

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **June 30, 2019**

OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___ to ___

Commission file number: **001-14733**

LITHIA MOTORS INC

(Exact name of registrant as specified in its charter)

Oregon

(State or other jurisdiction of
incorporation or organization)

93-0572810

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

150 N. Bartlett Street

Medford

Oregon

97501

(Address of principal executive offices)

(Zip Code)

(541) 776-6401

Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	<input checked="" type="checkbox"/>	Accelerated Filer	<input type="checkbox"/>
Non-Accelerated Filer	<input type="checkbox"/>	Smaller Reporting Company	<input type="checkbox"/>
		Emerging Growth Company	<input type="checkbox"/>

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

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered	Outstanding at July 26, 2019
Class A common stock without par value	LAD	The New York Stock Exchange	22,415,392
Class B common stock without par value	LAD	The New York Stock Exchange	800,000

LITHIA MOTORS, INC.
FORM 10-Q
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LITHIA MOTORS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In millions)
(Unaudited)

	June 30, 2019	December 31, 2018
Assets		
Current Assets:		
Cash and cash equivalents	\$ 44.7	\$ 31.6
Accounts receivable, net of allowance for doubtful accounts of \$6.6 and \$7.2	489.2	529.4
Inventories, net	2,431.9	2,365.3
Other current assets	65.7	65.1
Total Current Assets	3,031.5	2,991.4
Property and equipment, net of accumulated depreciation of \$262.8 and \$240.5	1,463.0	1,448.0
Operating lease right-of-use assets	255.0	—
Goodwill	457.3	434.9
Franchise value	309.1	288.7
Other non-current assets	258.7	221.0
Total Assets	\$ 5,774.6	\$ 5,384.0
Liabilities and Stockholders' Equity		
Current Liabilities:		
Floor plan notes payable	\$ 414.1	\$ 324.4
Floor plan notes payable: non-trade	1,709.6	1,733.3
Current maturities of long-term debt	25.4	25.9
Trade payables	129.4	126.3
Accrued liabilities	326.8	283.6
Total Current Liabilities	2,605.3	2,493.5
Long-term debt, less current maturities	1,324.1	1,358.2
Deferred revenue	129.3	121.7
Deferred income taxes	98.5	91.2
Noncurrent operating lease liabilities	240.3	—
Other long-term liabilities	102.4	122.2
Total Liabilities	4,499.9	4,186.8
Stockholders' Equity:		
Preferred stock - no par value; authorized 15.0 shares; none outstanding	—	—
Class A common stock - no par value; authorized 100.0 shares; issued and outstanding 22.4 and 22.0	13.0	—
Class B common stock - no par value; authorized 25.0 shares; issued and outstanding 0.8 and 1.0	0.1	0.1
Additional paid-in capital	—	35.0
Accumulated other comprehensive loss	(0.9)	—
Retained earnings	1,262.5	1,162.1
Total Stockholders' Equity	1,274.7	1,197.2
Total Liabilities and Stockholders' Equity	\$ 5,774.6	\$ 5,384.0

See accompanying condensed notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenues:				
New vehicle	\$ 1,707.4	\$ 1,726.8	\$ 3,168.5	\$ 3,181.5
Used vehicle retail	888.3	804.1	1,716.2	1,519.7
Used vehicle wholesale	81.7	85.3	159.1	161.3
Finance and insurance	129.0	114.5	246.5	221.0
Service, body and parts	335.5	311.4	652.9	597.1
Fleet and other	79.8	54.4	128.2	75.6
Total revenues	<u>3,221.7</u>	<u>3,096.5</u>	<u>6,071.4</u>	<u>5,756.2</u>
Cost of sales:				
New vehicle	1,612.0	1,625.3	2,987.2	2,993.1
Used vehicle retail	795.1	717.0	1,538.4	1,359.0
Used vehicle wholesale	79.9	83.4	156.4	158.4
Service, body and parts	165.2	157.7	323.1	305.0
Fleet and other	75.9	52.4	122.0	71.9
Total cost of sales	<u>2,728.1</u>	<u>2,635.8</u>	<u>5,127.1</u>	<u>4,887.4</u>
Gross profit	493.6	460.7	944.3	868.8
Asset impairments	—	—	0.5	—
Selling, general and administrative	356.5	333.3	678.3	630.8
Depreciation and amortization	20.2	18.8	40.0	35.7
Operating income	116.9	108.6	225.5	202.3
Floor plan interest expense	(19.4)	(15.6)	(37.5)	(29.2)
Other interest expense, net	(15.0)	(13.8)	(30.3)	(25.6)
Other income, net	3.0	1.6	5.6	3.0
Income before income taxes	85.5	80.8	163.3	150.5
Income tax provision	(23.6)	(20.1)	(45.0)	(37.8)
Net income	<u>\$ 61.9</u>	<u>\$ 60.7</u>	<u>\$ 118.3</u>	<u>\$ 112.7</u>
Basic net income per share				
	<u>\$ 2.65</u>	<u>\$ 2.45</u>	<u>\$ 5.10</u>	<u>\$ 4.52</u>
Shares used in basic per share calculations				
	<u>23.4</u>	<u>24.8</u>	<u>23.2</u>	<u>24.9</u>
Diluted net income per share				
	<u>\$ 2.63</u>	<u>\$ 2.44</u>	<u>\$ 5.08</u>	<u>\$ 4.50</u>
Shares used in diluted per share calculations				
	<u>23.5</u>	<u>24.9</u>	<u>23.3</u>	<u>25.0</u>
Cash dividends paid per Class A and Class B share				
	<u>\$ 0.30</u>	<u>\$ 0.29</u>	<u>\$ 0.59</u>	<u>\$ 0.56</u>

See accompanying condensed notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net income	\$ 61.9	\$ 60.7	\$ 118.3	\$ 112.7
Other comprehensive income, net of tax:				
Loss on cash flow hedges, net of tax expense of \$0.3, \$0.0, \$0.3, and \$0.0, respectively	(0.9)	—	(0.9)	—
Comprehensive income	\$ 61.0	\$ 60.7	\$ 117.4	\$ 112.7

See accompanying condensed notes to consolidated financial statements.

LITHIA MOTORS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
(In millions)
(Unaudited)

Three and Six Months Ended June 30, 2019

	Common Stock				Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
	Class A		Class B					
	Shares	Amount	Shares	Amount				
Balance at December 31, 2018	22.0	\$ —	1.0	\$ 0.1	\$ 35.0	\$ —	\$ 1,162.1	\$ 1,197.2
Net income	—	—	—	—	—	—	56.4	56.4
Issuance of stock in connection with employee stock plans	—	2.3	—	—	—	—	—	2.3
Issuance of restricted stock to employees	0.1	—	—	—	—	—	—	—
Repurchase of Class A common stock	—	(3.1)	—	—	—	—	—	(3.1)
Class B common stock converted to Class A common stock	0.2	—	(0.2)	—	—	—	—	—
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	10.5	—	—	(7.0)	—	—	3.5
Dividends paid	—	—	—	—	—	—	(6.7)	(6.7)
Retained Earnings Adjustment for Adoption of ASC 842	—	—	—	—	—	—	0.9	0.9
Balance at March 31, 2019	22.3	9.7	0.8	0.1	28.0	\$ —	1,212.7	1,250.5
Net income	—	—	—	—	—	—	61.9	61.9
Loss on cash flow hedges, net of tax expense of \$0.3	—	—	—	—	—	(0.9)	—	(0.9)
Issuance of stock in connection with employee stock plans	0.1	2.8	—	—	—	—	—	2.8
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	0.5	—	—	3.4	—	—	3.9
Option premiums paid	—	—	—	—	(31.4)	—	(5.1)	(36.5)
Dividends paid	—	—	—	—	—	—	(7.0)	(7.0)
Balance at June 30, 2019	22.4	\$ 13.0	0.8	\$ 0.1	\$ —	\$ (0.9)	\$ 1,262.5	\$ 1,274.7

See accompanying condensed notes to consolidated financial statements.

LITHIA MOTORS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
(In millions)
(Unaudited)

Three and Six Months Ended June 30, 2018

	Common Stock				Additional Paid- In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
	Class A		Class B					
	Shares	Amount	Shares	Amount				
Balance at December 31, 2017	23.9	\$ 149.1	1.0	\$ 0.1	\$ 11.3	—	\$ 922.7	\$ 1,083.2
Net income	—	—	—	—	—	—	52.1	52.1
Issuance of stock in connection with employee stock plans	—	1.8	—	—	—	—	—	1.8
Issuance of restricted stock to employees	0.1	—	—	—	—	—	—	—
Repurchase of Class A common stock	(0.1)	(8.2)	—	—	—	—	—	(8.2)
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	0.3	—	—	3.3	—	—	3.6
Dividends paid	—	—	—	—	—	—	(6.8)	(6.8)
Retained earnings adjustment for adoption of ASC 606	—	—	—	—	—	—	1.4	1.4
Balance at March 31, 2018	23.9	143.0	1.0	0.1	14.6	—	969.4	1,127.1
Net income	—	—	—	—	—	—	60.7	60.7
Issuance of stock in connection with employee stock plans	0.1	2.7	—	—	—	—	—	2.7
Repurchase of Class A common stock	(0.6)	(59.1)	—	—	—	—	—	(59.1)
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	7.8	—	—	(4.5)	—	—	3.3
Option premiums received (paid)	—	—	—	—	33.4	—	—	33.4
Dividends paid	—	—	—	—	—	—	(7.2)	(7.2)
Balance at June 30, 2018	23.4	\$ 94.4	1.0	\$ 0.1	\$ 43.5	\$ —	\$ 1,022.9	\$ 1,160.9

See accompanying condensed notes to consolidated financial statements.

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

	Six Months Ended June 30,	
	2019	2018
Cash flows from operating activities:		
Net income	\$ 118.3	\$ 112.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Asset impairments	0.5	—
Depreciation and amortization	40.0	35.7
Stock-based compensation	7.4	6.8
Gain on disposal of other assets	—	(0.1)
Loss on disposal of franchise	0.3	0.4
Deferred income taxes	7.6	0.3
(Increase) decrease (net of acquisitions and dispositions):		
Accounts receivable, net	40.1	47.9
Inventories	(63.0)	(35.5)
Other assets	6.4	20.6
Increase (decrease) (net of acquisitions and dispositions):		
Floor plan notes payable	89.7	15.1
Trade payables	3.5	2.9
Accrued liabilities	(8.8)	5.5
Other long-term liabilities and deferred revenue	2.4	24.0
Net cash provided by operating activities	244.4	236.3
Cash flows from investing activities:		
Capital expenditures	(57.8)	(72.4)
Proceeds from sales of assets	0.8	1.8
Cash paid for other investments	(6.7)	(7.1)
Cash paid for acquisitions, net of cash acquired	(75.0)	(374.6)
Proceeds from sales of stores	28.9	0.8
Net cash used in investing activities	(109.8)	(451.5)
Cash flows from financing activities:		
(Repayments) borrowings on floor plan notes payable, net: non-trade	(11.1)	85.8
Borrowings on lines of credit	1,411.0	1,353.3
Repayments on lines of credit	(1,450.0)	(1,254.1)
Principal payments on long-term debt and capital leases, scheduled	(12.0)	(9.6)
Principal payments on long-term debt and capital leases, other	(11.0)	(5.3)
Proceeds from issuance of long-term debt	—	62.1
Payments of debt issuance costs	(0.2)	(0.2)
Proceeds from issuance of common stock	5.1	4.5
Repurchase of common stock	(3.1)	(33.9)
Dividends paid	(13.7)	(13.9)
Payments of contingent consideration related to acquisitions	—	(0.8)
Other financing activity	(36.5)	—
Net cash (used in) provided by financing activities	(121.5)	187.9
Increase (decrease) in cash and cash equivalents	13.1	(27.3)
Cash and cash equivalents at beginning of period	31.6	57.3
Cash and cash equivalents at end of period	\$ 44.7	\$ 30.0
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ 69.5	\$ 54.7
Cash paid during the period for income taxes, net	7.2	2.3
Floor plan debt paid in connection with store disposals	4.8	5.2
Supplemental schedule of non-cash activities:		
Debt issued in connection with acquisitions	\$ 26.4	\$ 125.1
Debt assumed in connection with acquisitions	—	10.8
ROU assets obtained in exchange for lease liabilities ¹	260.3	—

¹ Amounts for the six months ended June 30, 2019 include the transition adjustment for the adoption of Topic 842.

See accompanying condensed notes to consolidated financial statements.

LITHIA MOTORS, INC. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Interim Financial Statements

Basis of Presentation

These condensed Consolidated Financial Statements contain unaudited information as of June 30, 2019, and for the three and six months ended June 30, 2019 and 2018. The unaudited interim financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by accounting principles generally accepted in the United States of America for annual financial statements are not included herein. In management's opinion, these unaudited financial statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the information when read in conjunction with our 2018 audited Consolidated Financial Statements and the related notes thereto. The financial information as of December 31, 2018, is derived from our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 22, 2019. The unaudited interim condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in our 2018 Annual Report on Form 10-K. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

In 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which requires leases with durations greater than twelve months to be recognized on the balance sheet, as right-of-use assets with corresponding operating lease liabilities. In July 2018, the FASB issued ASU No. 2018-11, "Targeted Improvements - Leases (Topic 842)." This update provides an optional transition method that allows entities to elect to apply the standard using the modified retrospective approach at its effective date, versus recasting the prior periods presented. If elected, an entity would recognize a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. We adopted the new standard as of January 1, 2019 using the transition method that provides for a cumulative-effect adjustment to retained earnings upon adoption. The Consolidated Financial Statements for the three and six-month periods ended June 30, 2019 are presented under the new standard, while comparative years presented are not adjusted and continue to be reported in accordance with our historical accounting policy. We elected the package of practical expedients, which permits us to not reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We elected the short-term lease recognition exemption for all leases that qualify. We have both real estate leases and equipment leases that are impacted by the new guidance. Most of our leases do not provide an implicit rate, therefore we use our incremental borrowing rate at the commencement date in determining the present value of lease payments. Adoption of the new standard resulted in the derecognition of a deferred gain from prior completed sale-leaseback transactions. This adjustment, net of tax, was recorded as \$0.9 million increase in retained earnings. See Note 10.

The impact of adopting Topic 842 on the accompanying Condensed Consolidated Balance Sheet as of January 1, 2019 was as follows (in millions):

Impact on Consolidated Balance Sheets	December 31, 2018	Adjustments	January 1, 2019
Operating lease right-of-use assets	\$ —	\$ 259.7	\$ 259.7
Total Assets	5,384.0	259.7	5,643.7
Operating lease liabilities:			
Accrued liabilities	283.6	26.6	310.2
Deferred revenue	121.7	(1.3)	120.4
Noncurrent operating lease liabilities	—	243.9	243.9
Other long-term liabilities	122.2	(10.3)	111.9
Total Liabilities	4,186.8	258.8	4,445.6
Retained earnings	1,162.1	0.9	1,163.0
Total Liabilities and Stockholders' Equity	5,384.0	259.7	5,643.7

Reclassifications

Certain immaterial reclassifications of amounts previously reported have been made to the accompanying condensed Consolidated Financial Statements to maintain consistency and comparability between periods presented.

Note 2. Contract Liabilities and Assets

Contract Liabilities

We are the obligor on our lifetime oil contracts. Revenue is allocated to these performance obligations and is recognized over time as services are provided to the customer. The amount of revenue recognized is calculated, net of cancellations, using an input method, which most closely depicts performance of the contracts. Our contract liability balances were \$160.7 million and \$149.6 million as of June 30, 2019, and December 31, 2018, respectively; and we recognized \$6.2 million and \$12.1 million of revenue in the three and six months ended June 30, 2019, respectively, related to our contract liability balance at December 31, 2018. Our contract liability balance is included in accrued liabilities and deferred revenue.

Contract Assets

Revenue from finance and insurance sales is recognized, net of estimated charge-backs, at the time of the sale of the related vehicle. We act as an agent in the sale of these contracts as the pricing is set by the third-party provider, and our commission is preset. A portion of the transaction price related to sales of finance and insurance contracts is considered variable consideration and is estimated and recognized upon the sale of the contract. Our contract asset balances associated with future estimated variable consideration were \$8.9 million and \$9.2 million as of June 30, 2019 and December 31, 2018, respectively; and are included in trade receivables and other non-current assets.

Note 3. Accounts Receivable and Contract Assets

Accounts receivable consisted of the following (in millions):

	June 30, 2019	December 31, 2018
Contracts in transit	\$ 254.5	\$ 294.0
Trade receivables	54.4	54.3
Vehicle receivables	57.8	51.6
Manufacturer receivables	102.4	105.5
Auto loan receivables	61.1	61.5
Other receivables	3.2	6.8
	<u>533.4</u>	<u>573.7</u>
Less: Allowance for doubtful accounts	(6.6)	(7.2)
Less: Long-term portion of accounts receivable, net	(37.6)	(37.1)
Total accounts receivable, net	<u>\$ 489.2</u>	<u>\$ 529.4</u>

Accounts receivable classifications include the following:

- Contracts in transit are receivables from various lenders for the financing of vehicles that we have arranged on behalf of the customer and are typically received approximately ten days after selling a vehicle.
- Trade receivables are comprised of amounts due from customers for open charge accounts, lenders for the commissions earned on financing and others for commissions earned on service contracts and insurance products.
- Vehicle receivables represent receivables for the portion of the vehicle sales price paid directly by the customer.
- Manufacturer receivables represent amounts due from manufacturers, including holdbacks, rebates, incentives and warranty claims.
- Auto loan receivables include amounts due from customers related to retail sales of vehicles and certain finance and insurance products.

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

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

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

Note 4. Inventories

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

	June 30, 2019	December 31, 2018
New vehicles	\$ 1,751.3	\$ 1,700.1
Used vehicles	591.5	576.8
Parts and accessories	89.1	88.4
Total inventories	<u>\$ 2,431.9</u>	<u>\$ 2,365.3</u>

Note 5. Goodwill and Franchise Value

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

	Domestic	Import	Luxury	Consolidated
Balance as of December 31, 2017 ¹	\$ 114.0	\$ 104.3	\$ 38.0	\$ 256.3
Additions through acquisitions ²	51.4	85.8	43.5	180.7
Reductions through divestitures	(0.9)	(1.2)	—	(2.1)
Balance as of December 31, 2018 ¹	164.5	188.9	81.5	434.9
Adjustments to purchase price allocations ³	1.6	1.6	1.9	5.1
Additions through acquisitions ³	6.2	9.0	2.2	17.4
Reductions through divestitures	(0.1)	—	—	(0.1)
Balance as of June 30, 2019 ¹	<u>\$ 172.2</u>	<u>\$ 199.5</u>	<u>\$ 85.6</u>	<u>\$ 457.3</u>

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

² Our purchase price allocation for the 2017 acquisitions of the Baierl Auto Group, the Downtown LA Auto Group, Crater Lake Ford Lincoln, Crater Lake Mazda, Albany CJD Fiat and the 2018 acquisition of Broadway Ford were finalized in 2018. Also, our purchase price allocation for the 2018 acquisition of Prestige Auto Group was preliminary and was allocated to our segments in 2018. As a result, we added \$180.7 million of goodwill.

