

LITHIA MOTORS INC  
Form 10-Q  
July 26, 2013

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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(Mark One)

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

**For the quarterly period ended June 30, 2013**

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**

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**LITHIA MOTORS, INC.**

(Exact name of registrant as specified in its charter)

**Oregon**

(State or other jurisdiction of incorporation or organization)

**93-0572810**

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

**150 N. Bartlett Street, Medford, Oregon 97501**

(Address of principal executive offices) (Zip Code)

Registrant's  
telephone

number,  
including area  
code:  
**541-776-6401**

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

Indicate by check mark whether the registrant has submitted electronically 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  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

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

|   |                                |
|---|--------------------------------|
| <b>Class A common stock without par value</b> | <b>23,283,345</b>              |
| <b>Class B common stock without par value</b> | <b>2,562,231</b>               |
| (Class)                                       | (Outstanding at July 26, 2013) |

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**LITHIA MOTORS, INC.**

**FORM 10-Q**

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**LITHIA MOTORS, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
(In thousands)  
(Unaudited)

|  | <b>June 30,<br/>2013</b> | <b>December<br/>31,<br/>2012</b> |
|--|--------------------------|----------------------------------|
| <b>Assets</b>  |                          |                                  |
| Current Assets:  |                          |                                  |
| Cash and cash equivalents  | \$20,257                 | \$42,839                         |
| Accounts receivable, net of allowance for doubtful accounts of \$152 and \$336                           | 143,833                  | 133,149                          |
| Inventories, net   | 783,840                  | 723,326                          |
| Deferred income taxes  | 2,824                    | 3,832                            |
| Other current assets   | 9,856                    | 17,484                           |
| Assets held for sale   | 10,733                   | 12,579                           |
| Total Current Assets   | 971,343                  | 933,209                          |
| Property and equipment, net of accumulated depreciation of \$100,638 and \$97,883                        | 443,516                  | 425,086                          |
| Goodwill   | 40,313                   | 32,047                           |
| Franchise value  | 66,465                   | 62,429                           |
| Deferred income taxes  | 22,190                   | 17,123                           |
| Other non-current assets   | 28,689                   | 22,808                           |
| Total Assets   | \$1,572,516              | \$1,492,702                      |
| <b>Liabilities and Stockholders' Equity</b>  |                          |                                  |
| Current Liabilities:   |                          |                                  |
| Floor plan notes payable   | \$16,912                 | \$13,454                         |
| Floor plan notes payable: non-trade  | 570,025                  | 568,130                          |
| Current maturities of long-term debt   | 6,951                    | 8,182                            |
| Trade payables   | 44,121                   | 41,589                           |
| Accrued liabilities  | 90,290                   | 81,602                           |
| Liabilities related to assets held for sale  | 6,378                    | 8,347                            |
| Total Current Liabilities  | 734,677                  | 721,304                          |
| Long-term debt, less current maturities  | 294,073                  | 286,876                          |
| Deferred revenue   | 38,557                   | 33,589                           |
| Other long-term liabilities  | 29,058                   | 22,832                           |
| Total Liabilities  | 1,096,365                | 1,064,601                        |
| 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 23,262 and 22,916 | 265,599                  | 268,801                          |
|  | 319                      | 343                              |

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Class B common stock - no par value; authorized 25,000 shares; issued and outstanding  
2,562 and 2,762

|  |             |             |
|--|-------------|-------------|
| Additional paid-in capital                 | 18,577      | 12,399      |
| Accumulated other comprehensive loss       | (1,771 )    | (2,615 )    |
| Retained earnings                          | 193,427     | 149,173     |
| Total Stockholders' Equity                 | 476,151     | 428,101     |
| Total Liabilities and Stockholders' Equity | \$1,572,516 | \$1,492,702 |

See accompanying notes to consolidated financial statements.

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

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2013</b>               | <b>2012</b> | <b>2013</b>             | <b>2012</b> |
| Revenues:  |                           |             |                         |             |
| New vehicle  | \$569,487                 | \$455,939   | \$1,062,928             | \$848,885   |
| Used vehicle retail                                    | 258,465                   | 207,341     | 497,693                 | 397,960     |
| Used vehicle wholesale                                 | 37,691                    | 35,106      | 77,197                  | 68,463      |
| Finance and insurance                                  | 34,218                    | 27,184      | 65,881                  | 52,060      |
| Service, body and parts                                | 94,462                    | 85,456      | 184,902                 | 169,000     |
| Fleet and other  | 14,182                    | 11,316      | 22,984                  | 24,220      |
| Total revenues   | 1,008,505                 | 822,342     | 1,911,585               | 1,560,588   |
| Cost of sales:   |                           |             |                         |             |
| New vehicle  | 530,699                   | 422,373     | 989,493                 | 785,067     |
| Used vehicle retail                                    | 219,572                   | 176,350     | 423,827                 | 338,692     |
| Used vehicle wholesale                                 | 36,996                    | 34,810      | 75,528                  | 67,770      |
| Service, body and parts                                | 47,769                    | 43,782      | 94,430                  | 87,191      |
| Fleet and other  | 13,636                    | 10,931      | 22,036                  | 23,438      |
| Total cost of sales                                    | 848,672                   | 688,246     | 1,605,314               | 1,302,158   |
| Gross profit   | 159,833                   | 134,096     | 306,271                 | 258,430     |
| Asset impairments                                      | -                         | -           | -                       | 115         |
| Selling, general and administrative                    | 109,283                   | 92,990      | 210,414                 | 181,429     |
| Depreciation and amortization                          | 4,899                     | 4,198       | 9,620                   | 8,336       |
| Operating income                                       | 45,651                    | 36,908      | 86,237                  | 68,550      |
| Floor plan interest expense                            | (3,036 )                  | (3,054 )    | (6,485 )                | (5,956 )    |
| Other interest expense                                 | (1,941 )                  | (2,530 )    | (4,302 )                | (5,257 )    |
| Other income, net                                      | 584                       | 819         | 1,385                   | 1,317       |
| Income from continuing operations before income taxes  | 41,258                    | 32,143      | 76,835                  | 58,654      |
| Income tax provision                                   | (15,977 )                 | (12,138 )   | (29,672 )               | (22,015 )   |
| Income from continuing operations, net of income tax   | 25,281                    | 20,005      | 47,163                  | 36,639      |
| Income from discontinued operations, net of income tax | 274                       | 486         | 447                     | 648         |
| Net income   | \$25,555                  | \$20,491    | \$47,610                | \$37,287    |
| Basic income per share from continuing operations      | \$0.98                    | \$0.78      | \$1.83                  | \$1.42      |
| Basic income per share from discontinued operations    | 0.01                      | 0.02        | 0.02                    | 0.02        |
| Basic net income per share                             | \$0.99                    | \$0.80      | \$1.85                  | \$1.44      |
| Shares used in basic per share calculations            | 25,782                    | 25,730      | 25,730                  | 25,860      |
| Diluted income per share from continuing operations    | \$0.97                    | \$0.76      | \$1.81                  | \$1.39      |
| Diluted income per share from discontinued operations  | 0.01                      | 0.02        | 0.01                    | 0.03        |
| Diluted net income per share                           | \$0.98                    | \$0.78      | \$1.82                  | \$1.42      |

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|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Shares used in diluted per share calculations | 26,134 | 26,185 | 26,120 | 26,331 |
|---|--------|--------|--------|--------|

See accompanying notes to consolidated financial statements.

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

|  | <b>Three Months</b>   |             | <b>Six Months</b>     |             |
|--|-----------------------|-------------|-----------------------|-------------|
|  | <b>Ended June 30,</b> |             | <b>Ended June 30,</b> |             |
|  | <b>2013</b>           | <b>2012</b> | <b>2013</b>           | <b>2012</b> |
| Net income   | \$25,555              | \$20,491    | \$47,610              | \$37,287    |
| Other comprehensive income, net of tax:  |                       |             |                       |             |
| Gain on cash flow hedges, net of tax expense of \$209, \$225, \$524, and \$490, respectively | 338                   | 364         | 844                   | 790         |
| Comprehensive income   | \$25,893              | \$20,855    | \$48,454              | \$38,077    |

See accompanying notes to consolidated financial statements.



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

|   | <b>Six Months Ended</b> |                  |
|---|-------------------------|------------------|
|   | <b>June 30,</b>         |                  |
|   | <b>2013</b>             | <b>2012</b>      |
| <b>Cash flows from operating activities:</b>  |                         |                  |
| Net income  | \$47,610                | \$37,287         |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                         |                  |
| Asset impairments   | -                       | 115              |
| Depreciation and amortization   | 9,620                   | 8,336            |
| Depreciation and amortization within discontinued operations                                | -                       | 124              |
| Stock-based compensation  | 2,603                   | 1,512            |
| (Gain) loss on disposal of other assets   | 33                      | (983 )           |
| Deferred income taxes   | 825                     | 302              |
| Excess tax benefit from share-based payment arrangements                                    | (5,408 )                | (1,026 )         |
| (Increase) decrease (net of acquisitions and dispositions):                                 |                         |                  |
| Trade receivables, net  | (10,684 )               | (18,305 )        |
| Inventories   | (48,899 )               | (109,592)        |
| Other current assets  | 5,980                   | 4,680            |
| Other non-current assets  | (3,394 )                | (1,847 )         |
| Increase (decrease) (net of acquisitions and dispositions):                                 |                         |                  |
| Floor plan notes payable  | 3,384                   | (94,305 )        |
| Trade payables  | 2,078                   | 7,289            |
| Accrued liabilities   | 8,812                   | 7,670            |
| Other long-term liabilities and deferred revenue  | 11,889                  | 6,700            |
| <b>Net cash provided by (used in) operating activities</b>                                  | <b>24,449</b>           | <b>(152,043)</b> |
| <b>Cash flows from investing activities:</b>  |                         |                  |
| Principal payments received on notes receivable   | 61                      | 50               |
| Capital expenditures  | (22,107 )               | (22,693 )        |
| Proceeds from sales of assets   | 420                     | 4,940            |
| Payments for life insurance policies  | (2,566 )                | (1,934 )         |
| Cash paid for acquisitions  | (31,786 )               | (12,782 )        |
| Proceeds from sales of stores   | -                       | 2,901            |
| <b>Net cash used in investing activities</b>  | <b>(55,978 )</b>        | <b>(29,518 )</b> |
| <b>Cash flows from financing activities:</b>  |                         |                  |
| Borrowings on floor plan notes payable: non-trade   | 5,989                   | 251,844          |
| Borrowings on lines of credit   | 358,000                 | 177,623          |
| Repayments on lines of credit   | (327,318)               | (212,623)        |
| Principal payments on long-term debt, scheduled   | (3,667 )                | (4,000 )         |
| Principal payments on long-term debt and capital leases, other                              | (25,770 )               | (32,049 )        |
| Proceeds from issuance of long-term debt  | 4,721                   | 14,169           |

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|  |                  |                 |
|--|------------------|-----------------|
| Proceeds from issuance of common stock                   | 2,843            | 2,671           |
| Repurchase of common stock                               | (7,903 )         | (20,606 )       |
| Excess tax benefit from share-based payment arrangements | 5,408            | 1,026           |
| Dividends paid   | (3,356 )         | (4,398 )        |
| Change in restricted cash                                | -                | 3,300           |
| <b>Net cash provided by financing activities</b>         | <b>8,947</b>     | <b>176,957</b>  |
| <br>   |                  |                 |
| <b>Decrease in cash and cash equivalents</b>             | <b>(22,582 )</b> | <b>(4,604 )</b> |
| <br>   |                  |                 |
| <b>Cash and cash equivalents at beginning of period</b>  | <b>42,839</b>    | <b>20,851</b>   |
| <b>Cash and cash equivalents at end of period</b>        | <b>\$20,257</b>  | <b>\$16,247</b> |
| <br>   |                  |                 |
| <b>Supplemental disclosure of cash flow information:</b> |                  |                 |
| Cash paid during the period for interest                 | \$10,989         | \$11,690        |
| Cash paid during the period for income taxes, net        | 16,111           | 14,217          |
| <br>   |                  |                 |
| <b>Supplemental schedule of non-cash activities:</b>     |                  |                 |
| Floor plan debt paid in connection with store disposals  | -                | 6,712           |
| Acquisition of assets with capital leases                | -                | 2,470           |

See accompanying notes to consolidated financial statements.

**LITHIA MOTORS, INC. AND SUBSIDIARIES**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. Interim Financial Statements**

**Basis of Presentation**

These condensed Consolidated Financial Statements contain unaudited information as of June 30, 2013 and for the three- and six-month periods ended June 30, 2013 and 2012. The unaudited interim financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by accounting principles generally accepted in the United States of America for annual financial statements are not included herein. In management's opinion, these unaudited financial statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the information when read in conjunction with our 2012 audited Consolidated Financial Statements and the related notes thereto. The financial information as of December 31, 2012 is derived from our 2012 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 2012 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.

