

LITHIA MOTORS INC  
Form DEF 14A  
April 29, 2008

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

**LITHIA MOTORS, INC.**

(Exact Name of Registrant as Specified In Its Charter)

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**LITHIA MOTORS, INC.**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**To Be Held On May 21, 2008**

To the Shareholders of Lithia Motors, Inc.:

I am pleased to invite you to the Annual Meeting of Shareholders of LITHIA MOTORS, INC., which will be held at our corporate headquarters located at 360 E. Jackson Street, Medford, Oregon 97501, in the Apple Street Conference Room, on Wednesday, May 21, 2008, at 2:00 p.m., Pacific Daylight Time for the following purposes:

1. To elect five (5) directors to serve for the ensuing year;
2. To approve the 2008 Discretionary Support Services and 2008 L2 Bonus Plans; and
3. To approve an amendment to the Lithia Motors, Inc. 1998 Employee Stock Purchase Plan to increase the number of shares issuable under the plan.

We will also consider and act on such other matters as may properly come before the meeting.

The Board of Directors has fixed the close of business on April 1, 2008 as the record date. Only holders of record of our common stock at the close of business on the record date will be entitled to notice of and to vote at the meeting and any adjournment thereof. Further information regarding voting rights and the matters to be voted upon is presented in this proxy statement.

The proxy statement, the proxy card, a return envelope and a copy of the Annual Report to Shareholders describing our operations for the year ended December 31, 2007 are enclosed.

I hope that you will be able to attend the meeting in person. Whether or not you plan to attend the meeting, please sign and return the enclosed proxy card promptly. Your shares will be voted at the meeting in accordance with your instructions.

Very truly yours,

SIDNEY B. DeBOER  
*Chairman of the Board and Chief Executive Officer*

April 30, 2008

**LITHIA MOTORS, INC.**

**PROXY STATEMENT**

**General**

This proxy statement and the accompanying 2007 Annual Report to Shareholders, the Notice of Annual Meeting and the proxy card are being furnished to the shareholders of Lithia Motors, Inc., an Oregon corporation, in connection with the solicitation of proxies by our Board of Directors for use at our 2008 Annual Meeting of Shareholders (the Annual Meeting). The Annual Meeting will be held at our corporate headquarters located at 360 E. Jackson Street, Medford, Oregon 97501, in the Apple Street Conference Room, on Wednesday, May 21, 2008, at 2:00 p.m. Pacific Daylight Savings Time and any adjournment thereof. These proxy materials and our 2007 Annual Report to Shareholders are being mailed on or about April 30, 2008 to shareholders of record as of April 1, 2008.

**Solicitation and Revocation of Proxies**

The Board of Directors is soliciting proxies for use at the Annual Meeting. All expenses associated with this solicitation will be borne by Lithia Motors, Inc.

The Board of Directors has designated Sidney B. DeBoer and M. L. Dick Heimann as the proxy holders for the Annual Meeting. All properly executed proxies will be voted (except to the extent that authority to vote has been withheld) and where a choice has been specified by the shareholder as provided in the proxy card, it will be voted in accordance with any specification made. Proxies submitted without specification will be voted to elect the nominees for directors proposed by the Board of Directors and for each of the proposals listed on the Notice of Annual Meeting.

A proxy may be revoked by a shareholder prior to its exercise by written notice to the Secretary of Lithia Motors, Inc., by submission of another proxy bearing a later date or by voting in person at the Annual Meeting. Such notice or later dated proxy will not affect a vote on any matter taken prior to its receipt by us.

Our principal executive office and mailing address is at 360 E. Jackson Street, Medford, Oregon 97501.

**Voting at the Meeting**

Our Class A common stock and Class B common stock constitute the only classes of securities entitled to notice of and to vote at the meeting. As of the record date, there were 16,141,522 shares of Class A common stock and 3,762,231 shares of Class B common stock outstanding and entitled to vote. All shares will vote together as a single voting group on all matters submitted to a vote of the shareholders at this year's Annual Meeting. Our executive officers and directors hold a total of approximately 2.7% of the Class A common stock and 100% of the Class B common stock, outstanding.

At the Annual Meeting, each share of Class A common stock outstanding is entitled to one vote per share and each share of Class B common stock outstanding is entitled to ten votes per share. For a quorum to exist, there must be represented at the meeting in person or by proxy shares representing a majority of the votes entitled to vote at the meeting.

Proxies that expressly indicate an abstention as to a particular proposal and broker non-votes will be counted for purposes of determining whether a quorum exists at the Annual Meeting.

Directors are elected by a plurality of the votes cast and only votes cast in favor of a nominee will be counted. However, if a director nominee receives more withheld votes than votes for, such event will result in eventual removal of such director nominee from the board of directors (See Proposal No. 1 for a further description of the Company's Director Resignation Policy). Proposals No. 2 and No. 3 will be approved if more votes are cast in favor of the proposal than cast against it. Therefore, abstention from voting and non-voting by brokers will have no effect on the outcomes of Proposals No. 2 or No. 3.

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**BUSINESS TO BE CONDUCTED AT THE MEETING**

**Proposal No. 1**

**Election of Directors**

Our bylaws provide for not less than two and not more than seven directors. The number of directors is currently set at five. Directors are elected by the shareholders at our Annual Meeting and serve until the next annual meeting or until their successors are elected and qualified. The following are the nominees proposed by our Board of Directors:

| <b>Nominee Name</b> | <b>Age</b> | <b>Has Been a Director Since</b> |
|---------------------|------------|----------------------------------|
| Sidney B. DeBoer    | 64         | 1968                             |
| Thomas Becker       | 56         | 1997                             |
| Maryann N. Keller   | 63         | 2005                             |
| William J. Young    | 64         | 1997                             |
| Bryan B. DeBoer     | 41         | new                              |

Each of these nominees, except Bryan DeBoer, is presently serving on our Board. Bryan DeBoer, who is currently serving as the President, is nominated to fill the position previously held by M.L. Dick Heimann, who is retiring from the Board at the end of his term. Mr. Heimann will remain as a member of the senior management of Lithia. Sidney DeBoer is the father of Bryan B. DeBoer, Jeffrey B. DeBoer and Mark DeBoer, each of whom serve as officers of the company. There are no other family relationships among our executive officers and directors.

**Director Resignation Policy/Election by Majority Vote**

Because the Board of Directors is elected by a plurality of votes under Oregon corporate law, it is possible directors can be elected with less than a majority vote in favor of their election. To address this corporate governance concern, the Board of Directors has adopted a Resignation Policy for its members to address the possibility in an uncontested election of directors of one or more directors being elected with more withhold votes being cast than votes being cast for such director. However, to ensure continuity on the Board and compliance with the applicable listing standards, a director receiving more withhold votes than votes for is not removed immediately but, rather, must tender a resignation from the Board within five (5) business days after certification of the election results. Within ninety (90) days after receipt of such resignation, the Corporate Governance Committee may accept or reject the resignation and disclose its decision on a Form 8-K. If the resignation is rejected, such director may not be nominated for re-election at the next meeting of shareholders to elect directors. The full policy is included in our Corporate Governance Guidelines which can be accessed on our website at [www.lithia.com](http://www.lithia.com).

**Biographical Information on our Nominees**

**Sid DeBoer** has served as our Chairman, Chief Executive Officer and Secretary since 1968. He also is a member of various automobile industry organizations, including the President's Club of the National Automobile Dealers Association, state auto dealers associations and the Chrysler National Dealer Council. Mr. DeBoer has earned several awards including the *Time Magazine Quality Dealer Award* in 1997, the *Sports Illustrated All-Star Dealer Award* in 1990 and Medford Chamber of Commerce Awards in 1986, 1991, 1993, 1998 and 2000. Mr. DeBoer is active with several community and charitable organizations, including Southern Oregon University Foundation Board, Oregon Community Foundation and Oregon Shakespeare Festival. Mr. DeBoer attended Stanford University and the University of Oregon.

**Tom Becker** became a director in March 1997. Mr. Becker is the Chief Executive Officer of Pacific Retirement Services, Inc. and Rogue Valley Manor, a continuing care retirement community, in Medford, Oregon. Pacific Retirement Services, Inc. is the parent corporation of over 30 retirement, senior housing and healthcare facilities in Washington, Oregon, California, Texas and Wisconsin and provides management, operations and development services to non-profit retirement committees owned by others.

Mr. Becker began his career with Rogue Valley Manor in January 1978. Mr. Becker holds a B.S. degree from the University of Oregon and serves on the Board of Directors of PremierWest Bancorp, Medford, Oregon.

**Maryann N. Keller** became a director in May 2005. Ms. Keller currently serves as the principal of Maryann Keller and Associates, a firm providing consulting services to automotive clients. From July 1999 to November 2000, Ms. Keller served as the President of the Automotive Services unit of Priceline.com. She joined Priceline.com from Furman Selz, an investment banking firm, where she served as a managing director of the firm from 1986 to 1999. Prior to joining Furman Selz, Ms. Keller was portfolio manager with Vilas-Fischer Associates from 1983 to 1986, and served as automotive industry analyst with Kidder Peabody & Co. Inc. and Paine Webber from 1972 to 1983. Ms. Keller also served as Chairman of the Society of Automotive Analysts from 1994 to 1999. She is currently a director of Dollar Thrifty Automotive Group, Inc., a publicly-traded rental car company.

**Bill Young** became a director in March 1997. Since February 2008, Mr. Young has been an independent automotive marketing consultant. From September 2003 until February 2008, Mr. Young was an Executive Director at J.D. Power and Associates, a global marketing information firm specializing in consumer research for the automotive industry. From 1994 through July 2000, Mr. Young was the Chairman of the Board, President and Chief Executive Officer of Advanced Machine Vision Corporation, operating in the machine vision industry. Prior to 1994, Mr. Young served with Volkswagen of America in various capacities for a period of 18 years, most recently as its President and Chief Executive Officer. Mr. Young also has extensive experience as an independent automotive marketing consultant.

**Bryan DeBoer** has served as our President and Chief Operating Officer since January 2006. Mr. DeBoer joined us in 1989 working in various capacities including General Manager of certain stores, Finance Manager and General Sales Manager. In 1996, Mr. DeBoer began serving on the acquisition team and was promoted to Vice President, Acquisitions in 1997. In March 2000, Mr. DeBoer was promoted to Senior Vice President, Mergers and Acquisitions/Operations and on August 1, 2003, he was promoted to Executive Vice President, Mergers and Acquisitions/Operations. Mr. DeBoer has a B.S. degree from Southern Oregon University. Mr. DeBoer also graduated from the National Auto Dealers Association Dealer Academy in 1990, where he was trained in all operational aspects of auto retailing.

**The Board of Directors recommends a vote FOR each of the nominees named above.**

#### **Director Independence**

Under the New York Stock Exchange ( NYSE ) rules, a director is not independent if he or she has a direct or indirect material relationship with the Company or management. In accordance with its charter, the Corporate Governance Committee annually reviews the independence of all non-employee directors and nominees and reports its findings to the full Board of Directors, which makes a determination about the independence of each director. All transactions and relationships between each director or any member of his or her immediate family and Lithia, its consolidated subsidiaries and affiliates and management are reviewed. These transactions and relationships are reviewed in the context of the specific independence standards enumerated in the NYSE listing standards, as well as other business and personal relationships that could compromise the independent judgment of each director. Other than the NYSE listing standards, we do not ascribe to categorical standards for determining independence, rather we review and evaluate the specific facts and circumstances relating to each transaction and relationship to determine whether it is a material relationship that could compromise the judgment of a director.

