, import or luxury segment revenue, such as our reserve for revenue reversals associated with unwound vehicle sales, and elimination of revenues associated with internal corporate vehicle purchases and leases with our stores. Corporate and other revenues were affected in 2017 by an increase in internal corporate vehicle purchases and leases with our stores



resulting in negative revenues compared to 2016.

These internal corporate expense allocations are also 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

30

---

floor plan financing charges, and internal fees charged to offset employees within our corporate headquarters who perform certain dealership functions.

The increase in Corporate and other segment income in 2018 compared to 2017 is primarily due to gains on the divestiture of stores of \$15.1 million and the addition of 17 stores, offset by changes to certain insurance and auto loan related reserves. In addition, 2018 included \$4.3 million of acquisition expense compared to \$6.0 million during 2017. The increase in Corporate and other segment income in 2017 compared to 2016 was primarily related to increased internal corporate expense allocations and increased store count.

See Note 18 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10-K for additional information.

#### Asset Impairment Charges

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

	Year Ended	
	December 31,	
	2018	2017
Equity-method investment	\$—	—\$14.0
Long-lived assets	1.3	—

During 2018, we recorded an asset impairment of \$1.3 million associated with certain real properties. The long-lived assets were tested for recoverability and were determined to have a carrying value exceeding their fair value.

Additionally, we recorded an asset impairment in 2016 associated with our equity-method investment in a limited liability company that participated in the NMTC Program. We evaluated this equity-method investment at the end of each reporting period and identified indications of loss resulting from other than temporary declines in value. We exited this equity-method investment in December 2016.

See Notes 1, 4, 12 and 17 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

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

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

(Dollars in millions)	Year Ended December 31,		2018 vs. 2017		2017 vs. 2016		
	2018	2017	Change	%	2017	Change	%
Personnel	\$824.8	\$695.5	\$129.3	18.6	\$597.2	\$98.3	16.5
Advertising	108.7	93.3	15.4	16.5	81.4	11.9	14.6
Rent	43.3	33.4	9.9	29.6	26.8	6.6	24.6
Facility costs	72.0	61.3	10.7	17.5	49.3	12.0	24.3
Gain on sale of assets	(14.8 )	(5.5 )	(9.3 )	169.1	(5.4 )	(0.1 )	1.9
Other	219.3	171.4	47.9	27.9	150.3	21.1	14.0
Total SG&A	\$1,253.3	\$1,049.4	\$203.9	19.4	\$899.6	\$149.8	16.7

Edgar Filing: LITHIA MOTORS INC - Form 10-K

	Year Ended December 31,				
			2018		2017
			vs.		vs.
	2017		2016		2016
As a % of gross profit	2018	2017	Change	2016	Change
Personnel	46.4 %	45.9 %	50 bps	45.9 %	—
Advertising	6.1 %	6.2 %	(10 )	6.3 %	(10)
Rent	2.4 %	2.2 %	20	2.1 %	10
Facility costs	4.1 %	4.0 %	10	3.8 %	20
Gain on sale of assets	(0.8 )%	(0.3 )%	(50 )	(0.4 )%	10
Other	12.3 %	11.2 %	110	11.4 %	(20)
Total SG&A	70.5 %	69.2 %	130 bps	69.1 %	10 bps

SG&A increased 19.4%, or \$203.9 million in 2018 compared to 2017. Overall increases in SG&A were primarily due to growth through acquisitions, acquisition expenses and increased allowance losses associated with auto loan receivables, offset by decreases in losses related to storm insurance reserve charges and acquisition expenses and an increase in gains on the disposal of stores. Other expenses in 2018 included acquisition expenses of \$4.3 million, compared to \$6.0 million in 2017; \$3.2 million of storm related insurance charges, compared to \$5.6 million in 2017; and auto loan allowance losses of \$4.2 million compared to \$1.2 million in 2017. Gains on the sale of stores were \$15.1 million and \$5.1 million in 2018 and 2017, respectively.

On a same store basis and excluding non-core charges, SG&A as a percent of gross profit was 70.6% in 2018 compared to 68.4% in 2017. Increases included auto loan allowance losses, data processing, rent, legal and professional fees and miscellaneous expense. Increases in data processing and professional fees include initiatives focusing on innovation and cyber security measures.

SG&A increased \$149.8 million in 2017 compared to 2016, primarily due to growth through acquisitions, as well as the various reserve charges mentioned above. SG&A in 2016 included a \$3.9 million legal reserve adjustment, offset by a \$1.1 million gain from the disposal of one of our stores.

SG&A adjusted for non-core charges was as follows (in millions):

(Dollars in millions)	Year Ended December 31,					
			2018 vs. 2017		2017 vs. 2016	
	2018	2017	Change	%	2016	Change %
Personnel	\$824.8	\$695.5	\$129.3	18.6 %	\$597.2	\$98.3 16.5 %
Advertising	108.7	93.3	15.4	16.5	81.4	11.9 14.6
Rent	43.3	33.4	9.9	29.6	26.8	6.6 24.6
Facility costs	72.0	61.3	10.7	17.5	49.3	12.0 24.3
Adjusted loss (gain) on sale of assets	0.5	(0.4 )	0.9	(225.0)	(4.3 )	3.9 (90.7)
Adjusted Other	214.6	160.1	54.5	34.0	146.3	13.8 9.4
Total Adjusted SG&A	\$1,263.9	\$1,043.2	\$220.7	21.2	\$896.7	\$146.5 16.3
	Year Ended December 31,					
			2018		2017 vs.	
			vs.		2016	
	2017		2016		Change	
As a % of gross profit	2018	2017	Change	2016	Change	
Personnel	46.4 %	45.9 %	50 bps	45.9 %	—	
Advertising	6.1 %	6.2 %	(10 )	6.3 %	(10)	
Rent	2.4 %	2.2 %	20	2.1 %	10	
Facility costs	4.1 %	4.0 %	10	3.8 %	20	

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Adjusted loss (gain) on sale of assets	— %	— %	—	(0.3 )%	30
Adjusted Other	12.1 %	10.5 %	160	11.1 %	(60)
Total Adjusted SG&A	71.1 %	68.8 %	230 bps	68.9 %	(10) bps

See “Non-GAAP Reconciliations” for more details.

32

---

### Depreciation and Amortization

Depreciation and amortization is comprised of depreciation expense related to buildings, significant remodels or improvements, furniture, tools, equipment and signage and amortization related to tradenames.

Year Ended December 31,

(Dollars in millions)	2018 vs.			2017 vs.		
	2018	2017	Change%	2016	Change%	
Depreciation and amortization	\$75.4	\$57.7	\$17.7 30.7%	\$49.3	\$8.4 17.0%	

Acquisition activity contributed to the increases in depreciation and amortization in 2018 compared to 2017 and in 2017 compared to 2016. During 2018, we purchased approximately \$108 million in depreciable property as part of our acquisitions of Day Auto Group and Prestige Auto Group. During 2017, we purchased approximately \$105 million in depreciable property as a part of our acquisitions of Baierl Auto Group and Downtown LA Auto Group. Capital expenditures totaled \$158.0 million and \$105.4 million, respectively, in 2018 and 2017. These investments increase the amount of depreciable assets. See the discussion under Liquidity and Capital Resources for additional information.

### Operating Income

Operating income as a percentage of revenue, or operating margin, was as follows:

	Year Ended		
	December 31,		
	2018	2017	2016
Operating margin	3.8%	4.1%	3.9%
Operating margin adjusted for non-core charges <sup>(1)</sup>	3.7%	4.1%	4.1%

<sup>(1)</sup> See “Non-GAAP Reconciliations” for additional information.

In 2018, our operating margin decreased 30 basis points compared to 2017. Adjusting for non-core charges, including storm related insurance charges and acquisition expenses, our operating margin decreased 40 basis points in 2018 compared to 2017. In 2018, the decrease in our operating margin was driven by our SG&A expense outpacing increases in gross profit. Adjusting for those non-core charges, our operating margin was 3.7% in 2018. Acquired stores generally have a lower operating efficiency than our other stores and negatively impact our operating margin as we integrate them into our cost structure.

In 2016, our operating margin was affected by acquisition activity, as well as a legal reserve adjustment. Adjusting for those non-core charges, our operating margin was 4.1% in 2016.

### Floor Plan Interest Expense and Floor Plan Assistance

Floor plan interest expense increased \$23.0 million in 2018 compared to 2017, due to an increase in inventory levels related to acquisitions and increasing interest rates. Increases in outstanding balances on our floor plan facilities related to acquisitions increased the expense \$8.8 million and changes in the interest rates on our floor plan facilities increased the expense \$14.2 million during 2018 compared to 2017.

Floor plan interest expense increased \$13.7 million in 2017 compared to 2016, as a result of increases in the average outstanding balances on our floor plan facilities due to an increase in new vehicle inventory levels and increasing interest rates. Changes in the average outstanding balances on our floor plan facilities increased the expense \$5.1 million and in the interest rates on our floor plan facilities increased the expense \$8.6 million during 2017 compared to 2016.

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, because manufacturers provide this assistance to offset inventory carrying costs, we believe

a comparison of floor plan interest expense to floor plan assistance is a useful measure of the efficiency of our new vehicle sales relative to stocking levels.

Edgar Filing: LITHIA MOTORS INC - Form 10-K

The following tables detail the carrying costs for new vehicles and include new vehicle floor plan interest net of floor plan assistance earned:

(Dollars in millions)	Year Ended December 31,							
	2018	2017	2018 vs. 2017		2016	2017 vs. 2016		
			Change	%		Change	%	
Floor plan interest expense (new vehicles)	\$62.3	\$39.3	\$23.0	58.5	%	\$25.6	\$13.7	53.5
Floor plan assistance (included as an offset to cost of sales)	(66.9)	(56.0)	(10.9)	19.5		(46.3)	(9.7)	21.0
Net new vehicle carrying costs (benefit)	\$(4.6)	\$(16.7)	\$12.1	(72.5)	%	\$(20.7)	\$4.0	(19.3)

Other Interest Expense

Other interest expense includes interest on debt incurred related to acquisitions, real estate mortgages, our used vehicle inventory financing facility and our revolving line of credit.

(Dollars in millions)	Year Ended December 31,							
	2018	2017	2018 vs. 2017		2016	2017 vs. 2016		
			Change	%		Change	%	
Mortgage interest	\$25.0	\$19.1	\$5.9	30.9	%	\$15.1	\$4.0	26.5
Other interest	32.3	16.2	16.1	99.4		8.5	7.7	90.6
Capitalized interest	(1.3)	(0.5)	(0.8)	160.0		(0.4)	(0.1)	25.0
Total other interest expense	\$56.0	\$34.8	\$21.2	60.9	%	\$23.2	\$11.6	50.0

The increase in other interest expense in 2018 compared to 2017 was primarily due to the issuance of \$300 million in aggregate principal amount of 5.25% Senior Notes due 2025 in July 2017 and increases in mortgage borrowings related to acquisitions. See also Note 6 of Notes to Consolidated Financial Statements for additional information.

The increase in other interest expense in 2017 compared to 2016 was also primarily due to the issuance of our 5.25% Senior Notes due 2025 in July 2017 and an increase in other interest related to higher volumes of borrowing on our credit facility and higher mortgage borrowings.

Other Income (Expense), net

Other income (expense), net primarily includes other income associated with legal settlements with the OEMs, interest income and the gains and losses related to equity-method investments.

(Dollars in millions)	Year Ended December 31,						
	2018	2017	2018 vs. 2017		2016	2017 vs. 2016	
			Change	%		Change	%
Other income (expense), net	\$8.8	\$12.2	(3.4)	NM	(6.1)	18.3	NM

NM - Not meaningful

The decrease in other income (expense), net in 2018 compared to 2017 was primarily due to a \$9.1 million gain related to legal settlements with OEMs associated with diesel emissions litigation recorded in the first quarter of 2017. 2018 included gains totaling approximately \$2.9 million related to proceeds from corporate owned life insurance and gains on miscellaneous investments.

The increase in other income (expense), net in 2017 compared to 2016 was primarily due to \$8.3 million in operating losses recorded in 2016 related to our equity-method investment with U.S. Bancorp Community Development Corporation, which we exited in December 2016, compared to the \$9.1 million gain recorded in 2017 related to legal settlements with OEMs as discussed above.





## Income Tax Provision

Our effective income tax rate was as follows:

	Year Ended December 31,		
	2018	2017	2016
Effective income tax rate	21.3%	29.3%	30.5%
Effective income tax rate excluding tax credits generated through our equity-method investment and other non-core items <sup>(1)</sup>	25.6%	38.7%	38.6%

<sup>(1)</sup> See "Non-GAAP Reconciliations" for more details

Our effective income tax rate in 2018 was positively impacted by the enactment of tax legislation commonly known as the Tax Cuts and Jobs Act (the "Act"), signed into law on December 22, 2017, which reduced the Federal corporate income tax rate to 21.0%. Our effective income tax rate in 2018 also benefited from return to provision adjustments to our income tax receivable and deferred taxes as a result of finalizing calculations supporting our 2017 federal income tax return. These adjustments are the result of tax planning undertaken in 2018 to change certain established tax accounting methods. Additionally, our effective income tax rate in 2018 was positively impacted by excess tax benefits related to our stock-based compensation and the revaluation of certain acquired deferred tax liabilities, resulting in a lower effective rate than expected for the full year. Partially offsetting these benefits were negative impacts from an increasing presence in states with higher income tax rates, including the impact of New Jersey Assembly Bill 4202, and the impact of tax reform on the deductibility of officer compensation. We continued to refine our calculations during 2018 and the accounting for the effects of the Act has been completed.

Our effective income tax rate for 2017 was also positively impacted by the Act, as well as by new stock guidance during 2017 that was applied to our stock-based compensation. Our effective income tax rate for 2016 was positively impacted by new markets tax credits that were generated through our equity-method investment with U.S. Bancorp Community Development Corporation.

## 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 because they exclude adjustments for items not related to our ongoing core business operations and other non-cash adjustments, and improves the period-to-period comparability of our results from the core business operations. We use these measures in conjunction with GAAP financial measures to assess our business, including our compliance with covenants in our credit facility and in communications with our Board of Directors concerning financial performance. These measures should not be considered an alternative to GAAP measures.

