

LITHIA MOTORS INC

FORM 10-K (Annual Report)

Filed 02/28/17 for the Period Ending 12/31/16

Address	150 NORTH BARTLETT STREET MEDFORD, OR 97501
Telephone	541-776-6401
CIK	0001023128
Symbol	LAD
SIC Code	5500 - Retail-Auto Dealers & Gasoline Stations
Industry	Auto Vehicles, Parts & Service Retailers
Sector	Consumer Cyclical
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-K

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

For the Fiscal Year Ended: December 31, 2016

OR

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

Commission File Number: 001 - 14733

LITHIA MOTORS, INC.
(Exact name of registrant as specified in its charter)

Oregon
(State or other jurisdiction of incorporation or organization)

93-0572810
(I.R.S. Employer Identification No.)

150 N. Bartlett Street, Medford, Oregon
(Address of principal executive offices)

97501
(Zip Code)

541-776-6401
(Registrant's telephone number including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Class A common stock, without par value

Name of each exchange on which registered
New York Stock Exchange

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

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately \$1,664,198 computed by reference to the last sales price (\$71.07) as reported by the New York Stock Exchange for the Registrant's Class A common stock, as of the last business day of the Registrant's most recently completed second fiscal quarter (June 30, 2016).

The number of shares outstanding of the Registrant's common stock as of February 28, 2017 was: Class A: 23,911,176 shares and Class B: 1,262,231 shares.

Documents Incorporated by Reference

The Registrant has incorporated into Part III of Form 10-K, by reference, portions of its Proxy Statement for its 2017 Annual Meeting of Shareholders.

LITHIA MOTORS, INC.
2016 FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS

	<u>Page</u>
PART I	
Item 1. Business	2
Item 1A. Risk Factors	11
Item 1B. Unresolved Staff Comments	25
Item 2. Properties	25
Item 3. Legal Proceedings	25
Item 4. Mine Safety Disclosure	27
PART II	
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	28
Item 6. Selected Financial Data	31
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	33
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	67
Item 8. Financial Statements and Supplementary Data	67
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	67
Item 9A. Controls and Procedures	67
Item 9B. Other Information	68
PART III	
Item 10. Directors, Executive Officers and Corporate Governance	69
Item 11. Executive Compensation	69
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	69
Item 13. Certain Relationships and Related Transactions, and Director Independence	69
Item 14. Principal Accountant Fees and Services	69
PART IV	
Item 15. Exhibits and Financial Statement Schedules	70
Signatures	73

PART I

Item 1. Business

Forward-Looking Statements

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

- Future market conditions;
- Expected operating results, such as improved store performance; maintaining incremental throughput between 45% and 50%; continued improvement of selling, general and administrative (“SG&A”) expenses as a percentage of gross profit and all projections;
- Anticipated integration, success and growth of acquired stores;
- Anticipated ability to capture additional market share;
- Anticipated ability to find accretive acquisitions;
- Expected revenues from acquired stores;
- Anticipated additions of dealership locations to our portfolio in the future;
- Anticipated availability of liquidity from our unfinanced operating real estate;
- Anticipated levels of capital expenditures in the future; and
- Our strategies for customer retention, growth, market position, financial results and risk management.

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

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

Overview

We are a leading operator of automotive franchises and a retailer of new and used vehicles and related services. As of February 28, 2017, we offered 30 brands of new vehicles and all brands of used vehicles in 154 stores in the United States and online at Lithia.com, DCHauto.com and CarboneCars.com. We sell new and used cars and replacement parts; provide vehicle maintenance, warranty, paint and repair services; arrange related financing; and sell vehicle service contracts, vehicle protection products and credit insurance.

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

The following table sets forth information about stores that were part of our continuing operations as of December 31, 2016:

State	Number of Stores	Percent of 2016 Revenue
California	35	22.5%
Oregon	25	16.7
New Jersey	11	14.0
Texas	16	13.1
Montana	11	6.1
Washington	8	5.3
Alaska	9	4.8
New York	10	4.2
Nevada	4	3.0
Idaho	4	2.7
Iowa	7	2.6
Hawaii	5	2.0
North Dakota	3	1.3
New Mexico	2	0.8
Massachusetts	1	0.5
Vermont	2	0.3
Wyoming	1	0.1
Total	154	100.0%

Business Strategy and Operations

Our mission statement is: “Driven by our employees and preferred by our customers, Lithia is the leading automotive retailer in each of our markets.” We offer customers convenient personalized service combined with the large company advantages of selection, competitive pricing and broad access to financing and warranties. We strive for diversification in our products, services, brands and geographic locations to manage 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 performance management strategy, standardized information systems and centrally and regionally-performed administrative functions, we seek to gain economies of scale from our dealership network.

We offer a variety of luxury, import and domestic new vehicle brands and models, reducing our dependence on any one manufacturer and our susceptibility to changing consumer preferences. Encompassing economy and luxury cars, sport utility vehicles (SUVs), crossovers, minivans and trucks, we believe our brand mix is well-suited to what customers demand in the markets we serve. Our new vehicle unit mix of 55% import, 33% domestic and 12% luxury compares to the national market mix of 47%, 45% and 8%, respectively, for the year ended December 31, 2016.

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

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

During 2016, we focused on achieving our mission through acquisitions and organic growth within our existing stores.

During 2016, we purchased 15 stores, one franchise and opened one new store. We invested \$140.2 million, net of floor plan debt, to acquire these stores and we expect these acquisitions to add over \$1.1 billion in annual revenues. Additionally, these acquisitions allow us to maintain an appropriate franchise mix and leverage our cost structure. We focus on successfully integrating acquired stores to achieve targeted returns.

We also organically grew our existing stores in 2016 by:

- increasing revenues in all core business lines;
- capturing a greater percentage of overall new vehicle sales in our local markets;
- capitalizing on a used vehicle market that is approximately three times larger than the new vehicle market by increasing sales of manufacturer certified pre-owned used vehicles; late model, lower-mileage vehicles; and value autos, which are older, higher mileage vehicles; and
- growing our service, body and parts revenues as units in operation increase.

We target SG&A as a percentage of gross profit in the upper 60% range and monitor how efficiently we leverage our cost structure by evaluating throughput. Throughput is calculated as the percentage of incremental gross profit dollars we retain after deducting increases in SG&A expense. For the years ended December 31, 2016 and 2015, our incremental throughput was 29.7% and 29.6%, respectively. Adjusting for non-core items, our adjusted throughput in 2016 and 2015 was 22.1% and 31.5%, respectively. See “Non-GAAP Reconciliations” for additional information.

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

As noted above, we acquired 15 stores and one franchise and opened one new store in 2016; we acquired six stores and one franchise, and opened one new store in 2015. Adjusting to exclude these locations and other non-core adjustments, our throughput contribution on a same store basis was 24% and 48% for the years ended December 31, 2016 and 2015, respectively. Increasing advertising spend and insurance cost, which outpaced gross profit growth, were the primary reasons we underperformed our throughput target. We continue to target a same store throughput contribution of 45% to 50% in 2017.

We evaluate how to allocate capital, including returning cash to our investors and investing in our stores. During 2016, we paid \$24.1 million in dividends and spent \$112.9 million to repurchase 1.4 million shares, or approximately 6% of total outstanding shares. We also invested in our store operations, making \$100.8 million in capital expenditures. We continue to manage our liquidity and available cash to prepare for future acquisition opportunities. As of December 31, 2016, we had \$188.4 million in available funds in cash and availability on our credit facilities, with an estimated additional \$168 million available if we financed our unencumbered owned real estate.

New Vehicles

In 2016, we sold 145,772 new vehicles, generating 22.2% of our gross profit for the year. New vehicle sales have the potential to create incremental future profit opportunities through certain manufacturer incentive programs, resale of used vehicles acquired through trade-in, arranging of third-party financing, vehicle service and insurance contracts, and future service and repair work.

In 2016, we represented 30 domestic and import brands ranging from economy to luxury cars, SUVs, crossovers, minivans and light trucks.

Manufacturer	Percent of 2016 New Vehicle Revenue	Percent of 2016 New Vehicle Gross Profit
Chrysler, Jeep, Dodge, Ram, Alfa Romeo	20.3%	20.8%
Honda, Acura	17.0	17.0
Toyota	15.8	15.8
Chevrolet, Cadillac, GMC, Buick	11.8	11.5
BMW, MINI	8.6	8.9
Ford, Lincoln	6.7	6.3
Subaru	5.2	4.8
Volkswagen, Audi	3.8	3.6
Nissan	3.0	3.2
Mercedes, Smart	2.6	2.6
Hyundai	2.0	2.5
Lexus	1.3	1.2
Kia	1.1	1.1
Mazda	0.3	0.2
Porsche	0.2	0.2
Fiat	0.2	0.2
Volvo	0.1	0.1
Mitsubishi	—	—*
Total	100.0%	100.0%

* Less than 0.1%

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

Used Vehicles

At each new vehicle store, we also sell used vehicles. In 2016, we sold 113,498 retail used vehicles, which generated 20.3% of our gross profit.

Our used vehicle operations give us an opportunity to:

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

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

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

Our near-term goal for used vehicles is to retail an average of 75 units per store per month. As of December 31, 2016, our stores sold an annualized average of 66 retail used units per month. We believe used vehicle sales represent a significant area for organic growth. As new vehicle sales growth rates return to average historical levels and we continue our focus on growing used retail sales, we believe our target is achievable.

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

Vehicle Financing, Service Contracts and Other Products

As part of the vehicle sales process, we assist in arranging customer vehicle financing options as well as offering extended warranties, insurance contracts and vehicle and theft protection products. The sale of these items generated 25.4% of our gross profit in 2016.

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

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

We arranged vehicle financing on 76.0% of the vehicles we sold during 2016. Our presence in multiple markets and changes in technology surrounding the credit application process have allowed us to utilize a larger network of lenders across a broader geographic area. Additionally, we continue to see the availability of consumer credit expand with lenders increasing the loan-to-value amount available to most customers. These shifts afford us the opportunity to sell additional or more comprehensive products, while remaining within a loan-to-value framework acceptable to our lenders.

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

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

We offer a lifetime lube, oil and filter (“LOF”) service, which, in 2016, was purchased by 26.0% of our total new and used vehicle buyers. This service, where customers prepay for their LOF services, helps us retain customers by building customer loyalty and provides opportunities for selling additional routine maintenance items and generating repeat service business. In 2016, we sold an average of \$62 of additional maintenance on each lifetime oil service we performed.

Service, Body and Parts

In 2016, our service, body and parts operations generated 31.5% of our gross profit. Our service, body and parts operations are an integral part of establishing customer loyalty and contribute significantly to our overall revenue and profits. We provide parts and service for the new vehicle brands sold by our stores, as well as service and repair most other makes and models.

The service and parts business provides important repeat revenues to our stores, which we seek to grow organically. Customer pay revenues represent sales for vehicle maintenance, service performed on vehicles that have fallen outside the manufacturer warranty period, repairs not covered by a manufacturer warranty, or maintenance and service on other makes and models. We believe increasing our product and service offerings for customers differentiates us from independent repair shops and dealerships with less scale. Our service and parts revenues benefit from the increases we have seen in new vehicle sales over the last few years as there are a greater number of late model vehicles in operation, which tend to visit franchised dealership locations more frequently than older vehicles due to the manufacturer warranty period. Additionally, certain franchises provide routine maintenance, such as oil changes, for two to four years after a vehicle is sold, which provides for future warranty work.

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

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

We believe body shops provide an attractive opportunity to grow our business, and we continue to evaluate potential locations to expand. We currently operate 22 collision repair centers: five in each Oregon and Texas; two each in Idaho, New York and Washington; and one each in Alaska, Iowa, Montana, Nevada, Vermont and Wyoming.

Segments

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

Marketing

We believe that stores with strong local identities and customer loyalty are critical to our success. We want our customers' experiences to be so satisfying that we earn their business for life. In conjunction with our manufacturer partners, we utilize an owner marketing strategy consisting of database analysis, email, traditional mail and phone contact to anticipate, listen and respond to customer needs.

To increase awareness and traffic at our stores, we use a combination of traditional, digital and social media to reach potential customers. Total advertising expense, net of manufacturer credits, was \$81.4 million in 2016, \$69.9 million in 2015 and \$46.7 million in 2014. In 2016, approximately 32% of those funds were spent in traditional media and 68% were spent in digital and owner communications and other media outlets. In all of our communications, we seek to convey the promise of a positive customer experience, competitive pricing and wide selection.

Certain advertising and marketing expenditures are offset by manufacturer cooperative programs which require us to submit requests for reimbursement to manufacturers for qualifying advertising expenditures. These advertising credits are not tied to specific vehicles and are earned as qualifying expenses are incurred. These reimbursements are recognized as a reduction of advertising expense. Manufacturer cooperative advertising credits were \$20.3 million in 2016, \$19.8 million in 2015 and \$16.3 million in 2014.

Many people now shop online before visiting our stores. We maintain websites for all of our stores and corporate sites (Lithia.com, DCHAuto.com and CarboneCars.com), to generate customer leads for our stores. We also support a corporate site (LithiaMotors.com) which provides our communities, investors, employees and recruits additional information about our company.

Our websites enable our customers to:

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

Mobile traffic now accounts for over 50% of our web traffic and all of our sites utilize responsive technology to enhance the mobile and tablet experience. We are working with our stores and manufacturer partners to develop additional tools that enable customers to complete as much of the vehicle buying process online before arriving at our stores: saving them time, improving their experience and increasing our productivity.

We post our inventory on major new and used vehicle listing services (cars.com, autotrader.com, kbb.com, edmunds.com, craigslist, and hundreds of local webpages) to reach online shoppers. We also employ search engine optimization, search engine marketing, online display and re-targeting as well as video pre-roll to reach more online prospects. We also encourage our stores to dedicate a larger share of their advertising spend to promoting service and repair work as we focus on customer acquisition and the value of customer retention.

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

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

Franchise Agreements

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

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

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

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

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

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

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

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

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

Competition

The retail automotive business is highly competitive. Currently, there are approximately 16,700 dealers in the United States, many of whom are independent stores managed by individuals, families or small retail groups. We compete primarily with other automotive retailers, both publicly- and privately-held.

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

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

Regulation

Automotive and Other Laws and Regulations

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

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

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

Environmental, Health, and Safety Laws and Regulations

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

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

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

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

Employees

As of December 31, 2016, we employed approximately 11,170 persons on a full-time equivalent basis.

Seasonality and Quarterly Fluctuations

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

Available Information and NYSE Compliance

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

Item 1A. Risk Factors

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

Risks related to our business

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

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

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

Our performance is subject to local economic, competitive and other conditions prevailing in our various geographic areas. Our dealerships are currently located in limited markets in 17 states, with sales in the top three states accounting for approximately 53% of our revenue in 2016. Our results of operations, therefore, depend substantially on general economic conditions, consumer spending levels and other factors in those markets and could be materially adversely affected to the extent these markets experience sustained economic downturns regardless of improvements in the U.S. economy overall.

Natural disasters and adverse weather conditions can disrupt our business.

Our dealerships are in states and regions in the U.S. in which actual or threatened natural disasters and severe weather events (such as hurricanes, earthquakes, fires, floods, landslides, wind and/or hail storms) or other extraordinary events have in the past, and may in the future, disrupt our dealership operations. A disruption in our operations may adversely impact our business, results of operations, financial condition and cash flows. In addition to business interruption, the automotive retailing business is subject to substantial risk of property loss due to the significant concentration of property at dealership locations.

The automotive manufacturing supply chain spans the globe. As such, supply chain disruptions resulting from natural disasters and adverse weather events may affect the flow of inventory or parts to us or our manufacturing partners. Such disruptions could have a material adverse effect on our business, financial condition, results of operations, or cash flows.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In late 2015, Volkswagen and related entities admitted utilizing software in certain diesel engine vehicles to detect when they were being emissions tested and to temporarily change performance to improve results. According to Automotive News, as of February 1, 2017, Volkswagen has agreed to spend up to \$25 billion to settle claims associated with emissions and excess pollution with owners, dealers, environmental regulators and U.S. states. Bosch, one of the largest suppliers of car parts, has agreed to pay claims up to \$163 million associated with similar claims and faces additional investigation on parts supplied to Fiat Chrysler vehicles.

The current and future impact on Volkswagen's operations, consumer reputation and future vehicle demand is unclear, as is the effect on our business for the Volkswagen, Audi and Porsche brands. Lithia currently operates six Volkswagen, four Audi and one Porsche stores, and approximately 3% of 2016 and 2015 new vehicle unit sales were within these brands. Changes in demand for Volkswagen, Audi and Porsche vehicles could significantly affect our business from those brands. Certain of the Company's related entities that operate its Volkswagen, Audi and Porsche stores have been named as defendants or otherwise served in certain putative class actions filed by automobile owners against dealerships selling these brands. The Company has tendered defense of these cases to the manufacturers, and the manufacturers have honored their contractual defense and indemnity obligations to date.

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

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

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

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

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

Vehicle manufacturers would be adversely affected by economic downturns or recessions, adverse fluctuations in currency exchange rates, significant declines in the sales of their new vehicles, increases in interest rates, declines in their credit ratings, port closures, labor strikes or similar disruptions (including within their major suppliers), supply shortages or rising raw material costs, rising employee benefit costs, adverse publicity that may reduce consumer demand for their products, product defects, vehicle recall campaigns, litigation, poor product mix or unappealing vehicle design, or other adverse events. These and other risks could materially adversely affect any manufacturer and limit its ability to profitably design, market, produce or distribute new vehicles, which, in turn, could materially adversely affect our business, results of operations, financial condition and cash flows.

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

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

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

- customer rebates;
- dealer incentives on new vehicles;
- special financing rates on certified, pre-owned cars; and
- below-market financing on new vehicles and special leasing terms.

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

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

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

Each of our stores operates pursuant to a Franchise Agreement with each of the respective manufacturers for which it serves as franchisee. Each of our stores may obtain new vehicles from manufacturers, service vehicles, sell new vehicles, and display vehicle manufacturers' brand only to the extent permitted under these agreements. As a result of the terms of our Franchise Agreements, manufacturers exert significant control over the day-to-day operations at our stores. Such agreements contain provisions for termination or non-renewal for a variety of causes, including service retention, facility compliance, customer satisfaction and sales and financial performance. From time to time, certain of our stores have failed to comply with certain provisions of their franchise agreements, and we cannot ensure that our stores will be able to comply with these provisions in the future.

Our Franchise Agreements expire at various times, and there can be no assurances that we will be able to renew these agreements on a timely basis or on acceptable terms or at all. Actions taken by a manufacturer to exploit its bargaining position in negotiating the terms of renewals of franchise agreements or otherwise could also have a material adverse effect on our revenues and profitability. If a manufacturer terminates or fails to renew one or more of our significant franchise agreements or a large number of our franchise agreements, such action could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

Our Franchise Agreements do not give us the exclusive right to a given geographic area. Manufacturers may be able to establish new franchises or relocate existing franchises, subject to applicable state franchise laws. The establishment of or relocation of franchises in our markets could have a material adverse effect on the business, financial condition and results of operations of our stores in the market in which the action is taken.

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

Certain of our Franchise Agreements prohibit transfers of ownership interests of a store or, in some cases, the ownership interests of the store's indirect parent companies, including the Company. Agreements with various manufacturers, including, among others, Honda/Acura, Hyundai, Mazda, Volkswagen, Mercedes-Benz, Subaru, Toyota, Ford/Lincoln, GM, and Nissan, provide that, under certain circumstances, we may lose a franchise and/or be forced to sell one or more stores or their assets if there occurs a prohibited transfer of ownership interests (in some cases not defined or defined ambiguously) or a person or entity acquires an ownership interest in us above a specified level (ranging from 20% to 50% depending on the particular manufacturer's restrictions and falling as low as 5% if another vehicle manufacturer or distributor is the entity acquiring the ownership interest) without the approval of the manufacturer. Transactions in our stock by our stockholders or prospective stockholders, including transactions in our Class B common stock, are generally outside of our control and may result in the termination or non-renewal of one or more of our franchises, may result in a forced sale of one or more of our stores or their assets at a price below fair market value or may impair our ability to negotiate new franchise agreements for dealerships we desire to acquire in the future, which may have a material adverse effect on our business, results of operations, financial condition and cash flows. These restrictions may also prevent or deter a prospective acquirer from acquiring control of us or otherwise adversely affect the market price of our Class A common stock or limit our ability to restructure our debt obligations.

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

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

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

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

Import product restrictions, currency valuations, and foreign trade risks may impair our ability to sell foreign vehicles or parts profitably.

A significant portion of the vehicles we sell are manufactured outside the U.S., and all of the vehicles we sell include parts manufactured outside the U.S. As a result, our operations are subject to customary risks of importing merchandise, including import duties, exchange rates, trade restrictions, work stoppages, transportation costs, natural or man-made disasters, and general political and socio-economic conditions in other countries. The U.S. or the countries from which our products are imported, may, from time to time, impose new quotas, duties, tariffs or other restrictions, or adjust presently prevailing quotas, duties or tariffs, which may affect our operations and our ability to purchase imported vehicles and/or parts at reasonable prices. Changes in U.S. trade policies, including the North American Free Trade Agreement or policies intended to penalize foreign manufacturing or imports, and policies of foreign countries in reaction to those changes could increase the prices we pay for some of the new vehicles and parts we sell. Any changes that increase the costs of vehicles and parts generally, to the extent passed on to customers, could negatively affect customer demand and our revenues and profitability. If not passed on to our customers, any cost increases will adversely affect our profitability. Any cost increase that disproportionately applies to manufacturers that sell to us could adversely affect our business compared to other automobile retailers. Fluctuations of the U.S. dollar against foreign currencies in the future may result in an increase in costs to us and in the retail price of such vehicles or parts, which could discourage consumers from purchasing such vehicles and adversely impact our profitability.

With the breadth of our operations and volume of consumer and financing transactions, compliance with the many applicable federal and state laws and regulations cannot be assured. New regulations are enacted on an ongoing basis. Claims may arise out of actual or alleged violations of these various laws and regulations which may be asserted against us through class actions or by governmental entities in civil or criminal investigations and proceedings. Fines, judgments and administrative sanctions can be severe.

We are subject to federal, state and local laws and regulations in the 17 states in which we operate. New laws and regulations are enacted on an ongoing basis. With the number of stores we operate, the number of personnel we employ and the large volume of transactions we handle, it is likely that technical mistakes will be made. These regulations affect our profitability and require ongoing training. Current practices in stores may become prohibited. We are responsible for ensuring that continued compliance with laws is maintained. If there are unauthorized activities, the state and federal authorities have the power to impose civil penalties and sanctions, suspend or withdraw dealer licenses or take other actions. These actions could materially impair our activities or our ability to acquire new stores in those states where violations occurred. Further, private causes of action on behalf of individuals or a class of individuals could result in significant damages or injunctive relief.

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

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

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

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

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

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

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

Our financing activities are subject to federal truth-in-lending, consumer leasing and equal credit opportunity laws and regulations, as well as state and local motor vehicle finance laws, installment finance laws, insurance laws, usury laws and other installment sales laws and regulations. Some states regulate finance, documentation and administrative fees that may be charged in connection with vehicle sales. Claims arising out of actual or alleged violations of law may be asserted against us or our dealerships by individuals or governmental entities and may expose us to significant damages or other penalties, including revocation or suspension of our licenses to conduct dealership operations and fines. In recent years, private plaintiffs and state attorneys general in the U.S. 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 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.

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

Our marketing and disclosure regarding the sale and servicing of vehicles is regulated by federal, state and local agencies including the Federal Trade Commission ("FTC") and state Attorneys General. For example, in January 2016, we settled FTC allegations that we did not adequately disclose information about used vehicles with open safety recalls. Under the settlement, we did not make any payments or admit wrong-doing, but we did agree to make specified disclosures on our website and to provide that disclosure to certain customers who had previously purchased a used vehicle from us.

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.

We are subject to tax liabilities imposed by the jurisdictions where we operate, which may vary significantly and are subject to change. Among others, these taxes include income taxes, property taxes, indirect taxes (excise/duty, sales/use and gross receipts taxes), payroll taxes, franchise taxes, withholding taxes and ad valorem taxes. These taxes may disproportionately affect us, compared to other businesses and our competitors. We may not be able to pass these taxes on to consumers in all cases and remain competitive.

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

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

In addition, our customers have an expectation that we will adequately protect their information from cyber-attack or other security breaches. A significant breach of customer, employee or other data could attract a substantial amount of media attention, damage our customer relationships and reputation and result in lost sales, fines, or lawsuits.

Our information technology systems, and those of our vendors, may be vulnerable to data protection breaches and cyber-attacks beyond our control and we may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. There are numerous opportunities for a data-security breach, including cyber-security breaches, burglary, lost or misplaced data, scams, misappropriation of data by employees, vendors or unaffiliated third parties, computer viruses, human errors, programming errors, vandalism, and other events. We invest in reasonable commercial security technology to protect our data and business processes against many of these risks. We also purchase insurance to mitigate the potential financial impact of many of these risks. Despite these precautions, we cannot assure that a breach will not occur and any breach or attack could have a negative impact on our operations or business reputation.

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

General

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

Manufacturers

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

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

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

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

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

Acquisition Risks

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

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

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

Consummation and Competition

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

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

Operating and Financial Condition

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

Limitations on Our Capital Resources

We make a substantial capital investment when we acquire dealerships. Limitations on our capital resources would restrict our ability to complete new acquisitions or could limit our operating or financial flexibility.

We finance acquisitions activity with cash flows from our operations, borrowings under our credit arrangements, proceeds from mortgage financing and the issuance of shares of Class A common stock. The size of our acquisition activity in recent years magnifies risks associated with debt service obligations. These risks include potential lower earnings per share, our inability to pay dividends and potential negative impacts to the debt covenants we negotiated under our credit agreement.

If we fail to meet the covenants in our credit facility, or if some other event occurs that results in a default or an acceleration of our repayment obligations under our credit agreements, we may not be able to refinance our debt on terms acceptable to us or at all. We may not be able to obtain financing in the future due to the market price of our Class A common stock and overall market conditions. Additionally, a substantial amount of assets of our dealerships are pledged to secure the indebtedness under our credit facility and our other floor plan financing indebtedness. These pledges may limit our ability to borrow from other sources in order to fund our acquisitions.

We are subject to substantial risk of loss under our various self-insurance programs including property and casualty, open lot vehicle coverage, workers' compensation and employee medical coverage. Our insurance does not fully cover all of our operational risks, and changes in the cost of insurance or the availability of insurance could materially increase our insurance costs or result in a decrease in our insurance coverage.

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

Under our self-insurance programs, we retain various levels of aggregate loss limits, per claim deductibles and claims-handling expenses. Costs in excess of these retained risks may be insured under various contracts with third-party insurance carriers. As of December 31, 2016, we had total reserve amounts associated with these programs of \$32.8 million.

The level of risk we retain may change in the future as insurance market conditions or other factors affecting the economics of our insurance purchasing change. The operation of automobile dealerships is subject to a broad variety of risks. In certain instances, our insurance may not fully cover an insured loss depending on the magnitude and nature of the claim. Accordingly, we cannot assure that we will not be exposed to uninsured or underinsured losses that could have a material adverse effect on our business, financial condition, results of operations or cash flows. Additionally, changes in the cost of insurance or the availability of insurance in the future could substantially increase our costs to maintain our current level of coverage or could cause us to reduce our insurance coverage and increase the portion of our risks that we self-insure.

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

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

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

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

We have granted in favor of certain of our lenders and other secured parties, including those under our \$2.05 billion revolving syndicated credit facility, a security interest in a substantial portion of our assets. If we default on our obligations under those agreements, the secured parties may be able to foreclose upon their security interests and otherwise be entitled to obtain or control those assets.

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

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

In addition, the lenders' obligations to make loans or other credit accommodations under certain credit agreements is subject to the satisfaction of certain conditions precedent including, for example, that our representations and warranties in the agreement are true and correct in all material respects as of the date of the proposed credit extension. If any of our representations and warranties in those agreements are not true and correct in all material respects as of the date of a proposed credit extension, or if other conditions precedent are not satisfied, we may not be able to request new loans or other credit accommodations under those credit facilities, which could have a material adverse impact on our business, results of operations, financial condition and cash flows.

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

As of December 31, 2016, approximately 88% of our total debt was variable rate. The majority of our variable rate debt is indexed to the one-month LIBOR rate. The current interest rate environment is at historically low levels, and interest rates will likely increase in the future. In the event interest rates increase, our borrowing costs may increase substantially. Additionally, fixed rate debt that matures may be renewed at interest rates significantly higher than current levels. As a result, this could have a material adverse impact on our business, results of operations, financial condition and cash flows.

We may not be able to satisfy our debt obligations upon the occurrence of a change in control or another event of default under our credit agreement.

Upon the occurrence of a change in control or another event of default as defined in our credit agreement, the agent under the credit agreement will have the right to declare all outstanding obligations immediately due and payable and to terminate the availability of future advances to us. There can be no assurance that we would have sufficient resources available to satisfy all of our obligations under the credit agreement in the event of a change in control or fundamental change. In the event we were unable to satisfy these obligations, it could have a material adverse impact on our business and our common stock holders. A "change in control" as defined in our credit agreement includes, among other events, the acquisition by any person, or two or more persons acting in concert, in either case other than Lithia Holdings Company, L.L.C., Sid DeBoer or Bryan DeBoer, of beneficial ownership (within the meaning of Rule 13d-3 of the SEC under the Securities Exchange Act of 1934) of 20% or more of the outstanding shares of our voting stock on a fully diluted basis.

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

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

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

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

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

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

Significant voting control is currently held by Sidney B. DeBoer, who may have interests different from our other shareholders. Further, 1.3 million shares of the approximately 1.3 million shares of our Class B common stock held by Lithia Holding Company, LLC (“Lithia Holding”) are pledged to secure indebtedness of Lithia Holding. The failure to repay the indebtedness could result in the sale of such shares and the loss of this significant voting control.

Sidney B. DeBoer, our Founder and Chairman of the Board, is the sole managing member of Lithia Holdings, which holds all of the outstanding shares of our Class B common stock. A holder of Class B common stock is entitled to ten votes for each share held, while a holder of Class A common stock is entitled to one vote per share held. On most matters, the Class A and Class B common stock vote together as a single class. As of February 28, 2017, Lithia Holding controlled, and Mr. DeBoer had the authority to vote, approximately 35% of the aggregate number of votes eligible to be cast by shareholders for the election of directors and most other shareholder actions. This amount of voting control may make certain changes in control or transactions more difficult. The interests of Mr. DeBoer may not always coincide with our interests as a company or the interests of other shareholders.

Lithia Holding has pledged 1.3 million shares of our Class B common stock to secure a loan from U.S. Bank National Association. If Lithia Holding is unable to repay the loan, the bank could foreclose on the Class B common stock, which would result in the automatic conversion of such shares to Class A common stock. The market price of our Class A common stock could decline if the bank foreclosed on the pledged stock and subsequently sold such stock in the open market.

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

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

Risks related to investing in our Class A common stock

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

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

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our stores and other facilities consist primarily of automobile showrooms, display lots, service facilities, collision repair and paint shops, supply facilities, automobile storage lots, parking lots and offices located in the states listed under the caption *Overview* in Item 1. We believe our facilities are currently adequate for our needs and are in good repair. Some of our facilities do not currently meet manufacturer image or size requirements and we are actively working to find a mutually acceptable outcome in terms of timing and overall cost. We own our corporate headquarters in Medford, Oregon, and numerous other properties used in our operations. Certain of our owned properties are mortgaged. As of December 31, 2016, we had outstanding mortgage debt of \$428.4 million. We also lease certain properties, providing future flexibility to relocate our retail stores as demographics, economics, traffic patterns or sales methods change. Most leases provide us the option to renew the lease for one or more lease extension periods. We also hold certain vacant facilities and undeveloped land for future expansion.

Item 3. Legal Proceedings

We are party to numerous legal proceedings arising in the normal course of our business. Although we do not anticipate that the resolution of legal proceedings arising in the normal course of business 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.

In Re Lithia Motors Derivative Litigation

On December 14, 2015, Shiva Y. Stein, a Lithia shareholder, filed derivative claims on behalf of Lithia against its Board of Directors (the “Board”), listing Lithia as a nominal defendant. The case, *Stein v. DeBoer, et al.*, Case No. 15CV33696, is pending in the Circuit Court of the State of Oregon for Marion County. Ms. Stein’s claims relate to the adoption of a transition agreement between Lithia and Sidney B. DeBoer, as disclosed in a Current Report on Form 8-K filed September 16, 2015. Ms. Stein alleges that Lithia’s directors breached their fiduciary duties of loyalty and due care, and wasted corporate assets, when they approved the agreement with Mr. DeBoer. Ms. Stein also alleges a claim against Sidney B. DeBoer, asserting that he has been unjustly enriched by the agreement. Ms. Stein is seeking relief in the amount of damages allegedly sustained by Lithia as a result of the alleged breaches of fiduciary duty and alleged corporate waste, disgorgement and imposition of a constructive trust on all property and profits Sidney B. DeBoer received as a result of the alleged wrongful conduct, and an award of the costs and disbursements of the lawsuit, including reasonable attorney fees, costs, and expenses. The Board and Mr. DeBoer filed Motions to Dismiss the Stein suit on February 26, 2016.

On February 12, 2016, Marty A. Jessos, a Lithia shareholder, also filed derivative claims on behalf of Lithia against the Board, listing Lithia as a nominal defendant. The case, *Jessos v. DeBoer, et al.*, Case No. 16CV04181, was filed in the Circuit Court of the State of Oregon for Multnomah County. The Jessos suit involves the same subject matter and alleges substantially the same facts, claims, and causes of action as the Stein suit. On March 22, 2016, the Jessos suit was transferred to Marion County Circuit Court. On April 4, 2016, the parties filed a Stipulation and [Proposed] Order of Consolidation in the Stein suit to consolidate both Stein and Jessos under the Stein suit, Case No. 15CV33696. On April 4, 2016, the Court signed the consolidation order. The case is now known as *In re Lithia Motors Derivative Litigation*, Case No. 15CV33696. Plaintiffs filed their consolidated complaint on April 15, 2016.

The Board and Mr. DeBoer filed Motions to Dismiss the consolidated complaint on May 10, 2016. The Court issued its ruling on the Motions on August 12, 2016. The Court determined that a majority of the Board was independent, but also that Plaintiffs alleged sufficient facts to withstand the Motions to Dismiss. For that reason, the Court denied the Board’s and Mr. DeBoer’s Motions. The Board and Mr. DeBoer filed their Answers to the consolidated complaint on October 10, 2016. The parties engaged in discovery, including depositions, and the Board and Mr. DeBoer filed Motions for Summary Judgment on December 29, 2016, which is pending. Although we do not anticipate that the resolution of this legal proceeding will have a material adverse effect on our business, results of operations, financial condition, or cash flows, we cannot predict this with certainty.