³ Our purchase price allocation for the acquisitions of the Ray Laks Honda, Ray Laks Acura, Day Auto Group, Prestige Auto Group, and Buhler Ford were finalized in 2019. As a result, we added \$22.5 million of goodwill.

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

	Franchise Value
Balance as of December 31, 2017	\$ 187.0
Additions through acquisitions ¹	103.5
Reductions through divestitures	(1.8)
Balance as of December 31, 2018	288.7
Adjustments to purchase price allocations ²	3.5
Additions through acquisitions ²	20.9
Reductions through divestitures	(4.0)
Balance as of June 30, 2019	<u>\$ 309.1</u>

¹ Our purchase price allocation for the 2017 acquisitions of the Baierl Auto Group, the Downtown LA Auto Group, Crater Lake Ford Lincoln, Crater Lake Mazda, Albany CJD Fiat and the 2018 acquisition of Broadway Ford were finalized in 2018. Also, our purchase price allocation for the 2018 acquisition of Prestige Auto Group was preliminary and was allocated to our segments in 2018. As a result, we added \$103.5 million of franchise value.

² Our purchase price allocation for the acquisitions of the Ray Laks Honda, Ray Laks Acura, Day Auto Group, Prestige Auto Group, and Buhler Ford were finalized in 2019. As a result, we added \$24.4 million of franchise value.

Note 6. Stockholders' Equity

Repurchases of Class A Common Stock

In May 2019, we entered into a structured repurchase agreement involving the use of capped call options for the purchase of our Class A common stock. We paid a fixed sum upon execution of the agreement in exchange for the right to receive either a pre-determined amount of cash or stock. Upon expiration of the agreement, if the closing market price of our common stock is above the pre-determined price, we will have our initial investment returned with a premium in either cash or Class A shares (at our election). If the closing market price of our common stock is at or below the pre-determined price, we will receive the number of shares specified in the agreement. We paid a net premium of \$36.5 million in the second quarter of 2019 to enter into this agreement, which was recorded as a reduction of additional paid-in-capital and retained earnings. As of June 30, 2019, the options were outstanding.

Note 7. Fair Value Measurements

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

- Level 1 - quoted prices in active markets for identical securities;
- Level 2 - other significant observable inputs, including quoted prices for similar securities, interest rates, prepayment spreads, credit risk; and
- Level 3 - significant unobservable inputs, including our own assumptions in determining fair value.

We determined the carrying value of cash equivalents, accounts receivable, trade payables, accrued liabilities and short-term borrowings approximate their fair values because of the nature of their terms and current market rates of these instruments. We believe the carrying value of our variable rate debt approximates fair value.

We have fixed rate debt primarily consisting of amounts outstanding under our senior notes and real estate mortgages. We calculated the estimated fair value of the senior notes using quoted prices for the identical liability (Level 1) and calculated the estimated fair value of the fixed rate real estate mortgages using a discounted cash flow methodology with estimated current interest rates based on a similar risk profile and duration (Level 2). The fixed cash flows are discounted and summed to compute the fair value of the debt. As of June 30, 2019, our real estate mortgages and other debt, which includes capital leases, had maturity dates between October 1, 2020, and August 31, 2038.

We have derivative instruments consisting of interest rate collars. The fair value of derivative liabilities is measured using observable Level 2 market expectations at each measurement date and is recorded as current liabilities and other long-term liabilities in the Consolidated Balance Sheets. See Note 11 for more details regarding our derivative contracts.

We estimate the value of other long-lived assets that are recorded at fair value on a non-recurring basis on a market valuation approach. We use prices and other relevant information generated primarily by recent market transactions involving similar or comparable assets, as well as our historical experience in divestitures, acquisitions and real estate transactions. Additionally, we may use a cost valuation approach to value long-lived assets when a market valuation approach is unavailable. Under this approach, we determine the cost to replace the service capacity of an asset, adjusted for physical and economic obsolescence. When available, we use valuation inputs from independent valuation experts, such as real estate appraisers and brokers, to corroborate our estimates of fair value. Real estate appraisers' and brokers' valuations are typically developed using one or more valuation techniques including market, income and replacement cost approaches. Because these valuations contain unobservable inputs, we classified the measurement of fair value of long-lived assets as Level 3.

There were no changes to our valuation techniques during the six-month period ended June 30, 2019.

Below are our derivative liabilities that are measured at fair value (in millions):

Fair Value at June 30, 2019	Level 1	Level 2	Level 3
Measured on a recurring basis:			
Derivative contract, net	\$ —	\$ 1.2	\$ —

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

	June 30, 2019	December 31, 2018
Carrying value		
5.25% Senior notes due 2025	\$ 300.0	\$ 300.0
Real estate mortgages and other debt	456.5	445.8
	<u>\$ 756.5</u>	<u>\$ 745.8</u>
Fair value		
5.25% Senior notes due 2025	\$ 306.4	\$ 278.6
Real estate mortgages and other debt	457.7	448.7
	<u>\$ 764.1</u>	<u>\$ 727.3</u>

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

Fair Value at December 31, 2018	Level 1	Level 2	Level 3
Measured on a non-recurring basis:			
Long-lived assets held and used:			
Certain buildings and improvements	\$ —	\$ —	\$ 2.3

Long-lived assets held and used are reviewed for impairment whenever events or circumstances indicate that the carrying amount of the assets may not be recoverable. During the six months ended June 30, 2019, we evaluated the future undiscounted net cash flows associated with certain properties, which were under contract to sell, and determined the carrying value was not recoverable and exceeded the estimated fair value. As a result of this evaluation, we recorded \$0.5 million of impairment charges associated with a property in 2019. The long-lived asset impaired in the first quarter of 2019 was sold in the second quarter of 2019.

Note 8. Net Income Per Share of Class A and Class B Common Stock

We compute net income per share of Class A and Class B common stock using the two-class method. Under this method, basic net income per share is computed using the weighted average number of common shares outstanding during the period excluding common shares underlying equity awards that are unvested or subject to forfeiture. Diluted net income per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of the common shares issuable upon the net exercise of stock options and unvested RSUs and is reflected in diluted earnings per share by application of the treasury stock method. The computation of the diluted net income per share of Class A common stock assumes the conversion of Class B common stock, while the diluted net income per share of Class B common stock does not assume the conversion of those shares.

Except with respect to voting and transfer rights, the rights of the holders of our Class A and Class B common stock are identical. Under our Articles of Incorporation, the Class A and Class B common stock share equally in any dividends, liquidation proceeds or other distribution with respect to our common stock and the Articles of Incorporation can only be amended by a vote of the shareholders. Additionally, Oregon law provides that amendments to our Articles of Incorporation that would adversely alter the rights, powers or preferences of a given class of stock, must be approved by the class of stock adversely affected by the proposed amendment. As a result, the undistributed earnings for each year are allocated based on the contractual participation rights of the Class A and Class B common shares as if the earnings for the year had been distributed. Because the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis.

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

Three Months Ended June 30, <i>(in millions, except per share data)</i>	2019		2018	
	Class A	Class B	Class A	Class B
Net income applicable to common stockholders - basic	\$ 59.8	\$ 2.1	\$ 58.2	\$ 2.5
Reallocation of net income due to conversion of Class B to Class A common shares outstanding	0.2	—	0.3	—
Conversion of Class B common shares into Class A common shares	1.9	—	2.2	—
Net income applicable to common stockholders - diluted	\$ 61.9	\$ 2.1	\$ 60.7	\$ 2.5
Weighted average common shares outstanding – basic	22.6	0.8	23.8	1.0
Conversion of Class B common shares into Class A common shares	0.8	—	1.0	—
Effect of dilutive stock options on weighted average common shares	0.1	—	0.1	—
Weighted average common shares outstanding – diluted	23.5	0.8	24.9	1.0
Net income per common share - basic	\$ 2.65	\$ 2.65	\$ 2.45	\$ 2.45
Net income per common share - diluted	\$ 2.63	\$ 2.63	\$ 2.44	\$ 2.44

The effect of antidilutive securities on Class A and Class B common stock was evaluated for the three-month periods ended June 30, 2019, and 2018 and was determined to be immaterial.

Six Months Ended June 30, <i>(in millions, except per share data)</i>	2019		2018	
	Class A	Class B	Class A	Class B
Net income applicable to common stockholders - basic	\$ 114.2	\$ 4.1	\$ 108.2	\$ 4.5
Reallocation of net income due to conversion of Class B to Class A common shares outstanding	0.5	—	0.6	—
Conversion of Class B common shares into Class A common shares	3.6	—	3.9	—
Net income applicable to common stockholders - diluted	\$ 118.3	\$ 4.1	\$ 112.7	\$ 4.5
Weighted average common shares outstanding – basic	22.4	0.8	23.9	1.0
Conversion of Class B common shares into Class A common shares	0.8	—	1.0	—
Effect of employee stock purchases and restricted stock units on weighted average common shares	0.1	—	0.1	—
Weighted average common shares outstanding – diluted	23.3	0.8	25.0	1.0
Net income per common share - basic	\$ 5.10	\$ 5.10	\$ 4.52	\$ 4.52
Net income per common share - diluted	\$ 5.08	\$ 5.08	\$ 4.50	\$ 4.50

The effect of antidilutive securities on Class A and Class B common stock was evaluated for the six-month period ended June 30, 2019, and 2018 and was determined to be immaterial.

Note 9. Segments

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

Our Domestic segment is comprised of retail automotive franchises that sell new vehicles manufactured by Chrysler, General Motors and Ford. Our Import segment is comprised of retail automotive franchises that sell new vehicles manufactured primarily by Honda, Toyota, Subaru, Nissan and Volkswagen. Our Luxury segment is comprised of retail automotive franchises that sell new vehicles manufactured primarily by BMW, Mercedes and Lexus. The franchises in each segment also sell used vehicles, parts and automotive services, as well as automotive finance and insurance products.

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenues:				
Domestic				
New vehicle	\$ 577.3	\$ 597.6	\$ 1,069.7	\$ 1,111.1
Used vehicle retail	321.0	283.4	621.5	548.3
Used vehicle wholesale	29.6	33.9	59.2	67.5
Finance and insurance	47.3	43.1	89.1	83.1
Service, body and parts	121.0	113.5	236.4	220.6
Fleet and other	15.1	23.6	32.1	35.1
	<u>1,111.3</u>	<u>1,095.1</u>	<u>2,108.0</u>	<u>2,065.7</u>
Import				
New vehicle	740.8	772.0	1,373.4	1,439.6
Used vehicle retail	363.5	335.6	704.8	643.3
Used vehicle wholesale	29.0	31.0	56.9	59.2
Finance and insurance	60.8	54.8	115.6	106.6
Service, body and parts	127.3	116.4	245.0	226.0
Fleet and other	11.6	12.9	28.9	18.5
	<u>1,333.0</u>	<u>1,322.7</u>	<u>2,524.6</u>	<u>2,493.2</u>
Luxury				
New vehicle	383.7	361.9	723.2	640.4
Used vehicle retail	203.1	184.9	389.4	327.8
Used vehicle wholesale	22.8	20.3	42.6	34.5
Finance and insurance	18.4	15.9	34.9	28.2
Service, body and parts	83.9	76.9	163.0	141.7
Fleet and other	52.7	17.6	66.5	21.4
	<u>764.6</u>	<u>677.5</u>	<u>1,419.6</u>	<u>1,194.0</u>
	<u>3,208.9</u>	<u>3,095.3</u>	<u>6,052.2</u>	<u>5,752.9</u>
Corporate and other	12.8	1.2	19.2	3.3
	<u>\$ 3,221.7</u>	<u>\$ 3,096.5</u>	<u>\$ 6,071.4</u>	<u>\$ 5,756.2</u>
Segment income¹:				
Domestic	\$ 36.5	\$ 28.6	\$ 56.3	\$ 54.2
Import	39.5	30.2	69.5	53.3
Luxury	15.5	11.9	23.4	18.8
	<u>91.5</u>	<u>70.7</u>	<u>149.2</u>	<u>126.3</u>
Corporate and other	26.2	41.1	78.7	82.5
Depreciation and amortization	(20.2)	(18.8)	(40.0)	(35.7)
Other interest expense	(15.0)	(13.8)	(30.2)	(25.6)
Other income, net	3.0	1.6	5.6	3.0
Income before income taxes	<u>\$ 85.5</u>	<u>\$ 80.8</u>	<u>\$ 163.3</u>	<u>\$ 150.5</u>

¹Segment income for each of the segments is defined as income before income taxes, depreciation and amortization, other interest expense and other income, net.

	June 30, 2019	December 31, 2018
Total assets:		
Domestic	\$ 1,478.7	\$ 1,488.0
Import	1,347.5	1,224.2
Luxury	907.9	934.6
Corporate and other	2,040.5	1,737.2
	<u>\$ 5,774.6</u>	<u>\$ 5,384.0</u>

Note 10. Leases

Lease Accounting

We lease certain dealerships, office space, land and equipment. Leases with an initial term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term. We have elected not to bifurcate lease and nonlease components related to leases of real property.

Most leases include one or more options to renew, with renewal terms that can extend the lease term from one to 26 years or more. The exercise of lease renewal options is at our sole discretion. Certain leases also include options to purchase the leased property. The depreciable life of assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise.

Certain of our lease agreements include rental payments based on a percentage of retail sales over contractual levels and others include rental payments adjusted periodically for inflation. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants.

We rent or sublease certain real estate to third parties.

As described further in "Note 1. Interim Financial Statements," we adopted Topic 842 as of January 1, 2019. Prior period amounts have not been adjusted and continue to be reported in accordance with our historic accounting under Topic 840.

The table below presents the lease-related liabilities recorded on the balance sheet (in millions):

	June 30, 2019	December 31, 2018
Operating lease liabilities:		
Current portion included in accrued liabilities	\$ 25.9	\$ —
Noncurrent operating lease liabilities	240.3	—
Total operating lease liabilities	266.2	—
Financing lease liabilities:		
Current portion included in current maturities of long-term debt	1.0	2.0
Long-term portion of lease liabilities in long-term debt	29.6	28.8
Total financing lease liabilities ¹	30.6	30.8
Total lease liabilities	<u>\$ 296.8</u>	<u>\$ 30.8</u>
Weighted-average remaining lease term:		
Operating leases	14 years	
Finance leases	14 years	
Weighted-average discount rate:		
Operating leases	5.08%	
Finance leases	5.81%	

¹ Corresponding finance lease assets are not material and are included in property and equipment, net of accumulated depreciation.

The components of lease costs, which were included in Selling, general and administrative in our Consolidated Statements of Operations, were as follows (in millions):

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Operating lease cost ¹	\$ 12.2	\$ 24.3
Variable lease cost ²	0.4	1.2
Sublease income	(1.2)	\$ (2.2)
Total lease costs	<u>\$ 11.4</u>	<u>23.3</u>

¹ Includes short-term and month-to-month lease costs, which are immaterial.

² Variable lease cost generally includes reimbursement for actual costs incurred by our lessors for common area maintenance, property taxes and insurance on leased real estate.

As of June 30, 2019, the maturities of our operating lease liabilities were as follows (in millions):

	Operating Leases
Remainder of 2019	\$ 19.7
Year Ending December 31,	
2020	37.1
2021	33.9
2022	31.3
2023	26.4
Thereafter	228.1
Total minimum lease payments	376.5
Less:	
Present value adjustment	(110.3)
Operating lease liabilities	<u>\$ 266.2</u>

Note 11. Derivative Financial Instruments

We account for derivative financial instruments by recording the fair value as either an asset or liability in our Consolidated Balance Sheets and recognize the resulting gains or losses as adjustments to accumulated other comprehensive income (loss). We do not hold or issue derivative financial instruments for trading or speculative purposes. For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated and qualify as cash flow hedges, the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive loss ("AOCI") in stockholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions.

In the second quarter of 2019, to hedge the business exposure to rising interest rates on a portion of our variable rate debt, we entered into a 5-year zero-cost interest rate collar, with an aggregate notional amount of \$300 million. This instrument hedges interest rate risk related to a portion of our \$1.7 billion of non-trade floor plan notes payable.

The gains and losses from the cash flow hedge are recorded in AOCI and released to interest expense in the same period that the hedged interest expense on the floor plan is recognized. As of June 30, 2019, we had a loss of \$1.2 million recorded associated with the fair value of our derivative instrument, included as a component of accrued liabilities and other long-term liabilities with the offset in AOCI. As of June 30, 2019, the amount of net losses we expect to reclassify from AOCI into interest expense in earnings within the next twelve months is immaterial. However, the actual amount reclassified could vary due to future changes in the fair value of these derivatives. No amounts were reclassified from AOCI in the three or six months ended June 30, 2019.

Note 12. Acquisitions

In the first six months of 2019, we completed the following acquisitions:

- On May 1, 2019, Hamilton Honda in Hamilton Township, New Jersey.
- On May 20, 2019, Morgantown Ford in Morgantown, West Virginia.

Revenue and operating income contributed by the 2019 acquisitions subsequent to the date of acquisition were as follows (in millions):

Six Months Ended June 30,	2019
Revenue	\$ 27.5
Operating income	0.6

In the first six months of 2018, we completed the following acquisitions:

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

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

The following tables summarize the consideration paid for the 2019 acquisitions and the amount of identified assets acquired and liabilities assumed as of the acquisition date (in millions):

	Consideration
Cash paid, net of cash acquired	\$ 75.0
Debt issued	26.4
	<u>\$ 101.4</u>

The purchase price allocations for the Hamilton Honda and Morgantown Ford acquisitions are preliminary, and we have not obtained and evaluated all of the detailed information necessary to finalize the opening balance sheet amounts in all respects. We recorded the purchase price allocations based upon information that is currently available. Unallocated items are recorded as a component of other non-current assets in the Consolidated Balance Sheets. The following table details the preliminary purchase price allocations (in millions):

	Assets Acquired and Liabilities Assumed
Inventories, net	\$ 31.4
Property and equipment, net	1.5
Other non-current assets	92.6
Other long-term liabilities	(24.1)
	<u>\$ 101.4</u>

In the three and six-month periods ended June 30, 2019, we recorded \$1.5 million and \$1.6 million, respectively, in acquisition-related expenses as a component of selling, general and administrative expense, respectively. Comparatively, we recorded \$3.3 million and \$4.2 million of acquisition-related expenses in each of the same periods in 2018.

