LITHIA MOTORS INC
Form 10-K
March 02, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-K

[X] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE**

SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended: December 31, 2014

OR

[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE**

SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-14733

LITHIA MOTORS, INC.

(Exact name of registrant as specified in its charter)

Oregon (State or other jurisdiction of incorporation or organization)	**93-0572810** (I.R.S. Employer Identification No.)
150 N. Bartlett Street, Medford, Oregon (Address of principal executive offices)	**97501** (Zip Code)

541-776-6401

(Registrant's telephone number including area code)

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

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

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

(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: Yes [X] No[ ]

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller reporting company [ ]

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately $2,214,824,000 computed by reference to the last sales price ($94.07) as reported by the New York Stock Exchange for the Registrant's Class A common stock, as of the last business day of the Registrant's most recently completed second fiscal quarter (June 30, 2014).

The number of shares outstanding of the Registrant's common stock as of March 2, 2015 was: Class A: 23,688,437 shares and Class B: 2,562,231 shares.

Documents Incorporated by Reference

The Registrant has incorporated into Part III of Form 10-K, by reference, portions of its Proxy Statement for its 2015 Annual Meeting of Shareholders.

LITHIA MOTORS, INC.

2014 FORM 10-K ANNUAL REPORT

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PART I

Item 1. Business

Forward-Looking Statements

Certain statements in this Annual Report, including in the sections entitled “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business” constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Generally, you can identify forward-looking statements by terms such as “project”, “outlook,” “target”, “may,” “will,” “would,” “should,” “seek,” “expect,” “plan,” “intend “anticipate,” “believe,” “estimate,” “predict,” “potential,” “likely,” “goal,” “strategy,” “future,” “maintain,” and “continue” or t these terms or other comparable terms. Examples of forward-looking statements in this Form 10-K include, among others, statements we make regarding:

- Future market conditions;
- Expected operating results, such as improved store performance, maintaining incremental throughput above 50% and increasing same store finance and insurance revenue per unit;
- The increase in our annual revenues that we estimate will result from the dealerships that we acquired and from the DCH Auto Group transaction;
- Anticipated ability to remain in compliance with the financial and restrictive covenants in our credit facility and other debt agreements;
- Anticipated availability of liquidity from our unfinanced operating real estate;
- Anticipated levels of capital expenditures in the future; and
- Our strategies for customer retention, growth, market position, financial results and risk management.

The forward-looking statements contained in this Annual Report involve known and unknown risks, uncertainties and situations that may cause our actual results to materially differ from the results expressed or implied by these statements. Some of those important factors are discussed in Part I, Item 1A. Risk Factors, Part II and in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations and, from time to time, in our other filings we make with the Securities and Exchange Commission (SEC).

By their nature, forward-looking statements involve risks and uncertainties because they relate to events that depend on circumstances that may or may not occur in the future. You should not place undue reliance on these forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. We assume no obligation to update or revise any forward-looking statement.

Overview

We are a leading operator of automotive franchises and a retailer of new and used vehicles and related services. As of March 2, 2015, we offered 30 brands of new vehicles and all brands of used vehicles in 130 stores in the United States and online at Lithia.com and DCHauto.com. We sell new and used cars and replacement parts; provide vehicle maintenance, warranty, paint and repair services; arrange related financing; and sell service contracts, vehicle protection products and credit insurance.

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

The following table sets forth information about stores that were part of our continuing operations as of December 31, 2014:

State	Number of Stores	Percent of 2014 Revenue	
Texas	17	20.7	%
Oregon	24	20.2	
California	30	15.8	
Montana	8	7.3	
Washington	7	6.8	
Alaska	9	6.6	
New Jersey	10	5.0	
Nevada	4	4.2	
Idaho	5	3.9	
Iowa	5	3.9	
North Dakota	3	1.9	
Hawaii	3	1.5	
New Mexico	2	1.3	
New York	3	0.9	
Total	130	100.0	%

Business Strategy and Operations

Our mission statement is: “Driven by our employees and preferred by our customers, Lithia is the leading automotive retailer in each of our markets.” We offer customers personal, convenient, flexible personalized service combined with the large company advantages of selection, competitive pricing, broad access to financing, and warranties. We strive for diversification in our products, services, brands and geographic locations to insulate us from market risk and to maintain profitability. We have developed a centralized support structure to reduce store level administrative functions. This allows store personnel to focus on providing a positive customer experience. With our management information systems and centrally-performed administrative functions in Medford, Oregon, and regional accounting processing centers, we seek to gain economies of scale from our dealership network.

We offer a variety of luxury, import and domestic new vehicle brands and models, reducing our dependence on any one manufacturer and our susceptibility to changing consumer preferences. Encompassing economy and luxury cars, sport utility vehicles (SUVs), crossovers, minivans and trucks, we believe our brand mix is well-suited to what customers demand in the markets we serve. Our new vehicle unit mix of 46% import, 43% domestic and 11% luxury aligns similarly with national market share, which was 48%, 45% and 7%, respectively, for the year ended December 31, 2014.

We have centralized many administrative functions to streamline store level operations. Accounts payable, accounts receivable, credit and collections, accounting and taxes, payroll and benefits, information technology, legal, human resources, personnel development, treasury, cash management, advertising and marketing are all centralized at our corporate headquarters. The reduction of administrative functions at our stores allows our local managers to focus on customer-facing opportunities to generate increased revenues and gross profit. Our operations are supported by our dedicated training and personnel development program, which shares best practices across our dealership network and seeks to develop our store management talent.

Operations are structured to promote an entrepreneurial environment at the dealership level. Each store's general manager and department managers, with assistance from regional and corporate management, are responsible for developing retail plans that perform in their stores. They are the leaders in driving dealership operations, personnel development, manufacturer relationships, store culture and financial performance.

During 2014, we focused on the following areas to achieve our mission:

- increasing revenues in all business lines;
- capturing a greater percentage of overall new vehicle sales in our local markets;
- capitalizing on a used vehicle market that is approximately three times larger than the new vehicle market by increasing sales of manufacturer certified pre-owned used vehicles; late model, lower-mileage vehicles; and value autos, which are older, higher mileage vehicles;
- growing our service, body and parts revenues as units in operation increase;
- leveraging our cost structure;
- diversifying our franchise mix through acquisitions;
- integrating acquired stores to achieve targeted returns;
- increasing our return to investors through dividends and strategic share buy backs;
- investing in our existing stores to increase profits; and
- increasing leveragability of the balance sheet to prepare for future expansion opportunities.

We believe we can leverage our cost structure as sales levels improve and we integrate acquired stores into our network. In 2014, we purchased 35 stores, including 27 stores on October 1, 2014 through the acquisition of DCH Auto Group (USA), and opened one franchise. We expect these acquisitions to add over $2.7 billion in revenues. Our acquisition targets typically have higher expenses as a percentage of gross profit than our existing store base. Due to the number of acquisitions and their relative size in 2014, our selling, general and administrative (“SG&A”) expense as a percentage of gross profit increased to 68.4% in 2014 from 67.7% in 2013. Adjusting for non-core items in both 2014 and 2013, our adjusted SG&A expense as a percentage of gross profit in 2014 was 67.7%, compared to 67.2% in 2013. See “Non-GAAP Reconciliations” for more details.

We are targeting SG&A as a percentage of gross profit in the lower 70% range, for the full year of 2015, primarily due to the inclusion of a full year of DCH Auto Group’s operations in our results. Over time, we seek to reduce this percentage to the upper 60% range, a goal we set in the second half of 2013 and achieved during the first three quarters of 2014.

We monitor how efficiently we leverage our cost structure by evaluating throughput, which is calculated as the percentage of incremental gross profit dollars we retain after deducting increases in SG&A expense. For the years ended December 31, 2014 and 2013, our incremental throughput was 29.4% and 41.4%, respectively. Adjusting for non-core items, our adjusted throughput in 2014 was 30.5% and in 2013 was 46.2%. See “Non-GAAP Reconciliations” for additional information.

Throughput contributions for newly opened or acquired stores are on a “first dollar” basis for the first twelve months of operations and typically reduce overall throughput. In the first year of operation, a store’s throughput is equal to the inverse of its SG&A as a percentage of gross profit. For example, a store which achieves SG&A as a percentage of gross profit of 70% will have throughput of 30% in the first year of operation.

We acquired 35 stores and opened one new store in 2014. In 2013, we acquired six stores and opened one new store. Adjusting to exclude these locations and other non-core adjustments, our throughput contribution on a same store basis was 42.9% and 51.4% for the years ended December 31, 2014 and 2013, respectively. We continue to target a same store throughput contribution of 45% to 50% in 2015.

We continuously evaluate our portfolio of franchises to balance our brand mix, minimize exposure to any one franchise and achieve financial returns. In the past three years we acquired or opened 48 stores. Additionally, we divest stores that are not meeting our financial return requirements or other performance expectations. Divestiture activity generated $17.2 million during the past three years as we sold three stores.

New Vehicles

In 2014, we sold 91,104 new vehicles, generating 24% of our gross profit for the year. New vehicle sales have the potential to create incremental profit opportunities through manufacturer incentives, resale of trade-in vehicles, sale of third-party financing, vehicle service and insurance contracts, and future service and repair work.

In 2014, we represented 30 domestic and import brands ranging from economy to luxury cars, SUVs, crossovers, minivans and light trucks.

Manufacturer	**Percent of 2014 New Vehicle Revenue**		**Percent of 2014 New Vehicle Gross Profit**	
Chrysler, Jeep, Dodge, Ram	26.6	%	23.3	%
Chevrolet, Cadillac, GMC, Buick	14.3		16.0	
Toyota, Scion	13.4		12.0	
Honda, Acura	10.5		11.6	
BMW, MINI	9.7		11.7	
Subaru	6.6		3.7	
Ford, Lincoln	6.1		5.5	
Mercedes, smart	3.4		5.0	
Nissan	2.7		2.9	
Volkswagen, Audi	2.6		3.2	
Hyundai	1.9		2.8	
Kia	0.8		0.7	
Lexus	0.6		0.5	
Porsche	0.4		0.7	
Mazda	0.2		0.2	
Mitsubishi	0.1		0.1	
Fiat	0.1		0.1	
Volvo	*		*	
Total	100.0	%	100.0	%

* Less than 0.1%

We purchase our new car inventory directly from manufacturers, who generally allocate new vehicles to stores based on availability, monthly sales and market area. Accordingly, we rely on the manufacturers to provide us with vehicles that meet consumer demand at suitable locations, with appropriate quantities and prices. However, if high demand vehicles, or vehicles with certain option configurations are in short supply, we exchange vehicles with other automotive retailers and between our own stores to accommodate customer demand and to balance inventory.

