

LITHIA MOTORS INC

FORM 10-K405

(Annual Report (Regulation S-K, item 405))

Filed 03/31/97 for the Period Ending 12/31/96

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

LITHIA MOTORS INC

FORM 10-K405

(Annual Report (Regulation S-K, item 405))

Filed 3/31/1997 For Period Ending 12/31/1996

Address	360 E JACKSON ST MEDFORD, Oregon 97501
Telephone	541-776-6899
CIK	0001023128
Industry	Retail (Specialty)
Sector	Services
Fiscal Year	12/31

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

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

For the Fiscal Year Ended: December 31, 1996

OR

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

COMMISSION FILE NUMBER: 000-21789

LITHIA MOTORS, INC.

(Exact name of registrant as specified in its charter)

OREGON
(State or other jurisdiction of incorporation
or organization)

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

360 E. JACKSON STREET, MEDFORD, OREGON
(Address of principal executive offices)

97501
(Zip Code)

541-776-6899

(Registrant's telephone number including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
CLASS A COMMON STOCK, WITHOUT PAR VALUE

(Title of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

The aggregate market value of the voting stock held by non-affiliates of the Registrant is \$25,773,750 as of February 28, 1997 based upon the last sales price (\$10.875) as reported by the Nasdaq National Market System.

The number of shares outstanding of the Registrant's Common Stock as of February 28, 1997 was: Class A: 2,895,550 shares and Class B: 4,110,000 shares.

The Index to Exhibits appears on page 22 of this document.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant has incorporated into Part III of Form 10-K, by reference, portions of its Information Statement, relating to the 1997 Annual Meeting of Shareholders.

LITHIA MOTORS, INC.
1996 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

FORWARD LOOKING STATEMENTS AND RISK FACTORS

This Form 10-K contains forward looking statements. These statements are necessarily subject to risk and uncertainty. Actual results could differ materially from those projected in these forward looking statements as a result of certain risk including those set forth in the Company's initial public offering prospectus dated December 18, 1996. These risk factors include, but are not limited to, the cyclical nature of automobile sales, the intense competition in the automobile retail industry and the Company's ability to negotiate profitable acquisitions and secure manufacturer approvals for such acquisitions.

INTRODUCTION

Lithia Motors, Inc. (the "Company" or "Lithia"), an Oregon corporation, was founded in 1946 and its two senior executives, Sidney B. DeBoer and M. L. Dick Heimann, have managed the Company's operations for over 25 years. Lithia is one of the larger retailers of new and used vehicles in the western United States, offering 16 domestic and imported makes of new automobiles and light trucks at eight locations. As an integral part of its operations, the Company arranges related financing and insurance and sells parts, service and ancillary products. Most of the Company's operations are currently located in Medford, Oregon, where it has a market share of over 40 percent. The Company has agreed to acquire certain assets and dealership operations from Magnussen Dodge Isuzu in Concord, California, and Magnussen - Barbee Ford, Lincoln Mercury in Napa, California.

DEALERSHIP OPERATIONS

The Company owns and operates eight dealership locations in Oregon, five in Medford and one each in Grants Pass and Eugene, Oregon and one in Vacaville, California. Each of the Company's dealerships sells new and used vehicles and related automotive parts and services. The Company's primary target market comprises middle-income customers seeking moderately-priced vehicles. The Company offers 16 makes of new vehicles, including Chrysler, Toyota, Plymouth, Dodge, Jeep/Eagle, Honda, Saturn, Mazda, Pontiac, Lincoln, Mercury, Isuzu, Suzuki, Kia and Volkswagen.

NEW VEHICLE SALES. The Company sells 16 domestic and imported brands ranging from economy to luxury cars, as well as sport utility vehicles, minivans and light trucks. The Company purchases substantially all of its new car inventory directly from manufacturers who allocate new vehicles to dealerships based on the amount of vehicles sold by the dealership and by the dealership's market area. The Company also exchanges vehicles with other dealers from time to time to accommodate customer demand and to balance inventory.

As required by law, the Company posts the manufacturer's suggested retail price on every new vehicle. As is customary in the automobile industry, the final sales price of a new vehicle is generally negotiated with the customer. However, at the Company's Saturn dealership, the final sales price does not deviate from the posted price. The Company is

continually evaluating its pricing practices and policies in light of changing consumer preferences and competitive factors.

The Company sells vehicles from the factory to a fleet purchaser utilizing

(i) "book only" fleet sales in which the Company never takes title of a vehicle; or (ii) fleet sales which pass through the Company's inventory. The Company realizes substantially less profit per vehicle on fleet sales than it does through retail sales. For "book only" fleet sales, only the net revenue is included in the Company's revenue.

USED VEHICLE SALES. The Company offers a variety of makes and models of used cars and light trucks of varying model years and prices. Used vehicle sales are an important part of the Company's overall profitability. The Company has made a strategic commitment to emphasize used vehicle sales. As part of its focus on used vehicle sales, the Company retains a full-time used vehicle manager at each of its locations and has allocated additional financing and display space to this effort. The Company believes there is substantial consumer demand for quality used vehicles, given the escalating prices of new vehicles.

The Company sells used vehicles to retail customers and, in the case of vehicles in poor condition or vehicles which have not sold within a specified period of time, to other dealers and to wholesalers.

The Company acquires the majority of its used vehicles through customer trade-ins. The Company also acquires its used vehicles at "closed" auctions which may be attended only by new vehicle dealers and which offer off-lease, rental and fleet vehicles, and at "open" auctions which offer repossessed vehicles and vehicles being sold by other dealers.

The Company sells the majority of its used vehicles to retail purchasers. In an effort to reach the Company's objective of two used vehicle sales for every new vehicle sale, the Company employs innovative marketing programs, such as "Priority You," which offers a 60-day/3,000-mile warranty and a 10-day/500-mile "no questions asked" exchange program on every used vehicle it sells in order to generate customer confidence in his or her purchasing decision. Each dealership's used vehicle manager is responsible for the purchasing and pricing of the used vehicle inventory. The Company strives to sell each of its used vehicles within 60 days of acquisition and financially motivates its used vehicle managers to effect such sales within that period.

VEHICLE FINANCING AND LEASING. The Company believes that its customers' ability to obtain financing at its dealerships is critical to its ability to sell new and used vehicles and ancillary products and services. The Company provides a variety of financing and leasing alternatives in order to meet the specific needs of each potential customer. The Company believes its ability to obtain customer-tailored financing on a "same day" basis provides it with an advantage over many of its competitors, particularly smaller competitors who lack the resources to offer vehicle financing or who do not generate sufficient volume to attract the diversity of financing sources that are available to the Company. Because of the high profit margins which are typically generated through sales of Financing and Insurance ("F&I") products, the Company employs more than one F&I manager at its dealership locations. The Company's F&I managers have extensive knowledge regarding available

financing alternatives and sources and are specially trained to determine the customer's financing needs to enable the customer to purchase or lease an automobile. The Company seeks to finance or arrange financing for every vehicle it sells and has financed or arranged financing for a larger percentage of its transactions than the industry average.

