LITHIA MOTORS INC
Form 10-Q
October 29, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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

Registrant s telephone number, including area code: 541-776-6401

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

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

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

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

Class A common stock without par value	**22,405,133**
Class B common stock without par value	**3,762,231**
(Class)	(Outstanding at October 29, 2010)

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

LITHIA MOTORS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	September 30, 2010	December 31, 2009
Assets		
Current Assets:		
Cash and cash equivalents	$ 15,301	$ 12,776
Contracts in transit	28,649	21,940
Trade receivables, net of allowance for doubtful accounts of $269 and $218	41,235	30,157
Inventories, net	392,906	328,726
Vehicles leased to others	8,253	7,384
Prepaid expenses and other	2,269	5,387
Deferred income taxes	790	
Assets held for sale		11,693
Total Current Assets	489,403	418,063
Land and buildings, net of accumulated depreciation of $29,420 and $25,495	313,290	326,625
Equipment and other, net of accumulated depreciation of $62,250 and $57,979	49,700	59,429
Goodwill	6,186	
Intangible assets, net of accumulated amortization of $110 and $93	45,299	42,496
Other non-current assets	8,817	7,752
Deferred income taxes	42,394	40,735
Total Assets	$ 955,089	$ 895,100
Liabilities and Stockholders Equity		
Current Liabilities:		
Floorplan notes payable	$ 67,750	$ 68,907
Floorplan notes payable: non-trade	156,199	141,581
Current maturities of line of credit		24,000
Current maturities of other long-term debt	14,898	14,303
Trade payables	24,957	18,782
Accrued liabilities	59,793	47,518
Deferred income taxes		1,036
Liabilities related to assets held for sale		5,050
Total Current Liabilities	323,597	321,177
Real estate debt, less current maturities	237,056	230,265

Other long-term debt, less current maturities	42,733	2,800
Deferred revenue	19,963	17,981
Other long-term liabilities	17,257	15,839
Total Liabilities	640,606	588,062
Stockholders Equity:		
Preferred stock - no par value; authorized 15,000 shares; none outstanding		
Class A common stock - no par value; authorized 100,000 shares; issued and outstanding 22,324 and 22,036	283,275	280,880
Class B common stock - no par value; authorized 25,000 shares; issued and outstanding 3,762 and 3,762	468	468
Additional paid-in capital	10,644	10,501
Accumulated other comprehensive loss	(5,676)	(3,850)
Retained earnings	25,772	19,039
Total Stockholders Equity	314,483	307,038
Total Liabilities and Stockholders Equity	$ 955,089	$ 895,100

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

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LITHIA MOTORS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Revenues:				
New vehicle sales	$ 293,237	$ 266,769	$ 777,575	$ 670,835
Used vehicle sales	189,667	150,080	521,437	419,689
Finance and insurance	18,928	15,704	49,840	44,098
Service, body and parts	77,733	74,538	218,526	219,807
Fleet and other	3,122	895	8,629	2,090
Total revenues	582,687	507,986	1,576,007	1,356,519
Cost of sales:				
New vehicle sales	269,018	242,963	712,857	612,942
Used vehicle sales	166,368	130,322	457,625	367,536
Service, body and parts	39,673	38,611	111,541	113,900
Fleet and other	2,684	597	7,392	1,078
Total cost of sales	477,743	412,493	1,289,415	1,095,456
Gross profit	104,944	95,493	286,592	261,063
Asset impairment charges		1,967	14,751	7,164
Selling, general and administrative	77,468	71,557	223,320	209,469
Depreciation - buildings	1,556	1,189	4,723	3,590
Depreciation and amortization - other	2,682	2,694	8,666	8,353
Operating income	23,238	18,086	35,132	32,487
Other income (expense):				
Floorplan interest expense	(3,085)	(3,053)	(8,403)	(8,628)
Other interest expense	(3,725)	(3,291)	(10,842)	(10,639)
Other income, net	73	25	356	1,447
Total other expense	(6,737)	(6,319)	(18,889)	(17,820)
Income from continuing operations before income taxes	16,501	11,767	16,243	14,667
Income tax expense	(6,709)	(4,792)	(6,522)	(5,937)
Income from continuing operations, net of tax	9,792	6,975	9,721	8,730
Income (loss) from discontinued operations, net of tax		(1,262)	(381)	1,975
Net income	$ 9,792	$ 5,713	$ 9,340	$ 10,705
Basic income per share from continuing operations	$ 0.37	$ 0.33	$ 0.37	$ 0.42
Basic income (loss) per share from discontinued operations		(0.06)	(0.01)	0.09

Basic net income per share	$	0.37	$	0.27	$	0.36	$	0.51
Shares used in basic per share calculations		26,120		21,165		26,011		21,000
Diluted income per share from continuing operations	$	0.37	$	0.33	$	0.37	$	0.41
Diluted income (loss) per share from discontinued operations				(0.06)		(0.01)		0.10
Diluted net income per share	$	0.37	$	0.27	$	0.36	$	0.51
Shares used in diluted per share calculations		26,328		21,448		26,191		21,124

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

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LITHIA MOTORS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine months ended September 30, 2010	2009
Cash flows from operating activities:		
Net income	$ 9,340	$ 10,705
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Asset impairments	14,751	7,164
Depreciation and amortization	13,389	11,943
Depreciation and amortization within discontinued operations	8	509
Amortization of debt discount		48
Stock-based compensation	1,450	1,584
Gain on early extinguishment of debt		(1,317)
(Gain) loss on disposal of other assets	(59)	332
(Gain) loss from disposal activities within discontinued operations	294	(8,314)
Deferred income taxes	(2,610)	1,006
Excess tax (benefit) deficits from share-based payment arrangements	(89)	45
(Increase) decrease, net of effect of acquisitions and divestitures:		
Trade receivables, net	(11,045)	11,032
Contracts in transit	(6,709)	8,900
Inventories	(55,359)	167,545
Vehicles leased to others	(1,870)	696
Prepaid expenses and other	2,564	19,136
Other non-current assets	(1,124)	7
(Increase) decrease, net of effect of acquisitions and divestitures:		
Floorplan notes payable	2,338	(170,803)
Trade payables	6,167	(431)
Accrued liabilities	11,181	4,680
Other long-term liabilities and deferred revenue	623	9,016
Net cash provided by (used in) operating activities	(16,760)	73,483
Cash flows from investing activities:		
Capital expenditures:		
Non-financeable	(2,519)	(4,446)
Financeable	(1,170)	(14,920)
Proceeds from sale of other assets	9,879	8,978
Cash paid for acquisitions, net of cash acquired	(23,691)	
Proceeds from sale of stores	941	26,607
Principal payments received on notes receivable	62	
Net cash provided by (used in) investing activities	(16,498)	16,219
Cash flows from financing activities:		
Flooring notes payable: non-trade	13,807	7,384
Borrowings on lines of credit	40,000	44,000
Repayments on lines of credit	(24,000)	(110,000)

Principal payments on long-term debt, scheduled		(6,119)		(14,423)
Principal payments on long-term debt and capital leases, other		(34,543)		(67,809)
Proceeds from issuance of long-term debt		47,820		42,904
Proceeds from issuance of common stock		2,155		1,796
Repurchase of common stock		(819)		(1)
Excess tax benefit (deficits) from share-based payment arrangements		89		(45)
Dividends paid		(2,607)		
Net cash provided by (used in) financing activities		35,783		(96,194)
Increase (decrease) in cash and cash equivalents		2,525		(6,492)
Cash and cash equivalents:				
Beginning of period		12,776		10,874
End of period	$	15,301	$	4,382
Supplemental disclosure of cash flow information:				
Cash paid during the period for interest	$	19,008	$	23,787
Cash paid (refunded) during the period for income taxes, net		3,215		(15,464)
Supplemental schedule of non-cash investing and financing activities:				
Floorplan debt acquired in connection with acquisitions	$	1,856	$	
Acquisition of assets with capital leases		62		5
Flooring debt paid in connection with store disposals		2,134		25,895
Debt issued in connection with acquisitions		63		

The accompanying notes are an integral part of these consolidated 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 September 30, 2010 and for the three- and nine-month periods ended September 30, 2010 and 2009. 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 include all adjustments necessary for a fair presentation of the information when read in conjunction with our 2009 audited consolidated financial statements and the related notes thereto. The financial information as of December 31, 2009 is derived from our 2009 Annual Report on Form 10-K. The interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our 2009 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.

Concentrations of Risk and Uncertainties Regarding Manufacturers

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

We enter into agreements (Franchise Agreements) with the manufacturers. Each Franchise Agreement generally limits the location of the store and provides the auto manufacturer approval rights over changes in store management and ownership. The auto manufacturers are also entitled to terminate the Franchise Agreement if a store is in material breach of the terms. Our ability to expand operations depends, in part, on obtaining consents of the manufacturers for the acquisition of additional stores, which may be withheld depending on the performance of our existing stores of that brand.

We are subject to a concentration of risk in the event of financial distress, including potential reorganization or bankruptcy, of a major vehicle manufacturer. Our sales volume could be materially adversely impacted by the manufacturers or distributors inability to supply the stores with an adequate supply of vehicles and related financing. Our Chrysler, General Motors (GM) and Ford (collectively, the Domestic Manufacturers) stores represented approximately 30%, 18% and 6% of our new vehicle sales for the nine months ended September 30, 2010, respectively, and approximately 30%, 18% and 5% for all of 2009, respectively.

We receive incentives from our manufacturers, including rebates, cash allowances, financing programs, discounts, holdbacks and other incentive consideration. These incentives are recorded as receivables on our balance sheet until payment is received. Our financial condition could be materially adversely impacted by the manufacturers or distributors inability to continue to offer these incentives at substantially similar terms, or to pay our outstanding receivables. Total receivables from Domestic Manufacturers were $9.1 million and $7.2 million as of September 30, 2010 and December 31, 2009, respectively.

We currently have relationships with a number of manufacturers or their affiliated finance companies, including Ally Bank (formerly GMAC LLC), Daimler Financial, Toyota Financial Services, Ford Motor Credit Company, VW Credit, Inc., American Honda Finance Corporation, Nissan Motor Acceptance Corporation and BMW Financial Services NA, LLC. These companies provide retail vehicle financing for our customers and provide us new vehicle floorplan financing for their respective brands. Ally

Bank serves as the primary lender for all other brands. At September 30, 2010, Ally Bank was the floorplan provider on approximately 69% of the floorplan notes payable outstanding. Certain of these companies have incurred significant losses and are operating under financial constraints. Other companies may incur losses in the future or undergo funding limitations. As a result, credit that has typically been extended to us by the companies may be modified with terms unacceptable to us or revoked entirely. If these events were to occur, we may not be able to pay our floorplan debts or borrow sufficient funds to refinance the vehicles. Even if new financing were available, it may not be on terms acceptable to us.

Most manufacturers are experiencing reduced sales due to the continued stressed economy. Many have disclosed substantial operating losses over the recent past. Two of these manufacturers, Chrysler and GM, filed a petition for Chapter 11 bankruptcy protection in the second quarter of 2009. Both succeeded in receiving approval for the transfer and sale of key operating assets into new companies with reduced debt, improved operating efficiencies, new ownership and resized operations.

In connection with its reorganization, the Chrysler entity emerging from bankruptcy protection (New Chrysler) assumed most Dealer Sales and Service (Franchise) Agreements but elected to reject certain Franchise Agreements to reduce its store count. Two of our Chrysler stores (Omaha, NE Chrysler Jeep Dodge and Colorado Springs, CO Chrysler Jeep) were not assumed and those dealerships have ceased operations. Five of our existing Dodge stores were awarded additional franchises to sell either the Chrysler or Jeep brands, or both.

GM undertook a similar process in its reorganization, and selected certain stores within its network for termination. The terminated stores were offered agreements winding down their operations with a final termination no later than October 2010. The GM closure list was not made public, and each terminated dealership signed a non-disclosure agreement with respect to its closure. During the reorganization, we received franchise agreement modification documents that terminate all operations at three locations, terminate Cadillac franchises at two Chevrolet/Cadillac stores, and terminate heavy truck franchises at two Chevrolet stores. We have also received notification that our one Saturn store would not be continued by GM, and we terminated the franchise in December 2009.