Edgar Filing: LITHIA MOTORS INC - Form 10-K

The following tables reconcile certain reported non-GAAP measures to the most comparable GAAP measure from our Consolidated Statements of Operations (in millions, except per share amounts):

Year Ended December 31, 2018							
	As reported	Disposal gain on sale of stores	Asset impairment	Insurance Reserves	Acquisition expenses	Tax Attribute	Adjusted
Asset impairments	\$1.3	\$—	\$ (1.3 )	\$ —	\$ —	\$—	\$—
Selling, general and administrative	1,253.3	15.4	—	(1.5 )	(3.3 )	—	1,263.9
Operating income	447.0	(15.4 )	1.3	1.5	3.3	—	437.7
Income before income taxes	\$337.5	\$(15.4 )	\$ 1.3	\$ 1.5	\$ 3.3	\$—	\$ 328.2
Income tax (provision) benefit	(71.8 )	4.0	(0.3 )	(0.4 )	(0.9 )	(14.8 )	(84.2 )
Net income	\$265.7	\$(11.4 )	\$ 1.0	\$ 1.1	\$ 2.4	\$(14.8 )	\$244.0
Diluted net income per share	\$10.86	\$(0.47 )	\$ 0.04	\$ 0.05	\$ 0.10	\$(0.60 )	\$9.98
Diluted share count	24.5						
Year Ended December 31, 2017							
	As reported	Disposal gain on sale of stores	Insurance Reserves	Acquisition expenses	OEM Settlement	Tax Reform	Adjusted
Selling, general and administrative	\$1,049.4	\$5.1	\$ (5.6 )	\$ (5.7 )	\$ —	\$—	\$1,043.2
Operating income	409.0	(5.1 )	5.6	5.7	—	—	415.2
Other (expense) income, net	12.2	—	—	—	(9.1 )	—	3.1
Income before income taxes	\$347.1	\$(5.1 )	\$ 5.6	\$ 5.7	\$ (9.1 )	\$—	\$344.2
Income tax (provision) benefit	(101.9 )	2.5	(2.2 )	(2.2 )	3.4	(32.9 )	(133.3 )
Net income	\$245.2	\$(2.6 )	\$ 3.4	\$ 3.5	\$(5.7 )	\$(32.9 )	\$210.9
Diluted net income per share	\$9.75	\$(0.10 )	\$ 0.14	\$ 0.14	\$(0.23 )	\$(1.31 )	\$8.39
Diluted share count	25.1						

	Year Ended December 31, 2016					
	As reported	Disposal gain on sale of stores	Legal Reserve	Equity-method investment	Tax attribute	Adjusted
Asset impairments	\$ 14.0	\$ —	\$ —	\$ (14.0 )	\$ —	\$ —
Selling, general and administrative	899.6	1.1	(3.9 )	—	—	896.8
Income from operations	338.4	(1.1 )	3.9	14.0	—	355.2
Other (expense) income, net	(6.1 )	—	—	8.3	—	2.2
Income before income taxes	\$ 283.5	\$ (1.1 )	\$ 3.9	\$ 22.3	\$ —	\$ 308.6
Income tax (provision) benefit	(86.4 )	0.4	(3.2 )	(28.6 )	(1.3 )	(119.1 )
Net income	\$ 197.1	\$ (0.7 )	\$ 0.7	\$ (6.3 )	\$ (1.3 )	\$ 189.5
Diluted net income per share	\$ 7.72	\$ (0.03 )	\$ 0.03	\$ (0.25 )	\$ (0.05 )	\$ 7.42
Diluted share count	25.5					

#### Liquidity and Capital Resources

We manage our liquidity and capital resources to fund our operating, investing and financing activities. We rely primarily on cash flows from operations and borrowings under our credit facilities as the main sources for liquidity. We use those funds to invest in capital expenditures, increase working capital and fulfill contractual obligations. Remaining funds are used for acquisitions, debt retirement, cash dividends, share repurchases and general business purposes.

#### Available Sources

Below is a summary of our immediately available funds (in millions):

	As of			
	December 31,		Change %	
	2018	2017		
Cash and cash equivalents	\$ 31.6	\$ 57.3	\$ (25.7)	(44.9)%
Available credit on the credit facilities	179.6	222.5	(42.9 )	(19.3)
Total current available funds	211.2	279.8	(68.6 )	(24.5)
Estimated funds from unfinanced real estate	247.7	236.1	11.6	4.9
Total estimated available funds	\$ 458.9	\$ 515.9	\$ (57.0)	(11.0)

Cash flows generated by operating activities and from our credit facility are our most significant sources of liquidity. We also have the ability to raise funds through mortgaging real estate. As of December 31, 2018, our unencumbered owned operating real estate had a book value of \$330.2 million. Assuming we can obtain financing on 75% of this value, we estimate we could have obtained additional funds of approximately \$247.7 million at December 31, 2018; however, no assurances can be provided that the appraised value of these properties will match or exceed their book values or that this capital source will be available on terms acceptable to us.

In July 2017, we issued \$300 million in aggregate principal amount of Senior Notes in a private placement under Rule 144A and Regulation S of the Securities Act of 1933. We used the net proceeds for general corporate purposes, including funding acquisitions, capital expenditures and debt repayment.

In addition to the above sources of liquidity, potential sources include the placement of subordinated debentures or loans, the sale of equity securities and the sale of stores or other assets. We 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.

Information about our cash flows, by category, is presented in our Consolidated Statements of Cash Flows. The following table summarizes our cash flows (in millions):

	Year Ended December 31,		
	2018	2017	2016
Net cash provided by operating activities	\$519.7	\$148.9	\$90.9
Net cash used in investing activities	(557.1 )	(538.2 )	(351.7)
Net cash provided by financing activities	11.7	396.3	266.1

#### Operating Activities

Cash provided by operating activities increased \$370.8 million in 2018 compared to 2017, primarily as a result of increased profitability and a decrease in trade receivables growth related to the timing of collections, a decrease in growth of same store inventory levels, an increase in floor plan notes payable due to a higher level of inventories floored through our manufacturer partners, and increases related to deferred tax balances that were positively impacted by the recently enacted tax legislation compared to the previous year's cash flows.

In 2018, we entered into a floor plan credit facility with Ford Motor Credit Company. This facility provides floor plan financing for new vehicle inventory at all of our Ford stores. As this facility is provided through a manufacturer partner, we classify these changes as an operating activity. During 2018 we reclassified \$214.4 million from financing activities to operating activities as these funds were used to pay off our Ford inventory previously floored under our syndicated line.

Borrowings from and repayments to our syndicated lending group related to our new vehicle inventory floor plan financing are presented as financing activities. To better understand the impact of changes in inventory and the associated financing, we also consider our net cash provided by operating activities adjusted to include cash activity associated with our new vehicle credit facility.

Adjusted net cash provided by operating activities is presented below (in millions):

	Year Ended December 31,				
	2018		2017		
	vs.		vs.		
	2017		2016		
(Dollars in millions)	2018	2017	Change	2016	Change
Net cash provided by operating activities – as reported	\$519.7	\$148.9	370.8	90.9	58.0
Add (Less): Net borrowings on floor plan notes payable: non-trade	(21.9 )	241.5	(263.4)	252.9	(11.4 )
Less: Borrowings on floor plan notes payable: non-trade associated with acquired new vehicle inventory	(120.0 )	(111.0 )	(9.0 )	(94.5 )	(16.5 )
Net cash provided by operating activities – adjusted	\$377.8	\$279.4	\$98.4	\$249.3	\$30.1

Inventories are the most significant component of our cash flow from operations. As of December 31, 2018, our new vehicle days supply was 71 days, or two days higher than our days supply as of December 31, 2017. Our days supply of used vehicles was 66 days, or one day lower than our days supply as of December 31, 2017. We calculate days supply of inventory based on current inventory levels, excluding in-transit vehicles, and a 30-day historical cost of sales level. We have continued to focus on managing our unit mix and maintaining an appropriate level of new and used vehicle inventory.

#### Investing Activities

Net cash used in investing activities totaled \$557.1 million and \$538.2 million, respectively, for 2018 and 2017. Cash flows from investing activities relate primarily to capital expenditures, acquisition and divestiture activity and sales of property and equipment.



Below are highlights of significant activity related to our cash flows from investing activities (in millions):

	Year Ended December 31,				
	2018		2017		2016
(Dollars in millions)	2018	2017	Change	2016	Change
Capital expenditures	\$(158.0)	\$(105.4)	(52.6 )	(100.8)	(4.6 )
Cash paid for acquisitions, net of cash acquired	(373.8 )	(460.4 )	86.6	(234.7)	(225.7)
Cash paid for other investments	(62.7 )	(8.6 )	(54.1 )	(30.3 )	21.7
Proceeds from sales of stores	34.3	20.9	13.4	11.9	9.0

#### Capital Expenditures

Below is a summary of our capital expenditure activities (in millions):

	Year Ended December 31,		
	2018	2017	2016
Post-acquisition capital improvements	\$59.0	\$41.2	\$31.5
Facilities for open points	8.4	0.5	—
Purchases of previously leased facilities	7.9	—	24.0
Existing facility improvements	53.5	29.6	24.2
Maintenance	29.2	34.1	21.1
Total capital expenditures	\$158.0	\$105.4	\$100.8

Many manufacturers provide assistance in the form of additional incentives or assistance if facilities meet manufacturer image standards and requirements. We expect that certain facility upgrades and remodels will generate additional manufacturer incentive payments. Also, tax laws allowing accelerated deductions for capital expenditures reduce the overall investment needed and encourage accelerated project timelines.

We expect to use a portion of our future capital expenditures to upgrade facilities that we recently acquired. This additional capital investment is contemplated in our initial evaluation of the investment return metrics applied to each acquisition and is usually associated with manufacturer image standards and requirements.

If we undertake a significant capital commitment in the future, we expect to pay for the commitment out of existing cash balances, construction financing and borrowings on our credit facility. Upon completion of the projects, we believe we would have the ability to secure 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.

#### Acquisitions

We focus on acquiring stores using our value-based strategy at purchase prices that meet our return thresholds and strategic objectives. We look for acquisitions that diversify our brand and geographic mix as we continue to evaluate our portfolio to minimize exposure to any one manufacturer and achieve financial returns.

Edgar Filing: LITHIA MOTORS INC - Form 10-K

We are able to subsequently floor new vehicle inventory acquired as part of an acquisition; however, the cash generated by these transactions are recorded as borrowings on floor plan notes payable, non-trade. Adjusted net cash paid for acquisitions, as well as certain other acquisition-related information is presented below (dollars in millions):

	Year Ended December 31,		
	2018	2017	2016
Number of stores acquired	17	18	15
Number of stores opened	1	1	1
Number of franchises added	—	—	1
Cash paid for acquisitions, net of cash acquired	\$(373.8)	\$(460.4)	\$(234.7)
Less: Borrowings on floor plan notes payable: non-trade associated with acquired new vehicle inventory	120.0	111.0	94.5
Cash paid for acquisitions, net of cash acquired – adjusted	\$(253.8)	\$(349.4)	\$(140.2)

We evaluate potential capital investments primarily based on targeted rates of return on assets and return on our net equity investment.

#### Other Investments

During the third quarter of 2018, we entered into a strategic partnership with Shift Technologies, Inc., a San Francisco-based digital retailer. Shift provides an innovative platform to consumers for a digital vehicle purchase and selling experience, providing vehicle pickup and delivery at a customer's location. We invested \$54 million, leading the series D fundraising round and becoming the largest shareholder.

#### Financing Activities

Net cash provided by financing activities, adjusted for borrowing on floor plan facilities: non-trade was as follows (in millions):

	Year Ended December 31,		
	2018	2017	2016
Cash provided by financing activities, as reported	\$11.7	\$396.3	\$266.1
Add (Less): Borrowings on floor plan notes payable: non-trade	21.9	(241.5)	(252.9)
Cash provided by financing activities, as adjusted	\$33.6	\$154.8	\$13.2

During 2018 we reclassified \$214.4 million from financing activities to operating activities related to the payoff of Ford new vehicle inventories that were previously floored through our syndicated line and are now floored through a floor plan credit facility with Ford Motor Credit Company. As this facility is provided through a manufacturer partner, we classify these changes as an operating activity.

Below are highlights of significant activity related to our cash flows from financing activities, excluding net borrowings on floor plan notes payable: non-trade, which are discussed above (in millions):

	Year Ended December 31,				
	2018	2017	Change	2016	Change
(Dollars in millions)					
Net borrowings (repayments) on lines of credit	\$191.8	\$(81.7)	\$273.5	\$121.3	\$(203.0)
Principal payments on long-term debt and capital leases, other	(26.1)	(50.3)	24.2	(27.7)	(22.6)
Proceeds from the issuance of long-term debt	62.1	395.9	(333.8)	66.5	329.4
Repurchases of common stock	(148.9)	(33.8)	(115.1)	(112.9)	79.1



Edgar Filing: LITHIA MOTORS INC - Form 10-K

Dividends paid	(27.7 )	(26.5 )	(1.2 )	(24.1 )	(2.4 )
Other financing activity	—	(33.4 )	33.4	—	(33.4 )

Borrowing and Repayment Activity

During 2018, we raised net proceeds of \$62.1 million through mortgages and borrowed \$191.8 million, net, on our lines of credit. These funds were primarily used for acquisitions, share repurchases and capital expenditures.

40

---

Our debt to total capital ratio, excluding floor plan notes payable, was 53.6% at December 31, 2018 compared to 49.2% at December 31, 2017. We partially funded our 2018 acquisition activity with additional debt.

#### Equity Transactions

Under the share repurchase program authorized by our Board of Directors and repurchases associated with stock compensation activity, we repurchased 2.1 million shares of our Class A common stock at an average price of \$85.10 per share in 2018. During the fourth quarter of 2018, our Board of Directors increased our share repurchase authorization by an additional \$250 million. As of December 31, 2018, we had \$233.6 million available for repurchase under the program. The authority to repurchase does not have an expiration date.

In order to lower the average cost of acquiring shares in our ongoing share repurchase program, in December 2017, we entered into a structured repurchase agreement involving the use of capped call options for the purchase of our Class A common stock. We paid a fixed sum upon execution of the agreement in exchange for the right to receive either a pre-determined amount of cash or stock. As of December 31, 2018, the capped call options had expired and all outstanding options were settled.

During 2018, we paid dividends on our Class A and Class B Common Stock as follows:

	Dividend amount per share	Total amount of dividend (in millions)
March 2018	\$ 0.27	\$ 6.7
May 2018	0.29	7.2
August 2018	0.29	7.0
November 2018	0.29	6.8

We evaluate performance and make a recommendation to the Board of Directors on dividend payments on a quarterly basis.

#### 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 millions):

	Outstanding as of December 31, 2018	Remaining Available as of December 31, 2018
Floor plan notes payable: non-trade	\$ 1,733.3	\$ — (1)
Floor plan notes payable	324.4	—
Used vehicle inventory financing facility	332.0	— (2)
Revolving lines of credit	131.6	179.6 (2),(3)
Real estate mortgages	592.3	—
5.25% Senior notes due 2025	300.0	—
Other debt	34.2	—
Unamortized debt issuance costs	(6.0)	) — (4)
Total debt	\$ 3,441.8	\$ 179.6

(1) As of December 31, 2018, we had a \$2.0 billion new vehicle floor plan commitment as part of our credit facility.

(2) The amount available on the credit facility is limited based on a borrowing base calculation and fluctuates monthly.

- (3) Available credit is based on the borrowing base amount effective as of November 30, 2018. This amount is reduced by \$12.3 million for outstanding letters of credit.

We adopted an accounting standard update that requires debt issuance costs be presented on the balance sheet as a reduction from the carrying amount of the related debt liability. We adopted the standard retrospectively and have

- (4) presented all debt issuance costs as a reduction from the carrying amount of the related debt liability for both current and prior periods. See Note 6 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

#### Credit Facility

Effective June 25, 2018, we amended our syndicated credit facility increasing the total financing commitment to \$2.6 billion and extended the term to July 2023. This syndicated credit facility is comprised of 20 financial institutions, including seven manufacturer-affiliated finance companies.

We have the option to reallocate the commitments, provided that the used vehicle inventory floor plan financing commitment does not exceed 16.5% of aggregate commitments, the revolving loan commitment does not exceed 18.75% of aggregate commitments, and the sum of these commitments plus the new vehicle inventory floor plan financing commitment does not exceed the aggregate total financing commitment of \$2.6 billion. Additionally, we may request an increase in the aggregate new vehicle floor plan commitment of up to \$400 million provided that the aggregate commitment does not exceed \$3 billion total availability. All borrowings from, and repayments to, our lending group are presented in the Consolidated Statements of Cash Flows as financing activities.

Our obligations under our revolving syndicated credit facility are secured by a substantial amount of our assets, including our inventory (including new and used vehicles, parts and accessories), equipment, accounts receivable (and other rights to payment) and our equity interests in certain of our subsidiaries. Under our revolving syndicated credit facility, our obligations relating to new vehicle floor plan loans are secured only by collateral owned by borrowers of new vehicle floor plan loans under the credit facility.

The interest rate on the credit facility varies based on the type of debt, with the rate of one-month LIBOR plus 1.25% for new vehicle floor plan financing, one-month LIBOR plus 1.50% for used vehicle floor plan financing; and a variable interest rate on the revolving financing ranging from the one-month LIBOR plus 1.25% to 2.50%, depending on our leverage ratio. The annual interest rate associated with our new vehicle floor plan commitment was 3.77% at December 31, 2018. The annual interest rate associated with both our used vehicle inventory financing facility and our revolving line of credit was 4.02% at December 31, 2018.