Used Vehicles

At each new vehicle store, we also sell used vehicles. In 2014, retail used vehicle sales generated 22% of our gross profit.

Our used vehicle operations give us an opportunity to:

- generate sales to customers unable or unwilling to purchase a new vehicle;
- generate sales of vehicle brands other than the store’s new vehicle franchise(s);
- increase vehicle sales by aggressively pursuing customer trade-ins; and
- increase finance and insurance revenues and service and parts sales.

We classify our used vehicles in three categories: manufacturer certified pre-owned used vehicles; late model, lower-mileage vehicles; and value autos. We offer manufacturer certified pre-owned used vehicles at most of our franchised dealerships. These vehicles undergo additional reconditioning and receive an extended factory-provided warranty. Late model, lower-mileage vehicles are reconditioned and offer a Lithia certified warranty. Value autos are older, higher mileage vehicles that undergo a safety check and a lesser degree of reconditioning. Value autos are offered to customers who desire a less expensive vehicle or a lower monthly payment.

We acquire our used vehicles through customer trade-ins, purchases from non-Lithia stores, independent vehicle wholesalers and private parties, and at closed auctions.

Our near-term goal for used vehicles is to retail an average of 75 units per store per month. In 2014, our stores sold an average of 56 retail used units per month. We believe used vehicles represent a significant area for organic growth. As new vehicle sales growth rates return to historical levels and we continue our focus on growing used retail sales, we believe our long-term target is achievable.

Wholesale transactions result from vehicles we have acquired via trade-in from customers or vehicles we have attempted to sell via retail that we elect to dispose of due to inventory age or other factors. As part of our used vehicle strategy, we have concentrated on directing more lower-priced, older vehicles to retail sale rather than wholesale disposal.

Vehicle Financing, Service Contracts and Other Products

As part of the vehicle sales process, we assist in arranging customer financing options as well as offer extended warranties, insurance contracts and vehicle and theft protection products. The sale of these items generated 23% of our gross profit.

We believe that arranging financing is an important part of our ability to sell vehicles and related products and services. Our sales personnel and finance and insurance managers receive training in securing customer financing and possess extensive knowledge of available financing alternatives. We attempt to arrange financing for every vehicle we sell and we offer customers financing on a “same day” basis, giving us an advantage, particularly over smaller competitors who do not generate enough sales to attract our breadth of finance sources.

We earn a commission on each finance, service and insurance contract we write and subsequently sell to a third-party. We normally arrange financing for customers by selling the contracts to outside sources on a non-recourse basis to avoid the risk of default.

We arranged financing on 78% of the vehicles we sold during 2014 and 2013. Our presence in multiple markets and changes in technology surrounding the credit application process have allowed us to utilize a larger network of lenders across a broader geographic area. Additionally, we continue to see the availability of consumer credit expand with lenders increasing the loan-to-value amount available to most customers. These shifts afford us the opportunity to sell additional or more comprehensive products, while remaining within a loan-to-value framework acceptable to our retail customer lenders.

We also market third-party extended warranty contracts, insurance contracts and vehicle and theft protection products to our customers. These products and services yield higher profit margins than vehicle sales and contribute significantly to our profitability. Extended warranty and service contracts for vehicles provide coverage for certain repairs beyond the duration or scope of the manufacturer’s warranty. We believe the sale of extended warranties, service contracts and vehicle and theft protection products increases our service and parts business. Additionally, these products build a customer base for future repair work to our locations.

When customers finance an automobile purchase, we offer them life, accident and disability insurance coverage, as well as guaranteed auto protection (“gap”) coverage that provides protection from loss incurred by the difference in the amount owed and the amount received under a comprehensive insurance claim. We receive a commission on each policy sold.

We offer a lifetime lube, oil and filter (“LOF”) service, which, in 2014, was purchased by 35% of our total new and used vehicle buyers. This service, where customers prepay for their LOF services, helps us retain customers by building customer loyalty and provides opportunities for selling additional routine maintenance items and generating repeat service business. In 2014, we sold an average of $50 of additional maintenance on each lifetime LOF service we performed.

Service, Body and Parts

In 2014, our service, body and parts operations generated 30% of our gross profit. Our service, body and parts operations are an integral part of establishing customer loyalty and contribute significantly to our overall revenue and profits. We provide parts and service for the new vehicle brands sold by our stores, as well as service most other makes and models.

The service and parts business provides important repeat revenues to our stores, which we seek to grow organically. Customer pay revenues represent sales for vehicle maintenance and service performed on other makes and models, as well as vehicles that have fallen outside of the manufacturer warranty coverage period. We believe increasing our product and service offerings for customers differentiates us. More diversified services with access to a variety of parts enable us to provide a better experience for our customers. Our service and parts revenues benefit from the increases we have seen in new vehicle sales over the last few years as there are a greater number of late model vehicles in operation, which tend to visit franchised dealership locations more frequently than older vehicles due to the manufacturer warranty period. Additionally, certain franchises provide routine maintenance, such as oil changes, for two to four years after a vehicle is sold, which provides for future warranty work.

We focus on growing our customer pay business and market our parts and service products by notifying owners when their vehicles are due for periodic service. This encourages preventive maintenance rather than post-breakdown repairs. The number of customers who purchase our lifetime LOF service helps to improve customer loyalty and provides opportunities for repeat parts and service business.

Revenues from the service and parts departments are particularly important during economic downturns, when owners tend to repair their existing vehicles rather than buy new vehicles. This partially mitigates the effects of a drop in new vehicle sales that may occur in a recessionary economic environment.

We believe body shops provide an attractive opportunity to grow our business, and we continue to evaluate potential locations to expand. We currently operate 18 collision repair centers: five in Texas; five in Oregon; two in Idaho; and one each in Alaska, Washington, Montana, Iowa, Nevada and New Jersey.

Segments

We report three business segments: Domestic, Import and Luxury. For certain financial information by segment, see Notes 1 and 19 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report.

Marketing

We emphasize customer satisfaction and we realize that customer retention is critical to our success. We want our customers' experiences to be satisfying so that they refer us to their families and friends. We utilize an owner marketing strategy consisting of database analysis, email, traditional mail and phone contact to maintain regular communication and solicit feedback.

To increase awareness and traffic at our stores, we use a combination of traditional, digital and social media to reach potential customers. Total advertising expense, net of manufacturer credits, was $46.7 million in 2014, $39.6 million in 2013 and $31.9 million in 2012. In 2014, approximately 38% of those funds were spent in traditional media and 62% were spent in digital and owner communications and other media outlets. In all of our communications, we seek to convey the promise of a positive customer experience, competitive pricing and wide selection.

Certain advertising and marketing expenditures are offset by manufacturer cooperative programs which require us to submit requests for reimbursement to manufacturers for qualifying advertising expenditures. These advertising credits are not tied to specific vehicles and are earned as qualifying expenses are incurred. These reimbursements are recognized as a reduction of advertising expense. Manufacturer cooperative advertising credits were $16.3 million in 2014, $11.8 million in 2013 and $9.6 million in 2012.

Many people now shop online before visiting our stores. We maintain websites for all of our stores and corporate sites (Lithia.com and DCHAuto.com) to generate customer leads for our stores.

Our websites enable our customers to:

- locate our stores and identify the new vehicle brands sold at each store;
- search new and pre-owned vehicle inventory;
- view current pricing and specials;
- calculate payments for purchase or lease;
- obtain a value for their vehicle to trade or sell to us;
- submit credit applications;
- shop for and order manufacturers' vehicle parts;
- schedule service appointments; and
- provide feedback about their experience.

We also maintain mobile versions of our websites and a mobile application in anticipation of greater adoption of mobile technology. Mobile traffic now accounts for 29% of our web traffic and all of the sites utilize responsive technology to enhance mobile and tablet usage.

We post our inventory on major new and used vehicle listing services (cars.com, autotrader.com, kbb.com, edmunds.com, eBay, craigslist, etc.) to reach online shoppers. We also employ search engine optimization, search engine marketing and online display advertising (including re-targeting) to reach more online prospects.

Social influence marketing represents a cost-effective method to enhance our corporate reputation and our stores' reputations, and increase vehicle sales and service. We deploy tools and training to our employees in ways that will help us listen to our customers and create more advocates for Lithia.

We also encourage our stores to give back to their local communities through financial and non-financial participation in local charities and events. Through Lithia4Kids and DCH Teen Safe Driving Foundation, our initiatives to increase employee volunteerism and community involvement, we focus the impact of our contributions on projects that support opportunities and the safety and development of young people.

Franchise Agreements

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

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

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

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

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

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

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

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

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

Competition

The retail automotive business is highly competitive. Currently, there are approximately 17,800 dealers in the United States, many of whom are independent stores managed by individuals, families or small retail groups. We compete primarily with other automotive retailers, both publicly- and privately-held.

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

We are larger and have more financial resources than most private automotive retailers with which we currently compete in the majority of our regional markets. We compete directly with retailers with similar or greater resources in markets such as metropolitan New York, the greater Los Angeles area, Seattle, Washington; Spokane, Washington; Anchorage, Alaska; Portland, Oregon and the San Francisco Bay Area, California. If we enter other new markets, we may face competitors that are larger or have access to greater financial resources. We do not have any cost advantage in purchasing new vehicles from manufacturers. We rely on advertising and merchandising, pricing, our customer guarantees and sales model, our sales expertise, service reputation and the location of our stores to sell new vehicles.

Regulation

Automotive and Other Laws and Regulations

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

Our financing activities with customers are subject to numerous federal, state and local laws and regulations. In 2013 and 2014, there was an increase in activity related to oversight of consumer lending by the Consumer Financial Protection Bureau (CFPB), which has broad regulatory powers. The CFPB does not have direct authority over automotive dealers; however, its regulation of larger automotive finance companies and other financial institutions could affect our financing activities. Claims arising out of actual or alleged violations of law may be asserted against us or our stores by individuals, a class of individuals, or governmental entities. These claims may expose us to significant damages or other penalties, including revocation or suspension of our licenses to conduct store operations and fines.

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

Environmental, Health, and Safety Laws and Regulations

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

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

Administration of the United States Department of Labor and related state agencies also apply.

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

We incur certain costs to comply with environmental, health and safety laws and regulations in the ordinary course of our business. We do not anticipate, however, that the costs of such compliance will have a material adverse effect on our business, results of operations, cash flows or financial condition, although such outcome is possible given the nature of our operations and the extensive environmental, public health and safety regulatory framework. We may become aware of minor contamination at certain of our facilities, and we conduct investigations and remediation at properties as needed. In certain cases, the current or prior property owner may conduct the investigation and/or remediation or we have been indemnified by either the current or prior property owner for such contamination. We do not currently expect to incur significant costs for the remediation. However, no assurances can be given that material environmental commitments or contingencies will not arise in the future, or that they do not already exist but are unknown to us.