The following unaudited proforma summary presents consolidated information as if all acquisitions in the three and six-month periods ended June 30, 2019 and 2018, had occurred on January 1, 2018 (in millions, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenue	\$ 3,242.2	\$ 3,157.7	\$ 6,142.0	\$ 6,061.6
Net income	62.0	60.9	118.6	111.8
Basic net income per share	2.65	2.46	5.11	4.48
Diluted net income per share	2.64	2.45	5.09	4.47

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

Note 13. Recent Accounting Pronouncements

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

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

Forward-Looking Statements and Risk Factors

Certain statements under the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" and elsewhere in this Form 10-Q constitute forward-looking statements within the meaning of the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995. Generally, you can identify forward-looking statements by terms such as "project", "outlook", "target", "may", "will", "would", "should", "seek", "expect", "plan", "intend", "forecast", "anticipate", "believe", "estimate", "predict", "potential", "likely", "goal", "strategy", "future", "maintain", and "continue" or the negative of these terms or other comparable terms. Examples of forward-looking statements in this Form 10-Q include, among others, statements we make regarding:

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

The forward-looking statements contained in this Form 10-Q involve known and unknown risks, uncertainties and situations that may cause our actual results to materially differ from the results expressed or implied by these statements. Certain important factors that could cause actual results to differ from our expectations are discussed in Part II - Other Information, Item 1A in this Form 10-Q and in the Risk Factors section of our 2018 Annual Report on Form 10-K, as supplemented and amended from time to time in Quarterly Reports on Form 10-Q and our other filings with the Securities and Exchange Commission (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

Lithia Motors, Inc. is one of the largest automotive retailers and providers of personal transportation solutions in the United States, and, in 2019, was ranked #265 on the Fortune 500. As of June 30, 2019, we operated 182 stores representing 28 brands in 19 states. We are a growth company powered by people and innovation. By purchasing and building strong businesses that have yet to realize their potential, we generate significant cash flows while maintaining low leverage. Operational excellence is achieved by refocusing the business on the consumer experience and by utilizing proprietary performance measurements to increase market share and profitability. Lithia's unique growth model reinvests to expand its nationwide network and to fund innovations that create personal transportation solutions wherever, whenever and however consumers desire.

We offer a wide range of products and services including new and used vehicles, finance and insurance products and automotive repair and maintenance. We strive for diversification in our products, services, brands and geographic locations to reduce dependence on any one manufacturer, reduce susceptibility to changing consumer preferences, manage market risk and maintain profitability.

We seek to provide customers a seamless, blended online and physical retail experience with broad selection and access to specialized expertise and knowledge. Our physical network enables us to provide convenient touch points for customers and provide services throughout the vehicle life cycle. We use digital technologies to further activate our physical network and capture additional earnings.

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

Driving operational excellence

We remain focused on achieving operational excellence at existing locations. Operations are structured to promote an entrepreneurial environment at the dealership level. Each store's general manager and department managers, with assistance from

regional and corporate management, are responsible for developing successful retail plans in their local markets. They drive dealership operations, personnel development, manufacturer relationships, store culture and financial performance. Strong performance creates synergistic benefits such as increased vehicle trade-ins resulting in additional used vehicle sales, incremental finance and insurance sales and ultimately, increased units in operation and customer retention, which generate additional service revenues.

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

We have centralized many administrative functions to drive efficiencies and streamline store-level operations. The reduction of administrative functions at our stores allows our local managers to focus on customer-facing opportunities to increase revenues and gross profit. Our operations are supported by our dedicated training and personnel development program, which shares best practices across our dealership network and seeks to develop management talent.

Growth through acquisition and network optimization

Our value-based acquisition strategy focuses on purchasing strong businesses that have yet to realize their earnings potential. As we integrate these stores into our existing network, we focus on improving performance. Our success is measured by achieving profitability through increasing market share and retaining customers while controlling costs. With our performance management strategy, standardized information systems and centrally- and regionally-performed administrative functions, we seek to gain economies of scale from our dealership network.

We target acquiring domestic, import and luxury franchises in cities ranging from mid-sized regional markets to metropolitan markets. We evaluate all brands for expansion opportunities provided the market is large enough to support adequate new vehicle sales to justify the required capital investment. We focus on successfully integrating acquired stores to achieve targeted returns. Platform acquisitions may include one or more locations which do not meet our criteria. We regularly optimize and balance our network through strategic divestitures to ensure continued high performance. The divestiture of these underperforming stores increases availability of capital and personnel resources and reduces future capital expenditures for facility improvements. We believe our disciplined approach and the current economic environment provide us with attractive acquisition opportunities and expanded coast to coast coverage.

Innovation and diversification

Driving growth and achieving earnings potential generates the free cash flow that allows us to invest in innovation, diversification and digital initiatives, thereby providing more ways to meet consumers' personal transportation needs. Through innovation and technology, we strive to provide customers a seamless, blended online and physical retail experience with broad selection and access to specialized expertise and knowledge. We prioritize creating internal solutions to improve our existing operations, gaining vertical and horizontal adjacencies to our core business, and expanding our market share through strategic partnerships.

Our partnership with Shift Technologies, Inc. continues to mature as we share best practices. Our team shares industry knowledge with Shift and we continue to create synergies through the sharing of technologies, data, our physical network, and our vendor and lender relationships.

Thoughtful capital allocation

Our capital deployment strategy is to target a 65% investment in acquisitions, 25% investment in capital expenditures, innovation and diversification and 10% in shareholder return in the form of dividends and share repurchases. This disciplined approach, combined with our ability to successfully integrate newly-acquired locations, drives growth and profitability. During the first six months of 2019, we paid \$13.7 million in dividends and invested \$57.8 million in our stores through capital expenditures. We continue to manage our liquidity and available cash to prepare for future acquisition and innovation opportunities. As of June 30, 2019, we had \$262.5 million in available funds in cash and availability on our credit facilities, with an estimated additional \$247.1 million available if we financed our unencumbered owned real estate.

Key Revenue and Gross Profit Metrics

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

	Three Months Ended June 30,			Six Months Ended June 30,		
	2019	2018	Change	2019	2018	Change
Revenues						
New vehicle	\$ 1,707.4	\$ 1,726.8	(1.1) %	\$ 3,168.5	\$ 3,181.5	(0.4) %
Used vehicle retail	888.3	804.1	10.5	1,716.2	1,519.7	12.9
Finance and insurance	129.0	114.5	12.7	246.5	221.0	11.5
Service, body and parts	335.5	311.4	7.7	652.9	597.1	9.3
Total Revenues	3,221.7	3,096.5	4.0	6,071.4	5,756.2	5.5
Gross profit						
New vehicle	\$ 95.4	\$ 101.5	(6.0) %	\$ 181.3	\$ 188.4	(3.8) %
Used vehicle retail	93.2	87.1	7.0	177.8	160.7	10.6
Finance and insurance	129.0	114.5	12.7	246.5	221.0	11.5
Service, body and parts	170.3	153.7	10.8	329.8	292.1	12.9
Total Gross Profit	493.6	460.7	7.1	944.3	868.8	8.7
Gross profit margins						
New vehicle	5.6%	5.9%	(30bps)	5.7%	5.9%	(20bps)
Used vehicle retail	10.5	10.8	(30)	10.4	10.6	(20)
Finance and insurance	100.0	100.0	—	100.0	100.0	—
Service, body and parts	50.8	49.4	140	50.5	48.9	160
Total Gross Profit Margin	15.3	14.9	40	15.6	15.1	50
Retail units sold						
New vehicles	45,887	49,027	(6.4) %	85,582	90,524	(5.5) %
Used vehicles	42,865	39,096	9.6	83,540	75,210	11.1
Average selling price per retail unit						
New vehicles	\$ 37,208	\$ 35,221	5.6 %	\$ 37,023	\$ 35,146	5.3 %
Used vehicles	20,724	20,567	0.8	20,543	20,206	1.7
Average gross profit per retail unit						
New vehicles	\$ 2,078	\$ 2,070	0.4 %	\$ 2,119	\$ 2,082	1.8 %
Used vehicles	2,174	2,228	(2.4)	2,128	2,137	(0.4)
Finance and insurance	1,453	1,299	11.9	1,457	1,333	9.3

Same Store Operating Data

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

Same store measures reflect results for stores that were operating in each comparison period and only include the months when operations occurred in both periods. For example, a store acquired in May 2018 would be included in same store operating data beginning in June 2019, after its first full complete comparable month of operation. The second quarter operating results for the same store comparisons would include results for that store in only the month of June for both comparable periods.

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2019	2018	Change	2019	2018	Change
Revenues						
New vehicle	\$ 1,679.7	\$ 1,675.8	0.2 %	\$ 3,048.7	\$ 3,090.5	(1.4) %
Used vehicle retail	875.9	780.1	12.3	1,653.7	1,477.8	11.9
Finance and insurance	126.7	111.1	14.0	239.5	214.8	11.5
Service, body and parts	330.2	301.1	9.7	626.8	579.6	8.1
Total Revenues	3,173.3	3,000.2	5.8	5,846.2	5,588.9	4.6
Gross profit						
New vehicle	\$ 94.0	\$ 98.1	(4.2) %	\$ 174.2	\$ 182.6	(4.6) %
Used vehicle retail	92.1	84.9	8.5	173.2	157.1	10.2
Finance and insurance	126.7	111.1	14.0	239.5	214.8	11.5
Service, body and parts	167.7	149.0	12.6	317.2	284.3	11.6
Total Gross Profit	486.2	446.8	8.8	912.7	845.1	8.0
Gross profit margins						
New vehicle	5.6%	5.9%	(30bps)	5.7%	5.9%	(20bps)
Used vehicle retail	10.5	10.9	(40)	10.5	10.6	(10)
Finance and insurance	100.0	100.0	—	100.0	100.0	—
Service, body and parts	50.8	49.5	130	50.6	49.0	160
Total Gross Profit Margin	15.3	14.9	40	15.6	15.1	50
Retail units sold						
New vehicles	45,046	47,431	(5.0) %	82,529	87,606	(5.8) %
Used vehicles	42,250	37,778	11.8	80,779	72,860	10.9
Average selling price per retail unit						
New vehicles	\$ 37,289	\$ 35,332	5.5 %	\$ 36,941	\$ 35,278	4.7 %
Used vehicles	20,731	20,649	0.4	20,472	20,282	0.9
Average gross profit per retail unit						
New vehicles	\$ 2,087	\$ 2,068	0.9 %	\$ 2,110	\$ 2,084	1.2 %
Used vehicles	2,179	2,247	(3.0)	2,144	2,156	(0.6)
Finance and insurance	1,451	1,304	11.3	1,467	1,339	9.6

During the three months ended June 30, 2019, we had net income of \$61.9 million, or \$2.63 per share on a diluted basis, compared to net income of \$60.7 million, or \$2.44 per share on a diluted basis, during the same period of 2018. During the six months ended June 30, 2019, we had net income of \$118.3 million, or \$5.08 per share on a diluted basis, compared to net income of \$112.7 million, or \$4.50 per share on a diluted basis, during the same period of 2018.

New Vehicles

Under our business strategy, we believe that our new vehicle sales create incremental profit opportunities through certain manufacturer incentive programs, arranging of third party financing, vehicle service and insurance contracts, future resale of used vehicles acquired through trade-in and parts and service work. Same store new vehicle revenues increased 0.2% and decreased 1.4%, respectively, for the three and six-month periods ended June 30, 2019 compared to the same periods in 2018. This was due to decreases in unit volume of 5.0% and 5.8%, partially offset by increases in average selling prices of 5.5% and 4.7%, in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018. Our stores focused on increasing gross profit per new vehicle sold during the 2019 periods, generating increases of 0.9% and 1.2% for the three and six months ended June 30, 2019, respectively, compared to the same periods of 2018. Total company gross profit per new vehicle sold increased 0.4% and 1.8%, from \$2,070 to \$2,078 and from \$2,082 to \$2,119, for the three and six month-periods ended June 30, 2019, respectively, compared to the same periods of 2018. Our stores remain nimble in their volume and gross margin strategies and adapt to local and regional market conditions.

Used Vehicles

Used vehicle retail sales are a strategic focus for organic growth. We offer three categories of used vehicles: manufacturer certified pre-owned ("CPO") vehicles; core vehicles, or late-model vehicles with lower mileage; and value autos, or vehicles with over 80,000 miles. We have established a company-wide target of achieving a per store average of 85 used retail units per month. Strategies to achieve this target include reducing wholesale sales and selling the full spectrum of used units, from late model CPO models to vehicles over ten years old. During the six months ended June 30, 2019, our stores sold an average of 72 used vehicles per store per month, compared to 67 used vehicles per store per month for the same period of 2018.

Used vehicle revenues for the three and six-month periods ended June 30, 2019, increased 10.5% and 12.9%, respectively, compared to the same periods of 2018. The increases were driven by strong performance in our core and value auto categories at our seasoned stores. On a same store basis, used vehicle sales for the three and six-month periods ended June 30, 2019, increased 12.3% and 11.9%, respectively, as compared to the same periods of 2018. These increases were primarily driven by increases in our core vehicle category of 19.4% and 16.6% for the three and six-month periods ended June 30, 2019 and increases in our value auto vehicle category of 18.9% and 18.4% for the same periods, respectively. The increases in our core vehicle category were due to increases in unit sales of 18.4% and 15.8%, respectively, with average selling price per vehicle remaining consistent over the same periods of 2018. The increases in our value auto category were due to increases in unit sales of 16.7% and 14.5%, respectively, and increases in average selling price per vehicle of 1.8% and 3.5%, respectively, compared to the same periods of 2018.

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

Finance and Insurance

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

The increases in finance and insurance revenue in the three and six-month periods ended June 30, 2019, compared to the same periods of 2018, were primarily due to expanded product offerings and increased penetration rates. Third-party extended warranty and insurance contracts yield higher profit margins than vehicle sales and contribute significantly to our profitability. Same store finance and insurance revenues increased 14.0% and 11.5% for the three and six-month periods ended June 30, 2019, respectively, as compared to the same periods of 2018. These increases were driven by increases in finance and insurance revenues per retail unit, combined with increases in used vehicle unit volume, offset by decreases in new vehicle unit volume. On a same store basis, our finance and insurance revenues per retail unit increased \$147 to \$1,451 and \$128 to \$1,467 per unit, respectively, in the three and six-month periods ended June 30, 2019, compared to the same periods of 2018, primarily due to increases in service contract penetration rates of 230 and 130 basis points, respectively.

Service, body and parts

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

Our service, body, and parts revenue grew in customer pay and warranty sales in the three and six-month periods ended June 30, 2019, compared to the same periods of 2018. The growth experienced in the three and six-month periods ended June 30, 2019, was due to more late-model units in operation. We believe the increased number of units in operation will continue to benefit our service, body and parts revenue in the coming years as more late-model vehicles age, necessitating repairs and maintenance.

We focus on retaining customers by offering competitively-priced routine maintenance and through our marketing efforts. In the three and six-month periods ended June 30, 2019, the largest contributions to our service, body and parts revenue growth were increases of \$12.8 million, or 7.7%, and \$23.5 million, or 7.5%, respectively, in same store customer pay revenue, compared to the same periods of 2018. Same store warranty revenue grew 18.8% and 15.6% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018. Performance in parts wholesale and body shop grew slightly compared to the same periods of 2018.

Same store service, body and parts gross profit increased 12.6% and 11.6% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018, primarily as a result of higher gross margins as our mix has shifted towards customer pay, which has higher margins than other service work.

Segments

Certain financial information by segment is as follows:

(Dollars in millions)	Three Months Ended June 30,		Increase	% Increase
	2019	2018		
Revenues:				
Domestic	\$ 1,111.3	\$ 1,095.1	\$ 16.2	1.5%
Import	1,333.0	1,322.7	10.3	0.8
Luxury	764.6	677.5	87.1	12.9
	3,208.9	3,095.3	113.6	3.7
Corporate and other	12.8	1.2	11.6	NM
	<u>\$ 3,221.7</u>	<u>\$ 3,096.5</u>	<u>\$ 125.2</u>	<u>4.0%</u>

NM - not meaningful

(Dollars in millions)	Six Months Ended June 30,		Increase	% Increase
	2019	2018		
Revenues:				
Domestic	\$ 2,108.0	\$ 2,065.7	\$ 42.3	2.0%
Import	2,524.6	2,493.2	31.4	1.3
Luxury	1,419.6	1,194.0	225.6	18.9
	6,052.2	5,752.9	299.3	5.2
Corporate and other	19.2	3.3	15.9	NM
	<u>\$ 6,071.4</u>	<u>\$ 5,756.2</u>	<u>\$ 315.2</u>	<u>5.5%</u>

NM - not meaningful

(Dollars in millions)	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Segment income¹:				
Domestic	\$ 36.5	\$ 28.6	\$ 7.9	27.6 %
Import	39.5	30.2	9.3	30.8
Luxury	15.5	11.9	3.6	30.3
	91.5	70.7	20.8	29.4
Corporate and other	26.2	41.1	(14.9)	(36.3)
Depreciation and amortization	(20.2)	(18.8)	1.4	7.4
Other interest expense	(15.0)	(13.8)	1.2	8.7
Other income, net	3.0	1.6	1.4	NM
Income before income taxes	\$ 85.5	\$ 80.8	\$ 4.7	5.8 %

¹Segment income for each reportable segment is defined as income before income taxes, depreciation and amortization, other interest expense and other expense, net.
NM – not meaningful

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Segment income¹:				
Domestic	\$ 56.3	\$ 54.2	\$ 2.1	3.9 %
Import	69.5	53.3	16.2	30.4
Luxury	23.4	18.8	4.6	24.5
	149.2	126.3	22.9	18.1
Corporate and other	78.7	82.5	(3.8)	(4.6)
Depreciation and amortization	(40.0)	(35.7)	4.3	12.0
Other interest expense	(30.2)	(25.6)	4.6	18.0
Other income, net	5.6	3.0	2.6	NM
Income before income taxes	\$ 163.3	\$ 150.5	\$ 12.8	8.5 %

¹Segment income for each reportable segment is defined as income before income taxes, depreciation and amortization, other interest expense and other expense, net.

NM – not meaningful

	Three Months Ended June 30,		Decrease	% Decrease
	2019	2018		
Retail new vehicle unit sales:				
Domestic	13,530	14,697	(1,167)	(7.9)%
Import	25,365	27,376	(2,011)	(7.3)
Luxury	7,032	7,050	(18)	(0.3)
	45,927	49,123	(3,196)	(6.5)
Allocated to management	(40)	(96)	(56)	NM
	45,887	49,027	(3,140)	(6.4)%

NM – Not meaningful

	Six Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Retail new vehicle unit sales:				
Domestic	25,285	27,353	(2,068)	(7.6)%
Import	47,186	51,016	(3,830)	(7.5)
Luxury	13,224	12,388	836	6.7
	85,695	90,757	(5,062)	(5.6)
Allocated to management	(113)	(233)	(120)	NM
	85,582	90,524	(4,942)	(5.5)%

NM – Not meaningful

Domestic

A summary of financial information for our Domestic segment follows:

(Dollars in millions)	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Revenue:				
New vehicle	\$ 577.3	\$ 597.6	\$ (20.3)	(3.4)%
Used vehicle retail	321.0	283.4	37.6	13.3
Used vehicle wholesale	29.6	33.9	(4.3)	(12.7)
Finance and insurance	47.3	43.1	4.2	9.7
Service, body and parts	121.0	113.5	7.5	6.6
Fleet and other	15.1	23.6	(8.5)	NM
	\$ 1,111.3	\$ 1,095.1	\$ 16.2	1.5
Segment income	\$ 36.5	\$ 28.6	\$ 7.9	27.6
Retail new vehicle unit sales	13,530	14,697	(1,167)	(7.9)

NM - not meaningful

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Revenue:				
New vehicle	\$ 1,069.7	\$ 1,111.1	\$ (41.4)	(3.7)%
Used vehicle retail	621.5	548.3	73.2	13.4
Used vehicle wholesale	59.2	67.5	(8.3)	(12.3)
Finance and insurance	89.1	83.1	6.0	7.2
Service, body and parts	236.4	220.6	15.8	7.2
Fleet and other	32.1	35.1	(3.0)	NM
	<u>\$ 2,108.0</u>	<u>\$ 2,065.7</u>	<u>\$ 42.3</u>	<u>2.0%</u>
Segment income	\$ 56.3	\$ 54.2	\$ 2.1	3.9%
Retail new vehicle unit sales	25,285	27,353	(2,068)	(7.6)%

NM - not meaningful

Our Domestic segment revenue increased 1.5% and 2.0% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018 due to increases in used vehicle retail, finance and insurance, and service, body and parts revenues, offset by decreases in new vehicle revenue.

