

LITHIA MOTORS INC
Form 10-Q
May 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from to

Commission file number: 001-14733

LITHIA MOTORS, INC.

(Exact name of registrant as specified in its charter)

Oregon

(State or other jurisdiction of
incorporation or organization)

93-0572810

(I.R.S. Employer Identification No.)

360 E. Jackson Street, Medford, Oregon

(Address of principal executive offices)

97501

(Zip Code)

Registrant's telephone number, including area code: **541-776-6899**

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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of

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accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. Large accelerated filer Accelerated
filer Non-accelerated filer

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

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

| | |
|---|---|
| Class A common stock without par value | 15,881,507 |
| Class B common stock without par value (Class) | 3,762,231 (Outstanding at May 3, 2007) |

LITHIA MOTORS, INC.

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

LITHIA MOTORS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

| | March 31, 2007 | December 31, 2006 |
|--|-------------------|----------------------|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 21,023 | \$ 26,600 |
| Contracts in transit | 62,334 | 56,211 |
| Trade receivables, net of allowance for doubtful accounts of \$413 and \$390 | 67,785 | 62,317 |
| Inventories, net | 599,942 | 603,306 |
| Vehicles leased to others, current portion | 8,789 | 7,698 |
| Prepaid expenses and other | 6,310 | 6,825 |
| Deferred income taxes | 610 | 1,198 |
| Assets held for sale | 13,324 | 15,485 |
| Total Current Assets | 780,117 | 779,640 |
| Land and buildings, net of accumulated depreciation of \$17,213 and \$15,953 | 339,924 | 327,890 |
| Equipment and other, net of accumulated depreciation of \$40,185 and \$38,866 | 96,689 | 89,213 |
| Goodwill | 314,877 | 307,424 |
| Other intangible assets, net of accumulated amortization of \$28 and \$21 | 72,036 | 69,054 |
| Other non-current assets | 5,343 | 6,136 |
| Total Assets | \$ 1,608,986 | \$ 1,579,357 |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities: | | |
| Floorplan notes payable | \$ 341,607 | \$ 422,411 |
| Floorplan notes payable: non-trade | 154,347 | 77,268 |
| Current maturities of long-term debt | 32,277 | 16,557 |
| Trade payables | 40,366 | 39,794 |
| Accrued liabilities | 61,113 | 62,299 |
| Liabilities held for sale | 9,880 | 11,610 |
| Total Current Liabilities | 639,590 | 629,939 |
| Used vehicle credit facility | 95,789 | 95,614 |
| Real estate debt, less current maturities | 149,112 | 155,890 |
| Other long-term debt, less current maturities | 156,806 | 140,879 |
| Other long-term liabilities | 13,117 | 13,509 |
| Deferred income taxes | 56,793 | 50,133 |
| Total Liabilities | 1,111,207 | 1,085,964 |
| Stockholders' Equity: | | |
| Preferred stock - no par value; authorized 15,000 shares; none outstanding | | |
| Class A common stock - no par value; authorized 100,000 shares; issued and outstanding 15,811 and 15,789 | 225,320 | 226,670 |
| Class B common stock - no par value; authorized 25,000 shares; issued and outstanding 3,762 and 3,762 | 468 | 468 |
| Additional paid-in capital | 6,318 | 5,574 |
| Accumulated other comprehensive loss | (44) |) |
| Retained earnings | 265,717 | 260,681 |
| Total Stockholders' Equity | 497,779 | 493,393 |

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| | | | | | |
|------------------------------------|--------|----|-----------|----|-----------|
| Total Liabilities and Stockholders | Equity | \$ | 1,608,986 | \$ | 1,579,357 |
|------------------------------------|--------|----|-----------|----|-----------|

The accompanying notes are an integral part of these consolidated financial statements.

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LITHIA MOTORS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2007 | 2006 |
| Revenues: | | |
| New vehicle sales | \$ 451,156 | \$ 420,395 |
| Used vehicle sales | 221,771 | 206,506 |
| Finance and insurance | 30,405 | 27,231 |
| Service, body and parts | 96,635 | 81,084 |
| Fleet and other | 689 | 1,155 |
| Total revenues | 800,656 | 736,371 |
| Cost of sales | 660,665 | 608,593 |
| Gross profit | 139,991 | 127,778 |
| Selling, general and administrative | 111,027 | 97,564 |
| Depreciation - buildings | 1,386 | 1,090 |
| Depreciation and amortization - other | 3,513 | 2,893 |
| Income from continuing operations | 24,065 | 26,231 |
| Other income (expense): | | |
| Floorplan interest expense | (7,656) | (5,405) |
| Other interest expense | (4,976) | (3,299) |
| Other income, net | 212 | 378 |
| | (12,420) | (8,326) |
| Income from continuing operations before income taxes | 11,645 | 17,905 |
| Income taxes | (4,576) | (6,969) |
| Income from continuing operations | 7,069 | 10,936 |
| Income (loss) from discontinued operations, net of income tax expense (benefit) of \$3 and \$(866) | 6 | (1,568) |
| Net income | \$ 7,075 | \$ 9,368 |
| Basic income per share from continuing operations | \$ 0.36 | \$ 0.56 |
| Basic loss per share from discontinued operations | | (0.08) |
| Basic net income per share | \$ 0.36 | \$ 0.48 |
| Shares used in basic per share calculations | 19,492 | 19,426 |
| Diluted income per share from continuing operations | \$ 0.34 | \$ 0.52 |
| Diluted loss per share from discontinued operations | | (0.07) |
| Diluted net income per share | \$ 0.34 | \$ 0.45 |
| Shares used in diluted per share calculations | 22,131 | 22,066 |

The accompanying notes are an integral part of these consolidated financial statements.