Employees

As of December 31, 2014, we employed approximately 8,827 persons on a full-time equivalent basis.

Seasonality and Quarterly Fluctuations

Historically, our sales have been lower in the first and fourth quarters of each year due to consumer purchasing patterns during the holiday season, inclement weather in certain of our markets and the reduced number of business days during the holiday season. As a result, financial performance is expected to be lower during the first and fourth quarters than during the second and third quarters of each fiscal year. More recently, our franchise diversification and cost control efforts have moderated the significance of our seasonality. We believe that interest rates, levels of consumer debt, consumer confidence and manufacturer sales incentives, as well as general economic conditions, also contribute to fluctuations in sales and operating results.

Available Information and NYSE Compliance

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (“SEC”) under the Securities Exchange Act of 1934 (the “Exchange Act”). You may inspect and copy our reports, proxy statements, and other information filed with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The SEC maintains an Internet Web site at http://www.sec.gov where you may access copies of our SEC filings. We also make available free of charge, on our website at www.lithia.com, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after they are filed electronically with the SEC. The information found on our website is not part of this Annual Report on Form 10-K. You may also obtain copies of these reports by contacting Investor Relations at 877-331-3084.

Item 1A. Risk Factors

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

Risks related to our business

Our business will be harmed if overall consumer demand suffers from a severe or sustained downturn.

Our business is heavily dependent on consumer demand and preferences. A downturn in overall levels of consumer spending may materially and adversely affect our revenues. Retail vehicle sales are cyclical and historically have experienced periodic downturns characterized by oversupply and weak demand. These cycles are often dependent on general economic conditions and consumer confidence, as well as the level of discretionary personal income and credit availability. Economic conditions may be anemic for an extended period of time, or deteriorate in the future. This would have a material adverse effect on our retail business, particularly sales of new and used automobiles.

Our business may be adversely affected by unfavorable conditions in our local markets, even if those conditions are not prominent nationally.

Our performance is subject to local economic, competitive and other conditions prevailing in our various geographic areas. Our dealerships are currently located in limited markets in 14 states, with sales in the top three states accounting for approximately 57% of our revenue in 2014. Our results of operations, therefore, depend substantially on general economic conditions and consumer spending levels in those markets and could be materially adversely affected to the extent these markets experience sustained economic downturns regardless of improvements in the U.S. economy overall.

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

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

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

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

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

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

Increasing fuel prices change consumer demand. Significant increases in fuel prices can be expected to reduce vehicle sales.

Historically, in times of rapid increase in crude oil and fuel prices, sales of vehicles have dropped, particularly in the short term, as the economy slows, consumer confidence wanes and fuel costs become more prominent to the consumer’s buying decision. In sustained periods of higher fuel costs, consumers who do purchase vehicles tend to prefer smaller, more fuel efficient vehicles (which typically have lower margins) or hybrid vehicles (which can be in limited supply during these periods).

Additionally, a significant portion of our new vehicle revenue and gross profit is derived from domestic manufacturers. These manufacturers have historically sold a higher percentage of trucks and SUVs than import or luxury brands. They may, therefore, experience a more significant decline in sales in the event that fuel prices increase.

A decline of available financing in the lending market has adversely affected, and may continue to adversely affect, our vehicle sales volume.

A significant portion of vehicle buyers finance their purchases of automobiles. Sub-prime lenders have historically provided financing for consumers who, for a variety of reasons, including poor credit histories and lack of down payment, do not have access to more traditional finance sources. If lenders tighten their credit standards or there is a decline in the availability of credit in the lending market, the ability of these consumers to purchase vehicles could be limited, which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

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

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

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

There can be no assurance that we will be able to successfully address the risks described above or those of the current economic circumstances and sales environment.

Our success depends in large part upon the overall demand for the particular lines of vehicles that each of our stores sell and the ability of the manufacturers to continue to deliver high quality, defect-free vehicles.

Demand for our primary manufacturers' vehicles, as well as the financial condition, management, marketing, production and distribution capabilities of these manufacturers, can significantly affect our business. Events that adversely affect a manufacturer's ability to timely deliver new vehicles may adversely affect us by reducing our supply of popular new vehicles and leading to lower sales in our stores during those periods than would otherwise occur. We depend on our manufacturers to deliver high-quality, defect-free vehicles. If manufacturers experience quality issues, our financial performance may be adversely impacted. In addition, the discontinuance of a particular brand could negatively impact our revenues and profitability.

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

Vehicle manufacturers would be adversely affected by economic downturns or recessions, adverse fluctuations in currency exchange rates, significant declines in the sales of their new vehicles, increases in interest rates, declines in their credit ratings, port closures, labor strikes or similar disruptions (including within their major suppliers), supply shortages or rising raw material costs, rising employee benefit costs, adverse publicity that may reduce consumer demand for their products, product defects, vehicle recall campaigns, litigation, poor product mix or unappealing vehicle design, or other adverse events. These and other risks could materially adversely affect any manufacturer and limit its ability to profitably design, market, produce or distribute new vehicles, which, in turn, could materially adversely affect our business, results of operations, financial condition and cash flows. In February 2015, for example, Honda and other manufacturers announced they would curtail car production in North America due to parts shortages caused by port closures and work slowdowns on the West Coast; if these continue and a materially lower number of Hondas are manufactured, our supply and sales of Hondas may materially decrease.

Additionally, federal and certain state laws mandate minimum levels of vehicle fuel economy and establish emission standards. These levels and standards could be increased in the future, including the required use of renewable energy sources. Such laws often increase the costs of new vehicles, which would be expected to reduce demand. Further, changes in these laws could result in fewer vehicles available for sale by manufacturers unwilling or unable to comply with the higher standards.

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

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

- customer rebates;
- dealer incentives on new vehicles;
- special financing rates on certified, pre-owned cars;
- below-market financing on new vehicles and special leasing terms; and
- sponsorship of used vehicle sales by authorized new vehicle dealers.

Our financial condition could be materially adversely impacted by a discontinuation or change in our manufacturers' or distributors' incentive programs. In addition, certain manufacturers use a dealership's manufacturer-determined customer satisfaction index, or "CSI", score as a factor governing participation in incentive programs. To the extent we do not meet minimum score requirements, we may be precluded from receiving certain incentives, which could materially adversely affect our business, results of operations, financial condition and cash flows.

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

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

Each of our stores operates pursuant to a Franchise Agreement with each of the respective manufacturers for which it serves as franchisee. Manufacturers exert significant control over our stores through the terms and conditions of their franchise agreements. Such agreements contain provisions for termination or non-renewal for a variety of causes, including service retention, facility compliance, customer satisfaction and sales and financial performance. From time to time, certain of our stores have failed to comply with certain provisions of their franchise agreements, and we cannot assure you that our stores will be able to comply with these provisions in the future. In addition, actions taken by a manufacturer to exploit its bargaining position in negotiating the terms of renewals of franchise agreements or otherwise could also have a material adverse effect on our revenues and profitability. If a manufacturer terminates or fails to renew one or more of our significant franchise agreements or a large number of our franchise agreements, such action could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

Manufacturer stock ownership restrictions may impair our ability to maintain or renew franchise agreements or issue additional equity.

Certain of our Franchise Agreements prohibit transfers of ownership interests of a store or, in selected cases, its parent. The most prohibitive restriction which could be imposed by various manufacturers, including Honda/Acura, Hyundai, Mazda and Nissan, provides that, under certain circumstances, we may lose a franchise if a person or entity acquires an ownership interest in us above a specified level (ranging from 20% to 50% depending on the particular manufacturer’s restrictions and falling as low as 5% if another vehicle manufacturer is the entity acquiring the ownership interest) without the approval of the applicable manufacturer. Other restrictions in certain Franchise Agreements with manufacturers, including Ford, GM, Honda/Acura and Toyota, provide that a change in control in the Company without prior consent is a violation of our franchise or dealer framework agreement. Transactions in our stock by our stockholders or prospective stockholders are generally outside of our control and may result in the termination or non-renewal of one or more of our franchises or impair our ability to negotiate new franchise agreements for dealerships we desire to acquire in the future, which may have a material adverse effect on our business, results of operations, financial condition and cash flows. These restrictions may also prevent or deter a prospective acquirer from acquiring control of us or otherwise adversely affect the market price of our Class A common stock or limit our ability to restructure our debt obligations.

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

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

In addition, these laws restrict the ability of automobile manufacturers to directly enter the retail market in the future. If manufacturers obtain the ability to directly retail vehicles and do so in our markets, such competition could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

Import product restrictions and foreign trade risks may impair our ability to sell foreign vehicles profitably.

A significant portion of the vehicles we sell, as well as certain major components of such vehicles, are manufactured outside the United States. Accordingly, we are affected by import and export restrictions of various jurisdictions and are dependent, to a certain extent, on general socio-economic conditions in, and political relations with, a number of foreign countries. Additionally, fluctuations in currency exchange rates may increase the price and adversely affect our sales of vehicles produced by foreign manufacturers. Imports into the United States may also be adversely affected by increased transportation costs and tariffs, quotas or duties, any of which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Environmental, health or safety regulations could have a material adverse effect on our business, results of operations, financial condition and cash flows or cause us to incur significant expenditures.

We are subject to various federal, state and local environmental, health and safety regulations that govern items such as the generation, storage, handling, use, treatment, recycling, transportation, disposal and remediation of hazardous material and the emission and discharge of hazardous material into the environment. Under certain environmental regulations or pursuant to signed private contracts, we could be held responsible for all of the costs relating to any contamination at our present, or our previously owned, facilities, and at third party waste disposal sites. We are aware of minor contamination at certain of our facilities, and we routinely conduct investigations and/or remediation at certain properties. The current level of contamination is such that we do not expect to incur significant costs for the remediation. In certain cases, the current or prior property owner is conducting the investigation and/or remediation or we have been indemnified by either the current or prior property owner for such contamination. There can be no assurance that these owners will remediate, or continue to remediate, these properties or pay, or continue to pay, pursuant to these indemnities. We are also required to obtain permits from governmental authorities for certain operations. If we violate or fail to fully comply with these regulations or permits, we could be fined or otherwise sanctioned by regulators.

