LITHIA MOTORS INC
Form S-3
January 25, 2002

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON JANUARY 25, 2002

REGISTRATION NO. 333-

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM S-3
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

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 Number)

360 EAST JACKSON STREET
MEDFORD, OREGON 97501
(541) 776-6401
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

SIDNEY B. DEBOER
LITHIA MOTORS, INC.
360 EAST JACKSON STREET
MEDFORD, OREGON 97501
(541) 776-6401
(Name, address, including zip code, and telephone number, including area code, of agent for service)

COPIES TO:

KENNETH E. ROBERTS, ESQ. FOSTER PEPPER & SHEFELMAN LLP 101 SW MAIN STREET, 15TH FLOOR PORTLAND, OREGON 97204 (503) 221-0607	BRUCE K. DALLAS, ESQ. DAVIS POLK & WARDWELL 1600 EL CAMINO REAL MENLO PARK, CALIFORNIA 940 (650) 752-2000

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC: As soon as practicable after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. [ ]

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 (the "Securities Act"), other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [ ]

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED(1)	PROPOSED MAXIMUM OFFERING PRICE PER SHARE(2)	PROPOSED MAXI AGGREGATE OFFE PRICE(2)
Class A common stock, no par value.....	5,750,000 shares	$19.84	$114,080,00

(1) Includes 750,000 shares, which the underwriters have the option to purchase to cover over-allotments, if any.

(2) Estimated solely for the purpose of computing the registration fee required by Section 6(b) of the Securities Act, and computed pursuant to Rule 457(c) of the Securities Act. The computation was based on the average of the high and low prices of our Class A common stock as reported by the NYSE on January 24, 2002.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(a), MAY DETERMINE.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND WE ARE NOT SOLICITING OFFERS TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

PROSPECTUS (Subject to Completion)

Issued January 25, 2002

5,000,000 Shares

LITHIA LOGO
CLASS A COMMON STOCK

LITHIA MOTORS, INC. IS OFFERING 4,000,000 SHARES OF ITS CLASS A COMMON STOCK AND THE SELLING STOCKHOLDER IS OFFERING 1,000,000 SHARES OF CLASS A COMMON STOCK. LITHIA WILL NOT RECEIVE ANY OF THE PROCEEDS FROM THE SHARES OF CLASS A COMMON STOCK SOLD BY SELLING STOCKHOLDERS.

OUR CLASS A COMMON STOCK IS LISTED ON THE NEW YORK STOCK EXCHANGE UNDER THE SYMBOL "LAD." ON JANUARY 24, 2002, THE CLOSING PRICE OF OUR CLASS A COMMON STOCK WAS $19.70 PER SHARE.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS. SEE "RISK FACTORS" BEGINNING ON PAGE 7.

PRICE $ A SHARE

	PRICE TO PUBLIC	UNDERWRITING DISCOUNTS AND COMMISSIONS	PROCEEDS TO LITHIA	PROCEEDS TO SELLING STOCKHOLDERS
Per Share.............................	$	$	$	$
Total.................................	$	$	$	$

We and certain other selling stockholders have granted the underwriters the right to purchase up to an additional 750,000 shares of Class A common stock to cover over-allotments.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Morgan Stanley & Co. Incorporated expects to deliver the shares to purchasers on , 2002.

MORGAN STANLEY STEPHENS INC.

, 2002

[INSIDE COVER TO INCLUDE MAP OF THE COMPANY'S STORE LOCATIONS IN THE WESTERN UNITED STATES]

TABLE OF CONTENTS

	PAGE
Prospectus Summary	1
Risk Factors	7
Cautionary Statement About Forward-Looking Statements	11
Use of Proceeds	12
Price Range of Common Stock	12
Dividend Policy	12
Capitalization	13
Selected Consolidated Financial Data	14
Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Business	28
Management	39
Principal and Selling Stockholders	41
Description of Capital Stock	44
Underwriters	48
Legal Matters	49
Experts	50
Where You Can Find More Information	50
Index to Financial Statements	F-1

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell shares of common stock and seeking offers to buy shares of common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of the common stock.

In this prospectus "Lithia," "we," "us" and "our" refers to Lithia Motors, Inc. and its subsidiaries, except where the context otherwise requires. Unless otherwise indicated, all information in this prospectus assumes no exercise of the underwriters' over-allotment option.

No automobile manufacturer has been involved, directly or indirectly, in the preparation of this prospectus or in the offering being made hereby. No manufacturer has been authorized to make any statements or representations in connection with the offering, and no manufacturer has any responsibility for the accuracy or completeness of this prospectus or for the offering.

PROSPECTUS SUMMARY

You should read the following summary together with the more detailed information concerning our company, the common stock being sold in this offering and our financial statements and notes thereto appearing or incorporated by reference in this prospectus. Because this is only a summary, you should carefully read all of this prospectus, including the risks described under "Risk Factors," before you invest in our common stock.

LITHIA MOTORS, INC.

Lithia Motors, Inc. is a leading operator of automotive franchise stores in the western United States. We sell new and used cars, light trucks and sport utility vehicles. We also provide vehicle maintenance, warranty and repair services and arrange financing, extended warranty and insurance contracts for our customers. We achieve gross margins above industry averages by selling a higher ratio of retail used vehicles to new vehicles and by arranging finance and extended warranty contracts for a greater percentage of our customers. In 2000, we achieved a gross margin of 16.1% compared with the industry average of 12.7%. We offer 24 brands of new vehicles, through 119 franchises in 63 stores. Our core markets are concentrated in the fastest growing regions in the United States with 15 stores in Oregon, 11 in California, 10 in Washington, 7 in Colorado, 7 in Idaho, 5 in Nevada, 3 in South Dakota, 3 in Texas and 2 in Alaska. Over 65% of our stores are located in markets where our store does not compete directly with any other franchised dealer selling the same brand.

We were founded in 1946. Our two senior executives have managed the company for more than 30 years. Since our initial public offering in 1996, we have grown from 5 to 63 stores primarily through an aggressive acquisition program, increasing annual revenues from $143 million in 1996 to $1.7 billion in 2000. We have achieved five-year compounded annual growth rates through December 31, 2000 of 85% for revenues, 75% for net income and 36% for earnings per share, together with a 6.9% average same store sales increase.

In 2000, due to the economic outlook at that time, we intentionally slowed our growth in anticipation of a more favorable acquisition environment. We believe the current economic environment provides us with an increasing number of attractive acquisition opportunities. As a result, we have accelerated our pace of acquisitions. Since July 2001, we have acquired 8 new stores compared with 9 in the preceding twelve months. We expect the majority of our future growth to come from acquisitions. Our ability to successfully identify and integrate acquired stores and to achieve financial performance superior to industry averages is a result of a focused acquisition strategy and disciplined operating standards for all departments.

The following factors permit us to experience relatively low earnings volatility compared with automotive manufacturers:

- 72% of our gross profits are achieved from the sale of higher margin used vehicles, service, body and parts and finance, extended warranty and insurance contracts, which are not as sensitive to economic downturns as are sales of new vehicles;

- over one-half of our costs are variable or discretionary, including personnel, advertising and inventory finance expenses;

- manufacturers bear the cost of consumer and dealer incentives which improves our margins and helps offset the effect of new vehicle sales declines; and

- we offer a wide variety of new vehicle brands, which minimizes our dependence on any one manufacturer and reduces our exposure to supply problems, product cycles and changing consumer preferences.

ACQUISITION GROWTH STRATEGY

The highly fragmented U.S. automotive retailing industry is estimated to generate approximately $1.0 trillion in revenue: $746 billion from sales of new and used vehicles and $219 billion from repair, service and parts. The automotive finance industry generates revenues of $493 billion for providing vehicle loans, leases, extended warranties and credit insurance. The 100 largest automotive retailers generated only approximately 16% of total new and used vehicle sales in 2001. Based on reported 2001 revenues and retail units sold, we are one of the 10 largest automotive retailers in the country. According to industry data, the number of franchised automotive stores has declined from more than 36,000 stores in 1960 to approximately 22,000 in 2001, which are operated by fewer than 14,000 retailers. Most stores are privately held. We expect further consolidation of the automotive retailing industry due to:

-- the number of owners who are nearing retirement age;

-- the desire of manufacturers to have dealers implement "best" customer service and operating practices;

-- pressures from manufacturers on automotive retailers to invest in upgraded facilities and information systems; and

-- the limited availability of new franchise locations.

The enormous size and fragmentation of the industry and the lack of attractive exit strategies create a favorable environment for us to pursue our acquisition strategy. We currently target acquisitions in 70 markets west of the Mississippi River where we have the opportunity to acquire single-point or well-protected franchise stores. We seek to enter a new territory either by acquiring one or two stores at a time until we establish significant market presence or by acquiring an entire group of stores.

We seek to acquire stores where we can apply our operating disciplines to enhance their profitability. We target stores with zero to 2% pretax margins, which encompasses over one-half of all U.S. new vehicle stores. Based upon our experience, our goal is to improve pretax margins to over 3%. As we integrate newly acquired stores, we improve their profitability by:

-- emphasizing sales of higher margin used vehicles and finance, warranty and insurance products;

-- utilizing specialized operational support teams to train and motivate store personnel;

-- increasing new vehicle sales through aggressive marketing and improved vehicle allocations from manufacturers;

-- standardizing management information systems to identify cost savings and revenue enhancing opportunities;

-- realizing volume pricing benefits in the cost of advertising, retail finance contracts, extended warranty and insurance products, flooring line interest and from other vendors; and

-- improving inventory, receivables and other asset controls.