In most cases, the Company arranges financing for its customers from third party sources, which relieves the Company from any credit risk. However, in certain circumstances where the Company believes the credit risk is manageable and the risk-weighted income is expected to exceed the earnings available upon the immediate sale of the finance contract, the Company will directly finance or lease the automobile to such customer. In these cases, the Company bears the risk of default by the borrower or lessee. Historically, the Company has provided direct financing for a minimal number of its new and used vehicle sales. The Company intends to continue providing financing to certain of its customers and may gradually expand its direct financing operations in circumstances where it believes attractive returns can be achieved or other operational benefits can be obtained.

ANCILLARY SERVICES AND PRODUCTS. In addition to arranging for vehicle financing, the Company's F&I managers also market a number of ancillary products and services to every purchaser of a new or used vehicle. Typically, these products and services yield high profit margins and contribute significantly to the overall profitability of the Company.

The Company offers extended service contracts which provide that, for a predetermined and prepaid price, all designated repairs covered by the plan during its term will be made by the Company at no additional charge above the deductible. While all new vehicles are sold with the automobile manufacturer's standard warranty, service plans provide additional coverage beyond the time frame or scope of the manufacturer's warranty. Purchasers of used vehicles are offered a similar extended service contract, even if the selected vehicle is no longer under the manufacturer's warranty.

Substantially all extended service contracts sold are written by the Company. The Company manages the service and warranty obligations that it sells and provides the parts and service (or pays the cost of others who may provide such parts and services) for claims made under the contract. Most required services under the contracts are provided by the Company, thereby increasing the Company's sales of parts and service.

The Company offers its customers credit life, health and accident insurance when they finance an automobile purchase. The Company receives a commission on each policy sold. The Company also offers other ancillary products such as protective coatings and automobile alarms.

The Company also owns and operates two automobile rental facilities, Avis Rent-A-Car and Discount Auto & Truck Rental, Inc., both located in Medford, Oregon.

PARTS AND SERVICE, BODY AND PAINT SHOP. The Company considers its parts and service operations to be an integral part of its customer service program and an important element of establishing customer loyalty. The Company provides parts and service primarily for the new vehicle brands sold by the Company's dealerships but may also service other vehicles.

The parts and service business is relatively stable and provides an important recurring revenue stream to the Company's dealerships. The Company markets its parts and service products by notifying the owners of vehicles purchased at its dealerships when their vehicles are due for periodic service. This practice encourages preventive maintenance rather than post-breakdown repairs. To a limited extent, revenues from the parts and service department are countercyclical to new car sales as owners repair existing vehicles rather than buy new vehicles. The Company believes this helps mitigate the effects of a downturn in the new vehicle sales cycle.

The Company has in excess of 80 service bays throughout its network of dealerships. All service facilities are equipped with technologically advanced tools and diagnostic equipment and are staffed by factory-trained and certified service technicians. The Company's dealerships feature various combinations of fully-equipped service facilities capable of handling almost any type of vehicle repair, from rebuilding engines and transmissions to routine maintenance functions including oil changes, front-end alignments and inspections. All dealerships offer lounges where service customers may relax or conduct business while waiting for service to be performed.

The Company has operated a full-service body and paint shop since 1970. The body and paint shop services all of the Company's dealerships located in southwest Oregon, other dealerships in the area that do not own a body and paint shop, and a number of major automotive casualty insurance companies that contract with the Company to perform insurance repairs. The Company, through an affiliate, is constructing a new 39,480 square-foot body and paint facility in Medford, Oregon, to handle the increased demand for the Company's body and paint services. The new facility, to be completed in Spring 1997, will have four paint booths as well as the latest technology, tools and equipment.

SALES AND MARKETING

The Company emphasizes customer satisfaction throughout its organization and continually seeks to maintain its reputation for quality and fairness. The Company's sales force works closely with each customer to identify an appropriate vehicle at a price affordable to that customer. The Company believes that its "counseling" approach during the sales process increases the likelihood that a customer will be satisfied with the vehicle purchased over a longer time period and enables the Company to sell more vehicles at higher gross profit margins.

The Company recently implemented a marketing program entitled "Priority You," which provides the Company's retail customers six value-added services, which the Company believes are important to the overall satisfaction of the customer, including a commitment to (i) provide a customer credit check within 10 minutes, (ii) complete a used vehicle appraisal within 30 minutes, (iii) complete the paper work within 90 minutes for a vehicle purchase, (iv) provide a 10-day/500-mile "no questions asked" right of exchange on any used vehicle sold, (v) provide a 60-day/3,000-mile warranty on all used vehicles sold and (vi) make a donation to a local charity or educational organization for every vehicle sold. The Company believes "Priority You" will help differentiate it from traditional dealerships, and thereby increase customer traffic and develop customer loyalty.

Advertising and marketing play a significant role in the success of the Company. The competitive environment of the automobile dealership industry requires that a substantial portion of each sales dollar be allocated to advertising. However, as is the case with most new automobile dealerships, the Company believes that approximately 75 percent of the Company's advertising and marketing expenses are paid for by the automobile manufacturers. The manufacturers also provide the Company with the benefit of market research, which assists the Company in developing its own advertising and marketing campaigns. The Company believes that it receives significant benefit from manufacturers' advertising, particularly in the medium-sized markets in which the Company has been the only representative of a manufacturer.

RELATIONSHIPS WITH AUTOMOBILE MANUFACTURERS

The Company has, either directly or through its subsidiaries, entered into franchise or dealer sales and service agreements with each manufacturer of the new vehicles it sells. The Company currently has agreements with Chrysler Corporation (Chrysler, Plymouth, Dodge, Jeep/Eagle), American Honda Motor Co. Inc. (Honda), American Isuzu Motors, Inc. (Isuzu), Ford Motor Company (Lincoln, Mercury), General Motors Corporation (Pontiac), Mazda Motor of America, Inc. (Mazda), Saturn Corporation (Saturn), Toyota Motor Distributors, Inc. (Toyota), American Suzuki Motor Corporation (Suzuki), Kia America Motors, Inc. (Kia) and Volkswagen of America (Volkswagen) (herein collectively referred to as "manufacturers").

The typical automobile franchise agreement specifies the locations at which the dealer has the right and the obligation to sell vehicles and related parts and products and to perform certain approved services in order to serve a specified market area. The designation of such areas and the allocation of new vehicles among dealerships are subject to the discretion of the manufacturer, which (except for Saturn) does not guarantee exclusivity within a specified territory. A franchise agreement may impose requirements on the dealer concerning such matters as the showroom, the facilities and equipment for servicing vehicles, the maintenance of inventories of vehicles and parts, the maintenance of minimum working capital, the training of personnel and the adherence to certain performance standards established by the manufacturer regarding sales volume and customer satisfaction. Compliance with these requirements is closely monitored by each manufacturer. In addition, manufacturers require each dealership to submit monthly and annual financial statements of operations. The franchise agreements also grant the dealer the non-exclusive right to use and display manufacturers' trademarks, service marks and designs in the form and manner approved by each manufacturer.