California Wage and Hour Litigations

In June 2012, Mr. Robles and Mr. Laredo brought claims against DCH Tustin Acura (*Robles v. Tustin Motors, Inc.*, Case No. 30-2012-00579414, filed in the Superior Court of California, Orange County) alleging that the employer underpaid technicians in light of California Wage Order provisions that require an employer to pay at least two times the minimum wage for each hour worked if the employee is required to bring his or her own tools. The complaint was amended in late 2013 to include allegations that the employer failed to pay technicians for non-productive time and/or time spent performing tasks not compensated by the flat-rate compensation system; off-the-clock time worked; and wages due at termination. The amended complaint also alleged that the employer failed to provide technicians accurate and complete wage statements; and statutory meal and rest periods. Plaintiffs are seeking relief on behalf of all employees at all DCH Auto Group dealerships in California. Plaintiffs also seek attorney fees and costs. These Plaintiffs (and several other former technicians in separate-but-partially-overlapping actions) also seek relief under California’s Private Attorney General Action (PAGA) provisions, which allow private plaintiffs to recover civil penalties on behalf of the State of California. DCH successfully compelled arbitration based on arbitration agreements between these claimants and the employer, although certain representative claims were excluded and stayed pending arbitration.

During the pendency of Robles, related cases were filed that made substantially similar technician claims including Holzer (see below). DCH and the Robles claimants settled their individual claims in mediation in 2015. In April 2016, DCH and all technician plaintiffs in Robles and the related cases agreed in principle to settle the representative claims, although this settlement has not yet been approved by the California courts as expressly contemplated by the parties and required by applicable law as a condition of the agreed release of claims. DCH Auto Group (USA) Limited must indemnify Lithia Motors, Inc. for losses related to this claim pursuant to the stock purchase agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014. As a result, we believe the exposure related to this lawsuit, when considered in relation to the terms of the stock purchase agreement, is immaterial to our financial statements.

In August 2014, Ms. Holzer filed a complaint in the Central District of California (*Holzer v. DCH Auto Group (USA) Inc.*, Case No. BC558869) alleging that her employer, an affiliate of DCH Auto Group (USA) Inc., failed to provide vehicle finance and sales persons, service advisors, and other clerical and hourly workers accurate and complete wage statements; and statutory meal and rest periods. The complaint also alleges that the employer failed to pay these employees for off-the-clock time worked; and wages due at termination. Plaintiffs also seek attorney fees and costs. DCH has sought to compel arbitration based on Plaintiffs' arbitration agreements. Plaintiffs (and several other employees in separate actions) are seeking relief under California's PAGA provisions.

During the pendency of Holzer, related cases were filed that made substantially similar non-technician claims. DCH and all non-technician claimants settled their individual claims in mediation in 2017. In January 2017, DCH and all non-technician plaintiffs agreed in principle to settle the representative claims, although this settlement has not yet been approved by the California courts as expressly contemplated by the parties and required by applicable law as a condition of the agreed release of claims. DCH Auto Group (USA) Limited must indemnify Lithia Motors, Inc. for losses related to this claim pursuant to the stock purchase agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014. As a result, we believe the exposure related to this lawsuit, when considered in relation to the terms of the stock purchase agreement, is immaterial to our financial statements.

Item 4. Mine Safety Disclosure

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Stock Prices and Dividends

Our Class A common stock trades on the New York Stock Exchange under the symbol LAD. The following table presents the high and low sale prices for our Class A common stock, as reported on the New York Stock Exchange Composite Tape for each of the quarters in 2015 and 2016:

	High	Low
2015		
First quarter	\$ 100.25	\$ 79.84
Second quarter	117.14	95.98
Third quarter	122.01	98.29
Fourth quarter	126.56	102.01
2016		
First quarter	\$ 105.38	\$ 72.30
Second quarter	93.16	68.70
Third quarter	95.67	69.36
Fourth quarter	101.89	75.85

The number of shareholders of record and approximate number of beneficial holders of Class A common stock as of February 28, 2017 was 536 and 31,901, respectively. All shares of Lithia's Class B common stock are held by Lithia Holding Company, LLC. Sidney B. DeBoer Trust U.T.A.D. January 30, 1997 (Trust) is the manager of Lithia Holding Company, L.L.C., and Sidney DeBoer, as the trustee of the Trust, has the authority to vote all of the issued and outstanding shares of our Class B common stock.

Dividends declared on our Class A and Class B common stock during 2014, 2015 and 2016 were as follows:

Quarter declared:	Dividend amount per share	Total amount of dividend (in thousands)
2014		
First quarter	\$ 0.13	\$ 3,378
Second quarter	0.16	4,179
Third quarter	0.16	4,174
Fourth quarter	0.16	4,198
2015		
First quarter	\$ 0.16	\$ 4,216
Second quarter	0.20	5,266
Third quarter	0.20	5,257
Fourth quarter	0.20	5,246
2016		
First quarter	\$ 0.20	\$ 5,151
Second quarter	0.25	6,373
Third quarter	0.25	6,299
Fourth quarter	0.25	6,308

Equity Compensation Plan Information

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

Repurchases of Equity Securities

We made the following repurchases of our common stock during the fourth quarter of 2016:

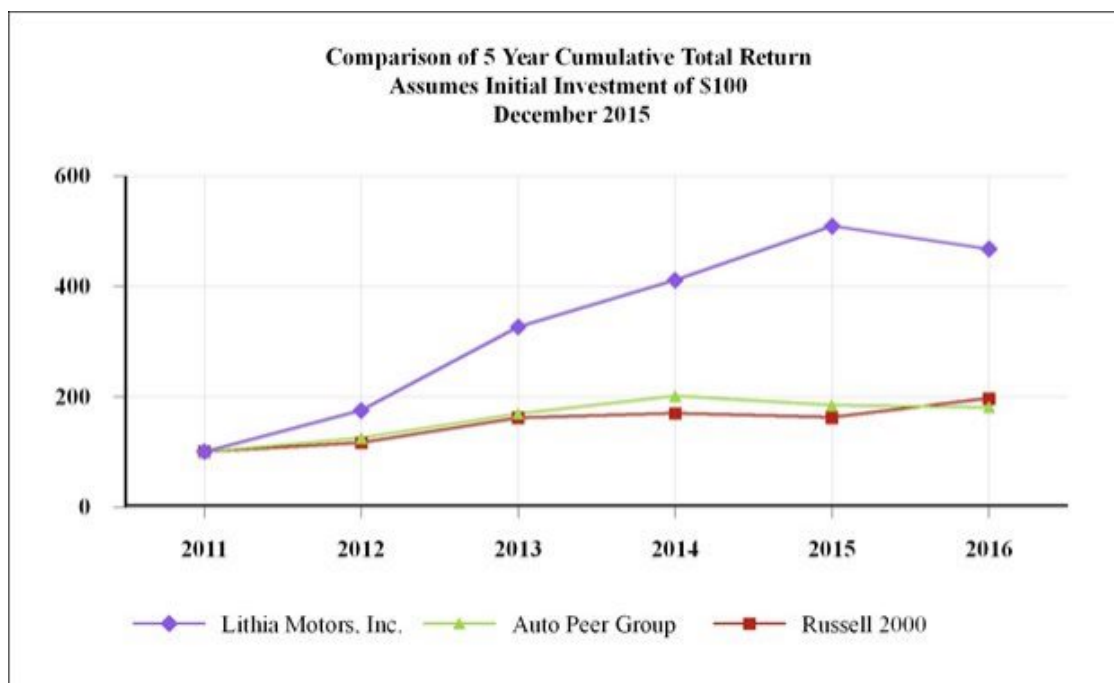
	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan ⁽¹⁾	Maximum dollar value of shares that may yet be purchased under publicly announced plan (in thousands) ⁽¹⁾
October	15,851	\$ 92.04	15,750	\$ 195,944
November	15,750	85.50	15,750	194,597
December	15,750	97.50	15,750	193,061
Total ⁽²⁾	<u>47,351</u>	91.68	<u>47,250</u>	193,061

(1) In February 2016, our Board of Directors authorized the repurchase of up to \$250 million of our Class A common stock. Through December 31, 2016, we have repurchased 713,725 shares at an average price of \$79.74 per share. This authority to repurchase shares does not have an expiration date.

(2) Includes 101 shares repurchased in association with tax withholdings on the vesting of RSUs.

Stock Performance Graph

The following line-graph shows the annual percentage change in the cumulative total returns for the past five years on an assumed \$100 initial investment and reinvestment of dividends, on (a) Lithia Motors, Inc.'s Class A common stock; (b) the Russell 2000; and (c) an auto peer group index composed of Penske Automotive Group, AutoNation, Sonic Automotive, Group 1 Automotive and Asbury Automotive Group, the only other comparable publicly traded automobile dealerships in the United States as of December 31, 2016. The peer group index utilizes the same methods of presentation and assumptions for the total return calculation as does Lithia Motors and the Russell 2000. All companies in the peer group index are weighted in accordance with their market capitalizations.



Company/Index	Base Period	Indexed Returns for the Year Ended				
	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Lithia Motors, Inc.	\$ 100.00	\$ 174.47	\$ 325.79	\$ 410.18	\$ 508.29	\$ 466.73
Auto Peer Group	100.00	124.40	168.44	200.51	184.03	180.50
Russell 2000	100.00	116.39	161.57	169.48	162.00	196.52

Item 6. Selected Financial Data

You should read the Selected Financial Data in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," our Consolidated Financial Statements and Notes thereto and other financial information contained elsewhere in this Annual Report on Form 10-K.

(In thousands, except per share amounts)

Consolidated Statements of Operations Data:	Year Ended December 31,				
	2016	2015	2014	2013	2012
Revenues:					
New vehicle	\$ 4,938,436	\$ 4,552,301	\$ 3,077,670	\$ 2,256,598	\$ 1,847,603
Used vehicle retail	2,226,951	1,927,016	1,362,481	1,032,224	833,484
Used vehicle wholesale	276,616	261,530	195,699	158,235	139,237
Finance and insurance	330,922	283,018	190,381	139,007	112,234
Service, body and parts	844,505	738,990	512,124	383,483	347,703
Fleet and other	60,727	101,397	51,971	36,202	36,226
Total revenues	\$ 8,678,157	\$ 7,864,252	\$ 5,390,326	\$ 4,005,749	\$ 3,316,487
Gross Profit:					
New vehicle	\$ 289,412	\$ 280,370	\$ 198,184	\$ 151,118	\$ 134,447
Used vehicle retail	263,684	241,249	179,253	150,858	121,721
Used vehicle wholesale	4,313	4,457	3,646	2,711	1,414
Finance and insurance	330,922	283,018	190,381	139,007	112,234
Service, body and parts	410,283	363,921	249,736	185,570	168,070
Fleet and other	2,701	2,619	2,122	1,689	1,414
Total gross profit	\$ 1,301,315	\$ 1,175,634	\$ 823,322	\$ 630,953	\$ 539,300
Operating income ⁽¹⁾	\$ 338,364	\$ 302,735	\$ 231,899	\$ 183,518	\$ 148,369
Income from continuing operations before income taxes ⁽¹⁾	\$ 283,523	\$ 262,704	\$ 210,495	\$ 165,788	\$ 128,457
Income from continuing operations ⁽¹⁾	\$ 197,058	\$ 182,999	\$ 135,540	\$ 105,214	\$ 79,395
Basic income per share from continuing operations	\$ 7.76	\$ 6.96	\$ 5.19	\$ 4.08	\$ 3.09
Basic income per share from discontinued operations	—	—	0.12	0.03	0.04
Basic net income per share	\$ 7.76	\$ 6.96	\$ 5.31	\$ 4.11	\$ 3.13
Shares used in basic per share	25,409	26,290	26,121	25,805	25,696
Diluted income per share from continuing operations	\$ 7.72	\$ 6.91	\$ 5.14	\$ 4.02	\$ 3.03
Diluted income per share from discontinued operations	—	—	0.12	0.03	0.04
Diluted net income per share	\$ 7.72	\$ 6.91	\$ 5.26	\$ 4.05	\$ 3.07
Shares used in diluted per share	25,521	26,490	26,382	26,191	26,170
Cash dividends declared per common share ⁽²⁾	\$ 0.95	\$ 0.76	\$ 0.61	\$ 0.39	\$ 0.47

(In thousands)

	As of December 31,				
Consolidated Balance Sheets Data:	2016	2015	2014	2013	2012
Working capital	\$ 365,200	\$ 288,040	\$ 172,909	\$ 209,038	\$ 211,905
Inventories	1,772,587	1,470,987	1,249,659	859,019	723,326
Total assets	3,844,150	3,225,130	2,879,093	1,723,930	1,491,069
Floor plan notes payable	1,601,497	1,313,955	1,178,679	713,855	581,584
Long-term debt, including current maturities	790,881	643,186	639,138	251,363	293,425
Total stockholders' equity	910,776	828,164	673,105	534,722	428,101

- (1) Includes \$14.0 million, \$20.1 million, \$1.9 million, and \$0.1 million in non-cash charges related to asset impairments for the years ended 2016, 2015, 2014 and 2012, respectively. We did not record any non-cash charges related to asset impairments in 2013. See Notes 1, 4 and 18 of Notes to Consolidated Financial Statements for additional information.
- (2) In November 2012, we paid dividends of \$2.5 million that had been declared in October 2012. An additional dividend payment of \$2.6 million was declared and paid in December 2012 in lieu of the dividend typically declared and paid in March of the following year.

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

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

Overview

We are a leading operator of automotive franchises and a retailer of new and used vehicles and related services. As of February 28, 2017, we offered 30 brands of new vehicles and all brands of used vehicles in 154 stores in the United States and online at Lithia.com, DCHauto.com and CarboneCars.com. We sell new and used cars and replacement parts; provide vehicle maintenance, warranty, paint and repair services; arrange related financing; and sell vehicle service contracts, vehicle protection products and credit insurance.

We believe that the fragmented nature of the automotive dealership sector provides us with the opportunity to achieve growth through consolidation. In 2016, the top ten automotive retailers, as reported by Automotive News, represented approximately 7% of the stores in the United States. Our dealerships are located across the United States. We seek domestic, import and luxury franchises in cities ranging from mid-sized regional markets to metropolitan markets. We evaluate all brands for expansion opportunities provided the market is large enough to support adequate new vehicle sales to justify the required capital investment. Our acquisition strategy has been to acquire dealerships at prices that meet our internal investment targets and, through the application of our centralized operating structure, leverage costs and improve store profitability. We believe our disciplined approach and the current economic environment provides us with attractive acquisition opportunities.

We also believe that we can continue to improve operations at our existing stores. By promoting entrepreneurial leadership within our general and department managers, we strive for continuous improvement to drive sales and capture market share in our local markets. Our goal is to retail an average of 75 used vehicles per store per month and we believe we can make additional improvements in our used vehicle sales performance by offering lower-priced value vehicles and selling brands other than the new vehicle franchise at each location. Our service, body and parts operations provide important repeat business for our stores. We continue to grow this business through increased marketing efforts, competitive pricing on routine maintenance items and diverse commodity product offerings. In 2016, we continued to experience organic growth and profitability through increasing market share and maintaining a lean cost structure, while adding significant revenue to our base through acquisitions.

As sales volume increases and we gain leverage in our cost structure, we anticipate targeting SG&A as a percentage of gross profit in the upper 60% range. As we focus on maintaining discipline in controlling costs, we continue to target maintaining, on a same store basis, between 45% and 50% of each incremental gross profit dollar after deducting SG&A expense.

Critical Accounting Policies and Estimates

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

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

Goodwill and Franchise Value

We are required to test our goodwill and franchise value for impairment at least annually, or more frequently if conditions indicate that an impairment may have occurred. Goodwill is tested for impairment at the reporting unit level. Our reporting units are individual retail automotive franchises as this is the level at which discrete financial information is available and for which operating results are regularly reviewed by our chief operating decision maker to allocate resources and assess performance.

We have the option to qualitatively or quantitatively assess goodwill for impairment and, in 2016, we evaluated our goodwill using a qualitative assessment process. If the qualitative factors determine that it is more likely than not that the fair value of the reporting unit exceeds the carrying amount, goodwill is not impaired. If the qualitative assessment determines it is more likely than not the fair value is less than the carrying amount, the first step of the two-step goodwill impairment test is performed.

As of December 31, 2016, we had \$259.4 million of goodwill on our balance sheet associated with 154 reporting units. No reporting unit accounted for more than 2.4% of our total goodwill as of December 31, 2016. The annual goodwill impairment analysis, which we perform as of October 1 of each year, did not result in an indication of impairment in 2016, 2015 or 2014.

We have determined the appropriate unit of accounting for testing franchise rights for impairment is on an individual store basis. We have the option to qualitatively or quantitatively assess indefinite-lived intangible assets for impairment. In 2016, we evaluated our indefinite-lived intangible assets using a qualitative assessment process. If the qualitative factors determine that it is more likely than not that the fair value of the individual store's franchise value exceeds the carrying amount, the franchise value is not impaired and the second step is not necessary. If the qualitative assessment determines it is more likely than not that the fair value is less than the carrying amount, then a quantitative valuation of our franchise value is performed and an impairment would be recorded.

As of December 31, 2016, we had \$184.3 million of franchise value on our balance sheet associated with 116 stores. No individual store accounted for more than 5% of our total franchise value as of December 31, 2016. Our impairment testing of franchise value did not indicate any impairment in 2016, 2015 or 2014.

We are subject to financial statement risk to the extent that our goodwill or franchise rights become impaired due to decreases in the fair value. A future decline in performance, decreases in projected growth rates or margin assumptions or changes in discount rates could result in a potential impairment, which could have a material adverse impact on our financial position and results of operations. Furthermore, if a manufacturer becomes insolvent, we may be required to record a partial or total impairment on the franchise value and/or goodwill related to that manufacturer. No individual manufacturer accounted for more than 18% of our total franchise value and goodwill as of December 31, 2016.

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

Long-Lived Assets

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

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

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

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

In 2016 and 2014, we did not record any impairments to long-lived assets; however, in 2015 we recorded \$3.6 million of impairment charges associated with certain properties and equipment. As the expected future use of these facilities changed, the long-lived assets were tested for recoverability and were determined to have a carrying value exceeding their fair value.

See Notes 1,4 and 12 of Notes to Consolidated Financial Statements for additional information.

Deferred Taxes

As of December 31, 2016, we had deferred tax assets of \$100.0 million, net of valuation allowance of \$0.2 million, and deferred tax liabilities of \$159.0 million. The principal components of our deferred tax assets are related to allowances and accruals and deferred revenue and cancellation reserves. The principal components of our deferred tax liabilities are related to depreciation on property and equipment, inventories and goodwill.

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

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

As of December 31, 2016, we had a \$0.2 million valuation allowance against our deferred tax assets associated with state net operating losses. Since these amounts are dependent on generating future taxable income, we evaluated the income expectations in the underlying states and determined that it is unlikely these amounts will be fully utilized. If we are unable to meet the projected taxable income levels utilized in our analysis, and depending on the availability of feasible tax planning strategies, we might record an additional valuation allowance on a portion or all of our deferred tax assets in the future.

Equity-Method Investment Associated with New Markets Tax Credits

In 2016 and 2015, we held an equity investment in a limited liability company managed by U.S. Bancorp Community Development Corporation. This investment generated new market tax credits under the New Markets Tax Credit Program (“NMTC Program”). The NMTC Program was established by Congress in 2000 to spur new or increased investments into operating businesses and real estate projects located in low-income communities. While U.S. Bancorp Community Development Corporation exercised management control over the limited liability company, due to the economic interest we held in the entity, we determined the appropriate accounting for our ownership portion of the entity was under the equity method of accounting. The equity-method investment generated operating losses on a quarterly basis and, accordingly, we were required to assess the investment for other than temporary impairment on a quarterly basis.

In 2016, we recorded asset impairments totaling \$14.0 million. We also recorded non-cash interest expense related to the discounted fair value of future equity contributions of \$0.2 million, an \$8.3 million charge to other income, net for our portion of the investment’s operating losses and a tax benefit of \$28.5 million. As of December 31, 2016, we no longer owned any interest in the equity investment.

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

Service Contracts and Other Insurance Contracts

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

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

At December 31, 2016, the reserve for future cancellations totaled \$44.2 million and is included in accrued liabilities and other long-term liabilities on our Consolidated Balance Sheets. A 10% increase in expected cancellations would result in an additional reserve of \$4.4 million.

Lifetime Lube, Oil and Filter Contracts

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

At December 31, 2016, the deferred revenue related to these self-insured contracts was \$99.6 million.

Self-Insurance Programs

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

At December 31, 2016, we had liabilities associated with these programs of \$32.8 million recorded as a component of accrued liabilities and other long-term liabilities on our Consolidated Balance Sheets.

Results of Continuing Operations

For the year ended December 31, 2016, we reported income from continuing operations, net of tax, of \$197.1 million, or \$7.72 per diluted share. For the years ended December 31, 2015 and 2014, we reported income from continuing operations, net of tax, of \$183.0 million, or \$6.91 per diluted share, and \$135.5 million, or \$5.14 per diluted share, respectively.

Discontinued Operations

In the third quarter of 2014, we early-adopted guidance that redefined discontinued operations. As a result, we determined that individual stores that met the criteria for held for sale after our adoption date would no longer qualify for classification as discontinued operations. We had previously reclassified a store's operations to discontinued operations in our Consolidated Statements of Operations, on a comparable basis for all periods presented, provided we did not expect to have any significant continuing involvement in the store's operations after its disposal.

We did not have any income from discontinued operations for the years ended December 31, 2016 or 2015. We realized income from discontinued operations, net of income tax expense, of \$3.2 million for the year ended December 31, 2014. See Note 15 of Notes to Consolidated Financial Statements for additional information.

Key Performance Metrics

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

		Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
2016	Revenues		Gross Profit		
New vehicle	\$ 4,938,436	56.9%	\$ 289,412	5.9%	22.2%
Used vehicle retail	2,226,951	25.7	263,684	11.8	20.3
Used vehicle wholesale	276,616	3.2	4,313	1.6	0.3
Finance and insurance (1)	330,922	3.8	330,922	100.0	25.4
Service, body and parts	844,505	9.7	410,283	48.6	31.5
Fleet and other	60,727	0.7	2,701	4.4	0.3
	<u>\$ 8,678,157</u>	<u>100.0%</u>	<u>\$ 1,301,315</u>	<u>15.0%</u>	<u>100.0%</u>

		Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
2015	Revenues		Gross Profit		
New vehicle	\$ 4,552,301	57.9%	\$ 280,370	6.2%	23.8%
Used vehicle retail	1,927,016	24.5	241,249	12.5	20.5
Used vehicle wholesale	261,530	3.3	4,457	1.7	0.4
Finance and insurance(1)	283,018	3.6	283,018	100.0	24.1
Service, body and parts	738,990	9.4	363,921	49.2	31.0
Fleet and other	101,397	1.3	2,619	2.6	0.2
	<u>\$ 7,864,252</u>	<u>100.0%</u>	<u>\$ 1,175,634</u>	<u>14.9%</u>	<u>100.0%</u>

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

(1) Commissions reported net of anticipated cancellations.

Same Store Operating Data

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

Same store measures reflect results for stores that were operating in each comparison period, and only include the months when operations occurred in both periods. For example, a store acquired in August 2015 would be included in same store operating data beginning in September 2016, after its first complete comparable month of operation. The operating results for the same store comparisons would include results for that store from September through December of each year.

New Vehicle Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Year Ended		Increase	% Increase
	December 31,			
	2016	2015		
Reported				
Revenue	\$ 4,938,436	\$ 4,552,301	\$ 386,135	8.5%
Gross profit	\$ 289,412	\$ 280,370	\$ 9,042	3.2
Gross margin	5.9%	6.2%	(30) bps	
Retail units sold	145,772	137,486	8,286	6.0
Average selling price per retail unit	\$ 33,878	\$ 33,111	\$ 767	2.3
Average gross profit per retail unit	\$ 1,985	\$ 2,039	\$ (54)	(2.6)
Same store				
Revenue	\$ 4,686,693	\$ 4,534,865	\$ 151,828	3.3%
Gross profit	\$ 274,772	\$ 279,201	\$ (4,429)	(1.6)
Gross margin	5.9%	6.2%	(30) bps	
Retail units sold	138,310	136,993	1,317	1.0
Average selling price per retail unit	\$ 33,885	\$ 33,103	\$ 782	2.4
Average gross profit per retail unit	\$ 1,987	\$ 2,038	\$ (51)	(2.5)

(Dollars in thousands, except per unit amounts)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2015	2014		
Reported				
Revenue	\$ 4,552,301	\$ 3,077,670	\$ 1,474,631	47.9%
Gross profit	\$ 280,370	\$ 198,184	\$ 82,186	41.5
Gross margin	6.2%	6.4%	(20) bps	
Retail units sold	137,486	91,104	46,382	50.9
Average selling price per retail unit	\$ 33,111	\$ 33,782	\$ (671)	(2.0)
Average gross profit per retail unit	\$ 2,039	\$ 2,175	\$ (136)	(6.3)
Same store				
Revenue	\$ 3,316,148	\$ 3,047,191	\$ 268,957	8.8%
Gross profit	\$ 205,105	\$ 195,862	\$ 9,243	4.7
Gross margin	6.2%	6.4%	(20) bps	
Retail units sold	96,273	90,091	6,182	6.9
Average selling price per retail unit	\$ 34,445	\$ 33,823	\$ 622	1.8
Average gross profit per retail unit	\$ 2,130	\$ 2,174	\$ (44)	(2.0)

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

New vehicle sales increased in 2016 compared to 2015 and 2015 compared to 2014 primarily driven by acquisitions. In 2016, we acquired 15 stores and 1 franchise and opened 1 store. In 2015, we acquired 6 stores and 1 franchise and opened 1 store.

Excluding the impact of acquisitions, on a same store basis, new vehicle sales increased 3.3% and included a 1.0% increase in unit volume growth and a 2.4% increase in the average selling price per retail unit in 2016 compared to 2015. New vehicle sales improved 8.8% in 2015 compared to 2014, primarily due to a 6.9% increase in unit volume growth and a 1.8% increase in average selling price per retail unit. The increases in average selling price are primarily a function of annual increases in manufacturer suggested retail price over the manufacturers' invoice cost of vehicles.

Same store unit sales compared to national performance were as follows:

	2016 compared to 2015	2015 compared to 2014	National growth in 2016 compared to 2015	National growth in 2015 compared to 2014
Domestic brand same store unit sales growth	(0.7)%	9.5%	(0.7)%	5.8%
Import brand same store unit sales growth	3.1	5.2	1.2	5.6
Luxury brand same store unit sales growth	(3.7)	3.1	1.7	6.7
Overall	1.0	6.9	0.4	5.8

In 2016, our overall unit volume growth out paced the national average mainly driven by growth in our import stores, specifically Honda and Nissan, offset by our luxury brand stores, which were impacted by performance at our BMW, Acura and Mercedes stores. We continue to focus on increasing our share of overall new vehicle sales within our markets.

New vehicle gross profit increased 3.2% in 2016 compared to 2015, primarily driven by the increase in unit sales gained through dealership acquisitions; however, on a same store basis, new vehicle gross profit decreased 1.6% in 2016 compared to 2015. The increase in unit sales on a same store basis was offset by a lower average gross profit per unit resulting in a same store decline in gross profit.

On a same store basis, the average gross profit per new retail unit decreased \$51, or 2.5%, in 2016 compared to 2015. Consumers are increasingly aware of our wholesale cost of vehicles and average transaction prices for new vehicle sales due to the proliferation of third-party providers distributing this information over the Internet. As a result, the average gross profit realized on new vehicle sales has been under pressure for the last several years across the automobile industry. In addition, we have pursued a volume-based strategy because this creates additional used vehicle trade-in opportunities, finance and insurance sales and future service work, which we believe will generate incremental business in future periods that will offset the lower new vehicle gross profit per unit that has occurred as a result of this strategy.

New vehicle gross profit increased 41.5% in 2015 compared to 2014, driven by dealership acquisitions. On a same store basis, gross profit increased 4.7% in 2015 compared to 2014, primarily due to a greater number of vehicles sold, partially offset by a decline in the average gross profit per retail vehicle sold.

Used Vehicle Retail Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Reported				
Retail revenue	\$ 2,226,951	\$ 1,927,016	\$ 299,935	15.6%
Retail gross profit	\$ 263,684	\$ 241,249	\$ 22,435	9.3
Retail gross margin	11.8%	12.5%	(70) bps	
Retail units sold	113,498	99,109	14,389	14.5
Average selling price per retail unit	\$ 19,621	\$ 19,443	\$ 178	0.9
Average gross profit per retail unit	\$ 2,323	\$ 2,434	\$ (111)	(4.6)
Same store				
Retail revenue	\$ 2,129,402	\$ 1,916,309	\$ 213,093	11.1%
Retail gross profit	\$ 252,554	\$ 240,299	\$ 12,255	5.1
Retail gross margin	11.9%	12.5%	(60) bps	
Retail units sold	107,919	98,531	9,388	9.5
Average selling price per retail unit	\$ 19,731	\$ 19,449	\$ 282	1.4
Average gross profit per retail unit	\$ 2,340	\$ 2,439	\$ (99)	(4.1)

(Dollars in thousands, except per unit amounts)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2015	2014		
Reported				
Retail revenue	\$ 1,927,016	\$ 1,362,481	\$ 564,535	41.4%
Retail gross profit	\$ 241,249	\$ 179,253	\$ 61,996	34.6
Retail gross margin	12.5%	13.2%	(70) bps	
Retail units sold	99,109	71,674	27,435	38.3
Average selling price per retail unit	\$ 19,443	\$ 19,009	\$ 434	2.3
Average gross profit per retail unit	\$ 2,434	\$ 2,501	\$ (67)	(2.7)
Same store				
Retail revenue	\$ 1,520,870	\$ 1,344,179	\$ 176,691	13.1%
Retail gross profit	\$ 196,705	\$ 177,406	\$ 19,299	10.9
Retail gross margin	12.9%	13.2%	(30) bps	
Retail units sold	77,136	70,558	6,578	9.3
Average selling price per retail unit	\$ 19,717	\$ 19,051	\$ 666	3.5
Average gross profit per retail unit	\$ 2,550	\$ 2,514	\$ 36	1.4

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

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

	2016 compared to 2015	2015 compared to 2014
Certified pre-owned vehicles	11.0%	16.9%
Core vehicles	13.2	12.3
Value autos	4.2	9.1
Overall	11.1	13.1

The same store sales increases in 2016 compared to 2015 and in 2015 compared to 2014 were a result of increased unit sales and increased average selling prices per unit as our mix shifted toward higher-priced certified pre-owned and core vehicles and away from value autos. This mix shift was primarily due to the increased number of off-lease vehicles as a result of increased new vehicle leasing since 2010. Because the average new vehicle lease is approximately 30 months, the supply of late model used vehicles is increasing.

On average, in 2016 and 2015, each of our stores sold 66 and 62 retail used vehicle units per month, respectively. We continue to target increasing sales to 75 units per store per month.

Used retail vehicle gross profit increased 9.3% in 2016 compared to 2015, primarily driven by acquisitions. On a same store basis, gross profit increased 5.1% in 2016 compared to 2015, due to increased unit volume and increased average selling price, offset by margin declines. We continue to see a mix shift toward certified pre-owned and core vehicles, which have higher average selling prices, but lower gross margins than value autos.

Used retail vehicle gross profit dollars increased 34.6% in 2015 compared to 2014 due to acquisitions. On a same store basis, gross profit increased 10.9% in 2015 compared to 2014. Volume growth, increased selling prices and increased gross profit per unit all contributed to this increase.

Used Vehicle Wholesale Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Reported				
Wholesale revenue	\$ 276,616	\$ 261,530	\$ 15,086	5.8%
Wholesale gross profit	\$ 4,313	\$ 4,457	\$ (144)	(3.2)
Wholesale gross margin	1.6%	1.7%	(10) bps	
Wholesale units sold	40,615	38,167	2,448	6.4
Average selling price per wholesale unit	\$ 6,811	\$ 6,852	\$ (41)	(0.6)
Average gross profit per retail unit	\$ 106	\$ 117	\$ (11)	(9.4)
Same store				
Wholesale revenue	\$ 261,957	\$ 260,341	\$ 1,616	0.6%
Wholesale gross profit	\$ 4,184	\$ 4,608	\$ (424)	(9.2)
Wholesale gross margin	1.6%	1.8%	(20) bps	
Wholesale units sold	38,234	37,966	268	0.7
Average selling price per wholesale unit	\$ 6,851	\$ 6,857	\$ (6)	(0.1)
Average gross profit per retail unit	\$ 109	\$ 121	\$ (12)	(9.9)

(Dollars in thousands, except per unit amounts)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2015	2014		
Reported				
Wholesale revenue	\$ 261,530	\$ 195,699	\$ 65,831	33.6%
Wholesale gross profit	\$ 4,457	\$ 3,646	\$ 811	22.2
Wholesale gross margin	1.7%	1.9%	(20) bps	
Wholesale units sold	38,167	27,918	10,249	36.7
Average selling price per wholesale unit	\$ 6,852	\$ 7,010	\$ (158)	(2.3)
Average gross profit per retail unit	\$ 117	\$ 131	\$ (14)	(10.7)
Same store				
Wholesale revenue	\$ 209,532	\$ 194,464	\$ 15,068	7.7%
Wholesale gross profit	\$ 4,086	\$ 3,807	\$ 279	7.3
Wholesale gross margin	2.0%	2.0%	— bps	
Wholesale units sold	28,468	27,621	847	3.1
Average selling price per wholesale unit	\$ 7,360	\$ 7,040	\$ 320	4.5
Average gross profit per retail unit	\$ 144	\$ 138	\$ 6	4.3

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

(Dollars in thousands, except per unit amounts)	Year Ended December 31,		Increase	% Increase
	2016	2015		
Reported				
Revenue	\$ 330,922	\$ 283,018	\$ 47,904	16.9%
Average finance and insurance per retail unit	1,276	1,196	80	6.7
Same store				
Revenue	\$ 317,780	\$ 281,898	\$ 35,882	12.7%
Average finance and insurance per retail unit	1,291	1,197	94	7.9

(Dollars in thousands, except per unit amounts)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Reported				
Revenue	\$ 283,018	\$ 190,381	\$ 92,637	48.7%
Average finance and insurance per retail unit	1,196	1,170	26	2.2
Same store				
Revenue	\$ 215,815	\$ 188,270	\$ 27,545	14.6%
Average finance and insurance per retail unit	1,245	1,172	73	6.2

The increase in finance and insurance revenue in 2016 compared to 2015 was primarily due to increased volume complemented by increased finance and insurance penetration rates. Finance and insurance sales in 2015 compared to 2014 increased due to acquisitions.