Under the terms of our credit facility we are subject to financial covenants and restrictive covenants that limit or restrict our incurring additional indebtedness, making investments, selling or acquiring assets and granting security interests in our assets.

Under our credit facility, we are required to maintain the ratios detailed in the following table:

Debt Covenant Ratio	Requirement	As of December 31, 2018
Current ratio	Not less than 1.10 to 1	1.27 to 1
Fixed charge coverage ratio	Not less than 1.20 to 1	1.91 to 1
Leverage ratio	Not more than 5.00 to 1	2.86 to 1

As of December 31, 2018, we were in compliance with all covenants. 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.

If we do not meet the financial and restrictive covenants and are unable to remediate or cure the condition or obtain a waiver from our lenders, a breach would give rise to remedies under the agreement, the most severe of which are the termination of the agreement, acceleration of the amounts owed and the seizure and sale of our assets comprising the collateral for the loans. A breach would also trigger cross-defaults under other debt agreements.

Although we refer to the lenders' obligations to make loans as "commitments," each lender's obligations to make any loan or other credit accommodations under the revolving syndicated credit facility is subject to the satisfaction of the conditions precedent specified in the credit agreement including, for example, that our representations and warranties in the agreement are true and correct in all material respects as of the date of each credit extension. If we are unable to satisfy the applicable conditions precedent, we may not be able to request new loans or other credit accommodations under our revolving syndicated credit facility.

Other Lines of Credit

During 2018 we entered into a revolving line of credit agreement with Ford Motor Credit Company. The revolving line of credit includes a commitment of up to \$40 million, secured by certain assets and up to another \$20 million unsecured. The interest rate on this revolving line varies based upon which component is utilized, with a rate of one-month LIBOR plus 2.70% for the secured commitment and one-month LIBOR plus 5.55% for the unsecured commitment. Including this new revolving line with Ford, we have other lines of credit with a total financing commitment of \$60.5 million for general corporate purposes, including acquisitions and working capital. Substantially all of these other lines of credit mature in 2021 and have interest rates ranging up to 8.07%. As of December 31, 2018, \$0.4 million was outstanding on these other lines of credit.

### Floor Plan Notes Payable

We have floor plan agreements with manufacturer-affiliated finance companies for certain new vehicles and vehicles that are designated for use as service loaners. As discussed above in Operating activities, during 2018 we expanded our floor plan agreement with Ford Motor Credit Company. This facility provides floor plan financing for new vehicle inventory at all of our Ford stores. The interest rates on these floor plan notes payable commitments vary by manufacturer and are variable rates. As of December 31, 2018, \$324.4 million was outstanding on these agreements at interest rates ranging up to 6.75%. Borrowings from, and repayments to, manufacturer-affiliated finance companies are classified as operating activities in the Consolidated Statements of Cash Flows.

### Real Estate Mortgages and Other Debt

We have mortgages associated with our owned real estate. Interest rates related to this debt ranged from 3.0% to 5.3% at December 31, 2018. The mortgages are payable in various installments through August 2038. As of December 31, 2018, we had fixed interest rates on 69.5% of our outstanding mortgage debt.

Our other debt includes capital leases and sellers' notes. The interest rates associated with our other debt ranged from 3.1% to 8.0% at December 31, 2018. This debt, which totaled 34.2 million at December 31, 2018, is due in various installments through December 2050.

### 5.25% Senior Notes Due 2025

On July 24, 2017, we issued \$300 million in aggregate principal amount of 5.25% Senior Notes due 2025 ("Notes") to eligible purchasers in a private placement under Rule 144A and Regulation S of the Securities Act of 1933. Interest accrues on the Notes from July 24, 2017 and is payable semiannually on February 1 and August 1. We may redeem the Notes in whole or in part at any time prior to August 1, 2020 at a price equal to 100% of the principal amount plus a make-whole premium set forth in the Indenture and accrued and unpaid interest. After August 1, 2020, we may redeem some or all of the Notes subject to the redemption prices set forth in the Indenture. If we experience specific kinds of changes of control, as described in the Indenture, we must offer to repurchase the Notes at 101% of their principal amount plus accrued and unpaid interest to the date of purchase.

### Contractual Payment Obligations

A summary of our contractual commitments and obligations as of December 31, 2018, was as follows (in millions):

Contractual Obligation	Total	Payments Due By Period			
		2019	2020 and 2021	2022 and 2023	2024 and beyond
Floor plan notes payable: non-trade <sup>(1)</sup>	\$ 1,733.3	\$ 1,733.3	\$—	\$—	\$—
Floor plan notes payable <sup>(1)</sup>	324.4	324.4	—	—	—
Used vehicle inventory financing facility <sup>(1)</sup>	332.0	—	—	332.0	—
Revolving lines of credit <sup>(1)(3)</sup>	131.6	0.4	—	131.2	—
Real estate mortgages, including interest <sup>(3)</sup>	765.9	49.4	139.0	159.0	418.5
5.25% Senior Notes Due 2025, including interest <sup>(3)</sup>	410.3	15.8	31.5	31.5	331.5
Other debt, including capital leases and interest	362.0	3.6	7.4	7.3	343.7
Charge-backs on various contracts	56.0	30.7	22.6	2.7	—
Operating leases <sup>(2)</sup>	464.9	43.6	78.9	65.6	276.8
Self-insurance programs	39.8	15.4	18.2	3.4	2.8
	\$4,620.2	\$2,216.6	\$297.6	\$732.7	\$1,373.3

Amounts for new vehicle floor plan commitment, floor plan notes payable, the used vehicle inventory financing facility and the revolving lines of credit do not include estimated interest payments. See Notes 1 and 6 of Notes to Consolidated Financial Statements.

- (2) Amounts for operating lease commitments do not include sublease income, and certain operating expenses such as maintenance, insurance and real estate taxes. See Note 7 of Notes to Consolidated Financial Statements.
- (3) Balances exclude net impact of debt issuance costs. See Note 6 of Notes to Consolidated Financial Statements.

#### Off-Balance Sheet Arrangements

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

#### Inflation and Changing Prices

Inflation and changing prices did not have a material impact on our revenues or income from operations in the years ended December 31, 2018, 2017 and 2016.

#### Critical Accounting Policies and Estimates

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

Our most critical accounting estimates include those related to goodwill and franchise value, income taxes, and acquisitions. We also have other key accounting policies for valuation of accounts receivable and expense accruals. However, these policies either do not meet the definition of critical accounting estimates described above or are not currently material items in our financial statements. We review our estimates, judgments and assumptions periodically and reflect the effects of revisions in the period that they are deemed to be necessary. We believe that these estimates are reasonable. However, actual results could differ materially from these estimates.

#### Goodwill and Franchise Value

We are required to test our goodwill and franchise value for impairment at least annually, or more frequently if conditions indicate that an impairment may have occurred. Goodwill is tested for impairment at the reporting unit level. Our reporting units are individual retail automotive stores as this is the level at which discrete financial information is available and for which operating results are regularly reviewed by our chief operating decision maker to allocate resources and assess performance.

We have the option to qualitatively or quantitatively assess goodwill for impairment and, in 2018, we evaluated our goodwill using a qualitative assessment process. If the qualitative factors determine that it is more likely than not that the fair value of the reporting unit exceeds the carrying amount, goodwill is not impaired. If the qualitative assessment determines it is more likely than not the fair value is less than the carrying amount, we would further evaluate for potential impairment.

As of December 31, 2018, we had \$434.9 million of goodwill on our balance sheet associated with 166 reporting units. No reporting unit accounted for more than 2.5% of our total goodwill as of December 31, 2018. The annual goodwill impairment analysis, which we perform as of October 1 of each year, did not result in an indication of impairment in 2018, 2017 or 2016.

We have determined the appropriate unit of accounting for testing franchise rights for impairment is on an individual store basis. We have the option to qualitatively or quantitatively assess indefinite-lived intangible assets for impairment. In 2018, we evaluated our indefinite-lived intangible assets using a qualitative assessment process. If the qualitative factors determine that it is more likely than not that the fair value of the individual store's franchise value exceeds the carrying amount, the franchise value is not impaired and the second step is not necessary. If the qualitative assessment determines it is more likely than not that the fair value is less than the carrying amount, then a quantitative valuation of our franchise value is performed and an impairment would be recorded.

As of December 31, 2018, we had \$288.7 million of franchise value on our balance sheet associated with 166 stores. No individual store accounted for more than 6.3% of our total franchise value as of December 31, 2018. Our



impairment testing of franchise value did not indicate any impairment in 2018, 2017 or 2016.

We are subject to financial statement risk to the extent that our goodwill or franchise rights become impaired due to decreases in the fair value. A future decline in performance, decreases in projected growth rates or margin assumptions or changes in discount rates could result in a potential impairment, which could have a material adverse impact on our financial position and results of operations. Furthermore, if a manufacturer becomes insolvent, we may be required to record a partial or total impairment on the franchise value and/or goodwill related to that manufacturer. No individual manufacturer accounted for more than 17.6% of our total franchise value and goodwill as of December 31, 2018.

See Notes 1 and 5 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

### Income Taxes

As of December 31, 2018, we had deferred tax assets of \$87.2 million, net of valuation allowance of \$1.1 million, and deferred tax liabilities of \$178.4 million. The principal components of our deferred tax assets are related to allowances and accruals, deferred revenue and cancellation reserves. The principal components of our deferred tax liabilities are related to depreciation on property and equipment, inventories and goodwill. As a result of the tax reform passed in December 2017, we recorded a reduction in the value of our net deferred tax liability of \$15.8 million.

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

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

As of December 31, 2018, we had a \$1.1 million valuation allowance against our deferred tax assets associated with state net operating losses. Since these amounts are dependent on generating future taxable income, we evaluated the income expectations in the underlying states and determined that it is unlikely these amounts will be fully utilized. If we are unable to meet the projected taxable income levels utilized in our analysis, and depending on the availability of feasible tax planning strategies, we might record an additional valuation allowance on a portion or all of our deferred tax assets in the future.

See Note 13 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

### Acquisitions

We account for acquisitions using the purchase method of accounting which requires recognition of assets acquired and liabilities assumed at fair value as of the date of the acquisition. Determination of the estimated fair value assigned to each assets acquired or liability assumed can materially impact the net income in subsequent periods through depreciation and amortization and potential impairment charges.

The most significant items we generally acquire in a transaction are inventory, long-lived assets, intangible franchise rights and goodwill. The fair value of acquired inventory is based on manufacturer invoice cost and market data. We estimate the fair value of property and equipment based on a market valuation approach. Additionally, we may use a cost valuation approach to value long-lived assets when a market valuation approach is unavailable. We apply an income approach for the fair value of intangible franchise rights which discounts the projected future net cash flow using an appropriate discount rate that reflects the risks associated with such projected future cash flow.

See Notes 1 and 14 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

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

#### Variable Rate Debt

Our syndicated credit facility, other floor plan notes payable and certain real estate mortgages are structured as variable rate debt. The interest rates on our variable rate debt are tied to either the one-month LIBOR, 3-month LIBOR, or the prime rate. These debt obligations, therefore, expose us to variability in interest payments due to changes in these rates. Certain floor plan debt is based on open-ended lines of credit tied to each individual store from the various manufacturer finance companies.

Our variable-rate floor plan notes payable, variable rate mortgage notes payable and other credit line borrowings subject us to market risk exposure. As of December 31, 2018, we had \$2.7 billion outstanding under such agreements at a weighted average interest rate of 3.8% per annum. A 10% increase in interest rates, or 38 basis points, would increase annual interest expense by approximately \$7.7 million, net of tax, based on amounts outstanding as of December 31, 2018.

#### Fixed Rate Debt

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

As of December 31, 2018, we had \$745.8 million of long-term fixed interest rate debt outstanding and recorded on the balance sheet, with maturity dates between January 12, 2019 and December 31, 2050. Based on discounted cash flows using current interest rates for comparable debt, we have determined that the fair value of this long-term fixed interest rate debt was approximately \$727.3 million as of December 31, 2018.

#### Risk Management Policies

We assess interest rate cash flow risk by identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. Our policy is to manage this risk through a mix of fixed rate and variable rate debt structures.

We maintain risk management controls to monitor interest rate cash flow attributable to both our outstanding and forecasted debt obligations, as well as our offsetting hedge positions. The risk management controls include assessing the impact to future cash flows of changes in interest rates.

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

The financial statements and notes thereto required by this item begin on page F-1 as listed in Item 15 of Part IV of this document. Quarterly financial data for each of the eight quarters in the two-year period ended December 31, 2018 is included following the financial statements and notes thereto.

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

None.

#### Item 9A. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

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

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

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

##### Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. In making this assessment, we used the criteria set forth in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In accordance with guidance issued by the SEC, companies are permitted to exclude acquisitions from their final assessment of internal controls over financial reporting during the year of the acquisition while integrating the acquired operations. Management's evaluation of internal control over financial reporting excludes the operations of the seventeen stores acquired in 2018, which represented 9% of total assets as of December 31, 2018 and 8% of total revenues for the year ended December 31, 2018.

Based on our assessment, our management concluded that, as of December 31, 2018, our internal control over financial reporting was effective.

KPMG LLP, our Independent Registered Public Accounting Firm, has issued an attestation report on our internal control over financial reporting as of December 31, 2018, which is included in Item 8 of this Form 10-K.

Item 9B. Other Information

None.

47

---

## PART III

## Item 10. Directors, Executive Officers and Corporate Governance

Information required by this item will be included in our Proxy Statement for our 2019 Annual Meeting of Shareholders and, upon filing with the SEC within 120 days of December 31, 2018, is incorporated herein by reference.

## Item 11. Executive Compensation

Information required by this item will be included in our Proxy Statement for our 2019 Annual Meeting of Shareholders and, upon filing with the SEC within 120 days of December 31, 2018, is incorporated herein by reference.

## Item 12. Security Ownership of Certain Beneficial Owners and Management

## Equity Compensation Plan Information

The following table summarizes equity securities authorized for issuance as of December 31, 2018.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) <sup>(2)</sup>
Equity compensation plans approved by shareholders	409,865	\$—	(1) 1,403,645
Equity compensation plans not approved by shareholders	—	—	—
Total	409,865	\$—	1,403,645

(1) There is no exercise price associated with our restricted stock units.

(2) Includes 1,265,002 shares available pursuant to our 2013 Amended and Restated Stock Incentive Plan and 138,643 shares available pursuant to our Employee Stock Purchase Plan.

The additional information required by this item will be included in our Proxy Statement for our 2019 Annual Meeting of Shareholders and, upon filing with the SEC within 120 days of December 31, 2018, is incorporated herein by reference.

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

Information required by this item will be included in our Proxy Statement for our 2019 Annual Meeting of Shareholders and, upon filing with the SEC within 120 days of December 31, 2018, is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information required by this item will be included in our Proxy Statement for our 2019 Annual Meeting of Shareholders and, upon filing with the SEC within 120 days of December 31, 2018, is incorporated herein by reference.



PART IV

Item 15. Exhibits and Financial Statement Schedules

Financial Statements and Schedules

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

	Page
Report of Independent Registered Public Accounting Firm	<u>F- 1</u>
Consolidated Balance Sheets as of December 31, 2018 and 2017	<u>F- 3</u>
Consolidated Statements of Operations for the years ended December 31, 2018, 2017 and 2016	<u>F- 4</u>
Consolidated Statements of Comprehensive Income for the years ended December 31, 2018, 2017 and 2016	<u>F- 5</u>
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2018, 2017 and 2016	<u>F- 6</u>
Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016	<u>F- 7</u>
Notes to Consolidated Financial Statements	<u>F- 8</u>
Selected Quarterly Financial Information (Unaudited)	<u>F- 34</u>

There are no schedules required to be filed herewith.

Item 16. Form 10-K Summary

None.

Exhibit Index

The following exhibits are filed herewith. An asterisk (\*) beside the exhibit number indicates the exhibits containing a management contract, compensatory plan or arrangement.