Most franchise agreements expire after a specified period of time, ranging from one to five years; however, some franchise agreements, including those with Chrysler, have no termination date. The typical franchise agreement provides for early termination or non-renewal by the manufacturer under certain circumstances such as change of management or ownership without manufacturer consent, insolvency or bankruptcy of the dealership, death or incapacity of the dealer manager, conviction of a dealer manager or owner of certain crimes, misrepresentation of certain information by the dealership, dealer manager or owner to the manufacturer, failure to adequately operate the dealership, failure to maintain any license, permit or authorization required for the conduct of business, or a material breach of other provisions of the franchise agreement including the dealership's

poor sales performance or low CSI ratings. The dealer is typically entitled to terminate the franchise agreement at any time without cause.

Each franchise agreement sets forth the name of the person approved by the manufacturer to exercise full managerial authority over the dealership's operations and the names and ownership percentages of the approved owners of the dealership, and contains provisions requiring the manufacturer's prior approval of changes in management or transfers of ownership of the dealership. Accordingly, any significant change in ownership, including the sale of shares by the Company to the public or the acquisition of a dealership from a third party, is subject to the consent of the respective manufacturer.

COMPETITION

The new and used automobile dealership business in which the Company operates is highly competitive. The automobile dealership industry is fragmented and characterized by a large number of independent operators, many of whom are individuals, families and small groups. In the sale of new vehicles, the Company principally competes with other new automobile dealers in the same general vicinity of the Company's dealership locations. Such competing dealerships may offer the same or different models and makes of vehicles that the Company sells. In the sale of used vehicles, the Company principally competes with other used automobile dealers and with new automobile dealers that operate used automobile lots in the same general vicinity of the Company's dealership locations. The Company believes that there are approximately 14 other new automobile dealerships and 66 other used automobile stores within a 50-mile radius of Medford, Oregon, near which all but one of the Company's dealerships are currently located. In addition, certain regional and national car rental companies operate retail used car lots to dispose of their used rental cars.

The Company also may face increased competition from certain automobile "superstores," such as CarMax, AutoNation USA and Driver's Mart Worldwide Inc. Such used automobile superstores have emerged recently in various areas of the United States and are beginning to expand nationally. However, the Company is not aware of any of such superstores currently located in any region where the Company operates dealerships. In addition, the Company competes to a lesser extent with an increasing number of automobile dealers that sell vehicles through nontraditional methods, such as through direct mail or via the Internet.

Due to the size and number of the automobile dealerships that the Company owns, the Company is relatively larger than the independent operators with which it currently competes. However, as it enters other markets, the Company may face competitors that are much larger and that have access to greater financial resources. Historically, the Company's size has permitted it to attract experienced and professional sales and service personnel and has provided the Company the resources to compete effectively. The Company, however, does not have any cost advantage in purchasing new vehicles from manufacturers and typically relies on advertising and merchandising, sales expertise, service reputation and location of its dealerships to sell new vehicles.

REGULATION

The Company's operations are subject to extensive regulation, supervision and licensing under various federal, state and local statutes, ordinances and regulations. Various state and federal regulatory agencies, such as OSHA and the EPA have jurisdiction over the operation of the Company's dealerships, repair shops, body shops and other operations, with respect to matters such as consumer protection, workers' safety and laws regarding clean air and water.

The relationship between a franchised automobile dealership and a manufacturer is governed by various federal and state laws established to protect dealerships from the generally unequal bargaining power between the parties. Federal laws, as well as Oregon and California state laws, prohibit a manufacturer from terminating or failing to renew a franchise without good cause. Under Oregon and California law, a manufacturer may not require a dealer to accept any vehicle, part or accessory not voluntarily ordered by the dealer, to refuse to deliver any new vehicle, part or accessory advertised by the manufacturer as available, or to require monetary participation in any sales promotion or advertising campaign. Manufacturers are also prohibited from preventing or attempting to prevent any reasonable changes in the capital structure or the manner in which a dealership is financed. Further, Oregon law prohibits a manufacturer from failing to give effect to, or attempting to prevent, the sale of the ownership or management, or an interest in the ownership or management, of a dealership. Under California law, a dealer, or any officer, partner or stockholder may sell or transfer any interest in the dealership business provided that the sale or transfer of such interest does not have the effect of a sale or transfer of the franchise, without the consent of the manufacturer. Manufacturers are, however, entitled to object to a sale or change of management where such an objection is related to material reasons relating to the character, financial ability or business experience of the proposed transferee. In both Oregon and California, a dealer is entitled to seek judicial relief to prevent a manufacturer from establishing a competing dealership of the same vehicle make within the dealer's relevant market area.

Automobile dealers and manufacturers are also subject to various federal and state laws established to protect consumers, including so-called "Lemon Laws" which require a manufacturer or the dealer to replace a new vehicle or accept it for a full refund within one year after initial purchase if the vehicle does not conform to the manufacturer's express warranties and the dealer or manufacturer, after a reasonable number of attempts, is unable to correct or repair the defect. Federal laws require certain written disclosures to be provided on new vehicles, including mileage and pricing information. In addition, the financing and insurance activities of the Company are subject to certain statutes governing credit reporting, debt collection and insurance industry regulation.

The imported automobiles purchased by the Company are subject to United States customs duties and, in the ordinary course of its business, the Company may, from time to time, be subject to claims for duties, penalties, liquidated damages, or other charges. Currently, United States customs duties are generally assessed at 2.5 percent of the customs value of the automobiles imported, as classified pursuant to the Harmonized Tariff Schedule of the United States.

As with automobile dealerships generally, and parts, service and body shop operations in particular, the Company's business involves the use, handling and contracting for recycling or disposal of hazardous or toxic substances or wastes, including environmentally sensitive materials such as motor oil, waste motor oil and filters, transmission fluid, antifreeze, freon, waste paint and lacquer thinner, batteries, solvents, lubricants, degreasing agents, gasoline and diesel fuels. The Company has also been required to remove aboveground and underground storage tanks containing such substances or wastes. Accordingly, the Company is subject to regulation by federal, state and local authorities establishing health and environmental quality standards, and liability related thereto, and providing penalties for violations of those standards. The Company is also subject to laws, ordinances and regulations governing remediation of contamination at facilities it operates or to which it sends hazardous or toxic substances or wastes for treatment, recycling or disposal. The Company believes that it does not have any material environmental liabilities and that compliance with environmental laws, ordinances and regulations will not, individually or in the aggregate have a material adverse effect on the Company's results of operations or financial condition.

EMPLOYEES

As of December 31, 1996, the Company employed approximately 420 persons on a full-time equivalent basis. None of the Company's employees is represented by a labor union or bound by a collective bargaining agreement. The Company believes it has a good relationship with its employees.

ITEM 2. PROPERTIES

The Company and its various dealerships and other facilities occupy an aggregate of approximately 39 acres of land, providing approximately 283,000 square feet of building space. Such properties consist primarily of automobile showrooms, display lots, service facilities, two body and paint shops, rental agencies, supply facilities, automobile storage lots, parking lots and offices. The Company believes its facilities are currently adequate for its needs and are in good maintenance and repair.