**Reclassifications**

Certain reclassifications of amounts previously reported have been made to the accompanying consolidated financial statements to maintain consistency and comparability between periods presented.

These reclassifications had no impact on previously reported net income.

**Note 2. Accounts Receivable**

Accounts receivable consisted of the following (in thousands):

|  | <b>June 30,</b> | <b>December</b> |
|--|-----------------|-----------------|
|  | <b>2013</b>     | <b>31,</b>      |

|   | <b>2012</b> |            |
|---|-------------|------------|
| Contracts in transit                                | \$72,315    | \$ 65,597  |
| Trade receivables                                   | 28,839      | 25,885     |
| Vehicle receivables                                 | 21,895      | 21,298     |
| Manufacturer receivables                            | 26,411      | 25,658     |
|   | 149,460     | 138,438    |
| Less: Allowance                                     | (152 )      | (336 )     |
| Less: Long-term portion of accounts receivable, net | (5,475 )    | (4,953 )   |
| Total accounts receivable, net                      | \$143,833   | \$ 133,149 |

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

### **Note 3. Inventories**

The components of inventory consisted of the following (in thousands):

|                       | <b>June 30,<br/>2013</b> | <b>December<br/>31,<br/>2012</b> |
|-----------------------|--------------------------|----------------------------------|
| New vehicles          | \$597,740                | \$ 563,275                       |
| Used vehicles         | 153,944                  | 130,529                          |
| Parts and accessories | 32,156                   | 29,522                           |
| Total inventories     | \$783,840                | \$ 723,326                       |

**Note 4. Goodwill**

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

|   | <b>Goodwill</b> |
|---|-----------------|
| <b>Balance as of December 31, 2011, gross</b> | \$318,224       |
| Accumulated impairment loss                   | (299,266)       |
| <b>Balance as of December 31, 2011, net</b>   | 18,958          |
| Additions through acquisitions                | 13,710          |
| Goodwill allocated to dispositions            | (621 )          |
| <b>Balance as of December 31, 2012, net</b>   | 32,047          |
| Additions through acquisitions                | 8,266           |
| <b>Balance as of June 30, 2013, net</b>       | \$40,313        |

**Note 5. Commitments and Contingencies***Litigation*

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

*Alaska Consumer Protection Act Claims*

In December 2006, a suit was filed against us (Jackie Neese, et al vs. Lithia Chrysler Jeep of Anchorage, Inc, et al, Case No. 3AN-06-13341 CI), and in April, 2007, a second case (Jackie Neese, et al vs. Lithia Chrysler Jeep of Anchorage, Inc, et al, Case No. 3AN-06-4815 CI) was filed against us, in the Superior Court for the State of Alaska, Third Judicial District at Anchorage. These suits were subsequently consolidated. In the suits, plaintiffs alleged that we, through our Alaska dealerships, engaged in three practices that purportedly violate Alaska consumer protection laws: (i) charging customers dealer fees and costs (including document preparation fees) not disclosed in the advertised price, (ii) failing to disclose the acquisition, mechanical and accident history of used vehicles or whether the vehicles were originally manufactured for sale in a foreign country, and (iii) engaging in deception, misrepresentation and fraud by providing to customers financing from third parties without disclosing that we receive a fee or discount for placing that loan. The suit sought statutory damages of \$500 for each violation or three times plaintiff's actual damages, whichever was greater, and attorney fees and costs.

In June 2013 the parties agreed to mediate the claims without pre-conditions. The mediation resulted in a settlement agreement with the plaintiffs under which we estimate we will pay \$3.8 million to settle all claims against us and to

pay plaintiffs' legal fees. The estimated payment assumes a participation rate by eligible class members based on historically experienced claim rates. An increased claim rate would result in additional payments. The estimated settlement amount was recorded as a component of selling, general and administrative expense in our Consolidated Statements of Operations and, as of June 30, 2013, was included as components of accrued liabilities and other long term liabilities in our Consolidated Balance Sheets. The settlement is subject to court approval and we cannot assure that the court will approve the settlement.

**Note 6. Stockholders' Equity*****Reclassification From Accumulated Other Comprehensive Loss***

The reclassification from accumulated other comprehensive loss was as follows (in thousands):

|                                  | <b>Three<br/>Months<br/>Ended<br/>June<br/>30, 2013</b> | <b>Six<br/>Months<br/>Ended<br/>June<br/>30, 2013</b> | <b>Affected Line Item in the Consolidated Statements of<br/>Operations</b> |
|----------------------------------|---|---|--|
| Loss on cash flow hedges         | \$ (166 )   | \$ (472 )   | Floor plan interest expense  |
| Taxes                            | 64  | 181   | Income tax provision   |
| Loss on cash flow hedges,<br>net | \$ (102 )   | \$ (291 )   |  |

See Note 9 for more details regarding our derivative contracts.

***Share Repurchases***

In August 2011, our Board of Directors authorized the repurchase of up to 2,000,000 shares of our Class A common stock. On July 20, 2012, our Board of Directors authorized the repurchase of 1,000,000 additional shares of our Class A common stock. In the six months ended June 30, 2013, we repurchased 127,900 shares at an average price of \$40.76 per share, for a total of \$5.2 million. Through June 30, 2013, we have repurchased 1,273,047 shares and 1,726,953 shares remained available for repurchase. This authority to repurchase shares does not have an expiration date and we may continue to repurchase shares from time to time as conditions warrant.

In addition, 59,721 shares subject to equity awards were repurchased during the first six months of 2013 at an average price of \$45.04, for a total of \$2.7 million, related to tax withholdings associated with the exercise of stock options or the vesting of restricted stock units.

***Dividends***

We declared and paid dividends on our Class A and Class B common stock during the second quarter of 2013, which related to our first quarter 2013 financial results, of \$0.13 per share, for a total of \$3.4 million.

See Note 13 for a discussion of a dividend related to our second quarter 2013 financial results.

**Note 7. Deferred Compensation and Long-term Incentive Plan**

We offer a deferred compensation and long-term incentive plan (the "LTIP") to provide certain employees the ability to accumulate assets for retirement on a tax deferred basis. We may make discretionary contributions to the LTIP. Discretionary contributions vest between one and seven years based on the employee's age and position. Additionally, a participant may defer a portion of his or her compensation and receive the deferred amount upon certain events, including termination or retirement.

In March 2013, we made a discretionary contribution of \$2.0 million to the LTIP. Participants will receive a guaranteed return of 5.25% in 2013. We recognized compensation expense related to the LTIP of \$0.4 million and \$0.7 million, respectively, for the three and six months ended June 30, 2013 and \$0.3 million and \$0.6 million, respectively, for the three and six months ended June 30, 2012. As of June 30, 2013 and December 31, 2012, the balance due to participants was \$5.2 million and \$3.6 million, respectively, and was included as a component of other long-term liabilities in the Consolidated Balance Sheets.



**Note 8. Fair Value Measurements**

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

- Level 1 – quoted prices in active markets for identical securities;
- Level 2 – other significant observable inputs, including quoted prices for similar securities, interest rates, prepayment spreads and credit risk; 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 each measurement date and an income approach to convert estimated future cash flows to a single present value 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 borrowings, 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 the measurement date.

Inputs are collected from Bloomberg on the last market day of the period. The same method 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.

There were no changes to our valuation techniques during the six-month period ended June 30, 2013.

***Assets and Liabilities Measured at Fair Value***

Following are the disclosures related to our assets and (liabilities) that are measured at fair value (in thousands):

| <b>Fair Value at June 30, 2013</b> | <b>Level<br/>1</b> | <b>Level<br/>2</b> | <b>Level<br/>3</b> |
|------------------------------------|--------------------|--------------------|--------------------|
|------------------------------------|--------------------|--------------------|--------------------|

**Measured on a recurring basis:**

Derivative contracts, net                   \$ -   \$(3,356)   \$ -

| <b>Fair Value at December 31, 2012</b> | <b>Level<br/>1</b> | <b>Level<br/>2</b> | <b>Level<br/>3</b> |
|--|--------------------|--------------------|--------------------|
|--|--------------------|--------------------|--------------------|

**Measured on a recurring basis:**

|                           |      |           |      |
|---------------------------|------|-----------|------|
| Derivative contracts, net | \$ - | \$(4,679) | \$ - |
|---------------------------|------|-----------|------|

See Note 9 for more details regarding our derivative contracts.

***Fair Value Disclosures for Financial Assets and Liabilities***

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

We have fixed rate debt and calculate the estimated fair value of our fixed rate debt using a discounted cash flow method. Using estimated current interest rates based on a similar risk profile and duration (Level 2), the fixed cash flows are discounted and summed to compute the fair value of the debt. As of June 30, 2013, this debt had maturity dates between November 2016 and May 2031. A summary of the aggregate carrying values and fair values of our long-term fixed interest rate debt is as follows (in thousands):

|                | <b>June 30,<br/>2013</b> | <b>December<br/>31, 2012</b> |
|----------------|--------------------------|------------------------------|
| Carrying value | \$ 135,261               | \$ 130,469                   |
| Fair value     | 135,137                  | 134,688                      |

#### **Note 9. Derivative Financial Instruments**

We enter into interest rate swaps to fix a portion of our interest expense. We do not enter into derivative instruments for any purpose other than to manage interest rate exposure to fluctuations in the one-month LIBOR benchmark. That is, we do not engage in interest rate speculation using derivative instruments.

Typically, we designate all interest rate swaps as cash flow hedges and, accordingly, we record the change in fair value for the effective portion of these interest rate swaps in comprehensive income rather than net income until the underlying hedged transaction affects net income. If a swap is no longer designated 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 loss is recognized in income as the forecasted transaction occurs. If the forecasted transaction is probable of not occurring, the gain or loss recorded in accumulated other comprehensive loss is recognized in income immediately. The estimated amount that we expect to reclassify from accumulated other comprehensive loss to net income within the next twelve months is \$1.1 million at June 30, 2013.

As of June 30, 2013, we had a \$25 million interest rate swap outstanding with U.S. Bank Dealer Commercial Services. This interest rate swap matures on June 15, 2016 and has a fixed rate of 5.587% per annum. The variable rate on the interest rate swap is the one-month LIBOR rate. At June 30, 2013, the one-month LIBOR rate was 0.20% per annum, as reported in the Wall Street Journal.

At June 30, 2013 and December 31, 2012, the fair value of our derivative instruments was included in our Consolidated Balance Sheets as follows (in thousands):

#### **Balance Sheet Information**

#### **Fair Value of Liability Derivatives**

| <b>Derivatives Designated as Hedging Instruments</b> |                             | <b>Location in Balance Sheet</b> | <b>June<br/>30,<br/>2013</b> |
|--|-----------------------------|----------------------------------|------------------------------|
| Interest Rate Swap Contracts                         | Accrued liabilities         |                                  | \$1,211                      |
|  | Other long-term liabilities |                                  | 2,145                        |
|  |                             |                                  | \$3,356                      |

| <b>Balance Sheet Information</b>                     |                             | <b>Fair Value of Liability Derivatives</b> | <b>December<br/>31,<br/>2012</b> |
|--|-----------------------------|--|----------------------------------|
| <b>Derivatives Designated as Hedging Instruments</b> |                             | <b>Location in Balance Sheet</b>           |                                  |
| Interest Rate Swap Contracts                         | Accrued liabilities         |  | \$ 1,839                         |
|  | Other long-term liabilities |  | 2,840                            |
|  |                             |  | \$ 4,679                         |

The effect of derivative instruments on our Consolidated Statements of Operations for the three- and six-month periods ended June 30, 2013 and 2012 was as follows (in thousands):

| Derivatives in Cash Flow Hedging Relationships | Amount of Gain Recognized in Accumulated OCI (Effective Portion) | Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion) | Location of Loss Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) | Amount of Loss Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) |
|--|--|--|--|--|--|
| <b>Three Months Ended</b>                      |  |  |  |  |  |
| <b>June 30, 2013</b>                           |  |  |  |  |  |
| Interest Rate Swap Contracts                   | \$ 381   | Floor plan interest expense  | \$ (166 )  | Floor plan interest expense  | \$ (296 )  |
| <b>Three Months Ended</b>                      |  |  |  |  |  |
| <b>June 30, 2012</b>                           |  |  |  |  |  |
| Interest Rate Swap Contracts                   | \$ 239   | Floor plan interest expense  | \$ (350 )  | Floor plan interest expense  | \$ (730 )  |
| Derivatives in Cash Flow Hedging Relationships | Amount of Gain Recognized in Accumulated OCI                     | Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Loss Reclassified from Accumulated OCI into                            | Location of Loss Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) | Amount of Loss Recognized in Income on Derivative (Ineffective   |

|                                 | <b>(Effective<br/>Portion)</b> |                                | <b>Income<br/>(Effective<br/>Portion)</b> |                                | <b>Portion<br/>and<br/>Amount<br/>Excluded<br/>from<br/>Effectiveness<br/>Testing)</b> |
|---------------------------------|--------------------------------|--------------------------------|---|--------------------------------|--|
| <b>Six Months Ended</b>         |                                |                                |   |                                |  |
| <b>June 30, 2013</b>            |                                |                                |   |                                |  |
| Interest Rate Swap<br>Contracts | \$ 896                         | Floor plan<br>interest expense | \$ (472 )                                 | Floor plan<br>interest expense | \$ (890 )  |
| <b>Six Months Ended</b>         |                                |                                |   |                                |  |
| <b>June 30, 2012</b>            |                                |                                |   |                                |  |
| Interest Rate Swap<br>Contracts | \$ 522                         | Floor plan<br>interest expense | \$ (758 )                                 | Floor plan<br>interest expense | \$ (1,384 )  |

See also Note 8.