Federal legislation was passed in December 2009 which provided Chrysler and GM dealers who were terminated or who had signed wind-down letters in the manufacturer bankruptcy process the opportunity to pursue reinstatements through an arbitration proceeding. The legislation instructed that the arbitrator, under the auspices of the American Arbitration Association, balance the economic interest of the dealership, the economic interest of the manufacturer, and the economic interest of the public at large and decide, based upon that balancing, whether or not the dealership should be reinstated into the applicable manufacturer s dealer network.

We filed notice of arbitration with respect to our previous Colorado Springs, CO Chrysler Jeep dealership; however, we withdrew the notice in the first quarter of 2010. We also filed notice of arbitration with respect to three GM dealerships and have signed agreements in the second quarter of 2010 reinstating two of those dealerships. We withdrew the notice for the third dealership in the second quarter of 2010.

As a result of this legislation, a competing dealership has been awarded reinstatement in a market we currently serve. Additionally, it is possible that other competing dealerships that were terminated or wound-down could be reinstated. If a competing dealership is reinstated in one of the markets where we were awarded additional franchises, there is a possibility the competing dealership could challenge our award of additional franchises. The competing dealership may impact the profitability of our store due to increased competition in the local market area. Further, such reinstatements could add additional costs and burdens on the reorganized manufacturers, reducing their competitiveness. We are unable to predict the ultimate financial impact on our business, if any.

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

While New Chrysler and GM have both emerged from bankruptcy protection and completed their reorganizations, and much of the near-term risk to the viability of the suppliers has been mitigated, the future remains uncertain. The success of the reorganizations and New Chrysler s integration with Fiat S.p.A., are unknown. The future financial condition of GM and New Chrysler, and their ability to provide products that result in sales and profits consistent with historical results is at risk. Resizing operations could negatively impact the volume of vehicles produced and made available to dealers. Shortages in inventory for any manufacturer as a result of production delays, recalls or other factors could also have a negative impact on our sales volumes and financial results. As such, no assurances can be given that our financial condition, results of operations and cash flows will not be adversely impacted in the future.

Note 2. Inventories

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

	September 30, 2010	December 31, 2009
New and program vehicles	$ 286,086	$ 238,814
Used vehicles	85,204	70,819
Parts and accessories	21,616	19,093
	$ 392,906	$ 328,726

Note 3. Credit Facility Amendment

In January 2010, we executed the eighth amendment to our Credit Facility, which increased the amount allowable for letters of credit to $2.0 million. In February 2010, we executed the ninth amendment to our Credit Facility, which altered the definition of vehicle equity in the agreement to allow more vehicles to be included in the borrowing base calculation.

In June 2010, we executed the tenth amendment to our Credit Facility. This amendment increased our borrowing capacity by $25 million in available credit for a total amount up to $75 million, extended the maturity date to June 30, 2013 and decreased the interest rate on the credit facility to the 1-month LIBOR plus 2.75%. Additionally, this amendment increased the amount of total funded debt we may carry from $260 million to $310 million. Our financial covenant related to vehicle equity was increased from a minimum of $45 million to a minimum of $65 million. In July 2010 we executed the eleventh amendment to the Credit Facility, which lowered the interest rate on the line to 1-month LIBOR plus 2.35%.

We had $40.0 million and $24.0 million outstanding on our Credit Facility as of September 30, 2010 and December 31, 2009, respectively.

Note 4. Contingencies

Litigation

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

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Alaska Service and Parts Advisors and Managers Overtime Suit

On March 22, 2006, seven former employees in Alaska brought suit against Lithia (Dunham, et al. v. Lithia Support Services, et al., 3AN-06-6338 Civil, Superior Court for the State of Alaska) seeking overtime wages, additional liquidated damages and attorney s fees. The complaint was later amended to include a total of 11 named plaintiffs. The court ordered the dispute to arbitration. In February 2008, the arbitrator granted the plaintiffs request to establish a class of plaintiffs consisting of all present and former service and parts department employees totaling approximately 150 individuals who were paid on a commission basis. We have filed a motion requesting reconsideration of this class certification, but the arbitrator died before issuing his opinion. The reconsideration sought a ruling whether these employees or some of these employees are exempt from the applicable state law that provides for the payment of overtime under certain circumstances. The replacement arbitrator has now been appointed and ruled to remove approximately 30 service and parts managers from the case. A class action opt-out notice was mailed to the service and parts employees in October 2009. Lithia and the plaintiffs have agreed to conduct the arbitration in two parts. The first arbitration will determine if liability exists for Lithia. This arbitration was conducted on September 27, 2010, and we are currently awaiting a decision. If the outcome of this arbitration determines that valid claims exist, a second arbitration will be conducted to determine the amount of damages, if any.

We intend to vigorously defend the matter noted above, and to assert available defenses. We cannot make an estimate of the likelihood of negative judgment in this case at this time, and estimate our exposure to be in a range of $0 to $1.5 million. The ultimate resolution of the above noted case is not expected to result in any significant settlement amounts. However, the resolution of this matter cannot be predicted with certainty, and an unfavorable resolution of the matter could have a material adverse effect on our results of operations, financial condition or cash flows.

Note 5. Comprehensive Income (Loss)

Comprehensive income (loss) for the three- and nine-month periods ended September 30, 2010 and 2009 was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	$ 9,792	$ 5,713	$ 9,340	$ 10,705
Cash flow hedges:				
Derivative gain (loss), net of tax effect of $168, $380, $1,122 and $(816), respectively	(272)	(618)	(1,826)	1,373
Total comprehensive income	$ 9,520	$ 5,095	$ 7,514	$ 12,078

Note 6. 2003 Stock Incentive Plan

At our 2010 Annual Meeting of Shareholders held in April 2010, our shareholders amended and restated the 2003 Stock Incentive Plan (the 2003 Plan), increasing the number of shares issuable by 600,000 shares to 2,800,000 shares.

Note 7. Reclassifications

The results of operations of stores classified as discontinued operations have been presented on a comparable basis for all periods presented in the accompanying consolidated statements of operations. See also Note 14.

Note 8. Earnings (Loss) Per Share

We compute net income (loss) per share of Class A and Class B common stock using the two-class method. Under this method, basic net income per share is computed using the weighted average number of common shares outstanding during the period excluding unvested common shares subject to repurchase or cancellation. Diluted net income per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period.

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Potential common shares consist of the incremental common shares issuable upon the exercise of stock options and unvested restricted shares subject to repurchase or cancellation. The dilutive effect of outstanding stock options and other grants is reflected in diluted earnings per share by application of the treasury stock method. The computation of the diluted net income per share of Class A common stock assumes the conversion of Class B common stock, while the diluted net income per share of Class B common stock does not assume the conversion of those shares.

Except with respect to voting rights, the rights of the holders of our Class A and Class B common stock are identical. Our Restated Articles of Incorporation require that the Class A and Class B common stock must share equally in any dividends, liquidation proceeds or other distribution with respect to our common stock and the Articles of Incorporation can only be amended by a vote of the shareholders. Additionally, Oregon law provides that amendments to our Articles of Incorporation, which would have the effect of adversely altering the rights, powers or preferences of a given class of stock, must be approved by the class of stock adversely affected by the proposed amendment. As a result, the undistributed earnings for each year are allocated based on the contractual participation rights of the Class A and Class B common shares as if the earnings for the year had been distributed. As the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis. Further, as we assume the conversion of Class B common stock in the computation of the diluted net income per share of Class A common stock, the undistributed earnings are equal to net income for that computation.

Following is a reconciliation of the income (loss) from continuing operations and weighted average shares used for our basic earnings per share (EPS) and diluted EPS from continuing operations for the three- and nine-month periods ended September 30, 2010 and 2009 (in thousands, except per share amounts):

Three Months Ended September 30,	**2010**		**2009**	
Basic EPS from Continuing Operations	**Class A**	**Class B**	**Class A**	**Class B**
Numerator:				
Income from continuing operations applicable to common stockholders	$ 8,382	$ 1,410	$ 5,735	$ 1,240
Distributed income applicable to common stockholders	(1,119)	(188)		
Basic undistributed income from continuing operations applicable to common stockholders	$ 7,263	$ 1,222	$ 5,735	$ 1,240
Denominator:				
Weighted average number of shares outstanding used to calculate basic income per share	22,358	3,762	17,403	3,762
Basic income per share applicable to common stockholders	$ 0.37	$ 0.37	$ 0.33	$ 0.33
Basic distributed income per share applicable to common stockholders	(0.05)	(0.05)		
Basic undistributed income per share applicable to common stockholders	$ 0.32	$ 0.32	$ 0.33	$ 0.33

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Three Months Ended September 30,	2010		2009	
Diluted EPS from Continuing Operations	**Class A**	**Class B**	**Class A**	**Class B**
Numerator:				
Distributed income applicable to common stockholders	$ (1,119)	$ (188)	$	$
Reallocation of earnings as a result of conversion of dilutive stock options	(1)	1		
Reallocation of distributed income due to conversion of Class B to Class A common shares outstanding	(187)			
Diluted distributed income applicable to common stockholders	$ (1,307)	$ (187)	$	$
Undistributed income from continuing operations applicable to common stockholders	$ 7,263	$ 1,222	$ 5,735	$ 1,240
Reallocation of earnings as a result of conversion of dilutive stock options	10	(10)	16	(16)
Reallocation of undistributed income due to conversion of Class B to Class A	1,212		1,224	
Diluted undistributed income from continuing operations applicable to common stockholders	$ 8,485	$ 1,212	$ 6,975	$ 1,224
Denominator:				
Weighted average number of shares outstanding used to calculate basic income (loss) per share	22,358	3,762	17,403	3,762
Weighted average number of shares from stock options	208		283	
Conversion of Class B to Class A common shares outstanding	3,762		3,762	
Weighted average number of shares outstanding used to calculate diluted income per share	26,328	3,762	21,448	3,762
Diluted income per share applicable to common stockholders	$ 0.37	$ 0.37	$ 0.33	$ 0.33
Diluted distributed income per share applicable to common stockholders	(0.05)	(0.05)		
Diluted undistributed income per share applicable to common stockholders	$ 0.32	$ 0.32	$ 0.33	$ 0.33

Three Months Ended September 30,	2010		2009	
Diluted EPS	**Class A**	**Class B**	**Class A**	**Class B**
Antidilutive Securities				
Shares issuable pursuant to stock options not included since they were antidilutive	708		808	

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Nine Months Ended September 30,	2010		2009	
Basic EPS from Continuing Operations	**Class A**	**Class B**	**Class A**	**Class B**
Numerator:				
Income from continuing operations applicable to common stockholders	$ 8,315	$ 1,406	$ 7,166	$ 1,564
Distributed income applicable to common stockholders	(2,230)	(377)		
Basic undistributed income from continuing operations applicable to common stockholders	$ 6,085	$ 1,029	$ 7,166	$ 1,564
Denominator:				
Weighted average number of shares outstanding used to calculate basic income per share	22,249	3,762	17,238	3,762
Basic income per share applicable to common stockholders	$ 0.37	$ 0.37	$ 0.42	$ 0.42
Basic distributed income per share applicable to common stockholders	(0.10)	(0.10)		
Basic undistributed income per share applicable to common stockholders	$ 0.27	$ 0.27	$ 0.42	$ 0.42

Nine Months Ended September 30,	2010		2009	
Diluted EPS from Continuing Operations	**Class A**	**Class B**	**Class A**	**Class B**
Numerator:				
Distributed income applicable to common stockholders	$ (2,230)	$ (377)	$	$
Reallocation of distributed income as a result of conversion of dilutive stock options	(3)	3		
Reallocation of distributed income due to conversion of Class B to Class A common shares outstanding	(374)			
Diluted distributed income applicable to common stockholders	$ (2,607)	$ (374)	$	$
Undistributed income from continuing operations applicable to common stockholders	$ 6,085	$ 1,029	$ 7,166	$ 1,564
Reallocation of undistributed income as a result of conversion of dilutive stock options	7	(7)	9	(9)
Reallocation of undistributed income due to conversion of Class B to Class A	1,022		1,555	
Diluted undistributed income from continuing operations applicable to common stockholders	$ 7,114	$ 1,022	$ 8,730	$ 1,555

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Nine Months Ended September 30,	2010		2009	
Denominator:				
Weighted average number of shares outstanding used to calculate basic income per share	22,249	3,762	17,238	3,762
Weighted average number of shares from stock options	180		124	
Conversion of Class B to Class A common shares outstanding	3,762		3,762	
Weighted average number of shares outstanding used to calculate diluted income per share	26,191	3,762	21,124	3,762
Diluted income per share available to common stockholders	$ 0.37	$ 0.37	$ 0.41	$ 0.41
Diluted distributed income per share applicable to common stockholders	(0.10)	(0.10)		
Diluted undistributed income per share applicable to common stockholders	$ 0.27	$ 0.27	$ 0.41	$ 0.41
Diluted EPS	**Class A**	**Class B**	**Class A**	**Class B**
Antidilutive Securities				
2 7/8% convertible senior subordinated notes			429	
Shares issuable pursuant to stock options not included since they were antidilutive	725		1,438	

Note 9. Asset Impairment Charges

Long-lived assets classified as held and used and definite-lived intangible assets are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. An estimate of future undiscounted net cash flows associated with the long-lived assets is used to determine if the carrying value of the assets is recoverable. An impairment charge is recorded for the amount the carrying value of the asset exceeds its fair value.