Our Domestic segment income increased 27.6% and 3.9% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018, primarily due to gross profit growth of 8.8% and 7.1%, respectively, partially offset by SG&A growth of 4.3% and 7.0%, respectively. Total SG&A as a percent of gross profit decreased from 74.4% to 71.3% for the three-month period and remained flat for the six-month period ended June 30, 2019, compared to the same periods of 2018. The decrease for the three-month period ended June 30, 2019 was driven by decreases in all categories of SG&A as a percentage of gross profit. Floor plan interest expense for domestic stores increased 9.1% and 14.6%, respectively, due to rising interest rates and increased volume for the three and six-month periods ended June 30, 2019, compared to the same periods of 2018.

Import

A summary of financial information for our Import segment follows:

(Dollars in millions)	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Revenue:				
New vehicle	\$ 740.8	\$ 772.0	\$ (31.2)	(4.0)%
Used vehicle retail	363.5	335.6	27.9	8.3
Used vehicle wholesale	29.0	31.0	(2.0)	(6.5)
Finance and insurance	60.8	54.8	6.0	10.9
Service, body and parts	127.3	116.4	10.9	9.4
Fleet and other	11.6	12.9	(1.3)	NM
	<u>\$ 1,333.0</u>	<u>\$ 1,322.7</u>	<u>\$ 10.3</u>	<u>0.8</u>
Segment income	\$ 39.5	\$ 30.2	\$ 9.3	30.8
Retail new vehicle unit sales	25,365	27,376	(2,011)	(7.3)

NM - not meaningful

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Revenue:				
New vehicle	\$ 1,373.4	\$ 1,439.6	\$ (66.2)	(4.6)%
Used vehicle retail	704.8	643.3	61.5	9.6
Used vehicle wholesale	56.9	59.2	(2.3)	(3.9)
Finance and insurance	115.6	106.6	9.0	8.4
Service, body and parts	245.0	226.0	19.0	8.4
Fleet and other	28.9	18.5	10.4	NM
	<u>\$ 2,524.6</u>	<u>\$ 2,493.2</u>	<u>\$ 31.4</u>	<u>1.3 %</u>
Segment income	<u>\$ 69.5</u>	<u>\$ 53.3</u>	<u>\$ 16.2</u>	<u>30.4 %</u>
Retail new vehicle unit sales	47,186	51,016	(3,830)	(7.5)%
NM - not meaningful				

Our Import segment revenue increased 0.8% and 1.3% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018 due to increases in used vehicle retail, finance and insurance, and service, body and parts revenues, offset by decreases in new vehicle revenue.

Import segment income increased 30.8% and 30.4% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018 primarily due to gross profit growth of 7.5% and 7.2%, respectively, partially offset by SG&A expense growth of 3.2% and 2.9%, respectively. Total import SG&A as a percent of gross profit decreased from 79.0% to 75.8% and from 80.4% to 77.2% for the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018. Improvements were seen in all SG&A categories as a percentage of gross profit. Floor plan interest expense for import stores increased 5.1% and 10.3%, respectively, due to rising interest rates and increased volume for the three and six-month periods ended June 30, 2019, compared to the same periods of 2018.

Luxury

A summary of financial information for our Luxury segment follows:

(Dollars in millions)	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Revenue:				
New vehicle	\$ 383.7	\$ 361.9	\$ 21.8	6.0 %
Used vehicle retail	203.1	184.9	18.2	9.8
Used vehicle wholesale	22.8	20.3	2.5	12.3
Finance and insurance	18.4	15.9	2.5	15.7
Service, body and parts	83.9	76.9	7.0	9.1
Fleet and other	52.7	17.6	35.1	NM
	<u>\$ 764.6</u>	<u>\$ 677.5</u>	<u>\$ 87.1</u>	<u>12.9</u>
Segment income	<u>\$ 15.5</u>	<u>\$ 11.9</u>	<u>\$ 3.6</u>	<u>30.3</u>
Retail new vehicle unit sales	7,032	7,050	(18)	(0.3)
NM - not meaningful				

(Dollars in millions)	Six Months Ended June 30,		Increase	% Increase
	2019	2018		
Revenue:				
New vehicle	\$ 723.2	\$ 640.4	\$ 82.8	12.9%
Used vehicle retail	389.4	327.8	61.6	18.8
Used vehicle wholesale	42.6	34.5	8.1	23.5
Finance and insurance	34.9	28.2	6.7	23.8
Service, body and parts	163.0	141.7	21.3	15.0
Fleet and other	66.5	21.4	45.1	NM
	<u>\$ 1,419.6</u>	<u>\$ 1,194.0</u>	<u>\$ 225.6</u>	<u>18.9%</u>
Segment income	\$ 23.4	\$ 18.8	\$ 4.6	24.5%
Retail new vehicle unit sales	13,224	12,388	836	6.7%

NM - not meaningful

Our Luxury segment revenue increased 12.9% and 18.9% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018 due to increases in all major business lines, led by strong fleet and new vehicle sales.

Our Luxury segment income increased 30.3% and 24.5% for the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018, primarily due to gross profit growth of 10.2% and 16.8%, respectively, offset by increases in SG&A expense of 6.5% and 14.4%, respectively. Luxury segment gross profit increases for the three and six-month periods ended June 30, 2019, compared to the same periods of 2018, were driven by strong performance in service, body and parts and increases in finance and insurance per unit. Total Luxury SG&A as a percent of gross profit decreased from 81.0% to 78.3% and from 82.4% to 80.7% for the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018. Improvements were seen in all SG&A categories as a percentage of gross profit. Floor plan interest expense increased 18.9% and 35.4% for the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018, due to rising interest rates and increased volume.

Corporate and Other

Revenues attributable to Corporate and other include the results of operations of our stand-alone body shops, offset by certain unallocated reserves and elimination adjustments related to vehicle sales.

(Dollars in millions)	Three Months Ended June 30,		Increase (Decrease)	% Decrease
	2019	2018		
Revenue, net	\$ 12.8	\$ 1.2	\$ 11.6	NM
Segment income	\$ 26.2	\$ 41.1	\$ (14.9)	(36.3)%

NM - not meaningful

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease)	% Decrease
	2019	2018		
Revenue, net	\$ 19.2	\$ 3.3	\$ 15.9	NM
Segment income	\$ 78.7	\$ 82.5	\$ (3.8)	(4.6)%

NM - not meaningful

The increases in Corporate and other revenue in the three and six-month periods ended June 30, 2019, compared to the same periods of 2018 were primarily related to increased finance and insurance incentives received that were not specifically related to any particular segment, and changes to certain reserves that were not specifically identified with our domestic, import or luxury segment revenue, such as our reserve for revenue reversals associated with unwound vehicle sales, and elimination of revenues associated with internal corporate vehicle purchases and leases with our stores.

Segment income attributable to Corporate and other includes amounts associated with the operating income from our stand-alone body shops and certain internal corporate expense allocations that reduce reportable segment income but increase Corporate and other income. These internal corporate expense allocations are used to increase comparability of our dealerships and reflect the capital burden a stand-alone dealership would experience. Examples of these internal allocations include internal rent expense,

internal floor plan financing charges, and internal fees charged to offset employees within our corporate headquarters who perform certain dealership functions. Segment income attributable to Corporate and other also includes gains on the divestiture of stores.

Corporate and other segment income decreased \$14.9 million and \$3.8 million for the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018, primarily due to increases to storm insurance reserve charges and increased personnel costs.

Asset Impairments

Asset impairments consist of the following:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Long-lived assets	\$ —	\$ —	\$ 0.5	\$ —

During the first quarter of 2019, we recorded an asset impairment of \$0.5 million associated with certain real properties which were under contract to sell. The long-lived assets were tested for recoverability and were determined to have a carrying value exceeding their fair value. See Note 7 of the Condensed Notes to the Consolidated Financial Statements for additional information.

Selling, General and Administrative Expense ("SG&A")

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

(Dollars in millions)	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Personnel	\$ 229.9	\$ 213.7	\$ 16.2	7.6 %
Advertising	28.0	27.6	0.4	1.4
Rent	10.6	11.9	(1.3)	(10.9)
Facility costs ¹	19.5	18.2	1.3	7.1
Loss on sale of assets	0.4	0.4	—	NM
Other	68.1	61.5	6.6	10.7
Total SG&A	\$ 356.5	\$ 333.3	\$ 23.2	7.0 %

¹ Includes variable lease costs related to the reimbursement of actual costs incurred by our lessors for common area maintenance, property taxes and insurance on leased property.

NM - not meaningful

As a % of gross profit	Three Months Ended June 30,		Increase (Decrease)
	2019	2018	
Personnel	46.6%	46.4%	20bp
Advertising	5.7	6.0	(30)
Rent	2.1	2.6	(50)
Facility costs	4.0	3.9	10
Loss on sale of assets	0.1	0.1	—
Other	13.7	13.4	30
Total SG&A	72.2%	72.4%	(20)bp

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Personnel	\$ 442.0	\$ 405.8	\$ 36.2	8.9 %
Advertising	54.5	53.1	1.4	2.6
Rent	20.8	23.1	(2.3)	(10.0)
Facility costs ¹	38.0	35.8	2.2	6.1
Loss on sale of assets	0.3	0.4	(0.1)	NM
Other	122.7	112.6	10.1	9.0
Total SG&A	\$ 678.3	\$ 630.8	\$ 47.5	7.5 %

¹ Includes variable lease costs related to the reimbursement of actual costs incurred by our lessors for common area maintenance, property taxes and insurance on leased property.

NM - not meaningful

As a % of gross profit	Six Months Ended June 30,		Increase (Decrease)
	2019	2018	
Personnel	46.8%	46.7%	10bp
Advertising	5.8%	6.1%	(30)
Rent	2.2%	2.7%	(50)
Facility costs	4.0%	4.1%	(10)
Loss on sale of assets	—%	—%	—
Other	13.0%	13.0%	—
Total SG&A	71.8%	72.6%	(80)bp

SG&A expense increased 7.0% and 7.5% in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018. Overall, SG&A expense increased due to personnel costs, driven by growth in gross profits, and storm reserve charges in the three and six-month periods ended June 30, 2019 compared to the same periods of 2018.

On a same store basis and excluding non-core charges, SG&A as a percentage of gross profit was 69.9% and 70.2% for the three and six-month periods ended June 30, 2019, respectively, compared to 71.0% and 71.7%, respectively, for the same periods of 2018. These decreases were primarily due to reduced rent expense and controlling overall costs while growing gross profit.

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

(Dollars in millions)	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Personnel	\$ 229.9	\$ 213.7	\$ 16.2	7.6 %
Advertising	28.0	27.6	0.4	1.4
Rent	10.6	11.9	(1.3)	(10.9)
Facility costs ¹	19.5	18.2	1.3	7.1
Adjusted loss on sale of assets	—	0.4	(0.4)	NM
Adjusted other	58.2	56.7	1.5	2.6
Adjusted total SG&A	\$ 346.2	\$ 328.5	\$ 17.7	5.4 %

¹ Includes variable lease costs related to the reimbursement of actual costs incurred by our lessors for common area maintenance, property taxes and insurance on leased property.

NM - not meaningful

As a % of gross profit	Three Months Ended June 30,		Increase (Decrease)
	2019	2018	
Personnel	46.6%	46.4%	20bp
Advertising	5.7%	6.0%	(30)
Rent	2.1%	2.6%	(50)
Facility costs	4.0%	3.9%	10
Adjusted loss on sale of assets	—%	0.1%	(10)
Adjusted other	11.7%	12.3%	(60)
Adjusted total SG&A	70.1%	71.3%	(120)bp

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
	2019	2018		
Personnel	\$ 442.0	\$ 405.8	\$ 36.2	8.9%
Advertising	54.5	53.1	1.4	2.6%
Rent	20.7	23.1	(2.4)	(10.4)%
Facility costs ¹	38.0	35.8	2.2	6.1%
Adjusted loss on sale of assets	—	0.4	(0.4)	NM
Adjusted other	112.7	107.8	4.9	4.5%
Adjusted total SG&A	\$ 667.9	\$ 626.0	\$ 41.9	6.7%

¹ Includes variable lease costs related to the reimbursement of actual costs incurred by our lessors for common area maintenance, property taxes and insurance on leased property.

NM - not meaningful

As a % of gross profit	Six Months Ended June 30,		Increase (Decrease)
	2019	2018	
Personnel	46.8%	46.7%	10bp
Advertising	5.8%	6.1%	(30)
Rent	2.2%	2.7%	(50)
Facility costs	4.0%	4.1%	(10)
Adjusted loss on sale of assets	—%	—%	—
Adjusted other	11.9%	12.5%	(60)
Adjusted total SG&A	70.7%	72.1%	(140)bp

Adjusted SG&A excludes \$8.4 million in storm insurance reserve charges, \$1.5 million in acquisition-related expenses, and a \$0.4 million net loss on store disposals in the three-month period ended June 30, 2019.

Adjusted SG&A excludes \$8.4 million in storm insurance reserve charges, \$1.7 million in acquisition-related expenses, and a \$0.3 million net loss on store disposals in the six-month period ended June 30, 2019.

For the three and six-month periods ended June 30, 2018, adjusted SG&A excludes acquisition related expenses of \$3.3 million and storm insurance reserve charges of \$1.5 million.

See "Non-GAAP Reconciliations" for more details.

Depreciation and Amortization

Depreciation and amortization is comprised of depreciation expense related to buildings, significant remodels or improvements, furniture, tools, equipment, signage, and amortization of certain intangible assets, including customer lists and non-compete agreements.

(Dollars in millions)	Three Months Ended June 30,		Increase	% Increase
	2019	2018		
Depreciation and amortization	\$ 20.2	\$ 18.8	\$ 1.4	7.4%

(Dollars in millions)	Six Months Ended June 30,		Increase	% Increase
	2019	2018		
Depreciation and amortization	\$ 40.0	\$ 35.7	\$ 4.3	12.0%

The increases of 7.4% and 12.0% in depreciation and amortization for the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018 were primarily due to capital expenditures and acquisitions that occurred in the first half of 2018. In 2018, we acquired approximately \$151 million in depreciable buildings and improvements and invested \$158 million in capital expenditures. For the first six months of 2019, capital expenditures totaled \$57.8 million. These investments increased the amount of depreciation expense in 2019. See the discussion under Liquidity and Capital Resources for additional information.

Operating Margin

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Operating margin	3.6%	3.5%	3.7%	3.5%
Operating margin adjusted for non-core charges ¹	3.9%	3.7%	3.9%	3.6%

¹ See "Non-GAAP Reconciliations" for more details.

Operating margin increased 10 and 20 basis points in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods in 2018. The increases in operating margin for the three and six-month periods ended June 30, 2019, were primarily due to overall increases in gross margin while continuing to integrate recently acquired stores and improvements in our cost structure compared to the same periods in 2018.

Floor Plan Interest Expense and Floor Plan Assistance

(Dollars in millions)	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2019	2018		2019	2018	
Floor plan interest expense (new vehicles)	\$ 19.4	\$ 15.6	24.4%	\$ 37.5	\$ 29.2	28.4%

Floor plan interest expense increased \$3.8 million and \$8.3 million in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018. The 24.4% increase in floor plan interest expense for the three-month period ended June 30, 2019, compared to the same period in 2018 includes a 6.5% increase related to the increase in same store inventory levels; a 1.1% decrease related to acquisition volume, net of divestitures; and a 19.0% increase related to increasing LIBOR rates as compared to the same period of 2018. The 28.4% increase in floor plan interest expense for the six-month period ended June 30, 2019, compared to the same period in 2018 includes a 6.5% increase related to the increase in same store inventory levels; a 1.9% increase due to acquisition volume, net of divestitures; and a 20.4% increase related to increasing LIBOR rates as compared to the same period of 2018.

Floor plan assistance is provided by manufacturers to support store financing of new vehicle inventory and is recorded as a component of new vehicle gross profit when the specific vehicle is sold. However, because manufacturers provide this assistance to offset inventory carrying costs, we believe a comparison of floor plan interest expense to floor plan assistance is a useful measure of the efficiency of our new vehicle sales relative to stocking levels.

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

(Dollars in millions)	Three Months Ended June 30,		Change	% Change
	2019	2018		
Floor plan interest expense (new vehicles)	\$ 19.4	\$ 15.6	\$ 3.8	24.4%
Floor plan assistance (included as an offset to cost of sales)	(17.3)	(17.5)	0.2	(1.1)
Net new vehicle carrying costs	\$ 2.1	\$ (1.9)	\$ 4.0	NM

NM - not meaningful

(Dollars in millions)	Six Months Ended June 30,		Change	% Change
	2019	2018		
Floor plan interest expense (new vehicles)	\$ 37.5	\$ 29.2	\$ 8.3	28.4%
Floor plan assistance (included as an offset to cost of sales)	(32.3)	(31.7)	(0.6)	1.9
Net new vehicle carrying costs	\$ 5.2	\$ (2.5)	\$ 7.7	NM

NM - Not meaningful

Other Interest Expense

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

(Dollars in millions)	Three Months Ended June 30,		Increase	% Increase
	2019	2018		
Mortgage interest	\$ 7.1	\$ 5.7	\$ 1.4	24.6
Other interest	8.6	8.4	0.2	2.4
Capitalized interest	(0.7)	(0.3)	0.4	NM
Total other interest expense	\$ 15.0	\$ 13.8	\$ 1.2	8.7%

NM - not meaningful

(Dollars in millions)	Six Months Ended June 30,		Increase	% Increase
	2019	2018		
Mortgage interest	\$ 14.0	\$ 10.6	\$ 3.4	32.1%
Other interest	17.6	15.5	2.1	13.5
Capitalized interest	(1.3)	(0.5)	0.8	NM
Total other interest expense	\$ 30.3	\$ 25.6	\$ 4.7	18.4%

NM - not meaningful

The increases of \$1.2 million and \$4.7 million in other interest expense in the three and six-month periods ended June 30, 2019, respectively, compared to the same periods of 2018 were primarily due to increased interest rates and higher mortgage interest due to additional mortgage financings.