**Note 10. Acquisitions**

On June 10, 2013, we acquired the inventory, property, equipment and intangible assets and assumed certain liabilities of OB Salem Auto Group, Inc. in Salem, Oregon from Michael O'Brien.

This acquired company contributed revenues of \$2.9 million for the six months ended June 30, 2013.

The following unaudited pro forma summary presents consolidated information as if the acquisitions in the three- and six-month periods ended June 30, 2012 and 2013 had occurred on January 1, 2012 (in thousands, except for per share amounts):

| <b>Three Months Ended June 30,</b>                              | <b>2013</b> | <b>2012</b> |
|---|-------------|-------------|
| Revenue   | \$1,026,597 | \$850,733   |
| Income from continuing operations, net of tax                   | 25,489      | 20,199      |
| Basic income per share from continuing operations, net of tax   | 0.99        | 0.79        |
| Diluted income per share from continuing operations, net of tax | 0.98        | 0.77        |
| <br>  |             |             |
| <b>Six Months Ended June 30,</b>                                | <b>2013</b> | <b>2012</b> |
| Revenue   | \$1,950,436 | \$1,620,574 |
| Income from continuing operations, net of tax                   | 47,609      | 36,995      |
| Basic income per share from continuing operations, net of tax   | 1.85        | 1.43        |
| Diluted income per share from continuing operations, net of tax | 1.82        | 1.40        |

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

The acquisition was accounted for using the acquisition method of accounting. No portion of the purchase price was paid with our equity securities. The following table summarizes the consideration paid for the acquisition and the amount of identified assets acquired and liabilities assumed as of the acquisition date (in thousands):

**Consideration**

Cash paid, net of cash acquired \$ 31,786

|                               | <b>Assets<br/>Acquired<br/>and<br/>Liabilities<br/>Assumed</b> |
|-------------------------------|--|
| Inventories                   | \$ 15,198  |
| Franchise value               | 4,036  |
| Property, plant and equipment | 4,697  |
| Other assets                  | 122  |
| Other liabilities             | (533 )   |
|                               | 23,520   |
| Goodwill                      | 8,266  |
|                               | \$ 31,786  |

We account for franchise value as an indefinite-lived intangible asset. We expect the full amount of the goodwill recognized to be deductible for tax purposes.



**Note 11. Discontinued Operations**

We classify a store as discontinued operations if the location has been sold, we have ceased operations at that location or the store meets the criteria 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 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 changes will be made to the plan or the plan to dispose of the store will be withdrawn.

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.

As of June 30, 2013, one of our stores continues to meet the criteria for classification of its assets and related liabilities as held for sale and its associated operating results are classified as discontinued operations.

Actual floor plan interest expense for the store classified as discontinued operations is directly related to the store's new vehicles. Interest expense related to our used vehicle inventory financing and revolving line of credit is allocated based on the working capital level of the store.

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

|  | <b>Three Months<br/>Ended</b> |             | <b>Six Months<br/>Ended</b> |             |
|--|-------------------------------|-------------|-----------------------------|-------------|
|  | <b>June 30,<br/>2013</b>      | <b>2012</b> | <b>June 30,<br/>2013</b>    | <b>2012</b> |
| Revenue  | \$10,078                      | \$24,782    | \$18,878                    | \$45,429    |
| Income from discontinued operations                            | \$409                         | \$771       | \$693                       | \$1,028     |
| Income tax expense   | (135 )                        | (285 )      | (246 )                      | (380 )      |
| Income from discontinued operations, net of income tax expense | \$274                         | \$486       | \$447                       | \$648       |

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

|                               | <b>June<br/>30,<br/>2013</b> | <b>December<br/>31, 2012</b> |
|-------------------------------|------------------------------|------------------------------|
| Inventories                   | \$7,486                      | \$ 9,412                     |
| Property, plant and equipment | 1,176                        | 1,102                        |
| Intangible assets             | 2,071                        | 2,065                        |
|                               | <b>\$10,733</b>              | <b>\$ 12,579</b>             |

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

|                          | <b>June<br/>30,<br/>2013</b> | <b>December<br/>31, 2012</b> |
|--------------------------|------------------------------|------------------------------|
| Floor plan notes payable | \$6,378                      | \$ 8,347                     |

**Note 12. Net Income Per Share of Class A and Class B Common Stock**

We compute net income per share of Class A and Class B common stock using the two-class method. Under this method, basic net income per share is computed using the weighted average number of common shares outstanding during the period excluding 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. 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 and transfer rights, the rights of the holders of our Class A and Class B common stock are identical. Our Articles of Incorporation require that the Class A and Class B common stock share equally in any dividends, liquidation proceeds or other distribution with respect to our common stock and the Articles of Incorporation can only be amended by a vote of the shareholders. Additionally, Oregon law provides that amendments to our Articles of Incorporation, 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 participation rights of the Class A and Class B common shares as if the earnings for the year had been distributed. Because the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis.

Following is a reconciliation of the income from continuing operations and weighted average shares used for our basic earnings per share ("EPS") and diluted EPS for the three- and six-month periods ended June 30, 2013 and 2012 (in thousands, except per share amounts):

| <b>Three Months Ended June 30,</b>  | <b>2013</b>        |                    | <b>2012</b>        |                    |
|---|--------------------|--------------------|--------------------|--------------------|
| <b>Basic EPS from Continuing Operations</b>   | <b>Class<br/>A</b> | <b>Class<br/>B</b> | <b>Class<br/>A</b> | <b>Class<br/>B</b> |
| <i>Numerator:</i>   |                    |                    |                    |                    |
| Income from continuing operations applicable to common stockholders                     | \$22,734           | \$2,547            | \$17,261           | \$2,744            |
| Distributed income applicable to common stockholders                                    | (3,018)            | (338)              | (2,230)            | (354)              |
| Basic undistributed income from continuing operations applicable to common stockholders | \$19,716           | \$2,209            | \$15,031           | \$2,390            |
| <i>Denominator:</i>   |                    |                    |                    |                    |
| Weighted average number of shares outstanding used to calculate basic income per share  | 23,185             | 2,597              | 22,201             | 3,529              |
|   | \$0.98             | \$0.98             | \$0.78             | \$0.78             |

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|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Basic income per share from continuing operations applicable to common stockholders               |         |         |         |         |
| Basic distributed income per share from continuing operations applicable to common stockholders   | (0.13 ) | (0.13 ) | (0.10 ) | (0.10 ) |
| Basic undistributed income per share from continuing operations applicable to common stockholders | \$0.85  | \$0.85  | \$0.68  | \$0.68  |

| <b>Three Months Ended June 30,</b>  | <b>2013</b>        |                    | <b>2012</b>        |                    |
|---|--------------------|--------------------|--------------------|--------------------|
| <b>Diluted EPS from Continuing Operations</b>   | <b>Class<br/>A</b> | <b>Class<br/>B</b> | <b>Class<br/>A</b> | <b>Class<br/>B</b> |
| <i><b>Numerator:</b></i>  |                    |                    |                    |                    |
| Distributed income applicable to common stockholders  | \$3,018            | \$338              | \$2,230            | \$354              |
| Reallocation of distributed income as a result of conversion of dilutive stock options                              | 5                  | (5 )               | 6                  | (6 )               |
| Reallocation of distributed income due to conversion of Class B to Class A common shares outstanding                | 333                | -                  | 348                | -                  |
| Diluted distributed income applicable to common stockholders  | \$3,356            | \$333              | \$2,584            | \$348              |
| Undistributed income from continuing operations applicable to common stockholders                                   | \$19,716           | \$2,209            | \$15,031           | \$2,390            |
| Reallocation of undistributed income as a result of conversion of dilutive stock options                            | 30                 | (30 )              | 42                 | (42 )              |
| Reallocation of undistributed income due to conversion of Class B to Class A  | 2,179              | -                  | 2,348              | -                  |
| Diluted undistributed income from continuing operations applicable to common stockholders                           | \$21,925           | \$2,179            | \$17,421           | \$2,348            |
| <i><b>Denominator:</b></i>  |                    |                    |                    |                    |
| Weighted average number of shares outstanding used to calculate basic income per share from continuing operations   | 23,185             | 2,597              | 22,201             | 3,529              |
| Weighted average number of shares from stock options  | 352                | -                  | 455                | -                  |
| Conversion of Class B to Class A common shares outstanding  | 2,597              | -                  | 3,529              | -                  |
| Weighted average number of shares outstanding used to calculate diluted income per share from continuing operations | 26,134             | 2,597              | 26,185             | 3,529              |
| Diluted income per share from continuing operations applicable to common stockholders                               | \$0.97             | \$0.97             | \$0.76             | \$0.76             |
| Diluted distributed income per share from continuing operations applicable to common stockholders                   | (0.13 )            | (0.13 )            | (0.10 )            | (0.10 )            |
| Diluted undistributed income per share from continuing operations applicable to common stockholders                 | \$0.84             | \$0.84             | \$0.66             | \$0.66             |

| <b>Three Months<br/>Ended June<br/>30,<br/>Diluted EPS<br/>Antidilutive<br/>Securities</b> | <b>2013</b>    |                | <b>2012</b>    |                |
|--|----------------|----------------|----------------|----------------|
| Shares issuable pursuant to stock options not included since they were antidilutive        | <b>Class A</b> | <b>Class B</b> | <b>Class A</b> | <b>Class B</b> |
|  | 18             | -              | 45             | -              |



| Six Months Ended June 30,   | 2013       |            | 2012       |            |
|---|------------|------------|------------|------------|
|   | Class<br>A | Class<br>B | Class<br>A | Class<br>B |
| <b>Basic EPS from Continuing Operations</b>   |            |            |            |            |
| <i>Numerator:</i>   |            |            |            |            |
| Income from continuing operations applicable to common stockholders                               | \$42,254   | \$4,909    | \$31,483   | \$5,156    |
| Distributed income applicable to common stockholders  | (3,007 )   | (349 )     | (3,779 )   | (619 )     |
| Basic undistributed income from continuing operations applicable to common stockholders           | \$39,247   | \$4,560    | \$27,704   | \$4,537    |
| <i>Denominator:</i>   |            |            |            |            |
| Weighted average number of shares outstanding used to calculate basic income per share            | 23,052     | 2,678      | 22,221     | 3,639      |
| Basic income per share from continuing operations applicable to common stockholders               | \$1.83     | \$1.83     | \$1.42     | \$1.42     |
| Basic distributed income per share from continuing operations applicable to common stockholders   | (0.13 )    | (0.13 )    | (0.17 )    | (0.17 )    |
| Basic undistributed income per share from continuing operations applicable to common stockholders | \$1.70     | \$1.70     | \$1.25     | \$1.25     |

| <b>Six Months Ended June 30,</b>  | <b>2013</b>    |                | <b>2012</b>    |                |
|---|----------------|----------------|----------------|----------------|
| <b>Diluted EPS from Continuing Operations</b>   | <b>Class A</b> | <b>Class B</b> | <b>Class A</b> | <b>Class B</b> |
| <b><i>Numerator:</i></b>  |                |                |                |                |
| Distributed income applicable to common stockholders  | \$3,007        | \$349          | \$3,779        | \$619          |
| Reallocation of distributed income as a result of conversion of dilutive stock options                              | 5              | (5 )           | 11             | (11 )          |
| Reallocation of distributed income due to conversion of Class B to Class A common shares outstanding                | 344            | -              | 608            | -              |
| Diluted distributed income applicable to common stockholders  | \$3,356        | \$344          | \$4,398        | \$608          |
| Undistributed income from continuing operations applicable to common stockholders                                   | \$39,247       | \$4,560        | \$27,704       | \$4,537        |
| Reallocation of undistributed income as a result of conversion of dilutive stock options                            | 69             | (69 )          | 81             | (81 )          |
| Reallocation of undistributed income due to conversion of Class B to Class A  | 4,491          | -              | 4,456          | -              |
| Diluted undistributed income from continuing operations applicable to common stockholders                           | \$43,807       | \$4,491        | \$32,241       | \$4,456        |
| <b><i>Denominator:</i></b>  |                |                |                |                |
| Weighted average number of shares outstanding used to calculate basic income per share from continuing operations   | 23,052         | 2,678          | 22,221         | 3,639          |
| Weighted average number of shares from stock options  | 390            | -              | 471            | -              |
| Conversion of Class B to Class A common shares outstanding  | 2,678          | -              | 3,639          | -              |
| Weighted average number of shares outstanding used to calculate diluted income per share from continuing operations | 26,120         | 2,678          | 26,331         | 3,639          |
| Diluted income per share from continuing operations applicable to common stockholders                               | \$1.81         | \$1.81         | \$1.39         | \$1.39         |
| Diluted distributed income per share from continuing operations applicable to common stockholders                   | (0.13 )        | (0.13 )        | (0.17 )        | (0.17 )        |
| Diluted undistributed income per share from continuing operations applicable to common stockholders                 | \$1.68         | \$1.68         | \$1.22         | \$1.22         |

| <b>Six Months Ended June 30,</b>  | <b>2013</b>    |                | <b>2012</b>    |                |
|---|----------------|----------------|----------------|----------------|
| <b>Diluted EPS Antidilutive Securities</b>  | <b>Class A</b> | <b>Class B</b> | <b>Class A</b> | <b>Class B</b> |
| Shares issuable pursuant to stock options not included since they were antidilutive | 19             | -              | 90             | -              |





### **Note 13. Subsequent Events**

On July 22, 2013, our Board of Directors approved a dividend of \$0.13 per share on our Class A and Class B Common stock related to our second quarter 2013 financial results. The dividend will total approximately \$3.4 million and will be paid on August 23, 2013 to shareholders of record on August 9, 2013.