As a result of this review, the Board of Directors affirmatively determined that Messrs. Becker and Young and Ms. Keller are each deemed independent. In making this determination, the Board reviewed Mr. Becker's relationship with our CEO arising from Mr. Becker serving as one of three board members charged with administering the Sid and Karen DeBoer Foundation, a benevolent trust created by Mr. DeBoer which is administered by the Oregon Community Foundation. Because he serves without compensation, because no one member has the ability to block or approve any action of the Foundation

and because neither Mr. Becker nor any affiliate of his are potential beneficiaries of the Foundation, the Board concluded that Mr. Becker's position with the Foundation does not impair or influence his ability to exercise his independent judgment as a director of Lithia.

#### **Lead Independent Director**

In compliance with the Corporate Governance Guidelines, the Board of Directors annually appoints a Lead Independent Director who presides over all meetings of the independent directors. Thomas Becker was selected as the Lead Independent Director at the May 2006 Board meeting and was reappointed in May 2007. Interested parties may contact the Lead Independent Director or the independent directors as a group by using the same contact procedures available to shareholders and interested parties for communicating with the Board of Directors (see, *Shareholder and Other Interested Parties Communications With Directors* ).

#### **Meetings and Committees of the Board of Directors**

The Board of Directors held five regular meetings during the year ended December 31, 2007 and did not take action pursuant to any unanimous written consents. During 2007, no director attended fewer than 75% of the meetings of the Board of Directors and any committees of which the director was a member. Throughout 2007, the standing committees of our Board of Directors were the Audit Committee, the Compensation Committee and the Corporate Governance Committee.

The directors are expected to attend our annual meeting of shareholders, but are not required to do so. All of our directors attended our 2007 Annual Meeting of Shareholders.

**The Compensation Committee** consisted of Messrs. Becker and Young (Chairman) and Ms. Keller during 2007. In addition, Gerald Taylor, a former Board member, served on the Compensation Committee during 2007 through the date of the 2007 Annual Shareholder Meeting in May 2007. All of the committee members are independent under NYSE listing standards. The Compensation Committee reviews the performance of Sidney DeBoer, our Chief Executive Officer, and establishes his base salary and incentive compensation. The Compensation Committee also approves the compensation for the other executive officers. The Compensation Committee also administers our 2003 Stock Incentive Plan, our 1998 Employee Stock Purchase Plan and our executive bonus plans. The Compensation Committee held six meetings during 2007. The current Compensation Committee Charter is available on our website at [www.lithia.com](http://www.lithia.com).

**The Audit Committee** consisted of Messrs. Becker (Chairman) and Young and Ms. Keller during 2007. In addition, Gerald Taylor served on the Audit Committee during 2007 through the date of the 2007 Annual Shareholder Meeting in May 2007. All of the members are independent as required by the NYSE listing standards. The Audit Committee is responsible for selecting and hiring our independent registered public accountants and for overseeing our accounting functions, our system of internal control established by management and the processes to assure compliance with applicable laws, regulations and internal policies. The Audit Committee held nine meetings during 2007.

The current Audit Committee Charter is available on our website at [www.lithia.com](http://www.lithia.com). Pursuant to the charter, each committee member, as determined in the business judgment of the Board, will be (a) independent, as that term is defined by the applicable securities regulations and listing standards; and (b) be financially literate and have the ability to read and understand basic financial statements. The Board has determined that all of the committee members satisfy these requirements.

**The Corporate Governance Committee** consisted of Messrs. Becker and Young and Ms. Keller (Chairman) during 2007. In addition, Gerald Taylor served as the Chairman of the Corporate Governance Committee during 2007 through the date of the 2007 Annual Shareholder Meeting in May 2007. The primary objectives of the Corporate Governance Committee are to assist the Board of Directors in:



identifying qualified individuals to become board members and recommending to the Board nominees for each annual meeting of the stockholders;

determining the composition of the Board and its committees;

developing and implementing a set of effective corporate governance policies and procedures;

developing and enforcing a Code of Business Conduct;

monitoring a process to assess the effectiveness of the Board, its members and its committees; and

ensuring compliance with the NYSE listing standards.

The Corporate Governance Committee held four meetings during 2007. The current Corporate Governance Committee Charter is available on our website at [www.lithia.com](http://www.lithia.com). Our Corporate Governance Guidelines are also available on our website at [www.lithia.com](http://www.lithia.com).

Any of the Committee Charters and our Corporate Governance Guidelines may be obtained by interested parties by requesting a written copy of the document from our Investor Relations Department, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501.

#### **Audit Committee Financial Expert**

Both Maryann Keller and Tom Becker possess the qualifications of an audit committee financial expert as such term is defined in the securities regulations. Prior to the date of our 2007 Annual Meeting in May 2007, Gerald Taylor, a former Director, possessed the qualifications of an audit committee financial expert.

#### **Director Qualifications and Nominations**

The Corporate Governance Committee is responsible for identifying and evaluating potential director nominees to fill any vacancies on the Board. We believe that the backgrounds and qualifications of our directors, considered as a group, should provide a composite mix of experience, knowledge and abilities that will allow the Board to fulfill its responsibilities. As a result, the Corporate Governance Committee annually reviews the composition of the Board and evaluates the qualifications and contributions of the current directors in the context of the desired composition of the Board, our operating requirements and the long-term interests of our shareholders. Consequently, the qualifications required of individuals for consideration as a board nominee will vary according to the particular areas of expertise being sought as a complement to our existing Board composition at the time of any vacancy. Potential candidates are identified from various sources, including management, other board members, legal counsel, business leaders and other industry executives and directors. To date, the Board has not used an outside director search firm to identify potential director nominees.

The Corporate Governance Committee evaluates potential nominees based on certain established criteria which include the individual's diversity, age, skills, experience and other factors it deems appropriate given our needs and the needs of the Board in order to maintain a desired balance of knowledge, experience and capabilities. Qualified director nominees should possess high moral character and personal integrity, high level of leadership or managerial experience, knowledge relative to matters affecting our business, the ability and willingness to contribute to the Board, the ability to exercise sound, independent business judgment, a long-term commitment to the interests of shareholders and our growth, the ability to dedicate sufficient time to Board activities and duties and, for independent directors, the absence of any conflicts of interest or material affiliations with the company.

We require all of our directors to sign, annually, a Confidentiality Agreement with the company to reinforce their commitment to protect our confidential information and our business reputation and to comply with applicable securities laws.

We seek to attract and retain qualified candidates for board membership, regardless of the origin of recommendation. The Corporate Governance Committee will consider potential nominees recommended



by any record or beneficial shareholder. Shareholders may recommend individuals to the Corporate Governance Committee for consideration as potential director nominees by submitting a written recommendation to the Chairman of the Corporate Governance Committee in accordance with our Shareholder Communication Policy. To be considered for nomination to the following year's Board of Directors, the written recommendation must be received at our principal executive office not less than 120 days prior to the first anniversary of the mailing of the preceding year's proxy materials. For our 2009 Annual Meeting, the recommendation must be received no later than December 22, 2008.

The written recommendation must include the candidate's name, together with appropriate biographical information, qualifications and background materials, a statement that the person submitting the recommendation is a shareholder entitled to vote in the election of directors and a consent to serve as director signed by the recommended individual. If the necessary information is received in a timely manner, the Corporate Governance Committee will evaluate the shareholder-recommended candidate using substantially the same process, and applying substantially the same criteria, as it uses to evaluate all other candidates. All qualified candidates are submitted to the Board for approval as director nominees. If the Board determines to nominate a shareholder-recommended candidate, the candidate's name will be included in our proxy and submitted to shareholders for election.

Under Oregon law, shareholders also have the right to directly nominate director nominees at the meeting, without any action or recommendation on the part of the Corporate Governance Committee or the Board of Directors, by delivering written notice of the proposed nomination to the Secretary of Lithia Motors, Inc. at 360 E. Jackson Street, Medford, Oregon 97501, and the inclusion of a statement that such shareholder intends to attend the meeting to make the nomination. If the shareholder wants the nominee included in our proxy statement, the notice must be received at above address not less than 120 days prior to the first anniversary of the mailing of the preceding year's proxy materials and must set forth all information required by Rule 14a-8 of the Securities Exchange Act of 1934, including, without limitation, the name, age, business address and residence address of each person being nominated, the principal occupation, or employment of such person, the class and number of shares of capital stock beneficially owned by the person, and all other information relating to such person that is or would be required to be disclosed in a solicitation of proxies pursuant to the rules and regulations under the Securities Exchange Act of 1934. In addition, certain information must be provided about the shareholder or shareholder group making a nomination. Finally, a shareholder or shareholder group making a nomination must comply with all other applicable requirements of the Exchange Act, including providing a nominee's consent to being named in a proxy statement and to serve as a director if elected.

**Proposal No. 2**

**Approval of the 2008 Discretionary Support Services Bonus Program and  
the 2008 L2 Performance Objectives and Bonus Program**

The Compensation Committee of the Board of Directors adopted the 2008 Discretionary Support Services Bonus Plan (the Lithia Plan ) and the 2008 L2 Performance Objectives and Bonus Program (the L2 Auto Plan ) on February 22, 2008. Participation by any executive officer in the bonus plans is conditional based upon the approval of the plans by the shareholders at the Annual Meeting. Shareholder approval of the bonus plans are required for performance based compensation payments to executive officers to be exempt from the deduction limitations contained in Section 162(m) of the Internal Revenue Code and related regulations. The Lithia Plan replaces the 2006 Discretionary Support Services Bonus Plan.

**Summary of the Bonus Plans**

*Participants.* The following named executive officers were eligible to participate in the bonus plans for 2007: Sidney B. DeBoer, Chief Executive Officer; Bryan B. DeBoer, President and Chief Operating Officer; M. L. Dick Heimann, Vice Chairman; R. Bradford Gray, Executive Vice President, and Jeffrey B. DeBoer, Senior Vice President and Chief Financial Officer. Certain other officers and managers were also eligible to participate in the bonus plans for a total of approximately 80 employees, including the five named executive officers.

*Administration.* The Compensation Committee, which is comprised solely of independent board members, is responsible for administering the bonus plans.

*Bonuses.* The bonus plans provide for the payment of an annual bonus. Under the bonus plans, each participant will have a Maximum Bonus Potential based on a percentage of that participant's annual salary. The participant's bonus received under the bonus plans will be a percentage of the participant's Maximum Bonus Potential, determined based on the accomplishment of certain shared company or division objectives, measured as of a December year-end. The specific performance targets and the percentage of the potential bonus attributed to each performance objective, if any, may change each year and are determined by the Compensation Committee before March 31 of each year.

*Performance Objectives.* The following are the general performance objectives for the bonus plans and the maximum percentage of the participant's Maximum Bonus Potential that may be achieved under each such performance objective for 2008. For each year, the Compensation Committee may change (i) which of these performance objectives will be considered, (ii) the specific targets, (iii) the inclusion or exclusion of initiatives or divisions, discontinued operations, non-recurring items or impairment charges, (iv) whether such objectives are thresholds to be achieved, relative changes from previous periods or are compared to a defined or identified peer group; and (v) the applicable percentages for each of the performance objectives. Further, the Compensation Committee determines or approves whether executives and others participate under the Lithia Plan or the L2 Auto Plan, or both.