LITHIA MOTORS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net income | \$ 7,075 | \$ 9,368 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 4,899 | 3,983 |
| Depreciation and amortization from discontinued operations | | 63 |
| Amortization of debt discount | 54 | |
| Stock-based compensation | 748 | 649 |
| (Gain) loss on sale of assets | 73 | (8) |
| Deferred income taxes | 8,147 | 1,133 |
| Excess tax benefits from share-based payment arrangements | (166) | (315) |
| (Increase) decrease, net of effect of acquisitions: | | |
| Trade and installment contract receivables, net | (5,265) | 1,883 |
| Contracts in transit | (6,123) | 794 |
| Inventories | 16,385 | (46,555) |
| Vehicles leased to others | (1,451) | (648) |
| Prepaid expenses and other | 693 | 2,276 |
| Other non-current assets | 740 | (3,562) |
| Increase (decrease), net of effect of acquisitions: | | |
| Floorplan notes payable | (82,530) | 14,656 |
| Trade payables | 572 | (488) |
| Accrued liabilities | (1,085) | 7,246 |
| Other long-term liabilities and deferred revenue | (684) | (249) |
| Net cash used in operating activities | (57,918) | (9,774) |
| Cash flows from investing activities: | | |
| Capital expenditures: | | |
| Non-financeable | (5,056) | (7,231) |
| Financeable | (22,589) | (7,514) |
| Proceeds from sale of assets | 3,748 | 279 |
| Cash paid for acquisitions, net of cash acquired | (12,459) | |
| Proceeds from sale of dealerships | | 2,226 |
| Net cash used in investing activities | (36,356) | (12,240) |
| Cash flows from financing activities: | | |
| Flooring notes payable: non-trade | 67,932 | 5,663 |
| Net borrowings (repayments) on lines of credit | 16,081 | (13,000) |
| Principal payments on long-term debt and capital leases | (2,635) | (1,891) |
| Proceeds from issuance of long-term debt | 11,516 | 16,009 |
| Proceeds from issuance of common stock | 1,737 | 2,115 |
| Excess tax benefits from share-based payment arrangements | 166 | 315 |
| Repurchases of common stock | (3,355) | |
| Dividends paid | (2,745) | (2,338) |
| Net cash provided by financing activities | 88,697 | 6,873 |
| Decrease in cash and cash equivalents | (5,577) | (15,141) |
| Cash and cash equivalents: | | |
| Beginning of period | 26,600 | 48,566 |
| End of period | \$ 21,023 | \$ 33,425 |

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Supplemental disclosures of cash flow information:

| | | | | |
|--|----|--------|----|-------|
| Cash paid during the period for interest | \$ | 12,937 | \$ | 9,291 |
| Cash paid during the period for income taxes | | 37 | | 15 |

Supplemental schedule of noncash investing and financing activities:

| | | | | |
|--|----|--------|----|-------|
| Floorplan debt acquired in connection with acquisitions | \$ | 13,232 | \$ | |
| Floorplan debt paid by purchaser in connection with dealership disposals | | | | 4,713 |
| Common stock received for the exercise price of stock options | | 87 | | |

The accompanying notes are an integral part of these consolidated financial statements.

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LITHIA MOTORS, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**Note 1. Basis of Presentation**

These condensed consolidated financial statements contain unaudited information as of March 31, 2007 and for the three-month periods ended March 31, 2007 and 2006. The unaudited interim financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by accounting principles generally accepted in the United States of America are not included herein. In management's opinion, these unaudited financial statements include all adjustments necessary for a fair presentation of the information when read in conjunction with our audited consolidated financial statements and the related notes thereto. The financial information as of December 31, 2006 is derived from our 2006 Annual Report on Form 10-K. The interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our 2006 Annual Report on Form 10-K. The results of operations for the interim period presented are not necessarily indicative of the results to be expected for the full year.

Note 2. Inventories

Inventories are valued at the lower of market value or cost, using the specific identification method for vehicles and parts. The cost of new and used vehicle inventories includes the cost of any equipment added, reconditioning and transportation. Inventories consisted of the following (in thousands):

| | March 31, 2007 | December 31, 2006 |
|--------------------------|---------------------------|------------------------------|
| New and program vehicles | \$ 462,110 | \$ 466,703 |
| Used vehicles | 105,256 | 103,857 |
| Parts and accessories | 32,576 | 32,746 |
| | \$ 599,942 | \$ 603,306 |

Note 3. Earnings Per Share

Following is a reconciliation of the income from continuing operations and weighted average shares used for our basic earnings per share (EPS) and diluted EPS (in thousands, except per share amounts):

| Three Months Ended March 31, | 2007 Income from Continuing Operations | Shares | Per Share Amount | 2006 Income from Continuing Operations | Shares | Per Share Amount |
|---|---|---------------|-----------------------------|---|---------------|-----------------------------|
| Basic EPS | | | | | | |
| Income from continuing operations available to common stockholders | \$ 7,069 | 19,492 | \$ 0.36 | \$ 10,936 | 19,426 | \$ 0.56 |
| Effect of Dilutive Securities | | | | | | |
| 2 7/8% convertible senior subordinated notes | 448 | 2,278 | (0.02) | 467 | 2,255 | (0.03) |
| Stock options and unvested restricted stock | | 361 | | | 385 | (0.01) |
| Diluted EPS | | | | | | |
| Income from continuing operations available to common stockholders | \$ 7,517 | 22,131 | \$ 0.34 | \$ 11,403 | 22,066 | \$ 0.52 |
| Antidilutive Securities | | | | | | |
| Shares issuable pursuant to stock options not included since they were antidilutive | | 464 | | | | |

Note 4. Comprehensive Income

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of cash flow hedging instruments, since their designation date of December 31, 2006, that are reflected in stockholders' equity, net of tax, instead of net

income. Comprehensive income was the same as net income for the three-month period ended March 31, 2006. **The following table sets forth the calculation of comprehensive income for the three-month period ended March 31, 2007 (in thousands):**

| | |
|--|----------|
| Three Months Ended March 31, | 2007 |
| Net income | \$ 7,075 |
| Cash flow hedges: | |
| Derivative loss, net of tax effect of \$27 | (44) |
| Total comprehensive income | \$ 7,031 |

Note 5. Acquisitions

The following acquisition was made in the first quarter of 2007:

- In February 2007, we acquired Jordan Motors, Inc., which was comprised of four stores, in Ames, Johnston and Des Moines, Iowa. The stores had annualized combined revenues of approximately \$100 million. The stores were renamed Honda of Ames, Lithia Nissan of Ames, Acura of Johnston, Lithia Infiniti of Des Moines, Lithia Volkswagen of Des Moines and Audi Des Moines. The three stores in Des Moines are considered one location.

The above acquisition was accounted for under the purchase method of accounting. Pro forma results of operations, assuming the above acquisition and the previously disclosed 2006 acquisitions occurred as of January 1, 2006, were as follows (in thousands, except per share amounts).

| | Three Months Ended March 31, | |
|----------------------------|---------------------------------|------------|
| | 2007 | 2006 |
| Total revenues | \$ 814,033 | \$ 839,069 |
| Net income | 7,158 | 8,952 |
| Basic earnings per share | 0.37 | 0.46 |
| Diluted earnings per share | 0.34 | 0.43 |

There are no future contingent payouts related to the 2007 acquisition and no portion of the purchase price was paid with our equity securities. During the first quarter of 2007, we acquired the four stores discussed above for \$12.5 million in cash, which included \$7.5 million of goodwill and \$3.0 million of other, primarily indefinite lived, intangible assets. The purchase price for the balance of the assets acquired was funded by borrowings. In addition, we acquired new vehicle inventory and associated floorplan debt in the amount of \$13.2 million in connection with the above acquisition.