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

### **Forward-Looking Statements and Risk Factors**

Certain statements under the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" and elsewhere in this Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Generally, you can identify forward-looking statements by terms such as "project," "target," "may," "will," "should," "expect," "plan," "intend," "forecast," "anticipate," "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. 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 our other filings with the Securities and Exchange Commission.

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. We assume no obligation to update or revise any forward-looking statement.

### **Overview**

We are a leading operator of automotive franchises and a retailer of new and used vehicles and services. As of July 26, 2013, we offer 27 brands of new vehicles and all brands of used vehicles in 91 stores in the United States and online at Lithia.com. We sell new and used cars and replacement parts; provide vehicle maintenance, warranty, paint and repair services; arrange related financing; and sell service contracts, vehicle protection products and credit insurance.

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

### **Results of Continuing Operations**

For the three months ended June 30, 2013 and 2012, we reported income from continuing operations, net of tax, of \$25.3 million, or \$0.97 per diluted share, and \$20.0 million, or \$0.76 per diluted share, respectively.

For the six months ended June 30, 2013 and 2012, we reported income from continuing operations, net of tax, of \$47.2 million, or \$1.81 per diluted share, and \$36.6 million, or \$1.39 per diluted share, respectively.

### Discontinued Operations

Results for stores sold, closed or held for sale, qualifying for reclassification under the applicable accounting guidance, are presented as discontinued operations for all periods in our Consolidated Statements of Operations. As a result, our results from continuing operations are presented on a comparable basis.

Income from discontinued operations, net of tax for the three months ended June 30, 2013 and 2012 totaled \$274,000 and \$486,000, respectively. Income from discontinued operations, net of tax for the six months ended June 30, 2013 and 2012 totaled \$447,000 and \$648,000, respectively. See Note 11 of the Condensed Notes to Consolidated Financial Statements for additional information.

### Key Performance Metrics

Key performance metrics for revenue and gross profit were as follows for the three and six months ended June 30, 2013 and 2012 (dollars in thousands):

| Three months ended<br>June 30, 2013  | Revenues    | Percent of<br>Total<br>Revenues | Gross<br>Profit | Gross<br>Profit<br>Margin |   | Percent<br>of<br>Total<br>Gross<br>Profit |   |
|--------------------------------------|-------------|---------------------------------|-----------------|---------------------------|---|---|---|
|                                      |             |                                 |                 |                           |   |   |   |
| New vehicle                          | \$569,487   | 56.5                            | % \$38,788      | 6.8                       | % | 24.3                                      | % |
| Used vehicle retail                  | 258,465     | 25.6                            | 38,893          | 15.0                      |   | 24.3                                      |   |
| Used vehicle wholesale               | 37,691      | 3.7                             | 695             | 1.8                       |   | 0.4                                       |   |
| Finance and insurance <sup>(1)</sup> | 34,218      | 3.4                             | 34,218          | 100.0                     |   | 21.4                                      |   |
| Service, body and parts              | 94,462      | 9.4                             | 46,693          | 49.4                      |   | 29.2                                      |   |
| Fleet and other                      | 14,182      | 1.4                             | 546             | 3.8                       |   | 0.4                                       |   |
|                                      | \$1,008,505 | 100.0                           | % \$159,833     | 15.8                      | % | 100.0                                     | % |

  

| Three months ended<br>June 30, 2012 | Revenues | Percent of<br>Total<br>Revenues | Gross<br>Profit | Gross<br>Profit<br>Margin |  | Percent<br>of<br>Total |  |
|-------------------------------------|----------|---------------------------------|-----------------|---------------------------|--|------------------------|--|
|                                     |          |                                 |                 |                           |  |                        |  |
|                                     |          |                                 |                 |                           |  |                        |  |

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|                                      |           |       |   |           |       | <b>Gross Profit</b> |         |
|--------------------------------------|-----------|-------|---|-----------|-------|---------------------|---------|
| New vehicle                          | \$455,939 | 55.4  | % | \$33,566  | 7.4   | %                   | 25.0 %  |
| Used vehicle retail                  | 207,341   | 25.2  |   | 30,991    | 14.9  |                     | 23.1    |
| Used vehicle wholesale               | 35,106    | 4.3   |   | 296       | 0.8   |                     | 0.2     |
| Finance and insurance <sup>(1)</sup> | 27,184    | 3.3   |   | 27,184    | 100.0 |                     | 20.3    |
| Service, body and parts              | 85,456    | 10.4  |   | 41,674    | 48.8  |                     | 31.1    |
| Fleet and other                      | 11,316    | 1.4   |   | 385       | 3.4   |                     | 0.3     |
|                                      | \$822,342 | 100.0 | % | \$134,096 | 16.3  | %                   | 100.0 % |

| <b>Six months ended<br/>June 30, 2013</b> | <b>Revenues</b> | <b>Percent of</b>     |                       | <b>Gross Profit</b> | <b>Gross Profit</b> | <b>Percent of Total</b> |                     |
|---|-----------------|-----------------------|-----------------------|---------------------|---------------------|-------------------------|---------------------|
|   |                 | <b>Total Revenues</b> | <b>Total Revenues</b> |                     |                     | <b>Margin</b>           | <b>Gross Profit</b> |
| New vehicle                               | \$1,062,928     | 55.6                  | %                     | \$73,435            | 6.9                 | %                       | 24.0 %              |
| Used vehicle retail                       | 497,693         | 26.0                  |                       | 73,866              | 14.8                |                         | 24.1                |
| Used vehicle wholesale                    | 77,197          | 4.0                   |                       | 1,669               | 2.2                 |                         | 0.6                 |
| Finance and insurance <sup>(1)</sup>      | 65,881          | 3.5                   |                       | 65,881              | 100.0               |                         | 21.5                |
| Service, body and parts                   | 184,902         | 9.7                   |                       | 90,472              | 48.9                |                         | 29.5                |
| Fleet and other                           | 22,984          | 1.2                   |                       | 948                 | 4.1                 |                         | 0.3                 |
|   | \$1,911,585     | 100.0                 | %                     | \$306,271           | 16.0                | %                       | 100.0 %             |

| <b>Six months ended<br/>June 30, 2012</b> | <b>Revenues</b> | <b>Percent of</b>     |                       | <b>Gross Profit</b> | <b>Gross Profit</b> | <b>Percent of Total</b> |                     |
|---|-----------------|-----------------------|-----------------------|---------------------|---------------------|-------------------------|---------------------|
|   |                 | <b>Total Revenues</b> | <b>Total Revenues</b> |                     |                     | <b>Margin</b>           | <b>Gross Profit</b> |
| New vehicle                               | \$848,885       | 54.4                  | %                     | \$63,818            | 7.5                 | %                       | 24.7 %              |
| Used vehicle retail                       | 397,960         | 25.5                  |                       | 59,268              | 14.9                |                         | 22.9                |
| Used vehicle wholesale                    | 68,463          | 4.4                   |                       | 693                 | 1.0                 |                         | 0.3                 |
| Finance and insurance <sup>(1)</sup>      | 52,060          | 3.3                   |                       | 52,060              | 100.0               |                         | 20.1                |
| Service, body and parts                   | 169,000         | 10.8                  |                       | 81,809              | 48.4                |                         | 31.7                |
| Fleet and other                           | 24,220          | 1.6                   |                       | 782                 | 3.2                 |                         | 0.3                 |
|   | \$1,560,588     | 100.0                 | %                     | \$258,430           | 16.6                | %                       | 100.0 %             |

(1)Commissions reported net of anticipated cancellations.

**Same Store Operating Data**

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

A same store metric represents stores that were operating during the three- and six-month periods ended June 30, 2013, and only includes the months when operations occur in both comparable periods. For example, a store acquired in May 2012 would be included in same store operating data beginning in June 2013, after its first full complete comparable month of operation, and operating results for same store comparisons would include only the period of June for both comparable periods.

***New Vehicle Revenues***

|  | <b>Three Months Ended</b> |             | <b>Increase<br/>(Decrease)</b> | <b>%<br/>Increase<br/>(Decrease)</b> |
|--|---------------------------|-------------|--------------------------------|--------------------------------------|
|  | <b>June 30,<br/>2013</b>  | <b>2012</b> |                                |                                      |
| <b>(Dollars in thousands, except per unit amounts)</b> |                           |             |                                |                                      |
| <b>Reported</b>  |                           |             |                                |                                      |
| Revenue  | \$ 569,487                | \$ 455,939  | \$ 113,548                     | 24.9 %                               |
| Gross profit   | \$ 38,788                 | \$ 33,566   | \$ 5,222                       | 15.6                                 |
| Gross margin   | 6.8 %                     | 7.4 %       | (60 )bp <sup>(1)</sup>         |                                      |
| Retail units sold                                      | 17,024                    | 13,974      | 3,050                          | 21.8                                 |
| Average selling price per retail unit                  | \$ 33,452                 | \$ 32,628   | \$ 824                         | 2.5                                  |
| Average gross profit per retail unit                   | \$ 2,278                  | \$ 2,402    | \$ (124 )                      | (5.2 )                               |
| <b>Same store</b>                                      |                           |             |                                |                                      |
| Revenue  | \$ 541,740                | \$ 455,658  | \$ 86,082                      | 18.9 %                               |
| Gross profit   | \$ 36,597                 | \$ 33,556   | \$ 3,041                       | 9.1                                  |
| Gross margin   | 6.8 %                     | 7.4 %       | (60 )bp                        |                                      |
| Retail units sold                                      | 16,212                    | 13,966      | 2,246                          | 16.1                                 |
| Average selling price per retail unit                  | \$ 33,416                 | \$ 32,626   | \$ 790                         | 2.4                                  |
| Average gross profit per retail unit                   | \$ 2,257                  | \$ 2,403    | \$ (146 )                      | (6.1 )                               |

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

|  | Six Months Ended |           | Increase<br>(Decrease) | %<br>Increase<br>(Decrease) |   |
|--|------------------|-----------|------------------------|-----------------------------|---|
|  | June 30,<br>2013 | 2012      |                        |                             |   |
| <b>(Dollars in thousands, except per unit amounts)</b> |                  |           |                        |                             |   |
| <b>Reported</b>  |                  |           |                        |                             |   |
| Revenue  | \$1,062,928      | \$848,885 | \$214,043              | 25.2                        | % |
| Gross profit   | \$73,435         | \$63,818  | \$9,617                | 15.1                        |   |
| Gross margin   | 6.9              | % 7.5     | % (60                  | )bp                         |   |
| Retail units sold                                      | 31,744           | 26,112    | 5,632                  | 21.6                        |   |
| Average selling price per retail unit                  | \$33,484         | \$32,509  | \$975                  | 3.0                         |   |
| Average gross profit per retail unit                   | \$2,313          | \$2,444   | \$(131)                | (5.4)                       | ) |
| <b>Same store</b>                                      |                  |           |                        |                             |   |
| Revenue  | \$1,015,760      | \$844,125 | \$171,635              | 20.3                        | % |
| Gross profit   | \$69,503         | \$63,351  | \$6,152                | 9.7                         |   |
| Gross margin   | 6.8              | % 7.5     | % (70                  | )bp                         |   |
| Retail units sold                                      | 30,363           | 25,970    | 4,393                  | 16.9                        |   |
| Average selling price per retail unit                  | \$33,454         | \$32,504  | \$950                  | 2.9                         |   |
| Average gross profit per retail unit                   | \$2,289          | \$2,439   | \$(150)                | (6.2)                       | ) |

New vehicle sales in the first half of 2013 improved compared to the first half of 2012 primarily due to volume growth as same store unit sales increased 16.1% and 16.9%, respectively, in the three- and six-month periods ended June 30, 2013 compared to the same periods in 2012.