**Lithia Plan**

| Objectives for 2008   | Maximum Percentage<br>of Maximum Bonus<br>for 2008 |
|---|--|
| <b><u>Financial Performance:</u></b>  |  |
| 1. Pre-Tax Net Profit<br>(continuing operations with L2 Auto division and impairment charges excluded)  | 25%  |
| 2. Pre-Tax Net Margin Retention<br>(pre-tax net profit/total revenue on continuing operations with L2 Auto division and impairment charges excluded; peer group comparison) | 13%  |

|  |    |
|--|----|
| 3. Used Vehicle Sales Growth Rate<br>(based on same-store revenue growth with L2 Auto excluded; peer group comparison) | 4% |
| 4. Fixed Department Sales Growth<br>(based on same-store revenue growth with L2 Auto excluded; peer group comparison)  | 4% |
| <b><i>Non-Financial Performance:</i></b>   |    |
| 5. Sales Satisfaction Scores<br>(% of seasoned stores equaling or exceeding specified manufacturers criteria)          | 5% |
| 6. Service Satisfaction Scores<br>(% of seasoned stores equaling or exceeding specified manufacturers criteria)        | 5% |
| 7. Minimum Sales Requirement<br>(% of seasoned stores at or above threshold set by specified manufacturers)            | 5% |
| 8. Approved to Purchase Stores<br>(satisfy specific manufacturers criteria to purchase stores)                         | 9% |
| <b><i>Project Related Objectives:</i></b>  |    |
| <b><i>Develop and Implement Customer-Focused Processes</i></b>   |    |
| 9. Modify Sales Process to Align with Assured Sales<br>(specific enumerated initiatives)                               | 4% |
| 10. Internet Sales Development<br>(specific enumerated initiatives)  | 2% |
| 11. Assured Guarantees<br>(specific enumerated initiatives)  | 1% |
| 12. Fixed Operations Initiatives<br>(specific enumerated initiatives)  | 3% |
| 13. Establish New Company Measurements<br>(specific enumerated initiatives)  | 1% |
| <b><i>Ingrain Sound Human Development</i></b>  |    |
| 14. Restructure Job Functions and Store Staffing<br>(specific enumerated initiatives)                                  | 2% |
| 15. Develop Compensation Plan that Supports New Sales Job Functions<br>(specific enumerated initiatives)               | 2% |
| 16. Develop Job Scheduling that Corresponds to New Job Functions and Customer Needs                                    | 1% |
| 17. Expand Leadership Development<br>(specific enumerated initiatives)   | 1% |
| 18. Modify Training Strategies<br>(specific enumerated initiatives)  | 1% |
| <b><i>Grow Value of the Lithia Brand</i></b>   |    |
| 19. Develop New Internet and External Communication Structure<br>(specific enumerated initiatives)                     | 1% |
| 20. Develop and Execute One-on-One Marketing Plan with Existing Customers<br>(specific enumerated initiatives)         | 1% |
| 21. Improve Customer Traffic<br>(specific enumerated initiatives)  | 1% |
| <b><i>Gain Cost Reductions</i></b>   |    |
| 22. Centralize Vehicle Pricing<br>(specific enumerated initiatives)  | 2% |

|   |    |
|---|----|
| 23. Centralize Used Vehicle Inventory Management<br>(specific enumerated initiatives) | 2% |
| 24. Centralize New Vehicle Inventory Management<br>(specific enumerated initiatives)  | 1% |
| 25. Centralize Fixed Operations<br>(specific enumerated initiatives)                  | 1% |
| 26. Office Automation and Centralization<br>(specific enumerated initiatives)         | 2% |
| 27. Revise Policies and Procedures<br>(specific enumerated initiatives)               | 1% |

For 2008, the peer group consists of the other publicly traded auto retailers: Asbury Automotive Group, Penske Automotive Group, AutoNation, Group 1 Automotive and Sonic Automotive.

### L2 Auto Bonus Plan

#### **Project Related Objectives:**

|   |     |
|---|-----|
| 1. Number of L2 Stores Open at Year End<br>(varying targets)                          | 15% |
| 2. Human Development<br>(specific target)   | 5%  |
| 3. Centralized National Internet ECommerce Model<br>(specific enumerated initiatives) | 5%  |
| 4. Centralized Lending Specialist Center<br>(specific enumerated initiatives)         | 5%  |
| 5. Automated Operational Reporting<br>(specific enumerated initiatives)               | 5%  |
| 6. Delivery/Appraisal Center Development Plan<br>(specific enumerated initiatives)    | 2%  |

#### **Performance Objectives:**

|  |     |
|--|-----|
| 7. Average Monthly Retail Unit Sales<br>(specific targets for opened stores)       | 30% |
| 8. Average Monthly Profitability<br>(specific targets for opened stores)           | 15% |
| 9. Average Front End Gross Profit<br>(specific targets for opened stores)          | 10% |
| 10. Average Finance/Insurance Gross Profit<br>(specific targets for opened stores) | 8%  |

The Compensation Committee has determined that any details regarding future performance objectives, other than such information which is disclosed herein, is confidential commercial or business information, the disclosure of which would have a material adverse effect on the company. As such, we are not disclosing certain confidential information which may be a material term of the performance objectives.

The payment of any bonuses is in the negative discretion of the Board of Directors. Performance achievement of each objective is determined in the sole judgment of the Compensation Committee. In making such judgment, the Compensation Committee disregards the impact (whether positive or negative) resulting from a change in accounting rules. Further, with respect to managers, the Compensation Committee may disregard the impacts resulting from a material change from the current core business model, a major acquisition or series of acquisitions, or a disposition of a major portion of our business.

Participants under the bonus plans, including our Named Executive Officers, have the potential of receiving bonuses under one or both of the plans. The selection of which plan or plans they participate under is determined by management (with respect to non-Named Executive Officers) or by the Compensation Committee. The determination generally reflects the contribution such participant is making to the success or operations of the new car franchise stores (the Lithia Plan) or the new L2 Auto operations (the L2 Auto Plan) or the specific incentives the Company wants to provide such participant. The maximum Bonus potential for each of the Named Executive Officers will be determined in 2008 based 80% on the Lithia Plan and 20% on the L2 Auto Plan.

The highest Maximum Bonus Potential of our senior executives under the bonus plans is equal to 150% of salary. If the highest threshold is attained for all objectives, the maximum amount of the bonuses payable related to performance in 2008 to the CEO and the other four named executive officers would be \$4,171,200. The total bonus amounts achieved in 2007, 2006, 2005, 2004 and 2003 under similar plans was 34.0%, 35.0%, 71.5%, 63.3% and 40.0%, respectively, of each participant's Maximum Bonus Potential. However, management and the Compensation Committee, under their negative discretion, elected to pay no bonuses to the Named Executive Officers under the Bonus Plan for 2007 performance.

*Federal Tax Consequences.* For federal income tax purposes, Section 162(m) of the Internal Revenue Code generally prohibits us from deducting employee compensation that otherwise would be deductible to the extent such compensation exceed \$1 million for any covered employees in any fiscal year. Compensation that is performance-based, as defined in Section 162(m), is not subject to the deductibility limitations if the bonus plans satisfies certain criteria. The bonus plans are intended to address the limitation on deductibility by providing for compensation that qualifies as performance-based compensation.

Compensation paid under the bonus plans will not be subject to the deduction limit if:

It is payable on account of the attainment of pre-established, objective performance goals set forth within the bonus plan;

The Compensation Committee, which is comprised solely of outside directors, approves the maximum individual awards on or near the beginning of each performance period;

The bonus plans, which set forth the material terms of the compensation and performance goals, is disclosed to and approved by shareholders before payment; and

The Compensation Committee certifies that the performance goal have been satisfied before payment.

The bonus plans contain provisions for each of the above requirements. It is believed that all goals can be objectively determined.

**New Plan Benefits**

The following table summarizes estimated bonus compensation that would be earned under the 2008 bonus plans based on 2008 salaries but using 2007 operating results and company or division performance.

| <b>Name and Position(s)</b>   | <b>Dollar Value <sup>1</sup></b> |
|---|----------------------------------|
| Sidney B. DeBoer Chairman, Chief Executive Officer and Secretary                  | \$ 161,280                       |
| Bryan B. DeBoer President and Chief Operating Officer                             | 119,808                          |
| M. L. Dick Heimann Vice Chairman  | 63,898                           |
| R. Bradford Gray Executive Vice President   | 108,288                          |
| Jeffrey B. DeBoer Senior Vice President and Chief Financial Officer               | 80,640                           |
| All Current Executive Officers as a Group (5 people)                              | 533,914                          |
| All Eligible Non-Executive Officer Employees as a Group (approximately 75 people) | 396,329                          |

- (1) Amounts are not indicative of amounts to be earned under the 2008 bonus plans during 2008 because such amounts were based upon the application of 2008 bonus criteria to 2007 operating results and company performance. Project or initiative related objectives under the bonus plans were considered not to have been achieved in 2007 because they represent new performance objectives for 2008. The listed executives have a Maximum Bonus Potential of 150% of base salary with the exception of M.L. Dick Heimann whose Maximum Bonus Potential is 100% of base salary.

**Vote Required**

The affirmative vote of a majority of the votes cast at the meeting and entitled to vote on this matter is necessary to approve the 2008 Discretionary Support Service Bonus Plan and the 2008 L2 Performance Objectives and Bonus Program.

**The Board of Directors has approved the adoption of the 2008 Discretionary Support Services Bonus Plan and the 2008 L2 Performance Objectives and Bonus Program and unanimously**

**recommends a vote FOR this proposal.**



**Proposal No. 3**

**Approval of an Amendment to the 1998 Employee Stock Purchase Plan**

**to Increase the Number of Shares Issuable Under the Plan**

The Company maintains the Lithia Motors 1998 Employee Stock Purchase Plan (the ESPP) as a cost effective means of encouraging and promoting ownership of our shares by our employees. The ESPP provides participating employees the opportunity to purchase Class A Common stock of the Company through payroll deductions. Participants may elect to set aside up to 10% of their annual salary, not to exceed \$25,000, to purchase shares each year. The shares are purchased at the end of each quarter at a price equal to 85% of the then current market price. Since its inception in 1998, employees have purchased 2,238,057 shares of Class A Common stock through the ESPP. Approximately one-quarter of our employees participate in the ESPP.

**Amendment to Increase the Number of Shares Under the ESPP**

Subject to approval by the shareholders, the Board of Directors approved an amendment to the ESPP to increase the number of shares authorized under the ESPP from 2.45 million to 3.45 million. Upon approval of the increase in authorized shares, the ESPP will have 1,211,943 shares available for future purchases. Based on historical participation, this number of available shares should be sufficient to cover employee purchases for three to four years; however the market price of our shares directly affects the number of shares purchased with the payroll deductions and the lower market price has resulted in a faster depletion of the shares previously authorized under this plan.

Because the named executive officers and non-employee directors were not eligible to participate in the ESPP under the IRC rules, none of these persons will receive shares under the ESPP. The following table summarizes shares purchased by participants in the ESPP from January 1, 2007 through December 31, 2007:

| Name and Position  | Number of Shares |
|--|------------------|
| Sidney B. DeBoer, Chairman, Chief Executive Officer and Secretary    |                  |
| M. L. Dick Heimann, Vice Chairman of the Board                       |                  |
| R. Bradford Gray, Executive Vice President                           |                  |
| Bryan DeBoer, President and Chief Operating Officer                  |                  |
| Jeffrey B. DeBoer, Senior Vice President and Chief Financial Officer |                  |
| All Current Executive Officers as a Group (5 people)                 |                  |
| All Non-Executive Officer Employees as a Group (1,976 participants)  | 291,379          |

**Summary of Plan**

**Administration**

The 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.