The following table sets forth each of the Company's facilities, the approximate square footage at each facility and the acreage of each location. All facilities are located in Medford, Oregon except for the Grants Pass Auto Center, located in Grants Pass, Oregon, Lithia Dodge of Eugene, in Eugene, Oregon and Lithia Toyota Kia of Vacaville, located in Vacaville, California. The Vacaville and the Avis Rent-A-Car facilities and minor parcels of land are leased from third parties and the new body and paint facility, the vacant parcel to be held for future expansion and the Lithia Dodge of Eugene facility are owned by the Company. All other facilities are leased from Lithia Properties, LLC, an Oregon limited liability company owned by certain affiliates of the Company.

DEALERSHIP/FACILITY -----	TOTAL BUILDING/ SQUARE FT. -----	TOTAL LAND/ ACRES -----
Lithia Motors	5,255	0.51
Lithia Honda Pontiac Suzuki Isuzu Volkswagen	32,978	4.47
Lithia Toyota Lincoln Mercury	35,849	3.92
Lithia Dodge Chrysler Plymouth Mazda Jeep/Eagle	45,596	4.12
Saturn of Southwest Oregon	11,226	2.33
Grants Pass Auto Center (Dodge)	27,978	3.69
Lithia Toyota Kia of Vacaville	22,900	4.18
Lithia Dodge of Eugene	24,996	3.68
Lithia Body & Paint(1)	20,508	0.95
Lithia Body & Paint(2)	41,729	5.01
Thrift Auto Supply	11,230	0.46
Discount Auto & Truck Rental	278	--
Cellular World	1,850	--
Avis Rent-A-Car	630	--
Vacant Parcel(3)	--	5.32

(1) A new facility is under construction. The current facility will be absorbed and utilized by the Lithia Dodge Chrysler Plymouth Mazda Jeep/Eagle dealership.

(2) Under construction. Expected to be occupied Spring 1997.

(3) Held for future development.

ITEM 3. LEGAL PROCEEDINGS

The Company is, from time to time, a party to litigation that arises in the normal course of its business operations. The Company does not believe it is presently a party to litigation that will have a material adverse effect on its business or operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company's shareholders during the quarter ended December 31, 1996.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Class A Common Stock trades on The Nasdaq National Market System under the symbol LMTR. The high and low sales prices of the Company's Common Stock for the period from December 18, 1996 (the date of the Company's initial public offering) through December 31, 1996 were as follows:

1996	High	Low
Quarter 4 (from December 18, 1996)	\$11.50	\$10.94

The number of shareholders of record of the Company's Class A Common Stock at February 28, 1997 was 36. All shares of the Company's Class B Common Stock is held by Lithia Holding Company LLC. There were no cash dividends declared or paid subsequent to the Company's initial public offering in December 1996. The Company does not anticipate declaring cash dividends in the foreseeable future.

On April 5, 1996, the Company issued 4,110,000 shares of Class B Common Stock pursuant to the terms of a Plan of Recapitalization under which Sidney B. DeBoer exchanged 75 shares of the Company's Common Stock for 2,568,750 shares of Class B Common Stock and M. L. Dick Heimann exchanged 45 shares of the Company's Common Stock for 1,541,250 shares of Class B Common Stock. The issuance of these securities was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

ITEM 6. SELECTED FINANCIAL DATA

(In thousands, except per share amounts)	1996	1995	1994	1993	1992
CONSOLIDATED STATEMENT OF OPERATIONS DATA					
Sales					
New vehicles	\$ 65,093	\$ 53,277	\$ 51,154	\$ 42,663	\$ 34,479
Used vehicles	58,609	44,061	42,381	34,986	29,930
Other operating revenues	19,142	16,858	15,888	14,590	15,030
Total sales	142,844	114,196	109,423	92,239	79,439
Cost of sales	118,647	93,132	90,324	74,780	65,417
Gross profit(1)	24,197	21,064	19,099	17,459	14,022
Selling, general and administrative(2)	20,277	16,735	15,174	15,122	14,124
Operating income (loss)	3,920	4,329	3,925	2,337	(102)
Interest income	193	179	99	216	161
Interest expense	(1,353)	(1,390)	(954)	(1,374)	(743)
Other income, net	1,156	1,035	902	607	1,200
Income before minority interest and income taxes	3,916	4,153	3,972	1,786	516
Minority interest in earnings	(687)	(778)	(458)	(233)	(168)
Income before taxes	3,229	3,375	3,514	1,553	348
Income tax benefit	813	--	--	--	--
Net income(1)(2)	4,042	3,375	3,514	1,553	348

(In thousands, except per share amounts)	1996	1995	1994	1993	1992

PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS DATA					
Income before taxes and minority interest, as reported	\$ 3,916	\$ 4,153	\$ 3,972	\$ 1,786	
Pro forma provision for taxes(3)	(1,521)	(1,598)	(1,521)	(697)	
Pro forma minority interest	(421)	(479)	(283)	(142)	
	-----	-----	-----	-----	-----
Pro forma net income	1,974	2,076	2,168	947	
	-----	-----	-----	-----	-----
Pro forma net income per share	\$ 0.40	\$ 0.42			
	-----	-----			
Shares used in per share calculations(4)	4,973	4,893			
	-----	-----			
CONSOLIDATED BALANCE SHEET DATA					
Working capital	\$ 20,221	\$ 5,026	\$ 6,034	\$ 13	\$ 1,369
Total assets	63,754	39,578	36,659	33,381	24,955
Long-term debt, less current maturities	6,160	10,743	6,748	3,789	4,012
Total shareholders' equity	24,736	851	2,80	31,184	1,238

(1) The Company utilizes and reports on the LIFO (Last In - First Out) method of accounting. The industry standard is to utilize the specific identification method of accounting for vehicles and the FIFO (First In - First Out) method of accounting for parts (collectively referred to as the "FIFO Method"). If the Company utilized the FIFO Method, gross profit for the five years ended December 31, 1996 would have been \$24.5 million, \$20.6 million, \$19.7 million, \$18.0 million and \$14.5, respectively. Net income for the five years ended December 31, 1996 would have been \$4.4 million, \$2.9 million, \$4.1 million, \$2.1 million and \$733,000, respectively.

(2) Prior to 1994, the Company and its affiliated entities paid cash bonuses to their shareholders and members in amounts approximating their respective income tax liability on their undistributed earnings (\$1.0 million in 1993 and \$640,000 in 1992), in addition to their normal salaries. These cash bonuses are reflected in the selling, general and administrative expense above. In 1994 and subsequent periods, cash to meet the shareholders' and members' tax liabilities was distributed to the shareholders and members as dividends. The Company believes that for a fair evaluation of its historical performance, results for 1992 and 1993 should be adjusted to eliminate such bonus payments.

(3) The Company was an S Corporation prior to December 18, 1996 and accordingly was not subject to federal and state income taxes during the periods indicated. Pro forma net income reflects federal and state income taxes as if the Company had been a C Corporation, based on the effective tax rates that would have been in effect during these periods. See Notes 1 and 10 to the Company's Consolidated Financial Statements.