Trends in same store penetration rates for total new and used retail vehicles sold are detailed below:

	2016	2015	2014
Vehicle financing	76%	77%	77%
Service contracts	44%	42%	43%
Lifetime lube, oil and filter contracts	26%	25%	32%

In 2016, the improved penetration rates associated with service contracts was a main contributor to the increase in finance and insurance revenues. In 2015, penetration rates remained steady on arranging financing and service contracts. Penetration rates in lifetime lube, oil and filter contracts decreased in 2015 compared to 2014 because we only began to offer this product at stores acquired as part of the DCH Auto Group in the second half of 2015, diluting the average across our entire store base. In 2016, we continued to integrate our lifetime lube, oil and filter contracts into the DCH Auto Group. Penetration rates, excluding the DCH stores, remained relatively consistent with 2014.

Service, Body and Parts Revenue and Gross Profit

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase
	2016	2015		
Reported				
Customer pay	\$ 462,626	\$ 414,063	\$ 48,563	11.7%
Warranty	199,049	165,902	33,147	20.0
Wholesale parts	123,440	111,557	11,883	10.7
Body shop	59,390	47,468	11,922	25.1
Total service, body and parts	<u>\$ 844,505</u>	<u>\$ 738,990</u>	<u>\$ 105,515</u>	14.3
Service, body and parts gross profit	\$ 410,283	\$ 363,921	\$ 46,362	12.7%
Service, body and parts gross margin	48.6%	49.2%	(60) bps	
Same store				
Customer pay	\$ 440,662	\$ 411,154	\$ 29,508	7.2%
Warranty	188,279	164,842	23,437	14.2
Wholesale parts	113,010	111,178	1,832	1.6
Body shop	55,446	47,334	8,112	17.1
Total service, body and parts	<u>\$ 797,397</u>	<u>\$ 734,508</u>	<u>\$ 62,889</u>	8.6
Service, body and parts gross profit	\$ 389,557	\$ 361,692	\$ 27,865	7.7%
Service, body and parts gross margin	48.9%	49.2%	(30) bps	

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Reported				
Customer pay	\$ 414,063	\$ 285,337	\$ 128,726	45.1%
Warranty	165,902	96,308	69,594	72.3
Wholesale parts	111,557	87,519	24,038	27.5
Body shop	47,468	42,960	4,508	10.5
Total service, body and parts	<u>\$ 738,990</u>	<u>\$ 512,124</u>	<u>\$ 226,866</u>	44.3
Service, body and parts gross profit	\$ 363,921	\$ 249,736	\$ 114,185	45.7%
Service, body and parts gross margin	49.2%	48.8%	40 bps	
Same store				
Customer pay	\$ 302,884	\$ 280,965	\$ 21,919	7.8%
Warranty	119,193	94,988	24,205	25.5
Wholesale parts	90,734	86,743	3,991	4.6
Body shop	44,513	42,924	1,589	3.7
Total service, body and parts	<u>\$ 557,324</u>	<u>\$ 505,620</u>	<u>\$ 51,704</u>	10.2
Service, body and parts gross profit	\$ 273,085	\$ 246,378	\$ 26,707	10.8%
Service, body and parts gross margin	49.0%	48.7%	30 bps	

Our service, body and parts sales grew in all areas in 2016 compared to 2015 and in 2015 compared to 2014. The growth in 2016 was primarily due to more late-model units in operation as new vehicle sales volumes have been increasing annually since 2010. The growth in 2015 was mainly due to acquisition activity. We believe this increase in units in operation will benefit our service, body and parts sales in the coming years as more late-model vehicles age, necessitating repairs and maintenance.

We focus on retaining customers by offering competitively priced routine maintenance and through our marketing efforts. We increased our same store customer pay business 7.2% in 2016 compared to 2015 and by 7.8% in 2015 compared to 2014.

Same store warranty sales increased 14.2% in 2016 compared to 2015 and 25.5% in 2015 compared to 2014, primarily due to significant vehicle recalls across multiple manufacturers. Additionally, we saw increases in warranty sales due to the growing number of units in operation. Routine maintenance, such as oil changes, offered by certain brands, including BMW, Toyota and General Motors, for two to four years after a vehicle is sold, provides for future work as consumers return to the franchised dealer for this maintenance item.

Increases (decreases) in same-store warranty work by segment were as follows:

	2016 compared to 2015	2015 compared to 2014
Domestic	10.7%	27.9%
Import	28.1	26.3
Luxury	(0.7)	20.9

Same store wholesale parts grew 1.6% and 4.6%, respectively, in 2016 compared to 2015 and in 2015 compared to 2014, primarily due to increased parts sales to independent repair shops, competing new vehicle dealers and wholesale accounts.

Same store body shop grew 17.1% and 3.7%, respectively, in 2016 compared to 2015 and in 2015 compared to 2014. These increases were due to increased productivity as we increased capacity and improved work flow. We focus on obtaining direct repair relationships with insurance companies as a strategy to increase business.

Same store service, body and parts gross profit increased 7.7% and 10.8%, respectively, in 2016 compared to 2015 and in 2015 compared to 2014. The growth in gross profit in 2016 compared to 2015 was relatively consistent with revenue growth. Our gross profit growth in 2015 compared to 2014 was driven by a shift in mix as the growth in warranty, which has a relatively higher gross margin, outpaced customer pay, wholesale parts and body shop growth compared to 2014.

Segments

Certain financial information by segment is as follows:

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Revenues:				
Domestic	\$ 3,381,715	\$ 3,038,883	\$ 342,832	11.3%
Import	3,764,255	3,330,949	433,306	13.0
Luxury	1,528,760	1,490,632	38,128	2.6
	<u>8,674,730</u>	<u>7,860,464</u>	<u>814,266</u>	<u>10.4</u>
Corporate and other	3,427	3,788	(361)	(9.5)
	<u>\$ 8,678,157</u>	<u>\$ 7,864,252</u>	<u>\$ 813,905</u>	<u>10.3</u>

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2015	2014		
Revenues:				
Domestic	\$ 3,038,883	\$ 2,569,928	\$ 468,955	18.2%
Import	3,330,949	1,889,579	1,441,370	76.3
Luxury	1,490,632	926,856	563,776	60.8
	<u>7,860,464</u>	<u>5,386,363</u>	<u>2,474,101</u>	<u>45.9</u>
Corporate and other	3,788	3,963	(175)	(4.4)
	<u>\$ 7,864,252</u>	<u>\$ 5,390,326</u>	<u>\$ 2,473,926</u>	<u>45.9</u>

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Segment income*:				
Domestic	\$ 106,210	\$ 115,145	\$ (8,935)	(7.8)%
Import	110,204	98,751	11,453	11.6
Luxury	31,467	36,391	(4,924)	(13.5)
	<u>247,881</u>	<u>250,287</u>	<u>(2,406)</u>	<u>(1.0)</u>
Corporate and other	114,321	74,514	39,807	53.4
Depreciation and amortization	(49,369)	(41,600)	7,769	18.7
Other interest expense	(23,207)	(19,491)	3,716	19.1
Other expense, net	(6,103)	(1,006)	5,097	NM
Income from continuing operations before income taxes	<u>\$ 283,523</u>	<u>\$ 262,704</u>	<u>\$ 20,819</u>	<u>7.9</u>

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase
	2015	2014		
Segment income*:				
Domestic	\$ 115,145	\$ 96,608	\$ 18,537	19.2%
Import	98,751	51,150	47,601	93.1
Luxury	36,391	25,448	10,943	43.0
	250,287	173,206	77,081	44.5
Corporate and other	74,514	71,195	3,319	4.7
Depreciation and amortization	(41,600)	(26,363)	15,237	57.8
Other interest expense	(19,491)	(10,742)	8,749	81.4
Other (expense) income, net	(1,006)	3,199	(4,205)	NM
Income from continuing operations before income taxes	\$ 262,704	\$ 210,495	\$ 52,209	24.8

*Segment income for each reportable segment is defined as Income from continuing operations before income taxes, depreciation and amortization, other interest expense and other (expense) income, net.

NM - Not meaningful

Retail new vehicle unit sales:	Year Ended December 31,		Increase	% Increase
	2016	2015		
Domestic	47,707	45,080	2,627	5.8%
Import	80,769	75,091	5,678	7.6
Luxury	17,591	17,556	35	0.2
	146,067	137,727	8,340	6.1
Allocated to management	(295)	(241)	54	22.4
	145,772	137,486	8,286	6.0

Retail new vehicle unit sales:	Year Ended December 31,		Increase	% Increase
	2015	2014		
Domestic	45,080	39,158	5,922	15.1%
Import	75,091	41,570	33,521	80.6
Luxury	17,556	10,570	6,986	66.1
	137,727	91,298	46,429	50.9
Allocated to management	(241)	(194)	47	24.2
	137,486	91,104	46,382	50.9

Domestic

A summary of financial information for our Domestic segment follows:

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Revenue	\$ 3,381,715	\$ 3,038,883	\$ 342,832	11.3%
Segment income	\$ 106,210	\$ 115,145	\$ (8,935)	(7.8)
Retail new vehicle unit sales	47,707	45,080	2,627	5.8

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Revenue	\$ 3,038,883	\$ 2,569,928	\$ 468,955	18.2%
Segment income	\$ 115,145	\$ 96,608	\$ 18,537	19.2
Retail new vehicle unit sales	45,080	39,158	5,922	15.1

Revenues in our Domestic segment increased in all major business lines in 2016 compared to 2015. Though new vehicle units declined 0.7% on a same store basis, increased average selling prices more than offset this factor. Additionally, our Domestic stores increased their used vehicle unit sales, improved finance and insurance income per retail unit and experienced strong growth in service, body and parts revenues. The acquisition of eight stores in 2016 contributed 3.7% of the 11.3% increase.

Our Domestic segment income decreased 7.8% in 2016 compared to 2015. The growth in gross profit was offset by increased SG&A expenses, primarily driven by increased variable cost associated with increased sales volume and the eight stores acquired in 2016. Additionally, floor plan interest expense increased due to higher inventory levels and rising interest rates.

Improvement in our Domestic operating results in 2015 compared to 2014 was primarily a result of the improvements in all business lines, improving economic environment, new product introductions from manufacturers and enhanced availability of late model used vehicles. Additionally, our stores experienced improved operational execution with growth in our segment income exceeding growth in revenues.

Import

A summary of financial information for our Import segment follows:

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2016	2015		
Revenue	\$ 3,764,255	\$ 3,330,949	\$ 433,306	13.0%
Segment income	\$ 110,204	\$ 98,751	\$ 11,453	11.6
Retail new vehicle unit sales	80,769	75,091	5,678	7.6

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Revenue	\$ 3,330,949	\$ 1,889,579	\$ 1,441,370	76.3%
Segment income	\$ 98,751	\$ 51,150	\$ 47,601	93.1
Retail new vehicle unit sales	75,091	41,570	33,521	80.6

The increase in our Import segment revenue in 2016 compared to 2015 resulted from increases in all business lines. On a same store basis, new vehicle unit sales for our Import stores outpaced national performance. Additionally, Import revenues benefited from improved used vehicle sales due to increased volume, increased finance and insurance revenues as a result of increased volume and finance and insurance income per retail unit sold and improved service, body and parts revenues. The acquisition of seven stores contributed 4.4% of the 13.0% increase.

Our segment income increased 11.6% in 2016 compared to 2015 mainly due to the improvements in all revenue categories discussed above and a slight improvement in gross margin. Additionally, the Import segment maintained a consistent SG&A expense as a percentage of gross profit in 2016 compared to 2015. These factors were offset slightly by higher floor plan interest costs due to higher inventory levels and higher interest rates.

Improvements in our Import operating results in 2015 compared to 2014 were primarily a result of the acquisition of the DCH Auto Group in October 2014. Of the 27 stores acquired in the DCH Auto Group acquisition, 17 of the locations were import brands, which generated over 90% of their revenues. Additionally, segment income growth exceeded growth in revenues as we integrated the DCH Auto Group into our existing cost structure.

Luxury

A summary of financial information for our Luxury segment follows:

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Revenue	\$ 1,528,760	\$ 1,490,632	\$ 38,128	2.6%
Segment income	\$ 31,467	\$ 36,391	\$ (4,924)	(13.5)
Retail new vehicle unit sales	17,591	17,556	35	0.2

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Revenue	\$ 1,490,632	\$ 926,856	\$ 563,776	60.8%
Segment income	\$ 36,391	\$ 25,448	\$ 10,943	43.0
Retail new vehicle unit sales	17,556	10,570	6,986	66.1

Our Luxury segment revenue increased in 2016 compared to 2015 primarily due to our acquisition of one store and improvements in finance and insurance and service body and parts revenues. New vehicle units sales declined 3.7% on a same store basis mainly related to our BMW, Audi and Mercedes franchises.

Our Luxury segment income decreased in 2016 compared to 2015. Gross profits growth outpaced revenue growth due to improved margins; however, increases in SG&A expense, mainly related to personnel cost and increases in floor plan interest expense due to higher inventory levels and rising interest rates, resulted in a decrease in segment income.

Improvements in our Luxury segment operating results in 2015 compared to 2014 were primarily a result of the acquisition of the DCH Auto Group, which included nine luxury stores in metropolitan markets, which typically are higher volume stores than stores in our historical markets.

See Note 19 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10-K for additional information.

Corporate and Other

Revenue attributable to Corporate and other includes the results of operations of our stand-alone collision center offset by certain unallocated reserve and elimination adjustments related to vehicle sales.

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Revenue	\$ 3,427	\$ 3,788	\$ (361)	(9.5)%
Segment income	\$ 114,321	\$ 74,514	\$ 39,807	53.4

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2015	2014		
Revenue	\$ 3,788	\$ 3,963	\$ (175)	(4.4)%
Segment income	\$ 74,514	\$ 71,195	\$ 3,319	4.7

The decreases in Corporate and other revenues in 2016 compared to 2015 and in 2015 compared to 2014 were primarily a result of changes to certain unallocated reserves.

Segment income attributable to Corporate and other includes amounts associated with the operating income from our stand-alone body shop and certain internal corporate expense allocations that reduce reportable segment income but increase Corporate and other income. These internal corporate expense allocations are used to increase comparability of our dealerships and reflect the capital burden a stand-alone dealership would experience. Examples of these internal allocations include internal rent expense, internal floor plan financing charges, and internal fees charged to offset employees within our corporate headquarters who perform certain dealership functions.

The increase in Corporate and other segment income in 2016 compared to 2015 was related to increased internal corporate expense allocations. Additionally, 2015 included an \$18.3 million charge associated with a transition agreement. See Note 16 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10-K for additional information regarding the transition agreement.

The increase in Corporate and other segment income in 2015 compared to 2014 was primarily related to reduced expense associated with certain insurance reserve adjustments and increased internal corporate expense allocations offset by an \$18.3 million charge associated with the transition agreement mentioned above.

Asset Impairment Charges

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

	Year Ended December 31,		
	2016	2015	2014
Equity-method investment	\$ 13,992	\$ 16,521	\$ 1,853
Long-lived assets	—	3,603	—

Asset impairments of our equity-method investment are associated with our investment in a limited liability company that participates in the NMTC Program. We evaluated this equity-method investment at the end of each reporting period and identified indications of loss resulting from other than temporary declines in value.

In 2015, we recorded \$3.6 million of impairment charges associated with certain properties and equipment. As the expected future use of these facilities and equipment changed, the long-lived assets were tested for recoverability and were determined to have a carrying value exceeding their fair value.

See Notes 1, 4, 12 and 18 of Notes to Consolidated Financial Statements for additional information.

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

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

(Dollars in thousands)	Year Ended December 31,			
	2016	2015	Increase	% Increase
Personnel	\$ 597,185	\$ 556,719	\$ 40,466	7.3%
Advertising	81,363	69,599	11,764	16.9
Rent	26,785	23,817	2,968	12.5
Facility costs	43,883	39,738	4,145	10.4
Other	150,374	121,302	29,072	24.0
Total SG&A	<u>\$ 899,590</u>	<u>\$ 811,175</u>	<u>\$ 88,415</u>	10.9

As a % of gross profit	Year Ended December 31,		Increase (Decrease)
	2016	2015	
Personnel	45.9%	47.4%	(150) bps
Advertising	6.3	5.9	40
Rent	2.1	2.0	10
Facility costs	3.4	3.4	—
Other	11.4	10.3	110
Total SG&A	69.1%	69.0%	10 bps

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Personnel	\$ 556,719	\$ 374,757	\$ 181,962	48.6%
Advertising	69,599	46,652	22,947	49.2
Rent	23,817	17,230	6,587	38.2
Facility costs	39,738	33,762	5,976	17.7
Other	121,302	90,806	30,496	33.6
Total SG&A	\$ 811,175	\$ 563,207	\$ 247,968	44.0

As a % of gross profit	Year Ended December 31,		Increase (Decrease)
	2015	2014	
Personnel	47.4%	45.5%	190 bps
Advertising	5.9	5.7	20
Rent	2.0	2.1	(10)
Facility costs	3.4	4.1	(70)
Other	10.3	11.0	(70)
Total SG&A	69.0%	68.4%	60 bps

SG&A increased \$88.4 million in 2016 compared to 2015, primarily driven by increased variable cost associated with increased sales volume and store count. Additionally, SG&A in 2016 included a \$3.9 million legal reserve adjustment, offset by a \$1.1 million gain associated with the sale of one of our stores.

SG&A increased \$248.0 million in 2015 compared to 2014, primarily due to acquisitions. We acquired the DCH Auto Group, a 27 store group, at the end of 2014. Additionally, SG&A in 2015 included a non-core charge of \$18.3 million associated with a transition agreement, offset by a \$5.9 million gain associated with the sale of two stores and adjustments to insurance reserves.

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

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase (Decrease)
	2016	2015		
Personnel	\$ 597,185	\$ 538,423	\$ 58,762	10.9%
Advertising	81,363	69,599	11,764	16.9
Rent	26,785	23,817	2,968	12.5
Facility costs	44,971	45,656	(685)	(1.5)
Other	146,437	121,303	25,134	20.7
Total SG&A	\$ 896,741	\$ 798,798	\$ 97,943	12.3

As a % of gross profit	Year Ended December 31,		Increase (Decrease)
	2016	2015	
Personnel	45.9%	45.8%	10 bps
Advertising	6.3	5.9	40
Rent	2.1	2.0	10
Facility costs	3.5	3.9	(40)
Other	11.1	10.3	80
Total SG&A	68.9%	67.9%	100 bps

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Personnel	\$ 538,423	\$ 374,758	\$ 163,665	43.7%
Advertising	69,599	46,652	22,947	49.2
Rent	23,817	17,230	6,587	38.2
Facility costs	45,656	33,763	11,893	35.2
Other	121,303	85,008	36,295	42.7
Total SG&A	\$ 798,798	\$ 557,411	\$ 241,387	43.3

As a % of gross profit	Year Ended December 31,		Increase (Decrease)
	2015	2014	
Personnel	45.8%	45.5%	30 bps
Advertising	5.9	5.7	20
Rent	2.0	2.1	(10)
Facility costs	3.9	4.1	(20)
Other	10.3	10.3	—
Total SG&A	67.9%	67.7%	20 bps

See “Non-GAAP Reconciliations” for more details.

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.

(Dollars in thousands)	Year Ended December 31,		Change	% of Change in Gross Profit
	2016	2015		
Gross profit	\$ 1,301,315	\$ 1,175,634	\$ 125,681	100.0%
SG&A expense	(899,590)	(811,175)	(88,415)	(70.3)
Throughput contribution			\$ 37,266	29.7%

(Dollars in thousands)	Year Ended December 31,		Change	% of Change in Gross Profit
	2015	2014		
Gross profit	\$ 1,175,634	\$ 823,322	\$ 352,312	100.0%
SG&A expense	(811,175)	(563,207)	(247,968)	(70.4)
Throughput contribution			\$ 104,344	29.6%

Throughput contributions for newly opened or acquired stores reduce overall throughput because, in the first year of operation, a store’s throughput is equal to the inverse of its SG&A as a percentage of gross profit. For example, a store which achieves SG&A as a percentage of gross profit of 70% will have throughput of 30% in the first year of operation.

We acquired 15 stores, one franchise and opened one new store in 2016 and acquired six stores, one franchise and opened one new store in 2015. Adjusting for these locations and the non-core adjustments discussed above, we estimate our throughput contribution on a same store basis was 24% in 2016 compared to 48% in 2015. Increasing advertising spend and insurance cost, which out paced gross profit growth, were the primary reasons we under performed our throughput target. We continue to target a same store throughput contribution in a range of 45% to 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.

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2016	2015		
Depreciation and amortization	\$ 49,369	\$ 41,600	\$ 7,769	18.7%

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Depreciation and amortization	\$ 41,600	\$ 26,363	\$ 15,237	57.8%

Acquisition activity contributed to the increase in depreciation and amortization expense in 2016 compared to 2015 and 2015 compared to 2014. Additionally, 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. Capital expenditures totaled \$100.8 million and \$83.2 million, respectively, in 2016 and 2015. These investments increase the amount of depreciable assets. See the discussion under Liquidity and Capital Resources for additional information.

Operating Income

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

	Year Ended December 31,		
	2016	2015	2014
Operating margin	3.9%	3.8%	4.3%
Operating margin adjusted for non-core charges ⁽¹⁾	4.1%	4.3%	4.4%

⁽¹⁾ See “Non-GAAP Reconciliations” for additional information.

In 2016, our operating margin improved 10 basis points compared to 2015. Adjusting for non-core charges, including asset impairments and a legal reserve, our operating margin was 4.1% in 2016, a decrease of 20 basis points compared to 2015. Acquired stores generally have a lower operating efficiency than our other stores and impacted our operating margin in 2016. In 2015, our operating margin was affected by asset impairments and a charge of \$18.3 million associated with a transition agreement. Adjusting for those non-core charges, our operating margin was 4.3% in 2015.

Floor Plan Interest Expense and Floor Plan Assistance

Floor plan interest expense increased \$6.0 million in 2016 compared to 2015, primarily as a result of an increase in the average outstanding balances on our floor plan facilities due to our increase in new vehicle inventory as discussed above. Changes in the average outstanding balances on our floor plan facilities increased the expense \$4.3 million and changes in the interest rates on our floor plan facilities increased the expense \$1.7 million during 2016 compared to 2015.

Floor plan interest expense increased \$5.7 million in 2015 compared to 2014. Changes in the average outstanding balances on our floor plan facilities increased the expense \$3.9 million and changes in the interest rates on our floor plan facilities increased the expense \$1.8 million.

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

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

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Floor plan interest expense (new vehicles)	\$ 25,531	\$ 19,534	\$ 5,997	30.7%
Floor plan assistance (included as an offset to cost of sales)	(46,328)	(41,438)	4,890	11.8
Net new vehicle carrying costs (benefit)	<u>\$ (20,797)</u>	<u>\$ (21,904)</u>	\$ (1,107)	(5.1)

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Floor plan interest expense (new vehicles)	\$ 19,534	\$ 13,861	\$ 5,673	40.9%
Floor plan assistance (included as an offset to cost of sales)	(41,438)	(28,748)	12,690	44.1
Net new vehicle carrying costs (benefit)	<u>\$ (21,904)</u>	<u>\$ (14,887)</u>	\$ 7,017	47.1

Other Interest Expense

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

(Dollars in thousands)	Year Ended December 31,		Increase (Decrease)	% Increase (Decrease)
	2016	2015		
Mortgage interest	\$ 15,102	\$ 13,295	\$ 1,807	13.6%
Other interest	8,519	6,646	1,873	28.2
Capitalized interest	(414)	(450)	(36)	(8.0)
Total other interest expense	<u>\$ 23,207</u>	<u>\$ 19,491</u>	\$ 3,716	19.1

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Mortgage interest	\$ 13,295	\$ 7,540	\$ 5,755	76.3%
Other interest	6,646	3,609	3,037	84.2
Capitalized interest	(450)	(407)	43	10.6
Total other interest expense	<u>\$ 19,491</u>	<u>\$ 10,742</u>	\$ 8,749	81.4

The increase in other interest expense in 2016 compared to 2015 was primarily due to higher volumes of borrowing on our credit facility and higher mortgage borrowings.

The increase in other interest expense in 2015 compared to 2014 was primarily due to an increase in other interest related to higher volumes of borrowing on our credit facility and higher mortgage borrowings, partially offset by increased capitalized interest.

Other (Expense) Income, net

Other (expense) income, net primarily includes interest income and the gains and losses related to equity-method investments.

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2016	2015		
Other income (expense), net	\$ (6,103)	\$ (1,006)	NM	NM

(Dollars in thousands)	Year Ended December 31,		Increase	% Increase
	2015	2014		
Other income (expense), net	\$ (1,006)	\$ 3,199	NM	NM

NM - Not meaningful.

The increase in expense in 2016 compared to 2015 was primarily due to \$8.3 million in operating losses related to our equity-method investment with U.S. Bancorp Community Development Corporation recorded in 2016 compared to \$6.9 million in operating losses recorded in 2015.

Other expense, net, recorded in 2015 was primarily due to operating losses of \$6.9 million recognized related to our equity-method investment with U.S. Bancorp Community Development Corporation compared to \$1.2 million in operating losses recorded in 2014.

Income Tax Provision

Our effective income tax rate was as follows:

	Year Ended December 31,		
	2016	2015	2014
Effective income tax rate	30.5%	30.3%	35.6%
Effective income tax rate excluding tax credits generated through our equity-method investment and other non-core items ⁽¹⁾	38.6%	38.4%	38.6%

⁽¹⁾ See “Non-GAAP Reconciliations” for more details.

Our effective income tax rate in 2016, 2015 and 2014 was positively affected by new markets tax credits that are generated through our equity-method investment with U.S. Bancorp Community Development Corporation.

Excluding the tax credits generated by our equity-method investment and adjusting for other non-core items, our effective income tax rate for 2016 would have been 38.6%, an increase of 20 basis points compared to the rate for 2015.

Non-GAAP Reconciliations

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

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

	Year Ended December 31, 2016					
	As reported	Disposal gain on sale of stores	Equity-method investment	Reserve adjustments	Tax attribute	Adjusted
Asset impairments	\$ 13,992	\$ —	\$ (13,992)	\$ —	\$ —	\$ —
Selling, general and administrative	899,590	1,087	—	(3,936)	—	896,741
Operating income (loss)	338,364	(1,087)	13,992	3,936	—	355,205
Other (expense) income, net	(6,103)	—	8,262	—	—	2,159
Income (loss) from continuing operations before income taxes	\$ 283,523	\$ (1,087)	\$ 22,254	\$ 3,936	\$ —	\$ 308,626
Income tax (provision) benefit	(86,465)	426	(28,530)	(3,250)	(1,320)	(119,139)
Income (loss) from continuing operations, net of income tax	\$ 197,058	\$ (661)	\$ (6,276)	\$ 686	\$ (1,320)	\$ 189,487
Diluted income (loss) per share from continuing operations	\$ 7.72	\$ (0.03)	\$ (0.25)	\$ 0.03	\$ (0.05)	\$ 7.42
Diluted share count	25,521					

	Year Ended December 31, 2015					
	As reported	Disposal gain on sale of stores	Asset impairment	Equity-method investment	Transition agreement	Adjusted
Asset impairments	\$ 20,124	\$ —	\$ (3,603)	\$ (16,521)	\$ —	\$ —
Selling, general and administrative	811,175	5,919	—	—	(18,296)	798,798
Income from operations	302,735	(5,919)	3,603	16,521	18,296	335,236
Other income, net	(1,006)	—	—	6,930	—	5,924
Income from continuing operations before income taxes	\$ 262,704	\$ (5,919)	\$ 3,603	\$ 23,451	\$ 18,296	\$ 302,135
Income tax provision	(79,705)	2,309	(1,385)	(30,832)	(6,507)	(116,120)
Income (loss) from continuing operations, net of income tax	\$ 182,999	\$ (3,610)	\$ 2,218	\$ (7,381)	\$ 11,789	\$ 186,015
Diluted income (loss) per share from continuing operations	\$ 6.91	\$ (0.14)	\$ 0.08	\$ (0.28)	\$ 0.45	\$ 7.02
Diluted share count	26,490					

Year Ended December 31, 2014

	As reported	Acquisition expenses	Reserve adjustments	Equity- method investment	Tax attribute	Adjusted
Asset impairments	\$ 1,853	\$ —	\$ —	\$ (1,853)	\$ —	\$ —
Selling, general and administrative	\$ 563,207	(1,865)	(3,931)	—	—	\$ 557,411
Income from operations	231,899	1,865	3,931	1,853	—	239,548
Other income, net	\$ 3,199	—	—	1,160	—	\$ 4,359
Income (loss) from continuing operations before income taxes	\$ 210,495	\$ 1,865	\$ 3,931	\$ 3,013	\$ —	\$ 219,304
Income tax (provision) benefit	(74,955)	(720)	(1,545)	(6,506)	(867)	(84,593)
Income (loss) from continuing operations, net of income tax	<u>\$ 135,540</u>	<u>\$ 1,145</u>	<u>\$ 2,386</u>	<u>\$ (3,493)</u>	<u>\$ (867)</u>	<u>\$ 134,711</u>
Diluted income (loss) per share from continuing operations	\$ 5.14	\$ 0.04	\$ 0.09	\$ (0.13)	\$ (0.03)	\$ 5.11
Diluted share count	26,382					

Liquidity and Capital Resources

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

Available Sources

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

	As of December 31,		Increase	% Increase
	2016	2015		
Cash and cash equivalents	\$ 50,282	\$ 45,008	\$ 5,274	11.7%
Available credit on the credit facilities	138,090	134,120	3,970	3.0
Total current available funds	188,372	179,128	9,244	5.2
Estimated funds from unfinanced real estate	168,383	158,605	9,778	6.2
Total estimated available funds	<u>\$ 356,755</u>	<u>\$ 337,733</u>	<u>\$ 19,022</u>	5.6

Cash flows generated by operating activities and from our credit facility are our most significant sources of liquidity. We also have the ability to raise funds through mortgaging real estate. As of December 31, 2016, our unencumbered owned operating real estate had a book value of \$224.5 million. Assuming we can obtain financing on 75% of this value, we estimate we could have obtained additional funds of approximately \$168.4 million at December 31, 2016; however, no assurances can be provided that the appraised value of these properties will match or exceed their book values or that this capital source will be available on terms acceptable to us.

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

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

	Year Ended December 31,		
	2016	2015	2014
Net cash provided by operating activities	\$ 86,516	\$ 74,539	\$ 30,967
Net cash used in investing activities	(351,693)	(169,733)	(736,332)
Net cash provided by financing activities	270,451	110,304	711,577

Operating Activities

Cash provided by operating activities increased \$12.0 million in 2016 compared to 2015, primarily as a result of increased profitability and increased amount of inventory acquired through investing activities, such as acquisitions, rather than normal operations compared to the previous year's cash flows, offset by increased trade receivables.

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

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

	Year Ended December 31,		
	2016	2015	Change
Net cash provided by operating activities – as reported	\$ 86,516	\$ 74,539	\$ 11,977
Add: Net borrowings on floor plan notes payable: non-trade	252,893	136,201	116,692
Less: Borrowings on floor plan notes payable: non-trade associated with acquired new vehicle inventory	(94,550)	(25,642)	(68,908)
Net cash provided by operating activities – adjusted	<u>\$ 244,859</u>	<u>\$ 185,098</u>	<u>\$ 59,761</u>

	Year Ended December 31,		
	2015	2014	Change
Net cash provided by operating activities – as reported	\$ 74,539	\$ 30,967	\$ 43,572
Add: Net borrowings on floor plan notes payable: non-trade	136,201	440,341	(304,140)
Less: Borrowings on floor plan notes payable: non-trade associated with acquired new vehicle inventory	(25,642)	(257,363)	231,721
Net cash provided by operating activities – adjusted	<u>\$ 185,098</u>	<u>\$ 213,945</u>	<u>\$ (28,847)</u>

Inventories are the most significant component of our cash flow from operations. As of December 31, 2016, our new vehicle days supply was 68 days, or one day higher than our days supply as of December 31, 2015. Our days supply of used vehicles was 56 days as of December 31, 2016, or one day higher than our days supply as of December 31, 2015. We calculate days supply of inventory based on current inventory levels, excluding in-transit vehicles, and a 30-day historical cost of sales level. We have continued to focus on managing our unit mix and maintaining an appropriate level of new and used vehicle inventory.

Investing Activities

Net cash used in investing activities totaled \$351.7 million and \$169.7 million, respectively, for 2016 and 2015. Cash flows from investing activities relate primarily to capital expenditures, acquisition and divestiture activity and sales of property and equipment.

Below are highlights of significant activity related to our cash flows from investing activities (in thousands):

	Year Ended December 31,		Decrease in Cash Flow
	2016	2015	
Capital expenditures	\$ (100,761)	\$ (83,244)	\$ (17,517)
Cash paid for acquisitions, net of cash acquired	(234,700)	(71,615)	(163,085)
Cash paid for other investments	(30,280)	(28,110)	(2,170)
Proceeds from sales of stores	11,837	12,966	(1,129)

	Year Ended December 31,		Increase (Decrease) in Cash Flow
	2015	2014	
Capital expenditures	\$ (83,244)	\$ (85,983)	\$ 2,739
Cash paid for acquisitions, net of cash acquired	(71,615)	(659,634)	588,019
Cash paid for other investments	(28,110)	(9,110)	(19,000)
Proceeds from sales of stores	12,966	10,617	2,349

Capital Expenditures

Below is a summary of our capital expenditure activities (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Post-acquisition capital improvements	\$ 31,489	\$ 32,802	\$ 20,760
Facilities for open points	—	3,338	6,700
Purchases of previously leased facilities	24,016	9,946	25,082
Existing facility improvements	24,249	20,245	19,813
Maintenance	21,007	16,913	13,628
Total capital expenditures	<u>\$ 100,761</u>	<u>\$ 83,244</u>	<u>\$ 85,983</u>

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

We expect to use a portion of our future capital expenditures to upgrade facilities that we recently acquired. This additional capital investment is contemplated in our initial evaluation of the investment return metrics applied to each acquisition and is usually associated with manufacturer image standards and requirements.

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

We expect to make expenditures of approximately \$123 million in 2017 for capital improvements at recently acquired stores, purchases of land for expansion of existing stores, facility image improvements, purchases of store facilities, purchases of previously leased facilities and replacement of equipment.