**Eligibility**

Employees of Lithia Motors, Inc. and its subsidiaries are eligible to participate in the ESPP after they have completed at least 90 days of continuous employment and work at least 20 hours per week.

Non-employee directors are not eligible to participate. Employees who own, or as a result of participation would own, stock possessing five percent or more of the combined voting power or value of all classes of our stock are not eligible. Messrs. Sidney DeBoer, M. L. Dick Heimann and R. Bradford Gray are not currently eligible to participate in the ESPP. Further, Messrs. Jeffrey DeBoer, Bryan DeBoer and Mark DeBoer, officers of the company, are not able to participate because of their family relationship with Sidney DeBoer.

***Participation***

Participation in the ESPP is voluntary and is dependent on each eligible employee's election to participate and his or her determination as to the level of payroll deductions. At the beginning of each fiscal quarter, eligible employees may elect to participate in the ESPP and each participating employee effectively is granted an option to purchase shares of the Company's Class A Common stock at the end of each fiscal quarter. Participation is effected through authorized payroll deductions which are limited to 10% of a participant's base pay, but no more than an amount sufficient to purchase shares having a fair market value of \$25,000 in any plan year. Employees may end their participation in the ESPP at any time during the quarter and their participation ends automatically on the termination of their employment.

***Purchase Price***

The price of shares purchased under the ESPP is equal to 85% of the fair market value of the Class A common stock at the end of each fiscal quarter.

***Amendment of the Purchase Plan***

The Board may amend or terminate the ESPP at any time, but may not increase the number of shares covered by the ESPP or amend the eligibility requirements without subsequent shareholder approval.

***Federal Tax Effects***

A participant acquiring stock pursuant to a qualified employee stock purchase plan receives favorable tax treatment in that the participant does not recognize any taxable income at the time of the grant of the option to purchase or upon exercise of such option to purchase. The tax treatment of the disposition of the stock depends upon whether the stock is disposed of within the holding period, which is two years from the date of grant. If the participant disposes of the stock after completion of the holding period, the lesser of (a) the sales price less the purchase price, or (b) 15 percent of the market value of the shares on the last day of the offering period, is taxable as ordinary income, and any further profit is taxable as long-term capital gain. If the participant disposes of the stock before the holding period expires (a disqualifying disposition), the difference between the price paid by the employee and the market value of the shares at the date of purchase is taxable as ordinary income, and the difference between the amount received by the employee on the disposition of the shares and the market value of the shares at the date of purchase is treated as a capital gain or loss. Upon a disqualifying disposition of the stock, Lithia may deduct from taxable income in the year of the disqualifying disposition an amount equal to the difference between the price paid by the employee and the market value of the shares at the date of purchase.

A copy of the amended and restated ESPP, as approved by the Board of Directors, was filed with the Securities and Exchange Commission as an exhibit to a Form 8-K on March 21, 2006. A copy of the ESPP can also be obtained upon request to Investor Relations, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501.

**The Board of Directors unanimously recommends that the shareholders vote in favor of the amendment to the 1998 Employee Stock Purchase Plan.**

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**EXECUTIVE OFFICERS**

The following table identifies our current executive officers, the positions they hold, and the year in which they became an employee. Our officers are elected by the Board of Directors to hold office until their successors are elected and qualified.

| <b>Name</b>        | <b>Age</b> | <b>Current Position(s)</b>                        | <b>With Company Since</b> |
|--------------------|------------|---|---------------------------|
| Sidney B. DeBoer   | 64         | Chairman, Chief Executive Officer and Secretary   | 1968                      |
| Bryan B. DeBoer    | 41         | President and Chief Operating Officer             | 1989                      |
| M. L. Dick Heimann | 64         | Vice Chairman                                     | 1970                      |
| R. Bradford Gray   | 56         | Executive Vice President                          | 1981                      |
| Jeffrey B. DeBoer  | 43         | Senior Vice President and Chief Financial Officer | 1997                      |

Information on the business backgrounds of Sidney B. DeBoer and Bryan B. DeBoer are provided in Election of Directors above.

**Dick Heimann.** In February 2007, Mr. Heimann was promoted to Vice Chairman. Prior to this, he served as our President of Corporate Affairs since January 2006. Prior to this, Mr. Heimann served as our Chief Operating Officer since 1996 and was appointed President in 1997. Mr. Heimann joined Lithia in 1970 as General Sales Manager, and later was promoted to General Manager and Partner of our first Dodge stores in Medford and Ashland, Oregon. He held various positions with us prior to becoming Vice President of Operations in 1979. From 1970 through this year's annual meeting, he has served as a director of the company. Prior to joining us, he served as a service representative and district manager of Chrysler Corporation from 1967 to 1970. He has been a member of various state and national automobile industry organizations and community charities. Mr. Heimann is a graduate of the University of Colorado with a B.A. in Biology and Languages.

**Brad Gray** has served as Executive Vice President involved in acquisitions and human resources since 1996 and was also a director from 1997 until May 2005. From 1981 to 1995, he served in various capacities, including as General Manager of our Lithia Dodge (1989-1991) and Grants Pass (1991-1995) stores. Since 1975, Mr. Gray has held various positions in the automobile sales industry, including sales representative, sales manager and general manager.

**Jeff DeBoer** joined us in March 1997 as Vice President, Finance and Investor Relations. In March 2000, Mr. DeBoer was promoted to Senior Vice President and Chief Financial Officer. Prior to joining Lithia, Mr. DeBoer was an equity analyst and sector fund manager at Fidelity Investments Japan from 1994 to 1997 and a Credit Officer at Fuji Bank, Ltd., in Tokyo, Japan from 1988 to 1992. Mr. DeBoer holds an undergraduate degree from Pomona College and an M.B.A. degree with a specialty in finance and investment management from London Business School. Mr. DeBoer also graduated from the National Auto Dealers Association Dealer Academy in 2002, where he was trained in all operational aspects of auto retailing.

**COMPENSATION DISCUSSION AND ANALYSIS**

Our Board of Directors is responsible for establishing and administering our compensation and employee benefit programs. In accordance with the Compensation Committee Charter, this Board duty has been delegated to the Compensation Committee (referred to in this analysis as the Committee), which annually reviews the executive compensation program and approves appropriate modifications to the senior executive compensation packages, including specific amounts and types of compensation used. The Committee is responsible for establishing the compensation of the CEO; and in the context of our overall compensation goals and objectives, reviews and approves the recommendations of the CEO regarding compensation and incentive plans of other senior executive officers. The Committee also establishes the annual compensation of the non-employee directors and oversees the equity compensation plans, including the administration of the 2003 Stock Incentive Plan and the Employee Stock Purchase Plan.

The Committee is comprised of three independent board members, William Young, Thomas Becker and Maryann Keller. Mr. Young currently serves as the Committee Chair.

### **Executive Compensation Philosophy and Objectives**

The objective of our compensation program is twofold: (1) to provide a competitive, comprehensive compensation package to attract, retain and motivate highly talented personnel at all levels of our organization; and (2) to provide incentives and rewards for implementing and accomplishing our short-term and long-term strategic and operational goals and objectives. Therefore, we strive to establish a compensation package that is competitive within the industry while maintaining and promoting the interests of the Company and all of our shareholders. Additionally, whenever appropriate, the compensation is structured to maximize the tax benefits available to us and minimize compensation expenses.

We believe that specific levels of compensation should reflect the comparative management responsibility of the position, the value of the position in the marketplace and the competition for quality, key personnel in our industry. In addition to a competitive base salary, we provide as an incentive a significant annual cash bonus plan opportunity to reward our executive management team for attaining specific financial and operational goals for the year. We also offer equity-based incentives which encourage our executive officers and directors to focus on maximizing shareholder wealth long term and allow each person to participate in our long-term growth and financial success. In light of this combination of base salary, potential annual bonuses and the accumulated value of equity awards granted to each executive, we do not sponsor any retirement plan other than our 401(k) plan generally available to all of our employees, believing that the executives are adequately compensated to provide for their own retirement.

### **Establishing Compensation**

The Committee is responsible for determining the compensation package of the CEO. For senior executive officers other than the CEO, the CEO recommends compensation packages for each, which is reviewed with the Committee and, after a discussion that may result in mutually agreeable changes, approved by the Committee. The Committee meets in executive session without the CEO to determine the amount or type of compensation to be paid to the CEO. During the fall of 2006, the Committee engaged an independent consultant to conduct a 360 degree review of the CEO's performance together with the named executive officers and the Board of Directors. Although this review is subjective in nature and was not directly tied to our strategic goals, the leadership performance of the CEO is an important factor in the effective implementation and execution of our strategic plan and maintaining continued growth and year-over-year profitability. In 2007, the Committee also engaged Rodeghero Consulting Group ( RCG ) as an independent compensation consultant reporting to the Committee with respect to the market competitiveness of the compensation for our CEO and other executive officers. The firm interviewed the Committee's chairman and the CEO, and reviewed the job descriptions of the executive officers.

The firm also gathered and analyzed data from three independent national sources considered most appropriate for the company, as well as a proxy data source for compensation information on seven companies for which data was available, whose operations and scope presented the best comparison with the company. Those companies were Asbury Automotive Group, Autonation, Group 1 Automotive, Carmax, Rush Enterprises, Sonic Automotive and United Auto Group.

RCG's report found that the compensation packages for the Chief Executive Officer, Chief Operating Officer and Chief Financial Officer generally reflected mid-market norms in the survey-based benchmarks, but generally lagged the proxy norms. The other executive positions were more difficult to analyze as their job descriptions did not match the survey data; however, RCG concluded the compensation package likely exceeded the range of normative practice represented in the survey data bases. The compensation elements of company executives represent less at risk pay, but the benefit packages, including pensions, were exceptionally below normative practices. The report did not rank the data based upon relative company performance.

Further, the Committee received advice and assistance from outside legal counsel and reviewed current articles regarding its responsibilities, changes in accounting rules and tax laws, alternative equity grant programs and emerging best practices.

When determining the amount and form of annual compensation for the CEO, the Committee reviewed the total compensation earned by our CEO. As part of this process, the Committee used tally sheets as a comparative tool to reflect the total cash and non-cash compensation and wealth accumulation for the executives associated with their service. The amount of base salary for our CEO is based on competitive market factors, the success and growth of our Company and the relative pay level within the senior management team. The base salaries of executive officers other than the CEO are based in part on their respective responsibilities and the relative internal pay equity among the senior executives.

Our 2006 Support Services Bonus Plan ( Bonus Plan ), approved by shareholders in May 2006, is intended to compensate the executive for the annual year-to-year performance, while equity-based awards are intended to reward long-term growth and align the interests of management with those of the shareholders. Because the payments under the Bonus Plan are purely performance based, prior bonus payments are not taken into consideration when setting the annual salaries or awarding options. Additionally, because options mature and eventually expire or are exercised, we continue to award option grants to the CEO and other senior executives as additional incentive to increase shareholder value. Annual stock option grants to the named executive officers have a four or five year service cliff vesting feature designed to ensure that the executives will always have multiple unvested options outstanding to maximize the job retention benefit of our option program.

The amount of the performance bonus each year is determined by formula set forth in the annual plan. Management initially proposes the performance criteria and terms of the annual plan relative to the company-wide strategic and annual operational goals and objectives, and submits the plan to the Committee. The Committee reviews the proposal, makes suggested changes and, after the final terms are agreed upon, approves the plan. Following the end of the year, the Committee and management review our performance relative to the prior year's written plan and determine the level of performance attained for that year and calculate the applicable bonuses. These calculations are reviewed and confirmed by our internal audit department in writing. All bonuses are approved by the Committee and paid in the first quarter of the following year. The current performance targets in the Bonus Plan are the same for all participants under the plan. In 2007, a total of 80 officers and managers participated in the Bonus Plan.