(4) See Note 1 to the Company's Consolidated Financial Statements for the calculation of weighted average shares outstanding.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following should be read in conjunction with the Consolidated Financial Statements of the Company and the notes thereto included elsewhere in this Form 10-K.

GENERAL

Lithia Motors is one of the larger retailers of new and used vehicles in the western United States, offering 16 domestic and imported makes of new automobiles and light trucks at eight locations. As an integral part of its operations, the Company arranges related financing and insurance and sells parts, service and ancillary products. Most of the Company's operations are currently located in Medford, Oregon, where it has a market share of over 40 percent. The Company has grown primarily by successfully acquiring and integrating dealerships and by obtaining new dealer franchises. The Company's strategy is to become a leading acquirer of dealerships in medium-sized markets in the western United States.

The following table sets forth selected condensed financial data expressed as a percentage of total sales for the periods indicated for the average automotive dealer in the United States (1996 data is not yet available).

AVERAGE U.S. DEALERSHIP STATEMENT OF OPERATIONS DATA:	YEAR ENDED DECEMBER 31,	
	1995	1994
Sales:		
New vehicles	58.6%	60.3%
Used vehicles	29.0	26.9
Parts and service, other	12.4	12.8
Total sales	100.0%	100.0%
Gross profit	12.9	13.1
Total dealership expense	11.5	11.3
Income before taxes	1.4%	1.8%

Source: AUTOMOTIVE EXECUTIVE/August 1996; NADA Industry Analysis Division

THE COMPANY

The Company and its affiliated entities have been treated for federal income tax purposes as S Corporations or as partnerships under the Internal Revenue Code since their inception and, as a result, have not been subject to federal or certain state income taxes. Immediately before the completion of the Company's initial public offering on December 18, 1996 and in connection with its restructuring, the Company and its affiliated entities that were S Corporations terminated their status as S Corporations and became subject to federal and state income tax at applicable C Corporation rates. Prior to 1994, the shareholders and members of the Company and the affiliated entities each received substantial year-end tax payment bonuses to provide the cash to pay income taxes on the Company's and affiliated entities income which was taxable to the principals.

The Company utilizes the LIFO (Last In-First Out) method of accounting for inventory ("LIFO Method"). Industry standard is to use the specific identification method of accounting for vehicles and the FIFO (First In-First Out) method of accounting for parts (herein collectively referred to as the "FIFO Method"). For industry comparability purposes, the following discussion and analysis of financial condition and results of operations includes references to both the LIFO and FIFO Methods of accounting.

The following table sets forth selected condensed financial data for the Company expressed as a percentage of total sales for the periods indicated below. Gross profit and pre-tax profit margins are presented on the LIFO Method and before minority interest.

LITHIA MOTORS, INC.

YEAR ENDED DECEMBER 31,

	1996	1995	1994
	-----	-----	-----
STATEMENT OF OPERATIONS DATA:			
Sales:			
New vehicles	45.6%	46.6%	46.8%
Used vehicles	41.0	38.6	38.7
Parts and service	9.2	9.6	9.1
Finance, insurance and other	4.2	5.2	5.4
	-----	-----	-----
Total sales	100.0%	100.0%	100.0%
Gross profit	16.9	18.4	17.5
Selling, general and administrative	14.2	14.6	13.9
	-----	-----	-----
Operating income	2.7	3.8	3.6
Other income (expense), net	--	(0.2)	0.0
	-----	-----	-----
Income before taxes and minority interest	2.7%	3.6%	3.6%
	-----	-----	-----

The following table sets forth selected condensed financial data for the Company expressed as a percentage of total sales for the periods indicated below. Gross profit and pre-tax profit margins are presented on the FIFO Method and before minority interest to permit comparisons to U.S. industry data.

YEAR ENDED DECEMBER 31,

	1996	1995	1994
STATEMENT OF OPERATIONS DATA:			
Total sales	100.0%	100.0%	100.0%
Gross profit(1)	17.2	18.1	18.0
Selling, general and administrative	14.2	14.7	13.9
Operating income(1)	3.0	3.4	4.1
Other income (expense), net	--	(0.2)	0.1
Income before taxes and minority interest(1)	3.0%	3.2%	4.2%

(1) Using the FIFO Method of accounting for inventory to permit comparisons to U.S. industry data.

RESULTS OF OPERATIONS

1996 COMPARED TO 1995

Net sales for the Company increased \$28.6 million, or 25 percent, to \$142.8 million for the year ended December 31, 1996 from \$114.2 million for 1995. Total vehicles sold during 1996 increased by 1,921, or 24 percent, to 9,780 in 1996 from 7,859 during 1995. The increase in sales was primarily from increased new and used vehicle unit sales as a result of increased levels of promotional activity for certain popular brands, increased availability of late model used vehicles (both retail and wholesale) which were in high demand and, although to a lesser extent, from increased average per unit sales prices on both new and used vehicles. Sales in the third and fourth quarters of 1996 were also slightly higher due to a hail storm that mildly damaged vehicles in the Company's lots in and around Medford, Oregon. Such vehicles were sold at reduced prices, increasing unit sales, but decreasing the gross margin percentage.

NEW VEHICLE SALES. The Company sells 16 domestic and imported brands ranging from economy to luxury cars, as well as sport utility vehicles, minivans and light trucks. In 1996 and 1995, the Company sold 3,272 and 2,715 new vehicles, generating revenues of \$65.1 million and \$53.2 million, which constituted 45.6 percent and 46.6 percent of the Company's total revenues, respectively. The gross profit margin achieved by the Company (on the FIFO Method) on new vehicle sales during 1996 and 1995 was 13.1 percent and 12.8 percent, respectively. The average gross profit margin obtained by franchised automobile dealers in the United States on sales of new vehicles has declined from over 7.0 percent in 1991 to 6.5 percent in 1995.

The Company purchases substantially all of its new car inventory directly from manufacturers who allocate new vehicles to dealerships based on the amount of vehicles sold by the dealership and by the dealership's market area. The Company will also exchange vehicles with other dealers to accommodate customer demand and to balance inventory.

The Company sells vehicles from the factory to a fleet purchaser utilizing (i) "book only" fleet sales in which the Company never takes title of a vehicle; or (ii) fleet sales which pass

through the Company's inventory. The Company realizes substantially less profit per vehicle on fleet sales than it does through retail sales. For "book only" fleet sales, only the net revenue is included in the Company's revenue.

USED VEHICLE SALES. The Company offers a variety of makes and models of used cars and light trucks of varying model years and prices. Used vehicle sales are an important part of the Company's overall profitability. In 1996 and 1995, the Company sold 6,508 and 5,144 used vehicles generating revenues of \$58.6 million and \$44.1 million, which constituted 41.0 percent and 38.6 percent of the Company's total revenue, respectively. The Company has made a strategic commitment to emphasize used vehicle sales. As part of its focus on used vehicle sales, the Company retains a full-time used vehicle manager at each of its locations and has allocated additional financing and display space to this effort. The Company believes there is substantial consumer demand for quality used vehicles, given the escalating prices of new vehicles.