Income Tax Provision

Our effective income tax rate was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Effective income tax rate	27.6%	24.9%	27.6%	25.1%

Our effective income tax rate for the three and six-month periods ended June 30, 2019 were negatively affected by excess tax deficiencies on stock awards vesting in the current periods and increases in the current state effective tax rate, primarily due to enactment of combined reporting in New Jersey beginning January 1, 2019. We estimate our annual effective tax rate, excluding non-core charges, to be 27.6%.

Non-GAAP Reconciliations

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

The following tables reconcile certain reported non-GAAP measures to the most comparable GAAP measure from our Consolidated Statements of Operations.

Three Months Ended June 30, 2019						
(Dollars in millions, except per share amounts)	As reported	Acquisition expenses	Net disposal loss on sale of stores	Insurance reserves	Adjusted	
Selling, general and administrative	\$ 356.5	\$ (1.5)	\$ (0.4)	\$ (8.4)	\$ 346.2	
Operating income	116.9	1.5	0.4	8.4	127.2	
Income before income taxes	\$ 85.5	\$ 1.5	\$ 0.4	\$ 8.4	\$ 95.8	
Income tax provision	(23.6)	(0.4)	(0.1)	(2.3)	(26.4)	
Net income	<u>\$ 61.9</u>	<u>\$ 1.1</u>	<u>\$ 0.3</u>	<u>\$ 6.1</u>	<u>\$ 69.4</u>	
Diluted net income per share	\$ 2.63	\$ 0.05	\$ 0.01	\$ 0.26	\$ 2.95	
Diluted share count	23.5					

Three Months Ended June 30, 2018						
(Dollars in millions, except per share amounts)	As reported	Acquisition expenses	Insurance reserves	Tax attributes	Adjusted	
Selling, general and administrative	\$ 333.3	\$ (3.3)	\$ (1.5)	\$ —	\$ 328.5	
Operating income	108.6	3.3	1.5	—	113.4	
Income before income taxes	\$ 80.8	\$ 3.3	\$ 1.5	\$ —	\$ 85.6	
Income tax provision	(20.1)	(0.9)	(0.4)	(1.4)	(22.8)	
Net income (loss)	<u>\$ 60.7</u>	<u>\$ 2.4</u>	<u>\$ 1.1</u>	<u>\$ (1.4)</u>	<u>\$ 62.8</u>	
Diluted net income (loss) per share	\$ 2.44	\$ 0.10	\$ 0.04	\$ (0.06)	\$ 2.52	
Diluted share count	24.9					

Six Months Ended June 30, 2019

(Dollars in millions, except per share amounts)	Six Months Ended June 30, 2019					
	As reported	Acquisition expenses	Net disposal loss on sale of stores	Insurance reserves	Asset impairments	Adjusted
Asset impairment	\$ 0.5	\$ —	\$ —	\$ —	\$ (0.5)	\$ —
Selling, general and administrative	678.3	(1.7)	(0.3)	(8.4)	—	667.9
Operating income	225.5	1.7	0.3	8.4	0.5	236.4
Income before income taxes	\$ 163.3	\$ 1.7	\$ 0.3	\$ 8.4	\$ 0.5	\$ 174.2
Income tax provision	(45.0)	(0.5)	(0.1)	(2.3)	(0.1)	(48.0)
Net income	\$ 118.3	\$ 1.2	\$ 0.2	\$ 6.1	\$ 0.4	\$ 126.2
Diluted net income per share	\$ 5.08	\$ 0.05	\$ 0.01	\$ 0.26	\$ 0.02	\$ 5.42
Diluted share count	23.3					

Six Months Ended June 30, 2018

(Dollars in millions, except per share amounts)	Six Months Ended June 30, 2018				
	As reported	Acquisition expenses	Insurance reserves	Tax attributes	Adjusted
Selling, general and administrative	\$ 630.8	\$ (3.3)	\$ (1.5)	\$ —	\$ 626.0
Operating income	202.3	3.3	1.5	—	207.1
Income before income taxes	\$ 150.5	\$ 3.3	\$ 1.5	\$ —	\$ 155.3
Income tax provision	(37.8)	(0.9)	(0.4)	(1.4)	(40.5)
Net income (loss)	\$ 112.7	\$ 2.4	\$ 1.1	\$ (1.4)	\$ 114.8
Diluted net income (loss) per share	\$ 4.50	\$ 0.11	\$ 0.04	\$ (0.06)	\$ 4.59
Diluted share count	25.0				

Liquidity and Capital Resources

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

Available Sources

Below is a summary of our immediately available funds:

(Dollars in millions)	As of June 30,			
	2019	2018	Increase	% Increase
Cash and cash equivalents	\$ 44.7	\$ 30.0	\$ 14.7	49.0%
Available credit on the credit facilities	217.8	204.3	13.5	6.6
Total current available funds	262.5	234.3	28.2	12.0
Estimated funds from unfinanced real estate	247.1	222.4	24.7	11.1
Total estimated available funds	\$ 509.6	\$ 456.7	\$ 52.9	11.6%

Cash flows generated by operating activities and borrowings under our credit facility and other types of debt are our most significant sources of liquidity. We also have the ability to raise funds through mortgaging real estate. As of June 30, 2019, our unencumbered owned operating real estate had a book value of \$329 million. Assuming we can obtain financing on 75% of this value, we estimate we could have obtained additional funds of approximately \$247 million at June 30, 2019; however, no assurances can be provided that the appraised value of these properties will match or exceed their book values or that this capital source will be available on terms acceptable to us.

In addition to the above sources of liquidity, potential sources include the placement of subordinated debt or loans, the sale of equity securities and the sale of stores or other assets. We evaluate all of these options and may select one or more of them depending on overall capital needs and the availability and cost of capital, although no assurances can be provided that these capital sources will be available in sufficient amounts or with terms acceptable to us.

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

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease) in Cash Flow
	2019	2018	
Net cash provided by operating activities	\$ 244.4	\$ 236.3	\$ 8.1
Net cash used in investing activities	(109.8)	(451.5)	341.7
Net cash (used in) provided by financing activities	(121.5)	187.9	(309.4)

Operating Activities

Cash provided by operating activities for the six-month period ended June 30, 2019, increased \$8.1 million compared to the same period of 2018, primarily related to an increase in floor plan notes payable related to our floor plan credit facility with Chrysler Capital, offset by increasing inventory growth, and a decrease in other long-term liabilities compared to the same period of 2018.

In the second quarter of 2019, we entered into a floor plan credit facility with Chrysler Capital. This facility provides floor plan financing for new vehicle inventory at certain Chrysler locations. As this facility is provided through a manufacturer partner, we classify these changes as an operating activity. During the second quarter of 2019, we reclassified \$52.0 million from financing activities to operating activities as these funds were used to pay off our Chrysler inventory previously floored under our syndicated line.

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

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

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease) in Cash Flow
	2019	2018	
Net cash provided by operating activities – as reported	\$ 244.4	\$ 236.3	\$ 8.1
Add: Net (repayments) borrowings on floor plan notes payable, non-trade	(11.1)	85.8	(96.9)
Less: Borrowings on floor plan notes payable, non-trade associated with acquired new vehicle inventory	(19.3)	(120.9)	101.6
Net cash provided by operating activities – adjusted	\$ 214.0	\$ 201.2	\$ 12.8

Inventories are the most significant component of our cash flow from operations. As of June 30, 2019, our new vehicle days' supply was 77, or six days higher than our days' supply as of December 31, 2018. Our days' supply of used vehicles was 61 days as of June 30, 2019, or five days lower than our days' supply as of December 31, 2018. We calculate days' supply of inventory based on current inventory levels, excluding in-transit vehicles, and a 30-day historical cost of sales level. We have continued to focus on managing our unit mix and maintaining an appropriate level of new and used vehicle inventory.

Investing Activities

Net cash used in investing activities totaled \$109.8 million and \$451.5 million, respectively, for the six-month periods ended June 30, 2019 and 2018.

Below are highlights of significant activity related to our cash flows from investing activities:

(Dollars in millions)	Six Months Ended June 30,		Increase in Cash Flow
	2019	2018	
Capital expenditures	\$ (57.8)	\$ (72.4)	\$ 14.6
Cash paid for acquisitions, net of cash acquired	(75.0)	(374.6)	299.6
Cash paid for other investments	(6.7)	(7.1)	0.4
Proceeds from sales of stores	28.9	0.8	28.1

Capital Expenditures

Below is a summary of our capital expenditure activities:

(Dollars in millions)	Six Months Ended June 30,	
	2019	2018
Post-acquisition capital improvements	\$ 14.0	\$ 31.1
Facilities for open points	1.6	6.2
Purchases of previously leased facilities	2.2	9.0
Existing facility improvements	20.3	7.9
Maintenance	19.7	18.2
Total capital expenditures	\$ 57.8	\$ 72.4

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

We expect to use a portion of our future capital expenditures to upgrade facilities that we recently acquired. This additional capital investment is contemplated in our initial evaluation of the investment return metrics applied to each acquisition and is usually associated with manufacturer standards and requirements. The decrease in capital expenditures for the six-month period ended June 30, 2019, compared to the same period of 2018 related primarily to lower post-acquisition capital improvements due to fewer acquisition related activities.

If we undertake a significant capital commitment in the future, we expect to pay for the commitment out of existing cash balances, construction financing and borrowings on our credit facility. Upon completion of the projects, we believe we would have the ability to secure long-term financing and general borrowings from third party lenders for 70% to 90% of the amounts expended, although no assurances can be provided that these financings will be available to us in sufficient amounts or on terms acceptable to us.

Acquisitions

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

We are able to subsequently floor new vehicle inventory acquired as part of an acquisition; however, the cash generated by this transaction is recorded as borrowings on floor plan notes payable, non-trade.

Adjusted net cash paid for acquisitions, as well as certain other acquisition-related information is presented below:

	Six Months Ended June 30,	
	2019	2018
Number of stores acquired	2	17
(Dollars in millions)		
Cash paid for acquisitions, net of cash acquired	\$ 75.0	\$ 374.6
Less: Borrowings on floor plan notes payable: non-trade associated with acquired new vehicle inventory	(19.3)	(120.9)
Cash paid for acquisitions, net of cash acquired – adjusted	<u>\$ 55.7</u>	<u>\$ 253.7</u>

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

Financing Activities

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

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease) in Cash Flow
	2019	2018	
Cash (used in) provided by financing activities, as reported	\$ (121.5)	\$ 187.9	\$ (309.4)
Adjust: Borrowings (repayments) on floor plan notes payable: non-trade	11.1	(85.8)	96.9
Cash used in financing activities – adjusted	<u>\$ (110.4)</u>	<u>\$ 102.1</u>	<u>\$ (212.5)</u>

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

(Dollars in millions)	Six Months Ended June 30,		Increase (Decrease) in Cash Flow
	2019	2018	
Net (repayments) borrowings on lines of credit	\$ (39.0)	\$ 99.2	\$ (138.2)
Principal payments on long-term debt and capital leases, unscheduled	(11.0)	(5.3)	(5.7)
Proceeds from issuance of long-term debt	—	62.1	(62.1)
Repurchases of common stock	(3.1)	(33.9)	30.8
Dividends paid	(13.7)	(13.9)	0.2
Other financing activity	(36.5)	—	(36.5)

Equity Transactions

In May 2019, we entered into a structured repurchase agreement involving the use of capped call options for the purchase of our Class A common stock. We paid a fixed sum upon execution of the agreement in exchange for the right to receive either a pre-determined amount of cash or stock. Upon expiration of the agreement, if the closing market price of our common stock is above the pre-determined price, we will have our initial investment returned with a premium in either cash or shares (at our election). If the closing market price of our common stock is at or below the pre-determined price, we will receive the number of shares specified in the agreement. We paid net premiums of \$36.5 million in the second quarter of 2019 to enter into this agreement, which was recorded as a reduction of additional paid-in-capital and retained earnings. As of June 30, 2019, the options were outstanding.

In the first six months of 2019, we declared and paid dividends on our Class A and Class B common stock as follows:

Dividend paid:	Dividend amount per share	Total amount of dividend (in millions)
March 2019	\$ 0.29	\$ 6.7
May 2019	\$ 0.30	\$ 7.0

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

Summary of Outstanding Balances on Credit Facilities and Long-Term Debt

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

(Dollars in millions)	As of June 30, 2019		
	Outstanding	Remaining Available	
Floor plan note payable: non-trade	\$ 1,709.6	\$ —	1
Floor plan notes payable	414.1	—	
Used vehicle inventory financing facility	320.0	1.9	2
Revolving lines of credit	104.5	215.9	2,3
Real estate mortgages	596.7	—	
5.25% Senior Subordinated Notes due 2025	300.0	—	
Other debt	33.8	—	
Total debt outstanding	3,478.7	217.8	
Less: unamortized debt issuance costs	(5.5)	—	
Total debt	\$ 3,473.2	\$ 217.8	

¹ As of June 30, 2019, we had a \$2.0 billion new vehicle floor plan commitment as part of our credit facility.

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

³ Available credit is based on the borrowing base amount effective as of May 31, 2019. This amount is reduced by \$13.0 million for outstanding letters of credit.

Credit Facility

Our syndicated credit facility is comprised of 20 financial institutions, including seven manufacturer-affiliated finance companies, with a maturity date of July 2023.

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

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

The interest rate on the credit facility, as amended, varies based on the type of debt, with the rate of one-month LIBOR plus 1.25% for new vehicle floor plan financing, one-month LIBOR plus 1.50% for used vehicle floor plan financing and a variable interest rate on the revolving financing ranging from the one-month LIBOR plus 1.25% to 2.25% depending on our leverage ratio. The annual interest rate associated with our new vehicle floor plan commitment was 3.65% at June 30, 2019. The annual interest rate associated with our used vehicle inventory financing facility and our revolving line of credit was 3.90% at June 30, 2019.

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

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

Debt Covenant Ratio	Requirement	As of June 30, 2019
Current ratio	Not less than 1.10 to 1	1.25 to 1
Fixed charge coverage ratio	Not less than 1.20 to 1	2.09 to 1
Leverage ratio	Not more than 5.00 to 1	2.66 to 1

As of June 30, 2019, we were in compliance with all covenants. We expect to remain in compliance with the financial and restrictive covenants in our credit facility and other debt agreements. However, no assurances can be provided that we will continue to remain in compliance with the financial and restrictive covenants.

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

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

Other Lines of Credit

During 2019 we entered into a revolving line of credit agreement with Chrysler Capital, a program of Chrysler Group LLC and Santander Consumer USA. The revolving line of credit includes a commitment of up to \$20.0 million, secured by certain assets from select Chrysler locations. The interest rate on this revolving line is equal to the one-month LIBOR rate plus 1.50%. Along with this new line with Chrysler Capital, we have a revolving line of credit with Ford Motor Credit Company, bringing our other lines of credit to a total financing commitment of \$80.0 million. These other lines of credit mature in 2021 and have interest rates up to 7.95%. As of June 30, 2019, nothing was outstanding on these other lines of credit.

Floor Plan Notes Payable

We have floor plan agreements with manufacturer-affiliated finance companies for certain new vehicles and vehicles that are designated for use as service loaners. During 2019 we entered into a floor plan agreement with Chrysler Capital. This facility provides floor plan financing for new vehicle inventory at select Chrysler locations. The interest rates on these floor plan notes payable commitments vary by manufacturer and are variable rates. As of June 30, 2019, \$414.1 million was outstanding on these agreements at interest rates ranging up to 7.00%. Borrowings from, and repayments to, manufacturer-affiliated finance companies are classified as operating activities in the Consolidated Statements of Cash Flows.

Real Estate Mortgages and Other Debt

We have mortgages associated with our owned real estate. Interest rates related to this debt ranged from 3.0% to 5.3% at June 30, 2019. The mortgages are payable in various installments through August 1, 2038. As of June 30, 2019, we had fixed interest rates on 71% of our outstanding mortgage debt.

Our other debt, which totaled \$33.8 million at June 30, 2019, includes finance leases and sellers' notes. See Note 10 of the Condensed Notes to the Consolidated Financial Statements for additional information on finance leases.

5.25% Senior Notes Due 2025

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

We paid \$5.0 million of underwriting and other fees in connection with this issuance, which is being amortized as interest expense over the term of the Notes. The Notes are fully and unconditionally guaranteed, jointly and severally, on a senior unsecured basis by each of our existing and future restricted subsidiaries that is a borrower under, or that guarantees obligations under, our credit facility or other indebtedness. The terms of the Notes, in certain circumstances, may restrict our ability to, among other things, incur additional indebtedness, pay dividends, repurchase our common stock, or merge, consolidate or sell all or substantially all our assets.

We used the net proceeds for general corporate purposes, which included funding acquisitions, capital expenditures, and debt repayment.

Recent Accounting Pronouncements

See Note 13 of the Condensed Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Critical Accounting Policies and Use of Estimates

There have been no material changes in the critical accounting policies and use of estimates described in our 2018 Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 22, 2019.

See also Note 1 and Note 10 of the Condensed Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q for additional information including the impact of our January 1, 2019 adoption of Topic 842 - Leases and related updates.

Seasonality and Quarterly Fluctuations

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

Off-Balance Sheet Arrangements

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in our reported market risks or risk management policies since the filing of our 2018 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 22, 2019.

Item 4. Controls and Procedures***Evaluation of Disclosure Controls and Procedures***

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

Changes in Internal Control Over Financial Reporting

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

PART II - OTHER INFORMATION

Item 1. 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 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in our 2018 Annual Report on Form 10-K. The information in this Form 10-Q should be read in conjunction with the risk factors and information disclosed in that report, which was filed with the Securities and Exchange Commission on February 22, 2019.

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

We repurchased the following shares of our Class A common stock during the second quarter of 2019:

	Total number of shares purchased ²	Average price paid per share	Total number of shares purchased as part of publicly announced plans ¹	Maximum dollar value of shares that may yet be purchased under publicly announced plan (in thousands) ¹
April	—	\$ —	—	\$ 233,603
May	127	113.54	—	233,603
June	—	—	—	233,603
	<u>127</u>	<u>\$ —</u>	<u>—</u>	<u>\$ 233,603</u>

¹ On October 22, 2018, our Board of Directors approved a \$250 million repurchase authorization. This authorization does not have an expiration date.

² The shares repurchased in the second quarter of 2019 were related to tax withholdings on vesting RSUs.

Item 6. Exhibits

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

3.1	Restated Articles of Incorporation as amended
3.3	Second Amended and Restated Bylaws of Lithia Motors, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Form 8-K filed April 25, 2019).
4.1	Indenture, dated as of July 24, 2017, among Lithia Motors, Inc., the Guarantors and the Trustee (incorporated by reference to exhibit 4.1 to Form 8-K dated July 24, 2017 and filed with the Securities and Exchange Commission on July 24, 2017).
4.2	Form of 5.250% Senior Notes due 2025 (included as part of Exhibit 4.1)(incorporated by reference to exhibit 4.1 to Form 8-K dated July 24, 2017 and filed with the Securities and Exchange Commission on July 24, 2017).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
32.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

SIGNATURE

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

Date: July 26, 2019

LITHIA MOTORS, INC.