Our portfolio of real estate includes properties held for future development, comprised of undeveloped land and vacant facilities. The undeveloped land was purchased in connection with our planned development of stand-alone used vehicle stores or to relocate existing new vehicle stores in certain markets. In 2008, our plans to develop the land were placed on hold until economic conditions improved. The vacant facilities are a result of the bankruptcy reorganization of Chrysler and GM, which terminated certain stores we operated, or through our election to close certain underperforming locations. We believe many of these locations are best utilized for retail automotive purposes reflective of our intended use and construction specifications.

In the fourth quarter of 2009, we completed an equity offering. One of the intended uses of the proceeds was, and remains, to fund potential acquisitions. Following the equity offering, we considered various strategies to convert our properties held for future development into operational assets. We ultimately concluded the best alternative was to seek new vehicle franchises that could be acquired and located in our properties. We began an exhaustive search to identify and ultimately acquire franchises in these markets.

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By the end of the second quarter of 2010, we evaluated the results of our comprehensive search and we determined that we would be unable to acquire franchises at reasonable prices to mitigate the continued holding costs of the facilities. We also determined that development opportunities for our undeveloped land would not be realizable within a short to medium-term time period. In addition, through the first half of 2010, we experienced various macroeconomic and industry specific factors which influenced our decision to modify our disposition strategy.

At the end of 2009, the projected rate of annualized United States new vehicle sales was forecasted to recover from the extremely low levels experienced in 2009 to a more robust level in 2010, with some analysts projecting as many as 13 million new vehicles sold in the year. However, as 2010 has progressed, the current annualized new vehicle sales levels have been revised down to approximately an 11.5 million unit range, and projections for the year 2011 and beyond have become more uncertain with respect to the pace at which a return to the higher sales levels experienced until 2007 will occur, if at all.

The closure of a number of automotive retail locations, due both to the economic downturn and as a result of the termination of franchises by major domestic manufacturers in connection with their bankruptcy proceedings, has created an oversupply of vacant dealership properties across the United States. At current sales levels, the existing automotive dealership network retains a significant idle capacity, which reduces the need for additional retail space provided by vacant dealership sites or by developing new sites. It has become apparent in 2010 that this oversupply of dealer capacity may take a significantly longer period to be absorbed than previously thought.

Additionally, much of the improvement in demand for properties held for future development is tied to a broader economic recovery. Retailers and other commercial users who are willing and able to make the often significant capital investment these properties require must feel more optimistic about the outlook for the future. While the economy has improved from the unprecedented depressed levels experienced in 2009, the longer-term outlook remains cautious. Anemic growth of economic activity out of the recession, a reduction in outlook for GDP growth by economists, persistently high unemployment rates, and the European credit crisis are impacting consumer confidence and delaying the expected rebound of the U.S. economy. The prospects for a quick recovery are low, with many predicting a long, slow recovery that may not reach levels experienced in the past decade for the foreseeable future.

Also, the relative financial condition of regional banks, many of which carry significant quantities of non-performing assets or other owned real estate, remains tenuous. As a result, their inability or unwillingness to finance the purchase of commercial properties for potential buyers significantly reduces the demand and opportunities for us to sell our holdings at reasonable prices. Overall, availability of credit for prospective buyers remains tight compared to historical levels, reducing the potential pool of buyers to only the most creditworthy market participants.

In the markets where our properties are located, we have experienced a large supply of vacant dealership sites, commercial real estate in general and available land for commercial and retail development, which allows prospective buyers a number of choices and increases price pressure. In evaluating broader commercial real estate trends, the supply of commercial real estate failed to decrease in the first half of the year and continues to significantly outstrip current demand. Sales activity remains limited given diverging price expectations by buyers and sellers. When sales do occur, the realized prices are often lower than in prior periods, reflecting the financially distressed nature of the seller and/or the leveraged negotiating position of the buyer.

As a result of these various considerations, we changed our strategy regarding our real estate held for development. Previously, we contemplated disposition in the normal course of business under a highest and best use scenario allowing for a market reasonable marketing period. In the second quarter of 2010, we adopted a strategy focused on a more immediate disposition to potential buyers meeting broader needs and characteristics, including a different commercial retail use, allowing for the redeployment of the invested capital to higher-growth potential opportunities within our business.

In the second quarter of 2010, we experienced an increase in sales interest by prospective buyers; although offers were made at prices significantly lower than we anticipated. In certain cases, these offers were made at amounts that we consider to be significantly lower than the value of these properties from a long-term income approach at their highest and best use. Also in some cases, the offers represented amounts less than current replacement cost. However, given the prospect of accepting these offers and effecting a quick sale, or alternatively continuing the capital investment in these non-operational properties for a longer period until we or other market participants can find a suitable operational use for these properties, we decided to accept certain offers and redeploy the capital elsewhere.

As a result of the above factors, we believe events and circumstances indicated the carrying amount of our non-operational assets may no longer be recoverable at June 30, 2010, triggering an interim impairment test on the totality of our portfolio of such assets. In connection with the impairment test, we recorded an impairment of $13.3 million in the second quarter of 2010.

In the third quarter of 2010, we closed on the sale of three non-operating properties at or above the then current carrying value. In addition, we are in advanced negotiations on the sale of several additional non-operating properties at prices at or above the current carrying value. As a result of these developments, no additional impairment charges were recorded in the three-month period ended September 30, 2010 and a total of $14.8 million was recorded in the nine-month period ended September 30, 2010, as a component of asset impairment charges on our Consolidated Statements of Operations.

As additional market information becomes available and negotiations with prospective buyers continue, estimated fair market values of our properties may change. These changes may result in the recognition of additional impairment charges in future periods.

Impairment charges recorded in the three and nine-months ended September 30, 2009, were associated with assets previously classified as held for sale. As a result of their reclassification in the fourth quarter of 2009 and first quarter of 2010, the associated impairment charges were reclassified from discontinued operations to continuing operations as a component of asset impairment charges. In addition, we recorded impairment charges on certain land and buildings of $1.0 million for the nine months ended September 30, 2009, as a component of selling, general and administrative expense.

Note 10. Stock-Based Compensation

In the first quarter of 2010, we issued non-participating restricted stock units covering 309,000 shares of our Class A common stock to certain employees. The restricted stock units fully vest on the fourth anniversary of the grant date. Total estimated compensation expense to be recognized over the vesting period related to these stock-based awards, calculated using a fair value methodology, is $1.5 million, of which approximately $0.3 million will be recognized in 2010.

In the second quarter of 2010, we issued non-qualified stock options covering 6,000 shares and non-participating restricted stock units covering 11,000 shares of our Class A common stock to members of our Board of Directors. All of these awards vest in approximately one year on the date of the next annual shareholders meeting. Total estimated compensation expense to be recognized over the vesting period related to these stock-based awards, calculated using a fair value methodology, is $110,000, of which approximately $75,000 will be recognized in 2010.

Note 11. Derivative Instruments

We enter into interest rate swaps to manage the variability of our interest rate exposure, thus fixing a portion of our interest expense in a rising or falling rate environment. We do not enter into derivative instruments for any purpose other than to manage interest rate exposure of the 1-month LIBOR benchmark. That is, we do not engage in interest rate speculation using derivative instruments.

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Typically, we designate all interest rate swaps as cash flow hedges and, accordingly, we record the change in fair value of these interest rate swaps in other comprehensive income rather than net income until the underlying hedged transaction affects net income. If a swap is no longer accounted for as a cash flow hedge and the forecasted transaction remains probable or reasonably possible of occurring, the gain or loss recorded in accumulated other comprehensive income is recognized in income as the forecasted transaction occurs. If the forecasted transaction is not probable of occurring, the gain or loss recorded in accumulated other comprehensive income (loss) is recognized in income immediately.

At September 30, 2010 and December 31, 2009, the net fair value of all of our agreements totaled a loss of $10.4 million and $6.9 million, respectively, which was recorded on our balance sheet as a component of accrued liabilities and other long-term liabilities. The estimated amount expected to be reclassified into earnings within the next twelve months was $3.1 million at September 30, 2010.

As of September 30, 2010, we had outstanding the following interest rate swaps with U.S. Bank Dealer Commercial Services:

effective June 16, 2006 a ten year, $25 million interest rate swap at a fixed rate of 5.587% per annum, variable rate adjusted on the 1st and 16th of each month;

effective January 26, 2008 a five year, $25 million interest rate swap at a fixed rate of 4.495% per annum, variable rate adjusted on the 26th of each month;

effective May 1, 2008 a five year, $25 million interest rate swap at a fixed rate of 3.495% per annum, variable rate adjusted on the 1st and 16th of each month; and

effective May 1, 2008 a five year, $25 million interest rate swap at a fixed rate of 3.495% per annum, variable rate adjusted on the 1st and 16th of each month.

We receive interest on all of the interest rate swaps at the one-month LIBOR rate. The one-month LIBOR rate at September 30, 2010 was 0.256% per annum, as reported in the Wall Street Journal.

The fair value of our derivative instruments was included in our balance sheet as follows:

Balance Sheet Information (in thousands)	**Fair Value of Asset Derivatives**		**Fair Value of Liability Derivatives**	
	Location in Balance Sheet	**September 30, 2010**	**Location in Balance Sheet**	**September 30, 2010**
Derivatives Designated as Hedging Instruments				
Interest Rate Swap Contracts	Prepaid expenses and other	$	Accrued liabilities	$ 3,092
	Other non-current assets		Other long-term liabilities	7,274
		$		$ 10,366

Balance Sheet Information (in thousands)	**Fair Value of Asset Derivatives**		**Fair Value of Liability Derivatives**	
	Location in Balance Sheet	**December 31, 2009**	**Location in Balance Sheet**	**December 31, 2009**
Derivatives Designated as Hedging Instruments				
Interest Rate Swap Contracts	Prepaid expenses and other	$	Accrued liabilities	$ 1,668
				5,212

	Other non-current assets	Other long-term liabilities
	$	$ 6,880

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The effect of derivative instruments on our Consolidated Statements of Operations for the three and nine-month periods ended September 30, 2010 and 2009 was as follows (in thousands):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in OCI (Effective Portion)	Location of Gain/(Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Three Months Ended September 30, 2010					
Interest Rate Swap Contracts	$ (1,132)	Floorplan Interest expense	$ (692)	Floorplan Interest expense	$ (903)
Three Months Ended September 30, 2009					
Interest Rate Swap Contracts	$ (2,018)	Floorplan Interest expense	$ (1,020)	Floorplan Interest expense	$ (76)

Derivatives Not Designated as Hedging Instruments	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
Three Months Ended September 30, 2010		
Interest Rate Swap Contracts	Floorplan interest expense	$
Three Months Ended September 30, 2009		
Interest Rate Swap Contracts	Floorplan interest expense	$

Derivatives in Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in OCI (Effective	Location of Gain/(Loss) Reclassified from Accumulated OCI into	Amount of Gain/(Loss) Reclassified from Accumulated	Location of Gain/(Loss) Recognized in Income on Derivative (Ineffective	Amount of Gain/(Loss) Recognized in Income on Derivative (Ineffective

	Portion)	Income (Effective Portion)	OCI into Income (Effective Portion)	Portion and Amount Excluded from Effectiveness Testing)	Portion and Amount Excluded from Effectiveness Testing)
Nine Months Ended September 30, 2010					
Interest Rate Swap Contracts	$ (5,164)	Floorplan Interest expense	$ (2,216)	Floorplan Interest expense	$ (1,390)
Nine Months Ended September 30, 2009					
Interest Rate Swap Contracts	$ (748)	Floorplan Interest expense	$ (2,937)	Floorplan Interest expense	$ 320

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Derivatives Not Designated as Hedging Instruments	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
Nine Months Ended September 30, 2010		
Interest Rate Swap Contracts	Floorplan interest expense	$
Nine Months Ended September 30, 2009		
Interest Rate Swap Contracts	Floorplan interest expense	$ (6)

See also Notes 5 and 12.