The number of new vehicles sold in the U.S. during the first six months of 2013 grew approximately 7.5% over the first six months of 2012. Growth in our domestic, import and luxury brand sales has outpaced the growth experienced nationally. Our domestic brand same store unit sales grew 13.7% and 15.7%, respectively, for the three- and six-month periods ended June 30, 2013 compared to the same periods in 2012. Same store unit sales for import brands grew 19.5% and 19.2%, respectively, while same store unit sales for luxury brands grew 16.2% and 14.9%, respectively, for the three- and six-month periods ended June 30, 2013 compared to the same periods in 2012. We continue to focus on increasing our share of overall new vehicle sales within our markets. Additionally, certain of our markets have seen an increase in local market sales volumes exceeding the national average.

New vehicle gross profit dollars increased 15.6% and 15.1%, respectively, for the three- and six-month periods ended June 30, 2013 compared to the same periods of 2012. These increases were due to a greater number of vehicles sold, partially offset by lower gross profit per unit and lower gross margin.

We focus on gross profit dollars earned per unit, not a gross margin percentage. On a same store basis, the average gross profit per retail unit decreased \$146 and \$150, respectively, for the three- and six-month periods ended June 30, 2013 compared to the same periods of 2012. These decreases were primarily due to the strategic decision to increase our market share in certain markets through lower pricing. Additionally, certain manufacturer incentives are tied to increases in units sold per store, and, given consecutive years of significant unit sales increases, these objectives have been more difficult to achieve in 2013 than in prior years, resulting in lower total incentive dollars earned.

We believe increasing new unit sales creates additional used vehicle trade-in opportunities, finance and insurance sales and future service work. We believe the incremental business generated in future periods will more than offset the slightly lower new vehicle gross profit per unit that has occurred with the pursuit of our volume-based strategy.

### *Used Vehicle Retail Revenues*

|   | Three Months Ended |           |          |            |
|---|--------------------|-----------|----------|------------|
|   | June 30,           |           | Increase | % Increase |
| (Dollars in thousands, except per unit amounts) | 2013               | 2012      |          |            |
| <b>Reported</b>                                 |                    |           |          |            |
| Retail revenue                                  | \$258,465          | \$207,341 | \$51,124 | 24.7 %     |
| Retail gross profit                             | \$38,893           | \$30,991  | \$7,902  | 25.5       |



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|                                       |           |   |           |   |          |    |        |
|---------------------------------------|-----------|---|-----------|---|----------|----|--------|
| Retail gross margin                   | 15.0      | % | 14.9      | % | 10       | bp |        |
| Retail units sold                     | 14,074    |   | 11,604    |   | 2,470    |    | 21.3   |
| Average selling price per retail unit | \$18,365  |   | \$17,868  |   | \$497    |    | 2.8    |
| Average gross profit per retail unit  | \$2,763   |   | \$2,671   |   | \$92     |    | 3.4    |
| <b>Same store</b>                     |           |   |           |   |          |    |        |
| Retail revenue                        | \$246,004 |   | \$207,269 |   | \$38,735 |    | 18.7 % |
| Retail gross profit                   | \$37,102  |   | \$30,971  |   | \$6,131  |    | 19.8   |
| Retail gross margin                   | 15.1      | % | 14.9      | % | 20       | bp |        |
| Retail units sold                     | 13,457    |   | 11,603    |   | 1,854    |    | 16.0   |
| Average selling price per retail unit | \$18,281  |   | \$17,863  |   | \$418    |    | 2.3    |
| Average gross profit per retail unit  | \$2,757   |   | \$2,669   |   | \$88     |    | 3.3    |

| (Dollars in thousands, except per unit amounts) | Six Months Ended |           |                     |  | % Increase (Decrease) |
|---|------------------|-----------|---------------------|--|-----------------------|
|   | June 30, 2013    | 2012      | Increase (Decrease) |  |                       |
| <b>Reported</b>                                 |                  |           |                     |  |                       |
| Retail revenue                                  | \$497,693        | \$397,960 | \$ 99,733           |  | 25.1 %                |
| Retail gross profit                             | \$73,866         | \$59,268  | \$ 14,598           |  | 24.6                  |
| Retail gross margin                             | 14.8 %           | 14.9 %    | (10 )               |  | bp                    |
| Retail units sold                               | 27,735           | 22,811    | 4,924               |  | 21.6                  |
| Average selling price per retail unit           | \$17,945         | \$17,446  | \$ 499              |  | 2.9                   |
| Average gross profit per retail unit            | \$2,663          | \$2,598   | \$ 65               |  | 2.5                   |
| <b>Same store</b>                               |                  |           |                     |  |                       |
| Retail revenue                                  | \$473,753        | \$394,769 | \$ 78,984           |  | 20.0 %                |
| Retail gross profit                             | \$70,850         | \$58,939  | \$ 11,911           |  | 20.2                  |
| Retail gross margin                             | 15.0 %           | 14.9 %    | 10                  |  | bp                    |
| Retail units sold                               | 26,507           | 22,618    | 3,889               |  | 17.2                  |
| Average selling price per retail unit           | \$17,873         | \$17,454  | \$ 419              |  | 2.4                   |
| Average gross profit per retail unit            | \$2,673          | \$2,606   | \$ 67               |  | 2.6                   |

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

During the three- and six-month periods ended June 30, 2013, sales increased in all three categories of used vehicles compared to the same periods of 2012.

Same store unit sales for manufacturer certified pre-owned vehicles increased 36.8% and 34.7%, respectively.

Same store unit sales for the core vehicle category increased 4.7% and 7.1%, respectively. We believe this area provides the largest opportunity for organic growth. Our focus is on improving our future results in this category as it has lagged the other two categories.

Same store unit sales for the value auto category increased 26.4% and 27.4%, respectively.

Our retail used-to-new vehicle sales ratio was 0.8:1 for the three-month periods ended June 30, 2013 and 2012. For the six-month periods ended June 30, 2013 and 2012, our retail used-to-new vehicle sales ratio was 0.9:1. On average, each of our stores currently sells approximately 54 retail used vehicle units per month and we target increasing average sales to 75 units per month.

Used retail vehicle gross profit dollars increased 25.5% and 24.6%, respectively, for the three- and six-month periods ended June 30, 2013 compared to the same periods of 2012. These increases were mainly related to volume growth, although gross profit per unit sold was also higher. Similar to new vehicle sales, we focus on gross profit dollars earned per unit, not on gross margin percentage, in evaluating our sales performance.

*Used Vehicle Wholesale Revenues*

|  | Three Months Ended |          | Increase<br>(Decrease) | % Increase<br>(Decrease) |   |
|--|--------------------|----------|------------------------|--------------------------|---|
|  | June 30,<br>2013   | 2012     |                        |                          |   |
| <b>(Dollars in thousands, except per unit amounts)</b> |                    |          |                        |                          |   |
| <b>Reported</b>  |                    |          |                        |                          |   |
| Wholesale revenue                                      | \$37,691           | \$35,106 | \$ 2,585               | 7.4                      | % |
| Wholesale gross profit                                 | \$695              | \$296    | \$ 399                 | 134.8                    |   |
| Wholesale gross margin                                 | 1.8                | % 0.8    | % 100                  | bp                       |   |
| Wholesale units sold                                   | 5,241              | 4,512    | 729                    | 16.2                     |   |
| Average selling price per wholesale unit               | \$7,192            | \$7,781  | \$ (589)               | (7.6)                    | ) |
| Average gross profit per retail unit                   | \$133              | \$66     | \$ 67                  | 101.5                    |   |
| <b>Same store</b>                                      |                    |          |                        |                          |   |
| Wholesale revenue                                      | \$35,609           | \$35,065 | \$ 544                 | 1.6                      | % |
| Wholesale gross profit                                 | \$861              | \$298    | \$ 563                 | 188.9                    |   |
| Wholesale gross margin                                 | 2.4                | % 0.8    | % 160                  | bp                       |   |
| Wholesale units sold                                   | 4,979              | 4,511    | 468                    | 10.4                     |   |
| Average selling price per wholesale unit               | \$7,152            | \$7,773  | \$ (621)               | (8.0)                    | ) |
| Average gross profit per retail unit                   | \$173              | \$66     | \$ 107                 | 162.1                    |   |
| <b>Six Months Ended</b>                                |                    |          |                        |                          |   |
|  | June 30,           |          | Increase<br>(Decrease) | % Increase<br>(Decrease) |   |
|  | 2013               | 2012     |                        |                          |   |
| <b>(Dollars in thousands, except per unit amounts)</b> |                    |          |                        |                          |   |
| <b>Reported</b>  |                    |          |                        |                          |   |
| Wholesale revenue                                      | \$77,197           | \$68,463 | \$ 8,734               | 12.8                     | % |
| Wholesale gross profit                                 | \$1,669            | \$693    | \$ 976                 | 140.8                    |   |
| Wholesale gross margin                                 | 2.2                | % 1.0    | % 120                  | bp                       |   |
| Wholesale units sold                                   | 10,565             | 8,993    | 1,572                  | 17.5                     |   |
| Average selling price per wholesale unit               | \$7,307            | \$7,613  | \$ (306)               | (4.0)                    | ) |
| Average gross profit per retail unit                   | \$158              | \$77     | \$ 81                  | 105.2                    |   |
| <b>Same store</b>                                      |                    |          |                        |                          |   |
| Wholesale revenue                                      | \$72,045           | \$67,808 | \$ 4,237               | 6.2                      | % |
| Wholesale gross profit                                 | \$1,760            | \$744    | \$ 1,016               | 136.6                    |   |
| Wholesale gross margin                                 | 2.4                | % 1.1    | % 130                  | bp                       |   |
| Wholesale units sold                                   | 9,969              | 8,898    | 1,071                  | 12.0                     |   |
| Average selling price per wholesale unit               | \$7,227            | \$7,621  | \$ (394)               | (5.2)                    | ) |

|                                      |       |      |       |       |
|--------------------------------------|-------|------|-------|-------|
| Average gross profit per retail unit | \$177 | \$84 | \$ 93 | 110.7 |
|--------------------------------------|-------|------|-------|-------|

Wholesale transactions are vehicles we have purchased from customers or vehicles we have attempted to sell via retail that we elect to dispose of due to inventory age or other factors. Wholesale vehicles are typically sold at or near inventory cost and do not comprise a meaningful component of our gross profit.

### *Finance and Insurance*

|  | <b>Three Months Ended</b> |             |                 |                 |   |
|--|---------------------------|-------------|-----------------|-----------------|---|
|  | <b>June 30,</b>           |             |                 | <b>%</b>        |   |
| <b>(Dollars in thousands, except per unit amounts)</b> | <b>2013</b>               | <b>2012</b> | <b>Increase</b> | <b>Increase</b> |   |
| <b>Reported</b>  |                           |             |                 |                 |   |
| Revenue  | \$34,218                  | \$27,184    | \$ 7,034        | 25.9            | % |
| Average finance and insurance per retail unit          | \$1,100                   | \$1,063     | \$ 37           | 3.5             | % |
| <b>Same store</b>                                      |                           |             |                 |                 |   |
| Revenue  | \$32,582                  | \$27,011    | \$ 5,571        | 20.6            | % |
| Average finance and insurance per retail unit          | \$1,098                   | \$1,056     | \$ 42           | 4.0             | % |

| (Dollars in thousands, except per unit amounts)<br>Reported | Six Months Ended |          | Increase | % Increase |   |
|---|------------------|----------|----------|------------|---|
|   | June 30, 2013    | 2012     |          |            |   |
| Revenue   | \$65,881         | \$52,060 | \$13,821 | 26.5       | % |
| Average finance and insurance per retail unit               | \$1,108          | \$1,064  | \$44     | 4.1        | % |
| <b>Same store</b>   |                  |          |          |            |   |
| Revenue   | \$62,560         | \$50,980 | \$11,580 | 22.7       | % |
| Average finance and insurance per retail unit               | \$1,100          | \$1,049  | \$51     | 4.9        | % |

The increases in finance and insurance sales were driven by increased vehicle sales volume in the three- and six-month periods ended June 30, 2013 compared to the same periods of 2012. The availability of consumer credit continued to expand through the first six months of 2013 with lenders increasing the average loan-to-value amount available to most customers. Additionally, we increased our penetration rate on arranging financing for our customers and the sale of extended service contracts. As a result, our average revenue per unit increased.