OPERATING GROWTH STRATEGY

We strive to maximize the overall franchise value of each store by using our disciplined operating strategy. We believe the application of this operating strategy provides us with a competitive advantage and is critical to our ability to achieve levels of profitability superior to industry averages. Our operating strategy consists of the following elements:

MAINTAIN COOPERATIVE RELATIONSHIPS WITH MANUFACTURERS

We strive to maintain our highly valued manufacturer/franchisee relationships. Manufacturers commit significant resources to the franchise system as the exclusive method of retailing their automotive products by:

-- funding dealer and customer incentives and rebates;

-- sharing in regional and national advertising expenses;

-- designating the franchise retailer as the exclusive warranty and recall service provider;

-- providing us with a low cost source of acquisition and working capital financing;

-- bearing a substantial portion of new vehicle inventory financing costs;

-- offering our customers low cost financing and lease options; and

-- training many of our employees.

We, in turn, cooperate in facility design, marketing efforts and manufacturer-preferred brand alignment within our markets. We believe our cooperative relationship with manufacturers facilitates their approval of new acquisitions.

EMPHASIZE SALES OF HIGHER MARGIN PRODUCTS AND SERVICES

We generate substantial incremental revenue and net income by arranging financing for the sale of vehicles, selling extended service contracts and other ancillary products, providing vehicle maintenance and retailing used vehicles.

Revenues and gross profit by product line were as follows for the first nine months of 2001:

	PERCENT OF TOTAL REVENUES	GROSS MARGIN	PERCENT OF GROSS PRO
New vehicles(1)..................................	51.8%	9.0%	28.1%
Retail used vehicles(2)..........................	26.9	12.8	20.9
Service, body and parts..........................	10.2	46.1	28.5
Finance and insurance(1)(3)......................	3.8	98.8	22.8

----

(1) Does not include fleet sales, representing 2.5% of total revenues and 0.4% of our total gross profit, which are included in our financial statements on a net profit basis under finance and insurance.

(2) Excludes wholesale used vehicle sales, representing 4.8% of total revenues with a negative gross margin contribution of 0.7%.

(3) Reported net of administration fees and anticipated cancellations.

Vehicle financing and leasing. We arrange third-party financing and leasing alternatives from multiple sources to meet the needs of each customer. Our ability to offer customer-tailored financing on a "same day" basis provides us with a competitive advantage, particularly over smaller competitors who do not generate sufficient volume to attract our breadth of financing sources. In 2000, we arranged financing for 73% of our new vehicle sales and 72% of our used vehicle sales, compared to the industry averages of 49% and 59%, respectively. Our average finance and insurance revenue per vehicle totaled $852 in 2000 compared to the industry average of $390. For the first nine months of 2001, we improved our finance and insurance revenues per vehicle to $917.

Service, body and parts. Our service, body and parts departments generate recurring, higher margin revenues. We achieved a gross margin of 46.1% for the first nine months of 2001. Our service, body and parts operation is an integral part of our customer service program and helps establish customer loyalty. Approximately 30% of our new and used vehicle buyers purchase a lifetime oil and filter service, which generates repeat business for our service departments. Additionally, we perform warranty and recall servicing for manufacturers at rates similar to our retail rates. Revenues from the service, body and parts departments are important during economic downturns as owners repair existing vehicles rather than buy new vehicles during such periods.

Used vehicle sales. Retail used vehicle sales are an important part of our overall profitability. In the first nine months of 2001, retail used vehicle sales generated a gross margin of 12.8% compared with a gross margin of 9.0% for new vehicle sales. We currently sell approximately one retail used vehicle for every new vehicle sold, compared to the industry average ratio of 0.8 to 1. Our used vehicle operations give us an opportunity to:

-- generate sales to customers financially unable or unwilling to purchase a new vehicle;

-- increase new and used vehicle sales by aggressively pursuing customer trade-ins; and

-- increase service contract sales and financing to used vehicle purchasers.

EMPLOY PROVEN MANAGEMENT TECHNIQUES

Each store is its own profit center and is managed by an experienced general manager who has primary responsibility for inventory, advertising, pricing and personnel. In order to provide additional support for improving performance, we make available to each store a team of specialists in new vehicle sales, used vehicle sales, finance and insurance, service and parts, and back-office administration. These teams utilize a standardized management information system that helps identify areas of potential cost savings as well as revenue enhancing opportunities in each department. A significant portion of the compensation of the general managers and department managers is based on their profitability. Our senior management monitors each store's sales, profitability and inventory.

FOCUS ON CUSTOMER SATISFACTION AND LOYALTY

We emphasize customer satisfaction and strive to develop a reputation for quality and fairness. We train our sales personnel to identify an appropriate vehicle for each of our customers at an affordable price.

We believe that our "Priority You" customer-oriented plan differentiates us from other automotive retail stores. "Priority You" commits us to provide:

- a complimentary credit check;
- a complimentary used vehicle appraisal;
- a 60-day/3,000 mile warranty on all used vehicles sold; and
- a community donation for every vehicle sold.

Our stores have received a number of dealer quality, sales volume and customer satisfaction awards from various manufacturers. These include: Chrysler's highest recognition for dealer excellence, the Five-Star Certification; Ford's Blue Oval Certificate; Toyota's President's Cup; Honda's President's Award; Dodge's National Charger Club membership; Volkswagen of America's Wolfsburg Crest Club Award; and Isuzu's Sendai Cup and President's Cup.

We were incorporated in 1946 in Oregon. Our principal executive offices are located at 360 East Jackson Street, Medford, Oregon 97501, and our telephone number at this location is (541) 776-6401. Our World Wide Web address is www.lithia.com. Information on our website does not constitute a part of this prospectus.

The Lithia logo is one of our registered trademarks. This prospectus also includes other trade names, trademarks and service marks of us and of the manufacturers.

THE OFFERING

Class A common stock offered by us..................	4,000,000 shares
Class A common stock offered by the selling stockholders....................................	1,000,000 shares
Total..	5,000,000 shares
Total common stock to be outstanding after this offering:	
Class A common stock.............................	13,344,512 shares
Class B common stock.............................	3,919,231 shares
Total..	17,263,743 shares
Over-allotment option..............................	750,000 shares
Voting Rights:	
Class A common stock.............................	One vote per share
Class B common stock.............................	Ten votes per share

Use of proceeds....................................	We will receive net proceeds from the offe of approximately $74.2 million. We intend use the proceeds primarily for acquisition additional stores and other general corpor purposes. Prior to such use, the funds wil used to reduce borrowings under our credit lines.
New York Stock Exchange symbol.....................	LAD

The above information is based upon 13,263,743 common shares outstanding as of January 24, 2002. This information does not include 1,409,745 shares of common stock subject to outstanding options at a weighted average exercise price of $14.02 and 402,192 shares of common stock reserved for future issuance under our stock option and employee purchase plans. See "Capitalization" and "Description of Capital Stock" for additional information concerning the number of outstanding shares of our capital stock and stock options.

5

SUMMARY CONSOLIDATED FINANCIAL DATA

The following table presents summary consolidated financial data of Lithia as of the dates and for the periods indicated. You should read our consolidated financial statements and related notes together with our "Management's Discussion and Analysis of Financial Condition and Results of Operations" included or incorporated by reference in this prospectus for more complete information. The "as adjusted" data gives effect to the sale of 4,000,000 shares of Class A common stock that we are offering under this prospectus at an assumed offering price of $19.70 per share, the closing price of our Class A common stock on January 24, 2002, after deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us.

	YEAR ENDED DECEMBER 31,				
	1996(1)	1997	1998	1999	2000
	(DOLLARS IN THOUSANDS EXCEPT PER SHARE AND VEHICL				
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Revenues:					
New vehicle sales........	$ 65,092	$ 161,294	$ 388,431	$ 673,339	$ 898,016
Used vehicle sales.......	58,611	113,099	220,544	375,562	480,846
Service, body and parts..................	13,197	29,828	72,216	120,722	164,002
F&I and other(2).........	5,944	15,574	33,549	73,036	115,747
Total revenues.........	142,844	319,795	714,740	1,242,659	1,658,611
Gross profit...............	25,819	54,746	115,361	199,286	267,569
Selling, general and administrative...........	19,830	40,625	85,188	146,381	195,500
Operating income...........	4,233	11,638	26,704	47,332	64,464

Flooring interest expense	(697)	(2,179)	(7,108)	(11,105)	(17,728)
Income before income taxes	4,229	9,497	17,782	32,051	39,535
Net income	$ 2,606	$ 5,959	$ 10,789	$ 19,174	$ 24,313
Basic net income per share(3)	$ 0.56	$ 0.85	$ 1.18	$ 1.67	$ 1.78
Diluted net income per share	$ 0.52	$ 0.82	$ 1.14	$ 1.60	$ 1.76
OTHER OPERATING DATA:					
Operating margin	3.0%	3.6%	3.7%	3.8%	3.9%
Number of stores	7	17	28	41	53
Number of stores acquired, net	2	10	11	13	8
Number of franchises	15	32	56	98	111
Same store sales growth	18.9%	4.8%	14.7%	6.9%	1.1%
New vehicles sold	3,274	7,413	17,708	28,645	37,230
Retail used vehicles sold	4,156	7,147	13,645	23,840	30,896
F&I per retail vehicle	$ 739	$ 935	$ 821	$ 884	$ 852

	AS OF SEPTEMBER 30, 2001	
	ACTUAL	AS ADJUSTED
	(IN THOUSANDS) (UNAUDITED)	
CONSOLIDATED BALANCE SHEET DATA:		
Working capital	$ 89,265	$ 95,428
Inventories	309,461	309,461
Total assets	657,379	657,379
Flooring notes payable	302,705	236,542
Short-term debt	9,352	9,352
Long-term debt, less current maturities	73,326	65,326
Stockholders' equity	196,524	270,687

----

(1) Restated to give effect to the conversion from the LIFO method of accounting for inventory to the FIFO method, which was effective January 1, 1997. Net income for 1996 is presented on a pro forma basis to reflect federal and state income taxes as if we had been a Subchapter C corporation based on the income tax rates in effect at that time.