Environmental, health and safety regulations are becoming increasingly stringent. There can be no assurance that the cost of compliance with these regulations will not result in a material adverse effect on our results of operations or financial condition. Further, no assurances can be given that additional environmental, health or safety matters will not arise or new conditions or facts will not develop in the future at our currently or formerly owned or operated facilities, or at sites that we may acquire in the future, which will require us to incur significant expenditures.

With the breadth of our operations and volume of consumer and financing transactions, compliance with the many applicable federal and state laws and regulations cannot be assured. New regulations are enacted on an ongoing basis. These regulations may impact our profitability and require continuous training and vigilance. Fines, judgments and administrative sanctions can be severe.

We are subject to federal, state and local laws and regulations in each of the 14 states where we have stores. New laws and regulations are enacted on an ongoing basis. With the number of stores we operate, the number of personnel we employ and the large volume of transactions we handle, it is likely that technical mistakes will be made. These regulations affect our profitability and require ongoing training. Current practices in stores may become prohibited. We are responsible for ensuring that continued compliance with laws is maintained. If there are unauthorized activities, the state and federal authorities have the power to impose civil penalties and sanctions, suspend or withdraw dealer licenses or take other actions. These actions could materially impair our activities or our ability to acquire new stores in those states where violations occurred. Further, private causes of action on behalf of individuals or a class of individuals could result in significant damages or injunctive relief.

Compliance with the variety of federal, state and local regulations cannot be assured. Claims may arise out of actual or alleged violations of these various laws and regulations which may be asserted against us through class actions or by governmental entities in civil or criminal investigations and proceedings.

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

Governmental regulations related to fuel economy standards and greenhouse gases may have an adverse impact on the ability of vehicle manufacturers to cost-effectively produce vehicles or design vehicles desired by customers. These regulations may also impact our ability to sell these vehicles at affordable prices.

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

Government regulations and compliance costs may adversely affect our business, and the failure to comply could have a material adverse effect on our results of operations.

We are, and expect to continue to be, subject to a wide range of federal, state and local laws and regulations, including local licensing requirements. These laws regulate the conduct of our business, including:

- motor vehicle and retail installment sales practices;
- leasing;
- sales of finance, insurance and vehicle protection products;
- consumer credit;
- deceptive trade practices;
- consumer protection;
- consumer privacy;
- money laundering;
- advertising;
- land use and zoning;
- health and safety;
and
- employment practices.

In every state where we operate, we must obtain certain licenses issued by state authorities to operate our businesses, including dealer, sales, finance and insurance-related licenses. State laws also regulate our advertising, operating, financing, employment and sales practices. Other laws and regulations include state franchise laws and regulations and laws and regulations applicable to new and used automobile dealers. In some states, some of our practices must be approved by regulatory agencies which have broad discretion. The enactment of new laws and regulations that materially impair or restrict our sales, finance and insurance or other operations could have a material adverse effect on our business, results of operations, financial condition, cash flows and prospects.

Our financing activities are subject to federal truth-in-lending, consumer leasing and equal credit opportunity laws and regulations, as well as state and local motor vehicle finance laws, installment finance laws, insurance laws, usury laws and other installment sales laws and regulations. Some states regulate finance, documentation and administrative fees that may be charged in connection with vehicle sales. Claims arising out of actual or alleged violations of law may be asserted against us or our dealerships by individuals or governmental entities and may expose us to significant damages or other penalties, including revocation or suspension of our licenses to conduct dealership operations and fines. In recent years, private plaintiffs and state attorneys general in the United States have increased their scrutiny of advertising, sales, and finance and insurance activities in the sale and leasing of motor vehicles. These activities have led many lenders to limit the amounts that may be charged to customers as fee income for these activities. If these or similar activities were to significantly restrict our ability to generate revenue from arranging financing for our customers, we could be adversely affected.

The Dodd-Frank Wall Street Reform and Consumer Protection Act established the Consumer Financial Protection Bureau (CFPB), which has broad regulatory powers. Although the CFPB may not exercise its authority over an automotive dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both, the Dodd-Frank Act and future regulatory actions by this bureau could lead to additional, indirect regulation of automotive dealers through its regulation of automotive finance companies and other financial institutions, and it could affect our arrangements with lending sources.

In March 2013, the CFPB issued a bulletin suggesting that auto dealers who arrange credit through outside parties may be participating in a credit decision such that they are subject to the Equal Credit Opportunity Act, including its anti-discrimination provisions. In particular, the CFPB highlighted that the payment to a dealer of the excess of the interest rate the dealer negotiates with the customer over the rate at which the lender is willing to provide financing may encourage pricing disparities on the basis of race, national origin, or potentially other prohibited bases. This bulletin may affect the willingness of outsider lenders to continue these practices, and heightened focus on these arrangements may affect our relationships and agreements, including our indemnification obligations, with lenders. The level of commissions paid by lenders to us for arranging financing may change due to this bulletin. These factors could adversely affect our business.

The vehicles we sell are also subject to the National Traffic and Motor Vehicle Safety Act, the Magnuson-Moss Warranty Act, Federal Motor Vehicle Safety Standards promulgated by the United States Department of Transportation and various state motor vehicle regulatory agencies. The imported automobiles we purchase are subject to U.S. customs duties and, in the ordinary course of our business, we may, from time to time, be subject to claims for duties, penalties, liquidated damages or other charges.

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

Likewise, employees and former employees are protected by a variety of employment-related laws and regulations relating to, among other things, wages and discrimination. Allegations of a violation could subject us to individual claims or consumer class actions, administrative investigations or adverse publicity. Such actions could expose us to substantial monetary damages and legal defense costs, injunctive relief and civil fines and penalties, and damage our reputation and sales.

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

A significant judgment against us, the loss of a significant license or permit or the imposition of a significant fine could have a material adverse effect on our business, financial condition and future prospects. We further expect that, from time to time, new laws and regulations, particularly in the labor, employment, environmental and consumer protection areas will be enacted, and compliance with such laws, or penalties for failure to comply, could significantly increase our costs.

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

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

Our information technology systems, and those of our vendors, may be vulnerable to data protection breaches and cyber-attacks beyond our control and we may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. We invest in security technology to protect our data and business processes against these risks. We also purchase insurance to mitigate the potential financial impact of these risks. Despite these precautions, we cannot assure that a breach will not occur and any breach or successful attack could have a negative impact on our operations or business reputation.

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

General

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

Limitations on our capital resources

The acquisition of additional stores will require substantial capital investment. Limitations on our capital resources would restrict our ability to complete new acquisitions.

We have financed our past acquisitions from a combination of the cash flow from our operations, borrowings under our credit arrangements, issuances of our common stock and proceeds from private debt offerings. The use of any of these financing sources could have the effect of reducing our earnings per share. We may not be able to obtain financing in the future due to the market price of our Class A common stock and overall market conditions. Furthermore, using cash to complete acquisitions could substantially limit our operating or financial flexibility.

Substantially all of the assets of our dealerships are pledged to secure the indebtedness under our credit facility and our other floor plan financing indebtedness. These pledges may limit our ability to borrow from other sources in order to fund our acquisitions.

Manufacturers

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

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

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

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

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

Acquisition risks

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

- failing to assimilate the operations and personnel of acquired dealerships;
- strain on our existing systems, procedures, structures and personnel;
- failing to achieve predicted sales levels;
- incurring significantly higher capital expenditures and operating expenses, which could substantially limit our operating or financial flexibility;
- entering new, unfamiliar markets;
- encountering undiscovered liabilities and operational difficulties at acquired dealerships;
- disrupting our ongoing business;
- diverting our management resources;
- failing to maintain uniform standards, controls and policies;
- impairing relationships with employees, manufacturers and customers as a result of changes in management;
- incurring increased expenses for accounting and computer systems, as well as integration difficulties;
- failing to obtain a manufacturer's consent to the acquisition of one or more of its dealership franchises or renew the franchise agreement on terms acceptable to us;
- incorrectly valuing entities to be acquired; and
- Incurring additional facility renovation costs or other expenses required by the manufacturer.

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

Consummation and competition

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

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

Operating and financial condition

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

Limitations on our capital resources

We make a substantial capital investment when we acquire dealerships. We finance these acquisitions with cash flows from our operations, borrowings under our credit arrangements, proceeds from mortgage financing and the issuance of shares of Class A common stock. The size of our recent acquisition activity magnifies risks associated with debt service obligations. These risks include potential lower earnings per share, our inability to pay dividends and potential negative impacts to the debt covenants we negotiated under our credit agreement. If we fail to meet the covenants in our credit facility, or if some other event occurs that results in a default or an acceleration of our repayment obligations under our credit agreements, we may not be able to refinance our debt on terms acceptable to us or at all. Furthermore, using cash to complete acquisitions could substantially limit our operating or financial flexibility.

We are subject to substantial risk of loss under our various self-insurance programs including property and casualty, open lot vehicle coverage, workers’ compensation and employee medical coverage.

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

Under our self-insurance programs, we retain various levels of aggregate loss limits, per claim deductibles and claims-handling expenses. Costs in excess of these retained risks may be insured under various contracts with third-party insurance carriers. As of December 31, 2014, we had total reserve amounts associated with these programs of $23.2 million. The level of risk we retain may change in the future as insurance market conditions or other factors affecting the economics of our insurance purchasing change. Although we believe we have sufficient insurance, we cannot assure that we will not be exposed to uninsured or underinsured losses that could have a material adverse effect on our business, financial condition, results of operations or cash flows.

Indefinite-lived intangible assets, which consist of goodwill and franchise value, comprise a meaningful portion of our total assets ($350.3 million, or 12% of our total assets, at December 31, 2014). We must assess our indefinite-lived intangible assets for impairment at least annually, which may result in a non-cash write-down of franchise rights or goodwill.

Indefinite-lived intangible assets are subject to impairment assessments at least annually (or more frequently when events or circumstances indicate that an impairment may have occurred) by applying a fair-value based test. Our principal intangible assets are goodwill and our rights under our Franchise Agreements with vehicle manufacturers. The risk of impairment charges associated with goodwill increases if there are declines in our market capitalization, profitability or cash flows. The risk of impairment charges associated with franchise value increases if operating losses are suffered at those stores, if a manufacturer files for bankruptcy or if the stores are closed. Impairment charges result in non-cash write-downs of the affected franchise values or goodwill. Furthermore, impairment charges could have an adverse impact on our ability to satisfy the financial ratios or other covenants under our debt agreements and could have a material adverse impact on our business, results of operations, financial condition and cash flows.

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

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

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

In addition, our loan agreements contain covenants that limit our discretion with respect to business matters, including incurring additional debt, acquisition activity or disposing of assets. Other covenants are financial in nature, including current ratio, fixed charge coverage and leverage ratio calculations. A breach of any of these covenants could result in a default under the applicable agreement. In addition, a default under one agreement could result in a default and acceleration of our repayment obligations under the other agreements under the cross-default provisions in such other agreements.