Acquisitions

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

We are able to subsequently floor new vehicle inventory acquired as part of an acquisition; however, the cash generated by this transaction is recorded as borrowings on floor plan notes payable, non-trade. Adjusted net cash paid for acquisitions, as well as certain other acquisition-related information is presented below (dollars in thousands):

	Year Ended December 31,		
	2016	2015	2014
Number of stores acquired	15	6	35
Number of stores opened	1	1	—
Number of franchises added	1	1	1
Cash paid for acquisitions, net of cash acquired	\$ (234,700)	\$ (71,615)	\$ (659,634)
Less: Borrowings on floor plan notes payable: non-trade associated with acquired new vehicle inventory	94,550	25,642	257,363
Cash paid for acquisitions, net of cash acquired – adjusted	<u>\$ (140,150)</u>	<u>\$ (45,973)</u>	<u>\$ (402,271)</u>

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

Financing Activities

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

	Year Ended December 31,		
	2016	2015	2014
Cash provided by financing activities, as reported	\$ 270,451	\$ 110,304	\$ 711,577
Less: cash provided by borrowings of floor plan notes payable: non-trade	(252,893)	(136,201)	(440,341)
Cash provided by (used in) financing activities, as adjusted	<u>\$ 17,558</u>	<u>\$ (25,897)</u>	<u>\$ 271,236</u>

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

	Year Ended December 31,		Increase (Decrease) in Cash Flow
	2016	2015	
Net borrowings (repayments) on lines of credit	\$ 121,261	\$ (36,523)	\$ 157,784
Principal payments on long-term debt and capital leases, other	(27,703)	(9,189)	(18,514)
Proceeds from the issuance of long-term debt	66,466	75,675	(9,209)
Repurchases of common stock	(112,939)	(31,548)	(81,391)
Dividends paid	(24,131)	(19,985)	(4,146)

	Year Ended December 31,		Decrease in Cash Flow
	2015	2014	
Net borrowings (repayments) on lines of credit	\$ (36,523)	\$ 183,769	\$ (220,292)
Principal payments on long-term debt, unscheduled	(9,189)	—	(9,189)
Proceeds from the issuance of long-term debt	75,675	124,902	(49,227)
Repurchases of common stock	(31,548)	(22,968)	(8,580)
Dividends paid	(19,985)	(15,929)	(4,056)

Borrowing and Repayment Activity

During 2016, we raised net mortgage proceeds of \$66.5 million and borrowed \$121.3 million on our line of credit. These funds were primarily used for acquisitions, share repurchases and capital expenditures.

Our debt to total capital ratio, excluding floor plan notes payable, was 46.5% at December 31, 2016 compared to 43.7% at December 31, 2015. We partially funded our 2016 acquisition activity with additional debt.

Equity Transactions

Under the share repurchase programs authorized by our Board of Directors and repurchases associated with stock compensation activity, we repurchased 1,407,674 shares of our Class A common stock at an average price of \$80.24 per share in 2016. As of December 31, 2016, we had \$193.1 million available for repurchase under our share repurchase program. The authority to repurchase does not have an expiration date.

In 2017 to date, we have repurchased approximately 39,000 shares at a weighted average price of \$100.60 per share. As of February 28, 2017, under our existing share repurchase authorization, approximately \$189 million remain available for purchase.

During 2016, we paid dividends on our Class A and Class B Common Stock as follows:

Dividend paid:	Dividend amount per share	Total amount of dividend (in thousands)
March 2016	\$ 0.20	\$ 5,151
May 2016	0.25	6,373
August 2016	0.25	6,299
November 2016	0.25	6,308

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

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

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

	Outstanding as of December 31, 2016	Remaining Available as of December 31, 2016
Floor plan note payable: non-trade	\$ 1,506,895	\$ — (1)
Floor plan notes payable	94,602	—
Used vehicle inventory financing facility	211,000	578 (2)
Revolving lines of credit	142,507	137,512 (2),(3)
Real estate mortgages	428,367	—
Other debt	11,191	—
Debt issuance costs	(2,184)	— (4)
Total debt	<u>\$ 2,392,378</u>	<u>\$ 138,090</u>

(1) As of December 31, 2016, we had a \$1.6 billion new vehicle floor plan commitment as part of our credit facility.

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

(3) Available credit is based on the borrowing base amount effective as of November 30, 2016. This amount is reduced by \$8.3 million for outstanding letters of credit.

(4) We adopted an accounting standard update that requires debt issuance costs be presented on the balance sheet as a reduction from the carrying amount of the related debt liability. We adopted the standard retrospectively and have presented all debt issuance costs as a reduction from the carrying amount of the related debt liability for both current and prior periods. See Note 6 of the Notes to Consolidated Financial Statements for additional information.

Credit Facility

We have a \$2.05 billion revolving syndicated credit facility which matures in July 2021. This syndicated credit facility is comprised of 18 financial institutions, including eight manufacturer-affiliated finance companies. Under our credit facility we are permitted to allocate the total financing commitment among floor plan financing for new vehicle inventory, floor plan financing for used vehicle inventory (up to a maximum of \$350 million) and revolving financing for general corporate purposes, including acquisitions and working capital (up to a maximum of \$400 million). Our credit facility may be expanded to \$2.40 billion total availability, subject to lender approval. All borrowings from, and repayments to, our lending group are presented in the Consolidated Statements of Cash Flows as financing activities.

The availability of the revolving line of credit under our syndicated credit facility is determined according to a borrowing base comprised of a portion of certain accounts, receivables, invoices, inventory and equipment. The borrowing base is reduced by the sum of the outstanding aggregate principal balance of new and used vehicle floorplan loans and new and used swing line loans.

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

We have the ability to deposit up to \$50 million in cash in Principal Reduction (PR) accounts associated with our new vehicle inventory floor plan commitment. The PR accounts are recognized as offsetting credits against outstanding amounts on our new vehicle floor plan commitment and would reduce interest expense associated with the outstanding principal balance. As of December 31, 2016, we had no balances in our PR accounts.

If the outstanding principal balance on our new vehicle inventory floor plan commitment, plus requests on any day, exceeds 95% of the loan commitment, a portion of the revolving line of credit must be reserved. The reserve amount is equal to the lesser of \$15.0 million or the maximum revolving line of credit commitment less the outstanding balance on the line less outstanding letters of credit. The reserve amount decreases the revolving line of credit availability and may be used to repay the new vehicle floor plan commitment balance.

The interest rate on the credit facility varies based on the type of debt, with the rate of one-month LIBOR plus 1.25% for new vehicle floor plan financing, one-month LIBOR plus 1.50% for used vehicle floor plan financing; and a variable interest rate on the revolving financing ranging from the one-month LIBOR plus 1.25% to 2.50%, depending on our leverage ratio. The annual interest rate associated with our new vehicle floor plan commitment, excluding the effects of our interest rate swaps, was 2.02% at December 31, 2016. The annual interest rate associated with our used vehicle inventory financing facility and our revolving line of credit was 2.27% and 2.52%, respectively, at December 31, 2016.

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

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

Debt Covenant Ratio	Requirement	As of December 31, 2016
Current ratio	Not less than 1.10 to 1	1.26 to 1
Fixed charge coverage ratio	Not less than 1.20 to 1	2.63 to 1
Leverage ratio	Not more than 5.00 to 1	2.18
Funded debt restriction	Not to exceed \$900 million	\$485.2 million

As of December 31, 2016, we were in compliance with all covenants. We expect to remain in compliance with the financial and restrictive covenants in our credit facility and other debt agreements. However, no assurances can be provided that we will continue to remain in compliance with the financial and restrictive covenants.

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

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

Other Lines of Credit

We have other lines of credit with a total financing commitment of \$38.5 million for general corporate purposes, including acquisitions and working capital. Substantially all of these other lines of credit mature in 2018 and have interest rates ranging up to 2.77%. As of December 31, 2016, we had outstanding debt of \$36.5 million on these other lines of credit.

Floor Plan Notes Payable

We have floor plan agreements with manufacturer-affiliated finance companies for certain new vehicles and vehicles that are designated for use as service loaners. The variable interest rates on these floor plan notes payable commitments vary by manufacturer. At December 31, 2016, \$94.6 million was outstanding on these arrangements. Borrowings from, and repayments to, manufacturer-affiliated finance companies are classified as operating activities in the Consolidated Statements of Cash Flows.

Real Estate Mortgages and Other Debt

We have mortgages associated with our owned real estate. Interest rates related to this debt ranged from 2.1% to 5.0% at December 31, 2016. The mortgages are payable in various installments through October 2034. As of December 31, 2016, we had fixed interest rates on 64.3% of our outstanding mortgage debt.

Our other debt includes capital leases and sellers' notes. Additionally, in 2015, our equity contribution obligations associated with the new markets tax credit equity-method investment were included in other debt. The interest rates associated with our other debt ranged from 4.3% to 9.7% at December 31, 2016. This debt, which totaled \$11.2 million at December 31, 2016, is due in various installments through December 2050.

Contractual Payment Obligations

A summary of our contractual commitments and obligations as of December 31, 2016, was as follows (in thousands):

<i>Contractual Obligation</i>	Payments Due By Period				
	Total	2017	2018 and 2019	2020 and 2021	2022 and beyond
New vehicle floor plan commitment ⁽¹⁾	\$ 1,506,895	\$ 1,506,895	\$ —	\$ —	\$ —
Floor plan notes payable ⁽¹⁾	94,602	94,602	—	—	—
Used vehicle inventory financing facility ⁽¹⁾	211,000	—	—	211,000	—
Revolving lines of credit ⁽¹⁾⁽³⁾	142,506	266	36,240	106,000	—
Real estate debt, including interest ⁽³⁾	523,324	36,156	111,028	93,927	282,213
Other debt, including capital leases and interest	27,182	1,418	2,887	2,844	20,033
Charge-backs on various contracts	44,229	24,320	18,019	1,819	71
Operating leases ⁽²⁾	251,806	27,294	49,589	42,475	132,449
Self-insurance programs	32,817	10,704	9,617	3,258	9,238
	<u>\$ 2,834,361</u>	<u>\$ 1,701,655</u>	<u>\$ 227,380</u>	<u>\$ 461,323</u>	<u>\$ 444,004</u>

(1) Amounts for new vehicle floor plan commitment, floor plan notes payable, the used vehicle inventory financing facility and the revolving line of credit do not include estimated interest payments. See Notes 1 and 6 in the Notes to Consolidated Financial Statements.

(2) Amounts for operating lease commitments do not include sublease income, and certain operating expenses such as maintenance, insurance and real estate taxes. See Note 7 in the Notes to Consolidated Financial Statements.

(3) Balances exclude net impact of debt issuance costs. See Note 6 in the Notes to Consolidated Financial Statements.

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.

Inflation and Changing Prices

Inflation and changing prices did not have a material impact on our revenues or income from continuing operations in the years ended December 31, 2016, 2015 and 2014.

Selected Consolidated Quarterly Financial Data

The following tables set forth our unaudited quarterly financial data (in thousands, except per share amounts): (1) (2)

2016	Three Months Ended,			
	March 31	June 30	September 30	December 31
Revenues:				
New vehicle	\$ 1,096,055	\$ 1,209,037	\$ 1,297,511	\$ 1,335,833
Used vehicle retail	532,726	553,647	580,885	559,693
Used vehicle wholesale	65,146	66,714	75,271	69,485
Finance and insurance	77,638	81,043	87,709	84,532
Service, body and parts	196,675	202,265	217,148	228,417
Fleet and other	14,621	20,633	11,443	14,030
Total revenues	1,982,861	2,133,339	2,269,967	2,291,990
Cost of sales	1,675,679	1,811,303	1,932,706	1,957,154
Gross profit	307,182	322,036	337,261	334,836
Asset impairments	3,498	3,498	3,498	3,498
Selling, general and administrative	219,106	215,526	228,134	236,824
Depreciation and amortization	11,663	12,503	12,206	12,997
Operating income	72,915	90,509	93,423	81,517
Floor plan interest expense	(5,909)	(6,209)	(6,186)	(7,227)
Other interest expense	(5,459)	(5,502)	(5,647)	(6,599)
Other expense, net	(1,526)	(1,495)	(1,513)	(1,569)
Income before income taxes	60,021	77,303	80,077	66,122
Income tax provision	(19,751)	(25,875)	(26,036)	(14,803)
Net income	\$ 40,270	\$ 51,428	\$ 54,041	\$ 51,319
Basic net income per share	\$ 1.56	\$ 2.02	\$ 2.15	\$ 2.04
Diluted net income per share	\$ 1.55	\$ 2.01	\$ 2.15	\$ 2.03

2015

	Three Months Ended,			
	March 31	June 30	September 30	December 31
Revenues:				
New vehicle	\$ 1,007,816	\$ 1,149,512	\$ 1,227,080	\$ 1,167,893
Used vehicle retail	462,931	488,801	505,885	469,399
Used vehicle wholesale	62,208	66,796	69,472	63,054
Finance and insurance	64,604	72,463	76,633	69,318
Service, body and parts	173,475	182,695	189,796	193,024
Fleet and other	18,144	36,680	15,979	30,594
Total revenues	1,789,178	1,996,947	2,084,845	1,993,282
Cost of sales	1,515,803	1,699,298	1,773,658	1,699,859
Gross profit	273,375	297,649	311,187	293,423
Asset impairments	4,130	6,130	4,131	5,733
Selling, general and administrative	191,618	195,610	223,728	200,219
Depreciation and amortization	9,726	10,287	10,531	11,056
Operating income	67,901	85,622	72,797	76,415
Floor plan interest expense	(4,649)	(4,655)	(4,951)	(5,279)
Other interest expense	(4,828)	(4,972)	(4,900)	(4,791)
Other (expense) income, net	(368)	(356)	(307)	25
Income before income taxes	58,056	75,639	62,639	66,370
Income tax provision	(17,403)	(24,416)	(19,248)	(18,638)
Net income	<u>\$ 40,653</u>	<u>\$ 51,223</u>	<u>\$ 43,391</u>	<u>\$ 47,732</u>
Basic net income per share	<u>\$ 1.55</u>	<u>\$ 1.95</u>	<u>\$ 1.64</u>	<u>\$ 1.82</u>
Diluted net income per share	<u>\$ 1.53</u>	<u>\$ 1.93</u>	<u>\$ 1.64</u>	<u>\$ 1.80</u>

(1) Quarterly data may not add to yearly totals due to rounding.

(2) Certain reclassifications of amounts previously reported have been made to the quarterly financial data to maintain consistency and comparability between periods presented.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Variable Rate Debt

Our syndicated credit facility, other floor plan notes payable and certain real estate mortgages are structured as variable rate debt. The interest rates on our variable rate debt are tied to either the one-month LIBOR, 3-month LIBOR, or the prime rate. These debt obligations, therefore, expose us to variability in interest payments due to changes in these rates. Certain floor plan debt is based on open-ended lines of credit tied to each individual store from the various manufacturer finance companies.

Our variable-rate floor plan notes payable, variable rate mortgage notes payable and other credit line borrowings subject us to market risk exposure. At December 31, 2016, we had \$2.1 billion outstanding under such agreements at a weighted average interest rate of 2.1% per annum. A 10% increase in interest rates, or 18 basis points, would increase annual interest expense by approximately \$2.6 million, net of tax, based on amounts outstanding at December 31, 2016.

Fixed Rate Debt

The fair value of our long-term fixed interest rate debt is subject to interest rate risk. Generally, the fair value of fixed interest rate debt will increase as interest rates fall because we would expect to be able to refinance for a lower rate. Conversely, the fair value of fixed interest rate debt will decrease as interest rates rise. The interest rate changes affect the fair value but do not impact earnings or cash flows.

At December 31, 2016, we had \$286.7 million of long-term fixed interest rate debt outstanding and recorded on the balance sheet, with maturity dates between May 1, 2018 and December 31, 2050. Based on discounted cash flows using current interest rates for comparable debt, we have determined that the fair value of this long-term fixed interest rate debt was approximately \$293.5 million at December 31, 2016.

Risk Management Policies

We assess interest rate cash flow risk by identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. Our policy is to manage this risk through a mix of fixed rate and variable rate debt structures.

We maintain risk management controls to monitor interest rate cash flow attributable to both our outstanding and forecasted debt obligations, as well as our offsetting hedge positions. The risk management controls include assessing the impact to future cash flows of changes in interest rates.

Item 8. Financial Statements and Supplementary Financial Data

The financial statements and notes thereto required by this item begin on page F-1 as listed in Item 15 of Part IV of this document. Quarterly financial data for each of the eight quarters in the two-year period ended December 31, 2016 is included in Item 7.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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 Annual Report on Form 10-K. 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.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016. In making this assessment, we used the criteria set forth in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In accordance with guidance issued by the SEC, companies are permitted to exclude acquisitions from their final assessment of internal controls over financial reporting during the year of the acquisition while integrating the acquired operations. Management's evaluation of internal control over financial reporting excludes the operations of the fifteen dealerships acquired in 2016. These stores represent approximately 8% of consolidated total assets as of December 31, 2016 and 3% of consolidated revenues as of and for the year ended December 31, 2016.

Based on our assessment, our management concluded that, as of December 31, 2016, our internal control over financial reporting was effective.

KPMG LLP, our Independent Registered Public Accounting Firm, has issued an attestation report on our internal control over financial reporting as of December 31, 2016, which is included in Item 8 of this Form 10-K.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information required by this item will be included in our Proxy Statement for our 2017 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 11. Executive Compensation

Information required by this item will be included in our Proxy Statement for our 2017 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Equity Compensation Plan Information

The following table summarizes equity securities authorized for issuance as of December 31, 2016.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) (2)
Equity compensation plans approved by shareholders	298,984	\$ — ⁽¹⁾	1,860,156
Equity compensation plans not approved by shareholders	—	—	—
Total	298,984	\$ —	1,860,156

(1) There is no exercise price associated with our restricted stock units.

(2) Includes 1,487,405 shares available pursuant to our 2013 Amended and Restated Stock Incentive Plan and 372,751 shares available pursuant to our Employee Stock Purchase Plan.

The additional information required by this item will be included under the caption *Security Ownership of Certain Beneficial Owners and Management* in our Proxy Statement for our 2017 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information required by this item will be included in our Proxy Statement for our 2017 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information required by this item will be included in our Proxy Statement for our 2017 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

Financial Statements and Schedules

The Consolidated Financial Statements, together with the reports thereon of KPMG LLP, Independent Registered Public Accounting Firm, are included on the pages indicated below:

	Page
Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets as of December 31, 2016 and 2015	F-3
Consolidated Statements of Operations for the years ended December 31, 2016, 2015 and 2014	F-4
Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014	F-5
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2016, 2015 and 2014	F-6
Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015 and 2014	F-7
Notes to Consolidated Financial Statements	F-8

There are no schedules required to be filed herewith.

Exhibit Index

The following exhibits are filed herewith. An asterisk (*) beside the exhibit number indicates the exhibits containing a management contract, compensatory plan or arrangement.

<u>Exhibit</u>	<u>Description</u>
2.1	Stock Purchase Agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014 (incorporated by reference to exhibit 2.1 to the Company's Form 8-K filed October 3, 2014)
2.1.1	First Amendment to Stock Purchase Agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited effective July 15, 2014 (incorporated by reference to exhibit 2.2 to the Company's Form 10-Q for the quarter ended June 30, 2014)
2.1.2	Second Amendment to Stock Purchase Agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited effective November 13, 2014 (incorporated by reference to exhibit 2.1.2 to the Company's Form 10-K for the year ended December 31, 2014)
3.1	Restated Articles of Incorporation of Lithia Motors, Inc., as amended May 13, 1999 (incorporated by reference to exhibit 3.1 to the Company's Form 10-K for the year ended December 31, 1999)
3.2	2013 Amended and Restated Bylaws of Lithia Motors, Inc. (incorporated by reference to exhibit 3.1 to the Company's Form 8-K filed August 26, 2013)
10.1*	2009 Employee Stock Purchase Plan (incorporated by reference to Appendix A to the Company's Proxy Statement for its 2009 annual meeting of shareholders filed on March 20, 2009)
10.1.1*	Amendment 2014-1 to the Lithia Motors, Inc. 2009 Employee Stock Purchase Plan (incorporated by reference to exhibit 10.1.1 to the Company's Form 10-K for the year ended December 31, 2014)
10.2*	Lithia Motors, Inc. 2013 Amended and Restated Stock Incentive Plan (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed May 2, 2013)
10.2.1*	RSU Deferral Plan (incorporated by reference to exhibit 10.3.1 to the Company's Form 10-K for the year ended December 31, 2011)
10.2.2*	Amendment to RSU Deferral Plan (incorporated by reference to exhibit 10.2.2 to the Company's Form 10-K for the year ended December 31, 2014)
10.2.3*	Restricted Stock Unit (RSU) Deferral Election Form (incorporated by reference to exhibit 10.2.3 to the Company's Form 10-K for the year ended December 31, 2014)
10.3*	Form of Restricted Stock Unit Agreement (2016 Performance- and Time-Vesting) (for Senior Executives) (incorporated by reference to exhibit 10.3.3 to the Company's Form 10-K for the year ended December 31, 2015)
10.3.1*	Form of Restricted Stock Unit Agreement (2017 Performance- and Time-Vesting) (for Senior Executives)
10.3.2*	Form of Restricted Stock Unit Agreement (Time-Vesting)
10.3.3*	Form of Restricted Stock Unit Agreement (Long-Term Performance-Vesting)
10.4*	Lithia Motors, Inc. 2013 Discretionary Support Services Variable Performance Compensation Plan (incorporated by reference to exhibit 10.2 to the Company's Form 8-K filed May 2, 2013)
10.5*	Form of Outside Director Nonqualified Deferred Compensation Agreement (incorporated by reference to exhibit 10.20 to the Company's Form 10-K for the year ended December 31, 2005)
10.6	Amended and Restated Loan Agreement among Lithia Motors, Inc., the subsidiaries of Lithia Motors, Inc. listed on the signature pages of the agreement or that thereafter become borrowers thereunder, the lenders party thereto from time to time, and U.S. Bank National Association (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed October 3, 2014)
10.6.1	First Amendment to Amended and Restated Loan Agreement (incorporated by reference to exhibit 10.4 to the Company's Form 10-Q for the quarter ended March 31, 2015)
10.6.2	Second Amendment to Amended and Restated Loan Agreement (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed December 22, 2015)
10.6.3	Third Amendment to Amended and Restated Loan Agreement (incorporated by reference to exhibit 10.1 to the Company's Form 10-Q for the quarter ended June 30, 2016)

<u>Exhibit</u>	<u>Description</u>
10.6.4	Fourth Amendment to Amended and Restated Loan Agreement (incorporated by reference to exhibit 10.2 to the Company's Form 10-Q for the quarter ended June 30, 2016)
10.7*	Amended and Restated Split-Dollar Agreement (incorporated by reference to exhibit 10.17 to the Company's Form 10-K for the year ended December 31, 2012)
10.8*	Form of Indemnity Agreement for each Named Executive Officer (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed May 29, 2009)
10.9*	Form of Indemnity Agreement for each non-management Director (incorporated by reference to exhibit 10.2 to the Company's Form 8-K filed May 29, 2009)
10.10*	Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan (incorporated by reference to exhibit 10.1 to the Company's Form 10-Q for the quarter ended March 31, 2016)
10.10.1*	Form of Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan – Notice of Discretionary Contribution Award for Sidney DeBoer (incorporated by reference to exhibit 10.22.1 to the Company's Form 10-K for the year ended December 31, 2010)
10.10.2*	Form of Executive Management Non-Qualified Deferred Compensation and Long-Term Incentive Plan – Notice of Discretionary Contribution Award (incorporated by reference to exhibit 10.22.2 to the Company's Form 10-K for the year ended December 31, 2010)
10.11*	Transition Agreement dated September 14, 2015 between Lithia Motors, Inc. and Sidney B. DeBoer (incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed September 17, 2015)
10.12*	Director Service Agreement effective January 1, 2016 between Lithia Motors, Inc. and Sidney B. DeBoer (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed September 17, 2015)
10.13*	Form of Employment and Change in Control Agreement dated February 4, 2016 between Lithia Motors, Inc. and Bryan DeBoer (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed February 5, 2016) ⁽¹⁾
12	Ratio of Earnings to Combined Fixed Charges
21	Subsidiaries of Lithia Motors, Inc.
23	Consent of KPMG LLP, Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
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.

(1) Substantially similar agreements exist between Lithia Motors, Inc. and each of Scott Hillier, Christopher S. Holzshu, John F. North III, George Liang, Mark DeBoer and Tom Dobry. The "Cash Change in Control Benefits" under the agreements with Mr. Mark DeBoer and Mr. Dobry provide for 12 months of base salary rather than 24 months.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: February 28, 2017

LITHIA MOTORS, INC.

By /s/ Bryan B. DeBoer

Bryan B. DeBoer

Director, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on February 28, 2017:

<u>Signature</u>	<u>Title</u>
<u>/s/ Bryan B. DeBoer</u> Bryan B. DeBoer	Director, President and Chief Executive Officer. (Principal Executive Officer)
<u>/s/ John F. North III</u> John F. North III	Senior Vice President and Chief Financial Officer (Principal Accounting Officer)
<u>/s/ Sidney B. DeBoer</u> Sidney B. DeBoer	Chairman of the Board
<u>/s/ Thomas Becker</u> Thomas Becker	Director
<u>/s/ Susan O. Cain</u> Susan O. Cain	Director
<u>/s/ Shau-wai Lam</u> Shau-wai Lam	Director
<u>/s/ Kenneth E. Roberts</u> Kenneth E. Roberts	Director
<u>/s/ David J. Robino</u> David J. Robino	Director

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Lithia Motors, Inc.:

We have audited the accompanying Consolidated Balance Sheets of Lithia Motors, Inc. and subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related Consolidated Statements of Operations, Comprehensive Income, Changes in Stockholders’ Equity, and Cash Flows for each of the years in the three-year period ended December 31, 2016. These Consolidated Financial Statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the Consolidated Financial Statements referred to above present fairly, in all material respects, the financial position of Lithia Motors, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Lithia Motors, Inc. and subsidiaries’ internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 28, 2017 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting. This report includes a paragraph stating that management excluded from its assessment of the effectiveness of Lithia Motors, Inc. and subsidiaries’ internal control over financial reporting as of December 31, 2016, 15 acquired stores’ internal control over financial reporting. The total assets of these 15 stores represented approximately 8% of consolidated total assets as of December 31, 2016 and approximately 3% of consolidated revenues for the year ended December 31, 2016. Our audit of internal control over financial reporting of Lithia Motors, Inc. also excluded an evaluation of the internal control over financial reporting of these 15 stores.

As discussed in Note 15 to the Consolidated Financial Statements, the Company has changed its method for reporting discontinued operations as of September 2014.

/s/ KPMG LLP

Portland, Oregon
February 28, 2017

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Lithia Motors, Inc.:

We have audited Lithia Motors, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Lithia Motors, Inc. completed the acquisition of 15 stores during 2016 and management excluded from its assessment of the effectiveness of Lithia Motors, Inc.'s internal control over financial reporting as of December 31, 2016, all of these acquired stores' internal control over financial reporting. The total assets of these 15 stores represented approximately 8% of consolidated total assets as of December 31, 2016 and approximately 3% of consolidated revenues for the year ended December 31, 2016. Our audit of internal control over financial reporting of Lithia Motors, Inc. also excluded an evaluation of the internal control over financial reporting of these 15 stores.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Consolidated Balance Sheets of Lithia Motors, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related Consolidated Statements of Operations, Comprehensive Income, Changes in Stockholders' Equity, and Cash Flows for each of the years in the three-year period ended December 31, 2016, and our report dated February 28, 2017 expressed an unqualified opinion on those Consolidated Financial Statements.

/s/ KPMG LLP

Portland, Oregon
February 28, 2017

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

	December 31,	
	2016	2015
Assets		
Current Assets:		
Cash and cash equivalents	\$ 50,282	\$ 45,008
Accounts receivable, net of allowance for doubtful accounts of \$5,281 and \$2,243	417,714	308,462
Inventories, net	1,772,587	1,470,987
Other current assets	46,611	54,022
Total Current Assets	2,287,194	1,878,479
Property and equipment, net of accumulated depreciation of \$167,300 and \$137,853	1,006,130	876,660
Goodwill	259,399	213,220
Franchise value	184,268	157,699
Other non-current assets	107,159	99,072
Total Assets	<u>\$ 3,844,150</u>	<u>\$ 3,225,130</u>
Liabilities and Stockholders' Equity		
Current Liabilities:		
Floor plan notes payable	\$ 94,602	\$ 48,083
Floor plan notes payable: non-trade	1,506,895	1,265,872
Current maturities of long-term debt	20,965	38,506
Trade payables	88,423	70,871
Accrued liabilities	211,109	167,107
Total Current Liabilities	1,921,994	1,590,439
Long-term debt, less current maturities	769,916	604,680
Deferred revenue	81,929	66,734
Deferred income taxes	59,075	53,129
Other long-term liabilities	100,460	81,984
Total Liabilities	2,933,374	2,396,966
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 23,382 and 23,676	165,512	258,410
Class B common stock - no par value; authorized 25,000 shares; issued and outstanding 1,762 and 2,542	219	316
Additional paid-in capital	41,225	38,822
Accumulated other comprehensive loss	—	(277)
Retained earnings	703,820	530,893
Total Stockholders' Equity	910,776	828,164
Total Liabilities and Stockholders' Equity	<u>\$ 3,844,150</u>	<u>\$ 3,225,130</u>

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2016	2015	2014
Revenues:			
New vehicle	\$ 4,938,436	\$ 4,552,301	\$ 3,077,670
Used vehicle retail	2,226,951	1,927,016	1,362,481
Used vehicle wholesale	276,616	261,530	195,699
Finance and insurance	330,922	283,018	190,381
Service, body and parts	844,505	738,990	512,124
Fleet and other	60,727	101,397	51,971
Total revenues	<u>8,678,157</u>	<u>7,864,252</u>	<u>5,390,326</u>
Cost of sales:			
New vehicle	4,649,024	4,271,931	2,879,486
Used vehicle retail	1,963,267	1,685,767	1,183,228
Used vehicle wholesale	272,303	257,073	192,053
Service, body and parts	434,222	375,069	262,388
Fleet and other	58,026	98,778	49,849
Total cost of sales	<u>7,376,842</u>	<u>6,688,618</u>	<u>4,567,004</u>
Gross profit	1,301,315	1,175,634	823,322
Asset impairments	13,992	20,124	1,853
Selling, general and administrative	899,590	811,175	563,207
Depreciation and amortization	49,369	41,600	26,363
Operating income	338,364	302,735	231,899
Floor plan interest expense	(25,531)	(19,534)	(13,861)
Other interest expense	(23,207)	(19,491)	(10,742)
Other (expense) income, net	(6,103)	(1,006)	3,199
Income from continuing operations before income taxes	283,523	262,704	210,495
Income tax provision	(86,465)	(79,705)	(74,955)
Income from continuing operations, net of income tax	197,058	182,999	135,540
Income from discontinued operations, net of income tax	—	—	3,180
Net income	<u>\$ 197,058</u>	<u>\$ 182,999</u>	<u>\$ 138,720</u>
Basic income per share from continuing operations			
Basic income per share from continuing operations	\$ 7.76	\$ 6.96	\$ 5.19
Basic income per share from discontinued operations	—	—	0.12
Basic net income per share	<u>\$ 7.76</u>	<u>\$ 6.96</u>	<u>\$ 5.31</u>
Shares used in basic per share calculations			
	<u>25,409</u>	<u>26,290</u>	<u>26,121</u>
Diluted income per share from continuing operations			
Diluted income per share from continuing operations	\$ 7.72	\$ 6.91	\$ 5.14
Diluted income per share from discontinued operations	—	—	0.12
Diluted net income per share	<u>\$ 7.72</u>	<u>\$ 6.91</u>	<u>\$ 5.26</u>
Shares used in diluted per share calculations			
	<u>25,521</u>	<u>26,490</u>	<u>26,382</u>
Cash dividend declared per Class A and Class B share	<u>\$ 0.95</u>	<u>\$ 0.76</u>	<u>\$ 0.61</u>

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2016	2015	2014
Net income	\$ 197,058	\$ 182,999	\$ 138,720
Other comprehensive income, net of tax:			
Gain on cash flow hedges, net of tax expense of \$175, \$399 and \$380	277	649	612
Comprehensive income	<u>\$ 197,335</u>	<u>\$ 183,648</u>	<u>\$ 139,332</u>

See accompanying notes to consolidated financial statements.