By: /s/ Tina Miller

Tina Miller

Vice President and Chief Accounting Officer

(Duly Authorized Officer and Principal Financial and Accounting Officer)

RESTATED ARTICLES OF INCORPORATION

OF

LITHIA MOTORS, INC.

(as amended as of April 25, 2019)

The following version of the Restated Articles of Incorporation of Lithia Motors, Inc., an Oregon corporation, filed with the Oregon Secretary of State on October 21, 1996, has been prepared for and filed with the Securities and Exchange Commission and includes the amendment reflected in Articles of Amendment filed with the Oregon Secretary of State on May 13, 1999 and April 25, 2019:

ARTICLE I: NAME OF CORPORATION

The name of the corporation is Lithia Motors, Inc.

ARTICLE II: NUMBER OF AUTHORIZED SHARES

The total number of shares of stock of all classes which the corporation shall have the authority to issue is one hundred forty million (140,000,000) shares, consisting of fifteen million (15,000,000) shares of a single class of preferred stock with no par value, one hundred million (100,000,000) shares of Class A Common Stock with no par value, and twenty-five million (25,000,000) shares of Class B Common Stock with no par value. After any shares of Class A Common Stock are issued and outstanding, the Board of Directors of the corporation shall not, without the vote or consent of the holders of the corporation's Class A Common Stock, issue any shares of Class B Common Stock except as provided by Article III, Section 2.

ARTICLE III: RIGHTS AND LIMITATIONS OF CAPITAL STOCK

The relative rights and limitations of each class of capital stock shall be as set forth in this Article III.

Section 1. Voting of Class A and Class B Stock.

- (a) In all elections of directors, and in all other matters as to which the vote or consent of shareholders of the corporation shall be required or shall be taken, each holder of one or more shares of Class A Common Stock shall be entitled to one (1) vote for each share of the Class A Common Stock then held.
- (b) In all elections of directors, and in all other matters as to which the vote or consent of shareholders of the corporation shall be required or shall be taken, each holder of one or more shares of Class B Common Stock shall be entitled to ten (10) votes for each share of the Class B Common Stock then held.

(c) Except as otherwise required by law, the holders of shares of Class A Common Stock and the holders of shares of Class B Common Stock shall vote together as one class on all matters submitted to a vote of the corporation's shareholders.

Section 2. Dividends and Distributions.

With Respect to Class A and Class B Stock. The holders of shares of Class A Common Stock and the holders of shares of Class B Common Stock shall be entitled to receive whatever dividends, payable in cash or otherwise, are lawfully declared by the Board of Directors from time to time with respect to those shares. Shares of Class A Common Stock and Class B Common Stock shall have equal rights to share in and receive any dividends, liquidation proceeds and other distributions made by the corporation with respect to the corporation's common stock. In furtherance of and not limiting the foregoing, in the event that the holders of shares of Class A Common Stock are entitled to receive a dividend or distribution payable in whole or in part in additional shares of Class A Common Stock, the holders of shares of Class B Common Stock shall be entitled to receive a proportionately equal dividend or distribution payable in shares of Class B Common Stock.

Section 3. Restrictions on Transfer of Class B Stock.

(a) Except as provided in subsection 3(b) of this Article III, no person holding shares of Class B Common Stock or any beneficial interest therein (a "Class B Holder") may transfer any interest in such Class B shares to any person other than a "Permitted Transferee". Neither the corporation nor the transfer agent, if any, for the Class B Common Stock (the "Transfer Agent"), shall register the transfer of any interest in shares of Class B Common Stock, except to a "Permitted Transferee" of the transferor.

(b) For purposes of this Section 3, the term "Permitted Transferee" shall mean and include the corporation and also shall have the following meanings in the indicated circumstances:

(1) In the case of a Class B Holder who is a natural person holding record and beneficial ownership of one or more shares of Class B Common Stock, "Permitted Transferee" means:

(i) The spouse of that Class B Holder (the "Spouse").

(ii) A lineal descendant of a great grandparent of that Class B Holder or of the Spouse (a "Descendant").

(iii) The trustee of a trust (including a voting trust) maintained for the benefit of any one or more of the following persons, and for no other person: (A) that Class B Holder, (B) the Spouse, (C) one or more Descendants, or (D) an organization to which contributions are deductible for federal income, estate or gift tax purposes (a "Charitable Organization"). A trust described in the preceding sentence may grant a general or special power of appointment to the Spouse or to one or more of the Descendants. A trust described in the first

sentence of this subsection 3(b)(1)(iii) may permit trust assets to be used to pay taxes, legacies and other obligations of the trust or of the estate of the Class B Holder which are payable by reason of the death of the Class B Holder, the Spouse or a Descendant. In order to be a "Permitted Transferee", a trust which is otherwise described in this subsection 3(b)(1)(iii) must prohibit any transfer (other than the granting of a power of appointment as provided in the second sentence of this subsection 3(b)(1)(iii)) of any beneficial interest in shares of Class B Common Stock to any person other than "Permitted Transferees" as defined in clauses (A) through (D) of this subsection 3(b)(1)(iii). A trust which satisfies all of the conditions of this subsection 3(b)(1)(iii) shall be referred to herein as a "Trust".

(iv) Any Charitable Organization, including but not limited to a Charitable Organization established by that Class B Holder or a Descendant.

(v) An Individual Retirement Account, as defined in Section 408(a) of the Internal Revenue Code, with respect to which that Class B Holder is a participant or beneficiary, but only if that Class B Holder is vested with the power to direct the investment of funds deposited into that Individual Retirement Account and to control the voting of securities held by that Individual Retirement Account (an "IRA").

(vi) A pension, profit sharing, stock bonus or other type of plan or trust with respect to which that Class B Holder is a participant or beneficiary and which satisfies the requirements for qualification under Section 401 of the Internal Revenue Code, but only if that Class B Holder is vested with the power to direct the investment of funds deposited into that plan or trust and to control the voting of securities held by that plan or trust (a "Plan").

(vii) A corporation all of the outstanding capital stock of which is owned by persons who are included in one or more of the following classes of permitted owners: (A) that Class B Holder, (B) the Spouse, (C) one or more Descendants, (D) any Permitted Transferee of that Class B Holder (determined pursuant to this subsection 3(b)), (E) any other Class B Holder, and/or (F) a Permitted Transferee of any other Class B Holder (determined pursuant to this subsection 3(b)). If 50% or more of the voting shares of a corporation described in the preceding sentence (or of any survivor of a merger or consolidation of such a corporation), are acquired in the aggregate by one or more persons who are not included in one or more of the classes of permitted owners described in the preceding sentence, then all shares of Class B Common Stock then held by that corporation shall be deemed without further act on any person's part to be converted into shares of Class A Common Stock in accordance with the provisions of subsection 4(b) of this Article III, and any and all stock certificates representing those shares of Class B Common Stock shall thereupon cease to represent shares of Class B Common Stock and shall thereafter be deemed for all purposes to represent an identical number of shares of Class A Common Stock.

(viii) A partnership in which more than fifty percent (50%) of the capital interests and more than fifty percent (50%) of the voting interests are owned by persons who are included in one or more of the following classes of permitted owners: (A) that Class B Holder, (B) the Spouse, (C) one or more Descendants, (D) any Permitted Transferee of that Class B Holder (determined pursuant to this subsection 3(b)), (E) any other Class B Holder, and/or (F) a

Permitted Transferee of any other Class B Holder (determined pursuant to this subsection

3(b)). If 50% or more of the capital interests or 50% or more of the voting interests in a partnership described in the preceding sentence are acquired in the aggregate by one or more persons who are not included in one or more of the classes of permitted owners described in the preceding sentence, then all shares of Class B Common Stock then held by that partnership shall be deemed without further act on any person's part to be converted into shares of Class A Common Stock in accordance with the provisions of subsection 4(b) of this Article III, and any and all stock certificates representing those shares of Class B Common Stock shall thereupon cease to represent shares of Class B Common Stock and shall thereafter be deemed for all purposes to represent an identical number of shares of Class A Common Stock.

(ix) A limited liability company in which more than fifty percent (50%) of the capital interests and more than fifty percent (50%) of the voting interests are owned by persons who are included in one or more of the following classes of permitted owners: (A) that Class B Holder, (B) the Spouse, (C) one or more Descendants, (D) any Permitted Transferee of that Class B Holder (determined pursuant to this subsection 3(b)), (E) any other Class B Holder, and/or (F) a Permitted Transferee of any other Class B Holder (determined pursuant to this subsection 3(b)). If 50% or more of the capital interests or 50% or more of the voting interests in a limited liability company described in the preceding sentence are acquired in the aggregate by one or more persons who are not included in one or more of the classes of permitted owners described in the preceding sentence, then all shares of Class B Common Stock then held by that limited liability company shall be deemed without further act on any person's part to be converted into shares of Class A Common Stock in accordance with the provisions of subsection 4(b) of this Article III, and any and all stock certificates representing those shares of Class B Common Stock shall thereupon cease to represent shares of Class B Common Stock and shall thereafter be deemed for all purposes to represent an identical number of shares of Class A Common Stock.

(x) Another Class B Holder or another Class B Holder's Permitted Transferee (determined pursuant to this subsection 3(b)).

(xi) In the event of the death of a Class B Holder, that Class B Holder's estate and heirs.

(2) In the case of a Class B Holder which is holding shares of Class B Common Stock as trustee of an IRA, a Plan or a Trust other than a Trust described in subsection 3(b)(3) of this Article III, each of the following shall be a "Permitted Transferee": (a) any participant in or beneficiary of such IRA, such Plan or such Trust, (b) the person who transferred those shares of Class B Common Stock to such IRA, such Plan or such Trust, and (c) a Permitted Transferee of any person described in clause (a) or (b) of this subsection 3(b)(2).

(3) In the case of a Class B Holder which is holding shares of Class B Common Stock as trustee pursuant to a Trust which is irrevocable on the "Issue Date" (as defined in subsection 3(d)(6)), "Permitted Transferee" means any person in existence on the Issue Date to whom or for whose benefit principal may be distributed either during the term of that Trust or at the end of the term of that Trust, whether by power of appointment or otherwise.

(4) In the case of a Class B Holder which is holding record (but not beneficial) ownership of shares of Class B Common Stock as nominee for the person who is the beneficial owner thereof on the "Issue Date", "Permitted Transferee" means that beneficial owner and a Permitted Transferee of that beneficial owner (determined pursuant to this subsection 3(b)).

(5) In the case of a Class B Holder which is a partnership holding record and beneficial ownership of shares of Class B Common Stock, "Permitted Transferee" means any person who is a partner of that partnership at the time that partnership first becomes a Class B Holder, and also means any Permitted Transferee of that partner (determined pursuant to this subsection 3(b)).

(6) In the case of a Class B Holder which is a limited liability company holding record and beneficial ownership of shares of Class B Common Stock, "Permitted Transferee" means any person who is a member of that limited liability company at the time that limited liability company first becomes a Class B Holder, and also means any Permitted Transferee of that member (determined pursuant to this subsection 3(b)).

(7) In the case of a Class B Holder which is a corporation (other than a Charitable Organization described in subsection 3(b)(1)(iv)) holding record and beneficial ownership of shares of Class B Common Stock (a "Corporate Holder"), "Permitted Transferee" means: (a) any person who is a shareholder of that Corporate Holder at the time the Corporate Holder first becomes a Class B Holder, or any Permitted Transferee of any such shareholder (determined pursuant to this subsection 3(b)); and (b) the survivor (the "Survivor") of a merger or consolidation of that Corporate Holder, but only for so long as that Survivor is controlled, directly or indirectly, by: (i) those shareholders of the Corporate Holder who are shareholders of the Corporate Holder at the time the Corporate Holder first becomes a Class B Holder, and/or (ii) any Permitted Transferees of such shareholders (determined pursuant to this subsection 3(b)).

(8) In the case of a Class B Holder which is the estate of a deceased Class B Holder which held record and beneficial ownership of shares of Class B Common Stock at the time of death, and in the case of a Class B Holder which is the estate of a bankrupt or insolvent Class B Holder which held record and beneficial ownership of shares of Class B Common Stock at the time of bankruptcy or insolvency, "Permitted Transferee" means a Permitted Transferee of that deceased, bankrupt or insolvent Class B Holder (determined pursuant to this subsection 3(b)).

(9) In the case of any Class B Holder who desires to gift one or more shares of Class B Common Stock to any other Class B Holder or to any Permitted Transferee of any other Class B Holder (determined pursuant to this subsection 3(b)), "Permitted Transferee" means any such other donee Class B Holder or Permitted Transferee.

(10) In the case of any Class B Holder, "Permitted Transferee" means any person which will hold record (but not beneficial) ownership of shares of Class B Common Stock as nominee for that Class B Holder or a Permitted Transferee of that Class B Holder (determined pursuant to this subsection 3(b)).

(11) Only those persons specifically identified as "Permitted Transferees" in the preceding provisions of this subsection 3(b) shall be "Permitted Transferees" for purposes of this Section 3.

(c) Notwithstanding any contrary provision set forth in this Section 3, any Class B Holder may pledge that Holder's shares of Class B Common Stock to a pledgee pursuant to a bona fide pledge of those shares as collateral security for indebtedness due to the pledgee, provided that such shares shall not be transferred to, registered in the name of, or voted by, the pledgee and shall remain subject to the provisions of this Section 3. In the event foreclosure or other similar action by a pledgee shall cause record or beneficial ownership of pledged Class B Common Stock to be transferred to a person who is not a Permitted Transferee of the pledgor, such pledged shares of Class B Common Stock shall be converted into shares of Class A Common Stock at the moment of transfer of ownership, in accordance with the provisions of subsection 4(b).

(d) For purposes of this Article III:

(1) The relationship between any two persons which is derived by or through legal adoption shall be considered a natural relationship.

(2) Each joint owner of shares of Class B Common Stock and each owner of a community property interest in shares of Class B Common Stock shall be considered a "Class B Holder" of such shares.

(3) A minor for whom shares of Class B Common Stock are held pursuant to a Uniform Transfer to Minors Act or similar law shall be considered to be the Class B Holder of such shares (and the custodian of those shares shall not be considered to be a Class B Holder of those shares).

(4) Unless otherwise specified, the term "person" means and includes natural persons, corporations, partnerships, unincorporated associations, firms, joint ventures, limited liability companies, trusts and all other entities.

(5) The term "transfer" shall mean and include any form of voluntary or involuntary sale, exchange, gift, bequest, devise, assignment, disposition, pledge, hypothecation, encumbrance, appointment, grant of voting power or proxy, or other conveyance of any and every kind, including but not limited to conveyances by operation of law.

(6) With respect to particular shares of Class B Common Stock, the "Issue Date" shall be the date on which those shares of Class B Common Stock are first issued by the corporation.

(e) Any purported transfer of shares of Class B Common Stock to any person who is not a Permitted Transferee shall be void and of no effect, and the purported transferee shall have no rights as a shareholder of the corporation and no other rights against or with respect to the corporation. The corporation may, as a condition to the transfer or the registration of transfer of

shares of Class B Common Stock to a purported Permitted Transferee, require the furnishing of such affidavits or other proof as the corporation deems necessary to establish that such transferee is a Permitted Transferee. Each certificate representing shares of Class B Common Stock shall be endorsed with a legend which states that shares of Class B Common Stock are not transferable to any person other than certain restricted transferees and are subject to certain restrictions as set forth in the Restated Articles of Incorporation filed by the corporation with the Secretary of State of the State of Oregon.

Section 4. Conversion of Class B Common Stock.

(a) Each holder of one or more shares of Class B Common Stock shall have the right and option at any time to convert one or more shares of Class B Common Stock into an equivalent number of fully paid and nonassessable shares of Class A Common Stock (i.e. one share of Class B Common Stock for one share of Class A Common Stock). Such right shall be exercised by the surrender to the corporation (at any time during normal business hours at the principal executive offices of the corporation or at the office of the Transfer Agent) of the certificate representing the share(s) of Class B Common Stock to be converted, accompanied by: (1) a written notice stating the election by the holder thereof to convert, and (2) instruments of transfer (if so required by the corporation or the Transfer Agent), in form satisfactory to the corporation and to the Transfer Agent, duly executed by such holder or such holder's duly authorized attorney, and (3) transfer tax stamps or funds therefor (if required pursuant to subsection 4(f)).

(b) Subject to, and without limiting the effect of, subsection 3(e), if there is any transfer or other change in the beneficial ownership (as determined under Rule 13d-3 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended) of any share of Class B Common Stock or of any interest in any share of Class B Common Stock, and if the new beneficial owner of that share of Class B Common Stock is not a "Permitted Transferee" (as defined in subsection 3(b) of this Article III) of the person who shall have been the beneficial owner of that share of Class B Common Stock immediately prior to that change in beneficial ownership, then each such share of Class B Common Stock shall thereupon be converted automatically into one (1) fully paid and nonassessable share of Class A Common Stock, and any and all stock certificates representing each such share of Class B Common Stock shall thereupon cease to represent shares of Class B Common Stock and shall thereafter be deemed for all purposes to represent an identical number of shares of Class A Common Stock.

(1) A determination by the Secretary of the corporation that a change in beneficial ownership of one or more shares of Class B Common Stock requires conversion under this subsection 4(b) shall be conclusive. If the Secretary of the corporation determines that a change in beneficial ownership of one or more shares of Class B Common Stock requires conversion under this subsection 4(b), then the Secretary of the corporation shall promptly request that each holder of record of each such share of Class B Common Stock deliver to the corporation for conversion hereunder, and each such holder shall thereupon be required, within ten (10) days following that request, to deliver to the corporation for conversion hereunder, the

certificate representing each such share of Class B Common Stock, together with instruments of transfer, in form satisfactory to the corporation and Transfer Agent, duly executed by such holder or such holder's duly authorized attorney, and together with transfer tax stamps or funds therefor (if required pursuant to subsection 4(f)).

(2) Notwithstanding any other provision of this Article III, the transfer to any person of capital interests, voting interests or other membership interests in a limited liability company which holds record and beneficial ownership of shares of Class B Common Stock shall not cause or be deemed to have caused any change in the beneficial ownership of any share(s) of Class B Common Stock or of any interest(s) in share(s) of Class B Common Stock which are owned by that limited liability company, unless and until such time as 50% or more of the capital interests or 50% or more of the voting interests in that limited liability company are held by one or more persons who would not be "Permitted Transferees" (as determined under subsection 3(b)(6)) of that limited liability company. If at any time the Secretary of the corporation determines that 50% or more of the capital interests or 50% or more of the voting interests in a limited liability company (which holds record and beneficial ownership of shares of Class B Common Stock) are acquired or held by one or more persons who would not be "Permitted Transferees" (as determined under subsection 3(b)(6)) of that limited liability company, then all shares of Class B Common Stock then held by that limited liability company shall be converted automatically into an equivalent number of shares of Class A Common Stock in accordance with the provisions of this subsection 4(b), and any and all stock certificates representing those shares of Class B Common Stock shall thereupon cease to represent shares of Class B Common Stock and shall thereafter be deemed for all purposes to represent an identical number of shares of Class A Common Stock.