Note 12. Fair Value Measurements

We adopted the provisions of Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements on January 1, 2010. The adoption requires disclosures about recurring and non-recurring fair value measurements, including transfers into and out of Level 1 and Level 2 fair value measurement categories. Clarification was also provided on the amount of disaggregation, inputs and valuation techniques required.

Additionally, information about purchases, sales, issuances and settlements on a gross basis will be required for Level 3 fair value measurements in interim and year-end periods ending after December 15, 2010. Since this pertains only to footnote disclosure, we do not believe it will have a material impact on our financial position or results of operations.

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 speeds, credit risk, etc.; and

Level 3 significant unobservable inputs, including our own assumptions in determining fair value.

The inputs or methodology used for valuing financial assets and liabilities are not necessarily an indication of the risk associated with investing in them.

We use the income approach to determine the fair value of our interest rate swaps using observable Level 2 market expectations at measurement date and an income approach to convert estimated future cash flows to a single present amount (discounted) assuming that participants are motivated, but not compelled to transact. Level 2 inputs for the swap valuations are limited to quoted prices for similar assets or liabilities in active markets (specifically futures contracts on LIBOR for the first two years) and inputs other than quoted prices that are observable for the asset or liability (specifically LIBOR cash and swap rates and credit risk at commonly quoted intervals). Mid-market pricing is used as a practical expedient for fair value measurements. Key inputs, including the cash rates for very short term, futures rates for up to two years and LIBOR swap rates beyond the derivative maturity are used to predict future reset rates to discount those future cash flows to present value at

measurement date. Inputs are collected from Bloomberg on the last market day of the period. The same methodology is used to determine the rate used to discount the future cash flows. The valuation of the interest rate swaps also takes into consideration our own, as well as the counterparty s, risk of non-performance under the contract. See also Note 11.

We estimate the fair value of our assets held for sale and liabilities related to assets held for sale based on a market valuation approach, which uses prices and other relevant information generated primarily by recent market transactions involving similar or comparable assets or liabilities, as well as our historical experience in divestitures, acquisitions and real estate transactions. When available, we use inputs from independent valuation experts, such as brokers and real estate appraisers, to corroborate our internal estimates. As these valuations contain unobservable inputs, we classified the assets held for sale and liabilities related to assets held for sale as Level 3.

We estimate the fair value of long-lived assets that are recorded at fair value based on a market valuation approach. We use prices and other relevant information generated primarily by recent market transactions involving similar or comparable assets or liabilities, 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. As these valuations contain unobservable inputs, we classified the long-lived assets as Level 3.

There were no changes to our valuation techniques during the nine-month period ended September 30, 2010.

There were no non-financial assets and liabilities measured at fair value at September 30, 2010, other than the option to purchase two of our stores provided to one of our executives in 2009, the value of which is estimated to be insignificant at September 30, 2010, based on the current and future expected performance of these stores (Level 3 input). The following table summarizes our non-financial assets and liabilities measured at fair value at December 31, 2009 (in thousands):

	December 31, 2009	
	Fair Value	**Input Level**
Assets held for sale	$ 11,693	Level 3
Liabilities related to assets held for sale	5,050	Level 3
Franchise value	1,691	Level 3
Long-lived assets	52,419	Level 3

The following tables summarize valuation adjustments recorded in our Consolidated Statements of Operations on non-financial assets measured and recorded at fair value on a non-recurring basis for the three-month period ended September 30, 2009 and the nine-month periods ended September 30, 2010 and 2009 (in thousands):

There were no valuation adjustments recorded for the three-month period ended September 30, 2010.

	Fair Value Measurement Using			
Three Months Ended September 30, 2009	**Level 1**	**Level 2**	**Level 3**	**Gain/(Loss)**
Assets held for sale	$	$	$ 124,845	$ (2,633)

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Valuation adjustments recorded in the three-months ended September 30, 2009 for assets held for sale totaled $2.6 million. $2.0 million was included as a component of asset impairment charges and $0.6 million was included as a component of income (loss) from discontinued operations, net of tax, in our Consolidated Statements of Operations. See also Note 14.

	Fair Value Measurement Using			
Nine Months Ended September 30, 2010	**Level 1**	**Level 2**	**Level 3**	**Gain/(Loss)**
Long-lived assets held and used:				
Building and improvements	$	$	$ 23,559	$ (8,573)
Land	$	$	$ 13,499	$ (6,178)

	Fair Value Measurement Using			
Nine Months Ended September 30, 2009	**Level 1**	**Level 2**	**Level 3**	**Gain/(Loss)**
Assets held for sale	$	$	$ 124,845	$ (8,729)

Valuation adjustments recorded in the nine-months ended September 30, 2009 for assets held for sale totaled $8.7 million. Of this amount, $7.2 million was included as a component of asset impairment charges and $1.5 million was included as a component of income (loss) from discontinued operations, net of tax, in our Consolidated Statements of Operations. See also Note 14.

We had $147.4 million and $162.4 million of long-term fixed interest rate debt outstanding as of September 30, 2010 and December 31, 2009, respectively. As of September 30, 2010, this debt had maturity dates between November 2011 and October 2029. We calculate the estimated fair value of our fixed rate debt using a discounted cash flow methodology. Using estimated current interest rates based on a similar risk profile and duration, the fixed cash flows are discounted and summed to compute the fair value of the debt. Based on this analysis, we have determined that the fair value of this long-term fixed interest rate debt was approximately $160.5 million and $166.8 million at September 30, 2010 and December 31, 2009, respectively. We believe the carrying value of our variable rate debt approximates fair value.

Note 13. Acquisitions

On July 19, 2010, we acquired the inventory, equipment, intangible assets and certain reserves related to Honda of Bend and agreed to the transfer of Chevrolet and Cadillac brands from Bob Thomas Chevrolet Cadillac, both located in Bend, Oregon. On August 9, 2010, we acquired the inventory, equipment, real estate, intangible assets and certain reserves related to Toyota of Billings from Prestige Toyota, located in Billings, Montana. Consideration paid for acquisitions totaled $25.5 million, of which $23.7 million was paid in cash and $1.8 million was financed through a floorplan credit facility. The fair values of assets acquired and liabilities assumed are not material to our Consolidated Balance Sheets. The results of operations of the acquired stores are included in our Consolidated Financial Statements from the date of acquisition.

Note 14. Discontinued Operations

We perform an internal evaluation of our store performance, on a store-by-store basis, in the last month of each quarter. If a store does not meet certain return on investment criteria established by our management team, the location is included on a watch list and is considered for potential disposition. Factors we consider in reaching the conclusion to dispose of a store include: (i) operating results of the store over a predetermined period of time subsequent to placing the store on the watch list, including prospects for improved financial performance; (ii) extent of capital improvements and commitments thereto necessary to optimize operational efficiencies and marketability of the associated franchise; (iii) outlook as to the economic prospects for the local market and viability of the franchise within that market; and (iv) geographic location and franchise mix of our portfolio.

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Once we have reached a decision to dispose of a store, we evaluate the following criteria as required by U.S. generally accepted accounting standards:

our management team, possessing the necessary authority, commits to a plan to sell the store;

the store is available for immediate sale in its present condition;

an active program to locate buyers and other actions that are required to sell the store are initiated;

a market for the store exists and we believe its sale is likely. We also expect to record the transfer of the store as a completed sale within one year;

active marketing of the store commences at a price that is reasonable in relation to the estimated fair market value; and

our management team believes it is unlikely that changes will be made to the plan or to withdraw the plan to dispose of the store.

If we determine the above criteria have been met, we classify the store assets to be disposed of, and liabilities directly associated with those assets, as held for sale in our Consolidated Balance Sheets.

We reclassify the store s operations to discontinued operations in our Consolidated Statements of Operations, on a comparable basis for all periods presented, provided we do not expect to have any significant continuing involvement in the store s operations after its disposal.

At December 31, 2009, two operating stores and three properties were classified as held for sale. Both operating stores were under contract to sell, and, based on our evaluation, we believe the locations met the criteria to be classified as held for sale at that time. Based on subsequent negotiations with the buyer in the first quarter of 2010, management concluded that it was no longer probable that the sale of these stores would be effected, resulting in the determination that these two operating stores no longer met all of the criteria for classification as held for sale at March 31, 2010. Therefore, in the first quarter of 2010, assets and related liabilities associated with two stores were reclassified from assets held for sale to held and used. Their associated results of operations were retrospectively reclassified from discontinued operations to continuing operations for all periods presented.

In the second quarter of 2010, we classified the operating results of Fresno Dodge, which was sold during the quarter, as discontinued operations. Additionally, one of the properties classified as held for sale as of December 31, 2009 was sold. Management evaluated the remaining two properties to determine if classification remained appropriate. Based on new facts and circumstances previously considered unlikely, management no longer believes the sales are probable. As a result the properties were reclassified to assets held and used in June 2010.

As of September 30, 2010 and December 31, 2009, we had no assets classified and two stores and three properties classified, respectively, as held for sale. Assets held for sale included the following (in thousands):

	September 30, 2010	December 31, 2009
Inventories	$	$ 8,098
Property, plant and equipment		3,572
Intangible assets		23
	$	$ 11,693

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

	September 30, 2010	December 31, 2009
Floorplan notes payable	$	$ 2,888
Real estate debt		2,162
	$	$ 5,050

Certain financial information related to discontinued operations was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue	$	$ 13,601	$ 6,002	$ 88,549
Pre-tax loss from discontinued operations	$	$ (1,514)	$ (341)	$ (5,202)
Gain (loss) on disposal activities		(799)	(294)	8,313
		(2,313)	(635)	3,111
Income tax benefit (expense)		1,051	254	(1,136)
Income (loss) from discontinued operations, net of income tax benefit	$	$ (1,262)	$ (381)	$ 1,975
Amount of goodwill and other intangible assets disposed of	$	$	$	$ 1,037
Cash generated from disposal activities	$	$ 4,556	$ 941	$ 26,607

The gain (loss) on disposal activities included the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Goodwill and other intangible assets	$	$ 261	$	$ 11,259
Property, plant and equipment		(108)	(210)	(1,230)
Inventory		(414)		945
Other		(538)	(84)	(2,661)
	$	$ (799)	$ (294)	$ 8,313

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Flooring interest	$	$ 40	$ 51	$ 408
Other interest		552	69	1,949
Total interest	$	$ 592	$ 120	$ 2,357

Note 15. Self-Insured Medical Plan Coverage

In the first quarter of 2010, we modified our employee medical insurance plan coverage. Effective with the plan year starting January 1, 2010, we changed employee coverage from a fully insured plan to a self-insured plan, except for a population of employees in select California dealerships that remain on a fully insured plan. We carry specific stop-loss coverage insurance in the event a large claim is made under the plan. We estimate the cost to provide medical benefits for existing claims, including claims incurred but not reported, based primarily on an analysis of our historical claims experience, the design of the plan and expectations of medical cost growth factors. We monitor actual claims activity and related costs on a regular basis and evaluate their impact on our assumptions. Any changes to assumptions, including actual claims experience and medical cost factors, may result in the recognition of additional charges, which could have a material adverse impact on our financial position and results of operations.