Exhibit Description

- 2.1 Stock Purchase Agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014 (incorporated by reference to exhibit 2.1 to the Company's Form 8-K filed October 3, 2014)
- 2.1.1 First Amendment to Stock Purchase Agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited effective July 15, 2014 (incorporated by reference to exhibit 2.2 to the Company's Form 10-Q for the quarter ended June 30, 2014)
- 2.1.2 Second Amendment to Stock Purchase Agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited effective November 13, 2014 (incorporated by reference to exhibit 2.1.2 to the Company's Form 10-K for the year ended December 31, 2014)
- 3.1 Restated Articles of Incorporation of Lithia Motors, Inc., as amended May 13, 1999 (incorporated by reference to exhibit 3.1 to the Company's Form 10-K for the year ended December 31, 1999)
- 3.2 2013 Amended and Restated Bylaws of Lithia Motors, Inc. (incorporated by reference to exhibit 3.1 to the Company's Form 8-K filed August 26, 2013)
- 4.1 Indenture, dated as of July 24, 2017, among Lithia Motors, Inc., the Guarantors and the Trustee (incorporated by reference to exhibit 4.1 to Form 8-K dated July 24, 2017 and filed with the Securities and Exchange Commission on July 24, 2017).

4.2 Form of 5.250% Senior Notes due 2025 (included as part of Exhibit 4.1)(incorporated by reference to exhibit 4.1 to Form 8-K dated July 24, 2017 and filed with the Securities and Exchange Commission on July 24, 2017).

10.1\* 2009 Employee Stock Purchase Plan (incorporated by reference to Appendix A to the Company's Proxy Statement for its 2009 annual meeting of shareholders filed on March 20, 2009)

10.1.1\* Amendment 2014-1 to the Lithia Motors, Inc. 2009 Employee Stock Purchase Plan (incorporated by reference to exhibit 10.1.1 to the Company's Form 10-K for the year ended December 31, 2014)

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Exhibit	Description
<u>10.2</u> *	Lithia Motors, Inc. 2013 Amended and Restated Stock Incentive Plan (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed May 2, 2013)
<u>10.2.1</u> *	RSU Deferral Plan (incorporated by reference to exhibit 10.3.1 to the Company's Form 10-K for the year ended December 31, 2011)
<u>10.2.2</u> *	Amendment to RSU Deferral Plan (incorporated by reference to exhibit 10.2.2 to the Company's Form 10-K for the year ended December 31, 2014)
<u>10.2.3</u> *	Restricted Stock Unit (RSU) Deferral Election Form (incorporated by reference to exhibit 10.2.3 to the Company's Form 10-K for the year ended December 31, 2014)
<u>10.3</u> *	Form of Restricted Stock Unit Agreement (2016 Performance- and Time-Vesting) (for Senior Executives) (incorporated by reference to exhibit 10.3.3 to the Company's Form 10-K for the year ended December 31, 2015)
<u>10.3.1</u> *	Form of Restricted Stock Unit Agreement (2017 Performance- and Time-Vesting) (for Senior Executives) (incorporated by reference to exhibit 10.3.1 to the Company's Form 10-K for the year ended December 31, 2016)
<u>10.3.2</u> *	Form of Restricted Stock Unit Agreement (2018 Performance- and Time-Vesting) (for Senior Executives) (incorporated by reference to exhibit 10.3.2 to the Company's Form 10-K for the year ended December 31, 2017)
<u>10.3.3</u> *	Form of Restricted Stock Unit Agreement (2019 Performance- and Time-Vesting) (for Senior Executives)
<u>10.3.4</u> *	Form of Restricted Stock Unit Agreement (Time-Vesting)
<u>10.4</u> *	Lithia Motors, Inc. 2013 Discretionary Support Services Variable Performance Compensation Plan (incorporated by reference to exhibit 10.2 to the Company's Form 8-K filed May 2, 2013)
<u>10.5</u> *	Form of Outside Director Nonqualified Deferred Compensation Agreement (incorporated by reference to exhibit 10.20 to the Company's Form 10-K for the year ended December 31, 2005)
<u>10.6</u>	Second Amended and Restated Loan Agreement, dated June 25, 2018, among Lithia Motors, Inc., the subsidiaries of Lithia Motors, Inc. listed on the signature pages of the agreement or that thereafter become borrowers thereunder, the lenders party thereto from time to time, and U.S. Bank National Association (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed June 29, 2018)
<u>10.6.1</u>	First Amendment to Second Amended and Restated Loan Agreement, dated August 31, 2018, among Lithia Motors, Inc., the subsidiaries of Lithia Motors, Inc. listed on the signature pages of the agreement or that thereafter become borrowers thereunder, the lenders party thereto from time to time, and U.S. Bank National Association (incorporated by reference to exhibit 10.1 to the Company's Form 10-Q filed October 26, 2018)
<u>10.6.2</u>	Second Amendment to Second Amended and Restated Loan Agreement, dated October 19, 2018, among Lithia Motors, Inc., the subsidiaries of Lithia Motors, Inc. listed on the signature pages of the agreement or that thereafter become borrowers thereunder, the lenders party thereto from time to time, and U.S. Bank National Association

- 10.7\* Amended and Restated Split-Dollar Agreement (incorporated by reference to exhibit 10.17 to the Company's Form 10-K for the year ended December 31, 2012)
- 10.8\* Form of Indemnity Agreement for each Named Executive Officer (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed May 29, 2009)
- 10.9\* Form of Indemnity Agreement for each non-management Director (incorporated by reference to exhibit 10.2 to the Company's Form 8-K filed May 29, 2009)
- 10.10\* Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan (incorporated by reference to exhibit 10.1 to the Company's Form 10-Q for the quarter ended March 31, 2016)
- 10.10.1\* Form of Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan – Notice of Discretionary Contribution Award for Sidney DeBoer (incorporated by reference to exhibit 10.22.1 to the Company's Form 10-K for the year ended December 31, 2010)
- 10.10.2\* Form of Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan – Notice of Discretionary Contribution Award (incorporated by reference to exhibit 10.22.2 to the Company's Form 10-K for the year ended December 31, 2010)
- 10.11\* Transition Agreement dated September 14, 2015 between Lithia Motors, Inc. and Sidney B. DeBoer (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed September 17, 2015)

Exhibit Description

- 10.11.1\* Amendment to Transition Agreement dated January 22, 2019 between Lithia Motors, Inc. and Sidney B. DeBoer (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed January 25, 2019)
- 10.11.2\* Class B Conversion Agreement dated January 22, 2019 between Lithia Motors, Inc. and Sidney B. DeBoer (incorporated by reference to exhibit 10.2 to the Company's Form 8-K filed January 25, 2019)
- 10.12\* Director Service Agreement effective January 1, 2016 between Lithia Motors, Inc. and Sidney B. DeBoer (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed September 17, 2015)
- 10.13\* Form of Employment and Change in Control Agreement dated February 4, 2016 between Lithia Motors, Inc. and Bryan DeBoer (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed February 5, 2016)<sup>(1)</sup>
- 21 Subsidiaries of Lithia Motors, Inc.
- 23 Consent of KPMG LLP, Independent Registered Public Accounting Firm
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.
- Substantially similar agreements exist between Lithia Motors, Inc. and each of Mark DeBoer, Tom Dobry, Scott Hillier, Christopher S. Holzshu, Erik Lewis, George Liang, John F. North III, and Bryan Osterhout. The "Cash Change in Control Benefits" under the agreements with Mark DeBoer and Tom Dobry provide for 12 months of base salary rather than 24 months.

SIGNATURES

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

Date: February 22, 2019 LITHIA MOTORS, INC.

By /s/ Bryan B. DeBoer  
Bryan B. DeBoer  
Director, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on February 22, 2019:

Signature	Title
/s/ Bryan B. DeBoer Bryan B. DeBoer	Director, President and Chief Executive Officer. (Principal Executive Officer)
/s/ John F. North, III John F. North, III	Senior Vice President and Chief Financial Officer (Principal Accounting Officer)
/s/ Sidney B. DeBoer Sidney B. DeBoer	Chairman of the Board
/s/ Thomas R. Becker Thomas Becker	Director
/s/ Susan O. Cain Susan O. Cain	Director
/s/ Louis P. Miramontes Louis P. Miramontes	Director
/s/ Kenneth E. Roberts Kenneth E. Roberts	Director
/s/ David J. Robino David J. Robino	Director

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors  
Lithia Motors, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Lithia Motors, Inc. and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 22, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 1993.  
Portland, Oregon  
February 22, 2019

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors  
Lithia Motors, Inc.:

Opinion on Internal Control Over Financial Reporting

We have audited Lithia Motors, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements), and our report dated February 22, 2019 expressed an unqualified opinion on those consolidated financial statements.

The Company acquired 17 stores during 2018, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2018, all of these acquired stores' internal control over financial reporting. The total assets of these 17 stores represented approximately 9% of consolidated total assets as of December 31, 2018 and approximately 8% of consolidated revenues for the year ended December 31, 2018. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of these 17 stores.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally



accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

/s/ KPMG LLP  
Portland, Oregon  
February 22, 2019

F- 2

---

## LITHIA MOTORS, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

(In millions)

	December 31,	
	2018	2017
Assets		
Current Assets:		
Cash and cash equivalents	\$31.6	\$57.3
Accounts receivable, net of allowance for doubtful accounts of \$7.2 and \$7.4	529.4	521.9
Inventories, net	2,365.3	2,132.7
Other current assets	65.1	70.9
Total Current Assets	2,991.4	2,782.8
Property and equipment, net of accumulated depreciation of \$240.5 and \$197.8	1,448.0	1,185.2
Goodwill	434.9	256.3
Franchise value	288.7	187.0
Other non-current assets	221.0	271.8
Total Assets	\$5,384.0	\$4,683.1
Liabilities and Stockholders' Equity		
Current Liabilities:		
Floor plan notes payable	\$324.4	\$116.8
Floor plan notes payable: non-trade	1,733.3	1,802.3
Current maturities of long-term debt	25.9	18.9
Trade payables	126.3	111.4
Accrued liabilities	283.6	251.6
Total Current Liabilities	2,493.5	2,301.0
Long-term debt, less current maturities	1,358.2	1,028.5
Deferred revenue	121.7	103.1
Deferred income taxes	91.2	56.3
Other long-term liabilities	122.2	111.0
Total Liabilities	4,186.8	3,599.9
Stockholders' Equity:		
Preferred stock - no par value; authorized 15.0 shares; none outstanding	—	—
Class A common stock - no par value; authorized 100.0 shares; issued and outstanding 22.0 and 24.0	—	149.1
Class B common stock - no par value; authorized 25.0 shares; issued and outstanding 1.0 and 1.0	0.1	0.1
Additional paid-in capital	35.0	11.3
Retained earnings	1,162.1	922.7
Total Stockholders' Equity	1,197.2	1,083.2
Total Liabilities and Stockholders' Equity	\$5,384.0	\$4,683.1

See accompanying notes to consolidated financial statements.

## LITHIA MOTORS, INC. AND SUBSIDIARIES

## Consolidated Statements of Operations

(In millions, except per share amounts)

	Year Ended December 31,		
	2018	2017	2016
Revenues:			
New vehicle	\$6,602.8	\$5,763.6	\$4,938.4
Used vehicle retail	3,079.0	2,544.4	2,227.0
Used vehicle wholesale	331.3	277.8	276.6
Finance and insurance	454.8	385.9	330.9
Service, body and parts	1,222.3	1,015.8	844.5
Fleet and other	131.2	99.0	60.8
Total revenues	11,821.4	10,086.5	8,678.2
Cost of sales:			
New vehicle	6,217.7	5,423.8	4,649.0
Used vehicle retail	2,756.1	2,257.6	1,963.3
Used vehicle wholesale	325.8	273.0	272.3
Service, body and parts	621.6	522.7	434.2
Fleet and other	123.2	93.3	58.1
Total cost of sales	10,044.4	8,570.4	7,376.9
Gross profit	1,777.0	1,516.1	1,301.3
Asset impairments	1.3	—	14.0
Selling, general and administrative	1,253.3	1,049.4	899.6
Depreciation and amortization	75.4	57.7	49.3
Operating income	447.0	409.0	338.4
Floor plan interest expense	(62.3 )	(39.3 )	(25.6 )
Other interest expense	(56.0 )	(34.8 )	(23.2 )
Other income (expense), net	8.8	12.2	(6.1 )
Income before income taxes	337.5	347.1	283.5
Income tax provision	(71.8 )	(101.9 )	(86.4 )
Net income	\$265.7	\$245.2	\$197.1
Basic net income per share	\$10.91	\$9.78	\$7.76
Shares used in basic per share calculations	24.4	25.1	25.4
Diluted net income per share	\$10.86	\$9.75	\$7.72
Shares used in diluted per share calculations	24.5	25.1	25.5
Cash dividends paid per Class A and Class B share	\$1.14	\$1.06	\$0.95

See accompanying notes to consolidated financial statements.

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

	Year Ended December		
	31,		
	2018	2017	2016
Net income	\$265.7	\$245.2	\$197.1
Other comprehensive income, net of tax:			
Gain on cash flow hedges, net of tax expense of \$0, \$0 and \$0.2	—	—	0.3
Comprehensive income	\$265.7	\$245.2	\$197.4

See accompanying notes to consolidated financial statements.

F- 5

---

## LITHIA MOTORS, INC. AND SUBSIDIARIES

## Consolidated Statements of Changes in Stockholders' Equity

(In millions)

	Common Stock		Class B		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
	Class A Shares	Amount	Shares	Amount				
Balance at December 31, 2015	23.6	\$ 258.5	2.6	\$ 0.3	\$ 38.8	\$ (0.3 )	\$ 530.8	\$ 828.1
Net income	—	—	—	—	—	—	197.1	197.1
Gain on cash flow hedges, net of tax expense of \$0.2	—	—	—	—	—	0.3	—	0.3
Issuance of stock in connection with employee stock plans	0.1	6.9	—	—	—	—	—	6.9
Issuance of restricted stock to employees	0.2	—	—	—	—	—	—	—
Repurchase of Class A common stock	(1.4 )	(112.9 )	—	—	—	—	—	(112.9 )
Class B common stock converted to Class A common stock	0.8	0.1	(0.8)	(0.1 )	—	—	—	—
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	13.0	—	—	2.4	—	—	15.4
Dividends paid	—	—	—	—	—	—	(24.1 )	(24.1 )
Balance at December 31, 2016	23.3	165.6	1.8	0.2	41.2	—	703.8	910.8
Adjustment to adopt ASU 2016-09	—	—	—	—	(0.2 )	—	0.2	—
Net income	—	—	—	—	—	—	245.2	245.2
Issuance of stock in connection with employee stock plans	0.1	7.5	—	—	—	—	—	7.5
Issuance of restricted stock to employees	0.1	—	—	—	—	—	—	—
Repurchase of Class A common stock	(0.4 )	(33.8 )	—	—	—	—	—	(33.8 )
Class B common stock converted to Class A common stock	0.8	0.1	(0.8)	(0.1 )	—	—	—	—
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	7.6	—	—	3.7	—	—	11.3
Option premiums paid	—	—	—	—	(33.4 )	—	—	(33.4 )
Dividends paid	—	—	—	—	—	—	(26.5 )	(26.5 )
Issuance of stock in connection with acquisitions	—	2.1	—	—	—	—	—	2.1
Balance at December 31, 2017	23.9	149.1	1.0	0.1	11.3	—	922.7	1,083.2
Net income	—	—	—	—	—	—	265.7	265.7
Issuance of stock in connection with employee stock plans	0.1	10.1	—	—	—	—	—	10.1
Issuance of restricted stock to employees	0.1	—	—	—	—	—	—	—
Repurchase of Class A common stock	(2.1 )	(168.5 )	—	—	19.6	—	—	(148.9 )
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	9.3	—	—	4.1	—	—	13.4
Dividends paid	—	—	—	—	—	—	(27.7 )	(27.7 )

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Cumulative effect adjustment to adopt ASC 606	—	—	—	—	—	—	1.4	1.4
Balance at December 31, 2018	22.0	\$—	1.0	\$ 0.1	\$ 35.0	\$ —	\$1,162.1	\$ 1,197.2

See accompanying notes to consolidated financial statements.