Within one year from the purchase date of each store, we may update the value allocated to its purchased assets and the resulting goodwill balances as a result of information received regarding the valuation of such assets and liabilities that was not available at the time of purchase. At March 31, 2007, there were 17 store acquisitions within the one year allocation window. All of the goodwill from the above acquisition is expected to be deductible for tax purposes.

Note 6. Dividend Payment

Cash dividends at the rate of \$0.14 per common share, which totaled approximately \$2.7 million, were paid on January 30, 2007 to shareholders of record on January 16, 2007.

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

Note 7. Stock-Based Compensation

In the first quarter of 2007, we issued our annual non-qualified stock option grants to executive officers and restricted stock grants to other employees. The non-qualified stock option grants cover a total of 108,000 shares of our common stock, were granted at the fair market value on the date of grant of \$28.34 per share and vest as to 100% of the shares on the fifth anniversary of the grant date and expire on the sixth anniversary. Restricted stock grants covering 60,821 shares of our common stock were also granted

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and have varying vesting provisions with full vesting occurring between four and five years. Total compensation related to these stock-based awards was \$2.1 million as calculated pursuant to the fair value methods prescribed by Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payments. Of the \$2.1 million, approximately \$0.4 million will be recognized in 2007.

Note 8. Discontinued Operations

We continually monitor the performance of each of our dealerships and make determinations to sell a dealership based primarily on return on capital criteria. When a dealership meets the criteria of held for sale, as defined in SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the results of operations are reclassified into discontinued operations. All dealerships included in discontinued operations have been, or will be, eliminated from our on-going operations upon completion of the sale. We anticipate the completion of the sale for each dealership to occur within 12 months from the date of determination.

As of March 31, 2007 and December 31, 2006, we had two dealerships held for sale and classified as discontinued operations. Certain financial information related to discontinued operations was as follows (in thousands):

| Three Months Ended March 31, | 2007 | 2006 |
|--|-----------|-----------|
| Revenue | \$ 12,313 | \$ 20,420 |
| Pre-tax income (loss) | 9 | (2,434) |
| Gain on disposal of discontinued operations, net of tax | | |
| Amount of goodwill and other intangible assets disposed of | | 1,946 |

The pre-tax loss in the first quarter of 2006 includes legal settlements related to dealerships in California that were sold in prior years.

Interest expense is allocated to stores classified as discontinued operations for actual flooring interest expense directly related to the new vehicles in the store. Interest expense related to our working capital, acquisition and used vehicle credit facility is allocated based on the amount of assets pledged towards the total borrowing base.

Assets held for sale included the following (in thousands):

| | March 31, 2007 | December 31, 2006 |
|--------------------------------------|-------------------|----------------------|
| Inventories | \$ 9,424 | \$ 11,594 |
| Property, plant and equipment | 2,958 | 2,949 |
| Goodwill and other intangible assets | 942 | 942 |
| | \$ 13,324 | \$ 15,485 |

Liabilities held for sale included the following (in thousands):

| | March 31, 2007 | December 31, 2006 |
|-------------------------|-------------------|----------------------|
| Floorplan notes payable | \$ 7,902 | \$ 9,605 |
| Real estate debt | 1,978 | 2,005 |
| | \$ 9,880 | \$ 11,610 |

Note 9. Adoption of Interpretation No. 48

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes , which is an interpretation of FASB Statement No. 109. Interpretation 48 applies to all tax positions accounted for under Statement 109. The interpretation applies to situations where the uncertainty is to the timing of the deduction, the amount of the deduction, or the validity of the deduction. Interpretation No. 48 is effective as of the beginning of the first fiscal year beginning after December 15, 2006 (January 1, 2007 for us). At adoption, companies must adjust their financial statements to reflect only those tax positions that are more-likely-than-not to be sustained as of

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

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the adoption date. Positions that meet this criterion should be measured using the largest benefit that is more than 50 percent likely to be realized. The necessary adjustment should be recorded directly to the beginning balance of retained earnings in the period of adoption and reported as a change in accounting principle, if material. However, because of the immaterial nature of the adjustment, we have not presented this item separately on the face of the balance sheet. At adoption, important information in regard to our reporting for Interpretation No. 48 was as follows:

| | |
|---|----|
| Total amount of unrecognized tax benefits | \$ |
| Amount of unrecognized tax benefits that would impact the effective rate if recognized | \$ |
| Nature and potential magnitude of significant changes in unrecognized tax benefits that are reasonably possible within the 12 months following the adoption date pursuant to paragraph 21(d) of Interpretation No. 48 | \$ |
| Accrued interest and penalties as of the date of adoption | \$ |

| | |
|---|--|
| Entity policy for classifying interest and penalties: | Tax expense |
| Description of open tax years: | Federal 2003 - 2006 15 States 2002 - 2006 |

Note 10. Repurchases of Common Stock

In the first quarter of 2007, we repurchased 124,809 shares of our Class A common stock for \$3.4 million, or an average price of \$26.88 per share. Of these repurchases, 121,800 were pursuant to the program approved by our Board of Directors in June 2000, which authorized the repurchase of up to 1,000,000 shares of our Class A common stock. Through March 31, 2007, we have purchased a total of 378,631 shares under this program.

Note 11. Reclassifications

There were no reclassifications to the prior period financial statements during the first quarter of 2007.

Note 12. Contingencies

Litigation

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

On November 25, 2003, Aimee Phillips filed a lawsuit in the U.S. District Court for the District of Oregon (Case No. 03-3109-HO) against Lithia Motors, Inc. and two of its wholly-owned subsidiaries alleging violations of state and federal RICO laws, the Oregon Unfair Trade Practices Act (UTPA) and common law fraud. Ms. Phillips seeks damages, attorney's fees and injunctive relief. Ms. Phillips' complaint stems from her purchase of a Toyota Tacoma pick-up truck on July 6, 2002. On May 14, 2004, we filed an answer to Ms. Phillips' Complaint. This case was consolidated with the Allen case described below and has a similar current procedural status.