(2) F&I and other includes finance, extended warranty and insurance revenues. It also includes net fleet sales of $456, $1,960, $7,813, $26,615, $57,723, $43,528, and $33,420 for these reported periods, respectively.

(3) Based on an April 2001 Financial Accounting Standards Board announcement, we restated basic income per share for the 1999 and 2000 periods to include the Series M preferred stock as common stock on an as if converted basis.

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.

Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment.

This prospectus also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this prospectus.

RISKS RELATED TO OUR BUSINESS

OUR ABILITY TO INCREASE REVENUES THROUGH OUR ACQUISITION GROWTH STRATEGY 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 additional acquisitions in our existing markets and in new geographic markets. To complete the acquisitions of additional stores, we need to successfully address each of the following challenges.

Limitations on our capital resources may prevent us from capitalizing on acquisition opportunities. Acquisitions of additional stores will require substantial capital investment. Limitations on our capital resources would restrict our ability to complete new acquisitions. Further, the use of any financing source could have the effect of reducing our earnings per share.

In the past, we have financed our acquisitions from a combination of the cash flow from our operations, borrowings under our credit arrangements and issuances of our common stock. Although we expect the proceeds from this offering, together with our other financing resources, to be sufficient for our currently anticipated acquisition program through 2003, we cannot guarantee that additional funds would be available in the future if needed. If we are unable to obtain financing on acceptable terms, we may be required to slow the pace of our currently anticipated acquisition program, which may materially and adversely affect our acquisition growth strategy.

On occasion, we finance acquisitions by issuing shares of our common stock as partial consideration for acquired stores. The extent to which we will be able or willing to issue our common stock for acquisitions will depend on the market value of the common stock from time to time and the willingness of potential acquisition candidates to accept our common stock as part of the consideration for the sale of their businesses. Accordingly, our ability to make acquisitions could be adversely affected if the price of our common stock declines. If potential acquisition candidates are unwilling to accept our common stock as partial consideration, we will be forced to rely solely on available cash from operations or debt financing, which could limit our currently anticipated acquisition program.

Manufacturers may restrict our ability to make new acquisitions. We are required to obtain consent from the applicable manufacturer prior to the acquisition of a franchised store. The term "manufacturer" in this prospectus refers to all of the manufacturers of new vehicles that we sell.

In determining whether to approve an acquisition, a manufacturer considers many factors including our financial condition, ownership structure, the number of current stores owned and our performance with those stores. 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 total sales that may be controlled by one dealer group;

-- ownership of stores in contiguous markets;

-- dualing of a franchise with another brand; and

-- frequency of acquisitions.

DaimlerChrysler has issued a policy statement to all of its dealers that it may disapprove any acquisition if the buyer would own more than ten stores nationally, six in any Chrysler-defined sales zone or two in the same market. Although we currently own 21 Chrysler stores, DaimlerChrysler has continued to approve new acquisitions; however, no assurance can be given that any future acquisition applications will be approved. There are approximately 4,300 Chrysler stores nationwide.

General Motors currently evaluates our acquisitions of GM stores on a case-by-case basis. GM, however, limits the maximum number of GM stores that we may acquire at any time to 50% of the GM stores, by franchise line, in a GM-defined geographic market area. GM has approximately 7,300 stores nationwide.

Ford currently limits the number of stores that we may own to the greater of (1) 15 Ford and 15 Lincoln Mercury stores and (2) that number of Ford and Lincoln Mercury stores accounting for 5% of the preceding year's total Ford, Lincoln and Mercury retail sales of those brands in the United States. In addition, Ford limits us to one Ford store in a Ford-defined market area having two or less authorized Ford stores and one-third of Ford stores in any Ford-defined market area having three or more authorized Ford stores. Ford has approximately 4,600 franchised stores nationwide.

Toyota restricts the number of stores that we may own and the time frame over which we may acquire them, and imposes specific performance criteria on existing stores as a condition to any future acquisitions. In order for us to acquire more than seven stores, we must execute Toyota's standard Level Two Multiple Ownership Agreement. Under the Level Two Multiple Ownership Agreement, we may acquire more than seven stores over a minimum of seven semi-annual periods, up to a maximum number of stores equal to 5% of Toyota's aggregate national annual retail sale volume. In addition, Toyota restricts the number of Toyota stores that we may acquire in any Toyota-defined region and Metro market, as well as any contiguous market. Toyota has approximately 1,200 stores nationwide.

We currently own 21 Chrysler, 8 General Motors, 6 Ford and 5 Toyota stores. As noted above, we currently own more Chrysler stores than provided in its policy guidelines and further acquisitions of Chrysler stores may be prohibited or severely limited. With respect to other manufacturers, we do not believe existing numerical limitations will materially restrict our acquisition program for a number of years.

A manufacturer also considers our past performance as measured by their customer satisfaction index, or CSI, scores and sales performance at our existing stores. At any point in time, some of our stores may have CSI scores below the manufacturers' sales zone averages or have achieved sales performances below the targets they have set. Our failure to maintain satisfactory CSI scores and to achieve sales performance goals could restrict our ability to complete future acquisitions. In particular, our current Nissan and Lincoln/ Mercury stores have not achieved manufacturer established sales goals and we do not believe we would receive approval to acquire any new Nissan or Lincoln/Mercury stores until our sales levels improve for a sustained period of time.

We may be unable to improve profitability of newly acquired stores. We target stores with pretax margins below our historical pretax margin. Our ability to improve the profitability of newly acquired stores depends in large part on our ability at such stores to:

- increase new vehicle sales;
- improve sales of higher margin used vehicles and finance and insurance products;
- train and motivate store management;
- achieve cost savings and realize revenue enhancing opportunities; and
- improve inventory, receivable and other controls.

If we fail to improve the profitability of newly acquired stores, we may be unable to maintain our historical pretax margin. Further, failure to improve the performance of under-performing stores could preclude us from receiving manufacturer approval for any new acquisitions of that brand.

Competition with other automotive retailers for attractive acquisition targets could restrict our ability to complete new acquisitions. In the current economic environment, we are presented with an increasing number of attractive acquisition opportunities. However, we compete with several other national automotive retailers, some of which have greater financial and managerial resources. Competition with existing automotive retailers and those formed in the future may result in fewer attractive acquisition opportunities and increased acquisition costs. If we cannot negotiate acquisitions on acceptable terms, our future revenue growth will be significantly limited.

THE LOSS OF KEY PERSONNEL AND THE FAILURE TO ATTRACT ADDITIONAL PROVEN MANAGEMENT PERSONNEL COULD ADVERSELY AFFECT OUR OPERATIONS AND GROWTH.

Our success depends to a significant degree on the efforts and abilities of our senior management, particularly Sidney B. DeBoer, our Chairman and Chief Executive Officer, M. L. Dick Heimann, our President and Chief Operating Officer, and R. Bradford Gray, our Executive Vice President. Further, we have identified Mr. DeBoer and/or Mr. Heimann in most of our store franchise agreements as the individuals who control the franchises and upon whose financial resources and management expertise the manufacturers may consider when awarding or approving the transfer of any franchise. The loss of either of those individuals could have a material adverse effect on our on-going relationship with the manufacturers.

In addition, we place substantial responsibility on our general managers for the profitability of their stores. We have increased our number of stores from 5 in 1996 to 63 as of January 2002. Many stores are offered for sale to us to enable the owner/manager to retire. These potential acquisitions are viable to us only if we are able to obtain replacement management. This has resulted in the need to hire many additional managers. As we continue to expand, the need for additional experienced managers will become even more critical. The market for qualified general managers is highly competitive. The loss of the services of key management personnel or the inability to attract additional qualified general managers could have a material adverse effect on our business and the execution of our acquisition growth strategy.

OUR STORES DEPEND ON VEHICLE SALES AND, THEREFORE, OUR SUCCESS DEPENDS IN LARGE PART UPON THE OVERALL DEMAND FOR THE PARTICULAR LINES OF VEHICLES THAT EACH OF OUR STORES SELLS.

Our Chrysler, GM, Ford and Toyota stores represent approximately three-fourths of our total new vehicle retail sales. 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, such as labor disputes and other production disruptions, including those which sometimes occur during periods of new product introductions, 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. Further, any event that causes adverse publicity involving any of our manufacturers or their vehicles could reduce sales of those vehicles and adversely affect our sales and profits.

CYCLICAL DOWNTURNS IN THE AUTOMOBILE INDUSTRY, THAT REDUCE OUR VEHICLE SALES, MAY ADVERSELY AFFECT OUR PROFITABILITY.

The automobile industry is cyclical and historically has experienced downturns characterized by oversupply and weak demand. Many factors affect the industry, including general economic conditions, consumer confidence, personal discretionary spending levels, interest rates and credit availability. We cannot guarantee that the industry will not experience sustained periods of decline in vehicle sales in the future. Any such decline could have an adverse effect on our business.

The automobile industry also experiences seasonal variations in revenue. Demand for automobiles is generally lower during the winter months than in other seasons, particularly in our market areas that experience harsh winters. Accordingly, we expect revenues and operating results generally to be lower in our

first and fourth quarters than in our second and third quarters for existing stores. With respect to our company, the timing and volume of our acquisitions has had a greater effect on our revenues than seasonal sales variations.