(c) If, on the record date for any annual meeting of shareholders, the number of shares of Class B Common Stock then outstanding is less than one percent (1%) of the aggregate number of shares of Class B Common Stock and Class A Common Stock then outstanding, as determined by the Secretary of the corporation, then each share of Class B Common Stock then outstanding shall thereupon automatically be converted into one (1) fully paid and nonassessable share of Class A Common Stock, and each share of Class B Common Stock then authorized but unissued shall thereupon automatically be deemed an authorized but unissued share of Class A Common Stock. Upon making such determination, the Secretary of the corporation shall promptly request that each holder of record of one or more shares of Class B Common Stock deliver to the corporation for conversion hereunder, and each such holder shall thereupon be required, within ten (10) days following that request, to deliver to the corporation for conversion hereunder, the certificates representing all shares of Class B Common Stock held by such holder, together with instruments of transfer in form satisfactory to the corporation and Transfer Agent, duly executed by such holder or such holder's duly authorized attorney, and together with transfer tax stamps or funds therefor (if required pursuant to subsection 4(f)).

(d) As promptly as practicable following the surrender for conversion of a certificate representing shares of Class B Common Stock in the manner provided in subsections (a), (b) or (c) of this Section 4 and the payment in cash of any amount required by the provisions of subsection 4(f), the corporation will deliver or cause to be delivered at the office of the Transfer

Agent, to or upon the written order of the holder of such certificate, a certificate or certificates representing the number of full shares of Class A Common Stock issuable upon such conversion, issued in such name or names as such holder may direct. In the case of a conversion under subsection 4(a), the conversion shall be deemed to have been made immediately prior to the close of business on the date of the surrender of the certificate representing the converted shares of Class B Common Stock. In the case of a conversion under subsection 4(b), the conversion shall be deemed to have been made on the date that the beneficial ownership of such share(s) has changed as set forth in subsection 4(b). In the case of a conversion under subsection 4(c), the conversion shall be deemed to have occurred on the annual meeting record date on which the condition set forth in subsection 4(c) is determined by the Secretary of the corporation to have occurred. Upon the date of any conversion under subsection 4(b), all rights of the holder of the converted share(s) of Class B Common Stock shall cease, and the new beneficial owner(s) of such shares shall be treated for all purposes as having become the record holder(s) of the shares of Class A Common Stock issued in the conversion. Upon the date of any conversion under subsection 4(c), all rights of the holders of shares of Class B Common Stock shall cease, and such holders shall be treated for all purposes as having become the record holders of the shares of Class A Common Stock issued in the conversion.

(e) The corporation covenants that it will at all times reserve and keep available, solely for the purpose of enabling the issuance upon conversion of all outstanding shares of Class B Common Stock, a number of shares of Class A Common Stock which is equal to the number of then-outstanding shares of Class B Common Stock. The preceding sentence shall not preclude the corporation from satisfying its obligations in respect of the conversion of outstanding shares of Class B Common Stock by delivery of purchased shares of Class A Common Stock which are held in the treasury of the corporation. The corporation covenants that if any shares of Class A Common Stock required to be reserved for purposes of conversion hereunder shall require registration with or the approval of any governmental authority under any federal or state law before such shares of Class A Common Stock may be issued upon conversion, then the corporation will cause such shares to be duly registered or approved. Prior to delivery of shares of Class A Common Stock which are required to be delivered in connection with the conversion of shares of Class B Common Stock, the corporation will endeavor to list those shares of Class A Common Stock upon each national securities exchange upon which the outstanding Class A Common Stock is listed at the time of such delivery. The corporation covenants that all shares of Class A Common Stock which are issued upon conversion of shares of fully paid and nonassessable Class B Common Stock shall, upon issue, be fully paid and nonassessable.

(f) The issuance of certificates for shares of Class A Common Stock upon conversion of shares of Class B Common Stock shall be made without charge for any stamp or other similar tax in respect of such issuance. However, if any such certificate is to be issued in a name other than the person in whose name the converted shares of Class B Common Stock are registered immediately prior to conversion, then the person or persons requesting the issuance thereof shall pay to the corporation the amount of any tax which may be payable in connection with any transfer involved in such issuance, or shall establish to the satisfaction of the corporation that such tax has been paid.

Section 5. Preferred Stock.

The Board of Directors of the corporation shall have the authority at any time, without action of the shareholders, to adopt and file articles of amendment which provide for the issuance of shares of preferred stock in one or more series. The Board of Directors may establish, fix and/or alter the designations, powers, preferences, qualifications, limitations, restrictions and/or relative rights applicable to any series of preferred stock, including, without limitation, dividend rights (and whether dividends are cumulative), conversion rights(if any), voting rights (including the number of votes, if any, per share, as well as the number of members, if any, of the Board of Directors or the percentage of members, if any, of the Board of Directors each series of preferred stock may be entitled to elect), rights and terms of redemption (including sinking fund provisions, if any), redemption price and liquidation preferences of any wholly unissued series of preferred stock, and the number of shares constituting any such series and the designation thereof. The Board of Directors also is authorized to increase or decrease the number of shares of any series of preferred stock subsequent to the issuance of shares of such series, but not below the number of shares of such series then outstanding. Notwithstanding the preceding sentences of this Section 5, the Board of Directors shall have no power to alter the rights of any shares of preferred stock then outstanding without the consent of the holders of a majority of the outstanding shares the rights of which are to be altered. Shares of preferred stock which are redeemed, purchased or otherwise acquired by the corporation may be reissued except as otherwise provided by law.

Section 6. Distributions.

Upon Liquidation. In the event of any dissolution, liquidation or winding up of the affairs of the corporation in accordance with applicable law, whether voluntary or involuntary, and after payment or provision for payment of the debts and other liabilities of the corporation, the holders of each series of preferred stock, if any, shall be entitled to receive, out of the net assets of the corporation, an amount for each share of preferred stock which is equal to the required amount which shall have been fixed and determined by the Board of Directors in the resolution or resolutions creating such shares and series, plus an amount equal to all dividends accrued and unpaid on shares of such series to the date fixed for distribution, and no more, before any of the assets of the corporation shall be distributed or paid over to the holders of Class A or Class B Common Stock. After payment in full of such amounts to the holders of preferred stock of all series, the remaining assets and funds of the corporation shall be divided among and paid to the holders of shares of Class A Common Stock and Class B Common Stock, with each share of Class A and Class B Common Stock being treated equally for such purposes. If, upon such dissolution, liquidation or winding up, the assets of the corporation distributable as aforesaid among the holders of preferred stock of all series shall be insufficient to permit full payment of the required preferential amounts to those holders, then the corporation's assets shall be distributed ratably among the holders of shares of preferred stock in proportion to the respective total amounts which the holders are entitled to receive as provided in this Section 6.

ARTICLE IV: MANAGEMENT OF CORPORATION

The following provisions are inserted for the management of the business and for the conduct of the affairs of the corporation, and for further definition, limitation and regulation of the powers of the corporation and of its directors and shareholders:

Section 1. Election of Directors.

(a) Except to the extent that these Restated Articles of Incorporation grant to the holders of any series of preferred stock the right (voting separately by class or series) to elect additional directors under specified circumstances, the number of directors of the corporation shall be as fixed from time to time by or pursuant to the Bylaws of the corporation. The election of directors need not be by written ballot unless required by the Bylaws of the corporation.

(b) At each annual meeting of shareholders the shareholders shall elect the directors to hold office until the next annual meeting of shareholders and until their respective successors are elected and qualified, subject to prior death, resignation or removal. If the directors shall not have been elected at any annual meeting of shareholders, they may be elected at a special meeting of shareholders called for that purpose in the manner provided by the Bylaws of the corporation.

(c) Except as provided in Section 2 of this Article IV and in this subsection 1(c), each director shall be elected by the vote of the majority of the votes cast. A majority of votes cast means that the number of votes cast "for" a director's election exceeds the number of votes cast "against" that director. The following shall not be votes cast: (1) a share whose ballot is marked as withheld; (2) a share otherwise present at the meeting but for which there is an abstention; and (3) a share otherwise present at the meeting for which a shareholder gives no authority or direction. In a contested election, the directors shall be elected by the vote of a plurality of the votes cast.

A contested election is one in which (1) on the last day for delivery of a notice pursuant to Article 1 of the Bylaws of the corporation for any shareholder nomination of a nominee for the Board of Directors, a shareholder has complied with the applicable nomination requirements regarding one or more nominees; and (2) prior to the date that notice of the meeting is given, the Board has not made a determination that none of the candidacies of such nominees creates a bona fide election contest. For purposes of this Section 1, it is assumed that on the last day for delivery of a notice under Article 1 of the Bylaws of the corporation, there is a candidate nominated by the Board of Directors for each of the director positions to be voted on at the meeting. The following procedures apply in a non-contested election. A nominee who does not receive a majority vote shall not be elected. Except as otherwise provided in this paragraph, an incumbent director not elected because he or she does not receive a majority vote shall continue to serve as a holdover director until the earliest of (x) 180 days after the date on which an inspector determines the voting results as to that director pursuant to Section 60.223 of the Oregon Business Corporation Act; (y) the date on which the Board of Directors appoints an individual to fill the office held by such director, which appointment shall constitute the filling of a vacancy by the Board pursuant to Section 2.2 of the Bylaws of the corporation; or (z) the date

of the director's resignation. Any vacancy resulting from the nonelection of a director under this Section 1 may be filled by the Board as provided in Section 2.2 of the Bylaws. The Nominating and Governance Committee of the Board of Directors, or any successor thereto, will consider promptly whether to fill the office of a nominee failing to receive a majority vote and make a recommendation to the Board of Directors about filling the office. The Board of Directors will act on the recommendation of the Nominating and Governance Committee, or any successor thereto, and within 180 days after the certification of the shareholder vote will disclose publicly its decision. Except as provided in the next sentence, no director who failed to receive a majority vote for election will participate in the Nominating and Governance Committee (or any successor thereto) recommendation or Board of Directors decision about filling his or her office. If no director receives a majority vote in an uncontested election, then the incumbent directors (i) will nominate a slate of directors and hold a special meeting for the purpose of electing those nominees as soon as practicable, and (ii) may in the interim fill one or more offices with the same director(s) who will continue in office until their successors are elected.

Section 2. Removal of Directors.

Except to the extent that these Restated Articles of Incorporation grant to the holders of any series of preferred stock the right (voting separately by class or series) to elect directors under specified circumstances, any director or directors may be removed from office at any time, with or without cause, by the affirmative vote of not less than a majority of the total number of votes represented by the then outstanding shares of capital stock of the corporation entitled to vote generally in the election of directors, voting together as a single class. Unless previously filled by the vote of at least a majority of the total number of votes represented by the then outstanding shares of capital stock of the corporation entitled to vote generally in the election of directors (voting together as a single class), any vacancy in the Board of Directors resulting from any such removal may be filled by vote of a majority of the directors then in office, even if less than a quorum, and any directors so chosen shall hold office until the next annual shareholders meeting and until their successors shall have been elected and qualified or until their earlier death, resignation or removal.

Section 3. Right of Preferred Stock to Vote for Directors.

Notwithstanding the foregoing paragraphs of this Article IV, if at any time the Board of Directors of the corporation shall have adopted and filed articles of amendment which give to the holders of any series of preferred stock issued by the corporation the right (voting separately by class or series) to elect directors at an annual or special meeting of shareholders, then the election, term of office, filling of vacancies and other features of such directorships shall be governed by the terms of those articles of amendment applicable thereto (as those articles may be amended from time to time).

Section 4. Calling of Meetings.

Special meetings of shareholders of the corporation for any purpose may be called at any time by: (i) a majority of the Board of Directors, or (ii) the President of the corporation, or (iii) one or more shareholders who, in the aggregate, own shares representing ten percent (10%) or more of

the total votes of all shares then outstanding. No other person or persons shall have authority to call a special meeting of the shareholders of the corporation.

ARTICLE V: NO PREEMPTIVE RIGHTS

No holder of shares of any class shall have any preemptive or preferential right to subscribe to or otherwise acquire any shares of stock of the corporation, or any obligations or securities convertible into or carrying options or warrants to purchase shares of stock of the corporation, whether now or hereafter authorized and whether unissued or held by the corporation as treasury stock (whether or not the issuance or sale of any such shares, obligations or securities would adversely affect such shareholder's proportionate voting power), other than any rights which the Board of Directors in its discretion may from time to time grant.

ARTICLE VI: ELECTIONS OR ACTIONS BY WRITTEN CONSENT

Any election of directors or other action by the shareholders of the corporation may be effected at an annual or special meeting of shareholders or by written consent of the shareholders given in lieu of such a meeting. The record date with respect to the determination of shareholders entitled to consent in writing to any action shall be the first date on which a signed written consent setting forth the action to be taken or proposed to be taken is delivered to the corporation by delivery to its registered office in Oregon, to its principal place of business, or to an officer or agent of the corporation having custody of the book in which proceedings of meetings of shareholders are recorded. Any action by written consent shall be deemed effective as of the day on which written consents, signed by all shareholders, are delivered to the corporation by delivery to its registered office in Oregon, to its principal place of business, or to an officer or agent of the corporation having custody of the book in which proceedings of meetings of shareholders are recorded. Any delivery which is made to the corporation's registered office under this Article VI shall be by hand or by certified or registered mail, return receipt requested.

ARTICLE VII: LIMITATION ON LIABILITY OF DIRECTORS

No director of the Corporation is personally liable to the Corporation or its shareholders for monetary damages for conduct as a director, except for the following:

- (a) Any breach of the director's duty of loyalty to the Corporation or its shareholders;
- (b) Acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- (c) Any distribution to shareholders that is unlawful under the Oregon Business Corporation Act or successor statute; or
- (d) Any transaction from which the director derived an improper personal benefit.

This Article VII does not limit or eliminate the liability of a director for any act or omission occurring before the effective date of this Article VII. No amendment to or repeal of this Article VII may make any director of the Corporation personally liable to the Corporation or its

shareholders for monetary damages for any act or omission as a director occurring before the effective date of that amendment or repeal. This Article VII is intended to limit the liability of any director of the Corporation to the greatest extent authorized under the Oregon Business Corporation Act. Any further limitation on the liability of directors authorized under any amendment to the Oregon Business Corporation Act is incorporated into this Article VII on the effective date of that amendment.

ARTICLE VIII: INDEMNIFICATION

Section 1. Non-Derivative Actions.

Subject to the provisions of Sections 3, 5 and 6 of this Article VIII, the Corporation shall indemnify any person who was or is a party to or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative, or investigative, (including all appeals) (other than an action by or in the right of the Corporation) by reason of or arising from the fact that the person is or was a director or officer of the Corporation or one of its subsidiaries, or is or was serving at the request of the Corporation as a director, officer, partner, or trustee of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, against reasonable expenses (including attorney's fees), judgments, fines, penalties, excise taxes assessed with respect to any employee benefit plan and amounts paid in settlement actually and reasonably incurred by the person to be indemnified in connection with such action, suit or proceeding if the person acted in good faith, did not engage in intentional misconduct, and, with respect to any criminal action or proceeding, did not know the conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith or, with respect to any criminal action or proceeding, that the person knew that the conduct was unlawful.

Section 2. Derivative Actions.

Subject to the provisions of Sections 3, 5 and 6 of this Article VIII, the Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit (including all appeals) by or in the right of the Corporation to procure a judgment in its favor by reason of or arising from the fact that the person is or was a director or officer of the Corporation or one of its subsidiaries, or is or was serving at the request of the Corporation as a director, officer, partner, or trustee of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, against reasonable expenses (including attorneys' fees) actually incurred by the person to be indemnified in connection with the defense or settlement of such action or suit if the person acted in good faith, provided, however, that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable for deliberate misconduct in the performance of that person's duty to the Corporation, for any transaction in which the person received an improper personal benefit, for any breach of the duty of loyalty to the Corporation, or for any distribution to shareholders which is unlawful under the Oregon Business Corporation Act, or successor statute, unless and only to the extent that the court in which such action or suit

was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the court shall deem proper.

Section 3. Determination of Right to Indemnification in Certain Cases.

Subject to the provisions of Sections 5 and 6 of this Article VIII, indemnification under Sections 1 and 2 of this Article VIII shall not be made by the Corporation unless it is expressly determined that indemnification of the person who is or was an officer or director, or is or was serving at the request of the Corporation as a director, officer, partner, or trustee of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, is proper in the circumstances because the person has met the applicable standard of conduct set forth in Sections 1 or 2 of this Article VIII. That determination may be made by any of the following:

- (a) By the Board of Directors by majority vote of a quorum consisting of directors who are not or were not parties to the action, suit or proceeding;
- (b) If a quorum cannot be obtained under paragraph (a) of this subsection, by majority vote of a committee duly designated by the Board of Directors consisting solely of two or more directors not at the time parties to the action, suit or proceeding (directors who are parties to the action, suit or proceeding may participate in designation of the committee);
- (c) By special legal counsel selected by the Board of Directors or its committee in the manner prescribed in (a) or (b) or, if a quorum of the Board of Directors cannot be obtained under (a) and a committee cannot be designated under (b) the special legal counsel shall be selected by majority vote of the full Board of Directors, including directors who are parties to the action, suit or proceeding;
- (d) If referred to them by Board of Directors of the Corporation by majority vote of a quorum (whether or not such quorum consists in whole or in part of directors who are parties to the action, suit or proceeding), by the shareholders; or
- (e) By a court of competent jurisdiction.

Section 4. Indemnification of Persons Other than Officers or Directors.

Subject to the provisions of Section 6 of this Article VIII, in the event any person not entitled to indemnification under Sections 1 and 2 of this Article VIII was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding of a type referred to in Sections 1 or 2 of this Article VIII by reason of or arising from the fact that such person is or was an employee or agent (including an attorney) of the Corporation or one of its subsidiaries, or is or was serving at the request of the Corporation as an employee or agent (including an attorney) of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, the Board of Directors of the Corporation by a majority vote of a quorum (whether or not such quorum consists in whole or in part of directors who were parties to such action, suit or proceeding) or the stockholders of the Corporation by a

majority vote of the outstanding shares upon referral to them by the Board of Directors of the Corporation by a majority vote of a quorum (whether or not such quorum consists in whole or in part of directors who were parties to such action, suit or proceeding) may, but shall not be required to, grant to such person a right of indemnification to the extent described in Sections 1 or 2 of this Article VIII as if the person were acting in a capacity referred to therein, provided that such person meets the applicable standard of conduct set forth in such Sections. Furthermore, the Board of Directors may designate by resolution in advance of any action, suit or proceeding, those employees or agents (including attorneys) who shall have all rights of indemnification granted under Sections 1 and 2 of this Article VIII.

Section 5. Successful Defense.

Notwithstanding any other provision of Sections 1, 2, 3 or 4 of this Article VIII, but subject to the provisions of Section 6 of this Article VIII, to the extent a director, officer, or employee is successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Sections 1, 2 or 4 of this Article VIII, or in defense of any claim, issue or matter therein, that person shall be indemnified against expenses (including attorneys fees) actually and reasonably incurred by him in connection therewith.