On April 28, 2004, Robert Allen and 29 other plaintiffs (Allen Plaintiffs) filed a lawsuit in the U.S. District Court for the District of Oregon (Case No. 04-3032-HO) against Lithia Motors, Inc. and three of its wholly-owned subsidiaries alleging violations of state and federal RICO laws, the Oregon UTPA and common law fraud. The Allen Plaintiffs seek damages, attorney's fees and injunctive relief. The Allen Plaintiffs' Complaint stems from vehicle purchases made at Lithia dealerships between July 2000 and April 2001. On August 27, 2004, we filed a Motion to Dismiss the Complaint. On May 26, 2005, the Court entered an Order granting Defendants' Motion to Dismiss plaintiffs' state and federal RICO claims with prejudice. The Court declined to exercise supplemental jurisdiction over plaintiffs' UTPA and fraud claims. Plaintiffs filed a Motion to Reconsider the dismissal Order. On August 23, 2005, the Court granted Plaintiffs' Motion for Reconsideration and permitted the filing of a Second Amended Complaint (SAC). On September 21,

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

2005, the Allen Plaintiffs, along with Ms. Phillips, filed the SAC. In this complaint, the Allen plaintiffs seek actual damages that total less than \$500,000, trebled, approximately \$3.0 million in mental distress claims, trebled, punitive damages of \$15.0 million, attorney's fees and injunctive relief. The SAC added as defendants certain officers and employees of Lithia. In addition, the SAC added a claim for relief based on the Truth in Lending Act (TILA). On November 14, 2005 we filed a second Motion to Dismiss the Complaint and a Motion to Compel Arbitration. On April 27, 2006, the court granted our motion to dismiss a number of the claims but permitted others to proceed. In particular, all TILA claims were dismissed, some of the RICO claims have been eliminated and any claims for non-economic damages for the alleged fraud have been dismissed. We believe the actions of the court have significantly narrowed the claims and potential damages sought by the plaintiffs. Lithia's motion to Compel Arbitration of Plaintiff's remaining claims was argued by the parties on March 13, 2007. We are still awaiting a ruling by the court.

On September 23, 2005, Maria Anabel Aripe and 19 other plaintiffs (Aripe Plaintiffs) filed a lawsuit in the U.S. District Court for the District of Oregon (Case No. 05-3083-HO) against Lithia Motors, Inc., 12 of its wholly-owned subsidiaries and certain officers and employees of Lithia, alleging violations of state and federal RICO laws, the Oregon UTPA, common law fraud and TILA. The Aripe Plaintiffs seek actual damages of less than \$600,000, trebled, approximately \$3.7 million in mental distress claims, trebled, punitive damages of \$12.6 million, attorney's fees and injunctive relief. The Aripe Plaintiffs' Complaint stems from vehicle purchases made at Lithia dealerships between May 2001 and August 2005 and is substantially similar to the allegations made in the Allen case. We expect certain of the rulings in the Allen case to apply equally to this case and proceedings in this matter are awaiting rulings in the Allen case. Once resolved, we further expect to file motions directed at all claims.

On May 30, 2006 four of our wholly owned subsidiaries located in Alaska were served with a lawsuit alleging that the dealerships failed to comply with Alaska law relating to various disclosures required to be made during the sale of a used vehicle. The complaint was filed by Jackie Lee Neese et al v. Lithia Chrysler Jeep of Anchorage, Inc. et al in the Superior Court for the State of Alaska at Anchorage, case number 3AN-06-04815CI. The complainants seek to represent other similarly situated customers. The court has not certified the suit as a class action.

We intend to vigorously defend all matters and management believes that the likelihood of a judgment for the amount of damages sought in any of the cases is remote.

Note 13. Subsequent Event

Dividend

In April 2007, we announced a dividend on our Class A and Class B common stock of \$0.14 per share for the first quarter of 2007. The dividend, which totaled approximately \$2.7 million, was paid on April 30, 2007 to shareholders of record on April 16, 2007.

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

Forward Looking Statements and Risk Factors

Some of the statements in this Form 10-Q constitute forward-looking statements. In some cases, you can identify forward-looking statements by terms such as may, will, should, expect, plan, intend, forecast, anticipate, believe, estimate, predict, potential, and combinations of these terms or other comparable terminology. The forward-looking statements contained in this Form 10-Q involve known and unknown risks, uncertainties and situations that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. Some of the important factors that could cause actual results to differ from our expectations are discussed in Item 1A to our 2006 Form 10-K, which was filed with the Securities and Exchange Commission on March 9, 2007. These risk factors have not significantly changed since the filing of the 2006 Form 10-K.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements.

Overview

We are a leading operator of automotive franchises and retailer of new and used vehicles and services. As of May 5, 2007, we offered 30 brands of new vehicles through 194 franchises in 108 stores in the Western United States and over the Internet. As of May 5, 2007 we operated 16 stores in Oregon, 15 in California, 14 in Texas, 12 in Washington, 8 in Iowa, 7 in Idaho, 7 in Colorado, 7 in Alaska, 7 in Montana, 6 in Nevada, 3 in Nebraska, 2 in South Dakota, 2 in North Dakota, 1 in New Mexico and 1 in Wisconsin. We sell new and used cars and light trucks; sell replacement parts; provide vehicle maintenance, warranty, paint and repair services; and arrange related financing, service contracts, protection products and credit insurance for our automotive customers.

We currently achieve gross profit margins above industry averages by selling a higher ratio of retail used vehicles to new vehicles and by arranging finance and extended warranty contracts for a greater percentage of our customers.

Our acquisition model is focused on acquiring new vehicle stores where the store is the dominant or the only franchise of that brand in the market. Our current brand mix is heavily weighted towards domestic brands at approximately 65%. Our strategy is to target a more balanced mix between our domestic, import and luxury brands in the years ahead. Our goal is to improve the operations of all four departments of every store we acquire. We have had success with this strategy since our initial public offering in 1996. Since 1996, our ability to integrate the stores that we acquire has increased dramatically. We have also developed a better process for identifying acquisition targets that fit our operating model. Our cash position, substantial lines of credit, plus an experienced and well-trained staff are all available to facilitate our continued growth as the opportunities develop.

In keeping with this model, we acquired 4 stores in the first four months of 2007 with total estimated annual revenues of approximately \$100 million. At May 5, 2007, we had 2 stores held for sale and listed as discontinued operations with combined revenues of approximately \$49 million.

We expect that manufacturers will continue to offer incentives on new vehicle sales during 2007 through a combination of repricing strategies, rebates, lease programs, early lease cancellation programs and low interest rate loans to consumers. To complement the manufacturers' incentive strategy, we employ a volume-based strategy for our new vehicle sales.

We have completed or are currently working on the following initiatives that we expect will improve our operations in future periods:

- A Customer Centric Sales Process, which will help leverage the benefits of our Lithia Store Management System (LSMS) which allows us to track advertising and increase the productivity

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of the sales staff by providing daily work plans and focused training. Under this program, showrooms are equipped with interactive personal computers, which allows the salesperson to quickly and efficiently enter data and interact with the customer to speed up the sales process;

- Improved functionality of our centralized inventory control and procurement process;
- IT initiatives related to automating our offices, centralizing certain office functions and establishing independent used vehicle operations;
- We expect to open our first independent used vehicle outlet, which we call L2 Auto, by late summer of 2007; and
- Used Vehicle First Look Technology has been fully integrated across the entire network of stores. We continue to train and optimize the usage of this technology in our stores.