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At September 30, 2010, the self-insured medical plan reserve, net of payments made in the period, totaled $1.1 million, and was included in accrued liabilities on our Consolidated Balance Sheets.

Note 16. Severance Reserve

In the second quarter of 2010, we entered into an agreement with Jeffrey DeBoer, Senior Vice President and Chief Financial Officer, stipulating a one-time cash payment associated with the acceptance of his resignation no later than October 31, 2010. Under the terms of the agreement, we will also provide out-placement consulting services for a maximum of two years, the option to purchase two vehicles leased from us and a pro-rated portion of his variable compensation. Mr. DeBoer also will provide his services as a consultant for up to two years.

As a result of this agreement, we recorded a reserve totaling $0.7 million in the second quarter of 2010 as a component of Selling, General and Administrative expense on our Consolidated Statements of Operations. No amounts had been paid as of September 30, 2010.

Note 17. Share Repurchases

In June 2000, our Board of Directors authorized the repurchase of up to 1,000,000 shares of our Class A common stock. Through September 30, 2010, we have purchased a total of 580,624 shares under this program, 100,893 of which were purchased in 2010 for an average price of $7.88 per share. As of September 30, 2010, 419,376 shares remained available for purchase pursuant to this program. We may continue to repurchase shares from time to time in the future as conditions warrant.

Note 18. Subsequent Event

Common Stock Dividend

On October 27, 2010, we announced that our Board of Directors approved a dividend of $0.05 per share on our Class A and Class B common stock for the third quarter of 2010. The dividend will total approximately $1.3 million and will be paid on November 26, 2010 to shareholders of record on November 12, 2010.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward Looking Statements and Risk Factors

Some of the 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 Private Securities Litigation Reform Act of 1995. Generally, you can identify forward-looking statements by terms such as may, will, should, expect, plan, intend, fc anticipate, believe, estimate, predict, potential, and continue or the negative of these terms or other comparable terminology. The forward-looking statements contained in this Form 10-Q involve known and unknown risks, uncertainties and situations that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. Some of the important factors that could cause actual results to differ from our expectations are discussed in Part II - Other Information, Item 1A. in this Form 10-Q and in the Risk Factors section of our Annual Report on Form 10-K, as supplemented and amended from time to time in Quarterly Reports on Form 10-Q and the Company s other filings with the SEC.

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

only as of the date on which it is made. The Company assumes no obligation to update or revise any forward-looking statements.

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Overview

We are a leading operator of automotive franchises and retailer of new and used vehicles and services. As of October 29, 2010, we offered 26 brands of new vehicles and all brands of used vehicles in 85 stores in the United States and online at Lithia.com. We sell new and used cars and light trucks, replacement parts, provide vehicle maintenance, warranty, paint and repair services and arrange related financing, service contracts, protection products and credit insurance.

Over the past two years, we have restructured our operations to align our costs with current industry vehicle sales levels. We believe that we are well positioned to benefit from an increase in new vehicle sales above current levels. We believe the actions we have taken over the past two years demonstrate the resiliency of our Company. However, no assurances can be given that industry sales will not experience a further decline, or that our restructuring plan was sufficient to meet our operating objectives in a declining market.

We continue to believe that the fragmented nature of the automotive retailing sector provides us with the opportunity to achieve growth through consolidation. We have completed over 100 acquisitions since our initial public offering in 1996. Our acquisition strategy has been to acquire underperforming stores and, through the application of our centralized operating structure, improve store profitability. We believe the current economic environment provides us with attractive acquisition opportunities.

Results of Continuing Operations

The results of operations of stores classified as discontinued operations have been presented on a comparable basis for all periods presented in the accompanying consolidated statements of operations. The following tables set forth the changes in our operating results from continuing operations in the three and nine-month periods ended September 30, 2010 compared to the three- and nine-month periods ended September 30, 2009:

(Dollars in thousands)	Three Months Ended September 30,		Increase	% Increase
	2010	2009	(Decrease)	(Decrease)
Revenues:				
New vehicle	$ 293,237	$ 266,769	$ 26,468	9.9%
Used vehicle retail	158,798	129,857	28,941	22.3
Used vehicle wholesale	30,869	20,223	10,646	52.6
Finance and insurance	18,928	15,704	3,224	20.5
Service, body and parts	77,733	74,538	3,195	4.3
Fleet and other	3,122	895	2,227	248.8
Total revenues	582,687	507,986	74,701	14.7
Cost of sales:				
New vehicle	269,018	242,963	26,055	10.7
Used vehicle retail	135,533	110,115	25,418	23.1
Used vehicle wholesale	30,835	20,207	10,628	52.6
Service, body and parts	39,673	38,611	1,062	2.8
Fleet and other	2,684	597	2,087	349.6
Total cost of sales	477,743	412,493	65,250	15.8
Gross profit	104,944	95,493	9,451	9.9
Asset impairment charges		1,967	(1,967)	(100.0)
Selling, general and administrative	77,468	71,557	5,911	8.3
Depreciation and amortization	4,238	3,883	355	9.1
Operating income	23,238	18,086	5,152	28.5

Floorplan interest expense	(3,085)	(3,053)	32	1.0
Other interest expense	(3,725)	(3,291)	434	13.2
Other income, net	73	25	48	192.0
Income from continuing operations before taxes	16,501	11,767	4,734	40.2
Income tax expense	(6,709)	(4,792)	1,917	40.0
Income from continuing operations	$ 9,792	$ 6,975	$ 2,817	40.4

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(Dollars in thousands)	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	Increase (Decrease)	% Increase (Decrease)
Revenues:				
New vehicle	$ 777,575	$ 670,835	$ 106,740	15.9%
Used vehicle retail	441,533	365,202	76,331	20.9
Used vehicle wholesale	79,904	54,487	25,417	46.6
Finance and insurance	49,840	44,098	5,742	13.0
Service, body and parts	218,526	219,807	(1,281)	(0.6)
Fleet and other	8,629	2,090	6,539	312.9
Total revenues	1,576,007	1,356,519	219,488	16.2
Cost of sales:				
New vehicle	712,857	612,942	99,915	16.3
Used vehicle retail	378,427	313,465	64,962	20.7
Used vehicle wholesale	79,198	54,071	25,127	46.5
Service, body and parts	111,541	113,900	(2,359)	(2.1)
Fleet and other	7,392	1,078	6,314	585.7
Total cost of sales	1,289,415	1,095,456	193,959	17.7
Gross profit	286,592	261,063	25,529	9.8
Asset impairment charges	14,751	7,164	7,587	105.9
Selling, general and administrative	223,320	209,469	13,851	6.6
Depreciation and amortization	13,389	11,943	1,446	12.1
Operating income	35,132	32,487	2,645	8.1
Floorplan interest expense	(8,403)	(8,628)	(225)	(2.6)
Other interest expense	(10,842)	(10,639)	203	1.9
Other income, net	356	1,447	(1,091)	(75.4)
Income from continuing operations before taxes	16,243	14,667	1,576	10.7
Income tax expense	(6,522)	(5,937)	585	9.9
Income from continuing operations	$ 9,721	$ 8,730	$ 991	11.4

Certain key performance metrics used to manage our business were as follows for the three- and nine-month periods ended September 30, 2010 and 2009:

Three Months Ended September 30, 2010	Percent of Total Revenues	Gross Margin	Percent of Total Gross Profit
New vehicle	50.3%	8.3%	23.1%
Used vehicle retail	27.3	14.7	22.2
Used vehicle wholesale	5.4	0.1	0.0
Finance and insurance[(1)]	3.2	100.0	18.0
Service, body and parts	13.3	49.0	36.3
Fleet and other	0.5	14.0	0.4

Three Months Ended September 30, 2009

	Percent of Total Revenues	Gross Margin	Percent of Total Gross Profit
New vehicle	52.5%	8.9%	24.9%
Used vehicle retail	25.6	15.2	20.7
Used vehicle wholesale	3.9	0.1	0.1
Finance and insurance[(1)]	3.1	100.0	16.4
Service, body and parts	14.7	48.2	37.6
Fleet and other	0.2	33.3	0.3

Nine Months Ended September 30, 2010	Percent of Total Revenues	Gross Margin	Percent of Total Gross Profit
New vehicle	49.3%	8.3%	22.6%
Used vehicle retail	28.0	14.3	22.0
Used vehicle wholesale	5.1	0.9	0.3
Finance and insurance[(1)]	3.2	100.0	17.4
Service, body and parts	13.9	49.0	37.3
Fleet and other	0.5	14.3	0.4

Nine Months Ended September 30, 2009	Percent of Total Revenues	Gross Margin	Percent of Total Gross Profit
New vehicle	49.5%	8.6%	22.2%
Used vehicle retail	26.9	14.2	19.8
Used vehicle wholesale	3.9	0.8	0.1
Finance and insurance[(1)]	3.3	100.0	16.9
Service, body and parts	16.2	48.2	40.6
Fleet and other	0.2	48.4	0.4

(1) Commissions reported net of anticipated cancellations.

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

	Three months ended September 30, 2010 vs. three months ended September 30, 2009
New vehicle retail, excluding fleet	8.0%
Used vehicle retail	19.8
Used vehicle wholesale	51.8
Total vehicle sales, excluding fleet	13.8
Finance and insurance	18.8
Service, body and parts	2.5
Total sales, excluding fleet	**12.2**

	Nine months ended September 30, 2010 vs. nine months ended September 30, 2009
New vehicle retail, excluding fleet	14.8%
Used vehicle retail	18.8
Used vehicle wholesale	45.4
Total vehicle sales, excluding fleet	17.7
Finance and insurance	11.5
Service, body and parts	(1.2)
Total sales, excluding fleet	**14.4**

Same-store sales are calculated for stores that were in operation as of September 30, 2010, and only include the months of operations for both comparable periods. For example, a store acquired in March 2009 would be included in same store operating data beginning in April 2010, after its first complete comparable month of operations. Thus, operating results for same store comparisons would include only the periods of April through December of both comparable years.

Certain other financial information was as follows:

	Three Months Ended September 30,	
	2010	2009
Total gross margin	18.0%	18.8%
Selling, general and administrative expenses as a % of gross profit	73.8	74.9
Operating margin	4.0	3.6
Pre-tax margin	2.8	2.3

	Nine Months Ended September 30,	
	2010	2009
Total gross margin	18.2%	19.2%

Selling, general and administrative expenses as a % of gross profit	77.9	80.2
Operating margin	2.2	2.4
Pre-tax margin	1.0	1.1

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Results of Operations

For the three months ended September 30, 2010, we realized a reported net income of $9.8 million, or $0.37 per diluted share. For the three months ended September 30, 2009, we realized a reported net income of $5.7 million, or $0.27 per diluted share.

For the nine months ended September 30, 2010, we realized a reported net income of $9.3 million, or $0.36 per diluted share. For the nine months ended September 30, 2009, we realized a reported net income of $10.7 million, or $0.51 per diluted share.