Under the Bonus Plan, the Committee has the negative discretion to reduce bonus payments to the participants from the amounts achieved under the plan. While a significant portion of the potential bonus amounts are based upon financial targets, others are project or initiative based. For 2007, the achievement of a number non-financial targets resulted in the bonus potential of 34% of the maximum target. However, in light of the substantially reduced income earned by the Company, the negative discretion under the plan was exercised with respect to the senior executives with no cash bonuses paid to them under the Bonus Plan for 2007.

We attempt to maximize the tax benefits related to compensation expense; however, tax considerations are not the compelling factor in determining the annual compensation package or form of compensation. With the adoption of SFAS No. 123R, Share-Based Payment, requiring the expensing of all forms of equity compensation, future awards may be structured to lessen our after-tax compensation expense. For example, we recently changed the term of our stock option awards from ten years to six years, which helped reduce the amount of expense. The Committee intends all compensation to be IRC 162(m) compliant to permit us to be able to deduct, for federal income tax purposes, all compensation paid to the named executive officers. Accordingly, the Bonus Plan is performance based and, as required, was submitted to shareholders for approval. Periodically and whenever changes are made to the performance criteria, the revised plan will be resubmitted to shareholders for approval.

We have not entered into employment agreements with any of the named executive officers, nor do we have any specific change of control agreements other than provisions in all of our stock option grant agreements that accelerate vesting upon a change in control. Our executives are also eligible to participate in benefit programs generally available to all full time employees, including health and disability insurance and participation in a 401(k) plan.

### **Components of 2007 Executive Officer Compensation**

We maintain a relatively simple compensation program compared to many other companies. We provide a base salary, an annual cash performance bonus, equity grants and limited personal perquisites and benefits.

#### ***Base Salary***

Base salaries are based on both financial and non-financial criteria, internal pay equity and current market conditions, including relative pay within the industry. Base salaries are established at the beginning of each year; however, any changes in base salary in a given year do not become effective until March 1 of that year. Therefore, the actual payment of the current year base salary runs from March of that year through the end to February of the following year.

Based on the RCG report and the challenging economic environment foreseen by the Committee, base salaries of the named executive officers were frozen at the 2006 levels.

#### ***Bonus Compensation***

##### **2006 Discretionary Support Services Bonus Plan**

Senior management recommended certain performance goals and objectives for 2007 under the Bonus Plan to reflect the anticipated sales environment for the Company, and our underlying strategic and operational objectives. These performance goals and objectives are incorporated into the Bonus Plan targets approved by the Committee. The performance criteria fell into three different categories approved by stockholders: Financial Performance Objectives, Non-Financial Performance Objectives and Project Related Objectives. Each of these categories was further broken down into sub-categories that were assigned specific target objectives. Some categories had several ranges of performance, while others were attained or not attained (i.e. Project Related Objectives). Each of these sub-categories was assigned a percentage, with a range of percentages assigned to a range of performance criteria. Collectively, all of the assigned percentages equaled 100%, meaning that if all of the sub-category performance levels were attained at their highest level, the executive would be entitled to receive 100% of the maximum bonus. If none of the minimum performance levels were attained, the executive would receive no bonus. The Financial Performance Objectives were weighed more heavily than the other objectives with 45% of the maximum bonus attributable to those goals. The Non-Financial Objectives comprised up to a maximum of 30%, while the Project Related Objectives comprised a maximum of 25%.

For 2007, the Bonus Plan provided for a maximum bonus payment equal to 150% of the named executive officer's base salary. The Committee recognized that the potential bonuses available to the executives could have been substantial, but believed that such rewards would be merited if the goals were fully achieved. The Committee also believed that the overall performance criteria established in 2007 were aggressive when the prior year's performance and the management's internal projections were compared with the goals established under the plan. For 2006, the actual performance percentage achieved was 35%. For 2002 through 2005, the performance percentages achieved under prior bonus plans were 40.0%, 40.0%, 63.3% and 71.5%, respectively.

The performance criteria for 2007 were as follows:

Financial Performance Objectives:

Pre-tax Net Profit;

Pre-tax Net Margin Retention;

Company Revenue/Net Profit Growth;

Used Vehicle Department Revenue and Gross Profit Growth; and

Fixed Departments Revenue/Gross Profit Growth.

Non-Financial Performance Objectives

Percentage of Dealerships meeting Manufacturer Minimum Sales Requirements;

Satisfying Manufacturer Criteria to Acquire Dealerships;

Percentage of Dealerships meeting or exceeding Manufacturer Sales Satisfaction Scores; and

Percentage of Dealerships meeting or exceeding Manufacturer Service Satisfaction Scores.

Project Objectives (these objectives generally are operational in nature)

Human Development Initiatives;

Assured Service & Express Lube Initiatives;

Assured Sales & Branding Initiatives;

Car Deal Process Initiative;

Internet Sales Initiative; and

Office Automation Initiatives.

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Under the Bonus Plan, participants were eligible to receive 34% of their maximum potential bonus amounts, primarily in achieving project objectives (23%) and to a lesser extent non-financial performance objectives (8%) and financial performance objectives (3%). Because of the significant shortfall in the Company's earnings expectations, the Committee, upon recommendation of management, exercised the negative discretion under the Bonus Plan to pay no bonuses to the named executive officers for 2007.

### *Equity Awards*

#### *2003 Stock Incentive Plan*

The 2003 Stock Incentive Plan provides for the issuance of non-qualified stock options, stock-settled stock appreciation rights, stock awards, stock units and performance awards. With respect to our store general managers (GMs), we do not grant any awards outright but permit each GM to elect to either take their achieved bonuses in cash or, alternatively, receive a restricted stock award equal to three times that amount but with a four-year cliff vesting. We believe this program will foster their ownership interest and provide a significant retention incentive since termination of employment prior to vesting will generally result in the loss of the shares. With respect to other officers below the named executive officers, we generally award time-vested restricted stock.

For our senior executives, including the named executive officers, we issue time-vested stock options. We believe options best align the interests of our executives with shareholders as the options bring value to the holder only if the market value of our shares increase and the executive continues with the Company until the grants vest and become exercisable. All options are granted with an exercise price equal to the market value on the day of grant and cliff-vest four or five years after the date of grant. The number of options granted to the senior executives was determined by the Committee based in part on the RCG report regarding equity grants. We also use stock options and stock awards as a significant portion of the compensation paid to our non-employee directors. The options to these directors are fully exercisable six months after the grant date.



### ***Employee Stock Purchase Plan***

We also maintain an Employee Stock Purchase Plan which is available to all eligible full-time employees. This is a tax-qualified plan designed to encourage employees to participate in the ownership and growth of the Company. This plan permits participants to contribute a part of their annual pay, up to \$25,000 annually, which is used to purchase our Class A Common stock each quarter at a price equal to 85% of the then market price. Because of limitations imposed by applicable tax regulations, our directors and all of our current named executive officers were ineligible to participate in this plan in 2007.

### ***Other Compensation***

We make contributions to the 401(k) accounts of all participating named executive officers on the same terms as those of other participants in our 401(k) plan and provide health and disability insurance for the named executive officers under the same plans as for other non-executive employees. We also provide an automobile allowance to our named executive officers and pay premiums on a long-term disability insurance policy for each.

Each year, we sponsor a business event in Hawaii for the high-achieving general managers of our dealerships. These qualifying dealership general managers, their regional managers and the named executive officers are all invited and encouraged to bring their spouses. Each attendee is responsible for the cost of the spouses' attendance; however, the Company pays to each attendee whose spouse also attended an amount equal to the estimated after-tax cost to the individual. Two of the named executive officers and their respective spouses did not attend the event in 2007.

We believe that the current mix and amount of compensation provides a competitive compensation package for our named executive officers, properly balancing the compensatory features with the performance features and providing incentive to implement and execute our short-term and long-term strategic and operational plans.

### ***Director Compensation***

The compensation structure for our non-employee directors for the 2006-2007 service year was:

A monthly retainer fee of \$3,000;

\$5,000 each for personal attendance at the regularly scheduled quarterly board and committee meetings;

a stock option award in the amount of 2,000 shares; and

a stock grant of 1,200 shares, plus an additional 100 shares for the audit committee chairperson.

The stock options are granted at the same time as the other annual stock options awarded in the first quarter of each year. The stock options vest after six months and have a term of six years. All stock grants are made after the annual shareholder meeting following a year of service and are subject to such director completing the year of service. All stock grants to directors are subject to a written agreement with the director that prohibits sale of such shares until the earlier of 3 years after the date of grant or 1 year after termination of board service.

In setting compensation for our non-employee directors for the 2007-2008 service year, the Committee engaged Rodeghero Consulting Group ( RCG ) as an independent consultant reporting to the Committee with respect to the market competitiveness of the compensation paid. The RCG report summarized and analyzed the compensation practices of the other publicly-held automotive and automotive related retailers. The report noted that the fee structure differs from the comparative companies in that no separate compensation is provided for committee meeting attendance, and that stock options reflect a smaller portion of the total compensation awarded in the comparison group. Total compensation was, however, well below average in the group.

The Committee noted that the Company was the smallest of the comparative group and recognized that, while their responsibility and efforts would not likely materially differ from those of other public company directors, some correlation between market capitalization and fees was appropriate. The Committee also observed that the 2006-2007 fee structure resulted in substantially all director compensation, after using the net after-tax cash proceeds to pay income taxes on the stock compensation received, being represented by equity in the Company.

After reviewing the RCG report, the Committee elected to continue all elements of the 2006-2007 compensation structure for the 2007-2008 service year.

We also offer our non-employee directors the opportunity to defer receipt of their director compensation through our Outside Director Non-Qualified Deferred Compensation Program. Under this program, the non-employee directors may defer receipt of all or a portion of their cash compensation and stock award. The cash portion accrues interest annually at a rate equal to our interest rate on our used car flooring line as of December 31 of the prior fiscal year. For funds deferred in 2007, the rate was 7.32%. For funds deferred in 2008, the rate will be 6.6%.

#### **Stock Option Grant Date Practices**

We award stock options and restricted stock awards to all persons selected to receive an award on the same date. The exercise price for stock options is determined in accordance with the terms of the 2003 Stock Incentive Plan which defines the fair market value as the average price between the high and low trading price on the date of grant. The expected date of grant is on or about March 10 of each year. This date coincides with the payment of the cash bonus under the Company's 2006 Discretionary Support Services Bonus Plan and also is expected to be after the release of year-end financial results and outside the regularly scheduled closed window period for the first quarter. Other than in the context of the foregoing, we do not consider the release of earnings information when granting awards.

All stock options and restricted stock awards are reviewed and approved at a Committee meeting in the first quarter of each year. The Committee approves the grants for each recipient and selects on or about March 10 as the effective date for such grants.

#### **COMPENSATION COMMITTEE REPORT**

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis, included elsewhere in this proxy statement, with management and, based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Company's annual report on Form 10-K and in this proxy statement.