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

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

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

As of December 31, 2014, including the effect of interest rate swaps, approximately 84.5% of our total debt was variable rate. The majority of our variable rate debt is indexed to the one-month LIBOR rate. The current interest rate environment is at historically low levels, and interest rates will likely increase in the future. In the event interest rates increase, our borrowing costs may increase substantially. Additionally, fixed rate debt that matures may be renewed at interest rates significantly higher than current levels. As a result, this could have a material adverse impact on our business, results of operations, financial condition and cash flows.

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

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

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

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

Our success depends to a significant degree on the efforts and abilities of our senior management, particularly Bryan B. DeBoer, our Director, President and Chief Executive Officer, and Christopher S. Holzshu, our Senior Vice President and Chief Financial Officer. Further, we have identified Bryan B. DeBoer in most of our store franchise agreements as the individual who controls the franchises and upon whose financial resources and management expertise the manufacturers may rely when awarding or approving the transfer of any franchise. If we lose these key personnel, our business may suffer.

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

The sole voting control of our company is currently held by Sidney B. DeBoer, who may have interests different from our other shareholders. Further, 1.8 million shares of the 2.6 million shares of our Class B common stock held by Lithia Holding Company, LLC ("Lithia Holding") are pledged to secure indebtedness of Lithia Holding. The failure to repay the indebtedness could result in the sale of such shares and the loss of such control, which may violate agreements with certain manufacturers.

Sidney B. DeBoer, our Founder and Executive Chairman, is the sole managing member of Lithia Holdings, which holds all of the outstanding shares of our Class B common stock. A holder of Class B common stock is entitled to ten votes for each share held, while a holder of Class A common stock is entitled to one vote per share held. On most matters, the Class A and Class B common stock vote together as a single class. As of March 2, 2015, Lithia Holding controlled, and Mr. DeBoer had the authority to vote, approximately 52% of the aggregate number of votes eligible to be cast by shareholders for the election of directors and most other shareholder actions. In addition, Mr. DeBoer may prevent a change in control of our Company and make certain transactions more difficult or impossible. The interest of Mr. DeBoer may not always coincide with our interests as a Company or the interest of other shareholders. Accordingly, Mr. DeBoer could cause us to enter into transactions or agreement that other shareholders would not approve or make decisions with which other shareholders may disagree.

Lithia Holding has pledged 1.8 million shares of our Class B common stock to secure a loan from U.S. Bank National Association. If Lithia Holding is unable to repay the loan, the bank could foreclose on the Class B common stock, which would result in the automatic conversion of such shares to Class A common stock and a change in control of our Company. If this change is not consented to by the manufacturers, we would have a technical violation under most of the dealer sales and service agreements held by us. In addition, the market price of our Class A common stock could decline if the bank foreclosed on the pledged stock and subsequently sold such stock in the open market.

Risks related to investing in our Class A common stock

Future sales of our Class A common stock in the public market could adversely impact the market price of our Class A common stock.

As of March 2, 2015, we had 2,592,302 shares of Class A common stock reserved for issuance under our equity plans (including our employee stock purchase plan). As of March 2, 2015, a total of 575,350 shares related to outstanding restricted stock, restricted stock units and options (with the options having a weighted average exercise price of $6.79 per share and options to purchase 6,834 shares being exercisable). In addition, we had 2,562,231 shares of Class B common stock outstanding convertible into 2,562,231 shares of Class A common stock.

In the future, we may issue additional shares of our Class A common stock to raise capital or effect acquisitions. We cannot predict the size of future sales or issuance or the effect, if any, they may have on the market price of our Class A common stock. The sale of substantial amounts of Class A common stock, or the perception that such sales may occur, could adversely affect the market price of our Class A common stock and impair our ability to raise capital through the sale of additional equity securities, or to sell equity at a price acceptable to us.

Volatility in the market price and trading volume of our Class A common stock could adversely impact the value of the shares of our Class A common stock.

The stock market in recent years has experienced significant price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies like ours. These broad market factors may materially reduce the market price of our Class A common stock, regardless of our operating performance. The market price of our Class A common stock, which has experienced large price and volume fluctuations over the last five years, could continue to fluctuate significantly for many reasons, including in response to the risks described herein or for reasons unrelated to our operations, such as:

- reports by industry analysts;
- changes in financial estimates by securities analysts or us, or our inability to meet or exceed securities analysts', investors' or our own estimates or expectations;
- actual or anticipated sales of common stock by existing shareholders or us;
- capital commitments;
- additions or departures of key personnel;
- developments in our business or in our industry;
- a prolonged downturn in our industry;
- general market conditions, such as interest or foreign exchange rates, commodity and equity prices, availability of credit, asset valuations and volatility;
- changes in global financial and economic markets;
- armed conflict, war or terrorism;
- regulatory changes affecting our industry generally or our business and operations in particular;
- changes in market valuations of other companies in our industry;
- the operating and securities price performance of companies that investors consider to be comparable to us; and
- announcements of strategic developments, acquisitions and other material events by us, our competitors or our suppliers.

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

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

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

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

Our business is seasonal, and events occurring during seasons in which revenues are typically higher may disproportionately affect our results of operations and financial condition.

Historically, our sales have been lower during the first and fourth quarters of each year due to consumer purchasing patterns during the holiday season, inclement weather in certain of our markets and the reduced number of business days during the holiday season. More recently our franchise diversification and cost controls have moderated this seasonality. However, if conditions occur during the second or third quarters that weaken automotive sales, such as severe weather in the geographic areas in which our dealerships operate, war, high fuel costs, depressed economic conditions including unemployment or weakened consumer confidence or similar adverse conditions, our revenues for the year may be disproportionately adversely affected.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

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

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosure

Not applicable.

PART II

Item 5.

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

Stock Prices and Dividends

Our Class A common stock trades on the New York Stock Exchange under the symbol LAD. The following table presents the high and low sale prices for our Class A common stock, as reported on the New York Stock Exchange Composite Tape for each of the quarters in 2013 and 2014:

2013	**High**	**Low**
First quarter	$47.63	$37.54
Second quarter	57.04	42.03
Third quarter	73.58	53.60
Fourth quarter	74.94	60.45
2014		
First quarter	$69.68	$53.57
Second quarter	94.31	64.37
Third quarter	97.20	75.21
Fourth quarter	90.44	63.05

The number of shareholders of record and approximate number of beneficial holders of Class A common stock as of March 2, 2015 was 605 and 51,052, respectively. All shares of Lithia's Class B common stock are held by Lithia Holding Company, LLC. Sidney B. DeBoer, as Manager of Lithia Holding Company, L.L.C., has the authority to vote all of the issued and outstanding shares of our Class B common stock.

Dividends declared on our Class A and Class B common stock during 2012, 2013 and 2014 were as follows:

Quarter declared:	**Divdend amount per share**	**Total amount of dividend (in thousands)**
2012		
First quarter	$ 0.07	$ 1,815
Second quarter	0.10	2,583
Third quarter	0.10	2,545
Fourth quarter(1)	0.20	5,123
2013		
First quarter	$ -	$ -
Second quarter	0.13	3,356
Third quarter	0.13	3,363
Fourth quarter	0.13	3,366
2014		
First quarter	$ 0.13	$ 3,378
Second quarter	0.16	4,179
Third quarter	0.16	4,174
Fourth quarter	0.16	4,198

(1) In November 2012, we paid dividends of $2.5 million that had been declared in October 2012. An additional dividend payment of $2.6 million was declared and paid in December 2012 in lieu of the dividend typically declared and paid in March of the following year.

Equity Compensation Plan Information

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

Repurchases of Equity Securities

We made the following repurchases of our common stock during the fourth quarter of 2014:

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan(1)	Maximum number of shares that may yet be purchased under the plan
October 1 – October 31	143,833	66.80	143,833	1,664,453
November 1 – November 30	9,396	74.67	9,396	1,520,620
December 1 – December 31	11,000	82.95	11,000	1,511,224
Total	164,229		164,299	1,500,224

(1) In 2011 and 2012, our Board of Directors authorized the repurchase of up to a total of 3,000,000 shares of our Class A common stock. Through December 31, 2014, we have repurchased 1,499,776 shares at an average price of $31.19 per share. This authority to repurchase shares does not have an expiration date nor a maximum aggregate dollar amount for repurchases.

Stock Performance Graph

The following line-graph shows the annual percentage change in the cumulative total returns for the past five years on an assumed $100 initial investment and reinvestment of dividends, on (a) Lithia Motors, Inc.'s Class A common stock; (b) the Russell 2000; and (c) an auto peer group index composed of Penske Automotive Group, AutoNation, Sonic Automotive, Group 1 Automotive and Asbury Automotive Group, the only other comparable publicly traded automobile dealerships in the United States as of December 31, 2014. The peer group index utilizes the same methods of presentation and assumptions for the total return calculation as does Lithia Motors and the Russell 2000. All companies in the peer group index are weighted in accordance with their market capitalizations.

	Base Period	**Indexed Returns for the Year Ended**				
Company/Index	**12/31/2009**	**12/31/2010**	**12/31/2011**	**12/31/2012**	**12/31/2013**	**12/31/2014**
Lithia Motors, Inc.	$ 100.00	$ 176.64	$ 274.22	$ 478.42	$ 893.38	$ 1,124.79
Auto Peer Group	100.00	139.26	172.28	214.32	290.19	345.44
Russell 2000	100.00	126.81	121.52	141.43	196.34	205.96

Item 6. Selected Financial Data

You should read the Selected Financial Data in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," our Consolidated Financial Statements and Notes thereto and other financial information contained elsewhere in this Annual Report on Form 10-K. The results of operations for stores classified as discontinued operations have been presented on a comparable basis for all periods presented.