Results of Continuing Operations

Certain revenue, gross profit margin and gross profit information by product line was as follows:

| Three Months Ended March 31, 2007 | Percent of Total Revenues | Gross Profit Margin | Percent of Total Gross Profit |
|-----------------------------------|---------------------------------|---------------------------|-------------------------------------|
| New vehicle | 56.3 | % 7.7 | % 24.8 |
| Used vehicle(1) | 27.7 | 12.9 | 20.5 |
| Finance and insurance(2) | 3.8 | 100.0 | 21.7 |
| Service, body and parts | 12.1 | 47.5 | 32.8 |
| Fleet and other | 0.1 | 45.9 | 0.2 |

| Three Months Ended March 31, 2006 | Percent of Total Revenues | Gross Profit Margin | Percent of Total Gross Profit |
|-----------------------------------|---------------------------------|---------------------------|-------------------------------------|
| New vehicle | 57.1 | % 7.9 | % 26.1 |
| Used vehicle(1) | 28.0 | 13.5 | 21.9 |
| Finance and insurance(2) | 3.7 | 100.0 | 21.3 |
| Service, body and parts | 11.0 | 47.9 | 30.4 |
| Fleet and other | 0.2 | 36.2 | 0.3 |

(1) Includes retail and wholesale used vehicles.

(2) Commissions reported net of anticipated cancellations.

The following table sets forth selected condensed financial data, expressed as a percentage of total revenues for the periods indicated.

| | Three Months Ended March 31, | |
|--|------------------------------|---------|
| | 2007(1) | 2006(1) |
| Revenues: | | |
| New vehicle | 56.3 | % 57.1 |
| Used vehicle | 27.7 | 28.0 |
| Finance and insurance | 3.8 | 3.7 |
| Service, body and parts | 12.1 | 11.0 |
| Fleet and other | 0.1 | 0.2 |
| Total revenues | 100.0 | % 100.0 |
| Gross profit | 17.5 | 17.4 |
| Selling, general and administrative expenses | 13.9 | 13.2 |

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

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| | | | | |
|--|-----|---|-----|---|
| Depreciation and amortization | 0.6 | | 0.5 | |
| Income from operations | 3.0 | | 3.6 | |
| Floorplan interest expense | 1.0 | | 0.7 | |
| Other interest expense | 0.6 | | 0.4 | |
| Other income, net | | | 0.1 | |
| Income from continuing operations before taxes | 1.5 | | 2.4 | |
| Income tax expense | 0.6 | | 0.9 | |
| Income from continuing operations | 0.9 | % | 1.5 | % |

(1) The percentages may not add due to rounding.

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The following tables set forth the changes in our operating results from continuing operations in the first quarter of 2007 compared to the first quarter of 2006:

| (Dollars in thousands) | Three Months Ended | | Increase (Decrease) | % | |
|--|--------------------|------------|------------------------|------------------------|------------------------|
| | March 31, 2007 | 2006 | | Increase (Decrease) | Increase (Decrease) |
| Revenues: | | | | | |
| New vehicle | \$ 451,156 | \$ 420,395 | \$ 30,761 | 7.3 | % |
| Used vehicle | 221,771 | 206,506 | 15,265 | 7.4 | |
| Finance and insurance | 30,405 | 27,231 | 3,174 | 11.7 | |
| Service, body and parts | 96,635 | 81,084 | 15,551 | 19.2 | |
| Fleet and other | 689 | 1,155 | (466) | (40.3) |) |
| Total revenues | 800,656 | 736,371 | 64,285 | 8.7 | |
| Cost of sales | 660,665 | 608,593 | 52,072 | 8.6 | |
| Gross profit | 139,991 | 127,778 | 12,213 | 9.6 | |
| Selling, general and administrative | 111,027 | 97,564 | 13,463 | 13.8 | |
| Depreciation and amortization | 4,899 | 3,983 | 916 | 23.0 | |
| Income from operations | 24,065 | 26,231 | (2,166) | (8.3) |) |
| Floorplan interest expense | (7,656) | (5,405) | 2,251 | 41.6 | |
| Other interest expense | (4,976) | (3,299) | 1,677 | 50.8 | |
| Other income, net | 212 | 378 | (166) | (43.9) |) |
| Income from continuing operations before taxes | 11,645 | 17,905 | (6,260) | (35.0) |) |
| Income tax expense | 4,576 | 6,969 | (2,393) | (34.3) |) |
| Income from continuing operations | \$ 7,069 | \$ 10,936 | \$ (3,867) | (35.4) |)% |

| | Three Months Ended | | Increase (Decrease) | % | |
|---|--------------------|-----------|------------------------|------------------------|------------------------|
| | March 31, 2007 | 2006 | | Increase (Decrease) | Increase (Decrease) |
| New units sold | 15,711 | 14,983 | 728 | 4.9 | % |
| Average selling price per new vehicle | \$ 28,716 | \$ 28,058 | \$ 658 | 2.3 | |
| Used units sold | 17,306 | 16,076 | 1,230 | 7.7 | |
| Average selling price per used vehicle | \$ 12,815 | \$ 12,846 | \$ (31) | (0.2) |) |
| Finance and insurance sales per retail unit | \$ 1,137 | \$ 1,063 | \$ 74 | 7.0 | |

Revenues

Total revenues increased 8.7% in the first quarter of 2007 compared to the first quarter of 2006 as a result of acquisitions, partially offset by a 2.1% decrease in same-store sales, excluding fleet. The first quarter of 2007 faced difficult comparisons with the first quarter of 2006 when total same store sales grew by 8.4%. The decrease in the first quarter of 2007 was also impacted by a weak retail sales environment.

Same-store sales percentage increases (decreases) were as follows:

| | First quarter of 2007 vs. first quarter of 2006 |
|--------------------------------------|--|
| New vehicle retail, excluding fleet | (3.9) % |
| Used vehicles, including wholesale | (1.9) |
| Total vehicle sales, excluding fleet | (3.2) |
| Finance and insurance | 2.9 |
| Service, body and parts | 4.9 |
| Total sales, excluding fleet | (2.1) |

Same store sales are calculated for stores that were in operation as of March 31, 2006, and only including the months of operations for both comparable periods. For example, a store acquired in January 2006 would be included in same store operating data beginning in February 2006,

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

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after its first full complete comparable month of operation. Thus, operating results for same store comparisons would include only the periods of February through March of both comparable years.

The 3.9% decrease in same-store new vehicle sales was primarily due to weak vehicle sales in January and February 2007 and declining sales of domestic manufacturers' vehicles that represent a large percentage of our new vehicle sales. Sales of Chrysler, Dodge and Jeep vehicles alone represented

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Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

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approximately 40% of our total new vehicle revenues in the first quarter of 2007. We experienced a stronger retail sales environment in the month of March 2007. We also faced difficult comparisons with the first quarter of 2006 when new vehicle same store sales increased 13.5% due to strong manufacturer incentives.

The 2.9% increase in same-store finance and insurance sales was due to a 7% increase in the finance and insurance sales per unit. The 2.9% increase was also partially offset by a decrease in same-store vehicle unit sales, which lowered the overall opportunity for finance and insurance sales.