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

	Common Stock				Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
	Class A		Class B					
	Shares	Amount	Shares	Amount				
Balance at December 31, 2013	23,329	\$ 268,255	2,562	\$ 319	\$ 22,598	\$ (1,538)	\$ 245,088	\$ 534,722
Net income							138,720	138,720
Gain on cash flow hedges, net of tax expense of \$380	—	—	—	—	—	612	—	612
Issuance of stock in connection with employee stock plans	118	4,590	—	—	—	—	—	4,590
Issuance of restricted stock to employees	288	—	—	—	—	—	—	—
Repurchase of Class A common stock	(333)	(22,968)	—	—	—	—	—	(22,968)
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	6,445	—	—	7,177	—	—	13,622
Issuance of stock in connection with acquisitions	269	19,736	—	—	—	—	—	19,736
Dividends paid	—	—	—	—	—	—	(15,929)	(15,929)
Balance at December 31, 2014	23,671	276,058	2,562	319	29,775	(926)	367,879	673,105
Net income	—	—	—	—	—	—	182,999	182,999
Gain on cash flow hedges, net of tax expense of \$399	—	—	—	—	—	649	—	649
Issuance of stock in connection with employee stock plans	74	6,065	—	—	—	—	—	6,065
Issuance of restricted stock to employees	217	—	—	—	—	—	—	—
Repurchase of Class A common stock	(306)	(31,548)	—	—	—	—	—	(31,548)
Class B common stock converted to Class A common stock	20	3	(20)	(3)	—	—	—	—
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	7,832	—	—	9,047	—	—	16,879
Dividends paid	—	—	—	—	—	—	(19,985)	(19,985)
Balance at December 31, 2015	23,676	258,410	2,542	316	38,822	(277)	530,893	828,164
Net income							197,058	197,058
Gain on cash flow hedges, net of tax expense of \$175	—	—	—	—	—	277	—	277
Issuance of stock in connection with employee stock plans	93	6,932	—	—	—	—	—	6,932
Issuance of restricted stock to employees	241	—	—	—	—	—	—	—
Repurchase of Class A common stock	(1,408)	(112,939)	—	—	—	—	—	(112,939)
Class B common stock converted to Class A common stock	780	97	(780)	(97)	—	—	—	—
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	13,012	—	—	2,403	—	—	15,415
Dividends Paid	—	—	—	—	—	—	(24,131)	(24,131)

**Balance at December 31,
2016**

23,382 \$ 165,512 1,762 \$ 219 \$ 41,225 \$ — \$ 703,820 \$ 910,776

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2016	2015	2014
Cash flows from operating activities:			
Net income	\$ 197,058	\$ 182,999	\$ 138,720
Adjustments to reconcile net income to net cash provided by operating activities:			
Asset impairments	13,992	20,124	1,853
Depreciation and amortization	49,369	41,600	26,363
Stock-based compensation	11,047	11,871	7,436
(Gain) loss on disposal of other assets	(4,343)	203	270
Gain from disposal activities	(1,102)	(5,919)	(5,744)
Deferred income taxes	10,138	12,341	13,355
Excess tax benefit from share-based payment arrangements	(4,389)	(5,012)	(6,186)
(Increase) decrease (net of acquisitions and dispositions):			
Trade receivables, net	(105,961)	(13,047)	(59,474)
Inventories	(168,847)	(197,079)	(76,002)
Other assets	(13,305)	(31,290)	(30,534)
Increase (decrease) (net of acquisitions and dispositions):			
Floor plan notes payable	16,385	7,035	(647)
Trade payables	16,449	674	(3,105)
Accrued liabilities	42,852	16,273	(13,471)
Other long-term liabilities and deferred revenue	27,173	33,766	38,133
Net cash provided by operating activities	86,516	74,539	30,967
Cash flows from investing activities:			
Principal payments received on notes receivable	—	—	2,882
Capital expenditures	(100,761)	(83,244)	(85,983)
Proceeds from sales of assets	2,211	270	4,896
Cash paid for other investments	(30,280)	(28,110)	(9,110)
Cash paid for acquisitions, net of cash acquired	(234,700)	(71,615)	(659,634)
Proceeds from sales of stores	11,837	12,966	10,617
Net cash used in investing activities	(351,693)	(169,733)	(736,332)
Cash flows from financing activities:			
Borrowings on floor plan notes payable: non-trade, net	252,893	136,201	440,341
Borrowings on lines of credit	1,244,343	1,261,597	1,435,144
Repayments on lines of credit	(1,123,082)	(1,298,120)	(1,251,375)
Principal payments on long-term debt, scheduled	(16,717)	(15,404)	(9,314)
Principal payments on long-term debt and capital leases, other	(27,703)	(9,189)	—
Proceeds from issuance of long-term debt	66,466	75,675	124,902
Proceeds from issuance of common stock	6,932	6,065	4,590
Repurchase of common stock	(112,939)	(31,548)	(22,968)
Excess tax benefit from share-based payment arrangements	4,389	5,012	6,186
Dividends paid	(24,131)	(19,985)	(15,929)
Net cash provided by financing activities	270,451	110,304	711,577
Increase in cash and cash equivalents	5,274	15,110	6,212
Cash and cash equivalents at beginning of year	45,008	29,898	23,686
Cash and cash equivalents at end of year	\$ 50,282	\$ 45,008	\$ 29,898
Supplemental disclosure of cash flow information:			
Cash paid during the period for interest	\$ 49,730	\$ 41,098	\$ 24,610
Cash paid during the period for income taxes, net	57,236	86,533	63,827
Supplemental schedule of non-cash activities:			
Debt issued in connection with acquisitions	\$ —	\$ 2,160	\$ 55,693
Non-cash assets transferred in connection with acquisitions	2,637	—	—
Debt forgiven in connection with acquisitions	\$ —	1,374	\$ —
Debt assumed in connection with acquisitions	48,081	—	—
Acquisition of assets with capital leases	8,916	—	—
Floor plan debt paid in connection with store disposals	5,284	4,400	3,311

See accompanying notes to consolidated financial statements.

LITHIA MOTORS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) **Summary of Significant Accounting Policies**

Organization and Business

We are a leading operator of automotive franchises and a retailer of new and used vehicles and related services. As of December 31, 2016, we offered 30 brands of new vehicles and all brands of used vehicles in 154 stores in the United States and online at Lithia.com, DCHauto.com and CarboneCars.com. We sell new and used cars and replacement parts; provide vehicle maintenance, warranty, paint and repair services; arrange related financing; and sell service contracts, vehicle protection products and credit insurance.

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

Basis of Presentation

The accompanying Consolidated Financial Statements reflect the results of operations, the financial position and the cash flows for Lithia Motors, Inc. and its directly and indirectly wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand and cash in bank accounts without restrictions.

Accounts Receivable

Accounts receivable include amounts due from the following:

- various lenders for the financing of vehicles sold;
- customers for vehicles sold and service and parts sales;
- manufacturers for factory rebates, dealer incentives and warranty reimbursement; and
- insurance companies and other miscellaneous receivables.

Receivables are recorded at invoice and do not bear interest until they are 60 days past due. The allowance for doubtful accounts represents an estimate of the amount of net losses inherent in our portfolio of accounts receivable as of the reporting date. We estimate an allowance for doubtful accounts based on our historical write-off experience and consider recent delinquency trends and recovery rates. Account balances are charged against the allowance after all appropriate means of collection have been exhausted and the potential for recovery is considered remote. The annual activity for charges and subsequent recoveries is immaterial. See Note 2.

Inventories

Inventories are valued at the lower of market value or cost, using a pooled approach for vehicles and the specific identification method for parts. Certain acquired inventories are valued using the last-in first-out (LIFO) method. The LIFO reserve associated with this inventory as of December 31, 2016 and 2015 was immaterial. The cost of new and used vehicle inventories includes the cost of any equipment added, reconditioning and transportation.

Manufacturers reimburse us for holdbacks, floor plan interest assistance and advertising assistance, which are reflected as a reduction in the carrying value of each vehicle purchased. We recognize advertising assistance, floor plan interest assistance, holdbacks, cash incentives and other rebates received from manufacturers that are tied to specific vehicles as a reduction to cost of sales as the related vehicles are sold.

Parts are valued at the lower of market value or cost using the specific identification method. Parts purchase discounts that we receive from the manufacturer are reflected as a reduction in the carrying value of the parts purchased from the manufacturer and are recognized as a reduction to cost of goods sold as the related inventory is sold. See Note 3.

Property and Equipment

Property and equipment are stated at cost and depreciated over their estimated useful lives on the straight-line basis. Leasehold improvements made at the inception of the lease or during the term of the lease are amortized on a straight-line basis over the shorter of the life of the improvement or the remaining term of the lease.

The range of estimated useful lives is as follows:

Buildings and improvements (in years)	5 to 40
Service equipment (in years)	5 to 15
Furniture, office equipment, signs and fixtures (in years)	3 to 10

The cost for maintenance, repairs and minor renewals is expensed as incurred, while significant remodels and betterments are capitalized. In addition, interest on borrowings for major capital projects, significant remodels, and betterments are capitalized. Capitalized interest becomes a part of the cost of the depreciable asset and is depreciated according to the estimated useful lives as previously stated. For the years ended December 31, 2016, 2015 and 2014, we recorded capitalized interest of \$0.4 million, \$0.5 million and \$0.4 million, respectively.

When an asset is retired, or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is credited or charged to income from continuing operations.

Leased property meeting certain criteria are recorded as capital leases. The Company has capital leases for certain locations, expiring at various dates through December 31, 2050. Our capital leases are included in property and equipment on our Consolidated Balance Sheets. Amortization of capitalized leased assets is computed on a straight-line basis over the term of the lease, unless the lease transfers title or it contains a bargain purchase option, in which case, it is amortized over the asset's useful life and is included in depreciation expense. Capital lease obligations are recorded as the lesser of the estimated fair market value of the leased property or the net present value of the aggregated future minimum payments and are included in current maturities of long-term debt and long-term debt on our Consolidated Balance Sheets. Interest associated with these obligations are included in other interest expense in the Consolidated Statements of Operations. See Note 7.

Long-lived assets held and used by us are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. We consider several factors when evaluating whether there are indications of potential impairment related to our long-lived assets, including store profitability, overall macroeconomic factors and the impact of our strategic management decisions. If recoverability testing is performed, we evaluate assets to be held and used by comparing the carrying amount of an asset to future net undiscounted cash flows associated with the asset, including its disposition. If such assets are considered to be impaired, the amount by which the carrying amount of the assets exceeds the fair value of the assets is recognized as a charge to income from continuing operations. See Notes 4 and 12.

Goodwill

Goodwill represents the excess purchase price over the fair value of net assets acquired which is not allocable to separately identifiable intangible assets. Other identifiable intangible assets, such as franchise rights, are separately recognized if the intangible asset is obtained through contractual or other legal right or if the intangible asset can be sold, transferred, licensed or exchanged.

Goodwill is not amortized but tested for impairment at least annually, and more frequently if events or circumstances indicate the carrying amount of the reporting unit more likely than not exceeds fair value. We have the option to qualitatively or quantitatively assess goodwill for impairment and we evaluated our goodwill using a qualitative assessment process. Goodwill is tested for impairment at the reporting unit level. Our reporting units are individual stores as this is the level at which discrete financial information is available and for which operating results are regularly reviewed by our chief operating decision maker to allocate resources and assess performance.

We test our goodwill for impairment on October 1 of each year. We have the option to qualitatively or quantitatively assess indefinite-lived intangible assets for impairment. In 2016, we evaluated our goodwill using a qualitative assessment process. If the qualitative factors determine that it is more likely than not that the fair value of the reporting unit exceeds the carrying amount, goodwill is not impaired. If the qualitative assessment determines it is more likely than not the fair value is less than the carrying amount, the first step of the two-step goodwill impairment test is performed. See Note 5.

Franchise Value

We enter into agreements (“Franchise Agreements”) with the manufacturers. Franchise value represents a right received under Franchise Agreements with manufacturers and is identified on an individual store basis.

We evaluated the useful lives of our Franchise Agreements based on the following factors:

- certain of our Franchise Agreements continue indefinitely by their terms;
- certain of our Franchise Agreements have limited terms, but are routinely renewed without substantial cost to us;
- other than franchise terminations related to the unprecedented reorganizations of Chrysler and General Motors, and allowed by bankruptcy law, we are not aware of manufacturers terminating Franchise Agreements against the wishes of the franchise owners in the ordinary course of business. A manufacturer may pressure a franchise owner to sell a franchise when the owner is in breach of the franchise agreement over an extended period of time;
- state dealership franchise laws typically limit the rights of the manufacturer to terminate or not renew a franchise;
- we are not aware of any legislation or other factors that would materially change the retail automotive franchise system; and
- as evidenced by our acquisition and disposition history, there is an active market for most automotive dealership franchises within the United States. We attribute value to the Franchise Agreements acquired with the dealerships we purchase based on the understanding and industry practice that the Franchise Agreements will be renewed indefinitely by the manufacturer.

Accordingly, we have determined that our Franchise Agreements will continue to contribute to our cash flows indefinitely and, therefore, have indefinite lives.

As an indefinite-lived intangible asset, franchise value is tested for impairment at least annually, and more frequently if events or circumstances indicate the carrying value may exceed fair value. The impairment test for indefinite-lived intangible assets requires the comparison of estimated fair value to carrying value. An impairment charge is recorded to the extent the fair value is less than the carrying value. We have the option to qualitatively or quantitatively assess indefinite-lived intangible assets for impairment. We evaluated our indefinite-lived intangible assets using a qualitative assessment process. We have determined the appropriate unit of accounting for testing franchise value for impairment is each individual store.

We test our franchise value for impairment on October 1 of each year. In 2016, we evaluated our indefinite-lived intangible assets using a qualitative assessment process. If the qualitative factors discussed above determine that it is more likely than not that the fair value of the individual store's franchise value exceeds the carrying amount, the franchise value is not impaired and the second step is not necessary. If the qualitative assessment determines it is more likely than not the fair value is less than the carrying value, then a quantitative valuation of our franchise value is performed and an impairment would be recorded. See Note 5.

Equity-Method Investments

We owned investments in certain partnerships which we account for under the equity method. These investments are included as a component of other non-current assets in our Consolidated Balance Sheets. We determined that we lack certain characteristics to direct the operations of the businesses and, as a result, do not qualify to consolidate these investments. Activity related to our equity-method investments is recognized in our Consolidated Statements of Operations as follows:

- an other than temporary decline in fair value is reflected as an asset impairment;
- our portion of the operating gains and losses is included as a component of other (expense) income, net;
- the amortization related to the discounted fair value of future equity contributions is recognized over the life of the investments as non-cash interest expense; and
- tax benefits and credits are reflected as a component of our income tax provision.

Periodically, whenever events or circumstances indicate that the carrying amount of assets may be impaired, we evaluate the equity-method investments for indications of loss resulting from an other than temporary decline. If the equity-method investment is determined to be impaired, the amount by which the carrying amount exceeds the fair value of the investment is recognized as a charge to income from continuing operations. See Notes 12 and 18.

Advertising

We expense production and other costs of advertising as incurred as a component of selling, general and administrative expense. Additionally, manufacturer cooperative advertising credits for qualifying, specifically-identified advertising expenditures are recognized as a reduction of advertising expense. Advertising expense and manufacturer cooperative advertising credits were as follows (in thousands):

Year Ended December 31,	2016	2015	2014
Advertising expense, gross	\$ 101,656	\$ 89,736	\$ 62,933
Manufacturer cooperative advertising credits	(20,293)	(19,801)	(16,281)
Advertising expense, net	\$ 81,363	\$ 69,935	\$ 46,652

Contract Origination Costs

Contract origination commissions paid to our employees directly related to the sale of our self-insured lifetime lube, oil and filter service contracts are deferred and charged to expense in proportion to the associated revenue to be recognized.

Legal Costs

We are a party to numerous legal proceedings arising in the normal course of business. We accrue for certain legal costs, including attorney fees and potential settlement claims related to various legal proceedings that are estimable and probable. See Note 7.

Stock-Based Compensation

Compensation costs associated with equity instruments exchanged for employee and director services are measured at the grant date, based on the fair value of the award, with estimated forfeitures considered, and recognized as an expense on the straight-line basis over the individual's requisite service period (generally the vesting period of the equity award). If there is a performance-based element to the award, the expense is recognized based on the estimated attainment level, estimated time to achieve the attainment level and/or the vesting period. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards. The fair value of non-vested stock awards is based on the intrinsic value on the date of grant. See Note 10.

Shares to be issued upon the exercise of stock options and the vesting of stock awards will come from newly issued shares.

Income and Other Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance, if needed, reduces deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized.

When there are situations with uncertainty as to the timing of the deduction, the amount of the deduction, or the validity of the deduction, we adjust our financial statements to reflect only those tax positions that are more-likely-than-not to be sustained. Positions that meet this criterion are measured using the largest benefit that is more than 50% likely to be realized. Interest and penalties are recorded as income tax provision in the period incurred or accrued when related to an uncertain tax position. See Note 13.

We account for all taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction (i.e., sales, use, value-added) on a net (excluded from revenues) basis.

Concentration of Risk and Uncertainties

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

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

We depend on our manufacturers to deliver high-quality, defect-free vehicles. In the event that manufacturers experience future quality issues, our financial performance may be adversely impacted.

We are subject to a concentration of risk in the event of financial distress, including potential reorganization or bankruptcy, of a major vehicle manufacturer. Our sales volume could be materially adversely impacted by the manufacturers' or distributors' inability to supply the stores with an adequate supply of vehicles. We also receive incentives and rebates from our manufacturers, including cash allowances, financing programs, discounts, holdbacks and other incentives. These incentives are recorded as accounts receivable in our Consolidated Balance Sheets until payment is received. Our financial condition could be materially adversely impacted by the manufacturers' or distributors' inability to continue to offer these incentives and rebates at substantially similar terms, or to pay our outstanding receivables.

We enter into Franchise Agreements with the manufacturers. The Franchise Agreements generally limit the location of the dealership and provide the auto manufacturer approval rights over changes in dealership management and ownership. The auto manufacturers are also entitled to terminate the Franchise Agreement if the dealership is in material breach of the terms. Our ability to expand operations depends, in part, on obtaining consents of the manufacturers for the acquisition of additional dealerships. See also "Goodwill" and "Franchise Value" above.

We have a credit facility with a syndicate of 18 financial institutions, including eight manufacturer-affiliated finance companies. Several of these financial institutions also provide vehicle financing for certain new vehicles, vehicles that are designated for use as service loaners and mortgage financing. This credit facility is the primary source of floor plan financing for our new vehicle inventory and also provides used vehicle financing and a revolving line of credit. The term of the facility extends through July 2021. At maturity, our financial condition could be materially adversely impacted if lenders are unable to provide credit that has typically been extended to us or with terms unacceptable to us. Our financial condition could be materially adversely impacted if these providers incur losses in the future or undergo funding limitations. See Note 6.

We anticipate continued organic growth and growth through acquisitions. This growth will require additional credit which may be unavailable or with terms unacceptable to us. If these events were to occur, we may not be able to borrow sufficient funds to facilitate our growth.

Financial Instruments, Fair Value and Market Risks

The carrying amounts of cash equivalents, accounts receivable, trade payables, accrued liabilities and short-term borrowings approximate fair value because of the short-term nature and current market rates of these instruments.

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates. See Note 12.

We have variable rate floor plan notes payable, mortgages and other credit line borrowings that subject us to market risk exposure. At December 31, 2016, we had \$2.1 billion outstanding in variable rate debt. These borrowings had interest rates ranging from 2.02% to 3.25% per annum. An increase or decrease in the interest rates would affect interest expense for the period accordingly.

The fair value of long-term, fixed interest rate debt is subject to interest rate risk. Generally, the fair value of fixed interest rate debt will increase as interest rates fall because we could refinance for a lower rate. Conversely, the fair value of fixed interest rate debt will decrease as interest rates rise. The interest rate changes affect the fair value, but do not impact earnings or cash flows. We monitor our fixed interest rate debt regularly, refinancing debt that is materially above market rates if permitted. See Note 12.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and related notes to financial statements. Changes in such estimates may affect amounts reported in future periods.

Estimates are used in the calculation of certain reserves maintained for charge-backs on estimated cancellations of service contracts; life, accident and disability insurance policies; finance fees from customer financing contracts and uncollectible accounts receivable.

We also use estimates in the calculation of various expenses, accruals and reserves, including anticipated losses related to workers' compensation insurance; anticipated losses related to self-insurance components of our property and casualty and medical insurance; self-insured lifetime lube, oil and filter service contracts; discretionary employee bonuses, the Transition Agreement with Sidney B. DeBoer, our Chairman of the Board; warranties provided on certain products and services; legal reserves and stock-based compensation. We also make certain estimates regarding the assessment of the recoverability of long-lived assets, indefinite-lived intangible assets and deferred tax assets.

We offer a limited warranty on the sale of most retail used vehicles. This warranty is based on mileage and time. We also offer a mileage and time based warranty on parts used in our service repair work and on tire purchases. The cost that may be incurred for these warranties is estimated at the time the related revenue is recorded. A reserve for these warranty liabilities is estimated based on current sales levels, warranty experience rates and estimated costs per claim. The annual activity for reserve increases and claims is immaterial. As of December 31, 2016 and 2015, the accrued warranty balance was \$0.4 million and \$0.5 million, respectively.

Fair Value of Assets Acquired and Liabilities Assumed

We estimate the fair value of the assets acquired and liabilities assumed in a business combination using various assumptions. The most significant assumptions used relate to determining the fair value of property and equipment and intangible franchise rights.

We estimate the fair value of property and equipment based on a market valuation approach. We use prices and other relevant information generated primarily by recent market transactions involving similar or comparable assets, as well as our historical experience in divestitures, acquisitions and real estate transactions. Additionally, we may use a cost valuation approach to value long-lived assets when a market valuation approach is unavailable. Under this approach, we determine the cost to replace the service capacity of an asset, adjusted for physical and economic obsolescence. When available, we use valuation inputs from independent valuation experts, such as real estate appraisers and brokers, to corroborate our estimates of fair value.

We use an MPEE model to determine the fair value of intangible franchise rights as discussed above under “Franchise Value.”

We use a relief-from-royalty method to determine the fair value of a trade name. Future cost savings associated with owning, rather than licensing, a trade name is estimated based on a royalty rate and management’s forecasted sales projections. The discount rate applied to the future cost savings factors an equity market risk premium, small stock risk premium, an average peer group beta, a risk-free interest rate and a premium for forecast risk.

Revenue Recognition

Revenue from the sale of a vehicle is recognized when a contract is signed by the customer, financing has been arranged or collectability is reasonably assured and the delivery of the vehicle to the customer is made. We do not allow the return of new or used vehicles, except where mandated by state law.

Revenue from parts and service is recognized upon delivery of the parts or service to the customer. We allow for customer returns on sales of our parts inventory up to 30 days after the sale. Most parts returns generally occur within one to two weeks from the time of sale, and are not significant.

Finance fees earned for notes placed with financial institutions in connection with customer vehicle financing are recognized, net of estimated charge-backs, as finance and insurance revenue upon acceptance of the credit by the financial institution and recognition of the sale of the vehicle.

Insurance income from third party insurance companies for commissions earned on credit life, accident and disability insurance policies sold in connection with the sale of a vehicle are recognized, net of anticipated cancellations, as finance and insurance revenue upon execution of the insurance contract and recognition of the sale of the vehicle.

Commissions from third party service contracts are recognized, net of anticipated cancellations, as finance and insurance revenue upon sale of the contracts and recognition of the sale of the vehicle. We also participate in future underwriting profit, pursuant to retrospective commission arrangements, which is recognized in income as earned.

Revenue related to self-insured lifetime lube, oil and filter service contracts is deferred and recognized based on expected future claims for service. The expected future claims experience is evaluated periodically to ensure it remains appropriate given actual claims history.

Segment Reporting

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

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

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

We define our chief operating decision maker (“CODM”) to be certain members of our executive management group. Historical and forecasted operational performance is evaluated on a store-by-store basis and on a consolidated basis by the CODM. We derive the operating results of the segments directly from our internal management reporting system. The accounting policies used to derive segment results are substantially the same as those used to determine our consolidated results, excepted for the internal allocation within Corporate and other discussed above. Our CODM measures the performance of each operating segment based on several metrics, including earnings from operations, and uses these results, in part, to evaluate the performance of, and to allocate resources to, each of the operating segments. See Note 19.

(2) Accounts Receivable

Accounts receivable consisted of the following (in thousands):

December 31,	2016	2015
Contracts in transit	\$ 233,506	\$ 168,460
Trade receivables	47,450	33,749
Vehicle receivables	43,937	36,470
Manufacturer receivables	76,948	59,215
Auto loan receivables	69,859	42,490
Other receivables	1,600	3,033
	<u>473,300</u>	<u>343,417</u>
Less: Allowance for doubtful accounts	(5,281)	(2,243)
Less: Long-term portion of accounts receivable, net	(50,305)	(32,712)
Total accounts receivable, net	<u>\$ 417,714</u>	<u>\$ 308,462</u>

Accounts receivable classifications include the following:

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

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

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

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

(3) Inventories

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

December 31,	2016	2015
New vehicles	\$ 1,338,110	\$ 1,113,613
Used vehicles	368,067	302,911
Parts and accessories	66,410	54,463
Total inventories	<u>\$ 1,772,587</u>	<u>\$ 1,470,987</u>

The new vehicle inventory cost is generally reduced by manufacturer holdbacks and incentives, while the related floor plan notes payable are reflective of the gross cost of the vehicle. As of December 31, 2016 and 2015, the carrying value of inventory had been reduced by \$18.1 million and \$13.6 million, respectively, for assistance received from manufacturers as discussed in Note 1.

(4) Property and Equipment

Property and equipment consisted of the following (in thousands):

December 31,	2016	2015
Land	\$ 318,832	\$ 281,982
Building and improvements	611,798	527,545
Service equipment	80,953	70,559
Furniture, office equipment, signs and fixtures	141,248	119,250
	1,152,831	999,336
Less accumulated depreciation	(167,300)	(137,853)
	985,531	861,483
Construction in progress	20,599	15,177
	<u>\$ 1,006,130</u>	<u>\$ 876,660</u>

Long-lived Asset Impairment Charges

In 2015, we recorded \$3.6 million of impairment charges associated with certain properties and equipment. As the expected future use of these facilities and equipment changed, the long-lived assets were tested for recoverability and were determined to have a carrying value exceeding their fair value. We did not record any impairment charges associated with properties and equipment in 2016 or 2014. In 2016, we tested long-lived assets for recoverability and determined their undiscounted cash flows exceeded their carrying value.

(5) Goodwill and Franchise Value

The following is a roll-forward of goodwill (in thousands):

	Domestic	Import	Luxury	Consolidated
Balance as of December 31, 2014 ¹	\$ 91,011	\$ 79,601	\$ 28,763	\$ 199,375
Additions through acquisitions	6,892	5,029	2,170	14,091
Reductions through divestitures	—	(246)	—	(246)
Balance as of December 31, 2015 ¹	97,903	84,384	30,933	213,220
Additions through acquisitions	18,154	21,795	7,448	47,397
Reductions through divestitures	(1,218)	—	—	(1,218)
Balance as of December 31, 2016 ¹	<u>\$ 114,839</u>	<u>\$ 106,179</u>	<u>\$ 38,381</u>	<u>\$ 259,399</u>

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

The following is a roll-forward of franchise value (in thousands):

	Franchise Value
Balance as of December 31, 2014	\$ 150,892
Additions through acquisitions	6,843
Reductions through divestitures	(36)
Balance as of December 31, 2015	157,699
Additions through acquisitions	27,087
Reductions through divestitures	(518)
Balance as of December 31, 2016	<u>\$ 184,268</u>

(6) **Credit Facilities and Long-Term Debt**

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

December 31,	2016	2015
New vehicle floor plan commitment	\$ 1,506,895	\$ 1,265,872
Floor plan notes payable	94,602	48,083
Total floor plan debt	1,601,497	1,313,955
Used vehicle inventory financing facility	211,000	171,000
Revolving lines of credit	142,507	61,246
Real estate mortgages	428,367	387,861
Other debt	11,191	25,248
Debt issuance costs	(2,184)	(2,169)
Total debt	\$ 2,392,378	\$ 1,957,141

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs (Subtopic 835-30)." ASU 2015-03 requires entities to present debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt liability. The new standard is effective for fiscal years beginning after December 15, 2016, and therein. We have adopted the retrospective application of the new guidance, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effect of presenting all debt issuance costs as a reduction from the carrying amount of the related debt liability for both current and prior periods. We reclassified \$2.2 million of debt issuance costs as a direct reduction from the carrying amount of debt as of December 31, 2015.

Credit Facility

We have a credit facility with a total financing commitment of \$2.05 billion which matures in July 2021. This syndicated credit facility is comprised of 18 financial institutions, including eight manufacturer-affiliated finance companies. Under our credit facility we are permitted to allocate the total financing commitment among floor plan financing for new vehicle inventory, floor plan financing for used vehicle inventory (up to a maximum of \$350 million) and revolving financing for general corporate purposes, including acquisitions and working capital (up to a maximum of \$400 million). Our credit facility may be expanded to \$2.4 billion total availability, subject to lender approval. All borrowings from, and repayments to, our lending group are presented in the Consolidated Statements of Cash Flows as financing activities.

The availability of the revolving line of credit under our syndicated credit facility is determined according to a borrowing base comprised of a portion of certain accounts, receivables, invoices, inventory and equipment. The borrowing base is reduced by the sum of the outstanding aggregate principal balance of new and used vehicle floor plan loans and new and used swing line loans.

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

We have the ability to deposit up to \$50 million in cash in Principal Reduction (PR) accounts associated with our new vehicle floor plan commitment. The PR accounts are recognized as offsetting credits against outstanding amounts on our new vehicle floor plan commitment and would reduce interest expense associated with the outstanding principal balance. As of December 31, 2016, we had no balances in our PR accounts.

If the outstanding principal balance on our new vehicle inventory floor plan commitment, plus requests on any day, exceeds 95% of the loan commitment, a portion of the revolving line of credit must be reserved. The reserve amount is equal to the lesser of \$15.0 million or the maximum revolving line of credit commitment less the outstanding balance on the line less outstanding letters of credit. The reserve amount decreases the revolving line of credit availability and may be used to repay the new vehicle floor plan commitment balance.

The interest rate on the credit facility varies based on the type of debt, with the rate of one-month LIBOR plus 1.25% for new vehicle floor plan financing, one-month LIBOR plus 1.50% for used vehicle floor plan financing; and a variable interest rate on the revolving financing ranging from the one-month LIBOR plus 1.25% to 2.50%, depending on our leverage ratio. The annual interest rate associated with our new vehicle floor plan commitment was 2.02% at December 31, 2016. The annual interest rate associated with our used vehicle inventory financing facility and our revolving line of credit was 2.27% and 2.52%, respectively, at December 31, 2016.

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

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

Debt Covenant Ratio	Requirement	As of December 31, 2016		
Current ratio	Not less than 1.10 to 1	1.26	to	1
Fixed charge coverage ratio	Not less than 1.20 to 1	2.63	to	1
Leverage ratio	Not more than 5.00 to 1	2.18	to	1
Funded debt restriction	Not to exceed \$900 million	\$485.2 million		

Other Lines of Credit

We have other lines of credit with a total financing commitment of \$38.5 million for general corporate purposes, including acquisitions and working capital. Substantially all of these other lines of credit mature in 2018 and have interest rates ranging up to 2.77%. As of December 31, 2016, we had outstanding debt of \$36.5 million on these other lines of credit.

Floor Plan Notes Payable

We have floor plan agreements with manufacturer-affiliated finance companies for certain new vehicles and vehicles that are designated for use as service loaners. The interest rates on these floor plan notes payable commitments vary by manufacturer and are variable rates. At December 31, 2016, \$94.6 million was outstanding on these agreements at interest rates ranging up to 3.25%. Borrowings from, and repayments to, manufacturer-affiliated finance companies are classified as operating activities in the Consolidated Statements of Cash Flows.

Real Estate Mortgages and Other Debt

We have mortgages associated with our owned real estate. Interest rates related to this debt ranged from 2.1% to 5.0% at December 31, 2016. The mortgages are payable in various installments through October 2034. As of December 31, 2016, we had fixed interest rates on 64.3% of our outstanding mortgage debt.

Our other debt includes capital leases and sellers' notes. The interest rates associated with our other debt ranged from 4.3% to 9.7% at December 31, 2016. This debt, which totaled \$11.2 million at December 31, 2016, is due in various installments through December 2050.

Future Principal Payments

The schedule of future principal payments associated with real estate mortgages and other debt as of December 31, 2016 was as follows (in thousands):

Year Ending December 31,		
2017	\$	20,608
2018		38,150
2019		45,189
2020		37,504
2021		34,897
Thereafter		263,210
Total principal payments	\$	439,558

(7) Commitments and Contingencies

Leases

We lease certain facilities under non-cancelable operating and capital leases. These leases expire at various dates through 2050. Certain lease commitments contain fixed payment increases at predetermined intervals over the life of the lease, while other lease commitments are subject to escalation clauses of an amount equal to the increase in the cost of living based on the "Consumer Price Index - U.S. Cities Average - All Items for all Urban Consumers" published by the U.S. Department of Labor, or a substantially equivalent regional index. Lease expense related to operating leases is recognized on a straight-line basis over the life of the lease.

The minimum lease payments under our operating and capital leases after December 31, 2016 are as follows (in thousands):

Year Ending December 31,		
2017	\$	27,294
2018		25,557
2019		24,031
2020		22,226
2021		20,249
Thereafter		132,449
Total minimum lease payments		251,806
Less: sublease rentals		(7,777)
	\$	244,029

Rent expense, net of sublease income, for all operating leases was \$26.8 million, \$23.8 million, and \$17.2 million for the years ended December 31, 2016, 2015 and 2014, respectively. These amounts are included as a component of selling, general and administrative expenses in our Consolidated Statements of Operations.

In connection with dispositions of dealerships, we occasionally assign or sublet our interests in any real property leases associated with such dealerships to the purchaser. We often retain responsibility for the performance of certain obligations under such leases to the extent that the assignee or sublessee does not perform. Additionally, we may remain subject to the terms of any guarantees and have correlating indemnification rights against the assignee or sublessee in the event of non-performance, as well as certain other defenses. We may also be called upon to perform other obligations under these leases, such as environmental remediation of the premises or repairs upon termination of the lease. We currently have no reason to believe that we will be called upon to perform any such services; however, there can be no assurance that any future performance required by us under these leases will not have a material adverse effect on our financial condition or results of operations.

Charge-Backs for Various Contracts

We have recorded a liability of \$44.2 million as of December 31, 2016 for our estimated contractual obligations related to potential charge-backs for vehicle service contracts, lifetime oil change contracts and other various insurance contracts that are terminated early by the customer. We estimate that the charge-backs will be paid out as follows (in thousands):

Year Ending December 31,	
2017	\$ 24,320
2018	12,831
2019	5,188
2020	1,498
2021	320
Thereafter	71
Total	\$ 44,228

Lifetime Lube, Oil and Filter Contracts

We retain the obligation for lifetime lube, oil and filter service contracts sold to our customers and assumed the liability of certain existing lifetime lube, oil and filter contracts. These amounts are recorded as deferred revenues. At the time of sale, we defer the full sale price and recognize the revenue based on the rate we expect future costs to be incurred. As of December 31, 2016, we had a deferred revenue balance of \$99.6 million associated with these contracts and estimate the deferred revenue will be recognized as follows (in thousands):

Year Ending December 31,	
2017	\$ 19,800
2018	15,661
2019	12,511
2020	10,400
2021	8,866
Thereafter	32,402
Total	\$ 99,640

The current portion of this deferred revenue balance is recorded as a component of accrued liabilities in our Consolidated Balance Sheets.

We periodically evaluate the estimated future costs of these assumed contracts and record a charge if future expected claim and cancellation costs exceed the deferred revenue to be recognized. As of December 31, 2016, we had a reserve balance of \$3.4 million recorded as a component of accrued liabilities and other long-term liabilities in our Consolidated Balance Sheets. The charges associated with this reserve were recognized in 2011 and earlier.

Self-insurance Programs

We self-insure a portion of our property and casualty insurance, vehicle open lot coverage, medical insurance and workers' compensation insurance. Third parties are engaged to assist in estimating the loss exposure related to the self-retained portion of the risk associated with these insurances. Additionally, we analyze our historical loss and claims experience to estimate the loss exposure associated with these programs. As of December 31, 2016 and 2015, we had liabilities associated with these programs of \$32.8 million and \$25.9 million, respectively, recorded as a component of accrued liabilities and other long-term liabilities in our Consolidated Balance Sheets.

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.

In Re Lithia Motors Derivative Litigation

On December 14, 2015, Shiva Y. Stein, a Lithia shareholder, filed derivative claims on behalf of Lithia against its Board of Directors (the “Board”), listing Lithia as a nominal defendant. The case, *Stein v. DeBoer, et al.*, Case No. 15CV33696, is pending in the Circuit Court of the State of Oregon for Marion County. Ms. Stein’s claims relate to the adoption of a transition agreement between Lithia and Sidney B. DeBoer, as disclosed in a Current Report on Form 8-K filed September 16, 2015. Ms. Stein alleges that Lithia’s directors breached their fiduciary duties of loyalty and due care, and wasted corporate assets, when they approved the agreement with Mr. DeBoer. Ms. Stein also alleges a claim against Sidney B. DeBoer, asserting that he has been unjustly enriched by the agreement. Ms. Stein is seeking relief in the amount of damages allegedly sustained by Lithia as a result of the alleged breaches of fiduciary duty and alleged corporate waste, disgorgement and imposition of a constructive trust on all property and profits Sidney B. DeBoer received as a result of the alleged wrongful conduct, and an award of the costs and disbursements of the lawsuit, including reasonable attorney fees, costs, and expenses. The Board and Mr. DeBoer filed Motions to Dismiss the Stein suit on February 26, 2016.