THE ABILITY OF OUR STORES TO MAKE NEW VEHICLE SALES DEPENDS IN LARGE PART ON THE MANUFACTURERS AND, THEREFORE, ANY DISRUPTION OR CHANGE IN OUR RELATIONSHIPS WITH MANUFACTURERS MAY MATERIALLY AND ADVERSELY AFFECT OUR PROFITABILITY.

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.

We depend on the manufacturers for sales incentives and other programs that are intended to promote sales or support our profitability. Manufacturers historically have made many changes to their incentive programs during each year. A discontinuation or change in manufacturers' incentive programs could adversely affect our business. Moreover, some manufacturers use a store's CSI scores as a factor for participating in incentive programs. Accordingly, failure to meet CSI standards could have a material adverse effect on us.

Each of our stores operates pursuant to a franchise agreement with each of the respective manufacturers for which it serves as franchisee. Manufacturers exert significant control over our stores through the terms and conditions of their franchise agreements, including provisions for termination or non-renewal for a variety of causes. From time-to-time, certain of our stores have failed to comply with certain provisions of their franchise agreements. These agreements and state law, however, generally afford us the opportunity to cure violations and no manufacturer has terminated or failed to renew any franchise agreement with us. If a manufacturer terminates or declines to renew one or more of our significant franchise agreements, such action could have a material adverse effect on us.

Our franchise agreements also specify that, 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. In addition, some manufacturers are in the process of realigning their stores along defined channels, such as combining Chrysler and Jeep in one location. As a result, manufacturers may require us to move or sell some stores. Moreover, our manufacturers generally require that the store meet defined image standards. All of these commitments could require us to make significant capital expenditures.

Some of our franchise agreements prohibit transfers of ownership interests of a store or, in some cases, its parent. The most prohibitive restriction, which has been imposed by various manufacturers, provides that, under certain circumstances, we may lose a franchise if a person or entity acquires an ownership interest in us above a specified level (ranging from 20% to 50% depending on the particular manufacturer's restrictions and falling as low as 5% if another vehicle manufacturer is the entity acquiring the ownership interest) without the approval of the applicable manufacturer. Violations by our stockholders or prospective stockholders are generally outside of our control and may result in the termination or non-renewal of one or more of our franchises, which may have a material adverse effect on us.

IMPORT PRODUCT RESTRICTIONS AND FOREIGN TRADE RISKS MAY IMPAIR OUR ABILITY TO SELL FOREIGN VEHICLES PROFITABLY.

Certain vehicles we sell, as well as certain major components of vehicles we sell, are manufactured outside the United States. Accordingly, we are subject to import and export restrictions of various jurisdictions and are dependent to some extent on general economic conditions in, and political relations with, a number of foreign countries. Additionally, fluctuations in currency exchange rates may adversely affect our sales of vehicles produced by foreign manufacturers. Imports into the United States may also be adversely affected by increased transportation costs and tariffs, quotas or duties, any of which could have a material adverse effect on us.

RISKS RELATED TO THIS OFFERING

THE SOLE VOTING CONTROL OF OUR COMPANY IS HELD BY SIDNEY B. DEBOER, WHO MAY HAVE INTERESTS DIFFERENT FROM YOUR INTERESTS.

Lithia Holding Company, LLC, of which Sidney B. DeBoer, our Chairman and

Chief Executive Officer, is the sole managing member, holds all of the outstanding shares of 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. Even after completion of the offering, Lithia Holding will control 75.0% of the aggregate number of votes eligible to be cast by stockholders for the election of directors and most other stockholder actions assuming no exercise of the over-allotment option and 74.3% if the underwriters exercise their over-allotment option in full. Therefore, Lithia Holding will control the election of our Board of Directors and will be in a position to control the policies and operations of the company. In addition, because Mr. DeBoer is the managing member of Lithia Holding, he currently controls and will continue to control, all of the outstanding Class B common stock, thereby allowing him to control the company. See "Principal and Selling Stockholders." So long as at least 16 2/3% of the total number of shares outstanding are shares of Class B common stock, the holders of Class B common stock will be able to control all matters requiring approval of 66 2/3% or less of the aggregate number of votes. Absent a significant increase in the number of shares of Class A common stock outstanding or conversion of Class B common stock into Class A common stock, the holders of shares of Class B common stock will be entitled to elect all members of the Board of Directors and control all matters subject to stockholder approval that do not require a class vote. See "Description of Capital Stock."

IF AMERICAN HONDA MOTOR CO. DOES NOT APPROVE OF THIS OFFERING, IT COULD TERMINATE OUR FRANCHISE AGREEMENTS AND PURCHASE OUR THREE HONDA STORES.

We are subject to an agreement with American Honda Motor Co., which requires us to secure prior approval of any public offering of our common stock or any reduction in the control held by Class B common stock owned by Lithia Holding Company. Although we have requested approval of this offering and the conversion and sale of some of the Class B common stock held by Lithia Holding Company, no assurance can be given such approval will be received. Failure to secure such approval would be a violation of our agreement with Honda and could permit Honda to terminate our existing Honda franchises and exercise its right to purchase those stores at a fair market value determined by the agreement. Although Honda did not approve our secondary public offering in 1998, it did not terminate our existing franchise and has since approved the acquisition of two new Honda stores. Nonetheless, no assurance can be given that Honda will not withhold its approval and attempt to terminate our existing franchise agreements. We currently operate three Honda stores with annual revenues of approximately $55 million.

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

Some of the statements under the sections entitled "Prospectus Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business" and elsewhere in this prospectus and in the documents incorporated by reference in this prospectus constitute forward-looking statements. In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expect," "plan," "intend," "forecast," "anticipate," "believe," "estimate," "predict," "potential," "continue" or the negative of these terms or other comparable terminology. The forward-looking statements contained in this prospectus involve known and unknown risks, uncertainties and situations that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. Some of the important factors that could cause actual results to differ from our expectations are discussed in the "Risk Factors" section of this prospectus.

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

USE OF PROCEEDS

We estimate that the net proceeds from the sale of the 4,000,000 shares of Class A common stock we are offering, based on an assumed public offering price of $19.70 per share which equals the closing price of our Class A common stock on January 24, 2002, will be approximately $74.2 million after deducting estimated underwriting discounts and commissions and estimated offering expenses. If the underwriters exercise their over-allotment option in full, we estimate the net proceeds from this offering will be approximately $83.5 million. We will not receive any proceeds from the Class A common stock being offered by the selling stockholders.

We intend to use the net proceeds from our sale of Class A common stock primarily to finance future acquisitions and other general corporate purposes. Prior to such use, we intend to reduce our outstanding borrowings under credit agreements with Ford Motor Credit and others. These credit lines currently bear interest at rates ranging from 3.4% to 4.6% per annum and expire in December 2003. We borrowed under these lines to purchase new and used vehicles and to fund some of our acquisitions.

PRICE RANGE OF COMMON STOCK

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 the periods indicated.

	CLASS A COMMON STOCK PRICE	
	HIGH	LOW
YEAR ENDED DECEMBER 31, 2000		
First Quarter	$18.19	$13.00
Second Quarter	17.13	11.63
Third Quarter	13.50	11.75
Fourth Quarter	14.13	11.38
YEAR ENDED DECEMBER 31, 2001		
First Quarter	$15.05	$12.06
Second Quarter	21.38	14.00
Third Quarter	19.06	12.50
Fourth Quarter	20.70	11.85
YEAR ENDED DECEMBER 31, 2002		
First Quarter (through January 24)	$21.75	$19.70

A recent closing price per share for our common stock as reported by the NYSE is set forth on the cover of this prospectus. On January 24, 2002, there were approximately 1,700 holders of record of our Class A common stock.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock and do not anticipate paying dividends for the foreseeable future. We intend to retain future earnings for acquisitions and operations. Our credit agreement with Ford Motor Credit Company precludes the payment of cash dividends without their prior consent. The payment of future dividends is also subject to the discretion of our Board of Directors.

12

CAPITALIZATION

The following table sets forth our short-term debt and capitalization as of September 30, 2001 and as adjusted to give effect to the conversion in January 2002 of 5,177 shares of Series M preferred stock into 249,034 shares of Class A common stock and the sale of the 4,000,000 shares of Class A common stock we are offering under this prospectus. For purposes of preparing this table, we have assumed a public offering price of $19.70 per share and have reduced the net proceeds received by the estimated underwriting discounts and commissions and the estimated offering expenses payable by us.

	AS OF SEPTEMBER 30, 2001	
	ACTUAL	AS ADJUSTED
	{(IN THOUSANDS)}	
Short-term debt:		
Flooring notes payable	$242,705	$236,542
Current maturities of long-term debt	9,334	9,334
Current portion of capital leases	18	18
Total short-term debt	$252,057	$245,894
Long-term debt:		
Used vehicle flooring facility	$ 60,000	$ --
Real estate debt, less current maturities	32,218	32,218
Long-term debt, less current maturities	41,088	33,088
Long-term capital leases, less current portion	20	20
Total long-term debt, less current maturities	133,326	65,326
Stockholders' equity:		
Preferred Stock, no par value 15,000,000 shares authorized; 15,000 shares designated Series M Preferred; issued and outstanding 9,676 actual and 4,499 as adjusted	5,806	2,699
Common Stock		
Class A common stock, no par value 100,000,000 shares authorized; issued and outstanding 8,802,076 actual and 13,051,110 as adjusted	113,014	190,284
Class B common stock, no par value 25,000,000 shares authorized; issued and outstanding 4,087,000 actual and as adjusted	508	508
Additional paid-in capital	456	456
Accumulated other comprehensive loss	(2,348)	(2,348)
Retained earnings	79,088	79,088

Total stockholders' equity	196,524	270,687
Total capitalization	$329,850	$336,013

The above information is based upon 13,263,743 common shares outstanding as of January 24, 2002. This information does not include 1,409,745 shares of common stock subject to outstanding options at a weighted average exercise price of $14.02 and 402,192 shares of common stock reserved for future issuance under our stock option and employee purchase plans. See "Description of Capital Stock" for additional information concerning the number of outstanding shares of our capital stock and stock options.