The Company sells used vehicles to retail customers and, in the case of vehicles in poor condition or vehicles which have not sold within a specified period of time, to other dealers and to wholesalers. Sales to other dealers and to wholesalers are frequently at, or close to, cost and therefore affect the Company's overall gross profit margin on used vehicle sales. Excluding wholesale transactions, the Company's gross profit margin (on the FIFO Method) on used vehicle sales was 13.4 percent in 1996 and 13.5 percent in 1995, as compared to the industry average for 1995 of 11.5 percent.

SERVICE, BODY, PARTS AND OTHER. The Company's service, body, parts and other operating revenue increased 13.0 percent to \$19.1 million during 1996, from \$16.9 million during 1995, due to an increased number of F&I transactions and to a lesser extent, an increase in revenues derived from service department maintenance and repairs. To a limited extent, revenues from the parts and service department are countercyclical to new car sales as owners repair existing vehicles rather than buy new vehicles. The Company believes this helps mitigate the affects of a downturn in the new vehicle sales cycle.

GROSS PROFIT. Gross profit (on the LIFO Method) increased 14.9 percent during 1996 to \$24.2 million, compared with \$21.1 million for 1995, primarily due to an increase in new and used vehicle unit sales during the period. Gross profit margin decreased to 16.9 percent for 1996 from 18.5 percent for 1995. The decrease in gross profit margins is primarily due to a reduction in gross profit margins on used vehicle sales, mostly caused by a shift in the overall mix of vehicles sold, with an increase in wholesale vehicles, which typically provide profit margins of only 2 percent to 3 percent. Gross profit margin in 1995 was favorably impacted by the reduction in new vehicle inventory during the period which resulted in historically lower vehicle inventory costs flowing through cost of sales. The Company's gross profit margins continue to exceed industry standards and remain in line with historical gross profit margins.

Gross profit (on the FIFO Method) increased 18.9 percent during 1996 to \$24.5 million, compared with \$20.6 million for 1995, primarily because of the increase in new and used vehicle unit sales during the period. Gross profit margin decreased to 17.2 percent for 1996 from 18.1 percent for 1995. The decrease in gross profit margins is primarily due to a reduction in gross profit margins on used vehicle sales, mostly caused by a shift in the

overall mix of vehicles sold, with an increase in wholesale vehicles, which typically provide profit margins of only 2 percent to 3 percent.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE. The Company's SG&A expense increased \$3.6 million, or 21.6 percent, to \$20.3 million for 1996 compared to \$16.7 million for 1995. SG&A as a percentage of sales decreased to 14.2 percent for 1996 from 14.7 percent for 1995. The increase in SG&A was due primarily to increased selling, or variable, expense related to the increase in sales, and to a lesser extent, an increase in compensation for additional personnel and management in preparation for acquisitions.

INTEREST EXPENSE. The Company distributed to the Principal Owners promissory notes ("Dividend Notes") in the aggregate amount of \$3.9 million, representing approximately all of the previously taxed undistributed earnings of the Company through December 31, 1995. The Company's interest expense remained stable at \$1.4 million for 1996 and 1995 as a result of such increase in the Dividend Notes outstanding for 1996, offset by a decrease in interest rates during 1996.

OTHER INCOME, NET. Other income, net, consisting primarily of management fees from Lithia Properties, equity in the income of Lithia Properties and other non-dealer service income, increased 14.9 percent to \$1.1 million for 1996 from \$1.0 million for 1995. This increase was primarily due to insurance proceeds received in 1996 related to damage caused by a hail storm.

INCOME TAX BENEFIT. The Company and its affiliated entities have been treated for federal income tax purposes as S Corporations or as partnerships under the Internal Revenue Code since their inception and, as a result, have not been subject to federal or certain state income taxes. Immediately before the completion of the Company's initial public offering on December 18, 1996 and in connection with its restructuring, the Company and its affiliated entities that were S Corporations terminated their status as S Corporations and became subject to federal and state income tax at applicable C Corporation rates. As a result of the conversion from S Corporation status to C Corporation status in December 1996, the Company recorded a deferred tax asset of \$906,000 and a corresponding benefit of \$906,000 to income taxes in the fourth quarter of 1996.

Prior to 1994, the shareholders and members of the Company and the affiliated entities each received substantial year-end tax payment bonuses to provide the cash to pay income taxes on the Company's and affiliated entities income which was taxable to the principals. Such payments were reflected in SG&A expense.

NET INCOME. If the FIFO Method of inventory accounting had been used by the Company in prior periods, income before taxes and minority interest would have been higher (lower) by \$314,000 and \$(426,000) for the years ended December 31, 1996 and 1995, respectively, from the reported results under the LIFO Method.

1995 COMPARED TO 1994

REVENUES. Revenue increased \$4.8 million, or 4.4 percent, to \$114.2 million in 1995 from \$109.4 million in 1994. New vehicle revenue increased 4.2 percent, while used vehicle revenue increased 4.0 percent. The increase in sales was due to per-unit price increases in new and used vehicles, offset in part by a reduction in unit sales of 1.1 percent. Industry and Company unit sales were essentially flat from 1994 to 1995.

The Company's other operating revenue increased 6.1 percent to \$16.9 million in 1995 compared to \$15.9 million in 1994, primarily due to an increase in revenues derived from service department maintenance and repairs.

GROSS PROFIT. Gross profit (on the LIFO Method) increased 10.3 percent in 1995 to \$21.1 million from \$19.1 million in 1994. Gross profit margin increased to 18.4 percent in 1995 from 17.5 percent in 1994. Gross profit margin in 1995 was favorably impacted by the reduction in new vehicle inventory during the period which resulted in historically lower vehicle inventory costs flowing through cost of sales.

Gross profit (on the FIFO Method) increased 4.6 percent in 1995 to \$20.6 million from \$19.7 million in 1994. Gross profit margin, at 18.1 percent, was essentially unchanged from 1994. Increases in gross profit margin on new vehicle sales were offset by a reduction in the gross profit margin on used vehicles and parts and service sales.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE. The Company's SG&A expense increased \$1.5 million, or 10.3 percent, to \$16.7 million, or 14.7 percent of the Company's revenue, in 1995, from \$15.2 million, or 13.9 percent of the Company's revenues, in 1994. A reserve for workers' compensation claims, expense associated with compensation, primarily from salaries and bonuses for the Company's managers, and, to a lesser extent, an increase in advertising expense accounted for a significant portion of the increase.

INTEREST EXPENSE. The Company's interest expense in 1995 increased 41.6 percent to \$1.4 million from \$954,000 in 1994. The increase was due primarily to an increase in the Company's average loan balances in 1995 as compared to 1994, and, to a lesser extent, an increase in interest rates on borrowed funds. Loan balances increased to support increased flooring of inventory, vehicles leased to others and notes to the Principal Owners incurred during the period.