On February 12, 2016, Marty A. Jessos, a Lithia shareholder, also filed derivative claims on behalf of Lithia against the Board, listing Lithia as a nominal defendant. The case, *Jessos v. DeBoer, et al.*, Case No. 16CV04181, was filed in the Circuit Court of the State of Oregon for Multnomah County. The Jessos suit involves the same subject matter and alleges substantially the same facts, claims, and causes of action as the Stein suit. On March 22, 2016, the Jessos suit was transferred to Marion County Circuit Court. On April 4, 2016, the parties filed a Stipulation and [Proposed] Order of Consolidation in the Stein suit to consolidate both Stein and Jessos under the Stein suit, Case No. 15CV33696. On April 4, 2016, the Court signed the consolidation order. The case is now known as *In re Lithia Motors Derivative Litigation*, Case No. 15CV33696. Plaintiffs filed their consolidated complaint on April 15, 2016.

The Board and Mr. DeBoer filed Motions to Dismiss the consolidated complaint on May 10, 2016. The Court issued its ruling on the Motions on August 12, 2016. The Court determined that a majority of the Board was independent, but also that Plaintiffs alleged sufficient facts to withstand the Motions to Dismiss. For that reason, the Court denied the Board’s and Mr. DeBoer’s Motions. The Board and Mr. DeBoer filed their Answers to the consolidated complaint on October 10, 2016. The parties engaged in discovery, including depositions, and the Board and Mr. DeBoer filed Motions for Summary Judgment on December 29, 2016, which is pending. Although we do not anticipate that the resolution of this legal proceeding will have a material adverse effect on our business, results of operations, financial condition, or cash flows, we cannot predict this with certainty.

California Wage and Hour Litigations

In June 2012, Mr. Robles and Mr. Laredo brought claims against DCH Tustin Acura (*Robles v. Tustin Motors, Inc.*, Case No. 30-2012-00579414, filed in the Superior Court of California, Orange County) alleging that the employer underpaid technicians in light of California Wage Order provisions that require an employer to pay at least two times the minimum wage for each hour worked if the employee is required to bring his or her own tools. The complaint was amended in late 2013 to include allegations that the employer failed to pay technicians for non-productive time and/or time spent performing tasks not compensated by the flat-rate compensation system; off-the-clock time worked; and wages due at termination. The amended complaint also alleged that the employer failed to provide technicians accurate and complete wage statements; and statutory meal and rest periods. Plaintiffs are seeking relief on behalf of all employees at all DCH Auto Group dealerships in California. Plaintiffs also seek attorney fees and costs. These Plaintiffs (and several other former technicians in separate-but-partially-overlapping actions) also seek relief under California’s Private Attorney General Action (PAGA) provisions, which allow private plaintiffs to recover civil penalties on behalf of the State of California. DCH successfully compelled arbitration based on arbitration agreements between these claimants and the employer, although certain representative claims were excluded and stayed pending arbitration.

During the pendency of Robles, related cases were filed that made substantially similar technician claims including Holzer (see below). DCH and the Robles claimants settled their individual claims in mediation in 2015. In April 2016, DCH and all technician plaintiffs in Robles and the related cases agreed in principle to settle the representative claims, although this settlement has not yet been approved by the California courts as expressly contemplated by the parties and required by applicable law as a condition of the agreed release of claims. DCH Auto Group (USA) Limited must indemnify Lithia Motors, Inc. for losses related to this claim pursuant to the stock purchase agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014. As a result, we believe the exposure related to this lawsuit, when considered in relation to the terms of the stock purchase agreement, is immaterial to our financial statements.

In August 2014, Ms. Holzer filed a complaint in the Central District of California (*Holzer v. DCH Auto Group (USA) Inc.*, Case No. BC558869) alleging that her employer, an affiliate of DCH Auto Group (USA) Inc., failed to provide vehicle finance and sales persons, service advisors, and other clerical and hourly workers accurate and complete wage statements; and statutory meal and rest periods. The complaint also alleges that the employer failed to pay these employees for off-the-clock time worked; and wages due at termination. Plaintiffs also seek attorney fees and costs. DCH has sought to compel arbitration based on Plaintiffs' arbitration agreements. Plaintiffs (and several other employees in separate actions) are seeking relief under California's PAGA provisions.

During the pendency of Holzer, related cases were filed that made substantially similar non-technician claims. DCH and all non-technician claimants settled their individual claims in mediation in 2017. In January 2017, DCH and all non-technician plaintiffs agreed in principle to settle the representative claims, although this settlement has not yet been approved by the California courts as expressly contemplated by the parties and required by applicable law as a condition of the agreed release of claims. DCH Auto Group (USA) Limited must indemnify Lithia Motors, Inc. for losses related to this claim pursuant to the stock purchase agreement between Lithia Motors, Inc. and DCH Auto Group (USA) Limited dated June 14, 2014. As a result, we believe the exposure related to this lawsuit, when considered in relation to the terms of the stock purchase agreement, is immaterial to our financial statements.

(8) Stockholders' Equity

Class A and Class B Common Stock

The shares of Class A common stock are not convertible into any other series or class of our securities. Each share of Class B common stock, however, is freely convertible into one share of Class A common stock at the option of the holder of the Class B common stock. All shares of Class B common stock shall automatically convert to shares of Class A common stock (on a share-for-share basis, subject to adjustment) on the earliest record date for an annual meeting of our stockholders on which the number of shares of Class B common stock outstanding is less than 1% of the total number of shares of common stock outstanding. Shares of Class B common stock may not be transferred to third parties, except for transfers to certain family members and in other limited circumstances.

Holders of Class A common stock are entitled to one vote for each share held of record and holders of Class B common stock are entitled to ten votes for each share held of record. The Class A common stock and Class B common stock vote together as a single class on all matters submitted to shareholders.

Repurchases of Class A Common Stock

Repurchases of our Class A Common Stock occurred under repurchase authorizations granted by our Board of Directors and related to shares withheld as part of the vesting of restricted stock units ("RSUs").

In August 2011, our Board of Directors authorized the repurchase of up to 2 million shares of our Class A common stock and, on July 20, 2012, our Board of Directors authorized the repurchase of 1 million additional shares of our Class A common stock. Effective February 29, 2016, our Board of Directors authorized the repurchase of up to \$250 million of our Class A common stock. This authorization replaced the existing authorizations, increasing the total and establishing a maximum dollar rather than share amount.

Share repurchases under our authorizations were as follows:

	Repurchases Occurring in 2016		Cumulative Repurchases as of December 31, 2016	
	Shares	Average Price	Shares	Average Price
2011 Share Repurchase Authorization	599,123	\$ 79.21	2,327,636	\$ 51.09
2016 Share Repurchase Authorization	713,725	\$ 79.74	713,725	\$ 79.74

As of December 31, 2016, we had \$193.1 million available for repurchases pursuant to our 2016 share repurchase authorization.

In addition, during 2016, we repurchased 94,826 shares at an average price of \$90.46 per share, for a total of \$8.6 million, related to tax withholdings associated with the vesting of RSUs. The repurchase of shares related to tax withholdings associated with stock awards does not reduce the number of shares available for repurchase as approved by our Board of Directors.

The following is a summary of our repurchases in the years ended December 31, 2016, 2015 and 2014:

Year Ended December 31,	2016	2015	2014
Shares repurchased pursuant to repurchase authorizations	1,312,848	228,737	226,729
Total purchase price (in thousands)	\$ 104,370	\$ 24,676	\$ 15,990
Average purchase price per share	\$ 79.50	\$ 107.88	\$ 70.52
Shares repurchased in association with tax withholdings on the vesting of RSUs	94,826	77,649	106,772

Dividends

We declared and paid dividends on our Class A and Class B Common Stock as follows:

Quarter declared	Dividend amount per Class A and Class B share	Total amount of dividend (in thousands)
2014		
First quarter	\$ 0.13	\$ 3,378
Second quarter	0.16	4,179
Third quarter	0.16	4,174
Fourth quarter	0.16	4,198
2015		
First quarter	\$ 0.16	\$ 4,216
Second quarter	0.20	5,266
Third quarter	0.20	5,257
Fourth quarter	0.20	5,246
2016		
First quarter	\$ 0.20	\$ 5,151
Second quarter	0.25	6,373
Third quarter	0.25	6,299
Fourth quarter	0.25	6,308

Reclassification From Accumulated Other Comprehensive Loss

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

Year Ended December 31,	2016	2015	2014	Affected Line Item in the Consolidated Statement of Operations
Loss on cash flow hedges	\$ (219)	\$ (449)	\$ (488)	Floor plan interest expense
Income tax benefits	85	174	187	Income tax provision
Loss on cash flow hedges, net	\$ (134)	\$ (275)	\$ (301)	

See Note 11 for more details regarding our derivative contracts.

(9) 401(k) Profit Sharing, Deferred Compensation and Long-Term Incentive Plans

We have a defined contribution 401(k) plan and trust covering substantially all full-time employees. The annual contribution to the plan is at the discretion of our Board of Directors. Contributions of \$5.4 million, \$5.3 million and \$3.2 million were recognized for the years ended December 31, 2016, 2015 and 2014, respectively. Employees may contribute to the plan if they meet certain eligibility requirements.

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.

The following is a summary related to our LTIP (in thousands):

Year Ended December 31,	2016	2015	2014
Compensation expense	\$ 1,081	\$ 1,812	\$ 1,877
Total discretionary contribution	\$ 1,785	\$ 2,249	\$ 2,450
Guaranteed annual return	5.25%	5.25%	5.25%

As of December 31, 2016 and 2015, the balance due to participants was \$23.5 million and \$19.7 million, respectively, and was included as a component of other long-term liabilities in the Consolidated Balance Sheets.

(10) Stock-Based Compensation**2009 Employee Stock Purchase Plan**

The 2009 Employee Stock Purchase Plan (the "2009 ESPP") allows for the issuance of 1,500,000 shares of our Class A common stock. The 2009 ESPP is intended to qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986, as amended, and is administered by the Compensation Committee of the Board of Directors.

Eligible employees are entitled to defer up to 10% of their base pay for the purchase of stock, up to \$25,000 of fair market value of our Class A common stock annually. The purchase price is equal to 85% of the fair market value at the end of the purchase period.

Following is information regarding our 2009 ESPP:

Year Ended December 31,	2016
Shares purchased pursuant to 2009 ESPP	94,909
Weighted average per share price of shares purchased	\$ 73.67
Weighted average per share discount from market value for shares purchased	\$ 13.00

As of December 31,	2016
Shares available for purchase pursuant to 2009 ESPP	372,751

Compensation expense related to our 2009 ESPP is calculated based on the 15% discount from the per share market price on the date of grant.

2013 Stock Incentive Plan

Our 2013 Stock Incentive Plan, as amended, (the "2013 Plan") allows for the grant of a total of 3.8 million shares in the form of stock appreciation rights, qualified stock options, nonqualified stock options and shares of restricted stock to our officers, key employees, directors and consultants. The 2013 Plan is administered by the Compensation Committee of the Board of Directors and permits accelerated vesting of outstanding awards upon the occurrence of certain changes in control. As of December 31, 2016, 1,487,405 shares of Class A common stock were available for future grants. As of December 31, 2016, there were no stock appreciation rights, qualified stock options or shares of restricted stock outstanding.

Restricted Stock Units ("RSUs")

RSU grants vest over a period up to four years from the date of grant. RSU activity was as follows:

	RSUs	Weighted average grant date fair value
Balance, December 31, 2015	411,074	\$ 59.13
Granted	144,152	82.90
Vested	(240,433)	47.45
Forfeited	(15,809)	79.34
Balance, December 31, 2016	<u>298,984</u>	<u>80.37</u>

We granted 33,548 time-vesting RSUs to members of our Board of Directors and employees in 2016. Each grant entitles the holder to receive shares of our Class A common stock upon vesting. A quarter of the RSUs vest on each of the four anniversaries of the grant date for employees and vests quarterly for our Board of Directors, over their service period.

Certain key employees were granted 79,034 performance and time-vesting RSUs in 2016. Of these, 46,258 shares were earned based on attaining various target levels of operational performance. Based on the levels of performance achieved in 2016, a weighted average attainment level of 58.5% for these RSUs was met. These RSUs will vest over four years from the grant date.

Twelve senior executives and vice presidents were also granted 31,570 long-term RSUs which vest based on attaining or exceeding a specified target level of adjusted net income per share in any fiscal year ending between December 31, 2016 and December 31, 2019. The RSUs will vest on the date the target level is certified.

Stock-Based Compensation

As of December 31, 2016, unrecognized stock-based compensation related to outstanding, but unvested RSUs was \$9.4 million, which will be recognized over the remaining weighted average vesting period of 2.1 years.

Certain information regarding our stock-based compensation was as follows:

Year Ended December 31,	2016		2015		2014	
Per share intrinsic value of non-vested stock granted	\$	82.90	\$	88.74	\$	68.99
Weighted average per share discount for compensation expense recognized under the 2009 ESPP		13.00		15.89		11.92
Total intrinsic value of stock options exercised (in millions)		—		0.5		3.1
Fair value of non-vested stock that vested during the period (in millions)		47.5		19.3		18.9
Stock-based compensation recognized in Consolidated Statements of Operations, as a component of selling, general and administrative expense (in millions)		11.0		11.9		7.4
Tax benefit recognized in Consolidated Statements of Operations (in millions)		3.8		4.2		2.6
Cash received from options exercised and shares purchased under all share-based arrangements (in millions)		7.0		6.5		4.9
Tax deduction realized related to stock options exercised (in millions)		8.9		7.6		8.4

(11) Derivative Financial Instruments

From time to time, we have entered 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.

We did not have any amounts associated with derivative contracts recorded on the balance sheet as of December 31, 2016. As of December 31, 2015, we had \$0.5 million recorded associated with the fair value of our derivative instruments, included as a component of accrued liabilities in our Consolidated Balance Sheets.

The effect of derivative instruments in our Consolidated Statements of Operations 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)
For the Year Ended December 31, 2016					
Interest rate swap contract	\$ 233	Floor plan interest expense	\$ (219)	Floor plan interest expense	\$ (352)
For the Year Ended December 31, 2015					
Interest rate swap contract	\$ 599	Floor plan interest expense	\$ (449)	Floor plan interest expense	\$ (758)
For the Year Ended December 31, 2014					
Interest rate swap contract	\$ 505	Floor plan interest expense	\$ (488)	Floor plan interest expense	\$ (732)

(12) Fair Value Measurements

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

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

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 any interest rate swap 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 valuation 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 and used to determine the rate applied to discount the future cash flows. The valuation of an interest rate swap also takes into consideration estimates of our own, as well as the counterparty's, risk of non-performance under the contract. See Note 8 and 11 for more details regarding our derivative contracts.

We estimate the value of our equity-method investments, which are recorded at fair value on a non-recurring basis, based on a market valuation approach. We use prices and other relevant information generated primarily by recent market transactions involving similar or comparable assets. Because these valuations contain unobservable inputs, we classified the measurement of fair value of our equity-method investments as Level 3.

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

There were no changes to our valuation techniques during the year ended December 31, 2016.

Assets and Liabilities Measured at Fair Value

We did not have any amounts associated with derivative contracts, our equity method investment or long-lived assets recorded at fair value as of December 31, 2016. Following are the disclosures related to our assets that are measured at fair value (in thousands) as of December 31, 2015:

Fair Value at December 31, 2015	Level 1	Level 2	Level 3
Measured on a recurring basis:			
Derivative contract, net	\$ —	\$ 532	\$ —
Measured on a non-recurring basis:			
Equity-method investment	\$ —	\$ —	\$ 22,284
Long-lived assets held and used:			
Certain buildings and improvements	\$ —	\$ —	\$ 6,559

See Note 11 for more details regarding our derivative contracts and Note 4 regarding our long-lived assets.

Based on operating losses recognized by the equity-method investment, we determined that an impairment of our investment had occurred. Accordingly, we performed a fair value calculation for this investment and determined that a \$14.0 million, \$16.5 million and \$1.9 million impairment, respectively, was required to be recorded as asset impairments in our Consolidated Statements of Operations for the years ended December 31, 2016, 2015 and 2014 respectively. See Note 18.

Fair Value Disclosures for Financial Assets and Liabilities

We have fixed rate debt and calculate the estimated fair value of our fixed rate debt using a discounted cash flow methodology. Using estimated current interest rates based on a similar risk profile and duration (Level 2), the fixed cash flows are discounted and summed to compute the fair value of the debt. As of December 31, 2016, this debt had maturity dates between May 1, 2018 and December 31, 2050. A summary of the aggregate carrying values and fair values of our long-term fixed interest rate debt is as follows (in thousands):

December 31,	2016		2015	
Carrying value	\$	286,660	\$	297,463
Fair value		293,522		296,961

We believe the carrying value of our variable rate debt approximates fair value.

(13) Income Taxes

Income Tax Provision

The income tax provision from continuing operations was as follows (in thousands):

Year Ended December 31,	2016		2015		2014	
Current:						
Federal	\$	68,088	\$	58,408	\$	56,342
State		13,884		14,572		7,944
		<u>81,972</u>		<u>72,980</u>		<u>64,286</u>
Deferred:						
Federal		4,893		6,046		10,433
State		(400)		679		236
		<u>4,493</u>		<u>6,725</u>		<u>10,669</u>
Total	\$	<u>86,465</u>	\$	<u>79,705</u>	\$	<u>74,955</u>

At December 31, 2016 and 2015, we had income taxes receivable of \$2.4 million and \$23.8 million, respectively, included as a component of other current assets in our Consolidated Balance Sheets.

The reconciliation between amounts computed using the federal income tax rate of 35% and our income tax provision from continuing operations is shown in the following tabulation (in thousands):

Year Ended December 31,	2016		2015		2014	
Federal tax provision at statutory rate	\$	99,233	\$	91,947	\$	73,673
State taxes, net of federal income tax benefit		10,784		9,357		6,526
Equity investment basis difference		9,470		11,048		1,422
Non-deductible items		1,436		882		1,766
Permanent differences related to employee stock purchase program		139		156		68
Net change in valuation allowance		(5,133)		(3,303)		(4,121)
General business credits		(27,950)		(29,093)		(4,002)
Other		(1,514)		(1,289)		(377)
Income tax provision	\$	<u>86,465</u>	\$	<u>79,705</u>	\$	<u>74,955</u>

Deferred Taxes

Individually significant components of the deferred tax assets and (liabilities) are presented below (in thousands):

December 31,	2016	2015
Deferred tax assets:		
Deferred revenue and cancellation reserves	\$ 49,332	\$ 39,323
Allowances and accruals, including state NOL carryforward amounts	49,074	43,185
Interest on derivatives	—	206
Credits and other	1,781	2,581
Capital loss carryforward	—	10,414
Valuation allowance	(227)	(5,360)
Total deferred tax assets	<u>99,960</u>	<u>90,349</u>
Deferred tax liabilities:		
Inventories	(22,253)	(21,313)
Goodwill	(41,107)	(31,258)
Property and equipment, principally due to differences in depreciation	(93,943)	(84,355)
Prepaid expenses and other	(1,732)	(6,552)
Total deferred tax liabilities	<u>(159,035)</u>	<u>(143,478)</u>
Total	<u>\$ (59,075)</u>	<u>\$ (53,129)</u>

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

As of December 31, 2016, we had a \$0.2 million valuation allowance recorded associated with state net operating losses. The valuation allowance decreased \$5.1 million in the current year primarily as a result of our equity investment in a partnership with U.S. Bancorp Community Development Corporation, expected state net operating loss utilization, and a certain amount of capital loss expiration. See also Note 18.

As of December 31, 2016, we no longer have an amount of capital loss carryforward. During 2016, we utilized the capital loss carryforward primarily related to capital gains generated as a result of our equity investment in a partnership with U.S. Bancorp Community Development Corporation. The remaining amount of capital loss and associated valuation allowance of \$0.2 million were written off due to expiration as of December 31, 2016.

State net operating loss carryforward amounts totaled approximately \$1.5 million, tax effected, at December 31, 2016 and have expiration dates through 2036. We believe that it is more likely than not that the benefit from certain state NOL carryforward amounts will not be realized. In recognition of this risk, we have recorded a valuation allowance of \$0.2 million on the deferred tax assets relating to these state NOL carryforwards. Additionally, we have \$1.5 million, tax effected, in state tax credit carryforwards with expiration dates through 2026. We believe it is more likely than not that the benefits from these state tax credit carryforwards will be realized.

Unrecognized Tax Benefits

The following is a reconciliation of our unrecognized tax benefits (in thousands):

Balance, December 31, 2014	\$	1,495
Decrease related to tax positions taken - prior year		(464)
Balance, December 31, 2015		1,031
Decrease related to tax positions taken - prior year		(1,031)
Balance, December 31, 2016	\$	<u>—</u>

The unrecognized tax benefits recorded were acquired as part of the acquisition of DCH. We recorded a tax indemnification asset related to the unrecognized tax benefit as we determined the amount would be recoverable from the seller. We have no unrecognized tax benefits recorded as of December 31, 2016.

Open tax years at December 31, 2016 included the following:

Federal	2013	-	2016
19 states	2012	-	2016

(14) Acquisitions

In 2016, we completed the following acquisitions:

- On January 26, 2016, we acquired Riverside Subaru in Riverside, California.
- On February 1, 2016, we acquired Ira Toyota in Milford, Massachusetts.
- On June 23, 2016, we acquired the Helena Buick GMC franchises in Helena, Montana.
- On August 1, 2016, we acquired Thousand Oaks Ford in Thousand Oaks, California.
- On September 12, 2016, we acquired Carbone Auto Group: a nine store platform in New York and Vermont.
- On September 28, 2016, we acquired Greiner Ford Lincoln in Casper, Wyoming.
- On October 5, 2016, we acquired Woodland Hills Audi in Woodland Hills, California.
- On November 16, 2016, we acquired Honolulu Ford in Honolulu, Hawaii.

Revenue and operating income contributed by the 2016 acquisitions subsequent to the date of acquisition were as follows (in thousands):

Year Ended December 31,		2016
Revenue	\$	266,160
Operating income		1,720

In 2015, we completed the following acquisitions:

- On May 14, 2015, we acquired a smart franchise from Smart Center of Omaha.
- On July 31, 2015, we acquired Bitterroot Ford in Missoula, Montana.
- On August 20, 2015, we acquired Acura of Honolulu in Honolulu, Hawaii.
- On September 28, 2015, we acquired Bennett Motors in Great Falls, Montana.
- On October 12, 2015, we acquired Crown Chrysler Jeep Dodge Ram Fiat in Concord, California.
- On December 17, 2015, we acquired Barton Chrysler Jeep Dodge Ram Alfa Fiat in Spokane, Washington.

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

No portion of the purchase price was paid with our equity securities. The following tables summarize the consideration paid for the acquisitions and the preliminary amount of identified assets acquired and liabilities assumed as of the acquisition date (in thousands):

Consideration paid for the Year Ended December 31,	2016	2015
Cash paid, net of cash acquired	\$ 234,700	\$ 71,615
Property and equipment transferred	2,637	—
Forgiven outstanding notes receivable	—	1,374
	<u>\$ 237,337</u>	<u>\$ 72,989</u>

Assets acquired and liabilities assumed for the Year Ended December 31,	2016	2015
Trade receivables, net	\$ —	\$ 36
Inventories	148,915	34,374
Franchise value	27,087	6,843
Property and equipment	75,345	22,118
Other assets	990	224
Floor plan notes payable	(30,134)	—
Debt and capital lease obligations	(22,813)	(2,160)
Other liabilities	(9,450)	(2,537)
	<u>189,940</u>	<u>58,898</u>
Goodwill	47,397	14,091
	<u>\$ 237,337</u>	<u>\$ 72,989</u>

The purchase price allocation for Carbone Auto Group acquisition is preliminary as we have not obtained all of the detailed information to finalize the opening balance sheet related to allocation of franchise value to each reporting unit. Management has recorded the purchase price allocations based on the information that is currently available.

We account for franchise value as an indefinite-lived intangible asset. We expect \$47.4 million of the goodwill recorded in 2016 to be deductible for tax purposes. In 2016, we recognized \$1.0 million in acquisition expenses as a component of selling, general and administrative expenses in the Consolidated Statements of Operations. We did not have any material acquisition-related expenses in 2015.

The following unaudited pro forma summary presents consolidated information as if the acquisitions had occurred on January 1 of the previous year (in thousands, except for per share amounts):

Year Ended December 31,	2016	2015
Revenue	\$ 9,297,452	\$ 8,905,065
Income from continuing operations, net of tax	202,639	189,505
Basic income per share from continuing operations, net of tax	7.98	7.21
Diluted income per share from continuing operations, net of tax	7.94	7.15

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.

(15) Discontinued Operations and Assets and Related Liabilities Held for Sale

We classify an asset group as held for sale 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 as follows:

- 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.

In April 2014, the Financial Accounting Standards Board (“FASB”) issued an accounting standard update that amended the accounting guidance related to discontinued operations. This amendment defines discontinued operations as a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has or will have a major effect on an entity’s operations and financial results. We early adopted this guidance in September 2014 and, as a result, determined that individual stores which met the criteria for held for sale after our adoption date would no longer qualify for classification as discontinued operations. We had previously reclassified a store’s operations to discontinued operations in our Consolidated Statements of Operations, on a comparable basis for all periods presented, provided we did not expect to have any significant continuing involvement in the store’s operations after its disposal.

On May 1, 2014, we completed the sale of one store which had been classified as held for sale since October 2012. This store’s operations have been reclassified to discontinued operations in our Consolidated Statement of Operations, on a comparable basis for all periods presented.

Actual floor plan interest expense for a 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. Interest expense included as a component of discontinued operations was as follows (in thousands):

Year Ended December 31,	2016	2015	2014
Floor plan interest	\$ —	\$ —	\$ 32
Other interest	—	—	8
Total interest	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 40</u>

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

Year Ended December 31,	2016	2015	2014
Revenue	\$ —	\$ —	\$ 12,569
Pre-tax loss from discontinued operations	\$ —	\$ —	\$ (467)
Net gain on disposal activities	—	—	5,744
			5,277
Income tax expense	—	—	(2,097)
Income from discontinued operations, net of income tax expense	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,180</u>
Goodwill and other intangible assets disposed of	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 211</u>

The net gain on disposal activities in 2014 included a \$6.8 million gain related to the disposal of goodwill and other intangible assets.

(16) Related Party Transactions

Transition Agreement

In September 2015, we entered into a transition agreement with Sidney B. DeBoer, our Chairman of the Board, which provided him certain benefits until his death. The agreement has an effective date of January 1, 2016 and the initial payment of these benefits began in the third quarter of 2016.

We recorded a charge of \$18.3 million in 2015 as a component of selling, general and administrative expense in our Consolidated Statement of Operations related to the present value of estimated future payments due pursuant to this agreement. We believe that this estimate is reasonable; however, actual cash flows could differ materially. We will periodically evaluate whether significant changes in our assumptions have occurred and record an adjustment if future expected cash flows are significantly different than the reserve recorded.

As of December 31, 2016, the balance associated with this agreement was \$17.3 million and was included as a component of accrued liabilities and other long-term liabilities in our Consolidated Balance Sheets.

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

Following is a reconciliation of the net income from continuing operations and weighted average shares used for our basic earnings per share (“EPS”) and diluted EPS (in thousands, except per share amounts):

Year Ended December 31, <i>(in thousands, except per share data)</i>	2016		2015		2014	
	Class A	Class B	Class A	Class B	Class A	Class B
Net income applicable to common stockholders - basic	\$ 182,369	\$ 14,689	\$ 165,172	\$ 17,827	\$ 122,246	\$ 13,294
Reallocation of distributed net income as a result of conversion of dilutive stock options	8	(8)	15	(15)	15	(15)
Reallocation of distributed net income due to conversion of Class B to Class A common shares outstanding	1,791	—	1,932	—	1,547	—
Conversion of Class B common shares into Class A common shares	12,833	—	15,760	—	11,616	—
Effect of dilutive stock options on net income	57	(57)	120	(120)	116	(116)
Net income applicable to common stockholders - diluted	<u>\$ 197,058</u>	<u>\$ 14,624</u>	<u>\$ 182,999</u>	<u>\$ 17,692</u>	<u>\$ 135,540</u>	<u>\$ 13,163</u>
Weighted average common shares outstanding – basic	23,515	1,894	23,729	2,561	23,559	2,562
Conversion of Class B common shares into Class A common shares	1,894	—	2,561	—	2,562	—
Effect of dilutive stock options on weighted average common shares	112	—	200	—	261	—
Weighted average common shares outstanding – diluted	<u>25,521</u>	<u>1,894</u>	<u>26,490</u>	<u>2,561</u>	<u>26,382</u>	<u>2,562</u>
Net income per common share - basic	\$ 7.76	\$ 7.76	\$ 6.96	\$ 6.96	\$ 5.19	\$ 5.19
Net income per common share - diluted	\$ 7.72	\$ 7.72	\$ 6.91	\$ 6.91	\$ 5.14	\$ 5.14
Antidilutive Securities						
Shares issuable pursuant to stock options not included since they were antidilutive	—	—	16	—	13	—

(18) Equity-Method Investments

In October 2014, we acquired a 99.9% membership interest in a limited liability company managed by U.S. Bancorp Community Development Corporation with an initial equity contribution of \$4.1 million. We made additional equity contributions to the entity of \$22.8 million in 2015 and \$22.8 million in 2016. We were obligated to make \$49.8 million of total contributions to the entity over a two-year period ending October 2016, all of which had been made as of December 31, 2016.

This investment generated new markets tax credits under the New Markets Tax Credit Program (“NMTC Program”). The NMTC Program was established by Congress in 2000 to spur new or increased investments into operating businesses and real estate projects located in low-income communities.

While U.S. Bancorp Community Development Corporation exercised management control over the limited liability company, due to the economic interest we held in the entity, we determined our ownership portion of the entity was appropriately accounted for using the equity method.

The following amounts related to this equity-method investment were recorded in our Consolidated Balance Sheets (in thousands):

December 31,	2016		2015	
Carrying value, recorded as a component of other non-current assets	\$	—	\$	22,284
Present value of the obligation associated with future equity contributions, recorded as a component of accrued liabilities and other long-term liabilities		—		22,511

The following amounts related to this equity-method investment were recorded in our Consolidated Statements of Operations (in thousands):

Year Ended December 31,	2016		2015		2014	
Asset impairments to write investment down to fair value	\$	13,992	\$	16,521	\$	1,853
Our portion of the partnership’s operating losses		8,262		6,929		1,160
Non-cash interest expense related to the amortization of the discounted fair value of future equity contributions		185		674		152
Tax benefits and credits generated		28,530		30,832		6,506

(19) Segments

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

Year Ended December 31,	2016	2015	2014
Revenues:			
Domestic	\$ 3,381,715	\$ 3,038,883	\$ 2,569,928
Import	3,764,255	3,330,949	1,889,579
Luxury	1,528,760	1,490,632	926,856
	<u>8,674,730</u>	<u>7,860,464</u>	<u>5,386,363</u>
Corporate and other	3,427	3,788	3,963
	<u>\$ 8,678,157</u>	<u>\$ 7,864,252</u>	<u>\$ 5,390,326</u>
Segment income*:			
Domestic	\$ 106,210	\$ 115,145	\$ 96,608
Import	110,204	98,751	51,150
Luxury	31,467	36,391	25,448
	<u>247,881</u>	<u>250,287</u>	<u>173,206</u>
Corporate and other	114,321	74,514	71,195
Depreciation and amortization	(49,369)	(41,600)	(26,363)
Other interest expense	(23,207)	(19,491)	(10,742)
Other (expense) income, net	(6,103)	(1,006)	3,199
Income from continuing operations before income taxes	<u>\$ 283,523</u>	<u>\$ 262,704</u>	<u>\$ 210,495</u>

*Segment income for each of the segments is defined as Income from continuing operations before income taxes, depreciation and amortization, other interest expense and other (expense) income, net.

Year Ended December 31,	2016	2015	2014
Floor plan interest expense:			
Domestic	\$ 26,445	\$ 21,061	\$ 17,895
Import	18,665	14,959	9,397
Luxury	10,999	9,096	5,098
	<u>56,109</u>	<u>45,116</u>	<u>32,390</u>
Corporate and other	(30,578)	(25,582)	(18,529)
	<u>\$ 25,531</u>	<u>\$ 19,534</u>	<u>\$ 13,861</u>

December 31,	2016	2015
Total assets:		
Domestic	\$ 1,225,387	\$ 993,426
Import	959,355	716,959
Luxury	511,779	475,305
Corporate and other	1,147,629	1,039,440
	<u>\$ 3,844,150</u>	<u>\$ 3,225,130</u>

(20) Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued accounting standards update ("ASU") 2014-09, "Revenue from Contracts with Customers," which amends the accounting guidance related to revenues. This amendment will replace most of the existing revenue recognition guidance when it becomes effective. The new standard, as amended in July 2015, is effective for fiscal years beginning after December 15, 2017 and entities are allowed to adopt the standard as early as annual periods beginning after December 15, 2016, and interim periods therein. The standard permits the use of either the retrospective or cumulative effect transition method. We have evaluated the effect this amendment has on our most significant types of transactions and expect the timing of our revenue recognition to generally remain the same. We plan to apply a cumulative effect transition method at adoption.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory (Topic 330)." ASU 2015-11 simplifies the accounting for the valuation of all inventory not accounted for using the last-in, first-out method by prescribing inventory be valued at the lower of cost or net realizable value. ASU 2015-11 is effective for public companies' annual periods, including interim periods within those fiscal years, beginning after December 15, 2016 on a prospective basis. Early adoption is permitted. We do not expect the adoption of ASU 2015-11 to have a material effect on our financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requires disclosing key information about leasing arrangements. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We are evaluating the effect this pronouncement will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation - Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies the accounting for several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. We believe this pronouncement will increase volatility in our effective tax rate, especially in the first quarter, as it relates to the recognition of the tax consequences of share-based payments. We plan to apply a prospective transition method associated with recognizing excess tax benefits and tax deficiencies in the income statement and will retrospectively apply amendments which impact the presentation of excess tax benefits on the cash flow statement.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides guidance for eight cash flow classification issues to reduce diversity in practice. The clarification includes guidance on items such as debt prepayment or debt extinguishment cost, contingent consideration payment made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies and distributions received from equity method investees. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted. We are evaluating the effect this pronouncement will have on our consolidated financial statements and related disclosures.

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

(21) Subsequent Events

Common Stock Dividend

On February 13, 2017, our Board of Directors approved a dividend of \$0.25 per share on our Class A and Class B common stock related to our fourth quarter 2016 financial results. The dividend will total approximately \$6.3 million and will be paid on March 24, 2017 to shareholders of record on March 10, 2017.