Non-GAAP Financial Measures

Due to the non-core nature of certain non-cash charges related to asset impairments, lease termination and severance reserves, disposal gains and gains on extinguishment of debt, we are providing our results of operations excluding these items. We believe that each of the non-GAAP financial measures provided improves the transparency of our disclosure, by presenting our results that exclude the impact of these items that affect the period-to-period comparability of our core operations. These presentations are not intended to provide selling, general and administrative costs, operating income, income from continuing operations before taxes or net income in accordance with GAAP and should not be considered an alternative to GAAP measures

The following table reconciles certain reported GAAP amounts per the Consolidated Statements of Operations to the comparable non-GAAP income (loss) amounts (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
Selling, General and Administrative	**2010**	**2009**	**2010**	**2009**
As reported	$ 77,468	$ 71,557	$ 223,320	$ 209,469
Disposal gain (loss)		(393)	365	(956)
Lease termination and severance reserves			(1,334)	
Adjusted	$ 77,468	$ 71,164	$ 222,351	$ 208,513
As a % of revenue				
As reported	13.3%	14.1	14.2%	15.4%
Adjusted	13.3	14.0	14.1	15.4
As a % of gross profit				
As reported	73.8%	74.9%	77.9%	80.2%
Adjusted	73.8	74.5	77.6	79.9
Operating Income				
As reported	$ 23,238	$ 18,086	$ 35,132	$ 32,487
Asset impairments and disposal gains, net		2,360	14,451	8,120
Lease termination and severance reserves			1,334	
Adjusted	$ 23,238	$ 20,446	$ 50,917	$ 40,607
As a % of revenue				
As reported	4.0%	3.6%	2.2%	2.4%
Adjusted	4.0	4.0	3.2	3.0

Income from Continuing Operations Before Income Taxes	Three Months Ended September 30,		Nine Months Ended September 30,	
As reported	$ 16,501	$ 11,767	$ 16,243	$ 14,667
Asset impairments and disposal gains, net		2,360	14,451	8,120
Lease termination and severance reserves			1,334	
Gain on extinguishment of debt				(1,317)
Adjusted	$ 16,501	$ 14,127	$ 32,028	$ 21,470
As a % of revenue				
As reported	2.8%	2.3%	1.0%	1.1%
Adjusted	2.8	2.8	2.0	1.6

	Three Months Ended September 30,			
	Income (loss)		Diluted income (loss) per share	
Continuing Operations	2010	2009	2010	2009
As reported	$ 9,792	$ 6,975	$ 0.37	$ 0.33
Asset impairments and disposal gains, net		1,571		0.07
Adjusted	$ 9,792	$ 8,546	$ 0.37	$ 0.40
Discontinued Operations				
As reported	$	$ (1,262)	$	$ (0.06)
Impairments and disposal loss, net		306		0.01
Adjusted	$	$ (956)	$	$ (0.05)
Consolidated Operations				
As reported	$ 9,792	$ 5,713	$ 0.37	$ 0.27
Adjusted	$ 9,792	$ 7,590	$ 0.37	$ 0.35

	Nine Months Ended September 30,			
	Income (loss)		Diluted income (loss) per share	
Continuing Operations	2010	2009	2010	2009
As reported	$ 9,721	$ 8,730	$ 0.37	$ 0.42
Asset impairments and disposal gains, net	8,777	5,002	0.34	0.24
Lease termination and severance reserves	725		0.03	
Gain on extinguishment of debt		(812)		(0.04)
Adjusted	$ 19,223	$ 12,920	$ 0.74	$ 0.62
Discontinued Operations				
As reported	$ (381)	$ 1,975	$ (0.01)	$ 0.09
Impairments and disposal (gain) loss, net	173	(5,115)		(0.24)
Adjusted	$ (208)	$ (3,140)	$ (0.01)	$ (0.15)
Consolidated Operations				
As reported	$ 9,340	$ 10,705	$ 0.36	$ 0.51

Adjusted	$ 19,015	$ 9,780	$ 0.73	$ 0.47

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New Vehicle Revenues

(Dollars in thousands)	Three Months Ended September 30,		Increase	% Increase
	2010	2009	(Decrease)	(Decrease)
Revenue	$ 293,237	$ 266,769	$ 26,468	9.9%
Retail units sold	9,232	9,278	(46)	(0.5)
Average selling price per retail unit	$ 31,763	$ 28,753	$ 3,010	10.5

(Dollars in thousands)	Nine Months Ended September 30,			%
	2010	2009	Increase	Increase
Revenue	$ 777,575	$ 670,835	$ 106,740	15.9%
Retail units sold	24,794	22,779	2,015	8.8
Average selling price per retail unit	$ 31,361	$ 29,450	$ 1,911	6.5

New vehicle sales have been at historic lows over the past two years, driven by weak consumer confidence and a lack of available credit. The third quarter of 2010 continued to indicate a transition to a slow recovery. The three months ended September 30, 2010 recovered slower than the first and second quarters of 2010, primarily due to the difficult comparison to the prior year as a result of the Cash for Clunkers program, which provided government sponsored rebates for consumers who elected to purchase a new vehicle with improved fuel economy. We believe that the new vehicle market has stabilized and will continue a slow recovery through the end of 2010.

Used Vehicle Revenues

(Dollars in thousands)	Three Months Ended September 30,		Increase	% Increase
	2010	2009	(Decrease)	(Decrease)
Retail revenue	$ 158,798	$ 129,857	$ 28,941	22.3%
Retail units sold	9,705	8,000	1,705	21.3
Average selling price per retail unit	$ 16,362	$ 16,232	$ 130	0.8
Wholesale revenue	$ 30,869	$ 20,223	$ 10,646	52.6
Wholesale units sold	4,066	4,178	(112)	(2.7)
Average selling price per wholesale unit	$ 7,592	$ 4,840	$ 2,752	56.9

(Dollars in thousands)	Nine Months Ended September 30,			%
	2010	2009	Increase	Increase
Retail revenue	$ 441,533	$ 365,202	$ 76,331	20.9%
Retail units sold	26,583	22,879	3,704	16.2
Average selling price per retail unit	$ 16,610	$ 15,962	$ 648	4.1
Wholesale revenue	$ 79,904	$ 54,487	$ 25,417	46.6
Wholesale units sold	10,657	10,457	200	1.9
Average selling price per wholesale unit	$ 7,498	$ 5,211	$ 2,287	43.9

Used vehicle retail unit sales have increased as consumers opt to purchase used vehicles instead of new vehicles, and as we increase the number of lower-price, higher-margin older used vehicles we sell. Average selling prices per retail unit have increased due to fewer late model used Cash for Clunkers on the market, reducing supply and increasing the price of these vehicles, which more than offset the additional lower-price vehicles we sold. We have focused our store personnel on maximizing retail used vehicle sales and reducing the number of used vehicles we wholesale after acquiring via trade-in. We have also increased the number of late-model, higher-cost vehicles we wholesale when we believe the likelihood of a quick retail sale is low. We achieved a used retail to new vehicle unit sales ratio at 1.1:1 for the first nine months of 2010.

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Finance and Insurance

(Dollars in thousands)	Three Months Ended September 30, 2010	2009	Increase	% Increase
Revenue	$ 18,928	$ 15,704	$ 3,224	20.5%
Revenue per retail unit	$ 1,000	$ 909	$ 91	10.0

(Dollars in thousands)	Nine Months Ended September 30, 2010	2009	Increase	% Increase
Revenue	$ 49,840	$ 44,098	$ 5,742	13.0%
Revenue per retail unit	$ 970	$ 966	$ 4	0.4

The increases in finance and insurance sales were primarily due to more vehicles sold in the first nine months of 2010 compared to the first nine months of 2009. Additionally, stronger penetration rates for certain products increased revenues. These increases were offset by our focus on selling more lower-priced, older used cars. These vehicles have less incremental finance and insurance opportunity due to the price of the vehicle and fewer available warranty coverage options.

During the first quarter of 2009, we discontinued the transfer of the obligation related to most of our lifetime lube, oil and filter insurance contracts to a third party. As a result, beginning March 1, 2009, we no longer recognize revenue related to earned commissions at the inception of the contract but, instead, defer the full sale price of the contract and recognize the revenue over the expected life of the contract as services are provided. This change improves our cash position as we retain 100% of the contract sales price, but defers the recognition of the revenues to later periods. Assuming we did not self-insure these contracts, our revenue per retail unit would have been higher by approximately $76 per vehicle and $82 per vehicle for the three months ended September 30, 2010 and 2009, respectively, and by $72 per vehicle and $64 per vehicle for the nine months ended September 30, 2010 and 2009, respectively.

Penetration rates for certain products were as follows:

	Three Months Ended September 30, 2010	2009	Nine Months Ended September 30, 2010	2009
Finance and insurance	72%	67%	71%	69%
Service contracts	40	40	41	41
Lifetime oil change and filter	34	37	34	35

Service, Body and Parts Revenue

(Dollars in thousands)	Three Months Ended September 30, 2010	2009	Increase	% Increase
Revenue	$ 77,733	$ 74,538	$ 3,195	4.3%

(Dollars in thousands)	Nine Months Ended September 30, 2010	2009	Decrease	% Decrease
Revenue	$ 218,526	$ 219,807	$ (1,281)	(0.6)%

The declines in new vehicle sales in 2008 and 2009 reduced the number of units-in-operation, particularly for the domestic automotive manufacturers. This lack of late-model vehicles in operation has put downward pressure on warranty work. To offset these trends, we have focused on increasing customer pay service and parts business.

The customer pay service and parts business, which represented 82.8% and 82.3%, respectively of the total service, body and parts business in the three- and nine-month periods ended September 30, 2010, was up 4.7% and 0.9%, respectively, on a same-store basis compared to the same periods in 2009.

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Warranty work accounted for approximately 17.2% and 17.7%, respectively, of our same-store service, body and parts sales in the three- and nine-month periods ended September 30, 2010 compared to 18.9% and 19.4%, respectively, in the three- and nine-month periods ended September 30, 2009. Same-store warranty sales were down 6.7% and 10.1%, respectively, in the three- and nine-month periods ended September 30, 2010 compared to the same periods of 2009. Domestic brand warranty work decreased by 15.1% and 20.2%, respectively, while import/luxury warranty work increased by 5.4% and 4.4%, respectively, mainly related to Toyota, during the three- and nine-month periods ended September 30, 2010 compared to the same periods in 2009.

Gross Profit

Gross profit increased $9.5 million and $25.5 million, respectively, in the three- and nine-month periods ended September 30, 2010 compared to the same periods of 2009 due to increases in total revenues, offset by decreases in our overall gross profit margin. Our gross profit margin by business line was as follows:

	Three Months Ended September 30,		**Basis Point Change***
	2010	**2009**	
New vehicle	8.3%	8.9%	(60) bp
Retail used vehicle	14.7	15.2	(50)
Wholesale used vehicle	0.1	0.1	
Finance and insurance	100.0	100.0	
Service, body and parts	49.0	48.2	80
Overall	**18.0**	**18.8**	**(80)**

	Nine Months Ended September 30,		**Basis Point Change***
	2010	**2009**	
New vehicle	8.3%	8.6%	(30) bp
Retail used vehicle	14.3	14.2	10
Wholesale used vehicle	0.9	0.8	10
Finance and insurance	100.0	100.0	
Service, body and parts	49.0	48.2	80
Overall	**18.2**	**19.2**	**(100)**

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

During 2010, we continue to focus on maximizing retail profit opportunities on each transaction. Our new and retail used vehicle sales have shifted towards higher-priced vehicles, including trucks, which have lower gross profit margins. We are also adjusting our used vehicle inventories to respond to shifts in consumer demand. We continue to increase sales to customers seeking lower-priced used vehicles, offsetting the trend experienced in retail used vehicle gross profit margins. We had a greater proportion of higher-margin service work in the service, body and parts business, leading to increases in gross profit margin compared to the prior year periods. Overall, as retail new and used vehicle sales increased, gross profit margin declined due to service, body and parts comprising a smaller percentage of total sales.

Asset Impairment Charges

Long-lived assets classified as held and used and definite-lived intangible assets are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. An estimate of future undiscounted net cash flows associated with the long-lived assets is used to determine if the carrying value of the assets is recoverable. An impairment charge is recorded for the amount the carrying value of the asset exceeds its fair value.

Our portfolio of real estate includes properties held for future development, comprised of undeveloped land and vacant facilities. The undeveloped land was purchased in connection with our planned development of stand-alone used vehicle stores or to relocate existing new

vehicle stores in certain markets. In 2008, our plans to develop the land were placed on hold until economic conditions

improved. The vacant facilities are a result of the bankruptcy reorganization of Chrysler and GM, which terminated certain stores we operated, or through our election to close certain underperforming locations. We believe many of these locations are best utilized for retail automotive purposes reflective of our intended use and construction specifications.

In the fourth quarter of 2009, we completed an equity offering. One of the intended uses of the proceeds was, and remains, to fund potential acquisitions. Following the equity offering, we considered various strategies to convert our properties held for future development into operational assets. We ultimately concluded the best alternative was to seek new vehicle franchises that could be acquired and located in our properties. We began an exhaustive search to identify and ultimately acquire franchises in these markets.

By the end of the second quarter of 2010, we evaluated the results of our comprehensive search and we determined that we would be unable to acquire franchises at reasonable prices to mitigate the continued holding costs of the facilities. We also determined that development opportunities for our undeveloped land would not be realizable within a short to medium-term time period. In addition, through the first half of 2010, we experienced various macroeconomic and industry specific factors which influenced our decision to modify our disposition strategy.