OTHER INCOME, NET. Other income, net, consisting primarily of management fees from Lithia Properties, equity in the income of Lithia Properties and other non-dealer service income, increased 14.7 percent to \$1.0 million for 1995 from \$902,000 in the prior year. This increase is attributable primarily to receipt of a judgment in a lawsuit brought by the Company.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 1996 the Company had working capital of \$20.2 million, which included \$15.4 million of cash. The \$5.7 million increase in cash is mainly as a result of \$24.2 million, net of associated expenses, provided by the issuance of the Company's Class A Common Stock in its initial public offering on December 18, 1996, \$1.5 million provided by operations, offset by \$6.9 million used for acquisitions, \$7.6 million net payments on long-

term debt and \$6.4 million for the distribution of dividends. The current ratio at December 31, 1996 and 1995 was 1.7:1 and 1.2:1, respectively.

Inventories increased \$10.5 million to \$28.2 million at December 31, 1996 from \$17.7 million at December 31, 1995 due primarily to the increase in the number of dealerships to 8 at December 31, 1996 from 6 at December 31, 1995, as well as same store growth.

The Company's principal needs for capital resources are to finance acquisitions, capital expenditures and increased working capital requirements. Historically, the Company has relied primarily upon internally generated cash flows from operations, borrowings under its credit facility and borrowings from its shareholders to finance its operations and expansion.

The Company currently has a credit facility with U.S. Bank, giving the Company access to an aggregate of approximately \$44.7 million of credit for various purposes. The principal component of the credit facility is the Flooring Line which permits the Company to borrow up to \$27.9 million, based on the level of the new and used vehicle inventories securing the line. The Flooring Line bears interest at rates from prime (for new vehicles) to prime plus 0.5% (for used vehicles). At December 31, 1996, the annualized rates of interest on the Flooring Line were from 8.25% to 8.75%. The principal payments are due within five business days of an automobile being sold. The Flooring Line also permits the Company to borrow at the U.S. Bank's Interbank Offering Rate, which is the rate offered to U.S. Bank for U.S. dollar deposits in the Eurodollar market selected by U.S. Bank. These borrowings are available only in increments of \$500,000 and cannot be prepaid before the end of their terms (typically, 60 or 90 days) without substantial penalty. The rate is generally one percentage point less than the standard rate available under the Flooring Line. The Flooring Line expires on September 10, 1997. Management believes that the Flooring Line provides the Company with financing at rates lower than those available from manufacturers. At December 31, 1996, there was approximately \$8.3 million available to the Company under the Flooring Line.

The credit facility provides a \$7.5 million line of credit to finance the purchase of vehicles used in the Company's fleet leasing and automobile rental businesses, at up to 105% of invoice for new vehicles, and 100% of KELLY WHOLESale BLUE BOOK price for used vehicles. This line of credit bears interest at prime plus 1.0% for fleet leases, and at prime plus 0.25% for rental vehicles. For either program, used vehicles over two years old are financed at prime plus 1.5%. An additional \$1.0 million is available under the credit facility for the purpose of in-house financing of vehicle sales and in-house leases (subject to a maximum amount equal to 75% of the total in-house vehicle receivables under 60 days past due). The borrowings under this line of credit, \$5.2 million at December 31, 1996, bear interest at prime plus 0.75% (9.0% at December 31, 1996). An additional line of credit of \$2.15 million is available for the purchase of equipment, \$1.4 million of which is available for purchasing equipment associated with future or pending acquisitions. The borrowings under this line of credit totaled \$126,000 at December 31, 1996 and bear interest at prime plus 0.5% (8.75% at December 31, 1996).

The credit facility also includes the Capital Line, a line of credit of \$6.0 million to finance acquisitions. The Capital Line bears interest at prime plus 0.75% and is secured by the Company's inventory, receivables, equipment and real property. During the first year in

which the Capital Line is used, interest only is payable monthly. After the first year, monthly payments are based on a ten-year amortization, with final payment due five years from the first draw. As of December 31, 1996, there were no borrowings under the Capital Line.

Long-term debt, including current portion, decreased \$4.8 million to \$8.0 million at December 31, 1996 from \$12.8 million at December 31, 1995, primarily as a result of payments made to shareholders and other affiliated parties related to prior undistributed Subchapter S earnings. At December 31, 1996, long-term debt, including current portion, consisted of \$1.8 million real estate loan for Lithia Dodge of Eugene, Oregon, \$5.7 million for vehicles leased to others and \$500,000 for equipment notes.

Capital expenditures, exclusive of acquisitions, were \$395,000 in 1996. The principal capital expenditures in 1996 included equipment, building improvements and computer equipment for use in the Company's dealerships.

The following table sets forth the estimated funds required to complete currently pending acquisitions. Acquisition costs are estimates as the actual purchase prices will depend on inventory levels at each acquired dealership upon closing. Estimates assume the purchase of used vehicles at each store location.

ACQUISITIONS	TOTAL ESTIMATED PURCHASE PRICE
-----	-----
Magnussen Dodge Isuzu	\$7,900,000
Magnussen - Barbee Ford, Lincoln Mercury	\$6,900,000

The Company anticipates that it will be able to satisfy its cash requirements through December 31, 1997, including its currently anticipated growth, primarily with cash flow from operations, borrowings under the Flooring Line and the Company's other lines of credit and the proceeds from its initial public offering in December 1996. However, if acquisition opportunities exceed current projections, further capital could be required.

SEASONALITY AND QUARTERLY FLUCTUATIONS

Historically, the Company's sales have been lower in the fourth quarter of each year largely 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 for the Company is generally lower during the fourth quarter than during the other quarters of each fiscal year; however, this did not hold true for the years 1996 and 1995. Management believes that interest rates, levels of consumer debt, consumer buying patterns and confidence, as well as general economic conditions, may also contribute to fluctuations in sales and operating results. The timing of acquisitions may cause substantial fluctuations of operating results from quarter to quarter.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY FINANCIAL DATA

The financial statements and notes thereto required by this item are included on pages F-1 through F-26 as listed in Item 14 of Part IV of this document.

Quarterly financial data, on the LIFO Method, pro forma for income taxes, for each of the eight quarters in the two year period ended December 31, 1996 is as follows:

IN THOUSANDS, EXCEPT PER SHARE DATA	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER
-----	-----	-----	-----	-----
1996				

Net sales	\$32,446	\$36,680	\$36,440	\$37,278
Gross profit	5,481	5,975	6,804	5,937
Income before minority interest and taxes as reported	819	1,084	1,528	485
Pro forma income taxes	319	422	594	186
Pro forma net income before minority interest	500	662	934	299
Pro forma net income per share - LIFO Method	0.10	0.13	0.19	0.06
 1995				

Net sales	\$27,118	\$27,278	\$31,526	\$28,274
Gross profit	4,854	4,909	5,792	5,509
Income before minority interest and taxes as reported	1,124	745	1,392	892
Pro forma income taxes	432	287	536	343
Pro forma net income before minority interest	692	458	856	549
Pro forma net income per share - LIFO Method	0.18	0.12	0.20	0.11

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III**ITEM 10. DIRECTORS AND EXECUTIVE OF THE REGISTRANT**

Information required by this item is included under the captions ELECTION OF DIRECTORS, EXECUTIVE OFFICERS and SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE, respectively in the Company's information Statement for its 1997 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is included under the caption EXECUTIVE COMPENSATION in the Company's Information Statement for its 1997 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is included under the caption SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT in the Company's Information Statement for its 1997 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is included under the caption CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS in the Company's Information Statement for its 1997 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

FINANCIAL STATEMENTS

The Consolidated Financial Statements, together with the report thereon of KPMG Peat Marwick LLP, are included on the pages indicated below:

	Page

Report of Independent Public Accountants	F-1
Consolidated Balance Sheets - December 31, 1996 and 1995	F-2
Consolidated Statements of Operations for the years ended December 31, 1996, 1995 and 1994	F-3
Consolidated Statements of Changes in Shareholders' Equity - December 31, 1996, 1995 and 1994	F-4
Consolidated Statements of Cash Flows for the years ended December 31, 1996, 1995 and 1994	F-5
Notes to Consolidated Financial Statements	F-6

FINANCIAL STATEMENT SCHEDULES

None.