F- 6

---

## LITHIA MOTORS, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(In millions)

	Year Ended December 31,		
	2018	2017	2016
Cash flows from operating activities:			
Net income	\$265.7	\$245.2	\$197.1
Adjustments to reconcile net income to net cash provided by operating activities:			
Asset impairments	1.3	—	14.0
Depreciation and amortization	75.4	57.7	49.3
Stock-based compensation	13.3	11.3	11.0
Loss (gain) on disposal of other assets	0.2	(0.4 )	(4.3 )
Gain from disposal activities	(15.1 )	(5.1 )	(1.1 )
Deferred income taxes	33.0	(2.8 )	10.1
(Increase) decrease (net of acquisitions and dispositions):			
Trade receivables, net	4.7	(57.4 )	(106.0 )
Inventories	(108.9 )	(193.1 )	(168.8 )
Other assets	(16.0 )	(3.1 )	(13.3 )
Increase (decrease) (net of acquisitions and dispositions):			
Floor plan notes payable	196.9	20.3	16.4
Trade payables	15.1	20.0	16.4
Accrued liabilities	28.9	37.2	42.9
Other long-term liabilities and deferred revenue	25.2	19.1	27.2
Net cash provided by operating activities	519.7	148.9	90.9
Cash flows from investing activities:			
Capital expenditures	(158.0 )	(105.4 )	(100.8 )
Proceeds from sales of assets	3.1	15.3	2.2
Cash paid for other investments	(62.7 )	(8.6 )	(30.3 )
Cash paid for acquisitions, net of cash acquired	(373.8 )	(460.4 )	(234.7 )
Proceeds from sales of stores	34.3	20.9	11.9
Net cash used in investing activities	(557.1 )	(538.2 )	(351.7 )
Cash flows from financing activities:			
(Repayments) borrowings on floor plan notes payable: non-trade, net	(21.9 )	241.5	252.9
Borrowings on lines of credit	2,691.4	1,754.5	1,244.3
Repayments on lines of credit	(2,499.6 )	(1,836.2 )	(1,123.1 )
Principal payments on long-term debt, scheduled	(26.5 )	(18.2 )	(16.7 )
Principal payments on long-term debt and capital leases, other	(26.1 )	(50.3 )	(27.7 )
Proceeds from issuance of long-term debt	62.1	395.9	66.5
Payment of debt issuance costs	(0.4 )	(4.7 )	—
Proceeds from issuance of common stock	10.1	7.5	6.9
Repurchase of common stock	(148.9 )	(33.8 )	(112.9 )
Dividends paid	(27.7 )	(26.5 )	(24.1 )
Payments of contingent consideration related to acquisitions	(0.8 )	—	—
Other financing activity	—	(33.4 )	—
Net cash provided by financing activities	11.7	396.3	266.1
(Decrease) increase in cash and cash equivalents	(25.7 )	7.0	5.3
Cash and cash equivalents at beginning of year	57.3	50.3	45.0
Cash and cash equivalents at end of year	\$31.6	\$57.3	\$50.3

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Supplemental disclosure of cash flow information:

Cash paid during the period for interest	\$117.1	\$68.9	\$49.7
Cash paid during the period for income taxes, net	32.9	127.3	57.2
Floor plan debt paid in connection with store disposals	33.1	3.7	5.3

Supplemental schedule of non-cash activities:

Debt issued in connection with acquisitions	\$125.1	\$1.8	\$—
Non-cash assets transferred in connection with acquisitions	—	—	2.6
Debt assumed in connection with acquisitions	10.8	84.3	48.1
Acquisition of assets with capital leases	—	—	8.9
Issuance of Class A common stock in connection with acquisition	—	2.1	—

See accompanying notes to consolidated financial statements.

F- 7

---



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

Note 1. Summary of Significant Accounting Policies

Organization and Business

We are one of the largest automotive retailers in the United States and are among the fastest growing companies in the Fortune 500 (#294-2018) with 182 stores representing 28 brands in 18 states. We offer vehicles online and through our nationwide retail network. Our "Growth Powered by People" strategy drives us to innovate and continuously improve the customer experience. 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.

Basis of Presentation

The accompanying Consolidated Financial Statements reflect the results of operations, the financial position and the cash flows for Lithia Motors, Inc. and its directly and indirectly wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivable 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 within five to ten days of selling a vehicle.
- Trade receivables are comprised of amounts due from customers, 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.

Receivables are recorded at invoice and do not bear interest until they are 60 days past due. The allowance for doubtful accounts represents an estimate of the amount of net losses inherent in our portfolio of accounts receivable as of the reporting date. We estimate an allowance for doubtful accounts based on our historical write-off experience and consider 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. See Note 2.

Inventories

Inventories are valued at the lower of net realizable value or cost, using the specific identification method for new vehicles, pooled approach for used vehicles, and the lower of cost (first-in, first-out) or market method for parts. The cost of new and used vehicle inventories includes the cost of any equipment added, reconditioning and transportation. Certain acquired inventories are valued using the last-in first-out (LIFO) method. The LIFO reserve associated with this inventory as of December 31, 2018 and 2017 was immaterial.

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

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

F- 8

---

### Property and Equipment

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

The range of estimated useful lives is as follows:

Buildings and improvements	5 to 40 years
Service equipment	5 to 15 years
Furniture, office equipment, signs and fixtures	3 to 10 years

The cost for maintenance, repairs and minor renewals is expensed as incurred, while significant remodels and betterments are capitalized. In addition, interest on borrowings for major capital projects, significant remodels, and betterments are capitalized. Capitalized interest becomes a part of the cost of the depreciable asset and is depreciated according to the estimated useful lives as previously stated. For the years ended December 31, 2018, 2017 and 2016, we recorded capitalized interest of \$1.3 million, \$0.5 million and \$0.4 million, respectively.

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

Leased property meeting certain criteria are recorded as capital leases. We have capital leases for certain locations, expiring at various dates through December 31, 2050. Our capital leases are included in property and equipment on our Consolidated Balance Sheets. Amortization of capitalized leased assets is computed on a straight-line basis over the term of the lease, unless the lease transfers title or it contains a bargain purchase option, in which case, it is amortized over the asset's useful life and is included in depreciation expense. Capital lease obligations are recorded as the lesser of the estimated fair market value of the leased property or the net present value of the aggregated future minimum payments and are included in current maturities of long-term debt and long-term debt on our Consolidated Balance Sheets. Interest associated with these obligations is included in other interest expense in the Consolidated Statements of Operations. See Note 7.

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

### Goodwill

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

Goodwill is not amortized but tested for impairment at least annually, and more frequently if events or circumstances indicate the carrying amount of the reporting unit more likely than not exceeds fair value. We have the option to qualitatively or quantitatively assess goodwill for impairment and we evaluated our goodwill using a qualitative assessment process. Goodwill is tested for impairment at the reporting unit level. Our reporting units are individual stores as this is the level at which discrete financial information is available and for which operating results are regularly reviewed by our chief operating decision maker to allocate resources and assess performance.

We test our goodwill for impairment on October 1 of each year. In 2018, we evaluated our goodwill using a qualitative assessment process. If the qualitative factors determine that it is more likely than not that the fair value of the reporting unit exceeds the carrying amount, goodwill is not impaired. If the qualitative assessment determines it is more likely than not the fair value is less than the carrying amount, we would further evaluate for potential impairment. See Note 5.

#### Franchise Value

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

F- 9

---

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

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

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

As an indefinite-lived intangible asset, franchise value is tested for impairment at least annually, and more frequently if events or circumstances indicate the carrying value may exceed fair value. The impairment test for indefinite-lived intangible assets requires the comparison of estimated fair value to carrying value. An impairment charge is recorded to the extent the fair value is less than the carrying value. We have the option to qualitatively or quantitatively assess indefinite-lived intangible assets for impairment. We evaluated our indefinite-lived intangible assets using a qualitative assessment process. We have determined the appropriate unit of accounting for testing franchise value for impairment is each individual store.

We test our franchise value for impairment on October 1 of each year. In 2018, we evaluated our franchise value using a qualitative assessment process. If the qualitative factors discussed above determine that it is more likely than not that the fair value of the individual store's franchise value exceeds the carrying amount, the franchise value is not impaired and the second step is not necessary. If the qualitative assessment determines it is more likely than not the fair value is less than the carrying value, then a quantitative valuation of our franchise value is performed and an impairment would be recorded. See Note 5.

#### Equity-Method Investments

In 2016, we owned investments in certain partnerships which we accounted for under the equity method. These investments were included as a component of other non-current assets in our Consolidated Balance Sheets. We determined that we lacked certain characteristics to direct the operations of the businesses and, as a result, did not qualify to consolidate these investments. Activity related to our equity-method investments is recognized in our Consolidated Statements of Operations as follows:

- an other than temporary decline in fair value is reflected as an asset impairment;
- our portion of the operating gains and losses is included as a component of other (expense) income, net;
- the amortization related to the discounted fair value of future equity contributions is recognized over the life of the investments as non-cash interest expense; and
- tax benefits and credits are reflected as a component of our income tax provision.

Periodically, whenever events or circumstances indicate that the carrying amount of assets may be impaired, we evaluate the equity-method investments for indications of loss resulting from an other than temporary decline. If the equity-method investment is determined to be impaired, the amount by which the carrying amount exceeds the fair

value of the investment is recognized as a charge to income from operations. See Notes 12 and 17.

#### Advertising

We expense production and other costs of advertising as incurred as a component of selling, general and administrative expense. Additionally, manufacturer cooperative advertising credits for qualifying, specifically-identified advertising expenditures are recognized as a reduction of advertising expense. Advertising expense and manufacturer cooperative advertising credits were as follows (in millions):

Year Ended December 31,	2018	2017	2016
Advertising expense, gross	\$134.2	\$116.1	\$101.7
Manufacturer cooperative advertising credits	(25.5 )	(22.8 )	(20.3 )
Advertising expense, net	\$108.7	\$93.3	\$81.4

F- 10

---

#### Contract Origination Costs

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

#### Legal Costs

We are a party to numerous legal proceedings arising in the normal course of business. We accrue for certain legal costs, including attorney fees and potential settlement claims related to various legal proceedings that are estimable and probable. See Note 7.

#### Stock-Based Compensation

Compensation costs associated with equity instruments exchanged for employee and director services are measured at the grant date, based on the fair value of the award. If there is a performance-based element to the award, the expense is recognized based on the estimated attainment level, estimated time to achieve the attainment level and/or the vesting period. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards. The fair value of non-vested stock awards is based on the intrinsic value on the date of grant. Shares to be issued upon the exercise of stock options and the vesting of stock awards will come from newly issued shares. See Note 10.

In January 2017, we adopted ASU 2016-09, which simplifies the accounting for several aspects of 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. As a result, we recorded the following:

Reclassified \$0.2 million as a decrease to additional paid-in capital and an increase to retained earnings upon adoption related to our policy election to record forfeitures as they occur.

All prior periods presented in our Consolidated Statements of Cash Flows have been adjusted for the presentation of excess tax benefits on the cash flow statement. This resulted in a \$4.4 million reclassification between financing and operating cash flows for the year ended December 31, 2016.

We had \$0.3 million of tax-affected state net operating loss carryforwards related to excess tax benefits for which a deferred tax asset had not been recognized. At adoption, this amount was recorded with the offset to retained earnings. Additionally, we do not believe that it is more-likely-than-not that the asset will be utilized and, as a result, a valuation allowance in the same amount was recorded that offset the impact to retained earnings. See Note 13.

#### Income and Other Taxes

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

When there are situations with uncertainty as to the timing of the deduction, the amount of the deduction, or the validity of the deduction, we adjust our financial statements to reflect only those tax positions that are more-likely-than-not to be sustained. Positions that meet this criterion are measured using the largest benefit that is more than 50% likely to be realized. Interest and penalties are recorded as income tax provision in the period incurred or accrued when related to an uncertain tax position. See Note 13.

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

#### Concentration of Risk and Uncertainties

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

We depend on our manufacturers to provide a supply of vehicles which supports expected sales levels. In the event that manufacturers are unable to supply the needed level of vehicles, our financial performance may be adversely impacted.

We depend on our manufacturers to deliver high-quality, defect-free vehicles. In the event that manufacturers experience future quality issues, our financial performance may be adversely impacted.

F- 11

---



We are subject to a concentration of risk in the event of financial distress, including potential reorganization or bankruptcy, of a major vehicle manufacturer. Our sales volume could be materially adversely impacted by the manufacturers' or distributors' inability to supply the stores with an adequate supply of vehicles. We also receive incentives and rebates from our manufacturers, including cash allowances, financing programs, discounts, holdbacks and other incentives. These incentives are recorded as accounts receivable in our Consolidated Balance Sheets until payment is received. Our financial condition could be materially adversely impacted by the manufacturers' or distributors' inability to continue to offer these incentives and rebates at substantially similar terms, or to pay our outstanding receivables.

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

We have a credit facility with a syndicate of 20 financial institutions, including seven manufacturer-affiliated finance companies. Several of these financial institutions also provide vehicle financing for certain new vehicles, vehicles that are designated for use as service loaners and mortgage financing. This credit facility is the primary source of floor plan financing for our new vehicle inventory and also provides used vehicle financing and a revolving line of credit. The term of the facility extends through July 2023. At maturity, our financial condition could be materially adversely impacted if lenders are unable to provide credit that has typically been extended to us or with terms unacceptable to us. Our financial condition could be materially adversely impacted if these providers incur losses in the future or undergo funding limitations. See Note 6.

We anticipate continued organic growth and growth through acquisitions. This growth will require additional credit which may be unavailable or with terms unacceptable to us. If these events were to occur, we may not be able to borrow sufficient funds to facilitate our growth.

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

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

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates. See Note 12.

We have variable rate floor plan notes payable, mortgages and other credit line borrowings that subject us to market risk exposure. At December 31, 2018, we had \$2.7 billion outstanding in variable rate debt. These borrowings had interest rates ranging from 3.77% to 6.75% per annum. An increase or decrease in the interest rates would affect interest expense for the period accordingly.

The fair value of long-term, fixed interest rate debt is subject to interest rate risk. Generally, the fair value of fixed interest rate debt will increase as interest rates fall because we could refinance for a lower rate. Conversely, the fair value of fixed interest rate debt will decrease as interest rates rise. The interest rate changes affect the fair value, but do not impact earnings or cash flows. We monitor our fixed interest rate debt regularly, refinancing debt that is materially above market rates if permitted. See Note 12.

#### Use of Estimates

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

Estimates are used in the calculation of certain reserves maintained for charge-backs on estimated cancellations of service contracts; life, accident and disability insurance policies; finance fees from customer financing contracts and uncollectible accounts receivable.

We also use estimates in the calculation of various expenses, accruals and reserves, including anticipated losses related to workers' compensation insurance; anticipated losses related to self-insurance components of our property and casualty and medical insurance; self-insured lifetime lube, oil and filter service contracts; discretionary employee bonuses, the Transition Agreement with Sidney B. DeBoer, our Chairman of the Board; warranties provided on certain products and services; legal reserves and stock-based compensation. We also make certain estimates regarding the assessment of the recoverability of long-lived assets, indefinite-lived intangible assets and deferred tax assets.

F- 12

---

We offer a limited warranty on the sale of most retail used vehicles. This warranty is based on mileage and time. We also offer a mileage and time based warranty on parts used in our service repair work and on tire purchases. The cost that may be incurred for these warranties is estimated at the time the related revenue is recorded. A reserve for these warranty liabilities is estimated based on current sales levels, warranty experience rates and estimated costs per claim. The annual activity for reserve increases and claims is immaterial. As of December 31, 2018 and 2017, the accrued warranty balance was \$0.5 million and \$0.4 million, respectively.

#### Fair Value of Assets Acquired and Liabilities Assumed

We estimate the fair value of the assets acquired and liabilities assumed in a business combination using various assumptions. The most significant assumptions used relate to determining the fair value of property and equipment and intangible franchise rights.