13

SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents consolidated balance sheet data and consolidated statements of operations data as of and for the years ended December 31, 1996 through 2000, which is derived from our audited consolidated financial statements. The consolidated financial data as of September 30, 2001 and for the nine months ended September 30, 2000 and 2001 are derived from our unaudited consolidated financial statements. You should read this data in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes thereto contained or incorporated by reference in this prospectus. The information as of September 30, 2001 and for the nine month periods ended September 30, 2000 and 2001 is unaudited and has been prepared on the same basis as our annual consolidated financial statements. In the opinion of management, this quarterly information reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the information for the periods presented. The results of operations for the nine month period ended September 30, 2001 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2001, or any future period.

	YEAR ENDED DECEMBER 31,				
	1996(1)	1997	1998	1999	2000
	(DOLLARS IN THOUSANDS EXCEPT PER SHARE				
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Revenues					
New vehicle sales	$ 65,092	$161,294	$388,431	$ 673,339	$ 898,01
Used vehicle sales	58,611	113,099	220,544	375,562	480,84
Service, body and parts	13,197	29,828	72,216	120,722	164,00
F&I and other(2)	5,944	15,574	33,549	73,036	115,74
Total revenues	142,844	319,795	714,740	1,242,659	1,658,61
Cost of sales	117,025	265,049	599,379	1,043,373	1,391,04
Gross profit	25,819	54,746	115,361	199,286	267,56
Selling, general and administrative	19,830	40,625	85,188	146,381	195,50
Depreciation and amortization	1,756	2,483	3,469	5,573	7,60

Operating income..................	4,233	11,638	26,704	47,332	64,46
Flooring interest expense.........	(697)	(2,179)	(7,108)	(11,105)	(17,72
Other interest expense............	(656)	(824)	(2,735)	(4,250)	(7,91
Other income (expense), net.......	1,349	862	921	74	71
Income before income taxes........	4,229	9,497	17,782	32,051	39,53
Income taxes(3)...................	(1,623)	(3,538)	(6,993)	(12,877)	(15,22
Net income(3).....................	$ 2,606	$ 5,959	$ 10,789	$ 19,174	$ 24,31
Basic net income per share(4).....	$ 0.56	$ 0.85	$ 1.18	$ 1.67	$ 1.7
Shares used in calculating basic net income per share............	4,657	6,988	9,147	11,506	13,65
Diluted net income per share......	$ 0.52	$ 0.82	$ 1.14	$ 1.60	$ 1.7
Shares used in calculating diluted net income per share............	4,973	7,303	9,470	11,998	13,80

	AS OF DECEMBER 31,				
	1996(1)	1997	1998	1999	20
				(DOLLARS IN THOUSANDS)	
CONSOLIDATED BALANCE SHEET DATA:					
Working capital...........................	$25,431	$ 23,870	$ 53,553	$ 74,999	$ 98
Inventories...............................	33,362	89,845	157,455	268,281	314
Total assets..............................	68,964	166,526	294,398	506,433	628
Flooring notes payable....................	19,645	82,598	129,167	243,903	314
Short-term debt...........................	2,355	2,787	3,143	7,132	5
Long-term debt, less current maturities...	6,160	26,558	41,420	38,411	72
Stockholders' equity......................	27,914	37,877	91,511	155,638	181

----

(1) Restated to give effect to the conversion from the LIFO method of accounting for inventory to the FIFO method, which was effective January 1, 1997.

(2) F&I and other includes finance, extended warranty and insurance revenues. It also includes net fleet sales of $456, $1,960, $7,813, $26,615, $57,723, $43,528, and $33,420 for these reported periods, respectively.

(3) Income taxes and net income for 1996 are presented on a pro forma basis to reflect federal and state income taxes as if we had been a Subchapter C corporation, based on the income tax rates that would have been in effect at that time.

(4) Based on an April 2001 Financial Accounting Standards Board announcement, we restated basic income per share for the 1999 and 2000 periods to include the Series M preferred stock as common stock on an as if converted basis.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We are a leading operator of automotive franchises and retailer of new and used vehicles and services. As of September 30, 2001, we offered 26 brands of new vehicles through 119 franchises in 61 stores in the western United States and over the internet. As of September 30, 2001, we operate 15 stores in Oregon, 14 in California, 8 in Washington, 7 in Colorado, 7 in Idaho, 5 in Nevada, 3 in South Dakota and 2 in Alaska. We sell new and used cars and light trucks; sell replacement parts; provide vehicle maintenance, warranty, paint and repair services; and arrange related financing and insurance for our automotive customers.

During an economic downturn, customers tend to shift towards the purchase of more reasonably priced new vehicle models or used vehicles. Many customers decide to delay purchasing a new vehicle and instead repair existing vehicles. In addition, manufacturers typically offer increased dealer and customer incentives during an economic downturn in order to support new vehicle sales volume. These factors lead to less cyclicality for automobile retailers than for automobile manufacturers.

Historically, new vehicle sales account for approximately 50% of our total revenues but less than 30% of total gross profit. We emphasize sales of higher margin products, which generate over 70% of our gross profits. Revenues and gross profit by product line were as follows for the first nine months of 2001:

	PERCENT OF TOTAL REVENUES	GROSS MARGIN	PERCENT OF TOTAL GROSS PROFIT
New vehicles(1)...............................	51.8%	9.0%	28.1%
Retail used vehicles(2).......................	26.9	12.8	20.9
Service, body and parts.......................	10.2	46.1	28.5
Finance and insurance(1)(3)...................	3.8	98.8	22.8

----

(1) Does not include fleet sales, representing 2.5% of total revenues and 0.4% of our total gross profit, which are included in our financial statements on a net profit basis under finance and insurance.

(2) Excludes wholesale used vehicle sales, representing 4.8% of total revenues with a negative gross margin contribution of 0.7%.

(3) Reported net of administration fees and anticipated cancellations.

RESULTS OF OPERATIONS

NINE MONTHS ENDED SEPTEMBER 30, 2000 COMPARED TO 2001

	{NINE MONTHS ENDED SEPTEMBER 30,} 2000	2001	INCREASE (DECREASE)	% INCREASE (DECREASE)

(DOLLARS IN THOUSANDS EXCEPT VEHICLE INFORMATION)

Revenues:				
New vehicle sales	$ 683,217	$ 701,095	$17,878	2.6%
Used vehicle sales	364,935	428,777	63,842	17.5
Service, body and parts	121,266	138,540	17,274	14.2
Finance and insurance and other revenues	87,102	85,107	(1,995)	(2.3)
Total revenues	1,256,520	1,353,519	96,999	7.7
Cost of sales	1,055,552	1,129,544	73,992	7.0
Gross profit	200,968	223,975	23,007	11.4
Selling, general and administrative	146,770	173,517	26,747	18.2
Depreciation and amortization	5,539	6,813	1,274	23.0
Income from operations	48,659	43,645	(5,014)	(10.3)
Floorplan interest expense	(13,894)	(11,877)	(2,017)	(14.5)
Other interest expense	(4,928)	(5,953)	1,025	20.8
Other, net	884	(365)	(1,249)	(141.3)
Income before income taxes	30,721	25,450	(5,271)	(17.2)
Income tax expense	(12,040)	(9,828)	(2,212)	(18.4)
Net income	$ 18,681	$ 15,622	$(3,059)	(16.4)%
New vehicles sold	28,555	28,576	21	0.1%
Average selling price	$ 23,926	$ 24,534	$ 608	2.5%
Used vehicles sold--retail	23,453	27,798	4,345	18.5%
Average selling price	$ 13,161	$ 13,118	$ (43)	(0.3)%
Used vehicles sold--wholesale	12,637	13,881	1,244	9.8%
Average selling price	$ 4,452	$ 4,619	$ 167	3.8%

16

The following tables set forth, for the periods indicated, historical condensed financial data expressed as a percentage of total revenues.

	{NINE MONTHS ENDED SEPTEMBER 30,	
	2000	2001
STATEMENT OF OPERATIONS DATA:		
Revenues:		
New vehicles	54.4%	51.8%
Used vehicles	29.0	31.7
Service, body and parts	9.7	10.2
Finance and insurance and other	6.9	6.3
Total revenues	100.0%	100.0%
Gross profit	16.0%	16.5%
Selling, general and administrative	11.7%	12.8%
Depreciation and amortization	0.4%	0.5%
Income from operations	3.9%	3.2%

Floorplan interest expense	1.1%	0.9%
Other interest expense	0.4%	0.4%
Other income (expense), net	0.1%	0.0%
Income before income tax	2.5%	1.9%
Income tax expense	1.0%	0.7%
Net income	1.5%	1.2%

Revenues. Total revenues increased 7.7% to record levels for the nine month period ended September 30, 2001 compared to the same period of 2000 due to acquisitions, which were partially offset by same store retail sales decreasing 4.7%. The decrease in same store retail sales was due to a slower new vehicle sales environment, offset in part by same store increases in used vehicle and finance and insurance sales. Manufacturers are currently offering incentives, including low interest rates and rebates, in order to attract new vehicle buyers. We expect these incentives to increase same store new vehicle sales in the fourth quarter of 2001. The availability of cash rebates and zero percent financing is expected to enhance our ability to sell finance, warranty and insurance products and services and not adversely affect our finance and insurance income.