(In thousands, except per share amounts)	**Year Ended December 31,**				
Consolidated Statements of Operations Data:	**2014**	**2013**	**2012**	**2011**	**2010**
Revenues:					
New vehicle	$3,077,670	$2,256,598	$1,847,603	$1,391,375	$1,020,883
Used vehicle retail	1,362,481	1,032,224	833,484	678,571	558,105
Used vehicle wholesale	195,699	158,235	139,237	128,329	103,817
Finance and insurance	190,381	139,007	112,234	84,130	64,217
Service, body and parts	512,124	383,483	347,703	315,958	277,945
Fleet and other	51,971	36,202	36,226	34,383	11,655
Total revenues	$5,390,326	$4,005,749	$3,316,487	$2,632,746	$2,036,622
Gross Profit:					
New vehicle	$198,184	$151,118	$134,447	$107,150	$83,646
Used vehicle retail	179,253	150,858	121,721	98,214	78,795
Used vehicle wholesale	3,646	2,711	1,414	597	703
Finance and insurance	190,381	139,007	112,234	84,130	64,217
Service, body and parts	249,736	185,570	168,070	152,220	133,942
Fleet and other	2,122	1,689	1,414	2,973	1,643
Total gross profit	$823,322	$630,953	$539,300	$445,284	$362,946
Operating income (1)	$231,899	$183,518	$148,369	$110,818	$46,470
Income from continuing operations before income taxes(1)	$210,495	$165,788	$128,457	$88,270	$22,212
Income from continuing operations(1)	$135,540	$105,214	$79,395	$55,210	$13,587
Basic income per share from continuing operations	$5.19	$4.08	$3.09	$2.10	$0.52
Basic income per share from discontinued operations	0.12	0.03	0.04	0.14	0.01
Basic net income per share	$5.31	$4.11	$3.13	$2.24	$0.53
Shares used in basic per share	26,121	25,805	25,696	26,230	26,062
Diluted income per share from continuing operations	$5.14	$4.02	$3.03	$2.07	$0.52
Diluted income per share from discontinued operations	0.12	**0.03**	**0.04**	0.14	0.00

Diluted net income per share	$5.26	$4.05	$3.07	$2.21	$0.52
Shares used in diluted per share		26,191	26,170	26,664	26,729
Cash dividends declared per common share[(2)]	$0.61	$0.39	$0.47	$0.26	$0.15

(In thousands)	**As of December 31,**				
Consolidated Balance Sheets Data:	**2014**	**2013**	**2012**	**2011**	**2010**
Working capital	$172,909	$209,038	$211,905	$191,607	$162,675
Inventories	1,249,659	859,019	723,326	506,484	415,228
Total assets	2,880,932	1,725,121	1,492,702	1,146,133	971,676
Floor plan notes payable	1,178,679	713,855	581,584	343,940	251,257
Long-term debt, including current maturities	640,978	252,554	295,058	286,874	280,774
Total stockholders' equity	673,105	534,722	428,101	367,121	320,217

(1) Includes $1.9 million, $0.1 million, $1.4 million and $15.3 million of non-cash charges related to asset impairments for the years ended 2014, 2012, 2011 and 2010, respectively. No non-cash charges related to asset impairments or terminated construction projects were recorded in 2013. See Notes 1, 4 and 18 of Notes to Consolidated Financial Statements for additional information.

(2) In November 2012, we paid dividends of $2.5 million that had been declared in October 2012. An additional dividend payment of $2.6 million was declared and paid in December 2012 in lieu of the dividend typically declared and paid in March of the following year.

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

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

Overview

We are a leading operator of automotive franchises and retailer of new and used vehicles and services. As of March 2, 2015, we offered 30 brands of new vehicles and all brands of used vehicles in 130 stores in the United States and online at Lithia.com and DCHauto.com. We sell new and used cars and replacement parts; provide vehicle maintenance, warranty, paint and repair services; arrange related financing; and sell service contracts, vehicle protection products and credit insurance.

We believe that the fragmented nature of the automotive dealership sector provides us with the opportunity to achieve growth through consolidation. In 2014, the top ten automotive retailers represented 6% of the stores in the United States. Our dealerships are located across the United States. We seek domestic, import and luxury franchises in cities ranging from mid-sized regional markets to metropolitan markets. We evaluate all brands for expansion opportunities provided the market is large enough to support adequate new vehicle sales to justify the required capital investment. Our acquisition strategy has been to acquire dealerships at prices that meet our internal investment targets and, through the application of our centralized operating structure, leverage costs and improve store profitability. We believe our disciplined approach and the current economic environment provides us with attractive acquisition opportunities.

We also believe that we can continue to improve operations at our existing stores. By promoting entrepreneurial leadership within our general and department managers, we strive for continuous improvement to drive sales and capture market share in our local markets. Our goal is to retail an average of 75 used vehicles per store per month and we believe we can make additional improvements in our used vehicle sales performance by offering lower-priced value vehicles and selling brands other than the new vehicle franchise at each location. Our service, body and parts operations provide important repeat business for our stores. We continue to grow this business through increased marketing efforts, competitive pricing on routine maintenance items and diverse commodity product offerings. In 2014, we continued to experience organic growth and profitability through increasing market share and maintaining a lean cost structure, while adding significant revenue to our base through acquisitions.

As sales volume increases and we gain leverage in our cost structure, we anticipate targeting SG&A as a percentage of gross profit in the lower 70% range. As we focus on maintaining discipline in controlling costs, in 2015 we continue to target retaining, on a same store basis, 50% of each incremental gross profit dollar after deducting SG&A expense.

Critical Accounting Policies and Estimates

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

Our most critical accounting estimates include those related to goodwill and franchise value, long-lived assets, deferred taxes, equity-method investment associated with new markets tax credits, service contracts and other insurance contracts, and lifetime lube, oil and filter contracts and self-insurance programs. We also have other key accounting policies for valuation of accounts receivable, expense accruals and revenue recognition. However, these policies either do not meet the definition of critical accounting estimates described above or are not currently material items in our financial statements. We review our estimates, judgments and assumptions periodically and reflect the effects of revisions in the period that they are deemed to be necessary. We believe that these estimates are reasonable. However, actual results could differ materially from these estimates.

Goodwill and Franchise Value

We are required to test our goodwill and franchise value for impairment at least annually, or more frequently if conditions indicate that an impairment may have occurred. Goodwill is tested for impairment at the reporting unit level. Our reporting units are individual retail automotive franchises as this is the level at which discrete financial information is available and for which operating results are regularly reviewed by our chief operating decision maker to allocate resources and assess performance. We have the option to qualitatively or quantitatively assess goodwill for impairment and, in 2014, evaluated our goodwill using a quantitative assessment process. We test goodwill for impairment using the Adjusted Present Value method ("APV") to estimate the fair value of our reporting unit. Under the APV method, future cash flows are based on recently prepared budget forecasts and business plans and are used to estimate the future economic benefits that the reporting unit will generate. An estimate of the appropriate discount rate is utilized to convert the future economic benefits to their present value equivalent.

The quantitative goodwill impairment test is a two-step process. The first step identifies potential impairments by comparing the calculated fair value of a reporting unit with its book value. If the fair value of the reporting unit exceeds the carrying amount, goodwill is not impaired and the second step is not necessary. If the carrying value exceeds the fair value, the second step includes determining the implied fair value in the same manner as the amount of goodwill recognized in a business combination is determined. The implied fair value of goodwill is then compared with the carrying amount to determine if an impairment loss should be recorded.

As of December 31, 2014, we had $199.4 million of goodwill on our balance sheet. The first step of our annual goodwill impairment analysis, which we perform as of October 1 of each year, did not result in an indication of impairment in 2014, 2013 or 2012.

We have determined the appropriate unit of accounting for testing franchise rights for impairment is on an individual store basis. We have the option to qualitatively or quantitatively assess indefinite-lived intangible assets for impairment. In 2014, we evaluated our indefinite-lived intangible assets using a quantitative assessment process. We estimate the fair value of our franchise rights primarily using the Multi-Period Excess Earnings ("MPEE") model. The forecasted cash flows used in the MPEE model contain inherent uncertainties, including significant estimates and assumptions related to growth rates, margins, general operating expenses, and cost of capital. We use primarily internally-developed forecasts and business plans to estimate the future cash flows that each franchise will generate.

We have determined that only certain cash flows of the store are directly attributable to the franchise rights. We estimate the appropriate interest rate to discount future cash flows to their present value equivalent taking into consideration factors such as a risk-free rate, a peer group average beta, an equity risk premium and a small stock risk premium.

We also may use a market approach to determine the fair value of our franchise rights. These market data points include our acquisition and divestiture experience and third-party broker estimates.

As of December 31, 2014, we had $150.9 million of franchise value on our balance sheet associated with 91 stores. No individual store accounted for more than 5% of our total franchise value as of December 31, 2014. Our impairment testing of franchise value did not indicate any impairment in 2014, 2013 or 2012.

We are subject to financial statement risk to the extent that our goodwill or franchise rights become impaired due to decreases in the fair value. A future decline in performance, decreases in projected growth rates or margin assumptions or changes in discount rates could result in a potential impairment, which could have a material adverse impact on our financial position and results of operations. Furthermore, if a manufacturer becomes insolvent, we may be required to record a partial or total impairment on the franchise value related to that manufacturer. No individual manufacturer accounted for more than 28% of our total franchise value as of December 31, 2014.

See Notes 1 and 5 of Notes to Consolidated Financial Statements for additional information.

Long-Lived Assets

We estimate the depreciable lives of our property and equipment, including leasehold improvements, and review each asset group for impairment when events or circumstances indicate that their carrying amounts may not be recoverable. We determined an asset group is comprised of the long-lived assets used in the operations of an individual store.

We determine a triggering event has occurred by reviewing store forecasted and historical financial performance. An asset group is evaluated for recoverability if it has an operating loss in the current year and two of the prior three years. Additionally, we may judgmentally evaluate an asset group if its financial performance indicates it may not support the carrying amount of the long-lived assets. If a store meets these criteria, we estimate the projected undiscounted cash flows for each asset group based on internally developed forecasts. If the undiscounted cash flows are lower than the carrying value of the asset group, we determine the fair value of the asset group based on additional market data, including recent experience in selling similar assets.

We hold certain property for future development or investment purposes. If a triggering event is deemed to have occurred, we evaluate the property for impairment by comparing its estimated fair value based on listing price less costs to sell and other market data, including similar property that is for sale or has been recently sold, to the current carrying value. If the carrying value is more than the estimated fair value, an impairment is recorded.

Although we believe our property and equipment and assets held and used are appropriately valued, the assumptions and estimates used may change and we may be required to record impairment charges to reduce the value of these assets. A future decline in store performance, decrease in projected growth rates or changes in other operating assumptions could result in an impairment of long-lived asset groups, which could have a material adverse impact on our financial position and results of operations.

In 2012, we determined triggering events had occurred associated with certain property held for future development or investment purchases. As a result, we performed impairment testing on those specific long-lived assets and recorded impairments related to long-lived assets of $0.1 million in 2012.

We did not record any impairments related to long-lived assets in 2014 or 2013.

See Notes 1 and 4 of Notes to Consolidated Financial Statements for additional information.