Submitted by the Compensation Committee of the Board of Directors:

Thomas Becker

Maryann N. Keller

William J. Young (Chair)

## EXECUTIVE COMPENSATION

## Summary Compensation Table for 2007

The following table provides certain summary information concerning compensation awarded to, earned by or paid to our (i) Principal Executive Officer (PEO); (ii) our Principal Financial Officer (PFO); and (iii) our three other executive officers (herein collectively referred to as the named executive officers) for the fiscal years ended December 31, 2007 and 2006.

| Name and<br>Principal Position                                    | Year | Salary     | Option<br>Awards <sup>(1)</sup> | Non-Equity<br>Incentive<br>Plan | All Other<br>Compensation <sup>(2)</sup> | Total        |
|---|------|------------|---------------------------------|---------------------------------|--|--------------|
|   |      |            |                                 | Compensation                    | Compensation                             |              |
| Sidney B. DeBoer<br>Chairman, CEO and Secretary                   | 2007 | \$ 840,000 | \$ 195,234                      | \$ 4,300                        | \$ 31,339                                | \$ 1,070,873 |
|   | 2006 | 822,500    | 184,806                         | 441,000                         | 22,532                                   | 1,470,838    |
| Jeffrey B. DeBoer<br>Senior Vice President and CFO                | 2007 | 420,000    | 109,244                         | 4,300                           | 17,834                                   | 551,378      |
|   | 2006 | 416,000    | 100,200                         | 220,500                         | 18,897                                   | 755,597      |
| M. L. Dick Heimann<br>President of Corporate Affairs and Director | 2007 | 624,000    | 168,767                         |                                 | 19,159                                   | 811,926      |
|   | 2006 | 620,000    | 169,877                         | 327,600                         | 19,293                                   | 1,136,770    |
| Bryan B. DeBoer<br>President and Chief Operating Officer          | 2007 | 624,000    | 141,697                         | 3,961                           | 23,873                                   | 793,531      |
|   | 2006 | 616,000    | 124,989                         | 327,600                         | 23,783                                   | 1,092,372    |
| R. Bradford Gray<br>Executive Vice President                      | 2007 | 564,000    | 129,473                         |                                 | 21,741                                   | 715,214      |
|   | 2006 | 560,000    | 129,357                         | 296,100                         | 13,899                                   | 999,356      |

(1) These amounts reflect the amount of the SFAS No. 123(R) compensation expense recognized relating to the unvested stock options held by each named executive officer, including any award made in 2007. The amounts were determined using the Black-Scholes valuation model. See Note 12 of Notes to Consolidated Financial Statements included in our Annual Report for the year ended December 31, 2007 for the valuation assumptions and other information related to our stock and option awards.

(2) All Other Compensation in 2007 included an auto allowance, company 401(k) contributions and long-term disability insurance premiums for each of the named executive officers.

## Grants of Plan-Based Awards Table for the Year Ended December 31, 2007

| Name               | Grant<br>Date | Board<br>Approval<br>Date | Estimated Future Payouts Under<br>Non-Equity Incentive Plan Awards |                |                 | All Other<br>Option<br>Awards:<br>Number of<br>Securities<br>Underlying<br>Options (#) | Exercise<br>or Base<br>Price of<br>Option<br>Awards<br>(\$/Sh) | Grant Date<br>Fair Value<br>of Stock<br>and Option<br>Awards<br>(\$) <sup>(1)</sup> |
|--------------------|---------------|---------------------------|--|----------------|-----------------|--|--|---|
|                    |               |                           | Threshold<br>(\$)  | Target<br>(\$) | Maximum<br>(\$) |  |  |   |
| Sidney B. DeBoer   | 03/01/07      | 02/23/07                  |  |                |                 |  |  |   |
|                    | 03/09/07      | 02/23/07                  |  |                |                 | 24,000   | \$ 28.34 \$ 222,240  |   |
| Jeffrey B. DeBoer  | 03/01/07      | 02/23/07                  |  |                |                 |  |  |   |
|                    | 03/09/07      | 02/23/07                  |  |                |                 | 14,000   | 28.34 129,640  |   |
| M. L. Dick Heimann | 03/01/07      | 02/23/07                  |  |                |                 |  |  |   |
|                    | 03/09/07      | 02/23/07                  |  |                |                 | 18,000   | 28.34 166,680  |   |
| Bryan B. DeBoer    | 03/01/07      | 02/23/07                  |  |                |                 |  |  |   |
|                    | 03/09/07      | 02/23/07                  |  |                |                 | 18,000   | 28.34 166,680  |   |
| R. Bradford Gray   | 03/01/07      | 02/23/07                  |  |                |                 |  |  |   |
|                    | 03/09/07      | 02/23/07                  |  |                |                 | 14,000   | 28.34 129,640  |   |

(1) This amount reflects the estimated fair value on the date of grant determined pursuant to SFAS No. 123R using the Black-Scholes valuation model. Each award had an estimated per share valuation equal to \$9.26. See Note 12 of Notes to Consolidated Financial

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Statements included in our Annual Report for the year ended December 31, 2007 for the valuation assumptions and other information related to our stock and option awards during 2007. This total amount will be proportionately recognized as compensation expense over a five-year period beginning on the date of grant, with the portion attributable to 2007 reflected as a component of the amount in the Option Awards column of the Summary Compensation Table.

The Compensation Committee approves the final executive officer compensation package at its regularly scheduled meeting in February each year, effective March 1. Therefore, the salary reflected in the Salary column in the Summary Compensation Table is comprised of two months at the annual rate established for 2006 and 10 months at the 2007 rate.

The 2006 Discretionary Support Services Bonus Program is structured such that the final bonus amount is tied directly to Lithia's performance for the year and is a single, definitive amount based on the performance criteria attained during the calendar year. As a result, depending on which criteria are satisfied and to what extent, the bonus could range from a minimum of 1.5% to a maximum of 150% of base salary (when all elements are satisfied at the highest level). Therefore, there is no target amount.

All equity awards and the performance criteria for the 2006 Discretionary Support Services Bonus Plan were approved by the Board of Directors at the regular board meeting on February 23, 2007, with the stock options to be granted on March 9, 2007 at the fair market value on that date in accordance with the terms of the 2003 Stock Incentive Plan, which is defined as the average between the high and the low trading price on the date of grant. The closing price on the date of grant was \$28.27. Each equity incentive award vests as to 100% on the five-year anniversary of the grant date, March 9, 2012.

Under the objectives and targets set for 2007 under the 2006 Discretionary Support Services Bonus Plan, each named executive officer was eligible to receive 34% of the maximum achievable bonus (in each case, 150% of base compensation); however, under the negative discretion preserved under the plan, no bonus was paid to any of the named executive officers.

**Outstanding Equity Awards at Year End 2007**

The following table sets forth the outstanding equity awards held by the named executive officers as of December 31, 2007:

| Name               | Option Awards  |  | Option<br>Exercise<br>Price (\$/Sh) | Option<br>Expiration<br>Date |
|--------------------|--|--|-------------------------------------|------------------------------|
|                    | Number of<br>Securities<br>Underlying<br>Unexercised<br>Options<br>Exercisable (#) | Number of<br>Securities<br>Underlying<br>Unexercised<br>Options<br>Unexercisable (#) |                                     |                              |
| Sidney B. DeBoer   | 22,010   |  | \$ 16.75                            | 01/06/10                     |
|                    | 16,000   |  | 1.00                                | 12/26/10                     |
|                    | 31,788   |  | 11.81                               | 12/26/10                     |
|                    | 16,000   |  | 19.24                               | 12/26/11                     |
|                    | 16,000   |  | 15.13                               | 12/26/12                     |
|                    |  | 16,002 <sup>(1)</sup>  | 29.42                               | 03/11/10                     |
|                    |  | 20,001 <sup>(2)</sup>  | 27.58                               | 03/10/11                     |
|                    |  | 24,000 <sup>(3)</sup>  | 31.67                               | 03/10/12                     |
| Jeffrey B. DeBoer  |  | 24,000 <sup>(4)</sup>  | 28.34                               | 03/09/13                     |
|                    | 4,000  |  | 16.50                               | 01/01/09                     |
|                    | 24,000   |  | 16.75                               | 01/06/10                     |
|                    | 8,000  |  | 1.00                                | 12/26/10                     |
|                    | 8,000  |  | 19.24                               | 12/26/11                     |
|                    | 8,000  |  | 15.13                               | 12/26/12                     |
|                    |  | 8,001 <sup>(1)</sup>   | 29.42                               | 03/11/10                     |
|                    |  | 12,000 <sup>(2)</sup>  | 27.58                               | 03/10/11                     |
| M. L. Dick Heimann |  | 14,000 <sup>(3)</sup>  | 31.67                               | 03/10/12                     |
|                    |  | 14,000 <sup>(4)</sup>  | 28.34                               | 03/09/13                     |
|                    | 22,010   |  | 16.75                               | 01/06/10                     |
|                    | 16,000   |  | 1.00                                | 12/26/10                     |
|                    | 31,788   |  | 11.81                               | 12/26/10                     |
|                    | 16,000   |  | 19.24                               | 12/26/11                     |
|                    | 16,000   |  | 15.13                               | 12/26/12                     |
|                    |  | 16,002 <sup>(1)</sup>  | 29.42                               | 03/11/10                     |
| Bryan B. DeBoer    |  | 18,000 <sup>(2)</sup>  | 27.58                               | 03/10/11                     |
|                    |  | 18,000 <sup>(3)</sup>  | 31.67                               | 03/10/12                     |
|                    |  | 18,000 <sup>(4)</sup>  | 28.34                               | 03/09/13                     |
|                    | 24,000   |  | 16.75                               | 01/06/10                     |
|                    | 8,000  |  | 1.00                                | 12/26/10                     |
|                    | 8,000  |  | 19.24                               | 12/26/11                     |
|                    | 8,000  |  | 15.13                               | 12/26/12                     |
|                    |  | 12,000 <sup>(1)</sup>  | 29.42                               | 03/11/10                     |
| R. Bradford Gray   |  | 16,002 <sup>(2)</sup>  | 27.58                               | 03/10/11                     |
|                    |  | 18,000 <sup>(3)</sup>  | 31.67                               | 03/10/12                     |
|                    |  | 18,000 <sup>(4)</sup>  | 28.34                               | 03/09/13                     |
|                    | 8,000  |  | 16.50                               | 01/01/09                     |
|                    | 28,000   |  | 16.75                               | 01/06/10                     |
|                    | 12,000   |  | 1.00                                | 12/26/10                     |
|                    | 12,000   |  | 19.24                               | 12/26/11                     |
|                    | 12,000   |  | 15.13                               | 12/26/12                     |
|                    | 12,000 <sup>(1)</sup>  | 29.42  | 03/11/10                            |                              |
|                    | 14,001 <sup>(2)</sup>  | 27.58  | 03/10/11                            |                              |
|                    | 14,000 <sup>(3)</sup>  | 31.67  | 03/10/12                            |                              |
|                    | 14,000 <sup>(4)</sup>  | 28.34  | 03/09/13                            |                              |

(1) Vests as to 100% of the covered shares on the fifth anniversary of the grant date, which is March 11, 2009.

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- (2) Vests as to 100% of the covered shares on the fifth anniversary of the grant date, which is March 10, 2010.
- (3) Vests as to 100% of the covered shares on the fifth anniversary of the grant date, which is March 10, 2011.
- (4) Vests as to 100% of the covered shares on the fifth anniversary of the grant date, which is March 9, 2012.