Other revenues include sales of finance, extended warranty and insurance contracts, presented net of administration fees and anticipated cancellations. It also includes fleet sales generally presented on a net basis.

Gross profit. Gross profit increased primarily due to increased total revenues and increased used vehicle and service, body and parts revenues as a percentage of total revenues. Incentives and rebates, including floorplan interest credit, received from manufacturers are recorded as a reduction to cost of goods sold. Gross margin expansion is common in the auto retailing industry as new vehicle sales slow and higher margin product lines become a larger percentage of total revenues. Gross profit margins achieved in the nine month periods ended September 30, 2000 and 2001 were as follows:

	NINE MONTHS ENDED, SEPTEMBER 30,		LITHIA
	2000	2001	MARGIN CHANGE*
New vehicles	8.9%	9.0%	+10 bp
Retail used vehicles	13.6	12.8	-80
Service and parts	45.2	46.1	+90
Overall	16.0	16.5	+50

----

* "bp" stands for basis points (one hundred basis points equals one percent)

The increase in the overall gross profit margin is primarily a result of a shift in mix to the more profitable used vehicle, service, body and parts and finance and insurance product lines, as well as lower cost of sales for new vehicles due to manufacturer incentives paid to us.

Selling, general and administrative expense. Selling, general and administrative expense ("SG&A") includes salaries and related personnel expenses, facility lease expense, advertising, legal, accounting, professional services and general corporate expenses. SG&A expense increased due primarily to increased selling, or variable, expenses related to the increase in revenues and the number of locations. As a percentage of revenue, SG&A expense increased in the nine month period ended September 30, 2001 compared to the same period of 2000 due to a shift in mix to more parts and service business, which has a higher SG&A expense component, and continued investments in acquisition integration and operational support teams in preparation for continued growth.

Depreciation and amortization. Depreciation and amortization expense increased primarily as a result of increased property and equipment and intangible assets related to acquisitions.

Income from operations. Operating margins decreased 70 basis points, or seven-tenths of one percent, in the nine month period ended September 30, 2001 compared to the same period of 2000 due to the increased operating expenses as a percentage of revenue as discussed above, partially offset by higher gross margins as a percentage of revenue.

Floorplan interest expense. The decrease in floorplan interest expense is primarily due to recent decreases in the effective interest rates on the floating rate credit lines as well as an overall decrease in the amount of flooring debt outstanding. We have been able to decrease our inventory levels despite the acquisition of several stores during 2001.

Other interest expense. The increase in other interest expense is due to higher debt levels as a result of acquisitions, offset in part by lower interest rates.

Income tax expense. Our effective tax rate declined to 38.6 percent in the first nine months of 2001 from 39.2 percent in the first nine months of 2000 as a result of an increasing mix of asset acquisitions compared to corporate acquisitions, which resulted in an increased weighting of deductible goodwill, as well as an increase in the mix of states with lower or no state income taxes.

Net income. Net income decreased to $15.6 million, a 16.4% decrease, for the nine months ended September 30, 2001 compared to the same period of 2000 as a result of the net effect of the changes discussed above.

RESULTS OF OPERATIONS

1999 COMPARED TO 2000

	YEAR ENDED DECEMBER 31, 1999	2000	INCREASE (DECREASE)	% INCREASE (DECREASE)
	(DOLLARS IN THOUSANDS EXCEPT VEHICLE INFORMATION)			
Revenues:				
New vehicle sales	$ 673,339	$ 898,016	$224,677	33.4%
Used vehicle sales	375,562	480,846	105,284	28.0
Service, body and parts	120,722	164,002	43,280	35.9
Other revenues	73,036	115,747	42,711	58.5
Total revenues	1,242,659	1,658,611	415,952	33.5
Cost of sales	1,043,373	1,391,042	347,669	33.3

Gross profit	199,286	267,569	68,283	34.3
Selling, general and administrative	146,381	195,500	49,119	33.6
Depreciation and amortization	5,573	7,605	2,032	36.5
Income from operations	47,332	64,464	17,132	36.2
Floorplan interest expense	(11,105)	(17,728)	6,623	59.6
Other interest expense	(4,250)	(7,917)	3,667	86.3
Other, net	74	716	642	867.6
Income before income taxes	32,051	39,535	7,484	23.4
Income tax expense	(12,877)	(15,222)	2,345	18.2
Net income	$ 19,174	$ 24,313	$ 5,139	26.8%
New vehicles sold	28,645	37,230	8,585	30.0%
Average selling price	$ 23,506	$ 24,121	$ 615	2.6%
Used vehicles sold--retail	23,840	30,896	7,056	29.6%
Average selling price	$ 13,148	$ 13,149	$ 1	--
Used vehicles sold--wholesale	13,424	16,751	3,327	24.8%
Average selling price	$ 4,627	$ 4,454	$ (173)	(3.7)%

Revenues. Same store retail sales increased 1.1% in 2000 compared to 1999. The increases in units sold and revenue from all sources are a result of acquisitions and internal growth.

Gross profit. Gross profit increased primarily due to increased total revenues and increased other revenues as a percentage of total revenues. Gross profit margins achieved in 1999 and 2000 were as follows:

	2000 INDUSTRY AVERAGE(1)	LITHIA 1999	LITHIA 2000	LITHIA MARGIN CHANGE(2)
New vehicles	6.1%	8.7%	9.0%	+30 bp
Retail used vehicles	10.9	12.8	13.6	+80
Service and parts	n/a	44.8	44.9	+10
Overall	12.7	16.0	16.1	+10

----

(1) Based on National Automotive Dealer Association data.

(2) "bp" stands for basis points (one hundred basis points equals one percent).

The increases in the gross profit margins are primarily a result of operational improvements at our newly acquired stores, as we implemented our business model.

Selling, general and administrative expense. Selling, general and administrative expense increased due primarily to increased selling, or variable, expense related to the increase in revenues and the number of total locations. Selling, general and administrative expense, as a percentage of revenue, remained constant in 2000 compared to 1999.

Depreciation and amortization. Depreciation and amortization expense increased primarily as a result of increased property and equipment and goodwill related to acquisitions in 1999 and 2000.

Income from operations. Operating margins improved ten basis points in 2000 compared to 1999. In addition to gaining efficiencies related to economies of scale, we have improved the operating margins at acquired stores that we have operated for a full year, bringing them more in line with our pre-existing stores.

Floorplan interest expense. Seventy-five percent of the increase in floorplan interest expense is due to additional flooring notes payable as a result of higher inventory levels from acquisitions. Twenty-five percent of the increase is due to an overall rise in borrowing rates during 2000.

Other interest expense. Eighty percent of the increase in other interest expense is due to higher debt levels as a result of acquisitions. Twenty percent of the increase is due to an overall rise in borrowing rates during 2000.

Income tax expense. Our effective tax rate declined to 38.5 percent in 2000 from 40.2 percent in 1999 as a result of an increasing mix of asset acquisitions compared to corporate acquisitions and the increased weighting of deductible goodwill, as well as an increase in the mix of states with lower or no state income taxes.

Net income. Net income increased primarily as a result of increased revenues as discussed above.

RESULTS OF OPERATIONS

1998 COMPARED TO 1999

	YEAR ENDED DECEMBER 31, 1998	YEAR ENDED DECEMBER 31, 1999	INCREASE (DECREASE)	% INCREASE (DECREASE)
	(DOLLARS IN THOUSANDS EXCEPT VEHICLE INFORMATION)			
Revenues:				
New vehicle sales	$388,431	$ 673,339	$284,908	73.3%
Used vehicle sales	220,544	375,562	155,018	70.3
Service, body and parts	72,216	120,722	48,506	67.2
Other revenues	33,549	73,036	39,487	117.7
Total revenues	714,740	1,242,659	527,919	73.9
Cost of sales	599,379	1,043,373	443,994	74.1
Gross profit	115,361	199,286	83,925	72.8
Selling, general and administrative	85,188	146,381	61,193	71.8
Depreciation and amortization	3,469	5,573	2,104	60.7
Income from operations	26,704	47,332	20,628	77.2
Floorplan interest expense	(7,108)	(11,105)	3,997	56.2
Other interest expense	(2,735)	(4,250)	1,515	55.4
Other, net	921	74	(847)	(92.0)
Income before income taxes	17,782	32,051	14,269	80.2

Income tax expense	(6,993)	(12,877)	5,884	84.1
Net income	$ 10,789	$ 19,174	$ 8,385	77.7%
New vehicles sold	$ 17,708	$ 28,645	$ 10,937	61.8%
Average selling price	21,935	23,506	1,571	7.2
Used vehicles sold--retail	$ 13,645	$ 23,840	$ 10,195	74.7%
Average selling price	12,768	13,148	380	3.0
Used vehicles sold--wholesale	$ 9,532	$ 13,424	$ 3,892	40.8%
Average selling price	4,860	4,627	(233)	(4.8)

Revenues. Same store sales growth was 6.9% in 1999, with a 17.8% increase in same store finance and insurance revenue. Same store sales growth was 14.7% in 1998. The increases in units sold and revenue from all sources are a result of acquisitions and internal growth.