Deferred Taxes

As of December 31, 2014, we had deferred tax assets of $65.5 million, net of valuation allowance of $8.7 million, and deferred tax liabilities of $110.9 million. The principal components of our deferred tax assets are related to goodwill, allowances and accruals, capital loss carryforwards, deferred revenue and cancellation reserves. The principal components of our deferred tax liabilities are related to depreciation on property and equipment, inventories and goodwill.

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

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

As of December 31, 2014, we had an $8.7 million valuation allowance against our deferred tax assets. This valuation allowance is mainly associated with losses from the sale of corporate entities. As these amounts are characterized as capital losses, we evaluated the availability of projected capital gains and determined that it is unlikely these amounts will be fully utilized. If we are unable to meet the projected taxable income levels utilized in our analysis, and depending on the availability of feasible tax planning strategies, we might record an additional valuation allowance on a portion or all of our deferred tax assets in the future.

Equity-Method Investment Associated with New Markets Tax Credits

As of December 31, 2014, we had a $33.3 million equity investment in a limited liability company managed by U.S. Bancorp Community Development Corporation. This investment will generate new market tax credits under the New Markets Tax Credit Program ("NMTC Program"). The NMTC Program was established by Congress in 2000 to spur new or increased investments into operating businesses and real estate projects located in low-income communities. The transaction obligates us to make $37.1 million of equity contributions to the entity over a two-year period ending in October 2016.

While U.S. Bancorp Community Development Corporation exercises management control over the limited liability company, due to the economic interest we hold in the entity, we determined the appropriate accounting for our ownership portion of the entity was under the equity method of accounting. Periodically, we evaluate the equity investment for indication of loss resulting from an other than temporary decline. As a result, the investment impacts both our operational results and our tax expense line items in our Consolidated Statements of Operations.

In 2014, we determined triggering events had occurred associated with certain equity-method investments. As a result, we performed impairment testing on those investments and recorded asset impairments totaling $1.9 million. We also recorded non-cash interest expense related to the discounted fair value of future equity contributions of $0.2 million, a $1.2 million charge to other income, net for our portion of the investment's operating losses and a tax benefit of $6.5 million.

See Notes 1, 12 and 18 of Notes to Consolidated Financial Statements for additional information.

Service Contracts and Other Insurance Contracts

We receive commissions from the sale of vehicle service contracts and certain other insurance contracts. The contracts are sold through unrelated third parties, but we may be charged back for a portion of the commissions in the event of early termination of the contracts by customers. We sell these contracts on a straight commission basis; in addition, we participate in future underwriting profit pursuant to retrospective commission arrangements, which are recognized as income upon receipt.

We record commissions at the time of sale of the vehicles, net of an estimated liability for future charge-backs. We have established a reserve for estimated future charge-backs based on an analysis of historical charge-backs in conjunction with estimated lives of the applicable contracts. If future cancellations are different than expected, we could have additional expense related to the cancellations in future periods, which could have a material adverse impact on our financial position and results of operations.

At December 31, 2014 and 2013, the reserve for future cancellations totaled $26.8 million and $18.2 million, respectively, and is included in accrued liabilities and other long-term liabilities on our Consolidated Balance Sheets. A 10% increase in expected cancellations would result in an additional reserve of $2.7 million.

Lifetime Lube, Oil and Filter Contracts

We retain the obligation for lifetime lube, oil and filter service contracts sold to our customers and assumed the liability of certain existing lifetime, lube, oil and filter contracts. Payments we receive upon sale of the lifetime oil contracts are deferred and recognized in revenue over the expected life of the service agreement to best match the expected timing of the costs to be incurred to perform the service. We estimate the timing and amount of future costs for claims and cancellations related to our lifetime lube, oil and filter contracts using historical experience rates and estimated future costs.

If our estimates of future costs to perform under the contracts exceed the existing deferred revenue, we would record a reserve for the additional expected cost. The estimate of future costs to perform under the contract are mainly dependent on our estimated number of oil changes to be performed over a vehicle's life and our assumptions about future costs expected to be incurred. Significant increases to either of these assumptions could have a material adverse impact on our financial position and results of operations.

At December 31, 2014, the deferred revenue related to these self-insured contracts was $63.4 million.

Self-Insurance Programs

We self-insure a portion of our property and casualty insurance, vehicle open lot coverage, medical insurance and workers' compensation insurance. We engage third-parties to assist in estimating the loss exposure related to the self-retained portion of the risk associated with these insurances. Additionally, we analyze our historical loss and claims trends associated with these programs. The maximum exposure on any single claim under our property and casualty insurance, medical insurance and workers' compensation insurance is $1 million. There is no limit on our exposure to wind and hail storms for our vehicle open lot coverage. Although we believe we have sufficient insurance, exposure to uninsured or underinsured losses may result in the recognition of additional charges, which could have a material adverse impact on our financial position and results of operations.

At December 31, 2014 and 2013, we had liabilities associated with these programs of $23.2 million and $12.0 million, respectively, recorded as a component of accrued liabilities and other long-term liabilities on our Consolidated Balance Sheets.

Results of Continuing Operations

For the year ended December 31, 2014, we reported income from continuing operations, net of tax, of $135.5 million, or $5.14 per diluted share. For the years ended December 31, 2013 and 2012, we reported income from continuing operations, net of tax, of $105.2 million, or $4.02 per diluted share, and $79.4 million, or $3.03 per diluted share, respectively.

Discontinued Operations

We early adopted the amendment to the accounting guidance related to discontinued operations in the third quarter of 2014. This amendment defines discontinued operations as a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has, or will have, a major effect on an entity's operations and financial results. As a result, we determined that individual stores which meet the criteria for held for sale after our adoption date will no longer qualify for classification as discontinued operations. We had previously reclassified a store's operations to discontinued operations in our Consolidated Statements of Operations, on a comparable basis for all periods presented, provided we did not expect to have any significant continuing involvement in the store's operations after its disposal.

We realized income from discontinued operations, net of income tax expense, of $3.2 million, $0.8 million and $1.0 million for the years ended December 31, 2014, 2013 and 2012, respectively. See Notes 1 and 15 of Notes to Consolidated Financial Statements for additional information.

Key Performance Metrics

Certain key performance metrics for revenue and gross profit were as follows for 2014, 2013 and 2012 (dollars in thousands):

2014	**Revenues**	**Percent of Total Revenues**		**Gross Profit**	**Gross Profit Margin**		**Percent of Total Gross Profit**	
New vehicle	$3,077,670	57.1	%	$198,184	6.4	%	24.1	%
Used vehicle retail	1,362,481	25.3		179,253	13.2		21.8	
Used vehicle wholesale	195,699	3.6		3,646	1.9		0.4	
Finance and insurance[1]	190,381	3.5		190,381	100.0		23.1	
Service, body and parts	512,124	9.5		249,736	48.8		30.3	
Fleet and other	51,971	1.0		2,122	4.1		0.3	
	$5,390,326	100.0	%	$823,322	15.3	%	100.0	%

2013	**Revenues**	**Percent of Total Revenues**		**Gross Profit**	**Gross Profit Margin**		**Percent of Total Gross Profit**	
New vehicle	$2,256,598	56.3	%	$151,118	6.7	%	24.0	%
Used vehicle retail	1,032,224	25.8		150,858	14.6		23.9	
Used vehicle wholesale	158,235	3.9		2,711	1.7		0.4	
Finance and insurance[1]	139,007	3.5		139,007	100.0		22.0	
Service, body and parts	383,483	9.6		185,570	48.4		29.4	
Fleet and other	36,202	0.9		1,689	4.7		0.3	
	$4,005,749	100.0	%	$630,953	15.8	%	100.0	%

2012	**Revenues**	**Percent of**	**Gross Profit**	**Gross Profit**	**Percent of**

		Total Revenues			Margin		Total Gross Profit	
New vehicle	$1,847,603	55.7	%	$134,447	7.3	%	24.9	%
Used vehicle retail	833,484	25.1		121,721	14.6		22.6	
Used vehicle wholesale	139,237	4.2		1,414	1.0		0.3	
Finance and insurance[1]	112,234	3.4		112,234	100.0		20.8	
Service, body and parts	347,703	10.5		168,070	48.3		31.1	
Fleet and other	36,226	1.1		1,414	3.9		0.3	
	$3,316,487	100.0	%	$539,300	16.3	%	100.0	%

(1) Commissions reported net of anticipated cancellations.

Same Store Operating Data

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

Same store measures reflect results for stores that were operating in each comparison period, and only includes the months when operations occurred in both periods. For example, a store acquired in August 2013 would be included in same store operating data beginning in September 2014, after its first full complete comparable month of operation. The operating results for the same store comparisons would include results for that store in September through December of each year.

New Vehicle Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2014	2013	Increase (Decrease)	% Increase (Decrease)
Reported				
Revenue	$3,077,670	$2,256,598	$ 821,072	36.4 %
Gross profit	$198,184	$151,118	$ 47,066	31.1
Gross margin	6.4 %	6.7 %	(30)bp(1)	
Retail units sold	91,104	66,857	24,247	36.3
Average selling price per retail unit	$33,782	$33,753	$ 29	0.1
Average gross profit per retail unit	$2,175	$2,260	$ (85)	(3.8)
Same store				
Revenue	$2,501,956	$2,252,242	$ 249,714	11.1 %
Gross profit	$163,611	$150,879	$ 12,732	8.4
Gross margin	6.5 %	6.7 %	(20)bp(1)	
Retail units sold	72,177	66,703	5,474	8.2
Average selling price per retail unit	$34,664	$33,765	$ 899	2.7
Average gross profit per retail unit	$2,267	$2,262	$ 5	0.2

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2013	2012	Increase (Decrease)	% Increase (Decrease)
Reported				
Revenue	$2,256,598	$1,847,603	$ 408,995	22.1 %
Gross profit	$151,118	$134,447	$ 16,671	12.4
Gross margin	6.7 %	7.3 %	(60)bp(1)	
Retail units sold	66,857	55,666	11,191	20.1
Average selling price per retail unit	$33,753	$33,191	$ 562	1.7
Average gross profit per retail unit	$2,260	$2,415	$ (155)	(6.4)
Same store				
Revenue	$2,143,952	$1,842,354	$ 301,598	16.4 %
Gross profit	$143,144	$133,965	$ 9,179	6.9
Gross margin	6.7 %	7.3 %	(60)bp(1)	
Retail units sold	63,384	55,505	7,879	14.2

Average selling price per retail unit	$33,825	$33,193	$632	1.9
Average gross profit per retail unit	$2,258	$2,414	$(156)	(6.5)

(1) A basis point is equal to 1/100th of one percent.