We estimate the fair value of property and equipment 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.

We estimate the fair value of our franchise rights primarily using the Multi-Period Excess Earnings (“MPEE”) model. The forecasted cash flows used in the MPEE model contain inherent uncertainties, including significant estimates and assumptions related to growth rates, margins, general operating expenses, and cost of capital. We use primarily internally-developed forecasts and business plans to estimate the future cash flows that each franchise will generate. We have determined that only certain cash flows of the store are directly attributable to the franchise rights. We estimate the appropriate interest rate to discount future cash flows to their present value equivalent taking into consideration factors such as a risk-free rate, a peer group average beta, an equity risk premium and a small stock risk premium. Additionally, we also may use a market approach to determine the fair value of our franchise rights. These market data points include our acquisition and divestiture experience and third-party broker estimates.

We use a relief-from-royalty method to determine the fair value of a trade name. Future cost savings associated with owning, rather than licensing, a trade name is estimated based on a royalty rate and management’s forecasted sales projections. The discount rate applied to the future cost savings factors an equity market risk premium, small stock risk premium, an average peer group beta, a risk-free interest rate and a premium for forecast risk.

#### Revenue Recognition

The following describes our major product lines, which represent the disaggregation of our revenues to transactions that are similar in nature, amount, timing, uncertainties and economic factors.

#### New Retail Vehicle and Used Retail Vehicle Sales

Revenue from the retail sale of a vehicle is recognized at a point in time, as all performance obligations are satisfied when a contract is signed by the customer, financing has been arranged or collectibility is probable and the control of the vehicle is transferred to the customer. The transaction price for a retail vehicle sale is specified in the contract with the customer and includes all cash and non-cash consideration. In a retail vehicle sale, customers often trade in their current vehicle. The trade-in is measured at its stand-alone selling price in the contract, utilizing various third-party pricing sources. There are no other non-cash forms of consideration related to retail sales. All vehicle rebates are applied to the vehicle purchase price at the time of the sale and are therefore incorporated into the price of the contract at the time of the exchange. We do not allow the return of new or used vehicles, except where mandated by state law.

Service, Body and Parts Sales

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

We are the obligor on our lifetime oil contracts. Revenue is allocated to these performance obligations and is recognized over time as services are provided to the customer. The amount of revenue recognized is calculated, net of cancellations, using an input method, which most closely depicts performance of the contracts. Our contract liability balances were \$149.6 million and \$126.1 million as of December 31, 2018, and December 31, 2017, respectively; and we recognized \$21.9 million of revenue in the year ended December 31, 2018, related to our opening contract liability balance. Our contract liability balance is included in accrued liabilities and deferred revenue.

F- 13

---

### Finance and Insurance Sales

Revenue from finance and insurance sales is recognized, net of estimated charge-backs, at the time of the sale of the related vehicle. As a part of the vehicle sale, we seek to arrange financing for customers and sell a variety of add-ons, such as extended warranty service contracts. These products are inherently attached to the governing vehicle and performance of the obligation cannot be performed without the underlying sale of the vehicle. We act as an agent in the sale of these contracts as the pricing is set by the third-party provider, and our commission is preset. A portion of the transaction price related to sales of finance and insurance contracts is considered variable consideration and is estimated and recognized upon the sale of the contract under the new standard. We recognized a \$9.2 million asset associated with future estimated variable consideration on January 1, 2018, related to contracts sold on or before December 31, 2017. Our contract asset balance was \$9.2 million as of December 31, 2018, and is included in trade receivables and other non-current assets.

### Segment Reporting

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 include the results of operations of our stand-alone collision center 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 operating 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, excepted for the internal allocation within Corporate and other discussed above. Our CODM measures the performance of each reportable 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 reportable segments. See Note 18.

### Note 2. Accounts Receivable

Accounts receivable consisted of the following (in millions):

December 31,	2018	2017
Contracts in transit	\$294.0	\$286.6
Trade receivables	54.3	45.9
Vehicle receivables	51.6	60.0
Manufacturer receivables	105.5	96.1

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Auto loan receivables	61.5	75.1
Other receivables	6.8	14.6
	573.7	578.3
Less: Allowance for doubtful accounts	(7.2 )	(7.4 )
Less: Long-term portion of accounts receivable, net	(37.1 )	(49.0 )
Total accounts receivable, net	\$529.4	\$521.9

F- 14

---

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 within five to ten days of selling a vehicle.
- Trade receivables are comprised of amounts due from customers, 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 consisted of the following (in millions):

December 31,	2018	2017
New vehicles	\$1,700.1	\$1,553.8
Used vehicles	576.8	500.0
Parts and accessories	88.4	78.9
Total inventories	\$2,365.3	\$2,132.7

The new vehicle inventory cost is generally reduced by manufacturer holdbacks and incentives, while the related floor plan notes payable are reflective of the gross cost of the vehicle. As of December 31, 2018 and 2017, the carrying value of inventory had been reduced by \$21.7 million and \$19.8 million, respectively, for assistance received from manufacturers as discussed in Note 1.

### Note 4. Property and Equipment

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

December 31,	2018	2017
Land	\$419.7	\$346.7
Building and improvements	821.6	685.5
Service equipment	106.3	94.1
Furniture, office equipment, signs and fixtures	283.5	231.5
	1,631.1	1,357.8
Less accumulated depreciation	(240.5 )	(197.8 )
	1,390.6	1,160.0

Construction in progress	57.4	25.2
	\$1,448.0	\$1,185.2

F- 15

---



### Long-lived Asset Impairment Charges

In 2018, we recorded \$1.3 million of impairment charges associated with certain property. The long-lived assets were tested for recoverability and were determined to have a carrying value exceeding their fair value. We did not record any impairment charges associated with property and equipment in 2017 or 2016.

### Note 5. Goodwill and Franchise Value

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

	Domestic	Import	Luxury	Consolidated
Balance as of December 31, 2016 <sup>1</sup>	\$ 114.8	\$106.2	\$38.4	\$ 259.4
Adjustments to purchase price allocations <sup>2</sup>	(0.8 )	(1.0 )	(0.4 )	(2.2 )
Reductions through divestitures	—	(0.9 )	—	(0.9 )
Balance as of December 31, 2017 <sup>1</sup>	114.0	104.3	38.0	256.3
Additions through acquisitions <sup>3</sup>	51.4	85.8	43.5	180.7
Reductions through divestitures	(0.9 )	(1.2 )	—	(2.1 )
Balance as of December 31, 2018 <sup>1,4</sup>	\$ 164.5	\$188.9	\$81.5	\$ 434.9

(1) Net of accumulated impairment losses of \$299.3 million recorded during the year ended December 31, 2008.

(2) Our purchase price allocation for the acquisition of the Carbone Auto Group was finalized in the third quarter of 2017, resulting in a reclassification of \$2.2 million from goodwill to franchise value.

Our purchase price allocation for the 2017 acquisition of the Baierl Auto Group was finalized in the second quarter of 2018. Our purchase price allocation for the 2017 acquisitions of the Downtown LA Auto Group, Crater Lake Ford Lincoln, and Crater Lake Mazda were finalized in the third quarter of 2018. Our purchase price allocation for (3) 2018 acquisition of Broadway Ford and the 2017 acquisition of Albany CJD Fiat were finalized in the fourth quarter of 2018. Our purchase price allocation for the 2018 acquisition of Prestige Auto Group is preliminary and was allocated to our segments in the fourth quarter of 2018, but is subject to change upon final valuation analysis. As a result, we added \$180.7 million of goodwill in 2018.

Our purchase price allocation is preliminary for the acquisitions of Ray Laks Honda, Ray Laks Acura, Day Auto (4) Group, and Buhler Ford. The primary balances still subject to analysis are the real estate assets, goodwill allocation to our segments and franchise value. See Note 14.

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

	Franchise Value
Balance as of December 31, 2016	\$ 184.3
Additions through acquisitions	0.5
Adjustments to purchase price allocations <sup>1</sup>	2.2
Balance as of December 31, 2017	187.0
Additions through acquisitions <sup>2</sup>	103.5
Reductions through divestitures	(1.8 )
Balance as of December 31, 2018 <sup>3</sup>	\$ 288.7

(1) Our purchase price allocation for the acquisition of the Carbone Auto Group was finalized in the third quarter of 2017, resulting in a reclassification of \$2.2 million from goodwill to franchise value.

Our purchase price allocation for the acquisition of the Baierl Auto Group was finalized in the second quarter of 2018. Our purchase price allocation for the acquisitions of the Downtown LA Auto Group, Crater Lake Ford (2) Lincoln, and Crater Lake Mazda were finalized in the third quarter of 2018. Our purchase price allocation for Broadway Ford and Albany CJD Fiat were finalized in the fourth quarter of 2018. Our purchase price allocation for Prestige Auto Group is preliminary and was allocated to our segments in the fourth quarter of 2018, but is subject to change upon final valuation analysis. As a result, we added \$103.5 million of franchise value in 2018.

(3) Our purchase price allocation is preliminary for the acquisition of the Ray Laks Honda, Ray Laks Acura, Day Auto Group, and Buhler Ford and the associated franchise value has not been allocated to each of our segments. The

primary balances still subject to analysis are the real estate assets, goodwill allocation to our segments and franchise value. See Note 14.

## Note 6. Credit Facilities and Long-Term Debt

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

December 31,	2018	2017
Floor plan notes payable: non-trade	\$1,733.3	\$1,802.3
Floor plan notes payable	324.4	116.8
Total floor plan debt	\$2,057.7	\$1,919.1
Used vehicle inventory financing facility	\$332.0	\$177.2
Revolving lines of credit	131.6	94.6
Real estate mortgages	592.3	470.0
5.25% Senior notes due 2025	300.0	300.0
Other debt	34.2	12.5
Total long-term debt outstanding	1,390.1	1,054.3
Less: unamortized debt issuance costs	(6.0 )	(6.9 )
Less: current maturities (net of current debt issuance costs)	(25.9 )	(18.9 )
Long-term debt	\$1,358.2	\$1,028.5

## Credit Facility

Effective June 25, 2018, we amended our syndicated credit facility increasing the total financing commitment to \$2.6 billion which matures in July 2023. Our syndicated credit facility is comprised of 20 financial institutions, including seven manufacturer-affiliated finance companies.

We have the option to reallocate the commitments, provided that the used vehicle inventory floor plan financing commitment does not exceed 16.5% of aggregate commitments, the revolving loan commitment does not exceed 18.75% of aggregate commitments, and the sum of these commitments plus the new vehicle inventory floor plan financing commitment does not exceed the aggregate total financing commitment of \$2.6 billion. Additionally, we may request an increase in the aggregate new vehicle floor plan commitment of up to \$400 million provided that the aggregate commitment does not exceed \$3.0 billion. All borrowings from, and repayments to, our lending group are presented in the Consolidated Statements of Cash Flows as financing activities.

Our obligations under our revolving syndicated credit facility are secured by a substantial amount of our assets, including our inventory (including new and used vehicles, parts and accessories), equipment, accounts receivable (and other rights to payment) and our equity interests in certain subsidiaries. Under our revolving syndicated credit facility, our obligations relating to new vehicle floor plan loans are secured only by collateral owned by borrowers of new vehicle floor plan loans under the credit facility.

The interest rate on the credit facility, as amended, varies based on the type of debt, with the rate of one-month LIBOR plus 1.25% for new vehicle floor plan financing, one-month LIBOR plus 1.50% for used vehicle floor plan financing; and a variable interest rate on the revolving financing ranging from the one-month LIBOR plus 1.25% to 2.50%, depending on our leverage ratio. The annual interest rate associated with our new vehicle floor plan commitment was 3.77% at December 31, 2018. The annual interest rate associated with both our used vehicle inventory financing facility and our revolving line of credit was 4.02% at December 31, 2018.

Under the terms of our credit facility we are subject to financial covenants and restrictive covenants that limit or restrict our incurring additional indebtedness, making investments, selling or acquiring assets and granting security interests in our assets.

Under our credit facility, we are required to maintain the ratios detailed in the following table:

Debt Covenant Ratio	Requirement	As of December 31, 2018
---------------------	-------------	-------------------------

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Current ratio	Not less than 1.10 to 1	1.27 to 1
Fixed charge coverage ratio	Not less than 1.20 to 1	1.91 to 1
Leverage ratio	Not more than 5.00 to 1	2.86 to 1

F- 17

---

#### Other Lines of Credit

During 2018, we entered into a revolving line of credit agreement with Ford Motor Credit Company. The revolving line of credit includes a commitment of up to \$40 million, secured by certain assets and up to another \$20 million unsecured. The interest rate on this revolving line varies based upon which component is utilized, with a rate of one-month LIBOR plus 2.70% for the secured commitment and one-month LIBOR plus 5.55% for the unsecured commitment. Including this new revolving line with Ford, we have other lines of credit with a total financing commitment of \$60.5 million for general corporate purposes, including acquisitions and working capital. Substantially all of these other lines of credit mature in 2021 and have interest rates ranging up to 8.07%. As of December 31, 2018, \$0.4 million was outstanding on these other lines of credit.

#### Floor Plan Notes Payable

We have floor plan agreements with manufacturer-affiliated finance companies for certain new vehicles and vehicles that are designated for use as service loaners. During 2018, we expanded our floor plan agreement with Ford Motor Credit Company. This facility provides floor plan financing for new vehicle inventory at all of our Ford stores. The interest rates on these floor plan notes payable commitments vary by manufacturer and are variable rates. As of December 31, 2018, \$324.4 million was outstanding on these agreements at interest rates ranging up to 6.75%. Borrowings from, and repayments to, manufacturer-affiliated finance companies are classified as operating activities in the Consolidated Statements of Cash Flows.

#### Real Estate Mortgages and Other Debt

We have mortgages associated with our owned real estate. Interest rates related to this debt ranged from 3.0% to 5.3% at December 31, 2018. The mortgages are payable in various installments through August 1, 2038. As of December 31, 2018, we had fixed interest rates on 69.5% of our outstanding mortgage debt.

Our other debt includes capital leases and sellers' notes. The interest rates associated with our other debt ranged from 3.1% to 8.0% at December 31, 2018. This debt, which totaled \$34.2 million at December 31, 2018, is due in various installments through December 2050.

#### 5.25% Senior Notes Due 2025

On July 24, 2017, we issued \$300 million in aggregate principal amount of 5.25% Senior Notes due 2025 ("the Notes") to eligible purchasers in a private placement under Rule 144A and Regulation S of the Securities Act of 1933. Interest accrues on the Notes from July 24, 2017 and is payable semiannually on February 1 and August 1. The first interest payment was paid on February 1, 2018. We may redeem the Notes in whole or in part at any time prior to August 1, 2020 at a price equal to 100% of the principal amount plus a make-whole premium set forth in the Indenture and accrued and unpaid interest. After August 1, 2020, we may redeem some or all of the Notes subject to the redemption prices set forth in the Indenture. If we experience specific kinds of changes of control, as described in the Indenture, we must offer to repurchase the Notes at 101% of their principal amount plus accrued and unpaid interest to the date of purchase.

#### Future Principal Payments

The schedule of future principal payments associated with real estate mortgages, our 5.25% Senior Notes and other debt as of December 31, 2018 was as follows (in millions):

Year Ending December 31,	
2019	\$26.2
2020	47.3
2021	50.4
2022	68.9
2023	57.6
Thereafter	676.1
Total principal payments	\$926.5

Note 7. Commitments and Contingencies

Leases

We lease certain facilities under non-cancelable operating and capital leases. These leases expire at various dates through 2050. Certain lease commitments contain fixed payment increases at predetermined intervals over the life of the lease, while other lease commitments are subject to escalation clauses of an amount equal to the increase in the cost of living based on the “Consumer Price Index - U.S. Cities Average - All Items for all Urban Consumers” published by the U.S. Department of Labor, or a substantially equivalent regional index. Lease expense related to operating leases is recognized on a straight-line basis over the life of the lease.