Penetration rates were as follows:

|                                | Three Months Ended |      | Six Months Ended |      |
|--------------------------------|--------------------|------|------------------|------|
|                                | June 30, 2013      | 2012 | June 30, 2013    | 2012 |
| Finance and insurance          | 78%                | 76%  | 77%              | 76%  |
| Service contracts              | 42                 | 41   | 42               | 41   |
| Lifetime oil change and filter | 37                 | 36   | 36               | 37   |

#### *Service, Body and Parts Revenue*

| (Dollars in thousands)<br>Reported | Three Months Ended |      | Increase | % Increase |  |
|------------------------------------|--------------------|------|----------|------------|--|
|                                    | June 30, 2013      | 2012 |          |            |  |

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|                                      |          |          |          |      |       |
|--------------------------------------|----------|----------|----------|------|-------|
| Customer pay                         | \$53,243 | \$48,884 | \$ 4,359 | 8.9  | %     |
| Warranty                             | 15,707   | 12,666   | 3,041    | 24.0 |       |
| Wholesale parts                      | 16,916   | 15,550   | 1,366    | 8.8  |       |
| Body shop                            | 8,596    | 8,356    | 240      | 2.9  |       |
| Total service, body and parts        | \$94,462 | \$85,456 | \$ 9,006 | 10.5 | %     |
| Service, body and parts gross profit | \$46,693 | \$41,674 | \$ 5,019 | 12.0 | %     |
| Service, body and parts gross margin | 49.4     | %        | 48.8     | %    | 60 bp |
| <b>Same store</b>                    |          |          |          |      |       |
| Customer pay                         | \$51,281 | \$48,877 | \$ 2,404 | 4.9  | %     |
| Warranty                             | 15,126   | 12,666   | 2,460    | 19.4 |       |
| Wholesale parts                      | 16,442   | 15,529   | 913      | 5.9  |       |
| Body shop                            | 8,596    | 8,355    | 241      | 2.9  |       |
| Total service, body and parts        | \$91,445 | \$85,427 | \$ 6,018 | 7.0  | %     |
| Service, body and parts gross profit | \$44,100 | \$40,775 | \$ 3,325 | 8.2  | %     |
| Service, body and parts gross margin | 48.2     | %        | 47.7     | %    | 50 bp |

| (Dollars in thousands)               | Six Months Ended |           |          |            |   |    |
|--------------------------------------|------------------|-----------|----------|------------|---|----|
|                                      | June 30,         |           | Increase | % Increase |   |    |
|                                      | 2013             | 2012      |          |            |   |    |
| <b>Reported</b>                      |                  |           |          |            |   |    |
| Customer pay                         | \$102,561        | \$94,833  | \$7,728  | 8.1        | % |    |
| Warranty                             | 30,047           | 25,561    | 4,486    | 17.6       |   |    |
| Wholesale parts                      | 34,266           | 31,821    | 2,445    | 7.7        |   |    |
| Body shop                            | 18,028           | 16,785    | 1,243    | 7.4        |   |    |
| Total service, body and parts        | \$184,902        | \$169,000 | \$15,902 | 9.4        | % |    |
| Service, body and parts gross profit | \$90,472         | \$81,809  | \$8,663  | 10.6       | % |    |
| Service, body and parts gross margin | 48.9             | % 48.4    | % 50     |            |   | bp |
| <b>Same store</b>                    |                  |           |          |            |   |    |
| Customer pay                         | \$98,876         | \$94,059  | \$4,817  | 5.1        | % |    |
| Warranty                             | 28,925           | 25,291    | 3,634    | 14.4       |   |    |
| Wholesale parts                      | 33,363           | 31,663    | 1,700    | 5.4        |   |    |
| Body shop                            | 18,028           | 16,780    | 1,248    | 7.4        |   |    |
| Total service, body and parts        | \$179,192        | \$167,793 | \$11,399 | 6.8        | % |    |
| Service, body and parts gross profit | \$85,926         | \$79,503  | \$6,423  | 8.1        | % |    |
| Service, body and parts gross margin | 48.0             | % 47.4    | % 60     |            |   | bp |

Our service, body and parts sales grew in all areas in the three- and six-month periods ended June 30, 2013 compared to the prior year periods. We focus on retaining customers by offering competitively-priced routine maintenance and increasing our marketing efforts. We increased our same store customer pay business 4.9% and 5.1%, respectively, in the three- and six-month periods ended June 30, 2013 compared to the same periods in 2012.

In the three- and six-month periods ended June 30, 2013 compared to the same periods of 2012, same store warranty sales increased 19.4% and 14.4%, respectively. Domestic brand warranty work increased 0.7% and 1.0%, import warranty work increased 31.6% and 24.6%, and luxury warranty work increased 38.5% and 26.1%, respectively. Import and luxury warranty work increased primarily due to recent recalls on certain models in 2013. Additionally, certain import and luxury franchises include routine maintenance such as oil changes for two to four years after a new vehicle is sold, which is included as warranty work. As a result, increasing new vehicle unit sales in these franchises also contributed to the period-over-period increases in warranty revenue.

Wholesale parts represented 18.0% and 18.6% of our same store service, body and parts revenue mix in the first three and six months of 2013, and 18.2% and 18.9% in the first three and six months of 2012, respectively. Wholesale parts grew 5.9% and 5.4%, respectively, in the first three and six months of 2013 compared to the same periods of 2012.



Body shop represented 9.4% and 10.1% of our same store service, body and parts revenue mix in the first three and six months of 2013, and 9.8% and 10.0% in the first three and six months of 2012, respectively. Body shop grew 2.9% and 7.4%, respectively, in the first three and six months of 2013 compared to the same periods of 2012.

Service, body and parts gross profit increased 12.0% and 10.6%, respectively, for the three- and six-month periods ended June 30, 2013 compared to the same periods of 2012, mainly due to sales growth in all service, body and parts areas.

***Gross Profit***

Gross profit increased \$25.7 million and \$47.8 million, respectively, in the three- and six-month periods ended June 30, 2013 compared to the same periods in 2012. These increases of 19.2% and 18.5%, respectively, were due to increased revenues, partially offset by declines in our overall gross profit margin.

Our overall gross profit margin was 15.8% and 16.3%, respectively, for the three months ended June 30, 2013 and 2012. For the six months ended June 30, 2013 and 2012, our overall gross profit margin was 16.0% and 16.6%, respectively.

We focus on growing overall gross profit dollars. This growth allows us to leverage our cost structure in our general and administrative expenses resulting in increased operating margin. We believe our “single-point” strategy of maintaining franchise exclusivity within the markets we serve protects profitability and supports higher margin levels within each business line.

### *Selling, General and Administrative Expense (“SG&A”)*

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

|                               | <b>Three Months Ended</b> |             | <b>Increase</b>   | <b>% Increase</b> |   |
|-------------------------------|---------------------------|-------------|-------------------|-------------------|---|
| <b>(Dollars in thousands)</b> | <b>June 30, 2013</b>      | <b>2012</b> | <b>(Decrease)</b> | <b>(Decrease)</b> |   |
| Personnel                     | \$70,692                  | \$60,969    | \$ 9,723          | 15.9              | % |
| Advertising                   | 9,700                     | 7,825       | 1,875             | 24.0              |   |
| Rent                          | 3,324                     | 3,905       | (581 )            | (14.9 )           |   |
| Facility costs                | 6,658                     | 5,863       | 795               | 13.6              |   |
| Other                         | 18,909                    | 14,428      | 4,481             | 31.1              |   |
| Total SG&A                    | \$109,283                 | \$92,990    | \$ 16,293         | 17.5              | % |

|                               | <b>Three Months Ended</b> |             | <b>Increase</b>   |    |
|-------------------------------|---------------------------|-------------|-------------------|----|
| <b>As a % of gross profit</b> | <b>June 30, 2013</b>      | <b>2012</b> | <b>(Decrease)</b> |    |
| Personnel                     | 44.2%                     | 45.5%       | (130 )            | bp |
| Advertising                   | 6.1                       | 5.8         | 30                |    |
| Rent                          | 2.1                       | 2.9         | (80 )             |    |
| Facility costs                | 4.2                       | 4.4         | (20 )             |    |
| Other                         | 11.8                      | 10.7        | 110               |    |
| Total SG&A                    | 68.4%                     | 69.3%       | (90 )             | bp |

### **Six Months Ended**

|                               | <b>June 30,</b> |             | <b>Increase</b>   | <b>%</b>          |   |
|-------------------------------|-----------------|-------------|-------------------|-------------------|---|
| <b>(Dollars in thousands)</b> | <b>2013</b>     | <b>2012</b> | <b>(Decrease)</b> | <b>(Decrease)</b> |   |
| Personnel                     | \$ 137,824      | \$ 119,492  | \$ 18,332         | 15.3              | % |
| Advertising                   | 18,602          | 14,089      | 4,513             | 32.0              |   |
| Rent                          | 7,053           | 7,735       | (682)             | (8.8)             | ) |
| Facility costs                | 13,327          | 11,882      | 1,445             | 12.2              |   |
| Other                         | 33,608          | 28,231      | 5,377             | 19.0              |   |
| Total SG&A                    | \$ 210,414      | \$ 181,429  | \$ 28,985         | 16.0              | % |

|                               | <b>Six Months Ended</b> |             |                   |      |
|-------------------------------|-------------------------|-------------|-------------------|------|
|                               | <b>June 30,</b>         |             | <b>Increase</b>   |      |
| <b>As a % of gross profit</b> | <b>2013</b>             | <b>2012</b> | <b>(Decrease)</b> |      |
| Personnel                     | 45.0%                   | 46.2%       | (120)             | ) bp |
| Advertising                   | 6.1                     | 5.5         | 60                |      |
| Rent                          | 2.3                     | 3.0         | (70)              | )    |
| Facility costs                | 4.3                     | 4.6         | (30)              | )    |
| Other                         | 11.0                    | 10.9        | 10                |      |
| Total SG&A                    | 68.7%                   | 70.2%       | (150)             | ) bp |

SG&A expense increased \$16.3 million and \$29.0 million, respectively, in the three- and six-month periods ended June 30, 2013 compared to the same periods in 2012. These increases were primarily driven by increased variable costs associated with improved sales and increases in advertising as we focused on gaining market share.

Additionally, during the second quarter of 2013, we recorded a \$3.8 million expense associated with a non-core legal reserve related to the settlement of a claim filed in 2006.

SG&A as a percentage of gross profit was 68.4% and 69.3%, respectively, for the three months ended June 30, 2013 and 2012, and 68.7% and 70.2%, respectively, for the six months ended June 30, 2013 and 2012. Excluding the non-core legal reserve, SG&A as a percentage of gross profit was 66.0% and 67.5%, respectively, for the three and six months ended June 30, 2013. See “Non-GAAP Reconciliations” for more details. As sales volume increases and we gain leverage in our cost structure, we anticipate maintaining SG&A as a percentage of gross profit in the high 60% range.