At the end of 2009, the projected rate of annualized United States new vehicle sales was forecasted to recover from the extremely low levels experienced in 2009 to a more robust level in 2010, with some analysts projecting as many as 13 million new vehicles sold in the year. However, as 2010 has progressed, the current annualized new vehicle sales levels have been revised down to approximately an 11.5 million unit range, and projections for the year 2011 and beyond have become more uncertain with respect to the pace at which a return to the higher sales levels experienced until 2007 will occur, if at all.

The closure of a number of automotive retail locations, due both to the economic downturn and as a result of the termination of franchises by major domestic manufacturers in connection with their bankruptcy proceedings, has created an oversupply of vacant dealership properties across the United States. At current sales levels, the existing automotive dealership network retains a significant idle capacity, which reduces the need for additional retail space provided by vacant dealership sites or by developing new sites. It has become apparent in 2010 that this oversupply of dealer capacity may take a significantly longer period to be absorbed than previously thought.

Additionally, much of the improvement in demand for properties held for future development is tied to a broader economic recovery. Retailers and other commercial users who are willing and able to make the often significant capital investment these properties require must feel more optimistic about the outlook for the future. While the economy has improved from the unprecedented depressed levels experienced in 2009, the longer-term outlook remains cautious. Anemic growth of economic activity out of the recession, a reduction in outlook for GDP growth by economists, persistently high unemployment rates, and the European credit crisis are impacting consumer confidence and delaying the expected rebound of the U.S. economy. The prospects for a quick recovery are low, with many predicting a long, slow recovery that may not reach levels experienced in the past decade for the foreseeable future.

Also, the relative financial condition of regional banks, many of which carry significant quantities of non-performing assets or other owned real estate, remains tenuous. As a result, their inability or unwillingness to finance the purchase of commercial properties for potential buyers significantly reduces the demand and opportunities for us to sell our holdings at reasonable prices. Overall, availability of credit for prospective buyers remains tight compared to historical levels, reducing the potential pool of buyers to only the most creditworthy market participants.

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In the markets where our properties are located, we have experienced a large supply of vacant dealership sites, commercial real estate in general and available land for commercial and retail

development, which allows prospective buyers a number of choices and increases price pressure. In evaluating broader commercial real estate trends, the supply of commercial real estate failed to decrease in the first half of the year and continues to significantly outstrip current demand. Sales activity remains limited given diverging price expectations by buyers and sellers. When sales do take place, the realized prices are often lower than in prior periods, reflecting the financially distressed nature of the seller and/or the leveraged negotiating position of the buyer.

As a result of these various considerations, we changed our strategy regarding our real estate held for development. Previously, we contemplated disposition in the normal course of business under a highest and best use scenario allowing for a market reasonable marketing period. In the second quarter of 2010, we adopted a strategy focused on a more immediate disposition to potential buyers meeting broader needs and characteristics, including a different commercial retail use, allowing for the redeployment of the invested capital to higher-growth potential opportunities within our business.

In the second quarter of 2010, we experienced an increase in sales interest by prospective buyers; although offers were made at prices significantly lower than we anticipated. In certain cases, these offers were made at amounts that we consider to be significantly lower than the value of these properties from a long-term income approach at their highest and best use. Also in some cases, the offers represented amounts less than current replacement cost. However, given the prospect of accepting these offers and effecting a quick sale, or alternatively continuing the capital investment in these non-operational properties for a longer period until we or other market participants can find a suitable operational use for these properties, we decided to accept certain offers and redeploy the capital elsewhere.

As a result of the above factors, we believe events and circumstances indicated the carrying amount of our non-operational assets may no longer be recoverable at June 30, 2010, triggering an interim impairment test on the totality of our portfolio of such assets.

In the third quarter of 2010, we closed on the sale of three non-operating properties at or above the current carrying value. In addition, we are in advanced negotiations on the sale of several additional non-operating properties at prices at or above the current carrying value. As a result of these developments, we concluded that a triggering event had not occurred as of September 30, 2010. No additional impairment charges were recorded in the three-month period ended September 30, 2010.

Asset impairments recorded as a component of continuing operations consisted of the following (in thousands):

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2010	**2009**	**2010**	**2009**
Intangible assets	$	$	$	$ 250
Long-lived assets		1,930	14,751	6,676
Costs to sell		37		238
Total asset impairments	$	$ 1,967	$ 14,751	$ 7,164

In addition, we recorded impairment charges on certain land and buildings of $1.0 million for the nine months ended September 30, 2009, as a component of selling, general and administrative expense.

As additional market information becomes available and negotiations with prospective buyers continue, estimated fair market values of our properties may change. These changes may result in the recognition of additional asset impairment charges in future periods.

Impairment charges recorded in the three and nine-months ended September 30, 2009, were associated with assets previously classified as held for sale. As a result of their reclassification in the fourth quarter of 2009 and first quarter of 2010, the associated impairment charges were reclassified from discontinued operations to continuing operations as a component of asset impairment charges.

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Selling, General and Administrative Expense

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

SG&A increased $5.9 million and $13.9 million in the three- and nine-month periods ended September 30, 2010 compared to same periods of 2009. Most of these increases were due to higher variable costs as sales volumes increased, and due to an increase in advertising spending to increase market share. Part of the increase in the nine-month period was a result of approximately $1.3 million in reserve adjustments recorded in the first and second quarters of 2010 related to a severance package and certain vacant leased facilities.

We believe SG&A as a percentage of revenue and gross profit is a key metric in evaluating our performance. Given the associated non-core charges related to the reserve adjustments discussed above, we have included an adjusted SG&A percentage calculation assuming the reserve adjustments are excluded. We believe that this non-GAAP financial measure improves the transparency of our disclosure, by providing period-to-period comparability of our results from core business operations. For a reconciliation of this non-GAAP financial measure, please see the Non-GAAP Financial Measures section above.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
SG&A as a % of revenue	13.3%	14.1%	14.2%	15.4%
SG&A as a % of gross profit	73.8	74.9	77.9	80.2
Adjusted SG&A as a % of revenue	13.3%	14.0%	14.1%	15.4%
Adjusted SG&A as a % of gross profit	73.8	74.5	77.6	79.9

The increases (decreases) in dollars spent were primarily due to the following:

	Three months ended September 30, 2010 vs. three months ended September 30, 2009
Increase related to salaries, bonuses and benefits	$ 2.2 million
Increase related to advertising expenses	2.1 million
Decrease related to rent expense	(0.2) million
Increase in other general expenses	1.8 million
	$ 5.9 million

	Nine months ended September 30, 2010 vs. nine months ended September 30, 2009
Increase related to salaries, bonuses and benefits	$ 7.5 million
Increase related to advertising expenses	5.6 million
Decrease related to facility costs	(0.2) million
Increase in other general expenses	1.0 million
	$ 13.9 million

Depreciation and Amortization

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

Depreciation and amortization increased $0.4 million and $1.4 million in the three- and nine-month periods ended September 30, 2010 compared to the same periods of 2009 due primarily to facilities previously classified as held for sale that, accordingly, were not being depreciated in 2009. The facilities were reclassified from held for sale to held and used in the fourth quarter of 2009 and, accordingly, are being depreciated in the current periods.

Operating Income

Operating income in the three- and nine-month periods ended September 30, 2010 was 4.0% and 2.2%, respectively, of revenue compared to 3.6% and 2.4%, respectively, in the comparable periods of 2009.

Adjusting for asset impairments, offset by gains on disposal of assets, and expenses related to reserves, operating income in the three- and nine-month periods ended September 30, 2010, was 4.0% and 3.2%, respectively, of revenue compared to 4.0% and 3.0%, respectively, in the comparable periods of 2009. For a reconciliation of this non-GAAP financial measure, please see the Non-GAAP Financial Measures section above.

Floorplan Interest Expense

Floorplan interest expense was flat and decreased $0.2 million in the three- and nine-month periods ended September 30, 2010 compared to the same periods of 2009. A decrease of $0.1 million and $1.2 million, respectively, resulted from changes in the average outstanding balances of our floorplan facilities. Additionally, changes in the average interest rates on our floorplan facilities decreased the expense $0.3 million and increased the expense $0.1 million, respectively, compared to the same periods of 2009. Changes from interest rate swaps resulted in increases of $0.4 million and $0.9 million, respectively, in the three- and nine-month periods ended September 30, 2010 compared to the same periods of 2009.

Other Interest Expense

Other interest expense includes interest on debt incurred related to acquisitions, real estate mortgages and our working capital, acquisition and used vehicle lines of credit. It also included interest on our senior subordinated convertible notes in the first three quarters of 2009.

With the repurchase of our convertible notes in 2009 and the reduction of outstanding amounts on our credit facility, other interest expense mainly related to mortgages in 2010. Mortgage interest expense for the three- and nine-month periods ended September 30, 2010 was $3.4 million and $10.2 million, respectively, compared to $2.9 million and $8.3 million, respectively, for the same periods in 2009.

Other interest expense also increased due to a reduction in capitalized interest recorded on construction projects. For the three- and nine-month periods ended September 30, 2010, we recorded no capitalized interest compared to $0.3 million and $0.9 million, respectively, for the same periods in 2009.

Income Tax Expense

Our effective income tax rate was 40.7% and 40.2% for the three- and nine-month periods ended September 30, 2010, respectively, compared to 40.7% and 40.5%, respectively, in the comparable periods of 2009. For the full year 2010, we anticipate our income tax rate to be approximately 40.9%.

Liquidity and Capital Resources

Principal Needs

Our principal needs for liquidity and capital resources are for capital expenditures, working capital, dividend payments, acquisitions, stock repurchases and debt repayment.

We have relied primarily upon internally generated cash flows from operations, borrowings under our credit agreements, financing of real estate and the proceeds from public equity and private debt offerings to finance operations and expansion. In addition, during the first nine months of 2010, we generated $24.1 million through the sale of assets and stores and the issuance of long-term debt, net of unscheduled long-term debt

repayments.

We have a $75 million Credit Facility with U.S. Bank National Association, which expires June 30, 2013. As of September 30, 2010, we had $40 million outstanding on this facility.

At September 30, 2010, we had approximately $15.3 million in cash and cash equivalents and $65.2 million in unfinanced new vehicles that could be financed immediately for cash. These amounts of available liquidity, combined with projections for future cash flows, are expected to be more than sufficient to fund our operations and capital needs through the next twelve months.

Summary of Outstanding Balances on Credit Facilities

Interest rates on all of our credit facilities, excluding the effects of our interest rate swaps, ranged from 1.8% to 5.0% at September 30, 2010. Amounts outstanding on the lines at September 30, 2010, together with amounts remaining available under such lines were as follows (in thousands):

	Outstanding at September 30, 2010	Remaining Availability at September 30, 2010
New and program vehicle lines	$ 223,949	$ [1]
Working capital, acquisition and used vehicle credit facility	40,000	30,443[2][3]
	$ 263,949	$ 30,443

(1) There are no formal limits on the new and program vehicle lines with certain lenders, and we had approximately $65.2 million in unfinanced new vehicles at September 30, 2010.
(2) Reduced by $1.4 million for outstanding letters of credit.
(3) The amount available on the line is limited based on a borrowing base calculation and fluctuates monthly.

Working Capital, Acquisition and Used Vehicle Credit Facility

We have a $75 million Credit Facility with U.S. Bank National Association, which expires June 30, 2013. We believe the Credit Facility continues to be an attractive source of financing given the current cost and availability of credit alternatives. The interest rate on the Credit Facility is the 1-month LIBOR plus 2.35%.

Loans are guaranteed by all of our subsidiaries and are secured by new vehicle inventory, used vehicle and parts inventory, equipment other than fixtures, deposit accounts, accounts receivable, investment property and other intangible personal property. Real estate, capital stock and other equity interests of our subsidiary stores and certain other subsidiaries are excluded. The lender s security interest in new vehicle inventory is subordinated to the interests of floorplan financing lenders, including Ally Bank, Daimler Financial, Toyota Financial Services, Ford Motor Credit Company, VW Credit, Inc., American Honda Finance Corporation, Nissan Motor Acceptance Corporation and BMW Financial Services NA, LLC.