Section 6. Condition Precedent to Indemnification.

Under Sections 1, 2, 4 or 5. Any person who desires to receive the benefits otherwise conferred by Sections 1, 2, 4 or 5 of this Article VIII shall promptly notify the Corporation that the person has been named a defendant to an action, suit or proceeding of a type referred to in Sections 1, 2, 4, or 5 of this Article VIII and intends to rely upon the right of indemnification described in Sections 1, 2, 4 or 5 of this Article VIII. The notice shall be in writing and mailed, via registered or certified mail, return receipt requested, to the President of the Corporation at the executive offices of the Corporation or, in the event the notice is from the President, to the registered agent of the Corporation. Failure to give the notice required hereby shall entitle the Board of Directors of the Corporation by a majority vote of a quorum (consisting of directors who, insofar as indemnity of officers or directors is concerned, were not parties to such action, suit or proceeding, but who, insofar as indemnity of employees or agents is concerned, may or may not have been parties) or, if referred to them by the Board of Directors of the Corporation by a majority vote of a quorum (consisting of directors who, insofar as indemnity of officers or directors is concerned, were not parties to such action, suit or proceeding, but who, insofar as indemnity of employees or agents is concerned, may or may not have been parties), the shareholders of the Corporation by a majority of the votes entitled to be cast by holders of shares of the Corporation's stock which have unlimited voting rights to make a determination that such a failure was prejudicial to the Corporation in the circumstances and that, therefore, the right to indemnification referred to in Sections 1, 2 or 4 of this Article VIII shall be denied in its entirety or reduced in amount.

Section 7. Advances for Expenses.

Expenses incurred by a person indemnified hereunder in defending a civil, criminal, administrative or investigative action, suit or proceeding (including all appeals) or threat thereof,

may be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such person to repay such expenses if it shall ultimately be determined that the person is not entitled to be indemnified by the Corporation and a written affirmation of the person's good faith belief that he or she has met the applicable standard of conduct. The undertaking must be a general personal obligation of the party receiving the advances but need not be secured and may be accepted without reference to financial ability to make repayment.

Section 8. Insurance.

The Corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation or one of its subsidiaries or is or was serving at the request of the Corporation as a director, officer, partner, trustee, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise against any liability asserted against and incurred by that person in any such capacity, or arising out of his status as such, whether or not the Corporation would have the power to indemnify that person against such liability under the provisions of this Article or under the Oregon Business Corporation Act.

Section 9. Purpose and Exclusivity.

The indemnification referred to in the various Sections of this Article VIII shall be deemed to be in addition to and not in lieu of any other rights to which those indemnified may be entitled under any statute, rule of law or equity, agreement, vote of the stockholders or Board of Directors or otherwise. The Corporation is authorized to enter into agreements of indemnification. The purpose of this Article VIII is to augment the provisions of the Oregon Business Corporation Act dealing with indemnification.

Section 10. Severability.

If any of the provisions of this Article VIII are found, in any action, suit or proceeding, to be invalid or ineffective, the validity and the effect of the remaining provisions shall not be affected.

ARTICLE IX: ARTICLES AND BYLAWS

Section 1. Restated Articles of Incorporation.

The corporation reserves the right to alter, amend, repeal or rescind any provision contained in these Restated Articles of Incorporation in any manner now or hereafter permitted by law, and all rights conferred on shareholders herein are granted subject to this reservation. The affirmative vote of the holders of not less than a majority of the total number of votes represented by the then outstanding shares of capital stock of the corporation entitled to vote generally in the election of directors, voting together as a single class, shall be required to amend or repeal these Restated Articles of Incorporation, or to adopt any provision inconsistent with the purpose or

intent of Articles IV through IX or Section 1 of Article III of these Restated Articles of Incorporation.

Section 2. Bylaws.

In furtherance and not in limitation of the powers conferred by the Oregon Business Corporation Act, the Board of Directors shall have the power to make, alter, amend, repeal or rescind the Bylaws of the corporation, subject to the power of the shareholders to alter, amend, repeal or rescind any Bylaw made by the Board of Directors.

ARTICLE IX Series M Preferred Stock

Ten Thousand Five Hundred (10,500) shares of Preferred Stock are hereby designated Series M-2002 Preferred Stock (the "Series M-2002 Preferred Stock"). An additional Four Thousand Five Hundred (4,500) shares of Preferred Stock are hereby designated Series M-2003 Preferred Stock (the "Series M-2003 Preferred Stock"). Collectively, the Series M-2002 Preferred Stock and the Series M-2003 Preferred Stock may be referred to as the Series M Preferred Stock. The Series M Preferred Stock will have the preferences, limitations, and relative rights as set forth in this Article IX. Except as otherwise provided in subsection 5(b) of this Article IX, the preferences, limitations and relative rights of the shares of Series M-2002 Preferred Stock and the shares of Series M-2003 Preferred Stock shall be the same.

Section 1. Voting.

Shares of Series M Preferred Stock will vote on an as-if converted basis together with shares of Common Stock as a single voting group on all matters submitted to a vote of the shareholders of the corporation. For purposes of this Section 1, "as-if converted" means that each holder of Series M Preferred Stock shall be entitled to cast a number of votes equal to the number of shares of Class A Common Stock that would have been issuable upon conversion of such holder's Series M Preferred Stock if the Company had given notice of conversion thereof on the date of the filing with the Colorado Secretary of State of Articles of Merger relating to the merger of Cherry Creek Dodge, Incorporated, a Colorado corporation, with and into Lithia Acquisition Corp. #99-1, a Colorado corporation (the "Filing Date"). Series M Preferred Stock will also entitle the holders thereof to vote as a separate voting group to the extent set forth in Section 6, below.

Section 2. Dividends.

Shares of Series M Preferred Stock shall not have a dividend preference. Shares of Series M Preferred Stock shall, however, participate in any dividend that may, from time to time, be declared by the Board of Directors of the corporation with respect to the corporation's Common Stock on an as-if converted basis. For purposes of this Section 2, "as-if converted" means that each holder of Series M Preferred Stock shall be entitled to receive the dividend that would be payable on, the number of shares of Class A Common Stock that would have been issuable upon

conversion of such holder's Series M Preferred Stock if the Company had given notice of conversion thereof on the record date for the dividend being paid.

Section 3. Distributions Upon Liquidation

(a) **Liquidation Preference.** Upon any dissolution, liquidation, or winding up of the corporation, whether voluntary or involuntary (a "Liquidation"), the holders of Series M Preferred Stock will be entitled to receive out of the assets of the corporation available for distribution to shareholders, before any payment or distribution may be made with respect to shares of Common Stock, an amount per share equal to \$1,000.00 (such amount to be adjusted proportionately in the event the shares of Series M Preferred Stock are subdivided into a greater number or combined into lesser number). The relative priority of the Series M Preferred Stock's liquidation rights in comparison to the liquidation rights of any other series of Preferred Stock which may be issued by the corporation will be as determined in the designation of rights and preferences of such other series.

(b) **Allocation of Liquidation Preference.** If upon any Liquidation, the assets available to be distributed to the holders of Series M Preferred Stock are insufficient to permit the payment to such holders of the full liquidation preference (including any accrued and unpaid dividends) to which they are entitled pursuant to subsection 3(a), then all of the assets of the corporation available for distribution will be distributed ratably to the holders of shares of Series M Preferred Stock in accordance with the amount payable with respect to each share.

Section 4. Redemption

(a) **Redemption at Option of the Corporation.** The corporation may redeem all or any part of the shares of Series M Preferred Stock. Any such redemption at the option of the corporation may occur at any time after that date which is two years from the date of the original issuance of the shares to be redeemed and from time to time thereafter and must occur in the manner prescribed in subsection 4(b) below. In the event of a partial redemption of the outstanding Series M Preferred Stock, the corporation shall call for redemption an equal portion of the shares of Series M Preferred Stock owned by each holder, subject to rounding.

(b) **Notice of Call for Redemption by the Corporation.** Before making any redemption pursuant to subsection 4(a), the corporation will deliver a written notice (a "Redemption Notice") to each record holder of any shares of Series M Preferred Stock. Any Redemption Notice will be sent by certified or registered mail, return receipt requested, or by overnight delivery service, to the address shown for such holder on the corporation's records. Any Redemption Notice will include: (i) the number of shares of Series M Preferred Stock held of record by such holder which the corporation proposes to redeem; (ii) the redemption price as determined in accordance with subsection 4(c) (the "Redemption Price") to be paid for each share repurchased; (iii) the date (the "Redemption Date") on which the corporation proposes to pay the Redemption Price for the shares to be redeemed; and (iv) the person and place to which the holder is to send the certificates representing the shares of Series M Preferred Stock being redeemed. Any Redemption Notice will be sent at least twenty (20) calendar days before the Redemption Date.

(c) **Redemption Price.** The Redemption Price of shares of Series M Preferred Stock will be \$1,000.00 per share (such amount to be adjusted proportionately in the event the shares of Series M Preferred Stock are subdivided into a greater number or combined into a lesser number). The redemption price shall be payable by wire transfer to such bank account as the holder may designate in writing at the time the certificate is surrendered; provided, however, that if the holder fails to provide wire instructions or the amount payable to the holder is less than \$10,000, the corporation may pay the Redemption Price by check delivered to the holder in person or by mail at the most recent address reflected on the corporation's records. The Redemption Price for each share of Series M Preferred Stock shall be paid on the Redemption Date or the date that the certificate representing such share is received by the Company at the place designated in the Redemption Notice, whichever is later. If less than all of the shares represented by a certificate are redeemed, the corporation shall promptly send to the holders a new certificate representing the unredeemed shares.

Section 5. Conversion.

The shares of Series M Preferred Stock will have the following conversion rights:

(a) **Conversion at the Option of the Corporation.** Each share of Series M Preferred Stock is convertible, at the option of the corporation, into fully paid and nonassessable shares of the corporation's Class A Common Stock, at the Conversion Ratio (as defined below) in effect at the time of conversion determined as provided in subsection 5(e).

(b) **Procedures for Conversion at the Option of the Corporation.** In order to effect any conversion pursuant to subsection 5(a), the corporation will deliver a written notice (a "Conversion Notice") to each record holder of any shares of Series M Preferred Stock. Any Conversion Notice will be sent by certified or registered mail, return receipt requested, or by overnight delivery service, to the address shown for such holder on the corporation's records. Any Conversion Notice will include: (i) the number of shares of Series M Preferred Stock held of record by such holder which the corporation proposes to convert; (ii) an explanation of the calculation of the Conversion Ratio; (iii) the number of shares of Class A Common Stock that such holder will receive as a result of the conversion; (iv) the proposed effective date (the "Conversion Date") on which the conversion shall be effective (which shall not be more than five business days after the date of the Conversion Notice); and (v) the person and place to which the holder is to send the certificates representing the shares of Series M Preferred Stock being converted.

(c) **Conversion at the Option of the Holder.** Any holder of shares of Series M-2002 Preferred Stock may, on or after the earlier of (a) the occurrence of a Change of Control of the corporation (as such phrase is hereinafter defined) or (b) the third anniversary of the Filing Date, tender for conversion all or any part of the shares of Series M-2002 Preferred Stock held by such holder. Any holder of shares of Series M-2003 Preferred Stock may, on or after the earlier of (a) the occurrence of a Change of Control of the corporation (as such phrase is hereinafter defined) or (b) the fourth anniversary of the Filing Date, tender for conversion all or any part of the shares of Series M-2003 Preferred Stock held by such holder. For purposes of this subsection 5(c) a "Change of Control" of the corporation shall be deemed to have occurred only if Lithia Holding

Company, L.L.C. ceases to be the beneficial owner of shares of the corporation's common stock which, in aggregate, represent at least 51% of the total votes of all outstanding shares of the corporation's common stock.

(d) Procedures for Conversion at the Option of the Holder. Any conversion of Series M Preferred Stock at the option of the holder of those shares shall be subject to the following terms and conditions:

1. Any holder of shares of Series M Preferred Stock who wishes to tender some or all of such shares for conversion must give written notice to the corporation at its principal office that the holder elects to convert such shares, including a statement of the number of shares of Series M Preferred Stock to be converted (the "Tendered Shares"), which shall be accompanied by the certificate or certificates representing the Tendered Shares (the "Conversion Election").

2. Within two business days of the receipt of a Conversion Election, the corporation will determine whether or not the approval of the corporation's shareholders is required under any applicable law or the listing requirements of any exchange on which any of the corporation's securities are then trading prior to the corporation issuing shares of Class A Common Stock upon the conversion of the Tendered Shares. This determination by the corporation shall be final as between the corporation and the holders of the Tendered Shares.

3. If the corporation determines that shareholder approval is not necessary prior to the issuance of shares of Class A Common Stock upon the conversion of the Tendered Shares or such shareholder approval has already been obtained, the corporation shall send the holders of the Tendered Shares a Conversion Notice containing the information required in a Conversion Notice given by the corporation pursuant to subsection 5(a) except that the Conversion Date specified in such Conversion Notice shall be a date no later than seven business days after the date on which the corporation received the Conversion Election and the corporation shall be responsible for forwarding on the certificate or certificates representing the Tendered Shares to the appropriate person and place. On such Conversion Date, the Tendered Shares shall be converted into fully paid and nonassessable shares of the corporation's Class A Common Stock, at the Conversion Ratio (as defined below) determined as provided in subsection 5(e).

4. If the corporation determines that shareholder approval is necessary prior to the issuance of shares of Class A Common Stock upon the conversion of the Tendered Shares and such shareholder approval has not already been obtained at the time of receipt of Conversion Election or is not obtained within such time after receipt of the Conversion Election as the holders of the Tendered Shares may, in their sole discretion, allow the corporation, the corporation shall redeem the Tendered Shares in accordance with Section 4 except that the Redemption Notice shall only state the corporation's intent to redeem the Tendered Shares and specify the Redemption Date and the Redemption Date specified in such Redemption Notice shall be a date no later than seven business days after the date on which the corporation received the Conversion Election.

(e) Conversion Ratio. Each share of Series M Preferred Stock shall be convertible into the number of shares of Class A Common Stock that results from dividing (1) \$1,000.00 (such amount to be adjusted proportionately in the event the shares of Series M Preferred Stock are subdivided into a greater number or combined into lesser number) by (2) the "fair market value" of the corporation's Class A Common Stock on the date the Conversion Notice or the Conversion Election, as the case may be, is given (the "Conversion Ratio"). For purposes of the foregoing, the "fair market value" of the corporation's Class A Common Stock on any date means the average Daily Sales Price over the 15 consecutive trading days ending with the second trading day preceding such date. Daily Sales Price means, for any trading day, (1) the last sales price of the Class A Common Stock reported by the New York Stock Exchange or other principal securities exchange on which shares of Class A Common Stock are then listed or admitted to trading or (2) if not on an exchange, the last sales price quoted by the National Association of Securities Dealers Automated Quotation System ("Nasdaq"), (3) if not traded on an exchange or quoted on Nasdaq, the average of the closing bid and asked prices for the Class A Common Stock as quoted by the National Quotation Bureau's "Pink Sheets" or the National Association of Securities Dealers' OTC Bulletin Board System or (4) if none of the above are available, the value of the Class A Common Stock as established in good faith by the corporation's board of directors. No fractional shares shall be issued upon any conversion of shares of Series M Preferred Stock. Instead, the number of shares of Class A Common Stock to be issued shall be rounded down to the nearest whole number and the holder shall receive a cash payment equal to the fair market value (as determined above) of the fractional share which the holder would otherwise have been entitled to receive.

(f) Conversion Procedures. As of the Conversion Date each holder of shares of Series M Preferred Stock whose shares are being converted will for all purposes be considered to be a holder of the shares of Class A Common Stock into which such shares are being converted and not as a holder of shares of Series M Preferred Stock specified in either the Conversion Notice or in such holder's Conversion Election. However, before any holder of Series M Preferred Stock will be entitled to receive a certificate representing the shares of Class A Common Stock into which the holder's shares of Series M Preferred Stock were converted or to receive any distribution with respect to such shares of Class A Common Stock, such holder must surrender the certificate or certificates representing the shares of Series M Preferred Stock which were converted at the office of the corporation or at the office of any transfer agent appointed to serve as such for the corporation's Class A Common Stock. Upon either the Conversion Date or, if later, the delivery by the holder of the certificates representing the shares of Series M Preferred Stock which were converted, the corporation will cause to be delivered a certificate issued in the name of such holder representing the shares of Class A Common Stock into which such shares of Series M Preferred Stock were converted and, if less than all of the shares of Series M Preferred Stock represented by the certificates so delivered were converted, a new certificate representing the unconverted shares of Series M Preferred Stock. If there exists any legend restricting transfer of the surrendered Series M Preferred Stock shares, such legend will be placed on the Class A Common Stock shares issued upon the conversion of such shares of Series M Preferred Stock.

Section 6. Protective Provisions.

Without either the approval of a majority of the outstanding shares of Series M Preferred Stock at a meeting of the shareholders with such holders being entitled to vote as a separate voting group or a written consent signed by the holders of all of the outstanding shares of Series M Preferred Stock, the corporation will not amend its Articles of Incorporation in a manner that would either (a) increase the number of shares of Preferred Stock designated as Series M-2002 Preferred Stock or the number of shares of Preferred Stock designated as Series M-2003 Preferred Stock; or (b) change or alter in any manner the preferences, limitations, or relative rights of the Series M Preferred Stock.

Section 7. Status of Acquired or Unissued Shares.

All shares of Series M Preferred Stock that are acquired at any time by the corporation by reason of redemption, conversion, or otherwise will automatically become undesignated shares of Preferred Stock. All shares designated as Series M Preferred Stock that remain unissued on December 31, 2000 will automatically become undesignated shares of Preferred Stock on such date.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO
RULE 13a-14(a) OR RULE 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934**

I, Bryan B. DeBoer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lithia Motors, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 26, 2019

/s/ Bryan B. DeBoer
Bryan B. DeBoer
President and Chief Executive Officer
Lithia Motors, Inc.

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO
RULE 13a-14(a) OR RULE 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934**

I, Tina Miller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lithia Motors, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 26, 2019

/s/ Tina Miller

Tina Miller
Chief Accounting Officer and Interim Principal Financial Officer
Lithia Motors, Inc.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO RULE 13a-14(b) OR RULE 15d-14(b)
OF THE SECURITIES EXCHANGE ACT OF 1934 AND 18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Lithia Motors, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bryan B. DeBoer, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Bryan B. DeBoer
Bryan B. DeBoer
President and Chief Executive Officer
Lithia Motors, Inc.
July 26, 2019

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO RULE 13a-14(b) OR RULE 15d-14(b)
OF THE SECURITIES EXCHANGE ACT OF 1934 AND 18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Lithia Motors, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Tina Miller, Chief Accounting Officer and Interim Principal Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Tina Miller
Tina Miller
Chief Accounting and Interim Principal Financial Officer
Lithia Motors, Inc.
July 26, 2019