We also measure the leverage of our cost structure by evaluating throughput, which is the incremental percentage of gross profit retained after deducting SG&A expense.

| (Dollars in thousands)  | Three Months Ended |            |           | % of Change in |   |
|-------------------------|--------------------|------------|-----------|----------------|---|
|                         | June 30, 2013      | 2012       | Change    | Gross Profit   |   |
| Gross profit            | \$ 159,833         | \$ 134,096 | \$ 25,737 | 100.0          | % |
| SG&A expense            | (109,283 )         | (92,990 )  | (16,293 ) | (63.3 )        | ) |
| Throughput contribution |                    |            | \$ 9,444  | 36.7           | % |

| (Dollars in thousands)  | Three Months Ended |           |          | % of Change in |   |
|-------------------------|--------------------|-----------|----------|----------------|---|
|                         | June 30, 2012      | 2011      | Change   | Gross Profit   |   |
| Gross profit            | \$134,096          | \$113,976 | \$20,120 | 100.0          | % |
| SG&A expense            | (92,990 )          | (79,903 ) | (13,087) | (65.0 )        | ) |
| Throughput contribution |                    |           | \$7,033  | 35.0           | % |

| (Dollars in thousands)  | Six Months Ended |           |          | % of Change in |   |
|-------------------------|------------------|-----------|----------|----------------|---|
|                         | June 30, 2013    | 2012      | Change   | Gross Profit   |   |
| Gross profit            | \$306,271        | \$258,430 | \$47,841 | 100.0          | % |
| SG&A expense            | (210,414)        | (181,429) | (28,985) | (60.6 )        | ) |
| Throughput contribution |                  |           | \$18,856 | 39.4           | % |

| (Dollars in thousands) | Six Months Ended |      |        | % of Change in |  |
|------------------------|------------------|------|--------|----------------|--|
|                        | June 30, 2012    | 2011 | Change | Gross Profit   |  |

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|                         |           |           |          |       |   |
|-------------------------|-----------|-----------|----------|-------|---|
| Gross profit            | \$258,430 | \$213,634 | \$44,796 | 100.0 | % |
| SG&A expense            | (181,429) | (155,196) | (26,233) | (58.6 | ) |
| Throughput contribution |           |           | \$18,563 | 41.4  | % |

Throughput, adjusted to exclude the \$3.8 million non-core legal reserve recorded in the second quarter of 2013, was 51.5% and 48.9%, respectively, for the three- and six-month periods ended June 30, 2013. See “Non-GAAP Reconciliations” for more details.

| (Dollars in thousands)           | Three Months Ended |           |          | Change | % of Change in |  |
|----------------------------------|--------------------|-----------|----------|--------|----------------|--|
|                                  | June 30, 2013      | 2012      |          |        | Gross Profit   |  |
| Gross profit                     | \$159,833          | \$134,096 | \$25,737 | 100.0  | %              |  |
| Adjusted SG&A expense            | (105,470)          | (92,990)  | (12,480) | (48.5  | )              |  |
| Adjusted throughput contribution |                    |           | \$13,257 | 51.5   | %              |  |

| (Dollars in thousands)           | Six Months Ended |           |          | Change | % of Change in |  |
|----------------------------------|------------------|-----------|----------|--------|----------------|--|
|                                  | June 30, 2013    | 2012      |          |        | Gross Profit   |  |
| Gross profit                     | \$306,271        | \$258,430 | \$47,841 | 100.0  | %              |  |
| Adjusted SG&A expense            | (206,601)        | (182,168) | (24,433) | (51.1  | )              |  |
| Adjusted throughput contribution |                  |           | \$23,408 | 48.9   | %              |  |

Throughput contributions for newly opened or acquired stores are on a “first dollar” basis for the first twelve months of operations. We acquired two stores and opened four new stores since the second quarter of 2012. Adjusting for these locations and the non-core legal reserve, our throughput contribution on a same store basis was estimated at 56.5% and 52.9%, respectively, for the three- and six-month periods ended June 30, 2013. We continue to target a same store throughput contribution of approximately 50%.

### ***Depreciation and Amortization***

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

|                               | <b>Three Months Ended</b> |             |                 |                 |          |
|-------------------------------|---------------------------|-------------|-----------------|-----------------|----------|
|                               |                           |             |                 |                 | <i>%</i> |
|                               | <b>June 30,</b>           |             |                 |                 |          |
| <b>(Dollars in thousands)</b> | <b>2013</b>               | <b>2012</b> | <b>Increase</b> | <b>Increase</b> |          |
| Depreciation and amortization | \$4,899                   | \$4,198     | \$ 701          | 16.7            | <i>%</i> |

|                               | <b>Six Months Ended</b> |             |                 |                 |          |
|-------------------------------|-------------------------|-------------|-----------------|-----------------|----------|
|                               |                         |             |                 |                 | <i>%</i> |
|                               | <b>June 30,</b>         |             |                 |                 |          |
| <b>(Dollars in thousands)</b> | <b>2013</b>             | <b>2012</b> | <b>Increase</b> | <b>Increase</b> |          |
| Depreciation and amortization | \$9,620                 | \$8,336     | \$ 1,284        | 15.4            | <i>%</i> |

Depreciation and amortization for the three and six months ended June 30, 2013 increased compared to the same periods of 2012 as we purchased previously leased facilities, built new facilities subsequent to the acquisition of stores and invested in improvements at our facilities and replacement of equipment. These investments increase the amount of depreciable assets and amortizable expenses. In the first half of 2013, we had capital expenditures of \$22.1 million and in the full year of 2012 we had capital expenditures of \$64.6 million.

### ***Operating Income***

Operating income was 4.5% of revenue for the three-month periods ended June 30, 2013 and 2012. Operating income as a percentage of revenue was 4.5% and 4.4%, respectively, for the six-month periods ended June 30, 2013 and 2012. We continue to focus on cost control which allows us to leverage our cost structure in an environment of improving sales.

***Floor Plan Interest Expense and Floor Plan Assistance***

Floor plan interest expense remained flat in the three months ended June 30, 2013 compared to the same period of 2012. Changes in the average outstanding balances on our floor plan facilities increased the expense \$0.6 million and the maturity of three interest rate swaps decreased the expense \$0.6 million during the three months ended June 30, 2013 compared to the same period of 2012. Interest rates on our floor plan facilities were consistent between periods.

Floor plan interest expense increased \$0.5 million in the six months ended June 30, 2013 compared to the same period of 2012. Changes in the average outstanding balances on our floor plan facilities increased the expense \$1.9 million, changes in the interest rates on our floor plan facilities decreased the expense \$0.6 million, and the maturity of three interest rate swaps further decreased the expense \$0.8 million during the six months ended June 30, 2013 compared to the same period of 2012.

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

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

| (Dollars in thousands)   | <b>Three Months Ended</b> |             |               |               |
|--|---------------------------|-------------|---------------|---------------|
|  | %                         |             |               |               |
|  | <b>June 30, 2013</b>      | <b>2012</b> | <b>Change</b> | <b>Change</b> |
| Floor plan interest expense (new vehicles)                     | \$3,036                   | \$3,054     | \$ (18 )      | (0.6 )%       |
| Floor plan assistance (included as an offset to cost of sales) | (5,354)                   | (4,187)     | 1,167         | 27.9          |
| Net new vehicle carrying costs                                 | \$(2,318)                 | \$(1,133)   | \$ 1,185      | 104.6 %       |

| (Dollars in thousands)   | <b>Six Months Ended</b> |             |               |               |
|--|-------------------------|-------------|---------------|---------------|
|  | %                       |             |               |               |
|  | <b>June 30, 2013</b>    | <b>2012</b> | <b>Change</b> | <b>Change</b> |
| Floor plan interest expense (new vehicles)                     | \$6,485                 | \$5,956     | \$ 529        | 8.9 %         |
| Floor plan assistance (included as an offset to cost of sales) | (9,765)                 | (7,830)     | 1,935         | 24.7          |
| Net new vehicle carrying costs                                 | \$(3,280)               | \$(1,874)   | \$ 1,406      | 75.0 %        |

### ***Other Interest Expense***

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

| (Dollars in thousands)       | <b>Three Months Ended</b> |             |                            |                            |
|------------------------------|---------------------------|-------------|----------------------------|----------------------------|
|                              | %                         |             |                            |                            |
|                              | <b>June 30, 2013</b>      | <b>2012</b> | <b>Increase (Decrease)</b> | <b>Increase (Decrease)</b> |
| Mortgage interest            | \$1,505                   | \$2,245     | \$ (740 )                  | (33.0 )%                   |
| Other interest               | 451                       | 384         | 67                         | 17.4                       |
| Capitalized interest         | (15 )                     | (99 )       | (84 )                      | (84.8 )                    |
| Total other interest expense | \$1,941                   | \$2,530     | \$ (589 )                  | (23.3 )%                   |

| (Dollars in thousands) | <b>Six Months Ended</b> |             |                 |                 |
|------------------------|-------------------------|-------------|-----------------|-----------------|
|                        | %                       |             |                 |                 |
|                        | <b>June 30, 2013</b>    | <b>2012</b> | <b>Decrease</b> | <b>Decrease</b> |



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|                              |         |         |           |          |
|------------------------------|---------|---------|-----------|----------|
| Mortgage interest            | \$3,491 | \$4,463 | \$ (972 ) | (21.8 )% |
| Other interest               | 846     | 986     | (140 )    | (14.2 )  |
| Capitalized interest         | (35 )   | (192 )  | (157 )    | (81.8 )  |
| Total other interest expense | \$4,302 | \$5,257 | \$ (955 ) | (18.2 )% |

Total other interest expense decreased \$0.6 million and \$1.0 million, respectively, in the first three and six months of 2013 compared to the same periods of 2012. In the full year of 2012 and first half of 2013, we had net mortgage reductions of \$1.5 million and \$24.7 million, respectively, which contributed to the decrease. In addition, we refinanced mortgages at lower interest rates, which lowered interest expense. Total other interest expense also decreased due to lower volumes of borrowing on our credit facility.

***Other Income, Net***

Other income, net primarily includes interest income and the gains related to an equity investment. Other income, net was \$0.6 million and \$0.8 million for the three-month periods ended June 30, 2013 and 2012, and \$1.4 million and \$1.3 million for the six-month periods ended June 30, 2013 and 2012, respectively.

***Income Tax Expense***

Our effective income tax rate was 38.7% and 38.6%, respectively, for the three- and six-month periods ended June 30, 2013 compared to 37.8% and 37.5%, respectively, in the comparable periods of 2012. Our effective income tax rate in the three- and six-month period ended June 30, 2013 benefitted from the recognition of a non-core tax attribute as well as tax benefits associated with the American Taxpayer Relief Act of 2012 enacted at the beginning of 2013. For the full year of 2013, we anticipate our income tax rate will be approximately 39.0%.

**Non-GAAP Reconciliations**

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

The following tables reconcile certain reported non-GAAP measures to the most comparable GAAP measures from our Consolidated Statements of Operations (dollars in thousands, except per share amounts):

**Three Months Ended June 30, 2013**

|   | <b>As reported</b> | <b>Legal accrual adjustments</b> | <b>Tax attribute</b> | <b>Adjusted</b> |
|---|--------------------|----------------------------------|----------------------|-----------------|
| Selling, general and administrative                   | \$ 109,283         | \$ (3,813 )                      | \$ -                 | \$ 105,470      |
| Operating income                                      | \$ 45,651          | \$ 3,813                         | \$ -                 | \$ 49,464       |
| Income from continuing operations before income taxes | \$ 41,258          | \$ 3,813                         | \$ -                 | \$ 45,071       |
| Income tax provision                                  | (15,977 )          | (1,484 )                         | (228 )               | (17,689 )       |
| Income from continuing operations, net of income tax  | \$ 25,281          | \$ 2,329                         | \$ (228 )            | \$ 27,382       |
| Diluted income per share from continuing operations   | \$ 0.97            | \$ 0.09                          | \$ (0.01 )           | \$ 1.05         |
| Diluted share count                                   | 26,134             |                                  |                      |                 |

**Six Months Ended June 30, 2013**

|   | <b>As reported</b> | <b>Legal accrual adjustments</b> | <b>Tax attribute</b> | <b>Adjusted</b> |
|---|--------------------|----------------------------------|----------------------|-----------------|
| Selling, general and administrative                   | \$ 210,414         | \$ (3,813 )                      | \$ -                 | \$ 206,601      |
| Operating income                                      | \$ 86,237          | \$ 3,813                         | \$ -                 | \$ 90,050       |
| Income from continuing operations before income taxes | \$ 76,835          | \$ 3,813                         | \$ -                 | \$ 80,648       |
| Income tax provision                                  | (29,672 )          | (1,484 )                         | (228 )               | (31,384 )       |
| Income from continuing operations, net of income tax  | \$ 47,163          | \$ 2,329                         | \$ (228 )            | \$ 49,264       |
| Diluted income per share from continuing operations   | \$ 1.81            | \$ 0.09                          | \$ (0.01 )           | \$ 1.89         |
| Diluted share count                                   | 26,120             |                                  |                      |                 |



**Three Months Ended June 30,  
2012**

|  | <b>As<br/>reported</b> | <b>Tax<br/>attribute</b> | <b>Adjusted</b> |
|--|------------------------|--------------------------|-----------------|
| Income from continuing operations before income taxes        | \$32,143               | \$ -                     | \$32,143        |
| Income tax expense   | (12,138)               | (573 )                   | (12,711 )       |
| Net income from continuing operations                        | \$20,005               | \$ (573 )                | \$19,432        |
| Diluted earnings (loss) per share from continuing operations | \$0.76                 | \$ (0.02 )               | \$0.74          |
| Diluted share count  | 26,185                 |                          |                 |

**Six Months Ended June 30, 2012**

|   | <b>As<br/>reported</b> | <b>Asset<br/>impairment<br/>and<br/>disposal<br/>gain</b> | <b>Equity<br/>investment</b> | <b>Tax<br/>attribute</b> | <b>Adjusted</b> |
|---|------------------------|---|------------------------------|--------------------------|-----------------|
| Asset impairments                                     | \$115                  | \$ (115 )   | \$ -                         | \$ -                     | \$-             |
| Selling, general and administrative                   | \$181,429              | \$ 739  | \$ -                         | \$ -                     | \$182,168       |
| Operating income                                      | \$68,550               | \$ (624 )   | \$ -                         | \$ -                     | \$67,926        |
| Other income, net                                     | \$1,317                | \$ -  | \$ (244 )                    | \$ -                     | \$1,073         |
| Income from continuing operations before income taxes | \$58,654               | \$ (624 )   | \$ (244 )                    | \$ -                     | \$57,786        |
| Income tax provision                                  | (22,015 )              | 244   | 95                           | (1,066 )                 | (22,742 )       |
| Income from continuing operations, net of income tax  | \$36,639               | \$ (380 )   | \$ (149 )                    | \$ (1,066 )              | \$35,044        |
| Diluted income per share from continuing operations   | \$1.39                 | \$ (0.01 )  | \$ (0.01 )                   | \$ (0.04 )               | \$1.33          |
| Diluted share count                                   | 26,331                 |   |                              |                          |                 |

**Liquidity and Capital Resources**

We manage our liquidity and capital resources to fund future capital expenditures, working capital requirements and contractual obligations. Additionally, we use capital resources to fund cash dividend payments, share repurchases and acquisitions.