**LITHIA MOTORS, INC.
RESTRICTED STOCK UNIT AGREEMENT
(2017 Performance- and Time-vesting)**

This Restricted Stock Unit Agreement (“**Agreement**”) is entered into pursuant to the 2013 Amended and Restated Stock Incentive Plan (the “**Plan**”) adopted by the Board of Directors and shareholders of Lithia Motors, Inc., an Oregon corporation (the “**Company**”), as amended from time to time. Unless otherwise defined herein, capitalized terms in this Agreement have the meanings given to them in the Plan. Any inconsistency between this Agreement and the terms and conditions of the Plan will be resolved in favor of the Plan. Compensation paid pursuant to this Agreement is intended to qualify as performance-based compensation under Section 162(m) of the Internal Revenue Code of 1986 (the “**Code**”).

“Recipient”	[]
Number of Restricted Stock Units (“RSUs”)	[]
“Date of Grant”	January 12, 2017

1. GRANT OF RESTRICTED STOCK UNIT AWARD

1.1 The Grant. The Company hereby awards to Recipient, and Recipient hereby accepts, the RSUs specified above on the terms and conditions set forth in this Agreement and the Plan (the “**Award**”). Each RSU represents the right to receive one share of Class A Common Stock of the Company (a “**Share**”) on an applicable Settlement Date, as defined in Section 1.3 of this Agreement, subject to the terms of this Agreement and the Plan.

1.2 Forfeiture; Vesting; Clawback . The RSUs are subject to forfeiture in accordance with the performance criteria specified in Section 1.2(a) of this Agreement. Any RSUs not forfeited will vest according to the schedule set forth in Section 1.2(b) of this Agreement. The RSUs, the Shares issued upon vesting of the RSUs and any proceeds received upon the sale of the Shares are subject to recovery by the Company as specified in Section 1.2(c) of this Agreement.

(a) *Forfeiture .*

- (i) The RSUs are subject to forfeiture based on the Company’s 2017 pro forma earnings per share, calculated as specified in Section 1.2(a)(iii) of this Agreement (the “**2017 Pro Forma EPS**”). The number of RSUs that will be forfeited is determined according to the highest earnings per share threshold set forth on the table below (each, an “**EPS Threshold**”) that the 2017 Pro Forma EPS meets or exceeds. The table below specifies the applicable percentage of RSUs that will be retained (the “**Earned RSUs**”), subject to adjustment as provided in Section 1.2(a)(ii), at the specified EPS Threshold. When the Committee certifies the number of Earned RSUs as provided in Section 1.2(a)(iii), all RSUs that are not Earned RSUs will be forfeited.

EPS Threshold	Percentage of Earned RSUs
\$ 8.48 (highest)	100.0%
\$ 8.37	95.0%
\$ 8.27	90.0%
\$ 7.86	85.0%
\$ 7.03	80.0%
\$ 6.62	75.0%
\$ 0.01	50.0%
\$ 0.00 or negative 2017 Pro Forma EPS (lowest)	0.0%

(ii) If the 2017 Pro Forma EPS is at least \$6.62 and falls between the EPS Thresholds specified in the table above, the percentage of Earned RSUs will be determined on a pro-rata basis and the number of Earned RSUs will be rounded to the nearest whole RSU. If the 2017 Pro Forma EPS is positive but less than \$6.62, the percentage of Earned RSUs will not exceed 50.0%.

Example 1: If the 2017 Pro Forma EPS is \$7.26, the percentage of Earned RSUs would be 80.0% plus an additional percentage calculated as follows: (a) the amount by which 2017 Pro Forma EPS exceeds the highest applicable EPS Threshold multiplied by (b) a fraction, (i) the numerator of which is 5.0% and the (ii) denominator of which is the difference between the highest applicable EPS Threshold and the next-highest EPS Threshold that was exceeded (in this example, \$7.86 - \$7.03 = \$0.83):

$$\$0.23 (5.0\%/\$0.83) = 1.4\%$$

The resulting percentage of Earned RSUs correlating to an EPS of \$7.26 would be 81.4%. If the Award were 1,000 RSUs, the number of Earned RSUs would be 81.4% of 1,000, or 814 RSUs. The number of forfeited RSUs would be 1,000 minus 814, or 186. The Earned RSUs would be subject to the vesting according to the schedule specified in Section 1.2(b) of this Agreement.

(iii) The 2017 Pro Forma EPS will be calculated by deducting from the Company's consolidated diluted income (loss) per share, as set forth in the audited consolidated statement of income for the Company and its subsidiaries for the 2017 fiscal year, non-operational transactions or disposal activities, for example:

- i. asset impairment and disposal gain;
- ii. gains or losses on the sale of real estate or stores;
- iii. gains or losses on equity investment;
- iv. reserves for real estate leases, Company-owned service contracts (e.g., lifetime oil), and legal matters; and
- v. related income tax adjustments for any of the above.

As soon as practicable, the Director of Internal Audit of the Company shall calculate the 2017 Pro Forma EPS, and shall submit those calculations to the Committee. At or prior to the regularly scheduled meeting of the Committee held in the first fiscal quarter of 2017, the Committee shall certify in writing (which may consist of approved minutes of the meeting) the 2017 Pro Forma EPS and the number of Earned RSUs. Unless otherwise required under this Agreement, no Shares or other amounts shall be delivered or paid unless the Committee certifies the 2017 Pro Forma EPS and the number of Earned RSUs. The Committee may reduce the amount of the compensation payable upon the attainment of the performance goals based on such factors as it deems appropriate, including subjective factors.

(b) *Vesting*. Subject to the continued employment of Recipient with the Company or any Subsidiary, (i) 0% of the Earned RSUs shall vest on the date that the Committee certifies the number of Earned RSUs and (ii) the remaining Earned RSUs shall vest on the dates set forth in the table below (each, a “**Vesting Date**”). The number of Shares to which Recipient is entitled on each Vesting Date shall be rounded up to the nearest whole Share (except for the last Vesting Date, on which all remaining RSUs shall vest).

Vesting Date	Vesting of Award
January 1, 2019	33%
January 1, 2020	33%
January 1, 2021	34%

Example 2: If there are 814 Earned RSUs, and the Committee certifies the number of Earned RSUs on February 1, 2017, the Earned RSUs would vest and entitle Recipient to receive Shares, subject to continued employment, as follows.

Vesting Date	Vesting of Award	Shares
January 1, 2019	33%	269
January 1, 2020	33%	269
January 1, 2021	34%	276

(c) *Clawback*. If the Company’s financial statements are restated at any time within three years after the Committee certifies the number of Earned RSUs under Section 1.2(a)(iii) of this Agreement, the 2017 Pro Forma EPS shall be recalculated (the resulting number, the “**Recalculated 2017 Pro Forma EPS**”) based on the restated financial statements. If, based on the Company’s restated financial statements, the Recalculated 2017 Pro Forma EPS is less than the 2017 Pro Forma EPS that the Committee previously certified, (i) any Earned RSUs subject to vesting shall be adjusted to reflect the number of RSUs that would have been Earned RSUs based on the Recalculated 2017 Pro Forma EPS and (ii) Recipient shall repay to the Company (1) a number of Shares calculated by subtracting the number of Shares Recipient should have received based on the Recalculated 2017 Pro Forma EPS from the number of Shares Recipient received under this Award (the “**Excess Shares**”) and (2) any dividend paid on the Excess Shares (the “**Excess Dividends**”). If any Excess Shares are sold by Recipient before the Company’s demand for repayment (including any Shares withheld for taxes under Section 4 of this Agreement), in lieu of repaying the Company the Excess Shares that were sold Recipient shall repay to the Company 100% of the proceeds of such sale or sales. The Committee may, in its sole discretion, reduce the amount to be repaid by Recipient to take into account the tax consequences of such repayment for Recipient. No additional RSUs shall be deemed Earned RSUs based on Recalculated 2017 Pro Forma EPS.

If any portion of the Excess Shares and Excess Dividends was deferred under the RSU Deferral Plan effective January 1, 2012 (the “**Deferral Plan**”), that portion shall be recovered by canceling the amounts so deferred under the Deferral Plan and any dividends or other earnings credited under the Deferral Plan with respect to such cancelled amounts. The Company may seek direct repayment from Recipient of any Excess Shares, Excess Dividends and proceeds not so recovered and may, to the extent permitted by applicable law, offset such amounts against any compensation or other amounts owed by the Company to Recipient. In particular, such amounts may be recovered by offset against the after-tax proceeds of deferred compensation payouts under the Company’s Deferred Compensation Plan, the Company’s Supplemental Executive Retirement Plan at the times such deferred compensation payouts occur under the terms of those plans. Amounts that remain unpaid for more than 60 days after demand by the Company shall accrue interest at the rate used from time to time for crediting interest under the Deferred Compensation Plan.

1.3 Settlement of Earned RSUs. There is no obligation for the Company to make payments or distributions with respect to RSUs except, subject to the terms and conditions of this Agreement, the issuance of Shares to settle vested RSUs after the applicable Vesting Date . The Company's issuance of one Share for each vested Earned RSU (" **Settlement** ") may be subject to such conditions, restrictions and contingencies as the Committee shall determine. Unless receipt of the Shares is validly deferred pursuant to the Deferral Plan, and except as otherwise provided in any Amended Employment and Change in Control Agreement between the Company and Recipient (as the same may be amended and/or restated from time to time), Earned RSUs shall be settled as soon as practicable after the applicable Vesting Date (each date of Settlement, a " **Settlement Date** "), but in no event later than March 15 of the calendar year following the calendar year in which the Vesting Date occurs. Notwithstanding the foregoing, the payment dates set forth in this Section 1.3 have been specified for the purpose of complying with the short-term deferral exception under Code Section 409A, and to the extent payments are made during the periods permitted under Code Section 409A (including applicable periods before or after the specified payment dates set forth in this Section 1.3), the Company shall be deemed to have satisfied its obligations under the Plan and shall be deemed not to be in breach of its payment obligations hereunder .

1.4 Termination of Recipient's Employment.

(a) *Voluntary or Involuntary Termination* . Except as otherwise provided in this Section 1.4, if Recipient's employment with the Company or any Subsidiary terminates as a result of a voluntary or involuntary termination, all outstanding unvested RSUs (whether or not determined to be Earned RSUs) shall immediately be forfeited. Recipient shall not be treated as terminating employment if Recipient is on an approved leave of absence.

(b) *Death* . If Recipient's employment with the Company or any Subsidiary terminates as a result of Recipient's death that occurs on or after January 1, 2017, Recipient shall become vested in a prorated number of Earned RSUs. The prorated portion of the Earned RSUs that is vested as of Recipient's death shall be the total number of Earned RSUs multiplied by a fraction, the numerator of which shall be the number of full months elapsed from the Date of Grant through the date of Recipient's death, and the denominator of which shall be 48. The Vesting Date for additional RSUs vesting under this Section 1.4(b) shall be the date of Recipient's death. Payment upon death shall be the total number of shares vested as a result of this Section 1.4(b), reduced by the number of Shares previously delivered to Recipient.

(c) *Disability* . If Recipient becomes Disabled while employed by the Company or a Subsidiary, Earned RSUs shall continue to vest as scheduled in Section 1.2 of this Agreement for so long as Recipient remains Disabled. If Recipient dies while Disabled, Section 1.4(b) of this Agreement shall apply.

(d) *Qualified Retirement* . If Recipient terminates employment due to a Qualified Retirement that occurs on or after January 1, 2017, Recipient shall become vested in a prorated number of Earned RSUs. A " **Qualified Retirement** " means Recipient voluntarily terminates employment on or after Recipient attains age 65 and has at least four complete years of employment with the Company or a Subsidiary. The prorated portion of the Earned RSUs that is vested as of Recipient's Qualified Retirement shall be the total number of Earned RSUs multiplied by a fraction, the numerator of which shall be the number of full months elapsed from the Date of Grant through the date of Recipient's Qualified Retirement, and the denominator of which shall be 48. The Vesting Date for additional RSUs vesting under this Section 1.4(d) shall be the date of Recipient's Qualified Retirement. Payment upon Qualified Retirement shall be the total number of shares vested as a result of this Section 1.4(d), reduced by the number of Shares previously delivered to Recipient.

Notwithstanding anything in this Agreement to the contrary, in no event will any Settlement occur prior to the applicable Vesting Date (i.e., the Vesting Date set forth in Section 1.2 unless the Vesting Date is earlier pursuant to Section 1.4 as a result of Recipient's death or Qualified Retirement).

2. REPRESENTATIONS AND COVENANTS OF RECIPIENT

2.1 No Representations by or on Behalf of the Company. Recipient is not relying on any representation, warranty or statement made by the Company or any agent, employee or officer, director, shareholder or other controlling person of the Company regarding the RSUs or this Agreement.

2.2 Tax Considerations. The Company has advised Recipient to seek Recipient's own tax and financial advice with regard to the federal and state tax considerations resulting from Recipient's receipt of the Award, the vesting of the Award and Recipient's receipt of the Shares upon Settlement of the vested portion of the Award. Recipient understands that the Company, to the extent required by law, will report to appropriate taxing authorities the payment to Recipient of compensation income upon the grant, vesting and/or Settlement of RSUs under the Award and Recipient shall be solely responsible for the payment of all federal and state taxes resulting from such grant, vesting and/or Settlement.

2.3 Agreement to Enter into Lock-Up Agreement with an Underwriter. Recipient understands and agrees that whenever the Company undertakes a firmly underwritten public offering of its securities, Recipient will, if requested to do so by the managing underwriter in such offering, enter into an agreement not to sell or dispose of any securities of the Company owned or controlled by Recipient, including any of the RSUs or the Shares, provided that such restriction will not extend beyond 12 months from the effective date of the registration statement filed in connection with such offering.

3. GENERAL RESTRICTIONS OF TRANSFERS OF RSUS

3.1 No Transfers of RSUs. Recipient agrees for himself or herself and his or her executors, administrators and other successors in interest that none of the RSUs, nor any interest therein, may be voluntarily or involuntarily sold, transferred, assigned, donated, pledged, hypothecated or otherwise disposed of, gratuitously or for consideration.

3.2 Award Adjustments. The number of RSUs granted under this Award shall, at the discretion of the Committee, be subject to adjustment under the Plan in the event the outstanding shares of Common Stock are hereafter increased, decreased, changed into or exchanged for a different number or kind of shares of Common Stock or for other securities of the Company or of another corporation, by reason of any reorganization, merger, consolidation, reclassification, stock split up, combination of shares of Common Stock, or dividend payable in shares of Common Stock or other securities of the Company. If Recipient receives any additional RSUs pursuant to the Plan, such additional (or other) RSUs shall be deemed granted hereunder and shall be subject to the same restrictions and obligations on the RSUs as originally granted as imposed by this Agreement.

3.3 Invalid Transfers. Any disposition of the RSUs other than in strict compliance with the provisions of this Agreement shall be void.

4. PAYMENT OF TAX WITHHOLDING AMOUNTS . To the extent the Company is responsible for withholding income taxes, Recipient must pay to the Company or make adequate provision for the payment of all Tax Withholding. If any RSUs are scheduled to vest during a period in which trading is not permitted under the Company's insider trading policy, to satisfy the Tax Withholding requirement, Recipient irrevocably elects to settle the Tax Withholding obligation by the Company withholding a number of Shares otherwise deliverable upon vesting having a market value sufficient to satisfy the statutory minimum tax withholding of Recipient. If the Company later determines that additional Tax Withholding was or has become required beyond any amount paid or provided for by Recipient, Recipient will pay such additional amount to the Company immediately upon demand by the Company. If Recipient fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to Recipient.

5. MISCELLANEOUS PROVISIONS

5.1 Amendment and Modification. Except as otherwise provided by the Plan, this Agreement may be amended, modified and supplemented only by written agreement of all of the parties hereto.

5.2 Assignment. This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns, but neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by Recipient without the prior written consent of the Company.

5.3 Governing Law. To the extent not preempted by federal law, this Agreement and the rights and obligations of the parties hereunder shall be governed by and construed in accordance with the internal laws of the State of Oregon applicable to the construction and enforcement of contracts wholly executed in Oregon by residents of Oregon and wholly performed in Oregon. Any action or proceeding brought by any party hereto shall be brought only in a state or federal court of competent jurisdiction located in the County of Multnomah in the State of Oregon and all parties hereto hereby submit to the in personal jurisdiction of such court for purposes of any such action or procedure.

5.4 Arbitration . The parties agree to submit any dispute arising under this Agreement to final, binding, private arbitration in Portland, Oregon. This includes not only disputes about the meaning or performance of this Agreement, but disputes about its negotiation, drafting or execution. The dispute will be determined by a single arbitrator in accordance with the then-existing rules of arbitration procedure of Multnomah County, Oregon Circuit Court, except that there shall be no right of de novo review in Circuit Court and the arbitrator may charge his or her standard arbitration fees rather than the fees prescribed in the Multnomah County Circuit Court arbitration procedures. The proceeding will be commenced by the filing of a civil complaint in Multnomah County Circuit Court and a simultaneous request for transfer to arbitration. The parties expressly agree that they may choose an arbitrator who is not on the list provided by the Multnomah County Circuit Court Arbitration Department, but if they are unable to agree upon the single arbitrator within 10 days of receipt of the Arbitration Department list, they will ask the Arbitration Department to make the selection for them. The arbitrator will have full authority to determine all issues, including arbitrability; to award any remedy, including permanent injunctive relief; and to determine any request for costs and expenses in accordance with Section 5.5 of this Agreement. The arbitrator's award may be reduced to final judgment in Multnomah County Circuit Court. The complaining party shall bear the arbitration expenses and may seek their recovery if it prevails. Notwithstanding any other provision of this Agreement, an aggrieved party may seek a temporary restraining order or preliminary injunction in Multnomah County Circuit Court to preserve the status quo during the arbitration proceeding.

5.5 Attorney Fees . If any suit, action or proceeding is instituted in connection with any controversy arising out of this Agreement or the enforcement of any right hereunder, the prevailing party will be entitled to recover, in addition to costs, such sums as the court or arbitrator may adjudge reasonable as attorney fees, including fees on any appeal.

5.6 Headings. The headings of the sections and subsections of this Agreement are inserted for convenience only and shall not constitute a part hereof.

5.7 Entire Agreement. This Agreement and the Plan embody the entire agreement and understanding of the parties hereto in respect of the subject matter contained herein and supersedes all prior written or oral communications or agreements all of which are merged herein. There are no restrictions, promises, warranties, covenants or undertakings, other than those expressly set forth or referred to herein.

5.8 No Waiver. No waiver of any provision of this Agreement or any rights or obligations of any party hereunder shall be effective, except pursuant to a written instrument signed by the party or parties waiving compliance, and any such waiver shall be effective only in the specific instance and for the specific purpose stated in such writing.

5.9 Severability of Provisions. In the event that any provision hereof is found invalid or unenforceable pursuant to judicial decree or decision, the remainder of this Agreement shall remain valid and enforceable according to its terms.

5.10 Incorporation by Reference, Etc. The provisions of the Plan are hereby incorporated herein by reference. Except as otherwise set forth herein, this Agreement shall be construed in accordance with the provisions of the Plan and any interpretations, amendments, rules and regulations promulgated by the Committee from time to time pursuant to the Plan. The Committee shall have the final authority to interpret and construe the Plan and this Agreement and to make any and all determinations under them, and its decision shall be final, binding and conclusive upon Recipient and his or her legal representative in respect to any questions arising under the Plan or this Agreement.

5.11 Notices. All notices or other communications pursuant to this Agreement shall be in writing and shall be deemed duly given if delivered personally or by courier service, or if mailed by certified mail, return receipt requested, prepaid and addressed to the Company executive offices to the attention of the Corporate Secretary, or if to Recipient, to the address maintained by the personnel department, or such other address as such party shall have furnished to the other party in writing.

5.12 Acceptance of Agreement. Unless Recipient notifies the Corporate Secretary in writing within 14 days after the Date of Grant that Recipient does not wish to accept this Agreement, Recipient will be deemed to have accepted this Agreement and will be bound by the terms of this Agreement and the Plan.

5.13 No Right of Employment. Nothing contained in the Plan or this Agreement shall be construed as giving Recipient any right to be retained, in any position, as an employee of the Company or any Subsidiary.

[Remainder of this page left blank intentionally .]

Recipient and the Company have executed this Agreement effective as of the Date of Grant.

RECIPIENT

Signature

Type or Print Name: _____

Social Security Number: _____

COMPANY

LITHIA MOTORS, INC.

By: _____

Name: Chris Holzshu

Title: Chief Human Resources Officer

*** Please take the time to read and understand this Agreement. If you have any specific questions or do not fully understand any of the provisions, please contact Larissa McAlister in writing.**

LITHIA MOTORS, INC.
RESTRICTED STOCK UNIT AGREEMENT
(20[] Time-vesting)

This Restricted Stock Unit Agreement (“ **Agreement** ”) is entered into pursuant to the 2013 Amended and Restated Stock Incentive Plan (the “ **Plan** ”) adopted by the Board of Directors and Shareholders of Lithia Motors, Inc., an Oregon corporation (the “ **Company** ”), as amended from time to time. Unless otherwise defined herein, capitalized terms in this Agreement have the meanings given to them in the Plan. Any inconsistency between this Agreement and the terms and conditions of the Plan will be resolved in favor of the Plan.

“**Recipient**” []
Number of Restricted Stock Units (“RSUs”) []
“Date of Grant” [], 20[]

1. GRANT OF RESTRICTED STOCK UNIT AWARD

1.1 The Grant. The Company hereby awards to Recipient, and Recipient hereby accepts, the RSUs specified above on the terms and conditions set forth in this Agreement and the Plan (the “ **Award** ”). Each RSU represents the right to receive one share of Class A Common Stock of the Company (a “ **Share** ”) on an applicable Settlement Date, as defined in Section 1.3 of this Agreement, subject to the terms of this Agreement and the Plan.

1.2 Vesting . Subject to the continued employment of Recipient with the Company or any Subsidiary, the RSUs (rounded to the nearest whole RSU) shall vest on the dates set forth in the table below (each, a “ **Vesting Date** ”).

Vesting Date	Vesting of Award	Vested RSUs
January 1, 20[]	[]%	[]
January 1, 20[]	[]%	[]
January 1, 20[]	[]%	[]
[January 1, 20[]	[]%	[]

1.3 Settlement of RSUs. There is no obligation for the Company to make payments or distributions with respect to RSUs except for the issuance of Shares to settle vested RSUs after the applicable Vesting Date. The Company’s issuance of one Share for each vested RSU (“ **Settlement** ”) may be subject to such conditions, restrictions and contingencies as the Committee shall determine. Unless receipt of the Shares is validly deferred pursuant to the RSU Deferral Plan effective January 1, 2012, RSUs shall be settled as soon as practicable after the applicable Vesting Date (each date of Settlement, a “ **Settlement Date** ”), but in no event later than March 15 of the calendar year following the calendar year in which the Vesting Date occurs. Notwithstanding the foregoing, the payment dates set forth in this Section 1.3 have been specified for the purpose of complying with the short-term deferral exception under Section 409A of the Internal Revenue Code of 1986, and to the extent payments are made during the periods permitted under Section 409A (including applicable periods before or after the specified payment dates set forth in this Section 1.3), the Company shall be deemed to have satisfied its obligations under the Plan and shall be deemed not to be in breach of its payment obligations hereunder .

1.4 Termination of Recipient's Employment.

(a) *Voluntary or Involuntary Termination.* Except as otherwise provided in this Section 1.4, if Recipient's employment with the Company or any Subsidiary terminates as a result of a voluntary or involuntary termination, all outstanding unvested RSUs shall immediately be forfeited. Recipient shall not be treated as terminating employment if Recipient is on an approved leave of absence.

(b) *Death.* If Recipient's employment with the Company or any Subsidiary terminates as a result of Recipient's death that occurs on or after January 1, 20[___], Recipient shall become vested in a prorated number of RSUs. The prorated portion of the RSUs that is vested as of Recipient's death shall be the total number of RSUs multiplied by a fraction, the numerator of which shall be the number of full months elapsed from the Date of Grant through the date of Recipient's death, and the denominator of which shall be 48. The Vesting Date for additional RSUs vesting under this Section 1.4(b) shall be the date of Recipient's death. Payment upon death shall be the total number of shares vested as a result of this Section 1.4(b), reduced by the number of Shares previously delivered to Recipient.

(c) *Disability.* If Recipient becomes Disabled while employed by the Company or a Subsidiary, RSUs shall continue to vest as scheduled in Section 1.2 of this Agreement for so long as Recipient remains Disabled. If Recipient dies while Disabled, Section 1.4(b) of this Agreement shall apply.

(d) *Qualified Retirement.* If Recipient terminates employment due to a Qualified Retirement that occurs on or after January 1, 20[___], Recipient shall become vested in a prorated number of RSUs. A "**Qualified Retirement**" means Recipient voluntarily terminates employment on or after Recipient attains age 65 and has at least four complete years of employment with the Company or a Subsidiary. The prorated portion of the RSUs that is vested as of Recipient's Qualified Retirement shall be the total number of RSUs multiplied by a fraction, the numerator of which shall be the number of full months elapsed from the Date of Grant through the date of Recipient's Qualified Retirement, and the denominator of which shall be 48. The Vesting Date for additional RSUs vesting under this Section 1.4(d) shall be the date of Recipient's Qualified Retirement. Payment upon Qualified Retirement shall be the total number of shares vested as a result of this Section 1.4(d), reduced by the number of Shares previously delivered to Recipient.

Notwithstanding anything in this Agreement to the contrary, in no event will any Settlement occur prior to the applicable Vesting Date (i.e., the Vesting Date set forth in Section 1.2 unless the Vesting Date is earlier pursuant to Section 1.4 as a result of Recipient's death or Qualified Retirement).

2. REPRESENTATIONS AND COVENANTS OF RECIPIENT

2.1 No Representations by or on Behalf of the Company. Recipient is not relying on any representation, warranty or statement made by the Company or any agent, employee or officer, director, shareholder or other controlling person of the Company regarding the RSUs or this Agreement.

2.2 Tax Considerations. The Company has advised Recipient to seek Recipient's own tax and financial advice with regard to the federal and state tax considerations resulting from Recipient's receipt of the Award and Recipient's receipt of the Shares upon Settlement of the vested portion of the Award. Recipient understands that the Company, to the extent required by law, will report to appropriate taxing authorities the payment to Recipient of compensation income upon the Settlement of RSUs under the Award and Recipient shall be solely responsible for the payment of all federal and state taxes resulting from such Settlement.

2.3 Agreement to Enter into Lock-Up Agreement with an Underwriter. Recipient understands and agrees that whenever the Company undertakes a firmly underwritten public offering of its securities, Recipient will, if requested to do so by the managing underwriter in such offering, enter into an agreement not to sell or dispose of any securities of the Company owned or controlled by Recipient, including any of the RSUs or the Shares, provided that such restriction will not extend beyond 12 months from the effective date of the registration statement filed in connection with such offering.

3. GENERAL RESTRICTIONS OF TRANSFERS OF UNVESTED RSUS

3.1 No Transfers of Unvested RSUs. Recipient agrees for himself or herself and his or her executors, administrators and other successors in interest that none of the RSUs, nor any interest therein, may be voluntarily or involuntarily sold, transferred, assigned, donated, pledged, hypothecated or otherwise disposed of, gratuitously or for consideration prior to their vesting in accordance with this Agreement.

3.2 Award Adjustments. The number of RSUs granted under this Award shall, at the discretion of the Committee, be subject to adjustment under the Plan in the event the outstanding shares of Common Stock are hereafter increased, decreased, changed into or exchanged for a different number or kind of shares of Common Stock or for other securities of the Company or of another corporation, by reason of any reorganization, merger, consolidation, reclassification, stock split up, combination of shares of Common Stock, or dividend payable in shares of Common Stock or other securities of the Company. If Recipient receives any additional RSUs pursuant to the Plan, such additional (or other) RSUs shall be deemed granted hereunder and shall be subject to the same restrictions and obligations on the RSUs as originally granted as imposed by this Agreement.

3.3 Invalid Transfers. Any disposition of the RSUs other than in strict compliance with the provisions of this Agreement shall be void.

4. PAYMENT OF TAX WITHHOLDING AMOUNTS. To the extent the Company is responsible for withholding income taxes, upon the vesting of the Award Recipient must pay to the Company or make adequate provision for the payment of all Tax Withholding. If any RSUs are scheduled to vest during a period in which trading is not permitted under the Company's insider trading policy, to satisfy the Tax Withholding requirement, Recipient irrevocably elects to settle the Tax Withholding obligation by the Company withholding a number of Shares otherwise deliverable upon vesting having a market value sufficient to satisfy the statutory minimum tax withholding of Recipient. If the Company later determines that additional Tax Withholding was or has become required beyond any amount paid or provided for by Recipient, Recipient will pay such additional amount to the Company immediately upon demand by the Company. If Recipient fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to Recipient.

5. MISCELLANEOUS PROVISIONS

5.1 Amendment and Modification. Except as otherwise provided by the Plan, this Agreement may be amended, modified and supplemented only by written agreement of all of the parties hereto.

5.2 Assignment. This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns, but neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by Recipient without the prior written consent of the Company.

5.3 Governing Law. To the extent not preempted by federal law, this Agreement and the rights and obligations of the parties hereunder shall be governed by and construed in accordance with the internal laws of the State of Oregon applicable to the construction and enforcement of contracts wholly executed in Oregon by residents of Oregon and wholly performed in Oregon. Any action or proceeding brought by any party hereto shall be brought only in a state or federal court of competent jurisdiction located in the County of Multnomah in the State of Oregon and all parties hereto hereby submit to the in personal jurisdiction of such court for purposes of any such action or procedure.

5.4 Arbitration . The parties agree to submit any dispute arising under this Agreement to final, binding, private arbitration in Portland, Oregon. This includes not only disputes about the meaning or performance of this Agreement, but disputes about its negotiation, drafting, or execution. The dispute will be determined by a single arbitrator in accordance with the then-existing rules of arbitration procedure of Multnomah County, Oregon Circuit Court, except that there shall be no right of de novo review in Circuit Court and the arbitrator may charge his or her standard arbitration fees rather than the fees prescribed in the Multnomah County Circuit Court arbitration procedures. The proceeding will be commenced by the filing of a civil complaint in Multnomah County Circuit Court and a simultaneous request for transfer to arbitration. The parties expressly agree that they may choose an arbitrator who is not on the list provided by the Multnomah County Circuit Court Arbitration Department, but if they are unable to agree upon the single arbitrator within ten days of receipt of the Arbitration Department list, they will ask the Arbitration Department to make the selection for them. The arbitrator will have full authority to determine all issues, including arbitrability; to award any remedy, including permanent injunctive relief; and to determine any request for costs and expenses in accordance with Section 5.5 of this Agreement. The arbitrator's award may be reduced to final judgment in Multnomah County Circuit Court. The complaining party shall bear the arbitration expenses and may seek their recovery if it prevails. Notwithstanding any other provision of this Agreement, an aggrieved party may seek a temporary restraining order or preliminary injunction in Multnomah County Circuit Court to preserve the status quo during the arbitration proceeding.

5.5 Attorney Fees . If any suit, action, or proceeding is instituted in connection with any controversy arising out of this Agreement or the enforcement of any right hereunder, the prevailing party will be entitled to recover, in addition to costs, such sums as the court or arbitrator may adjudge reasonable as attorney fees, including fees on any appeal.

5.6 Headings. The headings of the sections and subsections of this Agreement are inserted for convenience only and shall not constitute a part hereof.

5.7 Entire Agreement. This Agreement and the Plan embody the entire agreement and understanding of the parties hereto in respect of the subject matter contained herein and supersedes all prior written or oral communications or agreements all of which are merged herein. There are no restrictions, promises, warranties, covenants, or undertakings, other than those expressly set forth or referred to herein.

5.8 No Waiver. No waiver of any provision of this Agreement or any rights or obligations of any party hereunder shall be effective, except pursuant to a written instrument signed by the party or parties waiving compliance, and any such waiver shall be effective only in the specific instance and for the specific purpose stated in such writing.

5.9 Severability of Provisions. In the event that any provision hereof is found invalid or unenforceable pursuant to judicial decree or decision, the remainder of this Agreement shall remain valid and enforceable according to its terms.

5.10 Incorporation by Reference, Etc. The provisions of the Plan are hereby incorporated herein by reference. Except as otherwise set forth herein, this Agreement shall be construed in accordance with the provisions of the Plan and any interpretations, amendments, rules and regulations promulgated by the Committee from time to time pursuant to the Plan. The Committee shall have the final authority to interpret and construe the Plan and this Agreement and to make any and all determinations under them, and its decision shall be final, binding and conclusive upon Recipient and his or her legal representative in respect to any questions arising under the Plan or this Agreement.

5.11 Notices. All notices or other communications pursuant to this Agreement shall be in writing and shall be deemed duly given if delivered personally or by courier service, or if mailed by certified mail, return receipt requested, prepaid and addressed to the Company executive offices to the attention of the Corporate Secretary, or if to Recipient, to the address maintained by the personnel department, or such other address as such party shall have furnished to the other party in writing.

5.12 Acceptance of Agreement. Unless Recipient notifies the Corporate Secretary in writing within 14 days after the Date of Grant that Recipient does not wish to accept this Agreement, Recipient will be deemed to have accepted this Agreement and will be bound by the terms of this Agreement and the Plan.

5.13 No Right of Employment. Nothing contained in the Plan or this Agreement shall be construed as giving Recipient any right to be retained, in any position, as an employee of the Company or any Subsidiary.

[Remainder of this page left blank intentionally .]

Recipient and the Company have executed this Agreement effective as of the Grant Date.

RECIPIENT

Signature

Type or Print Name: _____

Social Security Number: _____

COMPANY

LITHIA MOTORS, INC.

By: _____

Name: Chris Holzshu

Title: Chief Human Resources Officer

*** Please take the time to read and understand this Agreement. If you have any specific questions or do not fully understand any of the provisions, please contact Larissa McAlister in writing.**

LITHIA MOTORS, INC.
RESTRICTED STOCK UNIT AGREEMENT
(20[] Long-term Performance-vesting) (\$[] EPS Award)

This Restricted Stock Unit Agreement (“**Agreement**”) is entered into pursuant to the 2013 Amended and Restated Stock Incentive Plan (the “**Plan**”) adopted by the Board of Directors and Shareholders of Lithia Motors, Inc., an Oregon corporation (the “**Company**”), as amended from time to time. Unless otherwise defined herein, capitalized terms in this Agreement have the meanings given to them in the Plan. Any inconsistency between this Agreement and the terms and conditions of the Plan will be resolved in favor of the Plan. Compensation paid pursuant to this Agreement is intended to qualify as performance-based compensation under Section 162(m) of the Internal Revenue Code of 1986 (the “**Code**”).