F- 18

---

The minimum lease payments under our operating and capital leases after December 31, 2018 are as follows (in millions):

Year Ending December 31,	
2019	\$43.6
2020	40.6
2021	38.3
2022	35.8
2023	29.8
Thereafter	276.8
Total minimum lease payments	464.9
Less: sublease rentals	(10.3 )
	\$454.6

Rent expense, net of sublease income, for all operating leases was \$43.3 million, \$33.4 million, and \$26.8 million for the years ended December 31, 2018, 2017 and 2016, respectively. These amounts are included as a component of selling, general and administrative expenses in our Consolidated Statements of Operations.

In connection with dispositions of stores, we occasionally assign or sublet our interests in any real property leases associated with such stores to the purchaser. We often retain responsibility for the performance of certain obligations under such leases to the extent that the assignee or sublessee does not perform. Additionally, we may remain subject to the terms of any guarantees and have correlating indemnification rights against the assignee or sublessee in the event of non-performance, as well as certain other defenses. We may also be called upon to perform other obligations under these leases, such as environmental remediation of the premises or repairs upon termination of the lease. We currently have no reason to believe that we will be called upon to perform any such services; however, there can be no assurance that any future performance required by us under these leases will not have a material adverse effect on our financial condition or results of operations.

#### Charge-Backs for Various Contracts

We have recorded a liability of \$56.0 million as of December 31, 2018 for our estimated contractual obligations related to potential charge-backs for vehicle service contracts, lifetime oil change contracts and other various insurance contracts that are terminated early by the customer. We estimate that the charge-backs will be paid out as follows (in millions):

Year Ending December 31,	
2019	\$30.7
2020	16.0
2021	6.6
2022	2.2
2023	0.5
Thereafter	—
Total	\$56.0

### Lifetime Lube, Oil and Filter Contracts

We retain the obligation for lifetime lube, oil and filter service contracts sold to our customers and assumed the liability of certain existing lifetime lube, oil and filter contracts. These amounts are recorded as a contract liability. At the time of sale, we defer the full sale price and recognize the revenue based on the rate we expect future costs to be incurred. As of December 31, 2018, we had a contract liability balance of \$150.5 million associated with these contracts and estimate the contract liability will be recognized as follows (in millions):

Year Ending December 31,	
2019	\$30.1
2020	23.9
2021	19.0
2022	15.8
2023	13.4
Thereafter	48.3
Total	\$150.5

The contract liability balance is recorded as components of deferred revenue and accrued liabilities in our Consolidated Balance Sheets.

We periodically evaluate the estimated future costs of these assumed contracts and record a charge if future expected claim and cancellation costs exceed the contract liability to be recognized. As of December 31, 2018, we had a reserve balance of \$3.4 million recorded as a component of accrued liabilities and other long-term liabilities in our Consolidated Balance Sheets. The charges associated with this reserve were recognized in 2011 and earlier.

### Self-insurance Programs

We self-insure a portion of our property and casualty insurance, vehicle open lot coverage, medical insurance and workers' compensation insurance. Third parties are engaged to assist in estimating the loss exposure related to the self-retained portion of the risk associated with these insurances. Additionally, we analyze our historical loss and claims experience to estimate the loss exposure associated with these programs. As of December 31, 2018 and 2017, we had liabilities associated with these programs of \$39.9 million and \$31.2 million, respectively, recorded as a component of accrued liabilities and other long-term liabilities in our Consolidated Balance Sheets.

### 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 will have a material adverse effect on our business, results of operations, financial condition, or cash flows, we cannot predict this with certainty.

### Note 8. Stockholders' Equity

#### Class A and Class B Common Stock

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

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



At a special meeting of shareholders held on January 21, 2019, Sidney B. DeBoer and the Company executed a Class B Conversion Agreement pursuant to which Mr. DeBoer agreed to cause all of the remaining 1,000,000 shares of our class B common stock to be converted into shares of our class A common stock by December 31, 2025. The Class B Conversion Agreement will require the conversion of at least 15% of the 1,000,000 class B shares by the end of every two years, with the first 15% to be converted

F- 20

---

by December 31, 2020, a total of 30% by December 31, 2022, a total of 45% by December 31, 2024, and the balance by December 31, 2025.

#### 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").

Effective February 29, 2016, our Board of Directors authorized the repurchase of up to \$250 million of our Class A common stock. This authorization was fully utilized as of December 31, 2018. On October 22, 2018, our Board of Directors approved an additional \$250 million repurchase authorization.

Share repurchases under our authorizations were as follows:

	Repurchases Occurring in 2018		Cumulative Repurchases as of December 31, 2018	
	Shares	Average Price	Shares	Average Price
Share Repurchase Authorization	2,112,370	\$ 84.72	3,155,095	\$ 84.43

As of December 31, 2018, we had \$233.6 million available for repurchases pursuant to our share repurchase authorization.

In addition, during 2018, we repurchased 30,119 shares at an average price of \$112.05 per share, for a total of \$3.4 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.

The following is a summary of our repurchases in the years ended December 31, 2018, 2017 and 2016:

Year Ended December 31,	2018	2017	2016
Shares repurchased pursuant to repurchase authorizations	2,112,370	329,000	1,312,848
Total purchase price (in millions)	\$ 179.0	\$ 30.5	\$ 104.4
Average purchase price per share	\$ 84.72	\$ 92.79	\$ 79.50
Shares repurchased in association with tax withholdings on the vesting of RSUs	30,119	32,457	94,826

In December 2017, we entered into a structured repurchase agreement involving the use of capped call options for the purchase of our Class A common stock. As of December 31, 2018, the capped call options had expired, and all outstanding options were settled.

During 2018, net repurchases and issuances of our Class A common stock exceeded our beginning of the year balance. The excess net repurchases were recorded as a reduction of additional paid in capital as of December 31, 2018.

## Dividends

We declared and paid dividends on our Class A and Class B Common Stock as follows:

Quarter declared	Dividend amount per Class A and Class B share	Total amount of dividends paid (in millions)
2016		
First quarter	\$ 0.20	\$ 5.1
Second quarter	0.25	6.4
Third quarter	0.25	6.3
Fourth quarter	0.25	6.3
2017		
First quarter	\$ 0.25	\$ 6.3
Second quarter	0.27	6.8
Third quarter	0.27	6.7
Fourth quarter	0.27	6.7
2018		
First quarter	\$ 0.27	\$ 6.7
Second quarter	0.29	7.2
Third quarter	0.29	7.0
Fourth quarter	0.29	6.8

## Reclassification From Accumulated Other Comprehensive Loss

The reclassification from accumulated other comprehensive loss was as follows (in millions):

Year Ended December 31,	2018	2017	2016	Affected Line Item in the Consolidated Statement of Operations
Loss on cash flow hedges	\$ —	—\$	—\$(0.2)	Floor plan interest expense
Income tax benefits	—	—	0.1	Income tax provision
Loss on cash flow hedges, net	\$ —	—\$	—\$(0.1)	

See Note 11.

## Note 9. 401(k) Profit Sharing, Deferred Compensation and Long-Term Incentive Plans

We have a defined contribution 401(k) plan and trust covering substantially all full-time employees. The annual contribution to the plan is at the discretion of our Board of Directors. Contributions of \$5.7 million, \$5.8 million, and \$5.4 million were recognized for the years ended December 31, 2018, 2017 and 2016, respectively. Employees may contribute to the plan if they meet certain eligibility requirements.

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, depending on position, also make discretionary contributions to the LTIP. These discretionary contributions vest between one and seven years based on the employee’s age. 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 (in millions):

Year Ended December 31,	2018	2017	2016
Compensation expense	\$1.3	\$1.1	\$1.1

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Total discretionary contribution	\$0.8	\$1.7	\$1.8
Guaranteed annual return	5.00 %	5.00 %	5.25 %

F- 22

---

As of December 31, 2018 and 2017, the balance due to participants was \$32.9 million and \$27.9 million, respectively, and was included as a component of other long-term liabilities in the Consolidated Balance Sheets.

#### Note 10. Stock-Based Compensation

##### 2009 Employee Stock Purchase Plan

The 2009 Employee Stock Purchase Plan (the “2009 ESPP”) allows for the issuance of 1,500,000 shares of our Class A common stock. The 2009 ESPP is intended to qualify as an “Employee Stock Purchase Plan” under Section 423 of the Internal Revenue Code of 1986, as amended, and is administered by the Compensation Committee of the Board of Directors.

Eligible employees are entitled to defer up to 10% of their base pay for the purchase of stock, up to \$25,000 of fair market value of our Class A common stock annually. The purchase price is equal to 85% of the fair market value at the end of the purchase period.

Following is information regarding our 2009 ESPP:

Year Ended December 31,	2018
Shares purchased pursuant to 2009 ESPP	143,227
Weighted average per share price of shares purchased	\$ 74.24
Weighted average per share discount from market value for shares purchased	\$ 13.10

As of December 31,	2018
Shares available for purchase pursuant to 2009 ESPP	138,643

Compensation expense related to our 2009 ESPP is calculated based on the 15% discount from the per share market price on the date of grant.

##### 2013 Stock Incentive Plan

Our 2013 Stock Incentive Plan, as amended, (the “2013 Plan”) allows for the grant of a total of 3.8 million shares in the form of stock appreciation rights, qualified stock options, nonqualified stock options, restricted share awards and restricted stock unit awards (“RSUs”) to our officers, key employees, directors and consultants. The 2013 Plan is administered by the Compensation Committee of the Board of Directors and permits accelerated vesting of outstanding awards upon the occurrence of certain changes in control. As of December 31, 2018, 1,265,002 shares of Class A common stock were available for future grants. As of December 31, 2018, there were no stock appreciation rights, qualified stock options, nonqualified stock options or restricted share awards outstanding.

##### Restricted Stock Unit Awards

RSU grants vest over a period of time up to four years from the date of grant. RSU activity was as follows:

	RSUs	Weighted average grant date fair value
Balance, December 31, 2017	344,804	\$ 91.81
Granted	182,893	86.84
Vested	(83,856 )	91.97
Forfeited	(33,976 )	94.33
Balance, December 31, 2018	409,865	99.72

We granted 40,979 time-vesting RSUs to members of our Board of Directors and employees in 2018. Each grant entitles the holder to receive shares of our Class A common stock upon vesting. A portion of the RSUs vest over four years, beginning on the second anniversary of the grant date, for employees and vests quarterly for our Board of Directors, over their service period.

F- 23

---

Certain key employees were granted 141,914 performance and time-vesting RSUs in 2018. Of these, 79,617 shares were earned based on attaining various target levels of operational performance. Based on the levels of performance achieved in 2018, a weighted average attainment level of 56.1% for these RSUs was met. These RSUs will vest over four years from the grant date.

#### Stock-Based Compensation

As of December 31, 2018, unrecognized stock-based compensation related to outstanding, but unvested RSUs was \$13.4 million, which will be recognized over the remaining weighted average vesting period of 2.0 years.

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

Year Ended December 31,	2018	2017	2016
Per share intrinsic value of non-vested stock granted	\$86.84	\$99.24	\$82.90
Weighted average per share discount for compensation expense recognized under the 2009 ESPP	13.10	15.20	13.00
Fair value of non-vested stock that vested during the period (in millions)	92.0	69.6	47.5
Stock-based compensation recognized in Consolidated Statements of Operations, as a component of selling, general and administrative expense (in millions)	13.4	11.3	11.0
Tax benefit recognized in Consolidated Statements of Operations (in millions)	3.5	3.5	3.8
Cash received from options exercised and shares purchased under all share-based arrangements (in millions)	10.6	7.8	7.0
Tax deduction realized related to stock options exercised (in millions)	9.0	9.0	8.9

#### Note 11. Derivative Financial Instruments

From time to time, we have entered into interest rate swaps to fix a portion of our interest expense. 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.

The effect of derivative instruments in our Consolidated Statements of Operations was as follows (in millions):

	Amount of gain recognized in Accumulated OCI (effective portion)	Location of 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)
Derivatives in Cash Flow Hedging Relationships					

Edgar Filing: LITHIA MOTORS INC - Form 10-K

Year Ended  
December 31, 2016

Interest rate swap contract	\$ 0.2	Floor plan interest expense	\$ (0.2 )	Floor plan interest expense	\$ (0.4 )
-----------------------------	--------	-----------------------------	-----------	-----------------------------	-----------

We did not have any activity related to the effect of derivative instruments in 2017 or 2018.

F- 24

---



## Note 12. 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.

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 primarily consisting of amounts outstanding under our senior notes and real estate mortgages. We calculated the estimated fair value of the senior notes using quoted prices for the identical liability (Level 1) and calculated the estimated fair value of the fixed rate real estate mortgages using a discounted cash flow methodology with 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 December 31, 2018, our real estate mortgages and other debt, which includes capital leases, had maturity dates between January 12, 2019 and December 31, 2050.

We estimate the value of other long-lived assets that are recorded at fair value on a non-recurring basis 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 year ended December 31, 2018.

A summary of the aggregate carrying values, excluding unamortized debt issuance cost, and fair values of our long-term fixed interest rate debt is as follows (in millions):

December 31,	2018	2017
Carrying value		
5.25% Senior Notes due 2025	\$ 300.0	\$ 300.0
Real Estate Mortgages and Other Debt	445.8	376.9
	\$ 745.8	\$ 676.9
Fair value		
5.25% Senior Notes due 2025	\$ 278.6	\$ 312.8
Real Estate Mortgages and Other Debt	448.7	385.3
	\$ 727.3	\$ 698.1

Below are our long-lived assets that are measured at fair value (in millions):

Fair Value at December 31, 2018

Edgar Filing: LITHIA MOTORS INC - Form 10-K

	Level 1	Level 2	Level 3
Measured on a non-recurring basis:			
Long-lived assets held and used:			
Certain buildings and improvements	\$	—\$	—\$ 2.3

F- 25

---

## Note 13. Income Taxes

## Income Tax Provision

The income tax provision was as follows (in millions):

Year Ended December 31,	2018	2017	2016
Current:			
Federal	\$30.3	\$95.1	\$68.1
State	11.5	16.9	13.8
	41.8	112.0	81.9
Deferred:			
Federal	20.4	(14.2 )	4.9
State	9.6	4.1	(0.4 )
	30.0	(10.1 )	4.5
Total	\$71.8	\$101.9	\$86.4

At December 31, 2018 and 2017, we had income taxes receivable of \$17.1 million and \$22.5 million, respectively, included as a component of other current assets in our Consolidated Balance Sheets.

The reconciliation between amounts computed using the federal income tax rate of 21% in 2018 and 35% in all other years and our income tax provision is shown in the following tabulation (in millions):

Year Ended December 31,	2018	2017	2016
Federal tax provision at statutory rate	\$70.9	\$121.5	\$99.2
State taxes, net of federal income tax benefit	16.1	13.3	10.8
Equity investment basis difference	—	—	9.5
Non-deductible items	1.5	1.3	1.4
Permanent differences related to stock-based compensation	(0.1 )	(0.8 )	0.1
Net change in valuation allowance	0.5	0.3	(5.1 )
General business credits	(1.1 )	(0.9 )	(28.0 )
Deferred revaluation for change in statutory tax rate	(15.8 )	(32.9 )	—
Other	(0.2 )	0.1	(1.5 )
Income tax provision	\$71.8	\$101.9	\$86.4

## Deferred Taxes

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

December 31,	2018	2017
Deferred tax assets:		
Deferred revenue and cancellation reserves	\$47.2	\$39.4
Allowances and accruals, including state NOL carryforward amounts	40.8	36.3
Credits and other	0.3	1.1
Valuation allowance	(1.1 )	(0.6 )
Total deferred tax assets	87.2	76.2
Deferred tax liabilities:		
Inventories	(42.0 )	(20.9 )
Goodwill	(48.2 )	(35.0 )
Property and equipment, principally due to differences in depreciation	(78.0 )	(73.4 )
Prepaid expenses and other	(10.2 )	(3.2 )
Total deferred tax liabilities	(178.4 )	(132.5 )
Total	\$(91.2 )	\$(56.3 )

As noted at December 31, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act") on December 22, 2017. The Tax Act makes broad and complex changes to the U.S. tax code including, but not limited to, reduction of the U.S. federal corporate income tax rate, expanded bonus depreciation provisions that will allow for full expensing of qualified property, a new limitation on the deductibility of business interest expense, and expanded limitations on the deductibility of executive compensation for covered individuals.