**Available Sources**

We have relied primarily on cash flows from operations, borrowings under our credit agreements, financing of real estate and the proceeds from equity and debt offerings to finance operations and expansion. Based on these factors and

our normal operational cash flow, we believe we have sufficient availability to accommodate both our short- and long-term capital needs.

Below is a summary and discussion of our available funds (in thousands):

|   | <b>As of<br/>June 30,<br/>2013</b> | <b>As of<br/>December<br/>31,<br/>2012</b> | <b>Decrease</b> | <b>%<br/>Decrease</b> |
|---|------------------------------------|--|-----------------|-----------------------|
| Cash and cash equivalents               | \$20,257                           | \$42,839                                   | \$(22,582 )     | (52.7 )%              |
| Available credit on the credit facility | 90,983                             | 120,536                                    | (29,553 )       | (24.5 )               |
| Total available funds                   | \$111,240                          | \$163,375                                  | \$(52,135 )     | (31.9 )%              |

Historically, we have raised capital through the sale of assets, sale of stores, issuance of stock and the issuance of debt. We may strategically use excess cash to reduce the amount of debt outstanding when appropriate. During the first six months of 2013, we retired \$25.8 million of outstanding mortgage debt.

We have the ability to raise funds through the financing of owned operating real estate. As of June 30, 2013, our unfinanced owned operating real estate had a book value of \$163.7 million. Assuming we can obtain financing on 75% of this value, we estimate we could have obtained additional funds of approximately \$122.8 million at June 30, 2013; however, no assurances can be provided that the appraised value of this property will match or exceed its book value or that this capital source will be available on terms acceptable to us.

We have an effective shelf registration statement with the SEC that allows us to offer for sale, from time to time and as the capital markets permit, up to \$100 million in various forms of debt or equity securities. We have no immediate plans to access such funds, and no assurances can be provided that this capital source will be available on terms acceptable to us.

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

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

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

|  | <b>Outstanding<br/>as of June<br/>30, 2013</b> | <b>Remaining<br/>Available<br/>as of June<br/>30, 2013</b> |         |
|--|--|--|---------|
| New vehicle floor plan commitment                | \$ 570,025                                     | \$ -   | (1),(4) |
| Floor plan notes payable                         | 16,912   | -  | (4)     |
| Used vehicle inventory financing facility        | 80,000   | -  | (3)     |
| Revolving line of credit                         | 50,036   | 90,983   | (2),(3) |
| Real estate mortgages                            | 168,236  | -  |         |
| Other debt                                       | 2,752  | -  |         |
| Liabilities associated with assets held for sale | 6,378  | -  | (4)     |
| Total debt                                       | \$ 894,339                                     | \$ 90,983  |         |

(1) We have a \$575 million new vehicle floor plan commitment as part of our credit facility.

(2) Available credit is based on the borrowing base amount effective as of June 30, 2013. This amount is reduced by \$4.0 million for outstanding letters of credit.

(3) The amount available on the credit facility is limited based on a borrowing base calculation and fluctuates monthly. As of June 30, 2013, an additional \$5.0 million of floor plan notes payable outstanding on our new vehicle floor

(4) plan commitment and \$1.4 million of floor plan notes payable on vehicles designated as service loaners were recorded as liabilities related to assets held for sale.

### ***Credit Facility***

We have an \$800 million credit facility with a syndicate of 10 financial institutions, including four manufacturer-affiliated finance companies. This financing commitment is comprised of \$575 million in new vehicle inventory floor plan financing, \$80 million in used vehicle inventory financing and \$145 million on a revolving line of credit for general corporate purposes, including acquisitions and working capital. All borrowings from, and repayments to, our syndicated lending group are presented in the Consolidated Statements of Cash Flows as financing activities.

The new vehicle floor plan financing commitment is collateralized by our new vehicle inventory. Our used vehicle inventory financing facility is collateralized by our used vehicle inventory that is less than 180 days old. Our revolving line of credit is secured by our outstanding receivables related to vehicle sales, other eligible receivables, parts and accessories and equipment. If the outstanding principal balance on our new vehicle inventory floor plan facility, plus requests on any day, exceeds 95% of the loan commitment, a portion of the revolving loan commitment must be reserved. The reserve amount is equal to the lesser of \$15.0 million or the maximum revolving loan commitment less the outstanding balance on the loan less outstanding letters of credit. The reserve amount will decrease the revolving loan availability and may be used to repay the new vehicle floor plan balance.

The interest rate on the credit facility varies based on the type of debt and the calculated leverage ratio, with the rate ranging from the one-month LIBOR plus 1.5% to the one-month LIBOR plus 2.5%. The annual interest rate associated with our new vehicle floor plan commitment, excluding the effects of our interest rate swaps, was 1.7% at June 30, 2013. The annual interest rate associated with our used vehicle inventory financing facility and our revolving line of credit was 1.95% at June 30, 2013.

Our financial covenants related to this credit facility include maintaining a current ratio of not less than 1.20x, a fixed charge coverage ratio of not less than 1.20x, a leverage ratio of not more than 5.0x and funded debt of not more than \$375 million.

### ***Floor Plan Notes Payable***

We have floor plan agreements with manufacturer-affiliated finance companies for vehicles that are designated for use as service loaners. The interest rates on the floor plan notes payable commitments vary by manufacturer and are variable rates. Borrowings from, and repayments to, manufacturer-affiliated finance companies are classified as operating activities on the Consolidated Statements of Cash Flows.

### ***Real Estate Mortgages and Other Debt***



We have mortgages associated with our owned real estate. Interest rates related to this debt ranged from 1.8% to 4.4% at June 30, 2013. The mortgages are payable in various installments through May 2031. As of June 30, 2013, we had fixed interest rates on 79% of our outstanding mortgages.

Our other debt includes various notes, capital leases and obligations assumed as a result of acquisitions and other agreements and had interest rates that ranged from 2.0% to 9.0% at June 30, 2013. This debt, which totaled \$2.8 million at June 30, 2013, is due in various installments through May 2019.

***Debt Covenants***

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

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

| <b>Debt Covenant Ratio</b>  | <b>Requirement</b>          | <b>As of June 30, 2013</b> |
|-----------------------------|-----------------------------|----------------------------|
| Current ratio               | Not less than 1.20 to 1     | 1.43 to 1                  |
| Fixed charge coverage ratio | Not less than 1.20 to 1     | 3.23 to 1                  |
| Leverage ratio              | Not more than 5.00 to 1     | 1.83 to 1                  |
| Funded debt restriction     | Not to exceed \$375 million | \$171.0 million            |

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

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

### ***Inventories***

We calculate days supply of inventory based on current inventory levels, excluding in-transit vehicles, and a 30-day historical cost of sales level. As of June 30, 2013, our new vehicle days supply was 76, or two days higher than our days supply as of June 30, 2012. The increase in our current new vehicle inventory levels is partly related to increasing the inventory of certain truck models prior to manufacturer-planned platform changes, when production is halted and additional vehicles are not available for several months. Our days supply of used vehicles was 51 days as of June 30, 2013, or one day lower than our days supply level as of June 30, 2012. We have continued to focus on managing our mix and maintaining an appropriate level of used vehicle inventory.

### ***Capital Expenditures***

Capital expenditures were \$22.1 million and \$22.7 million for the six months ended June 30, 2013 and 2012, respectively. We anticipate approximately \$55 million in capital expenditures for 2013. This amount is associated with image improvements, purchases of store facilities, purchases of previously leased facilities and replacement of equipment.

Many manufacturers provide assistance in the form of additional vehicle incentives if facilities meet image standards and requirements. We believe it is an attractive time to invest in facility upgrades and remodels that will generate additional manufacturer incentive payments. Also, tax laws allowing accelerated deductions for capital expenditures reduce the overall investment needed and encourage accelerated project timelines.

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

### *Dividends*

Management evaluates performance and makes a recommendation to the Board of Directors on dividend payments on a quarterly basis. A dividend payment was paid in December 2012 in lieu of the dividend typically declared and paid in March of the following year. Accordingly, we did not pay dividends on our Class A and Class B common stock during the first quarter of 2013. In the second quarter of 2013, we paid dividends on our Class A and Class B common stock of \$3.4 million.

Our Board of Directors approved a dividend of \$0.13 per share on our Class A and Class B common stock related to our second quarter 2013 financial results. The dividend will total approximately \$3.4 million and will be paid on August 23, 2013 to shareholders of record on August 9, 2013.

### ***Common Stock Repurchases***

In August 2011, our Board of Directors authorized the repurchase of up to 2,000,000 shares of our Class A common stock. On July 20, 2012, our Board of Directors authorized the repurchase of 1,000,000 additional shares of our Class A common stock. We did not repurchase any shares of our Class A common stock during the second quarter of 2013. In the six months ended June 30, 2013, we repurchased 127,900 shares at an average price of \$40.76 per share, for a total of \$5.2 million. Through June 30, 2013, we have repurchased 1,273,047 shares and 1,726,953 shares remained available for repurchase. This authority to repurchase shares does not have an expiration date and we may continue to repurchase shares from time to time as conditions warrant.

In addition, 59,721 shares were repurchased during the first quarter of 2013 at an average price of \$45.04, for a total of \$2.7 million, related to the payment of taxes associated with the exercise of stock options or the vesting of restricted stock units.

### ***Critical Accounting Policies and Use of Estimates***

There have been no material changes in our critical accounting policies and use of estimates as described in our 2012 Annual Report on Form 10-K as filed with the Securities and Exchange Commission on February 22, 2013.

### ***Seasonality and Quarterly Fluctuations***

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

### ***Off-Balance Sheet Arrangements***

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

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes in our reported market risks or risk management policies since the filing of our 2012 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 22, 2013.

**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**

Except as disclosed in Note 5 of the Condensed Notes to Consolidated Financial Statements in this Quarterly Report on Form 10-Q, there have been no new proceedings or material changes to proceedings previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012. The information in this Form 10-Q should be read in conjunction with the legal proceedings disclosed in that report, which was filed with the Securities and Exchange Commission on February 22, 2013.

**Item 1A. Risk Factors**

Except for the risk factor set forth below, there have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012. The information below 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, 2012, which was filed with the Securities and Exchange Commission on February 22, 2013.

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

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

- motor vehicle and retail installment sales practices;
- leasing;
- sales of finance, insurance and vehicle protection products;
- consumer credit;

deceptive trade practices;  
consumer protection;  
consumer privacy;  
money laundering;  
advertising;  
land use and zoning;  
    health and safety;  
    and  
employment practices.

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

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

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

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

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

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



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

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

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

## **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 (incorporated by reference to exhibit 3.1 to our Form 10-K for the year ended December 31, 1999).
- 3.2 Amended and Restated Bylaws of Lithia Motors, Inc. (Corrected) (incorporated by reference to exhibit 3.2 to our Form 10-K for the year ended December 31, 2008).
- 10.1\* 2013 Amended and Restated Stock Incentive Plan (incorporated by reference to Exhibit 10.1 to Form 8-K dated April 26, 2013 and filed with the Securities and Exchange Commission on May 2, 2013).
- 10.2\* 2013 Discretionary Support Services Variable Performance Compensation Plan (incorporated by reference to Exhibit 10.1 to Form 8-K dated April 26, 2013 and filed with the Securities and Exchange Commission on May 2, 2013).
- 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.

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- 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.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

\*Indicates a management contract, compensatory plan or arrangement.

**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: July 26, 2013 LITHIA MOTORS, INC.

By: /s/ Christopher S. Holzshu  
Christopher S. Holzshu  
Senior Vice President,  
Chief Financial Officer and Secretary  
(Principal Financial Officer)

By: /s/ John F. North III  
John F. North III  
Vice President and  
Corporate Controller  
(Principal Accounting Officer)