Gross profit. Gross profit increased primarily due to increased revenues as indicated above. Gross profit margins achieved in 1998 and 1999 were as follows:

	1999 INDUSTRY AVERAGE(1)	LITHIA 1998	LITHIA 1999	LITHIA MARGIN CHANGE(2)
New vehicles	6.4%	8.9%	8.7%	-20 bp
Retail used vehicles	10.7	12.7	12.8	+10
Service and parts	n/a	45.5	44.8	-70
Overall	12.6	16.1	16.0	-10

----

(1) Based on National Automotive Dealer Association data.

(2) "bp" stands for basis points (one hundred basis points equals one percent).

The decrease in the new vehicle gross profit margins is primarily due to the mix of stores added due to acquisitions. These stores have lower selling, general and administrative costs as a percentage of revenues than our preexisting stores, lending themselves to a high volume, low cost strategy of retailing vehicles. The

21

increase in the retail used vehicle gross profit margin is primarily due to improved inventory management company wide and operational improvements at newly acquired stores, as we implemented our business model.

Selling, general and administrative expense. Selling, general and administrative expense ("SG&A") increased due primarily to increased selling, or variable, expense related to the increase in revenues and the number of total locations. The decrease in SG&A as a percent of total revenues is a result of economies of scale gained as the fixed expenses are spread over a larger revenue base and from economies of scale as we consolidate multiple stores in a single market.

Depreciation and amortization. Depreciation and amortization expense increased primarily as a result of increased property and equipment and goodwill related to acquisitions in 1998 and 1999.

Income from operations. In addition to gaining efficiencies related to economies of scale, we improved the operating margins at acquired stores that we have operated for a full year, bringing them more in line with our pre-existing stores.

Floorplan interest expense. Floorplan interest expense increased as a result of increased flooring notes payable related to increased inventories as a result of the increase in stores owned and vehicles sold. We reduced our floorplan interest expense as a percentage of total revenues by successfully managing inventory levels.

Net income. Net income increased as a result of the net effect of the individual line item changes discussed above.

SELECTED CONSOLIDATED QUARTERLY FINANCIAL DATA

The following tables set forth the company's unaudited quarterly financial data for the quarterly periods presented. This presentation should be read in conjunction with the consolidated financial statements of the company and the notes thereto contained or incorporated by reference in this prospectus.

	THREE MONTHS ENDED,			
	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
	(IN THOUSANDS EXCEPT PER SHARE DATA)			
1999				
Revenues:				
New vehicle sales	$116,853	$167,222	$199,107	$190,157
Used vehicle sales	71,809	93,049	105,434	105,270
Service, body and parts	23,430	28,477	33,898	34,917
Other revenues	12,053	19,005	18,930	23,048
Total revenues	224,145	307,753	357,369	353,392
Cost of sales	188,945	258,967	300,124	295,337
Gross profit	35,200	48,786	57,245	58,055
Selling, general and administrative	26,648	36,061	41,564	42,108
Depreciation and amortization	1,075	1,364	1,560	1,574
Income from operations	7,477	11,361	14,121	14,373
Flooring interest expense	(2,109)	(2,179)	(3,090)	(3,727)
Other interest expense and other, net	(363)	(1,403)	(1,107)	(1,303)
Income before income taxes	5,005	7,779	9,924	9,343
Income taxes	(1,976)	(3,202)	(4,071)	(3,628)
Net income	$ 3,029	$ 4,577	$ 5,853	$ 5,715
Basic net income per share(1)	$ 0.30	$ 0.41	$ 0.48	$ 0.46
Diluted net income per share	$ 0.29	$ 0.40	$ 0.47	$ 0.43

	THREE MONTHS ENDED,			
	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
	(IN THOUSANDS EXCEPT PER SHARE DATA)			
2000				
Revenues:				
New vehicle sales	$218,009	$222,039	$243,169	$214,799
Used vehicle sales	116,698	119,277	128,960	115,911
Service, body and parts	38,457	40,476	42,333	42,736
Other revenues	22,439	36,059	28,604	28,645
Total revenues	395,603	417,851	443,066	402,091
Cost of sales	332,739	350,667	372,146	335,490
Gross profit	62,864	67,184	70,920	66,601
Selling, general and administrative	47,201	48,528	51,041	48,730
Depreciation and amortization	1,720	1,887	1,932	2,066
Income from operations	13,943	16,769	17,947	15,805
Flooring interest expense	(3,861)	(4,712)	(5,321)	(3,834)
Other interest expense and other, net	(1,667)	(1,557)	(820)	(3,157)
Income before income taxes	8,415	10,500	11,806	8,814
Income taxes	(3,451)	(4,306)	(4,283)	(3,182)
Net income	$ 4,964	$ 6,194	$ 7,523	$ 5,632
Basic net income per share(1)	$ 0.37	$ 0.45	$ 0.55	$ 0.41
Diluted net income per share	$ 0.37	$ 0.45	$ 0.55	$ 0.41
2001				
Revenues:				
New vehicle sales	$214,957	$238,651	$247,487	
Used vehicle sales	136,939	142,043	149,795	
Service, body and parts	45,145	45,511	47,884	
Other revenues	23,110	35,845	26,152	
Total revenues	420,151	462,050	471,318	
Cost of sales	351,254	386,840	391,450	
Gross profit	68,897	75,210	79,868	
Selling, general and administrative	55,038	58,783	59,696	
Depreciation and amortization	2,215	2,226	2,372	
Income from operations	11,644	14,201	17,800	
Flooring interest expense	(4,655)	(3,832)	(3,390)	
Other interest expense and other, net	(2,346)	(2,123)	(1,849)	
Income before income taxes	4,643	8,246	12,561	
Income taxes	(1,788)	(3,175)	(4,865)	
Net income	$ 2,855	$ 5,071	$ 7,696	

Basic net income per share(1)..........	$ 0.21	$ 0.38	$ 0.57
Diluted net income per share...........	$ 0.21	$ 0.37	$ 0.56

----

(1) Pursuant to an April 2001 Financial Accounting Standards Board announcement, the company has restated its basic EPS for the second, third and fourth quarters of 1999, for each quarter of 2000 and for the first quarter of 2001 to include its Series M preferred stock as common stock on an as if converted basis.

LIQUIDITY AND CAPITAL RESOURCES

Our principal needs for capital resources are to finance acquisitions and capital expenditures, as well as for working capital. We have relied primarily upon internally generated cash flows from operations, borrowings under our credit agreements and the proceeds from public equity offerings to finance operations and expansion. We believe that our available cash, cash equivalents, available lines of credit and cash flows from operations will be sufficient to meet our anticipated operating expenses and capital requirements for at least twelve months. These resources and anticipated net proceeds from this offering will be sufficient to fund our anticipated acquisitions through 2003.

In June 2000, our Board of Directors authorized the repurchase of up to 1,000,000 shares of Class A common stock. We have purchased 40,000 shares under this program and may continue to do so from time to time in the future as conditions warrant.

We have credit facilities with Ford Motor Credit Company totaling $580 million, which expire December 1, 2003 with interest due monthly. The facilities include $250 million for new and program vehicle flooring, $150 million for used vehicle flooring, $130 million for franchise acquisitions and $50 million for mortgage financing. We also have the option to convert the acquisition line into a five-year term loan.

Toyota Financial Services, DaimlerChrysler Financial Corporation and General Motors Acceptance Corporation have agreed to floor all of our new vehicles for their respective brands with Ford Credit serving as the primary lender for all other brands.

The credit lines with Ford Motor Credit are cross-collateralized and are secured by inventory, accounts receivable, intangible assets and equipment. We pledged to Ford Motor Credit the stock of all of our subsidiaries except entities operating BMW, Honda, Nissan or Toyota stores. The mortgage line is secured by related property. The other new vehicle lines are secured by new vehicle inventory of the relevant brands.

The financial covenants in our agreement with Ford Motor Credit require us to maintain compliance with, among other things, specified ratios of (1) total debt to tangible base capital; (2) total adjusted debt to tangible base capital; (3) current ratio; (4) fixed charge coverage; and (5) net cash. In addition, we have pledged substantially all the shares of our subsidiaries in connection with our credit lines with Ford Motor Credit. The Ford Motor Credit agreements also preclude the payment of cash dividends without prior consent. Lithia was in compliance with all such covenants at September 30, 2001.

We also have a real estate line of credit with Toyota Financial Services totaling $18 million, which expires July 2, 2006. This line of credit is secured by the real estate financed under this line of credit.

In addition, U.S. Bank N.A. has extended a $27.5 million revolving line of credit for leased vehicles and equipment purchases, which expires January 31, 2004.

Interest rates on all of the above facilities ranged from 4.09% to 5.34% at September 30, 2001. Amounts outstanding on the lines at September 30, 2001 and December 31, 2001 together with amounts remaining available under such lines were as follows:

	OUTSTANDING		REMAINING AVAILABILITY AS
	SEPTEMBER 30, 2001	DECEMBER 31, 2001	DECEMBER 31, 2001
	(IN THOUSANDS)		
New and Program Vehicle Lines......................	$242,705	$211,947	*
Used Vehicle Line............	60,000	69,000	81,000
Acquisition Line.............	8,000	22,000	108,000
Real Estate Lines............	8,610	13,740	4,260
Equipment/Leased Vehicle Line.......................	27,500	27,500	0
	$346,815	$344,187	193,260

----

* There are no formal limits on the new and program vehicle lines.

24

At September 30, 2001, we had capital commitments of approximately $10.5 million for the construction of five new store facilities and additions to two existing facilities, of which $6.4 million is anticipated to be incurred through the end of 2001 and the balance in 2002. Approximately $5.8 million has already been paid for these commitments from available cash balances. We expect to pay for the construction out of existing cash balances until completion of the projects, at which time we anticipate securing long-term financing and general borrowings from third party lenders for 85% to 100% of the amounts expended.