“**Recipient**” []
Number of Restricted Stock Units (“RSUs”) []
“**Date of Grant**” [], 20[]

1. GRANT OF RESTRICTED STOCK UNIT AWARD

1.1 The Grant. The Company hereby awards to Recipient and Recipient accepts the RSUs specified above on the terms and conditions set forth in this Agreement and the Plan (the “**Award**”). Each RSU represents the right to receive one share of Class A Common Stock of the Company (a “**Share**”) on the Settlement Date (as defined in Section 1.4 of this Agreement), subject to the terms of this Agreement and the Plan.

1.2 Forfeiture; Vesting .

(a) *Forfeiture.* The RSUs are subject to forfeiture in accordance with the performance criteria specified in Section 1.2(b) of this Agreement. On March 15, 20[], any RSUs that are not vested will be forfeited.

(b) *Vesting.* Subject to the continued employment of Recipient with the Company or any Subsidiary, the RSUs shall vest, and no longer be subject to forfeiture, on the date that the Committee certifies that the Company’s Pro Forma EPS (as defined in Section 1.2(c)) for the Company’s most recently completed fiscal year met or exceeded \$[] (the “**EPS Threshold**”).

(c) *Calculation of Pro Forma EPS.* “**Pro Forma EPS**” means the Company’s consolidated diluted income (loss) per share, as set forth in the audited consolidated statement of income for the Company and its subsidiaries for the fiscal year, excluding non-operational transactions or disposal activities, for example:

- i. asset impairment and disposal gain;
 - ii. gains or losses on the sale of real estate or stores;
 - iii. gains or losses on equity investment; and
 - iv. reserves for real estate leases, Company-owned service contracts (e.g., lifetime oil), and legal matters; and
 - v. related income tax adjustments.
-

As soon as practicable after each fiscal year, the Director of Internal Audit of the Company shall calculate the Pro Forma EPS, and shall submit those calculations to the Committee. At or prior to the regularly scheduled meeting of the Committee held in the first fiscal quarter, the Committee shall certify in writing (which may consist of approved minutes of the meeting) the Pro Forma EPS attained for the prior fiscal year. No Shares or other amounts shall be delivered or paid unless the Committee certifies the Pro Forma EPS. The Committee may reduce the amount of the compensation payable upon the attainment of the performance goals based on such factors as it deems appropriate, including subjective factors.

1.3 Clawback. If the Company's financial statements are restated within three years after it is determined that the EPS Threshold has been met or exceeded, the EPS for the applicable period shall be recalculated (the resulting number, the "**Recalculated EPS**") based on the Company's restated financial statements. If the Recalculated EPS is less than the EPS calculated before the Company's financial statements were restated, Recipient shall repay to the Company (a) the number of Shares calculated by subtracting the number of Shares Recipient would have received based on the Recalculated EPS from the number of Shares Recipient received (the "**Excess Shares**") and (b) any dividend paid on the Excess Shares (the "**Excess Dividends**"). If any Excess Shares are sold by Recipient before the Company's demand for repayment (including any Shares withheld for taxes under Section 4 of this Agreement), in lieu of repaying the Company the Excess Shares that were sold Recipient shall repay to the Company 100% of the proceeds of such sale or sales. The Committee may, in its sole discretion, reduce the amount to be repaid by Recipient to take into account the tax consequences of such repayment for Recipient.

If any portion of the Excess Shares and Excess Dividends was deferred under the RSU Deferral Plan effective January 1, 2012 (the "**Deferral Plan**"), that portion shall be recovered by canceling the amounts so deferred under the Deferral Plan and any dividends or other earnings credited under the Deferral Plan with respect to such cancelled amounts. The Company may seek direct repayment from Recipient of any Excess Shares, Excess Dividends and proceeds not so recovered and may, to the extent permitted by applicable law, offset such amounts against any compensation or other amounts owed by the Company to Recipient. In particular, such amounts may be recovered by offset against the after-tax proceeds of deferred compensation payouts under the Company's Deferred Compensation Plan or the Company's Supplemental Executive Retirement Plan at the times such deferred compensation payouts occur under the terms of those plans. Amounts that remain unpaid for more than 60 days after demand by the Company shall accrue interest at the rate used from time to time for crediting interest under the Deferred Compensation Plan.

1.4 Settlement of RSUs. There is no obligation for the Company to make payments or distributions with respect to RSUs except, subject to the terms and conditions of this Agreement, the issuance of Shares to settle vested RSUs after the applicable Vesting Date. The Company's issuance of one Share for each vested RSU ("**Settlement**") may be subject to such conditions, restrictions and contingencies as the Committee shall determine. Unless receipt of the Shares is validly deferred pursuant to the Deferral Plan, and except as otherwise provided in any Amended Employment and Change in Control Agreement between the Company and Recipient (as the same may be amended and/or restated from time to time), RSUs shall be settled as soon as practicable after they have vested (the date of Settlement, the "**Settlement Date**"), but in no event later than March 15 of the calendar year following the calendar year in which the RSUs vested. Notwithstanding the foregoing, the payment dates set forth in this Section 1.4 have been specified for the purpose of complying with the short-term deferral exception under Code Section 409A, and to the extent payments are made during the periods permitted under Code Section 409A (including applicable periods before or after the specified payment dates set forth in this Section 1.4), the Company shall be deemed to have satisfied its obligations under the Plan and shall be deemed not to be in breach of its payment obligations hereunder.

1.5 Termination of Recipient's Employment; Extended Leave of Absence. If Recipient's employment is terminated for any reason, including a voluntary or involuntary termination, or upon Recipient's death, Disability or retirement, any unvested RSUs will be forfeited. If Recipient is on unpaid leave for more than six months, any unvested RSUs will be forfeited.

2. REPRESENTATIONS AND COVENANTS OF RECIPIENT

2.1 No Representations by or on Behalf of the Company. Recipient is not relying on any representation, warranty or statement made by the Company or any agent, employee or officer, director, shareholder or other controlling person of the Company regarding the RSUs or this Agreement.

2.2 Tax Considerations. The Company has advised Recipient to seek Recipient's own tax and financial advice with regard to the federal and state tax considerations resulting from Recipient's receipt of the Award, vesting of the Award and Recipient's receipt of the Shares upon Settlement of the vested portion of the Award. Recipient understands that the Company, to the extent required by law, will report to appropriate taxing authorities the payment to Recipient of compensation income upon the grant, vesting and/or Settlement of RSUs under the Award and Recipient shall be solely responsible for the payment of all federal and state taxes resulting from such grant, vesting and/or Settlement.

2.3 Agreement to Enter into Lock-Up Agreement with an Underwriter. Recipient understands and agrees that whenever the Company undertakes a firmly underwritten public offering of its securities, Recipient will, if requested to do so by the managing underwriter in such offering, enter into an agreement not to sell or dispose of any securities of the Company owned or controlled by Recipient, including any of the RSUs or the Shares, provided that such restriction will not extend beyond 12 months from the effective date of the registration statement filed in connection with such offering.

3. GENERAL RESTRICTIONS OF TRANSFERS OF RSUS

3.1 No Transfers of RSUs. Recipient agrees for himself or herself and his or her executors, administrators and other successors in interest that none of the RSUs, nor any interest therein, may be voluntarily or involuntarily sold, transferred, assigned, donated, pledged, hypothecated or otherwise disposed of, gratuitously or for consideration.

3.2 Award Adjustments. The number of RSUs granted under this Award shall, at the discretion of the Committee, be subject to adjustment under the Plan in the event the outstanding shares of Common Stock are hereafter increased, decreased, changed into or exchanged for a different number or kind of shares of Common Stock or for other securities of the Company or of another corporation, by reason of any reorganization, merger, consolidation, reclassification, stock split up, combination of shares of Common Stock, or dividend payable in shares of Common Stock or other securities of the Company. If Recipient receives any additional RSUs pursuant to the Plan, such additional (or other) RSUs shall be deemed granted hereunder and shall be subject to the same restrictions and obligations on the RSUs as originally granted as imposed by this Agreement.

3.3 Invalid Transfers. Any disposition of the RSUs other than in strict compliance with the provisions of this Agreement shall be void.

4. PAYMENT OF TAX WITHHOLDING AMOUNTS. To the extent the Company is responsible for withholding income taxes, Recipient must pay to the Company or make adequate provision for the payment of all Tax Withholding. If any RSUs are scheduled to vest during a period in which trading is not permitted under the Company's insider trading policy, to satisfy the Tax Withholding requirement, Recipient irrevocably elects to settle the Tax Withholding obligation by the Company withholding a number of Shares otherwise deliverable upon vesting having a market value sufficient to satisfy the statutory minimum tax withholding of Recipient. If the Company later determines that additional Tax Withholding was or has become required beyond any amount paid or provided for by Recipient, Recipient will pay such additional amount to the Company immediately upon demand by the Company. If Recipient fails to pay the amount demanded, the Company may withhold that amount from other amounts payable by the Company to Recipient.

5. MISCELLANEOUS PROVISIONS

5.1 Amendment and Modification. Except as otherwise provided by the Plan, this Agreement may be amended, modified and supplemented only by written agreement of all of the parties hereto.

5.2 Assignment. This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns, but neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by Recipient without the prior written consent of the Company.

5.3 Governing Law. To the extent not preempted by federal law, this Agreement and the rights and obligations of the parties hereunder shall be governed by and construed in accordance with the internal laws of the State of Oregon applicable to the construction and enforcement of contracts wholly executed in Oregon by residents of Oregon and wholly performed in Oregon. Any action or proceeding brought by any party hereto shall be brought only in a state or federal court of competent jurisdiction located in the County of Multnomah in the State of Oregon and all parties hereto hereby submit to the in personal jurisdiction of such court for purposes of any such action or procedure.

5.4 Arbitration . The parties agree to submit any dispute arising under this Agreement to final, binding, private arbitration in Portland, Oregon. This includes not only disputes about the meaning or performance of this Agreement, but disputes about its negotiation, drafting, or execution. The dispute will be determined by a single arbitrator in accordance with the then-existing rules of arbitration procedure of Multnomah County, Oregon Circuit Court, except that there shall be no right of de novo review in Circuit Court and the arbitrator may charge his or her standard arbitration fees rather than the fees prescribed in the Multnomah County Circuit Court arbitration procedures. The proceeding will be commenced by the filing of a civil complaint in Multnomah County Circuit Court and a simultaneous request for transfer to arbitration. The parties expressly agree that they may choose an arbitrator who is not on the list provided by the Multnomah County Circuit Court Arbitration Department, but if they are unable to agree upon the single arbitrator within ten days of receipt of the Arbitration Department list, they will ask the Arbitration Department to make the selection for them. The arbitrator will have full authority to determine all issues, including arbitrability; to award any remedy, including permanent injunctive relief; and to determine any request for costs and expenses in accordance with Section 5.5 of this Agreement. The arbitrator's award may be reduced to final judgment in Multnomah County Circuit Court. The complaining party shall bear the arbitration expenses and may seek their recovery if it prevails. Notwithstanding any other provision of this Agreement, an aggrieved party may seek a temporary restraining order or preliminary injunction in Multnomah County Circuit Court to preserve the status quo during the arbitration proceeding.

5.5 Attorney Fees . If any suit, action, or proceeding is instituted in connection with any controversy arising out of this Agreement or the enforcement of any right hereunder, the prevailing party will be entitled to recover, in addition to costs, such sums as the court or arbitrator may adjudge reasonable as attorney fees, including fees on any appeal.

5.6 Headings. The headings of the sections and subsections of this Agreement are inserted for convenience only and shall not constitute a part hereof.

5.7 Entire Agreement. This Agreement and the Plan embody the entire agreement and understanding of the parties hereto in respect of the subject matter contained herein and supersedes all prior written or oral communications or agreements all of which are merged herein. There are no restrictions, promises, warranties, covenants, or undertakings, other than those expressly set forth or referred to herein.

5.8 No Waiver. No waiver of any provision of this Agreement or any rights or obligations of any party hereunder shall be effective, except pursuant to a written instrument signed by the party or parties waiving compliance, and any such waiver shall be effective only in the specific instance and for the specific purpose stated in such writing.

5.9 Severability of Provisions. In the event that any provision hereof is found invalid or unenforceable pursuant to judicial decree or decision, the remainder of this Agreement shall remain valid and enforceable according to its terms.

5.10 Incorporation by Reference, Etc. The provisions of the Plan are hereby incorporated herein by reference. Except as otherwise set forth herein, this Agreement shall be construed in accordance with the provisions of the Plan and any interpretations, amendments, rules and regulations promulgated by the Committee from time to time pursuant to the Plan. The Committee shall have the final authority to interpret and construe the Plan and this Agreement and to make any and all determinations under them, and its decision shall be final, binding and conclusive upon Recipient and his or her legal representative in respect to any questions arising under the Plan or this Agreement.

5.11 Notices. All notices or other communications pursuant to this Agreement shall be in writing and shall be deemed duly given if delivered personally or by courier service, or if mailed by certified mail, return receipt requested, prepaid and addressed to the Company executive offices to the attention of the Corporate Secretary, or if to Recipient, to the address maintained by the personnel department, or such other address as such party shall have furnished to the other party in writing.

5.12 Acceptance of Agreement. Unless Recipient notifies the Corporate Secretary in writing within 14 days after the Date of Grant that Recipient does not wish to accept this Agreement, Recipient will be deemed to have accepted this Agreement and will be bound by the terms of this Agreement and the Plan.

5.13 No Right of Employment. Nothing contained in the Plan or this Agreement shall be construed as giving Recipient any right to be retained, in any position, as an employee of the Company or any Subsidiary.

[Remainder of this page left blank intentionally .]

Recipient and the Company have executed this Agreement effective as of the Date of Grant.

RECIPIENT

Signature

Type or Print Name: _____

Social Security Number: _____

COMPANY

LITHIA MOTORS, INC.

By: _____

Name: Christopher Holzshu

Title: Chief Financial Officer

*** Please take the time to read and understand this Agreement. If you have any specific questions or do not fully understand any of the provisions, please contact Chris Holzshu in writing.**

RATIO OF EARNINGS TO COMBINED FIXED CHARGES

The following table shows the ratio of earnings to combined fixed charges for us and our consolidated subsidiaries for the dates indicated.

(Dollars in Thousands)

	Year Ended December 31,				
	2016	2015	2014	2013	2012
Earnings					
Income from continuing operations before income taxes	\$ 283,523	\$ 262,704	\$ 210,495	\$ 165,788	\$ 128,457
Fixed charges	54,068	46,413	29,797	25,820	27,381
Amortization of capitalized interest	297	287	280	276	270
Capitalized interest	(414)	(407)	(85)	(294)	(163)
Total earnings	337,474	240,172	191,803	155,820	115,243
Fixed Charges					
Floor plan interest expense	25,531	19,534	13,861	12,373	12,816
Other interest expense (1)	23,207	19,491	10,742	8,350	9,621
Capitalized interest costs	414	450	407	85	294
Interest component of rent expense	4,916	6,938	4,787	5,012	4,650
Total fixed charges	54,068	46,413	29,797	25,820	27,381
Ratio of earnings to fixed charges	6.2x	8.1x	7.4x	5.7x	4.3x

(1) Other interest expense includes amortization of debt issuance costs

For purposes of these ratios, “earnings” consist of income from continuing operations before income taxes and fixed charges, and “fixed charges” consist of interest expense on indebtedness and the interest component of rental expense, and amortization of debt discount and issuance expenses.

We did not have any preferred stock outstanding for the periods presented above, and therefore the ratios of earnings to combined fixed charges and preferred stock dividends would be the same as the ratios of earnings to combined fixed charges presented above.

LIST OF SUBSIDIARIES
(as of December 31, 2016)

NAME OF ENTITY	STATE OF ORIGIN	ASSUMED BUSINESS NAME(S) (if different than entity name)
Lithia Imports of Anchorage, Inc.	Alaska	Lithia Hyundai of Anchorage Lithia Kia of Anchorage Lithia Anchorage Auto Body
Lithia NA, Inc.	Alaska	BMW of Anchorage MINI of Anchorage
Lithia of Anchorage, Inc.	Alaska	Lithia Chrysler Jeep Dodge of Anchorage Lithia Value Autos
Lithia of Fairbanks, Inc.	Alaska	Chevrolet Buick GMC of Fairbanks
Lithia of South Central AK, Inc.	Alaska	Chevrolet of South Anchorage Chevrolet of Wasilla
Lithia of Wasilla, LLC	Alaska	Lithia Chrysler Jeep Dodge Ram of Wasilla
DCH (Oxnard) Inc.	California	DCH Honda of Oxnard Honda of Oxnard Supercraft Auto Body & Paint DCH Used Car Superstore
DCH CA LLC	California	DCH Acura of Temecula DCH Acura Temecula
DCH Calabasas-A, LLC	California	Audi Calabasas
DCH California Investments LLC	California	
DCH California Motors Inc.	California	DCH Toyota of Oxnard Toyota of Oxnard DCH Scion of Oxnard
DCH Del Norte, INC.	California	DCH Lexus of Oxnard Lexus of Oxnard DCH Lexus of Santa Barbara
DCH Korean Imports LLC	California	DCH Kia of Temecula
DCH Mission Valley LLC	California	DCH Honda of Mission Valley
DCH Oxnard 1521 Imports Inc.	California	DCH Audi of Oxnard Audi of Oxnard
DCH Riverside-S, Inc.	California	DCH Subaru of Riverside
DCH Simi Valley Inc.	California	DCH Toyota of Simi Valley Toyota of Simi Valley DCH Scion of Simi Valley
DCH Temecula Imports LLC	California	DCH Honda of Temecula DCH Honda Temecula
DCH Temecula Motors LLC	California	DCH Chrysler Jeep Dodge of Temecula DCH Chrysler Jeep of Temecula DCH Dodge of Temecula
DCH Temecula Motors II, Inc.	California	DCH FIAT of Temecula
DCH Thousand Oaks-F, Inc.	California	DCH Ford of Thousand Oaks
DCH Torrance Imports Inc.	California	DCH Toyota of Torrance DCH Scion of Torrance Torrance Toyota Torrance Scion Toyota Scion

Lithia CIMR, Inc.	California	Lithia Chevrolet of Redding
Lithia FMF, Inc.	California	Lithia Ford of Fresno Lithia Ford Lincoln of Fresno
Lithia Fresno, Inc.	California	Lithia Subaru of Fresno Fresno Mitsubishi
Lithia JEF, Inc.	California	Lithia Hyundai of Fresno
Lithia MMF, Inc.	California	Lithia Mazda of Fresno Lithia Suzuki of Fresno
Lithia NC, Inc.	California	Nissan of Clovis
Lithia NF, Inc.	California	Lithia Nissan of Fresno
Lithia of Concord I, Inc.	California	Lithia Chrysler Dodge Jeep Ram of Concord
Lithia of Concord II, Inc.	California	Lithia FIAT of Concord
Lithia of Eureka, Inc.	California	Lithia Chrysler Jeep Dodge of Eureka
Lithia of Lodi, Inc.	California	Lodi Toyota Lodi Scion
Lithia of Santa Rosa, Inc.	California	Lithia Chrysler Jeep Dodge of Santa Rosa
Lithia of Stockton, Inc.	California	Nissan of Stockton, Kia of Stockton
Lithia of Stockton-V, Inc.	California	Volkswagen of Stockton
Lithia of Walnut Creek, Inc.	California	Diablo Subaru of Walnut Creek
Lithia Sea P, Inc.	California	Porsche of Monterey
Lithia Seaside, Inc.	California	BMW of Monterey
Lithia TR, Inc.	California	Lithia Toyota of Redding Lithia Scion of Redding
Lithia VF, Inc.	California	Volvo of Fresno
LLL Sales CO LLC	California	DCH Gardena Honda Gardena Honda Gardena Honda, a DCH Company All-Savers Auto Sales & Leasing
Tustin Motors Inc.	California	Honda Acura DCH Tustin Acura Tustin Acura
Dah Chong Hong CA Trading LLC	Delaware	
DCH Auto Group (USA) Inc.	Delaware	
DCH Holdings LLC	Delaware	
DCH Mamaroneck LLC	Delaware	DCH Toyota City DCH Scion City
DCH NJ Team Member Services Corporation	Delaware	
DCH North America Inc.	Delaware	
DCH NY Motors LLC	Delaware	DCH Wappingers Falls Toyota DCH Wappingers Falls Auto Group DCH Wappingers Falls Scion
DCH TL Holdings LLC	Delaware	
DCH TL NY Holdings LLC	Delaware	
Lithia Auction & Recon, LLC	Delaware	Auction & Recon
Lithia of Honolulu-F, LLC	Delaware	Honolulu Ford
Lithia of Honolulu-A, Inc.	Hawaii	Acura of Honolulu

Lithia of Honolulu-BGMCC, LLC	Hawaii	Honolulu Buick GMC Honolulu Buick GMC Cadillac Honolulu Cadillac
Lithia of Honolulu-V, LLC	Hawaii	Honolulu Volkswagen
Lithia of Maui-H, LLC	Hawaii	Island Honda
Lithia CCTF, Inc.	Idaho	Chevrolet of Twin Falls
Lithia Ford of Boise, Inc.	Idaho	Lithia Ford of Boise Lithia Ford Lincoln of Boise Auto Credit of Idaho Lithia Body & Paint of Boise
Lithia of Pocatello, Inc.	Idaho	Lithia Chrysler Jeep Dodge of Pocatello Lithia Hyundai of Pocatello Lithia Dodge Trucks of Pocatello
Lithia of TF, Inc.	Idaho	Lithia Chrysler Jeep Dodge of Twin Falls
Lithia AcDM, Inc.	Iowa	Acura of Johnston
Lithia HDM, Inc.	Iowa	Honda of Ames
Lithia MBDM, Inc.	Iowa	Mercedes Benz of Des Moines European Motorcars Des Moines
Lithia NDM, Inc.	Iowa	Lithia Nissan of Ames
Lithia of Des Moines, Inc.	Iowa	BMW of Des Moines European Motorcars Des Moines Lithia Body and Paint of Des Moines
Lithia VAuDM, Inc.	Iowa	Audi Des Moines Lithia Volkswagen of Des Moines Assured Used Cars & Trucks Lithia Audi of Des Moines
Milford DCH, Inc.	Massachusetts	DCH Toyota of Milford
Lithia BCRGF, Inc.	Montana	Budget Rent A Car of Great Falls Montana
Lithia CDH, Inc.	Montana	Lithia Chrysler Jeep Dodge of Helena
Lithia HGF, Inc.	Montana	Honda of Great Falls
Lithia LBGGF, Inc.	Montana	Lithia Buick GMC of Great Falls
Lithia LHGF, Inc.	Montana	Lithia Hyundai of Great Falls
Lithia LSGF, Inc.	Montana	Lithia Subaru of Great Falls
Lithia of Billings II LLC	Montana	Lithia Toyota of Billings Lithia Scion of Billings
Lithia of Billings, Inc.	Montana	Lithia Chrysler Jeep Dodge of Billings
Lithia of Great Falls, Inc.	Montana	Lithia Chrysler Jeep Dodge of Great Falls
Lithia of Helena, Inc.	Montana	Chevrolet of Helena
Lithia of Missoula II LLC	Montana	Lithia Toyota of Missoula Lithia Scion of Missoula
Lithia of Missoula, Inc.	Montana	Lithia Chrysler Jeep Dodge of Missoula Lithia Auto Center of Missoula
Lithia of Missoula III, Inc.	Montana	Lithia Ford of Missoula
Lithia Reno Sub-Hyun, Inc.	Nevada	Lithia Reno Subaru Lithia Body & Paint
Lithia SALMIR, Inc.	Nevada	Lithia Volkswagen of Reno Lithia Hyundai of Reno Lithia Chrysler Jeep of Reno
797 Valley Street, LLC	New Jersey	

Dah Chong Hong Trading Corporation	New Jersey	
Daron Motors LLC	New Jersey	DCH Academy Honda Academy Honda
DCH Bloomfield LLC	New Jersey	DCH Bloomfield BMW DCH Essex BMW Essex BMW BMW of Bloomfield Parkway BMW
DCH DMS NJ, LLC	New Jersey	
DCH Essex Inc. fka DCH-Millburn Inc. (fka DCH Essex LLC)	New Jersey	DCH Audi DCH Maplewood Audi DCH Millburn Audi Essex Motors Millburn Audi
DCH Financial NJ, LLC	New Jersey	
DCH Freehold LLC	New Jersey	Freehold Toyota DCH Freehold Toyota DCH Freehold Scion
DCH Freehold-V, LLC	New Jersey	DCH Volkswagen of Freehold
DCH Investments Inc. (New Jersey)	New Jersey	
DCH Leasing Corporation	New Jersey	
DCH Monmouth LLC	New Jersey	BMW of Freehold
DCH Montclair LLC	New Jersey	Montclair Acura DCH Montclair Acura
DCH Motors LLC	New Jersey	Kay Honda DCH Motors DCH Kay Honda
DCH Support Services, LLC	New Jersey	
Freehold Nissan LLC	New Jersey	DCH Freehold Nissan Freehold Nissan
Paramus World Motors LLC	New Jersey	DCH Paramus Honda Paramus Honda Crown Leasing
Sharlene Realty LLC	New Jersey	DCH Brunswick Toyota DCH Brunswick Scion DCH Collision Center
LDLC, LLC	New Mexico	Lithia Dodge of Las Cruces
Lithia CJDSF, Inc.	New Mexico	Lithia Chrysler Jeep Dodge of Santa Fe
DCH Investments, Inc. (New York)	New York	
DCH Management Inc.	New York	
DCH Nanuet LLC	New York	DCH Honda of Nanuet
Lithia of Troy, LLC	New York	Carbone Subaru
Lithia of Utica-1, LLC	New York	BMW of Utica
Lithia of Utica-2, LLC	New York	Don's Ford
Lithia of Utica-3, LLC	New York	Don's Subaru
Lithia of Yorkville-1, LLC	New York	Carbone Chevrolet Buick Cadillac GMC
Lithia of Yorkville-2, LLC	New York	Carbone Chrysler Dodge Jeep Ram
Lithia of Yorkville-3, LLC	New York	Carbone Honda
Lithia of Yorkville-4, LLC	New York	Carbone Hyundai

Lithia of Yorkville-5, LLC	New York	Carbone Nissan
Lithia ND Acquisition Corp. #1	North Dakota	Lithia Ford Lincoln of Grand Forks
Lithia ND Acquisition Corp. #3	North Dakota	Lithia Chrysler Jeep Dodge of Grand Forks
Lithia ND Acquisition Corp. #4	North Dakota	Lithia Toyota of Grand Forks Lithia Scion of Grand Forks Lithia Toyota Scion of Grand Forks
Cadillac of Portland Lloyd Center, LLC	Oregon	Cadillac of Portland
Hutchins Eugene Nissan, Inc.	Oregon	Lithia Nissan of Eugene
Hutchins Imported Motors, Inc.	Oregon	Lithia Toyota of Springfield Lithia Scion of Springfield Lithia Toyota Scion of Springfield
LAD Advertising, Inc.	Oregon	LAD Advertising LAD Printing The Print Shop at the Commons The Print Shop
LBMP, LLC	Oregon	BMW Portland
LFKF, LLC	Oregon	Lithia Ford of Klamath Falls
LGPAC, Inc.	Oregon	Lithia's Grants Pass Auto Center Xpress Lube
Lithia Aircraft, Inc.	Oregon	
Lithia BNM, Inc.	Oregon	
Lithia Community Development Company, Inc.	Oregon	
Lithia DE, Inc.	Oregon	Lithia Chrysler Jeep Dodge of Eugene
Lithia DM, Inc.	Oregon	Lithia Dodge Lithia Chrysler Jeep Dodge Xpress Lube
Lithia Financial Corporation	Oregon	Lithia Leasing
Lithia HPI, Inc.	Oregon	
Lithia Klamath, Inc.	Oregon	Lithia Chrysler Jeep Dodge of Klamath Falls Lithia Toyota of Klamath Falls Lithia Scion of Klamath Falls Lithia Klamath Falls Auto Center Lithia Body and Paint of Klamath Falls
Lithia Medford Hon, Inc.	Oregon	Lithia Honda
Lithia Motors Support Services, Inc.	Oregon	Lithia's LAD Travel Service
Lithia MTLM, Inc.	Oregon	Lithia Toyota Lithia Scion Lithia Toyota Scion
Lithia of Bend #1, LLC	Oregon	Bend Honda
Lithia of Bend #2, LLC	Oregon	Chevrolet Cadillac of Bend Lithia Body & Paint of Bend
Lithia of Eugene, LLC	Oregon	Lithia FIAT of Eugene
Lithia of Milwaukie, Inc.	Oregon	Lithia Chevrolet on McLoughlin
Lithia of Portland, LLC	Oregon	Buick GMC of Portland
Lithia of Roseburg, Inc.	Oregon	Lithia Chrysler Jeep Dodge of Roseburg Lithia Roseburg Auto Center
Lithia Oregon Investments - 1, LLC	Oregon	N/A
Lithia Oregon Investments - 2, LLC	Oregon	N/A

Lithia Real Estate, Inc.	Oregon	
Lithia Rose-FT, Inc.	Oregon	Lithia Ford Lincoln of Roseburg Assured Dealer Services of Roseburg
Lithia SOC, Inc.	Oregon	Lithia Subaru of Oregon City
LMBB, LLC	Oregon	Mercedes-Benz of Beaverton
LMBP, LLC	Oregon	Mercedes-Benz of Portland Smart Center of Portland
LMOP, LLC	Oregon	MINI of Portland
LSTAR, LLC	Oregon	
Medford Insurance, LLC	Oregon	
RFA Holdings, LLC	Oregon	
Salem-B, LLC	Oregon	BMW of Salem
Salem-H, LLC	Oregon	Honda of Salem
Salem-V, LLC	Oregon	Volkswagen of Salem
Southern Cascades Finance Corporation	Oregon	
Lithia Automotive, Inc.	South Dakota	
Lithia Bryan Texas, Inc.	Texas	Lithia Chrysler Jeep Dodge of Bryan College Station
Lithia CJDO, Inc.	Texas	All American Chrysler Jeep Dodge of Odessa
Lithia CJDSA, Inc.	Texas	All American Chrysler Jeep Dodge of San Angelo All American Autoplex
Lithia CM, Inc.	Texas	All American Chevrolet of Midland
Lithia CO, Inc.	Texas	All American Chevrolet of Odessa
Lithia CSA, Inc.	Texas	All American Chevrolet of San Angelo
Lithia DMID, Inc.	Texas	All American Chrysler Jeep Dodge of Midland
Lithia FBCCS, LLC	Texas	Alfa Romeo FIAT of Bryan College Station
Lithia FLCC, LLC	Texas	Access Ford Lincoln of Corpus Christi
Lithia HMID, Inc.	Texas	Lithia Hyundai of Odessa
Lithia NSA, Inc.	Texas	Honda of San Angelo All American Autoplex
Lithia of Abilene, Inc.	Texas	Honda of Abilene
Lithia of Clear Lake, LLC	Texas	Subaru of Clear Lake
Lithia of Corpus Christi, Inc.	Texas	Lithia Chrysler Jeep Dodge of Corpus Christi Lithia Dodge of Corpus Christi
Lithia of Killeen, LLC	Texas	All American Chevrolet of Killeen
Lithia TA, Inc.	Texas	Lithia Toyota of Abilene Lithia Scion of Abilene
Lithia TO, Inc.	Texas	Lithia Toyota of Odessa Lithia Scion of Odessa
Lithia of Bennington - 1, LLC	Vermont	Carbone Ford of Bennington
Lithia of Bennington - 2, LLC	Vermont	Carbone Hyundai of Bennington
Lithia of Bennington - 3, LLC	Vermont	Carbone Honda of Bennington
Lithia of Bennington - 4, LLC	Vermont	Carbone Toyota of Bennington
Camp Automotive, Inc.	Washington	Camp BMW Camp Chevrolet Subaru of Spokane Camp Cadillac

Lithia Dodge of Tri-Cities, Inc.	Washington	Lithia Chrysler Jeep Dodge of Tri-Cities
Lithia of Bellingham, LLC	Washington	Chevrolet Cadillac of Bellingham Chambers Chevrolet Cadillac of Bellingham Chevrolet Buick GMC Cadillac of Bellingham
Lithia of Seattle, Inc.	Washington	BMW Seattle
Lithia of Spokane, Inc.	Washington	Mercedes Benz of Spokane
Lithia of Spokane II, Inc.	Washington	Lithia Chrysler Dodge Jeep Ram of Spokane
Lithia of Casper, LLC	Wyoming	Greiner Ford Lincoln of Casper

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Lithia Motors, Inc.:

We consent to the incorporation by reference in the registration statement (Nos. 333-190192, 333-43593, 333-69169, 333-156410, 333-39092, 333-61802, 333-106686, 333-116839, 333-116840, 333-135350, 333-161590 and 333-168737) on Forms S-8 of Lithia Motors, Inc. of our reports dated February 28, 2017, with respect to the Consolidated Balance Sheets of Lithia Motors, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related Consolidated Statements of Operations, Comprehensive Income, Changes in Stockholders' Equity and Cash Flows for each of the years in the three-year period ended December 31, 2016, and the effectiveness of internal control over financial reporting as of December 31, 2016, which reports appear in the December 31, 2016 annual report on Form 10-K of Lithia Motors, Inc.

Our report on the effectiveness of internal control over financial reporting as of December 31, 2016 includes a paragraph stating that management excluded from its assessment of the effectiveness of Lithia Motors, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, 15 acquired stores' internal control over financial reporting. The total assets of these 15 stores represented approximately 8% of consolidated total assets as of December 31, 2016 and approximately 3% of consolidated revenues for the year ended December 31, 2016. Our audit of internal control over financial reporting for Lithia Motors, Inc. also excluded an evaluation of the internal control over financial reporting of these 15 stores.

Our report refers to a change to the Company's method for reporting discontinued operations.

/s/ KPMG LLP

Portland, Oregon
February 28, 2017

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

I, Bryan B. DeBoer, certify that:

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

Date: February 28, 2017

/s/ Bryan B. DeBoer

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

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

I, Christopher S. Holzshu, certify that:

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

Date: February 28, 2017

/s/ John F. North, III

John F. North, III

Senior Vice President and Chief Financial Officer

Lithia Motors, Inc.

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

In connection with the Annual Report of Lithia Motors, Inc. (the "Company") on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bryan B. DeBoer, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Bryan B. DeBoer

Bryan B. DeBoer

President and Chief Executive Officer

Lithia Motors, Inc.

February 28, 2017

**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**

In connection with the Annual Report of Lithia Motors, Inc. (the "Company") on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Christopher S. Holzshu, Senior Vice President, Chief Financial Officer and Secretary of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ John F. North, III

John F. North, III
Senior Vice President and Chief Financial Officer
Lithia Motors, Inc.
February 28, 2017