The 4.9% increase in service, body and parts sales was primarily due to a 5.9% increase in the customer-pay portion of the business, where all three segments were up on a same store sales basis. The customer-pay portion of the business represents approximately 82% of total service, body and parts sales. This increase was partially offset by a 1.2% decrease in same-store warranty sales in the first quarter of 2007 compared to the first quarter of 2006.

Penetration rates for certain products were as follows:

| Three Months Ended March 31, | 2007 | 2006 |
|--------------------------------|------|------|
| Finance and insurance | 78 % | 78 % |
| Service contracts | 43 | 43 |
| Lifetime oil change and filter | 38 | 39 |

Gross Profit

Gross profit increased \$12.2 million in the first quarter of 2007 compared to the first quarter of 2006 primarily due to increased total revenues. Our gross profit margin by business line was as follows:

| | Three Months Ended | | Basis Point |
|-------------------------|--------------------|-------|-------------|
| | March 31, 2007 | 2006 | |
| New vehicle | 7.7 % | 7.9 % | (20)bp* |
| Retail used vehicle | 15.0 | 15.2 | (20) |
| Wholesale used vehicle | 4.0 | 5.1 | (110) |
| Finance and insurance | 100.0 | 100.0 | |
| Service, body and parts | 47.5 | 47.9 | (40) |
| Overall | 17.5 | 17.4 | 10 |

* bp stands for basis points (one hundred basis points equals one percent).

The decrease in new vehicle gross profit margins in the first quarter of 2007 compared to the first quarter of 2006 was primarily due to a more competitive retail sales environment in the first quarter of 2007. However, gross profit was positively affected by a shift in mix back towards more trucks and SUVs, which typically have higher gross profits.

Retail used vehicle gross profit margins decreased in the first quarter of 2007 compared to the first quarter of 2006, primarily due to more aggressive pricing strategies. However, they remain above our 5-year historical average of 14.2%.

Gross profit margins in the service, body and parts business line decreased in the first quarter of 2007 compared to the first quarter of 2006 due to a shift in mix towards selling more parts and accessories, which carry lower margins than the service side of the business. However, our same-store gross profit increased 3.3% as a result of increased volume.

The increase in our overall gross profit margin was due to a shift in mix to a higher percentage of finance and insurance and service, body and parts revenue as a percentage of total revenue.

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

Selling, General and Administrative Expense

Selling, general and administrative expense (SG&A) includes salaries and related personnel expenses, facility lease expense, advertising (net of manufacturer cooperative advertising credits), legal, accounting, professional services and general corporate expenses.

Selling, general and administrative expense increased \$13.5 million in the first quarter of 2007 compared to the first quarter of 2006, and also increased to 13.9% of revenue in the first quarter of 2007 compared to 13.2% of revenue in the first quarter of 2006. Approximately \$10.3 million of the increase in dollars spent in the first quarter of 2007 compared to the first quarter of 2006 was due to increased selling, or variable, expenses related to the increases in acquisition revenues and the number of locations. In addition, employee benefit costs increased \$0.9 million, rent expense increased \$0.8 million, utilities increased \$0.4million, property taxes increased \$0.3 million and maintenance and repairs increased \$0.3 million.

At our stores, we have been more successful at controlling our SG&A expenses. On a combined basis, sales compensation and advertising expenses as a percentage of gross profit was down 60 basis points in the first quarter of 2007 compared to the first quarter of 2006.

SG&A as a percentage of gross profit is an industry standard for measuring performance relative to SG&A. As a result of charges detailed above, as well as costs related to our investments in personnel for our centralization efforts, L2 Auto and the other initiatives, SG&A as a percentage of gross profit increased by 290 basis points to 79.3% in the first quarter of 2007 compared to 76.4% in the first quarter of 2006. However, despite the additional charges for our operational initiatives and other items discussed above, we are close to our 5-year first quarter historical average of 79.1%. In addition, our SG&A as a percentage of gross profit for the month of March 2007 was 71.8%, which demonstrates how incremental sales and a strong month can positively affect our performance.

Depreciation and Amortization

Depreciation and amortization increased \$0.9 million in the first quarter of 2007 compared to the first quarter of 2006 due to the addition of property and equipment primarily related to our acquisitions, as well as leasehold improvements to existing facilities.

Income from Operations

Operating margins decreased by 60 basis points in the first quarter of 2007 to 3.0% from 3.6% in the first quarter of 2006. The decrease was due primarily to the increased SG&A as discussed above.

Floorplan Interest Expense

Floorplan interest expense increased \$2.3 million in the first quarter of 2007 compared to the first quarter of 2006. An increase of \$1.1 million resulted from increases in the average interest rates on our floorplan facilities. Additionally, in the first quarter of 2006, we recorded a \$1.5 million benefit to interest expense related to the changes in fair value of our interest rate swaps. In the first quarter of 2007, changes in the fair value of our interest rate swaps were recorded in Accumulated Other Comprehensive Income. These increases were partially offset by a \$0.3 million decrease as a result of a decrease in the average outstanding balances of our floorplan facilities.

Other Interest Expense

Other interest expense includes interest on our senior subordinated convertible notes, debt incurred related to acquisitions, real estate mortgages and our working capital, acquisition and used vehicle line of credit.

Other interest expense increased \$1.7 million in the first quarter of 2007 compared to the first quarter of 2006. Changes in the weighted average interest rate on our debt in the first quarter of 2007 compared to the first quarter of 2006 increased other interest expense by approximately \$0.1 million and changes in the average outstanding balances resulted in an increase of approximately \$1.6 million. Interest expense related to the \$85.0 million of senior subordinated convertible notes that were issued in May 2004 totals

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approximately \$763,000 per quarter, which consists of \$611,000 of contractual interest and \$152,000 of amortization of debt issuance costs.

Other interest expense excludes \$0.7 million and \$0.2 million, respectively, of capitalized interest in the three month periods ended March 31, 2007 and 2006.

Income Tax Expense

Our effective tax rate was 39.3% in the first quarter of 2007 compared to 38.9% in the first quarter of 2006. Our federal income tax rate is 35% and our state income tax rate is currently 3.05%, which varies with the mix of states where our stores are located. We also have certain non-deductible expenses and other adjustments that increase our effective rate. Our effective tax rate may be affected in the future by the mix of asset acquisitions compared to corporate acquisitions, as well as by the mix of states where our stores are located. Our tax rate in the first quarter of 2006 also includes a reduction in amounts provided for identified tax contingencies.

Income from Continuing Operations

Income from continuing operations as a percentage of revenue decreased in the first quarter of 2007 compared to the first quarter of 2006 primarily as a result of the increased SG&A and interest expense as discussed above.