SEASONALITY AND QUARTERLY FLUCTUATIONS

Historically, our sales have been lower in the first and fourth quarters of each year due to consumer purchasing patterns during the holiday season, inclement weather and the reduced number of business days during the holiday season. As a result, financial performance may be lower during the first and fourth quarters than during the other quarters of each fiscal year. We believe that interest rates, levels of consumer debt, consumer confidence and buying patterns, as well as general economic conditions, also contribute to fluctuations in sales and operating results. Historically, the timing and frequency of acquisitions has been the largest contributor to fluctuations in our operating results from quarter to quarter.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of."

We adopted the provisions of SFAS No. 141 on July 1, 2001, and SFAS No. 142 on January 1, 2002. Furthermore, goodwill and intangible assets determined to have an indeterminable useful life acquired in a purchase business combination completed after June 30, 2001 but before SFAS No. 142 was adopted in full, were not amortized, but evaluated for impairment in accordance with the appropriate pre-SFAS No. 142 accounting literature. Goodwill and intangible assets acquired in business combinations completed before July 1, 2001 continued to be amortized and tested for impairment in accordance with the appropriate pre-SFAS No. 142 accounting requirements prior to the adoption of SFAS No. 142.

SFAS No. 141 requires, upon adoption of SFAS No. 142, that we evaluate our existing intangible assets and goodwill that we acquired in prior purchase business combinations, and make any necessary reclassifications in order to conform with the new criteria in SFAS No. 141 for recognition apart from goodwill. We do not anticipate reclassifying any intangibles to intangibles with determinable useful lives. For intangible assets identified as having indefinite useful lives, we are required to test them for impairment in accordance with the provisions of SFAS No. 142 within the first interim period and recognize any impairment losses as the cumulative effect of a change in accounting principle in the first interim period. We do not anticipate incurring any impairment loss charges upon adoption of SFAS No. 142.

The adoption of SFAS No. 141 did not have a significant impact on our financial condition or results of operations. As of September 30, 2001, we expect a reduction in annual amortization expense of approximately $3.7 million in 2002 upon adoption of SFAS No. 142.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

VARIABLE RATE DEBT

We use variable-rate debt to finance our new and program vehicle inventory. The interest rate on the flooring debt is tied to the one month LIBOR. These debt obligations therefore expose us to variability in

25

interest payments due to changes in the one month LIBOR. The flooring debt is based on open-ended lines of credit tied to each individual store from the various manufacturer finance companies. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases.

Our variable rate flooring notes payable and other credit line borrowings subject us to market risk exposure. At September 30, 2001, we had $346.8 million outstanding under such agreements at interest rates ranging from 4.09% to 5.34% per annum. A 10% increase in interest rates would increase interest expense by approximately $212,000, net of tax, for the remaining three months of 2001 based on amounts outstanding on the lines of credit at September 30, 2001.

HEDGING STRATEGIES

We believe it is prudent to limit the variability of a portion of our interest payments. Accordingly, we have entered into interest rate swaps to manage the variability of our interest rate exposure, thus leveling a portion of our interest expense in a rising or falling rate environment. We currently have hedged approximately 16.5% of our flooring debt.

The interest rate swaps change the variable-rate cash flow exposure on a portion of the flooring debt to fixed rate cash flows by entering into receive-variable, pay-fixed interest rate swaps. Under the interest rate swaps, we receive variable interest rate payments and make fixed interest rate payments, thereby creating fixed rate flooring debt.

We have entered into the following interest rate swaps with U.S. Bank Dealer Commercial Services:

-- effective September 1, 2000--a five year, $25 million interest rate swap at a fixed rate of 6.88% per annum.

-- effective November 1, 2000--a three year, $25 million interest rate swap at a fixed rate of 6.47% per annum.

We earn interest on both of the $25 million interest rate swaps at the one month LIBOR rate adjusted on the first and sixteenth of every month and we are obligated to pay interest at the fixed rate set for each swap (6.88% or 6.47% per annum) on the same amount. The difference between interest earned and the interest obligation accrued is received or paid each month and is recorded in the statement of operations as flooring interest expense. The one month LIBOR rate at September 30, 2001 was 2.63% per annum.

We do not enter into derivative instruments for any purpose other than to manage interest rate exposure. That is, we do not speculate using derivative instruments.

The fair value of interest rate swap agreements and the amount of hedging losses deferred on interest rate swaps was $3.8 million at September 30, 2001. Changes in the fair value of the interest rate swaps are reported, net of related income taxes, in accumulated other comprehensive income. These amounts are subsequently reclassified into interest expense as a yield adjustment in the same period in which the related interest on the flooring debt affects earnings. Because the critical terms of the interest rate swap and the underlying debt obligation are the same, there was no ineffectiveness recorded in interest expense.

Incremental interest expense incurred as a result of the interest rate swaps was $789,000 for the nine month period ended September 30, 2001. Interest expense savings on un-hedged debt as a result of decreasing interest rates from December 31, 2000 through September 30, 2001 was approximately $3.8 million.

At current interest rates, we estimate that we will incur additional interest expense of $510,000 related to interest rate swaps during the last quarter of 2001. We expect to save approximately $2.0 million on our un-hedged debt during the last quarter of 2001 due to lower interest rates, assuming debt levels and interest rates consistent with those at September 30, 2001 compared to December 31, 2000.

RISK MANAGEMENT POLICIES

We assess interest rate cash flow risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities.

We maintain risk management control systems 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 control systems involve the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on our future cash flows.

As of September 30, 2001, approximately 77% of our total debt outstanding was subject to un-hedged variable rates of interest. As a result, recent interest rate declines have resulted in a net reduction of our interest expense compared to what it would have been at similar debt levels with interest rates unchanged. We intend to continue to gradually hedge our interest rate exposure if market rates continue to decline.

BUSINESS

OVERVIEW

We are a leading operator of automotive franchise stores in the western United States. We sell new and used cars, light trucks and sport utility vehicles. We also provide vehicle maintenance, warranty and repair services and arrange financing, extended warranty and insurance contracts for our customers. We achieve gross margins above industry averages by selling a higher ratio of retail used vehicles to new vehicles and by arranging finance and extended warranty contracts for a greater percentage of our customers. In 2000 we achieved a gross margin of 16.1% compared with the industry average of 12.7%. We offer 24 brands of new vehicles, through 119 franchises in 63 stores. Our core markets are concentrated in the fastest growing regions in the United States with 15 stores in Oregon, 11 in California, 10 in Washington, 7 in Colorado, 7 in Idaho, 5 in Nevada, 3 in South Dakota, 3 in Texas and 2 in Alaska. Over 65% of our stores are located in markets where our store does not compete directly with any other franchised dealer selling the same brand.

We were founded in 1946. Our two senior executives have managed the company for more than 30 years. Since our initial public offering in 1996, we have grown from 5 to 63 stores primarily through an aggressive acquisition program, increasing annual revenues from $143 million in 1996 to $1.7 billion in 2000. We have achieved five-year compounded annual growth rates through December 31, 2000 of 85% for revenues, 75% for net income and 36% for earnings per share, together with a 6.9% average same store sales increase.

THE INDUSTRY

At approximately $1.0 trillion in annual sales, automotive retailing is the largest retail trade sector in the United States and comprises roughly 10% of the GDP. The industry is highly fragmented with the 10 largest automotive retailers generating approximately 4.0% of total industry revenues in 2000. The number of franchised stores has declined significantly since 1960 from more than 36,000 stores to approximately 22,000 in 2001. In the U.S., vehicles can be purchased from approximately 22,000 franchised dealers, 53,000 independent used vehicle dealers, or through casual (person to person) transactions. New vehicles can only be sold through automotive retail stores franchised by auto manufacturers. These franchise stores have designated trade territories under state franchise law protection which limits the number of new stores that can be opened in any given area.

Consolidation is expected to continue as many smaller dealerships are now being forced to consider selling or joining forces with larger dealership groups, given the large capital requirements necessary to operate in today's retail environment. With many dealer/owners reaching retirement age, many of whom have no clear succession plans, larger, well-capitalized automotive retail operators provide an attractive exit strategy. We believe these factors, in conjunction with an uncertain economic forecast, provide an attractive environment for continuing consolidation.

Unlike other retailing segments, auto manufacturers provide unparalleled support to the auto retailer. Manufacturers often bear the burden of markdown risks on slow-moving inventory as they provide aggressive dealer incentives to clear aged inventory in order to free the inventory pipeline for new dealer purchases. In addition, an auto retailer's net inventory investment is relatively small, given floor plan financing from manufacturers. Furthermore, manufacturers provide low-cost financing for working capital and acquisitions, credit to consumers to finance vehicle purchases as well as pay retail prices to dealers for servicing vehicles under manufacturers' warranties.

Sales in the automotive sector are affected by general economic conditions including rates of employment, income growth, interest rates, and general consumer sentiment. Since 1990, new vehicle revenues have grown at a 5.3% compound annual rate and used vehicles at a 4.7% compound annual rate. New and used unit sales however, have increased at a slower compound annual rate of 2.3% and 0.6%, respectively. Slower unit volume growth over this time period has been offset by rising prices associated with new vehicles and the higher prices paid for later model used vehicles, which now comprise a growing portion of the used vehicle market. New vehicle sales usually decline during a weak economy; however, the higher margin service and parts business typically benefits in the same environment because consumers tend to keep their vehicles

longer. Strong sales of new vehicles in recent years have provided a population of vehicles for future service and parts revenues. Automotive retailers benefit from their designation as an