**Option Exercises and Stock Vested for the Year Ended December 31, 2007**

The following table summarizes the number of stock options exercised during 2007 for each named executive officer. The value realized is the actual dollar value the executive received on the exercise date based on the fair market value of the stock on that date. No named executive officers have received restricted stock awards.

| Name            | Option Awards            |                                 |
|-----------------|--------------------------|---------------------------------|
|                 | Number of Shares         |                                 |
|                 | Acquired on Exercise (#) | Value Realized on Exercise (\$) |
| Bryan B. DeBoer | 12,000                   | \$ 263,320                      |

**POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE-IN-CONTROL**

We do not have any employment agreements or any other agreements or understandings with any of the named executive officers that provide for supplemental payments after the executive's employment terminates or in the event of a change-in-control. The only effective change-in-control provision relates to the acceleration of stock-based awards, which is present in all of our stock option and restricted share agreements. If a change-in-control event occurred on December 31, 2007, no amounts would be realized by any of the named executive officers upon the acceleration of their outstanding stock options because they all had exercise prices above the December 31, 2007 closing share price of \$13.73 per share.

**COMPENSATION OF DIRECTORS**

The following table summarizes compensation paid to members of our Board of Directors during calendar 2007, which represents the 2007 portion of both the 2006-2007 Board term and the 2007-2008 Board term:

| Name              | Fees Earned          | Stock                      | Option      | Total (\$) |
|-------------------|----------------------|----------------------------|-------------|------------|
|                   | or Paid in Cash (\$) | Awards (\$) <sup>(1)</sup> | Awards (\$) |            |
| Thomas Becker     | \$ 56,000            | \$ 35,269                  | \$ 18,520   | \$ 109,789 |
| Maryann N. Keller | 53,000               | 32,556                     | 18,520      | 104,076    |
| William J. Young  | 56,000               | 32,556                     | 18,520      | 107,076    |

(1) The amount set forth in the stock awards column reflects the value of each award as of the grant date using the average of the high and low trading prices on the grant date of \$27.13. Mr. Becker received 1,300 shares and the other directors each received 1,200 shares. These shares were fully vested on the date of grant.

Directors serve from annual meeting to annual meeting rather than on a calendar year. The cost of the Directors' services, however, is accounted for on a calendar year as earned. The fees reflected in the column Fees Earned or Paid in Cash in the above table are the actual fees earned in 2007. The option and stock awards reflect the amounts actually expensed during the year. All stock and option awards are granted pursuant to a previously approved compensation package for board members. Stock awards are granted in June of each year following twelve months of service and option awards are granted in March each year. The amounts reflected in the columns Stock Awards and Option Awards are the value of the awards granted in 2007; however, because directors serve from annual meeting to annual meeting, only half of this amount is attributable to services performed in 2007, the other half being attributable to the last half of 2006.



At its regular board meeting held on February 23, 2007, in conjunction with the review and approval of all equity awards for management and other Company employees, the Board of Directors approved as partial board compensation, stock option grants to each non-employee director to be issued on March 9, 2007, with an expiration date of March 9, 2013. The exercise price for those grants was \$28.34, which represented the average between the high and low trading price on the date of grant. The closing price on that date was \$28.27. These option awards vested six months after the grant date and the amount included in this column is the SFAS No. 123R estimated fair value of the award on the grant date. See Note 12 of Notes to Consolidated Financial Statements included in our Annual Report for the year ended December 31, 2007 for the valuation assumptions and other information related to our stock and option awards.

Under the Outside Directors Nonqualified Deferred Compensation Plan adopted by the Board on November 22, 2005, non-employee directors may elect to defer receipt of all or any portion of their board service compensation. If stock compensation is deferred, the director's deferral account, which is maintained for accounting purposes only, will be credited with the stock and any cash or stock dividends, stock splits or the like that would have been paid or issuable with respect to the deferred shares. The cash component of the deferral account, including all deferred cash compensation and other cash interest and dividends credited to the account, will accrue interest at an annual rate equal to the interest rate on our used car flooring line of credit, by reference to such rate as of the last business day of the preceding year. The deferred compensation will be paid to the director beginning within one month following termination of the director's service on the board, either in a lump sum or installments, based on the director's election prior to the deferral.

Equity incentive awards outstanding at December 31, 2007 for each independent Director were as follows:

| Name              | Unvested<br>Stock<br>Awards (#) | Option<br>Awards (#) |
|-------------------|---------------------------------|----------------------|
| Thomas Becker     |                                 | 12,000               |
| Maryann N. Keller |                                 | 4,000                |
| William J. Young  |                                 | 12,000               |

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**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth, as of April 1, 2008, certain information with respect to ownership of our common stock of (i) each director, (ii) each executive officer, (iii) all persons known by us to be beneficial owners of more than 5% of any class of our common stock, and (iv) all current executive officers and directors as a group.

| Shareholder  | Class <sup>(1)</sup> | Number of Shares <sup>(2) (3)</sup> | Percent of Shares Outstanding <sup>(3)</sup> |
|--|----------------------|-------------------------------------|--|
| Lithia Holding Company, LLC <sup>(4) (5)</sup>   | Class B              | 3,762,231                           | 100%   |
| Sidney B. DeBoer <sup>(4) (5)</sup>  | Class A              | 231,094                             | 1.4%   |
|  | Class B              | 3,762,231                           | 100%   |
| Invesco Ltd. <sup>(6)</sup><br>1360 Peachtree Street NE<br>Atlanta, Georgia 30309  | Class A              | 2,702,339                           | 16.7%  |
| FMR Corp. <sup>(7)</sup><br>82 Devonshire Street<br>Boston, Massachusetts 02109  | Class A              | 1,696,005                           | 10.5%  |
| Neuberger Berman Inc. <sup>(8)</sup><br>605 Third Avenue<br>New York, New York 10158   | Class A              | 1,475,941                           | 9.1%   |
| Dimensional Fund Advisors LP <sup>(9)</sup><br>1299 Ocean Avenue, 11 <sup>th</sup> Floor<br>Santa Monica, California 90401         | Class A              | 1,226,917                           | 7.6%   |
| Wellington Management Company, LLP <sup>(10)</sup><br>75 State Street<br>Boston, Massachusetts 02109                               | Class A              | 926,200                             | 5.7%   |
| M. L. Dick Heimann <sup>(4) (5)</sup>  | Class A              | 326,143                             | 2.0%   |
| R. Bradford Gray <sup>(4) (5)</sup>  | Class A              | 117,712                             | *  |
| Bryan B. DeBoer <sup>(4) (5)</sup>   | Class A              | 46,000                              | *  |
| Jeffrey B. DeBoer <sup>(4) (5)</sup>   | Class A              | 56,564                              | *  |
| Thomas Becker <sup>(4)</sup>   | Class A              | 29,500                              | *  |
| William J. Young <sup>(4)</sup>  | Class A              | 19,800                              | *  |
| Maryann N. Keller <sup>(4)</sup>   | Class A              | 6,100                               | *  |
| All current executive officers and directors as a group (8 persons)  | Class A              | 832,913                             | 5.0%   |
|  | Class B              | 3,762,231                           | 100%   |
| Combined Class A ownership assuming conversion of all Class B shares for all current officers and directors as a group (8 persons) |                      | 4,595,144                           | 22.6%  |

\* Less than one percent

- (1) The Class A common stock is entitled to one vote per share and the Class B common stock is entitled to 10 votes per share and is convertible into Class A common stock on a share-for-share basis at the option of the holder thereof or under certain other circumstances.
- (2) Includes shares subject to options exercisable within 60 days of April 1, 2008, shares held in 401(k) accounts and shares held by spouses as follows:

| Name  | Options exercisable<br>within 60 days | Shares held in<br>401(k) account | Shares held<br>by spouse |
|---|---------------------------------------|----------------------------------|--------------------------|
| Sidney B. DeBoer  | 101,798                               |                                  |                          |
| M. L. Dick Heimann                                      | 101,798                               | 68,261                           | 15,964                   |
| R. Bradford Gray  | 72,000                                |                                  |                          |
| Bryan B. DeBoer   | 40,000                                |                                  |                          |
| Jeffrey B. DeBoer                                       | 52,000                                | 2,853                            |                          |
| Thomas Becker   | 12,000                                |                                  |                          |
| William J. Young  | 12,000                                |                                  |                          |
| Maryann N. Keller                                       | 4,000                                 |                                  |                          |
| All current executive officers and directors as a group | 395,596                               | 71,114                           | 15,964                   |

Mr. Sidney DeBoer's shares and the all current executive officers and directors as a group shares also include 79,500 Class A shares held by the DeBoer Family LLC and all Class B shares held by Lithia Holding Company, LLC, which Mr. Sidney DeBoer controls.

- (3) Applicable percentage of ownership is based on 16,141,522 shares of Class A common stock outstanding and 3,762,231 shares of Class B common stock outstanding as of April 1, 2008, together with applicable options for such shareholders. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission, and includes voting and investment power with respect to shares. Unless otherwise indicated, the beneficial owner is deemed to have sole voting and dispositive power with respect to all shares held. Shares of common stock subject to options currently exercisable or exercisable within 60 days after April 1, 2008 are deemed outstanding for computing the percentage ownership of the person holding such options, but are not deemed outstanding for computing the percentage of any other person.
- (4) The shares owned by each executive officer may be held in a brokerage account and certain executive officers may have margin loans secured by the entire account assets, which could include shares of Class A Common stock that could be sold by the broker to satisfy a potential margin call. Additionally, 3,762,231 shares of Class B common stock are pledged to secure a loan. Each listed person can be reached c/o 360 E. Jackson Street, Medford, Oregon 97501.
- (5) Sidney DeBoer, as the manager of Lithia Holding Company and pursuant to the terms of its operating agreement, has the sole voting and investment power with respect to all of the Class B common stock. Accordingly, all shares held by Lithia Holding Company are deemed beneficially owned by him. The following table gives tabular information regarding the ownership of Lithia Holding Company, LLC:

| Unit Holder            | Units Owned |         |
|------------------------|-------------|---------|
|                        | Number      | Percent |
| DeBoer Family LLC      | 46,167      | 48.9%   |
| Heimann Family LLC     | 34,875      | 36.9%   |
| R. Bradford Gray       | 7,000       | 7.4%    |
| DeBoer Insurance, LLC  | 4,990       | 5.3%    |
| Sidney B. DeBoer Trust | 1,425       | 1.5%    |
|                        | 94,457      | 100.0%  |

Sidney B. DeBoer is the manager of the DeBoer Family LLC, whose members include Mr. DeBoer, his spouse and other family members. M. L. Dick Heimann is the manager of the Heimann Family LLC, whose members include Mr. Heimann and other family members. Bryan DeBoer is the manager of DeBoer Insurance, LLC, whose members are Bryan B. DeBoer, Jeffrey B. DeBoer and Mark D. DeBoer. Sidney B. DeBoer is the trustee and owner of the Sidney B. DeBoer Trust.

- (6) Based solely on information provided on Schedule 13G filed with the Securities and Exchange Commission by Invesco Ltd., a holding company. The beneficial ownership of one investment company, AIM Funds Management Inc., amounted to 2,695,800 of the shares. Invesco Ltd. has sole voting and dispositive power with respect to all 2,702,339 shares.
- (7) Based solely on information provided on Schedule 13G/A filed with the Securities and Exchange Commission by FMR LLC ( FMR ). The beneficial ownership of one investment company, Fidelity Low Priced Stock Fund, amounted to 1,597,105 of the shares. FMR has sole voting power with respect to 43,400 shares and sole dispositive power with respect to all 1,696,005 shares.
- (8) Based solely on information provided on Schedule 13G filed with the Securities and Exchange Commission by Neuberger Berman Inc. ( Neuberger ), a group of investment companies. Three investment companies, Neuberger Berman, LLC, Neuberger Berman Management

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Inc. and Neuberger Berman Equity Funds were deemed to beneficial owners of 1,475,941, 1,224,034 and 1,214,034 of the shares, respectively. Neuberger has sole voting power with respect to 200 shares and shared voting power with respect to 1,224,034 shares. Neuberger has shared dispositive power with respect to all 1,475,941 shares.