Discontinued Operations

As of March 31, 2007 and December 31, 2006, we had two dealerships held for sale and classified as discontinued operations. Certain financial information related to discontinued operations was as follows (in thousands):

| Three Months Ended March 31, | 2007 | 2006 |
|--|-----------|-----------|
| Revenue | \$ 12,313 | \$ 20,420 |
| Pre-tax income (loss) | 9 | (2,434) |
| Gain on disposal of discontinued operations, net of tax | | |
| Amount of goodwill and other intangible assets disposed of | | 1,946 |

The pre-tax loss in the first quarter of 2006 includes legal settlements related to dealerships in California that were sold in prior years.

Assets held for sale included the following (in thousands):

| | March 31, 2007 | December 31, 2006 |
|--------------------------------------|-------------------|----------------------|
| Inventories | \$ 9,424 | \$ 11,594 |
| Property, plant and equipment | 2,958 | 2,949 |
| Goodwill and other intangible assets | 942 | 942 |
| | \$ 13,324 | \$ 15,485 |

Liabilities held for sale included the following (in thousands):

| | March 31, 2007 | December 31, 2006 |
|-------------------------|-------------------|----------------------|
| Floorplan notes payable | \$ 7,902 | \$ 9,605 |
| Real estate debt | 1,978 | 2,005 |
| | \$ 9,880 | \$ 11,610 |

Seasonality and Quarterly Fluctuations

Historically, our sales have been lower in the first and fourth quarters of each year due to consumer purchasing patterns during the holiday season, inclement weather in certain of our markets and the reduced number of business days during the holiday season. As a result, financial performance is expected to be lower during the first and fourth quarters than during the second and third quarters of each fiscal year. We

Comprehensive income for the three-month period ended March 31, 2007 included the change in the fair value of c

believe that interest rates, levels of consumer debt, consumer confidence and manufacturer sales incentives, as well as general economic conditions, also contribute to fluctuations in sales and operating results. Acquisitions have also been a contributor to fluctuations in our operating results from quarter to quarter.

Liquidity and Capital Resources

Our principal needs for capital resources are to finance acquisitions and capital expenditures, as well as for working capital and the funding of our cash dividend payments. We have relied primarily upon internally generated cash flows from operations, borrowings under our credit agreements and the proceeds from public equity and private debt offerings to finance operations and expansion. We believe that our available cash, cash equivalents, available lines of credit and cash flows from operations will be sufficient to meet our anticipated operating expenses, capital requirements, projected acquisitions and current level of cash dividends for at least the next 12 months from March 31, 2007.

Our inventories decreased to \$599.9 million at March 31, 2007 from \$603.3 million at December 31, 2006. We slowed ordering vehicles in the third and fourth quarters of 2006 and worked to sell down our new vehicle inventory. As a result, our days supply of new vehicles at March 31, 2007 was 16 days below our average historical March 31 balances and more than 17 days below our December 31, 2006 levels.

Our focus on new vehicle unit sales in 2006 led to more trade-ins, which resulted in increased used vehicle inventories. However, we were able to work these inventories down during the first quarter of 2007 and, at March 31, 2007, our days supply of used vehicles was at our average levels for March 31.

In connection with decreasing our vehicle inventories, we were able to decrease our new vehicle flooring notes payable and used vehicle credit facility to \$591.7 million at March 31, 2007 from \$595.3 million at December 31, 2006. New vehicles are financed at approximately 100% and used vehicles are financed at approximately 90% of cost. Used vehicles are financed as needed, utilizing our used vehicle credit facility.

Our Board of Directors declared dividends of \$0.14 per share on our Class A and Class B common stock, which were paid in January 2007 and April 2007, and totaled approximately \$2.7 million each. We anticipate recommending to the Board of Directors the approval of a cash dividend each quarter.

In June 2000, our Board of Directors authorized the repurchase of up to 1,000,000 shares of our Class A common stock. Through March 31, 2007, we have purchased a total of 378,631 shares under this program, of which 121,800 were purchased during the first quarter of 2007. We may continue to repurchase shares from time to time in the future as conditions warrant. The recent change in the tax law tends to equalize the benefits of dividends and share repurchases as a means to return capital or earnings to shareholders. As a result, we believe it is now advantageous to shareholders to have a dividend in place. With the dividend, we are able to offer an immediate and tangible return to our shareholders without reducing our already limited market float, which occurs when we repurchase shares. However, when we believe that repurchases present an attractive use of our capital, we would expect to make strategic repurchases.

We have a working capital, acquisition and used vehicle credit facility with U.S. Bank National Association, DaimlerChrysler Financial Services Americas LLC (DCFS) and Toyota Motor Credit Corporation (TMCC), totaling up to \$225 million, which expires August 31, 2009. Loans are guaranteed by all of our subsidiaries and are secured by new vehicle inventory, used vehicle and parts inventory, equipment other than fixtures, deposit accounts, accounts receivable, investment property and other intangible personal property. Stock and other equity interests of our subsidiary dealerships and certain other subsidiaries are excluded. The lenders' security interest in new vehicle inventory is subordinated to the interests of floorplan financing lenders, including DCFS and TMCC. The agreement for this facility provides for events of default that include nonpayment, breach of covenants, a change of control and certain cross-defaults with other indebtedness. In the event of a default, the agreement provides that the lenders may declare the entire principal balance immediately due, foreclose on collateral and increase the applicable interest rate to the revolving loan rate plus 3 percent, among other remedies.

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The facility agreement includes financial and restrictive covenants typical of such agreements. Financial covenants include requirements to maintain a minimum total net worth and imposes minimum current ratio, fixed charge coverage ratio and cash flow leverage ratio requirements. The covenants restrict us from incurring additional indebtedness, making investments, selling or acquiring assets and granting security interests in our assets. At March 31, 2007, we were in compliance with all of the financial and restrictive covenants.

In addition, cash dividends are limited to \$15 million per fiscal year and repurchases by us of our common stock are limited to \$20 million per fiscal year.

Ford Motor Credit, General Motors Acceptance Corporation (GMAC), Volkswagen Credit and BMW Financial Services NA, LLC have agreed to floor all of our new vehicles for their respective brands with DaimlerChrysler Financial Services Americas LLC and Toyota Motor Credit Corporation serving as the primary lenders for substantially all other brands. These new vehicle lines are secured by new vehicle inventory of the relevant brands. Vehicles financed by lenders not directly associated with the manufacturer are classified as floorplan notes payable: non-trade and are included as a financing activity in our statements of cash flows. Vehicles financed by lenders directly associated with the manufacturer are classified as floorplan notes payable and are included as an operating activity.