As of December 31, 2018, we have completed our accounting for the effects of Tax Act. As part of this process, we remeasured federal deferred tax assets and liabilities to reflect a change to the tax rate at which they are expected to reverse in the future, which is generally 21%. As of December 31, 2017, a provisional benefit of \$32.9 million was recorded related to the remeasurement of our deferred tax balances. As of December 31, 2018, an additional \$15.8 million benefit was recorded, which primarily relates to return to provision adjustments to our deferred tax balances as a result of changes to certain established tax accounting methods in 2018.

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

As of December 31, 2018, we had a \$1.1 million valuation allowance recorded associated with our deferred tax assets. The entire allowance is associated with state net operating losses generated in current and previous years. The valuation allowance increased \$0.5 million in the current year as a result of losses incurred, the benefits of which are not expected to be realized.

As of December 31, 2018, we had state net operating loss (NOL) carryforward amounts totaling approximately \$3.0 million, tax effected, with expiration dates through 2038. We believe that it is more likely than not that the benefit from certain state NOL carryforward amounts will not be realized. In recognition of this risk, we have recorded a valuation allowance of \$1.1 million on the deferred tax assets relating to these state NOL carryforwards. We had \$0.4 million, tax effected, in state tax credit carryforwards with expiration dates through 2027. We believe it is more likely than not that the benefits from these state tax credit carryforwards will be realized.

Unrecognized Tax Benefits

We have no unrecognized tax benefits recorded as of December 31, 2018, 2017 and 2016.

Open tax years at December 31, 2018 included the following:

Federal 2015 - 2018

20 states 2014 - 2018

F- 27

---

## Note 14. Acquisitions

In 2018, we completed the following acquisitions:

- On January 15, 2018, Ray Laks Honda in Orchard Park, New York and Ray Laks Acura in Buffalo, New York.
- On February 26, 2018, Day Auto Group, a seven store platform based in Pennsylvania.
- On March 1, 2018, Prestige Auto Group, a six store platform based in New Jersey and New York.
- On April 2, 2018, Broadway Ford in Idaho Falls, Idaho.
- On April 23, 2018, Buhler Ford in Eatontown, New Jersey.

Revenue and operating income contributed by the 2018 acquisitions subsequent to the date of acquisition were as follows (in millions):

Year Ended December 31, 2018	
Revenue	\$913.5
Operating loss	(2.6 )

In 2017, we completed the following acquisitions:

- On May 1, 2017, Baierl Auto Group, an eight store platform based in Pennsylvania.
- On August 7, 2017, Downtown LA ("DTLA") Auto Group, a seven store platform based in California.
- On November 11, 2017, Albany CJD Fiat in Albany, New York.
- On November 15, 2017, Crater Lake Ford Lincoln and Crater Lake Mazda in Medford, Oregon.

All acquisitions were accounted for as business combinations under the acquisition method of accounting. The results of operations of the acquired stores are included in our Consolidated Financial Statements from the date of acquisition.

The following tables summarize the consideration paid in cash and equity securities for the acquisitions and the preliminary amount of identified assets acquired and liabilities assumed as of the acquisition date (in millions):

Consideration paid for the Year Ended December 31,	2018	2017
Cash paid, net of cash acquired	\$373.8	\$460.4
Equity securities issued	—	2.1
Debt issued	125.1	1.8
	\$498.9	\$464.3
Assets acquired and liabilities assumed for the Year Ended December 31,	2018	2017
Trade receivables, net	\$0.7	\$46.9
Inventories	180.0	189.8
Franchise value	29.8	73.7
Property and equipment	179.7	166.0
Other assets	48.6	18.3
Floor plan notes payable	(10.8 )	(72.5 )
Debt and capital lease obligations	—	(38.7 )
Deferred taxes, net	—	(2.0 )
Other liabilities	(2.3 )	(24.7 )
	425.7	356.8
Goodwill	73.2	107.5
	\$498.9	\$464.3

The purchase price allocations for the Ray Laks Honda, Ray Laks Acura, Day Auto Group, Prestige Auto Group, and Buhler Ford acquisitions are preliminary as we have not obtained all of the detailed information to finalize the opening balance sheet related to real estate purchased, leases assumed and the allocation of franchise value to each reporting unit. Management has recorded the purchase price allocations based on the information that is currently

available.

F- 28

---

We expect substantially all of the goodwill related to acquisitions completed in 2018 to be deductible for federal income tax purposes.

We account for franchise value as an indefinite-lived intangible asset. We recognized \$4.3 million and \$6.0 million, respectively, in acquisition related expenses as a component of selling, general and administrative expenses in the Consolidated Statements of Operations in 2018 and 2017, respectively.

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

Year Ended December 31,	2018	2017
Revenue	\$12,021.6	\$12,039.9
Net income	264.4	248.9
Basic net income per share	10.85	9.93
Diluted net income per share	10.81	9.90

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

#### Note 15. Related Party Transactions

##### Transition Agreement

In September 2015, we entered into a transition agreement with Sidney B. DeBoer, our Chairman of the Board, which provided him certain benefits until his death. The agreement has an effective date of January 1, 2016 and the initial payment of these benefits began in the third quarter of 2016. On January 22, 2019, we amended the transition agreement to end the annual payments to Mr. DeBoer after 17 years, commencing January 1, 2019, or upon Mr. DeBoer's death, whichever occurs first.

We recorded a charge of \$18.3 million in 2015 as a component of selling, general and administrative expense in our Consolidated Statement of Operations related to the present value of estimated future payments due pursuant to this agreement. We believe that this estimate is reasonable; however, actual cash flows could differ materially. We will periodically evaluate whether significant changes in our assumptions have occurred and record an adjustment if future expected cash flows are significantly different than the reserve recorded. As a result of the amendment to the agreement on January 22, 2019, no change was made to the reserve.

The balance associated with this agreement was \$15.7 million and \$16.8 million as of December 31, 2018 and 2017, respectively, and was included as a component of accrued liabilities and other long-term liabilities in our Consolidated Balance Sheets.

#### Note 16. 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

F- 29

---

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):

Year Ended December 31,	2018		2017		2016	
(in millions, except per share data)	Class A	Class B	Class A	Class B	Class A	Class B
Net income applicable to common stockholders - basic	\$254.8	\$10.9	\$233.4	\$11.8	\$182.4	\$14.7
Reallocation of distributed net income as a result of conversion of dilutive stock options	—	—	—	—	—	—
Reallocation of distributed net income due to conversion of Class B to Class A common shares outstanding	1.1	—	1.3	—	1.8	—
Conversion of Class B common shares into Class A common shares	9.8	—	10.5	—	12.8	—
Effect of dilutive stock options on net income	—	—	—	—	0.1	(0.1 )
Net income applicable to common stockholders - diluted	\$265.7	\$10.9	\$245.2	\$11.8	\$197.1	\$14.6
Weighted average common shares outstanding – basic	23.4	1.0	23.9	1.2	23.5	1.9
Conversion of Class B common shares into Class A common shares	1.0	—	1.2	—	1.9	—
Effect of employee stock purchases and restricted stock units on weighted average common shares	0.1	—	—	—	0.1	—
Weighted average common shares outstanding – diluted	24.5	1.0	25.1	1.2	25.5	1.9
Net income per common share - basic	\$10.91	\$10.91	\$9.78	\$9.78	\$7.76	\$7.76
Net income per common share - diluted	\$10.86	\$10.86	\$9.75	\$9.76	\$7.72	\$7.72
Antidilutive Securities						
Shares issuable pursuant to employee stock purchases not included since they were antidilutive	—	—	—	—	—	—

#### Note 17. Equity-Method Investments

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 \$22.9 million in 2015 and \$22.8 million in 2016. We were obligated to make \$49.8 million of total contributions to the entity over a two-year period ended October 2016, all of which had been made as of December 31, 2016.

This investment generated 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 exercised management control over the limited liability company, due to the economic interest we held in the entity, we determined our ownership portion of the entity was appropriately accounted for using the equity method.

As of December 31, 2018 and 2017 no amounts related to this equity-method investment were recorded in our Consolidated Balance Sheets.



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

Year Ended December 31,	2018	2017	2016
Asset impairments to write investment down to fair value	\$ —	—	—\$14.0
Our portion of the partnership's operating losses	—	—	8.3
Non-cash interest expense related to the amortization of the discounted fair value of future equity contributions	—	—	0.2
Tax benefits and credits generated	—	—	28.5

Note 18. Segments

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

Year Ended December 31,	2018	2017	2016
Revenues:			
Domestic	\$4,215.0	\$3,845.8	\$3,381.7
Import	5,038.1	4,432.8	3,764.3
Luxury	2,560.3	1,810.1	1,528.7
	11,813.4	10,088.7	8,674.7
Corporate and other	8.0	(2.2 )	3.5
	\$11,821.4	\$10,086.5	\$8,678.2

Segment income\*:

Domestic	\$97.6	\$105.2	\$106.2
Import	116.2	117.8	110.2
Luxury	43.9	37.0	31.5
	257.7	260.0	247.9
Corporate and other	202.4	167.4	114.2
Depreciation and amortization	(75.4 )	(57.7 )	(49.3 )
Other interest expense	(56.0 )	(34.8 )	(23.2 )
Other (expense) income, net	8.8	12.2	(6.1 )
Income before income taxes	\$337.5	\$347.1	\$283.5

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

Year Ended December 31,	2018	2017	2016
Floor plan interest expense:			
Domestic	\$52.4	\$37.2	\$26.4
Import	41.6	29.0	18.7
Luxury	25.6	15.8	11.0
	119.6	82.0	56.1
Corporate and other	(57.3 )	(42.7 )	(30.5 )
	\$62.3	\$39.3	\$25.6

December 31,	2018	2017
Total assets:		
Domestic	\$1,488.0	\$1,338.2
Import	1,224.2	1,137.9
Luxury	934.6	641.1
Corporate and other	1,737.2	1,565.9
	\$5,384.0	\$4,683.1

#### Note 19. Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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. The new standard results in the recording of a right-of-use asset and a lease liability for all leases with a term longer than 12 months. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We intend to adopt this ASU on January 1, 2019. While management is still evaluating the impact of adopting the provisions of this ASU, we expect the impact to be the present value of minimum lease payments described in Note 7 to the Consolidated Financial Statements. The Company is in the final stages of implementing software to calculate the impact. We continue to identify and evaluate if there are other leases impacted. The majority of our real estate leases are classified as operating leases under the current guidance. We expect ASU 2016-02 to impact our consolidated balance sheets primarily due to the recognition of a right-of-use asset and an associated lease liability and our consolidated income statement related to the changes in expense recognition.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment." ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. An entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if applicable. The loss recognized should not exceed the total amount of goodwill allocated to the reporting unit. The same impairment test also applies to any reporting unit with a zero or negative carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASU 2017-04 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019, on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. We do not expect the adoption of ASU 2017-04 to have a material effect on our financial position, results of operations or cash flows.

#### Note 20. Investments

On September 12, 2018, we invested \$54 million in Shift Technologies, Inc., a San Francisco-based digital retailer, in exchange for Series D convertible preferred stock. We have determined that our investment in Shift does not meet the criteria for a variable interest entity, and we do not have control or significant influence over Shift. As a result, we currently recorded a cost method investment within other non-current assets on our Consolidated Balance Sheets as of December 31, 2018.

As of December 31, 2018, there were no identified events or changes in circumstances that would have a significant effect on the value of the investment. We did not record any impairment charges associated with this investment in the year ended December 31, 2018.



## Note 21. Changes in Accounting Policies

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which amends the accounting guidance related to revenues. This amendment replaced most of the existing revenue recognition guidance. The new standard, as amended in July 2015, is effective for fiscal years beginning after December 15, 2017, and interim periods therein. The standard permits the use of either the retrospective or cumulative effect transition method. We adopted this standard utilizing a cumulative effect transition method effective January 2018. While the adoption of the new standard did not have a significant effect on earnings or on the timing of our most significant types of transactions, we made the following changes to our revenue policies:

A portion of the transaction price related to sales of finance and insurance contracts is considered variable consideration and subject to accelerated recognition under the new standard. Accordingly, we recognized a \$9.2 million asset associated with future estimated variable consideration and a net of tax increase to retained earnings of \$6.5 million. We do not believe there will be a significant impact to future revenue recognized.

The adoption of the new standard clarifies the determination and capitalization of direct costs incurred. As a result, we reassessed the method used to capitalize and amortize direct costs associated with the sale of lifetime lube, oil and filter contracts, which resulted in a \$7.2 million reduction in prepaid commissions and a net of tax \$5.1 million reduction to retained earnings.

These changes had an immaterial effect on our Consolidated Statements of Operations and the following impact on our Consolidated Balance Sheets (in millions):

Impact on Consolidated Balance Sheets	As Reported	Adjustments	Balances
	December 31, 2018		without the adoption of Topic 606
Accounts receivable, net	\$ 529.4	\$ (3.6 )	\$ 525.8
Other current assets	65.1	(1.9 )	63.2
Other non-current assets	221.0	5.4	226.4
Total Assets	5,384.0	(0.1 )	5,383.9
Accrued Liabilities	283.6	0.4	284.0
Deferred income taxes	91.2	(0.6 )	90.6
Total Liabilities	4,186.8	(0.2 )	4,186.6
Retained earnings	1,162.1	0.1	1,162.2
Total Liabilities and Stockholders' Equity	5,384.0	(0.1 )	5,383.9

## Note 22. Subsequent Events

## Transition Agreement Amendment

At a special meeting of shareholders held on January 21, 2019 (the "Special Meeting"), our shareholders approved an amendment to the transition agreement, dated September 14, 2015, between the Company and Sidney B. DeBoer (the "Transition Agreement") that will end the annual payments to Mr. DeBoer under the Transition Agreement after 17 years, commencing January 1, 2019, or Mr. DeBoer's death, whichever occurs first. See Note 15.

## Class B Conversion Agreement

Sidney B. DeBoer and the Company executed a Class B Conversion Agreement pursuant to which all of the remaining 1,000,000 shares of our class B common stock will be converted into shares of our class A common stock by December 31, 2025. The Class B Conversion Agreement will require the conversion of at least 15% of the 1,000,000 class B shares by the end of every two years, with the first 15% to be converted by December 31, 2020, a total of 30%

Edgar Filing: LITHIA MOTORS INC - Form 10-K

by December 31, 2022, a total of 45% by December 31, 2024, and the balance by December 31, 2025. On January 21, 2019, Mr. DeBoer completed a conversion of 200,000 Class B shares.

F- 33

---



LITHIA MOTORS, INC. AND SUBSIDIARIES  
 SELECTED CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following tables set forth our unaudited quarterly financial data (in millions, except per share amounts):<sup>(1)</sup>

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue	2018\$2,659.7	\$3,096.5	\$3,092.0	\$2,973.2
	20172,236.1	2,467.0	2,680.3	2,703.0
Gross profit	2018408.1	460.7	466.2	441.9
	2017341.7	375.3	403.0	396.1
Operating income	201893.8	108.6	137.6	107.1
	201786.1	103.9	106.0	112.9
Income before income taxes	201869.8	80.8	109.0	78.0
	201781.3	87.8	86.5	91.4
Net income	201852.1	60.7	93.1	59.9
	201750.7	53.2	51.9	89.4
Basic net income per share	20182.08	2.45	3.85	2.55
	20172.01	2.12	2.07	3.58
Diluted net income per share	20182.07	2.44	3.84	2.54
	20172.01	2.12	2.07	3.56

<sup>(1)</sup> Quarterly data may not add to yearly totals due to rounding.