New vehicle sales improved primarily due to volume growth as year-over-year same store sales volume increased 8.2% in 2014 compared to 2013. This growth was in addition to the 14.2% year-over-year same store sales volume increase experienced in 2013 compared to 2012. Same store unit sales increased in all categories in 2014 compared to 2013 as well as in 2013 compared to 2012 as follows:

	2014 compared to 2013	**2013 compared to 2012**	**National growth in 2014 compared to 2013**
Domestic brand same store unit sales growth	8.7 %	11.8 %	6.0 %
Import brand same store unit sales growth	7.0 %	17.5 %	5.6 %
Luxury brand same store unit sales growth	10.2 %	15.0 %	6.6 %
Overall	8.2 %	14.2 %	

We continue to focus on increasing our share of overall new vehicle sales within our markets. In 2014, this rate of growth was slower than in 2013 as it was off of a higher overall base as national new vehicle sales volumes have been increasing over the last several years.

Recovery in some of our specific markets behaved differently than the national average. Certain of our markets saw an increase in local market sales volumes exceeding the national average, while others continued to lag behind the national average due to differing levels of economic recovery in different parts of the country, including economic activity and regional employment levels recovering at different rates. As of the end of 2014, we believe approximately one third of our markets continue to be below the pre-recessionary vehicle registration levels experienced in 2006.

In addition to the increases in unit volume, increases of 2.7% and 1.9%, respectively, in 2014 compared to 2013 and in 2013 compared to 2012, in the average selling prices contributed to the overall increases in same store new vehicle revenue.

New vehicle gross profit dollars increased 31.1% in 2014 compared to 2013. On a same store basis, gross profit increased 8.4% in 2014 compared to 2013. These increases were primarily due to a greater number of vehicles sold.

We focus on gross profit dollars earned per unit, not a gross margin percentage. With our volume-based strategy, on a same store basis, the average gross profit per new retail unit increased just $5.00, or 0.2%, in 2014 compared to 2013. We believe our volume-based strategy creates additional used vehicle trade-in opportunities, finance and insurance sales and future service work, which will generate incremental business in future periods that will more than offset the limited growth in new vehicle gross profit per unit that has occurred with the pursuit of this strategy.

New vehicle sales improved throughout 2014 compared to 2013 primarily due to an overall market recovery. Additionally, we increased our share of vehicle sales in several of our markets in 2014.

Used Vehicle Retail Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2014	2013	Increase (Decrease)	% Increase (Decrease)
Reported				
Retail revenue	$1,362,481	$1,032,224	$330,257	32.0 %
Retail gross profit	$179,253	$150,858	$28,395	18.8
Retail gross margin	13.2 %	14.6 %	(140)bp	
Retail units sold	71,674	57,061	14,613	25.6 %
Average selling price per retail unit	$19,009	$18,090	$919	5.1
Average gross profit per retail unit	$2,501	$2,644	$(143)	(5.4)

Same store				
Retail revenue	$1,181,168	$1,031,101	$150,067	14.6 %
Retail gross profit	$158,350	$150,715	$7,635	5.1
Retail gross margin	13.4 %	14.6 %	(120)bp	
Retail units sold	61,561	56,997	4,564	8.0 %
Average selling price per retail unit	$19,187	$18,090	$1,097	6.1
Average gross profit per retail unit	$2,572	$2,644	$(72)	(2.7)

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2013	2012	Increase	% Increase
Reported				
Retail revenue	$1,032,224	$833,484	$198,740	23.8 %
Retail gross profit	$150,858	$121,721	$29,137	23.9
Retail gross margin	14.6 %	14.6 %	-	
Retail units sold	57,061	47,965	9,096	19.0
Average selling price per retail unit	$18,090	$17,377	$713	4.1
Average gross profit per retail unit	$2,644	$2,538	$106	4.2
Same store				
Retail revenue	$981,643	$829,876	$151,767	18.3 %
Retail gross profit	$144,942	$121,319	$23,623	19.5
Retail gross margin	14.8 %	14.6 %	10bp	
Retail units sold	54,337	47,752	6,585	13.8
Average selling price per retail unit	$18,066	$17,379	$687	4.0
Average gross profit per retail unit	$2,667	$2,541	$126	5.0

Used vehicle retail sales are a strategic focus for organic growth. We offer three categories of used vehicles: manufacturer certified pre-owned vehicles; core vehicles, or late-model vehicles with lower mileage; and value autos, or vehicles with over 80,000 miles. Additionally, our volume-based strategy for new vehicle sales increases the organic opportunity to convert vehicles acquired via trade to retail used vehicle sales.

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

	2014 compared to 2013	2013 compared to 2012
Certified pre-owned vehicles	24.5 %	29.6 %
Core vehicles	11.8 %	18.1 %
Value autos	8.5 %	6.7 %
Overall	14.6 %	13.8 %

On average, in 2014, each of our stores sold 56 retail used vehicle units per month, compared to 53 retail used vehicle units per store per month in 2013. We continue to target increasing sales to 75 units per store per month.

Used retail vehicle gross profit dollars increased 18.8% in 2014 compared to 2013. On a same store basis, gross profit increased 5.1% in 2014 compared to 2013. These increases were primarily due to volume growth, partially offset by decreases in the average gross profit per unit sold. The volume growth was driven by a larger number of late model vehicles being available in the marketplace compared to the prior few years. Vehicle production levels were cut significantly in the 2009 and 2010 model years, and as production increased in subsequent years, a greater number of vehicles are available due to the natural trade cycle and more lease returns. Similar to new vehicle sales, we focus on gross profit dollars earned per unit, not on gross margin percentage, in evaluating our sales performance. Gross profit per unit was lower in 2014 than in 2013 primarily due to shift in mix to more late model vehicles due to the increase in supply noted above. These vehicles are more homogenous in nature and typically are more commoditized relative to older cars that have a wider variety of mileage and condition, allowing more gross profit to be earned per vehicle due to their unique nature.

Used vehicle retail unit sales increased in 2013 compared to 2012 as we increased both our volume of sales and the average gross profit per unit sold. These improvements were a result of efforts to grow our overall used vehicle unit sales per store, coupled with an improving used vehicle market relative to 2012, and a strategic shift to continue to sell older used vehicles which tend to have higher gross margins due to the more heterogeneous nature of vehicles in this category which allow less comparison shopping by consumers and command higher prices due to shortage of supply.

Used Vehicle Wholesale Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2014	2013	Increase (Decrease)	% Increase (Decrease)
Reported				
Wholesale revenue	$195,699	$158,235	$ 37,464	23.7 %
Wholesale gross profit	$3,646	$2,711	$ 935	34.5
Wholesale gross margin	1.9 %	1.7 %	20bp	
Wholesale units sold	27,918	22,086	5,832	26.4
Average selling price per wholesale unit	$7,010	$7,164	$ (154)	(2.2)
Average gross profit per retail unit	$131	$123	$ 8	6.5
Same store				
Wholesale revenue	$172,585	$158,210	$ 14,375	9.1 %
Wholesale gross profit	$3,728	$2,823	$ 905	32.1
Wholesale gross margin	2.2 %	1.8 %	40bp	
Wholesale units sold	23,582	22,085	1,497	6.8
Average selling price per wholesale unit	$7,319	$7,164	$ 155	2.2
Average gross profit per retail unit	$158	$128	$ 30	23.4

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2013	2012	Increase (Decrease)	% Increase (Decrease)
Reported				
Wholesale revenue	$158,235	$139,237	$ 18,998	13.6 %
Wholesale gross profit	$2,711	$1,414	$ 1,297	91.7
Wholesale gross margin	1.7 %	1.0 %	70bp	
Wholesale units sold	22,086	19,144	2,942	15.4
Average selling price per wholesale unit	$7,164	$7,273	$ (109)	(1.5)
Average gross profit per retail unit	$123	$74	$ 49	66.2
Same store				
Wholesale revenue	$149,951	$138,540	$ 11,411	8.2 %
Wholesale gross profit	$2,750	$1,463	$ 1,287	88.0
Wholesale gross margin	1.8 %	1.1 %	70bp	
Wholesale units sold	21,049	19,047	2,002	10.5
Average selling price per wholesale unit	$7,124	$7,274	$ (150)	(2.1)
Average gross profit per retail unit	$131	$77	$ 54	70.1

Wholesale transactions are vehicles we have purchased from customers or vehicles we have attempted to sell via retail that we elect to dispose of due to inventory age or other factors. Wholesale vehicles are typically sold at or near inventory cost and do not comprise a meaningful component of our gross profit. We generated wholesale gross profit of $3.6 million, $2.7 million and $1.4 million in 2014, 2013 and 2012, respectively.

Finance and Insurance

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2014	2013	Increase	% Increase
Reported				
Revenue	$190,381	$139,007	$51,374	37.0 %
Average finance and insurance per retail unit	$1,170	$1,122	$48	4.3 %
Same store				
Revenue	$161,205	$138,850	$22,355	16.1 %
Average finance and insurance per retail unit	$1,205	$1,122	$83	7.4 %

(Dollars in thousands, except per unit amounts)	Year Ended December 31, 2013	2012	Increase	% Increase
Reported				
Revenue	$139,007	$112,234	$26,773	23.9 %
Average finance and insurance per retail unit	$1,122	$1,083	$39	3.6 %
Same store				
Revenue	$133,269	$111,902	$21,367	19.1 %
Average finance and insurance per retail unit	$1,132	$1,084	$48	4.4 %

The increases in finance and insurance sales in 2014 compared to 2013 and in 2013 compared to 2012 were driven by increased vehicle sales volume and higher average selling prices per retail unit. Trends in penetration rates are detailed below:

	2014	2013	2012
Finance and insurance	78%	78%	76%
Service contracts	43	42	41
Lifetime lube, oil and filter contracts	35	36	35

We believe the availability of credit is one of the key indicators of our ability to retail automobiles, as we arrange financing on almost 80% of the vehicles we sell and believe a significant amount of the vehicles we do not arrange financing for are financed elsewhere. To evaluate the availability of credit, we categorize our customers based on their Fair, Isaac and Company (FICO) credit score. The distribution by credit score for the customers we arranged financing for was as follows:

	FICO Score Range	2014	2013	2012
Prime	680 and above	70.3%	70.3%	70.1%
Non-prime	620-679	18.1	18.4	18.3
Sub-prime	619 or less	11.6	11.3	11.6

We continued to see the availability of consumer credit expand in 2014 compared to 2013 and in 2013 compared to 2012 with lenders increasing the average loan-to-value amount available to most customers.

Service, Body and Parts Revenue and Gross Profit

	Year Ended December 31,			
(Dollars in thousands)	2014	2013	Increase	% Increase
Reported				
Customer pay	$285,337	$214,173	$71,164	33.2 %