On November 30, 2006, General Motors (GM) completed the sale of a majority equity stake in GMAC to an investment consortium. Although GMAC will continue to be the exclusive provider of GM financial products and services and continues to have the relationships with GM, a majority equity stake in GMAC has been sold to an independent third-party and GM has indicated in its public filings that it no longer controls the GMAC entity. As a result, we will be treating new vehicles financed by GMAC after the change in ownership control as floorplan notes payable: non-trade and related changes as a financing activity in our statements of cash flows. Vehicles financed prior to this change in control will continue to be classified as floorplan notes payable: trade, with related changes reflected as operating activities in our statements of cash flows, since these GMAC vehicle financings occurred while GM retained control of GMAC as its captive finance subsidiary.

We expect to be in compliance with the covenants for all of our debt agreements in the foreseeable future. In the event that we are unable to meet such requirements, and any available cure period has passed, the lender may require an acceleration of payment, increase the interest rate or limit our ability to borrow or pay cash dividends.

Interest rates on all of the above facilities ranged from 6.47% to 7.50% at March 31, 2007. Amounts outstanding on the lines at March 31, 2007, together with amounts remaining available under such lines were as follows (in thousands):

| | Outstanding at March 31, 2007 | Remaining Availability as of March 31, 2007 | |
|---|----------------------------------|--|-----|
| New and program vehicle lines | \$ 495,954 | \$ | (1) |
| Working capital, acquisition and used vehicle credit facility | 160,081 | 63,985 | (2) |
| | \$ 656,035 | \$ 63,985 | |

(1) There are no formal limits on the new and program vehicle lines with certain lenders.

(2) Reduced by \$934,000 for outstanding letters of credit.

We also have outstanding \$85.0 million of 2.875% senior subordinated convertible notes due 2014. We will also pay contingent interest on the notes during any six-month interest period beginning May 1, 2009, in which the trading price of the notes for a specified period of time equals or exceeds 120% of the principal amount of the notes. The notes are convertible into shares of our Class A common stock at a price of \$37.69 per share upon the satisfaction of certain conditions and upon the occurrence of certain events as follows:

- if, prior to May 1, 2009, and during any calendar quarter, the closing sale price of our common stock exceeds 120% of the conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding calendar quarter;

- if, after May 1, 2009, the closing sale price of our common stock exceeds 120% of the conversion price;
- if, during the five business day period after any five consecutive trading day period in which the trading price per \$1,000 principal amount of notes for each day of such period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of \$1,000 principal amount of the notes;
- if the notes have been called for redemption; or
- upon certain specified corporate events.

A declaration and payment of a dividend in excess of \$0.08 per share per quarter will result in an adjustment in the conversion rate for the notes if such cumulative adjustment exceeds 1% of the current conversion rate. Effective January 17, 2007, we exceeded the 1% threshold required for a change in the conversion rate. The current conversion rate per \$1,000 of notes is 26.8556.

The notes are redeemable at our option beginning May 6, 2009 at the redemption price of 100% of the principal amount plus any accrued interest. The holders of the notes can require us to repurchase all or some of the notes on May 1, 2009 and upon certain events constituting a fundamental change or a termination of trading. A fundamental change is any transaction or event in which all or substantially all of our common stock is exchanged for, converted into, acquired for, or constitutes solely the right to receive, consideration that is not all, or substantially all, common stock that is listed on, or immediately after the transaction or event, will be listed on, a United States national securities exchange. A termination of trading will have occurred if our common stock is not listed for trading on a national securities exchange or the Nasdaq National Market.

Our earnings to fixed charge coverage ratio, as defined in the senior subordinated convertible notes, was 1.71 for the quarter ended March 31, 2007.

Capital Commitments

We had capital commitments of \$63.2 million at March 31, 2007 for the construction of seven new facilities and additions to two existing facilities. Of the new facilities, five are replacing existing facilities. We have already incurred \$11.1 million for these projects and anticipate incurring an additional \$41.6 million in the remainder of 2007 and \$21.6 million in 2008. We expect to pay for the construction out of existing cash balances until completion of the projects, at which time we anticipate securing long-term financing and general borrowings from third party lenders for 70% to 90% of the amounts expended.

We also had capital commitments of \$0.8 million for the acquisition and development of hardware and software for several information technology initiatives. We anticipate incurring these amounts during the remainder of 2007.

In addition to the above, we have approximately \$104.2 million in planned capital expenditures under consideration for various new facilities and remodeling projects. These projects are still in the planning stage or are awaiting approvals from governmental agencies or manufacturers. We feel that these projects are a critical part of our future growth strategy.

There were no significant changes to our other contractual payment obligations from those reported in our 2006 Form 10-K.

Critical Accounting Policies and Use of Estimates

We reaffirm our critical accounting policies and use of estimates as described in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 9, 2007.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in our reported market risks or risk management policies since the filing of our 2006 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 9, 2007.

Item 4. Controls and Procedures

Changes in Internal Controls

There has been 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.

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our President and 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.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are party to numerous legal proceedings arising in the normal course of our business. While we cannot predict with certainty the outcomes of these matters, we do not anticipate that the resolution of these proceedings will have a material adverse effect on our business, results of operations, financial condition or cash flows. See also Note 12 of Condensed Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

We intend to vigorously defend all matters and management believes that the likelihood of a judgment for the amount of damages sought in any outstanding case is remote.

Item 1A. Risk Factors

Our Annual Report on Form 10-K for the year ended December 31, 2006 includes a detailed discussion of our risk factors. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K. Accordingly, the information in this Form 10-Q should be read in conjunction with the risk factors and information disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006, which was filed with the Securities and Exchange Commission on March 9, 2007. See also Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations in this report under the heading Forward-Looking Statements.

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

We repurchased the following shares of our Class A common stock during the first quarter of 2007:

| | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plan | Maximum number of shares that may yet be purchased under the plan |
|---------------------------|----------------------------------|------------------------------|---|---|
| January 1 to January 31 | 3,009 | \$ 28.90 | 256,831 | 743,169 |
| February 1 to February 28 | | | | |
| March 1 to March 31 | 121,800 | 26.83 | 378,631 | 621,369 |
| Total | 124,809 | 26.88 | 378,631 | 621,369 |

The plan to repurchase up to a total of 1.0 million shares of our Class A common stock was approved by our Board of Directors in June 2000 and renewed in August 2005 and does not have an expiration date.

Item 6. Exhibits

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

- 3.1 Restated Articles of Incorporation of Lithia Motors, Inc., as amended May 13, 1999 (filed as Exhibit 3.1 to Form 10-K filed March 30, 2000 and incorporated herein by reference).
- 3.2 Bylaws (filed as Exhibit 3.2 to Form S-1, Registration Statement No. 333-14031, as declared effective by the Securities and Exchange Commission on December 18, 1996 and incorporated herein by reference).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 8, 2007

LITHIA MOTORS, INC.

By /s/ JEFFREY B. DEBOER
Jeffrey B. DeBoer
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

By /s/ LINDA A. GANIM
Linda A. Ganim
Vice President and Chief Accounting Officer
(Principal Accounting Officer)