- (9) Based solely on information provided on Schedule 13G/A filed with the Securities and Exchange Commission by Dimensional fund Advisors LP, a registered investment adviser.
- (10) Based solely on information provided on Schedule 13G filed with the Securities and Exchange Commission by Wellington Management Company, LLP ( Wellington ), an investment advisor. Wellington does not have sole voting power with respect to any of the shares, has shared voting power with respect to 595,200 shares and shared dispositive power with respect to all 926,200 shares.

## **SHAREHOLDER AND OTHER INTERESTED PARTIES COMMUNICATIONS WITH DIRECTORS**

The Board of Directors has adopted a Shareholder and Interested Party Communication Policy to promote more efficient shareholder and interested party communications with the Board and management. Our Investor Relations Department is responsible for receiving and routing all shareholder and interested party communications. Corporate governance issues are the responsibility of the Corporate Governance Committee. Our Audit Committee handles concerns or allegations regarding possible violations of accounting or financial reporting matters. Management is the more appropriate group for handling all other matters and we encourage you to contact them accordingly.

All correspondence with the Board of Directors or its members must be in writing, directed to the attention of either the Board of Directors or an individual director and delivered to: Investor Relations Department, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501. A complete copy of our Shareholder Communications Policy is available on our website at [www.lithia.com](http://www.lithia.com) and interested persons may obtain a written copy from the Investor Relations Department.

## **CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The Audit Committee reviews all potential conflicts of interest and transactions with related parties. Although we do not maintain a written policy or have written procedures for such review, our Code of Ethics imposes an obligation on each director and executive officer to disclose any potential conflict of interest involving such person and the Company. Further, each director and named executive officer signs a detailed questionnaire used in the preparation of this proxy statement which requires the disclosure, among other things, of any related party transaction. The Audit Committee reviews and approves all such transactions. Additionally, as regular course of conduct, the Board of Directors reviews and ratifies all transactions and relationships involving immediate family members of any director and named executive officer.

In 2007, Mark DeBoer, son of CEO, Sidney B. DeBoer, and brother of President, Bryan B. DeBoer, and of CFO, Jeffrey B. DeBoer, received a salary of \$457,905 and other compensatory arrangements totaling \$761. The salary and other compensatory arrangements were reviewed and ratified by the Compensation Committee.

During 2007, the Company owned and operated corporate aircraft for business use. The Board of Directors has adopted a policy permitting a limited number of executives and one board member to lease the aircraft under a dry-lease arrangement on terms made available to other third parties and at a rate believed by the Compensation Committee to be fair and in the economic interest of the Company. During 2007, two people, Mr. Heimann and Mr. Becker, utilized the aircraft and reimbursed the Company \$1,320 and \$975, respectively.

During 2007, the Company entered into a Split Dollar Agreement with its CEO, Sidney B. DeBoer, under which his named beneficiary would receive \$12.0 million of death benefits under a \$37.3 million key-man life insurance policy owned by the Company. Pursuant to the agreement, he pays his pro rata share of the premium due on this term life insurance policy. No compensation is deemed received by him as a result of this arrangement.

## **CODE OF ETHICS**

We adopted a Code of Business Conduct that applies to all of our directors, officers and employees, including our principal executive, financial and accounting officers. A complete copy of our Code of Business Conduct is available on our website at [www.lithia.com](http://www.lithia.com), or you may request a copy by mail from our Investor Relations Department, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501. We intend to publicly disclose all amendments to and waivers of the Code of Business Conduct on our website.

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

The Compensation Committee of the Board of Directors was composed of Messrs. Becker and Young (Chairman) and Ms. Keller during 2007. In addition, Gerald Taylor, a former Board member, served on the Compensation Committee during 2007 through the date of the 2007 Annual Shareholder Meeting in May 2007.

Although Sidney DeBoer, our Chief Executive Officer, served on our Board of Directors in 2007 and participated in compensation discussions, he did not participate in any deliberations or decisions regarding his own compensation. During 2007, none of our executive officers served as a member of the Board of Directors or compensation committee of any entity that has one or more executive officers serving as a member of our Board or Compensation Committee.

**INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Our Audit Committee retained KPMG LLP as our independent registered public accounting firm for the year ended December 31, 2007. A representative of KPMG LLP is expected to be present at the Annual Meeting. The representative will be given the opportunity to make a statement on behalf of the firm if such representative so desires, and will be available to respond to appropriate shareholder questions.

**Fees Paid to KPMG LLP Related to Fiscal 2007 and 2006**

|                    | 2007         | %<br>approved<br>by Audit<br>Committee | 2006       | %<br>approved<br>by Audit<br>Committee |
|--------------------|--------------|--|------------|--|
| Audit Fees         | \$ 1,171,502 | 100%                                   | \$ 900,230 | 100%                                   |
| Audit Related Fees |              |  |            |  |
| Tax Fees           |              |  |            |  |
| All Other Fees     |              |  |            |  |
|                    | \$ 1,171,502 |  | \$ 900,230 |  |

**Pre-Approval Policies**

All audit and non-audit services performed by KPMG LLP, and all audit services performed by other independent registered public accounting firms, must be pre-approved by the Audit Committee. These services include, but are not limited to, the annual financial statement audit, audits of employee benefit plans, technical accounting guidance, tax compliance assistance, assistance with tax rulemaking interpretation and assistance with executing our acquisition strategy. KPMG LLP may not perform any prohibited services as defined by the Sarbanes-Oxley Act of 2002 including, but not limited to, any bookkeeping or related services, information systems consulting, internal audit outsourcing, legal services and management or human resources functions.

**REPORT OF THE AUDIT COMMITTEE**

The Audit Committee of the Board of Directors reports to the Board and is responsible for assisting the Board in fulfilling its oversight responsibilities relating to (a) the preparation and integrity of Lithia's financial statements; (b) the engagement of the independent registered public accounting firm and the evaluation of their performance, qualifications and independence; (c) the implementation and evaluation of Lithia's internal accounting and financial controls, procedures and policies; and (d) the compliance with certain legal and regulatory requirements, including programs and policies established by management or the Board. The current charter was amended on February 23, 2007 and is available on our website at [www.lithia.com](http://www.lithia.com).

In discharging our responsibilities, we have met with Lithia's management and its independent registered public accounting firm, KPMG LLP, to review Lithia's accounting functions and the audit process. We discussed and reviewed with the independent registered public accounting firm all matters that the independent registered public accounting firm was required to communicate and discuss with the Audit Committee under applicable auditing standards, including those described in Statement on Auditing Standards No. 61, as amended, regarding communications with audit committees. We also discussed and reviewed the results of the independent registered public accounting firm's audit of Lithia's financial statements, the quality and adequacy of Lithia's internal control and issues relating to auditor independence. We also obtained a formal written statement relating to independence consistent with Independence Standards Board Standard No. 1, Independence Discussions with Audit Committee, and discussed with the auditors any relationships that may impact their objectivity and independence.

Based on our review and discussions with Lithia's management and independent registered public accountants, we recommended to the Board that the audited financial statements be included in Lithia's Annual Report on Form 10-K for the fiscal year ended December 31, 2007, for filing with the Securities and Exchange Commission.

We also meet regularly with Lithia's internal audit manager to review the nature and extent of Lithia's internal controls, the review procedures performed by internal audit regarding such controls and the frequency and results of such reviews. We note that a follow-up procedure is in place to monitor any corrective actions that have been recommended.

Submitted by:

Thomas Becker (Chair)  
Maryann N. Keller  
William J. Young

**SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16 of the Securities Exchange Act of 1934, as amended, ( Section 16 ) requires our executive officers and directors and all persons who beneficially own more than 10% of our common stock (referred to as ten percent shareholders ) to file with the Securities and Exchange Commission and the New York Stock Exchange initial reports of beneficial ownership and all subsequent changes in their ownership of our common stock and other equity securities.

Based solely on the review of copies of the forms provided to us and the representations by the executive officers, directors and ten percent shareholders, we believe, to the best of our knowledge, that all Section 16(a) filing requirements were met for fiscal year ended December 31, 2007, except for one untimely Form 4 for each of our executive officers and directors disclosing the annual stock incentive awards granted on March 9, 2007.

**OTHER BUSINESS AND SHAREHOLDER PROPOSALS**

We know of no other business to be conducted at the Annual Meeting. Proposals intended to be presented by any shareholder at our 2009 Annual Meeting must be received by us in writing at our principal office no later than December 22, 2008 (120 days prior to the anniversary of the mailing of the prior years proxy materials) and must satisfy the conditions established by the Securities and Exchange Commission for shareholder proposals to be included in our proxy statement for that meeting.

**FORM 10-K**

We will provide, without charge, a copy of our Annual Report on Form 10-K as filed with the Securities and Exchange Commission. Written requests should be mailed to the attention of Investor Relations, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501. You may also find our Form 10-K on our website at [www.lithia.com](http://www.lithia.com).

Dated: April 30, 2008



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LITHIA MOTORS, INC.

**Revocable Proxy for Annual Meeting of Shareholders to be Held on May 21, 2008**

The undersigned hereby appoints Sidney B. DeBoer and M. L. Dick Heimann, and each of them, proxies of the undersigned, each with full power of substitution to represent and to vote on behalf of the undersigned all shares of Class A Common Stock of Lithia Motors, Inc. at the annual meeting to be held at 2:00 p.m. on Wednesday, May 21, 2008, and any adjournments or postponements thereof, with all powers the undersigned would possess if personally present, with respect to the following:

1. Election of Directors                    " FOR all nominees listed below except as marked to the contrary below  
  " WITHHOLD AUTHORITY to vote for all nominees listed below

To withhold authority to vote for any individual nominee, strike a line through the nominee's name in the list below:

|                          |                         |                     |
|--------------------------|-------------------------|---------------------|
| <b>Sidney B. DeBoer</b>  | <b>Thomas Becker</b>    | <b>Bryan DeBoer</b> |
| <b>Maryann N. Keller</b> | <b>William J. Young</b> |                     |

2. To approve the 2008 Discretionary Support Services Bonus Plan and 2008 L2 Performance Objectives and Bonus Program.

FOR    "                                    AGAINST    "                                    ABSTAIN    "

3. To approve an amendment to the Lithia Motors, Inc. 1998 Employee Stock Purchase Plan to increase the number of shares issuable under the plan.

FOR    "                                    AGAINST    "                                    ABSTAIN    "

Other Matters. At the discretion of the proxy holder, on such other business as may properly come before the meeting and any adjournments or postponements thereof.

**THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS OF THE COMPANY. IF NO SPECIFIC DIRECTION IS GIVEN, THIS PROXY WILL BE VOTED FOR EACH OF THE NOMINEES FOR DIRECTOR AND FOR PROPOSALS 2 AND 3.**

Dated \_\_\_\_\_, 2008

Signature of Stockholder(s)

Signature of Stockholder(s)

Please date and sign above exactly as your name appears on your stock certificate(s) (which should be the same as the name on the address label on the envelope in which this proxy was sent to you), including designation as executor, trustee, etc., if applicable. A corporation must sign its name by the president or other authorized officer. All co-owners must sign.