The Credit Facility agreement provides for events of default that include nonpayment, breach of covenants, a change of control and certain cross-defaults with other indebtedness. In the event of a default, the agreement provides that the lenders may declare the entire principal balance immediately due, foreclose on collateral and increase the applicable interest rate to the revolving loan rate plus 3%, among other remedies.

Debt Covenants

We are subject to certain financial and restrictive covenants for all of our debt agreements. The covenants restrict us from incurring additional indebtedness, making investments, selling or acquiring assets and granting security interests in our assets.

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The Credit Facility stipulates the following financial covenants:

Debt Covenant Ratios	Requirement	As of September 30, 2010
Minimum tangible net worth	Not less than $200 million	$266.2 million
Vehicle equity	Not less than $65 million	$195.6 million
Fixed charge coverage ratio	Not less than 1.20 to 1	1.60 to 1
Liabilities to tangible net worth ratio	Not more than 4.00 to 1	2.41 to 1

Accordingly, we were in compliance with the Credit Facility financial covenants as of September 30, 2010.

While we expect to remain in compliance with the financial and restrictive covenants in our Credit Facility and other debt agreements, no assurances can be provided that we will continue to remain in compliance with the financial and restrictive covenants.

In the event that we are unable to meet the financial and restrictive covenants, we would enter into a discussion with the lenders to remediate the condition. If we were unable to remediate or cure the condition, a breach would give rise to certain remedies under the agreement, the most severe of which is the termination of the agreement and acceleration of the amounts owed, including the triggering of cross-default provisions to other debt agreements.

New Vehicle Flooring

Ally Bank (previously GMAC LLC), Daimler Financial, Toyota Financial Services, Ford Motor Credit Company, VW Credit, Inc., American Honda Finance Corporation, Nissan Motor Acceptance Corporation and BMW Financial Services NA, LLC provide new vehicle floorplan financing for their respective brands. Ally Bank serves as the primary lenders for all other brands. The new vehicle lines are secured by new vehicle inventory of the stores financed by that lender.

Vehicles financed by lenders not directly associated with the manufacturer are classified as floorplan notes payable: non-trade and are included as a financing activity in our statements of cash flows. Vehicles financed by lenders directly associated with the manufacturer are classified as floorplan notes payable and are included as an operating activity.

To improve the visibility of cash flows related to vehicle financing, which is a core part of our business, the non-GAAP financial measures below demonstrate cash flows assuming all floorplan notes payable are included as an operating activity. We believe that this non-GAAP financial measure improves the transparency of our disclosure, by providing period-to-period comparability of our results from core business operations.

(In thousands)	Nine Months Ended September 30,	
	2010	2009
As Reported		
Cash flow from (used in) operations	$ (16,760)	$ 73,483
Change in floorplan notes payable: non-trade	13,807	7,384
Adjusted	$ (2,953)	$ 80,867
As Reported		
Cash flow from (used in) financing	$ 35,783	$ (96,194)
Change in floorplan notes payable: non-trade	(13,807)	(7,384)
Adjusted	$ 21,976	$ (103,578)

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Inventories and Floorplan Notes Payable

Our days supply of new vehicles at September 30, 2010 was seven days above our five year historical September 30 balance and six days above our December 31, 2009 level. Prior year inventory levels were unusually low due to the impact of the Cash for Clunkers program and limited supply from domestic manufacturers. Our new vehicle floorplan notes payable increased to $223.9 million at September 30, 2010 from $210.5 million at December 31, 2009. New vehicles are financed at approximately 100% of invoice cost. As of September 30, 2010, we had $65.2 million in unfinanced new vehicles.

Floorplan assistance is provided by manufacturers to specifically support store financing of new vehicle inventory. Under U.S. generally accepted accounting principles, floorplan assistance is recorded as a component of new vehicle gross profit when the specific vehicle is sold. However, as manufacturers provide this assistance to offset inventory carrying costs, we believe a comparison of floorplan interest expense to floorplan assistance can be used to evaluate the efficiency of our new vehicle sales relative to stocking levels.

The following table details the carrying costs for new vehicles and includes new and program vehicle floorplan interest net of floorplan assistance earned (dollars in thousands):

	Three Months Ended September 30,		Increase	% Increase
	2010	2009	(Decrease)	(Decrease)
Floorplan interest expense (new vehicles)	$ 3,085	$ 3,053	$ 32	1.0%
Floorplan assistance (included in cost of sales)	(2,592)	(2,700)	(108)	(4.0)
Net new vehicle carrying costs	$ 493	$ 353	$ 140	39.7

	Nine Months Ended September 30,		Increase	% Increase
	2010	2009	(Decrease)	(Decrease)
Floorplan interest expense (new vehicles)	$ 8,403	$ 8,628	$ (225)	(2.6)%
Floorplan assistance (included in cost of sales)	(7,151)	(7,175)	(24)	(0.3)
Net new vehicle carrying costs	$ 1,252	$ 1,453	$ (201)	(13.8)

Our days supply of used vehicles at September 30, 2010 was five days below our five year historical September 30 balance and six days above our December 31, 2009 balance. We continue to focus on stocking more higher-mileage, lower-cost vehicles to match consumer preference and to provide opportunities for incremental sales. We believe our current used vehicle inventory levels are appropriate given our projected sales volumes and the shift in consumer demand away from new vehicles.

Dividends and Share Repurchases

Our Board of Directors declared dividends of $0.05 per share on our Class A and Class B common stock for each of the first, second and third quarters of 2010. The third quarter dividend was declared on October 27, 2010, and will be paid on November 26, 2010. The dividend totaled approximately $1.3 million per quarter, for a total of $3.9 million in 2010. Our Management evaluates performance and makes a recommendation on dividend payments on a quarterly basis.

In June 2000, our Board of Directors authorized the repurchase of up to 1,000,000 shares of our Class A common stock. Through September 30, 2010, we have purchased a total of 580,624 shares under this program, 100,893 of which were purchased in 2010 for an average price of $7.88 per share. As of September 30, 2010, 419,376 shares remained available for purchase pursuant to this program. We may continue to repurchase shares from time to time in the future as conditions warrant.

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Capital Commitments

We had capital commitments totaling $4.3 million at September 30, 2010. In addition, we have approximately $22.1 million in capital expenditures we are considering for various remodeling projects and equipment upgrades over the next one to three years. These projects are still in the planning stage or are awaiting approval from manufacturers. We will continue to evaluate the advisability of the expenditures given the current economic environment and anticipate a prudent approach to future capital commitments.

In the event we undertake a significant capital commitment in the future, we expect to pay for the construction out of existing cash balances, construction financing and borrowings on our Credit Facility. Upon completion of major projects, we would anticipate securing longer-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.

We anticipate approximately $2.5 million in non-financeable capital expenditures in the next one to three years for various facilities and other construction projects currently under consideration. Non-financeable capital expenditures are defined as minor upgrades to existing facilities, minor leasehold improvements, the percentage of major construction typically not financed by commercial mortgage debt, and purchases of furniture and equipment. We will continue to evaluate the advisability of the expenditures given the current weak economic environment, and anticipate a prudent approach to future capital commitments.

Critical Accounting Policies and Use of Estimates

In the first quarter of 2010, we modified our employee medical insurance plan coverage. Effective with the plan year starting January 1, 2010, we changed employee coverage from a fully insured plan to a self-insured plan, except for a population of employees in select California dealerships that remains on a fully insured plan. We carry specific stop-loss coverage insurance in the event a large claim is made under the plan. We estimate the cost to provide medical benefits for existing claims, including claims incurred but not reported, based primarily on an analysis of our historical claims experience, the design of the plan and expectations of medical cost growth factors. We monitor actual claims activity and related costs on a regular basis and evaluate their impact on our assumptions. Actual claims experience may deviate from historical experience, which could cause our estimated liability to either be over or under accrued. Any changes to assumptions, including actual claims experience and medical cost factors, could result in the recognition of additional charges, which could have a material adverse impact on our financial position and results of operations.

At September 30, 2010 the self-insured medical plan reserve, net of payments made in the period, totaled $1.1 million, and was included in accrued liabilities on our Consolidated Balance Sheets. A 10% increase in claims experience would result in additional self-insured medical reserves of $0.1 million at September 30, 2010.

With the addition of the above, we reaffirm our critical accounting policies and use of estimates as described in our 2009 Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 3, 2010.

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 2009 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 3, 2010.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this 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 last 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. While we cannot predict with certainty the outcomes of these matters, we do not anticipate that the resolution of matters arising in the normal course of business or the proceeding described below will have a material adverse effect on our business, results of operations, financial condition or cash flows.

Alaska Service and Parts Advisors and Managers Overtime Suit

On March 22, 2006, seven former employees in Alaska brought suit against Lithia (Dunham, et al. v. Lithia Support Services, et al., 3AN-06-6338 Civil, Superior Court for the State of Alaska) seeking overtime wages, additional liquidated damages and attorney s fees. The complaint was later amended to include a total of 11 named plaintiffs. The court ordered the dispute to arbitration. In February 2008, the arbitrator granted the plaintiffs request to establish a class of plaintiffs consisting of all present and former service and parts department employees totaling approximately 150 individuals who were paid on a commission basis. We have filed a motion requesting reconsideration of this class certification, but the arbitrator died before issuing his opinion. The reconsideration sought a ruling whether these employees or some of these employees are exempt from the applicable state law that provides for the payment of overtime under certain circumstances. The replacement arbitrator has now been appointed and ruled to remove approximately 30 service and parts managers from the case. A class action opt-out notice was mailed to the service and parts employees in October 2009. Lithia and the plaintiffs have agreed to conduct the arbitration in two parts. The first arbitration will determine if liability exists for Lithia. This arbitration was conducted on September 27, 2010, and we are currently awaiting a decision. If the outcome of this arbitration determines that valid claims exist, a second arbitration will be conducted to determine the amount of damages, if any.

We intend to vigorously defend the matter noted above, and to assert available defenses. We cannot make an estimate of the likelihood of negative judgment in the case at this time and estimate our range of exposure to be between $0 and $1.5 million. The ultimate resolution of the above noted case is not expected to result in any significant settlement amounts. However, the resolution of the matter cannot be predicted with certainty, and an unfavorable resolution of the matter could have a material adverse effect on our results of operations, financial condition or cash flows.

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Item 1A. Risk Factors

Our Annual Report on Form 10-K for the year ended December 31, 2009 includes a detailed discussion of our risk factors. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K. Accordingly, the information in this Form 10-Q should be read in conjunction with the risk factors and information disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009, which was filed with the Securities and Exchange Commission on March 3, 2010.

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

We repurchased the following shares of our Class A common stock during the third quarter of 2010:

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan	Maximum number of shares that may yet be purchased under the plan
July 1 to July 31		$		520,269
August 1 to August 31	96,393	7.87	96,393	423,876
September 1 to September 30	4,500	7.98	4,500	419,376
Total	100,893	7.88	100,893	419,376

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

Item 6. Exhibits

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

3.1 Restated Articles of Incorporation of Lithia Motors, Inc., as amended May 13, 1999 (filed as Exhibit 3.1 to Form 10-K filed March 30, 2000 and incorporated herein by reference).

3.2 Amended and Restated Bylaws of Lithia Motors, Inc. - Corrected (filed as Exhibit 3.2 to Form 10-K filed March 16, 2009 and incorporated herein by reference).

10.1 Lithia Motors, Inc. Amended and Restated 2003 Stock Incentive Plan (filed as Exhibit 10.1 to Form 10-Q filed April 30, 2010 and incorporated herein by reference).

10.2 10th Amendment to Loan Agreement with U.S. Bank National Association (filed as Exhibit 10.1 to Form 8-K filed June 30, 2010 and incorporated herein by reference).

10.3 Separation, Consulting and Release Agreement with Jeffrey B. DeBoer (filed as Exhibit 99.1 to Form 8-K filed June 14, 2010 and incorporated herein by reference).

10.4 11th Amendment to Loan Agreement with U.S. Bank National Association (filed as Exhibit 10.4 to Form 10-Q filed August 5, 2010 and incorporated herein by reference).

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.

32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

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SIGNATURES

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

Date: October 29, 2010

LITHIA MOTORS, INC.

By: /s/Sidney B. DeBoer
Sidney B. DeBoer
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

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