EXHIBITS

The following exhibits are filed herewith:

Exhibit No.	Description
*3.1	Restated Articles of Incorporation of Lithia Motors, Inc.
*3.2	Bylaws of Lithia Motors, Inc.
*4.1	Specimen Common Stock certificate
*10.1	1996 Stock Incentive Plan
*10.2.1	Incentive Stock Option Agreement
*10.2.2	Non-Qualified Stock Option Agreement
*10.2.3	Incentive Stock Option Agreement
*10.3.1	Chrysler Corporation Chrysler Sales and Service Agreement, dated January 10, 1994, between Chrysler Corporation and Lithia Chrysler Plymouth Jeep Eagle, Inc. (standard provisions are in Exhibit 10.3.2 hereto) (1)
*10.3.2	Chrysler Corporation Dealer Agreement Standard Provisions
*10.4.1	Honda Automobile Dealer Sales and Service Agreement dated August 11, 1994, between American Honda Motor Company, Inc. and Lithia Motors, Inc. dba Lithia Honda (standard provisions are in Exhibit 10.4.2 hereto)
*10.4.2	American Honda Automobile Dealer's Standard Agreement
*10.5.1	Isuzu Dealer Sales and Service Agreement, dated June 5, 1996 between American Isuzu Motors, Inc. and Lithia Motors, Inc.
*10.5.2	Isuzu Dealer Sales and Service Agreement General Provisions
10.5.3	Supplemental Agreement, dated December 27, 1996, to Isuzu Dealer Sales and Service Agreement.
*10.6.1	Mercury Sales and Service Agreement, dated December 28, 1979, between Ford Motor Company and Lithia Motors, Inc. (general provisions are in Exhibit 10.6.5 hereto) (2)
*10.6.2	Amendment, dated May 22, 1989, to Mercury Sales and Service Agreement and Lincoln Sales and Service Agreement
*10.6.3	Ford Motor Company Imported Vehicle Sales and Service Agreement, dated July 2, 1984, between Ford Motor Company and Lithia Motors, Inc. dba Lithia Toyota, Lincoln-Mercury (General provisions are in Exhibit 10.6.4 hereto)
*10.6.4	Ford Motor Company Imported Vehicle Sales and Service Agreement General Provisions
*10.6.5	Mercury Sales and Service Agreement General Provisions (2)
*10.7.1	General Motors Corporation Dealer Sales and Service Agreement, dated March 12, 1993, between General Motors Corporation Pontiac Division and Lithia Motors, Inc. dba Lithia Pontiac
*10.7.2	General Motors Dealer Sales and Service Agreement Standard Provisions
*10.8.1	Mazda Dealer Agreement, dated April 11, 1994 between Mazda Motor of America, Inc. and Lithia Dodge, L.L.C. dba Lithia Mazda
*10.8.2	Letter, dated September 29, 1995 extending Mazda Dealer Agreement between Mazda Motor of America, Inc. and Lithia Dodge, L.L.C. dba Lithia Mazda
*10.9	Saturn Distribution Corporation Dealer Agreement, dated September 12, 1991, between Saturn Distribution Corporation and Medford Dodge dba Saturn of Medford
*10.10.1	Toyota Dealer Agreement, dated January 30, 1990, between Toyota Motor Distributors, Inc. and Lithia Motors, Inc. dba Medford Toyota (12)
*10.10.2	Toyota Dealer Agreement Standard Provisions (12)
*10.10.3	Agreement, dated September 30, 1996, between Toyota Motor Sales, U.S.A., Inc. and Lithia Motors, Inc.

Exhibit No.	Description
10.10.4	Addendum, dated December 23, 1996, to Section X - Additional Provisions to Toyota Dealer Agreement dated November 15, 1996 between Toyota Motor Sales, USA, Inc. and Lithia TKV, Inc.
*10.11	Suzuki Term Dealer Sales and Service Agreement, dated May 13, 1996, between American Suzuki Motor Corporation and Lithia Motors, Inc. dba Lithia Suzuki
*10.12.1	Commercial Lease, effective January 1, 1997, between Lithia Properties, L.L.C. and Lithia Motors, Inc. (3)
10.12.2	First Amendment to Lease Agreement, dated February 7, 1997, between Lithia Properties, L.L.C. and Lithia Motors (3)
*10.13.1	Asset Purchase Agreement, dated August 2, 1996, between Lithia Motors, Inc. and Roberts Dodge, Inc.
*10.13.2	Land Sale Contract, dated August 2, 1996, between Lithia Properties, L.L.C. and Milford G. Roberts, Sr. and Sandra L. Roberts
*10.13.3	Assignment of Land Sale Contract, dated November 5, 1996, between Lithia Properties, LLC and Lithia Motors, Inc.
*10.14	Purchase and Sale Agreement between Lithia Motors, Inc. and Sam Linder, Inc.
*10.15.1	Alternative Rate Option Promissory Note by Lithia Motors, Inc., Lithia TLM, LLC, Lithia Dodge, L.L.C., and Lithia's Grants Pass Auto Center, L.L.C., to United States National Bank of Oregon in the amount of \$18 million (4)
*10.15.2	Promissory Note by Lithia Motors, Inc. to United States National Bank of Oregon in the amount of \$6.0 million (5)
*10.15.3	Promissory Note by Lithia Leasing, Inc. to United States National Bank of Oregon in the amount of \$1.4 million (6)
*10.16.1	Promissory Note between Lithia Motors, Inc. and Sidney B. DeBoer in the amount of \$500,000 (7)
*10.16.2	Subordination Agreement between Lithia Motors, Inc., Sidney B. DeBoer and United States National Bank (8)
*10.17.1	Floor Plan Accommodation Agreement (Security Agreement) between Lithia Motors, Inc. and United States National Bank of Oregon (9)
*10.17.2	Corporate Resolution to Guarantee of Lithia Motors, Inc. (10)
*10.18	Commercial Guaranty under which Sidney B. DeBoer is the guarantor of obligations of Lithia Motors, Inc. to United States National Bank of Oregon (11)
*10.19	Management Contract between Lithia Leasing, Inc. and Lithia Properties LLC.
*10.20	Commercial Security Agreement, dated September 9, 1996, between Lithia Motors, Inc. and United States National Bank
*10.21	Purchase and Sale Agreement, dated December 13, 1996, between Lithia Properties and Lithia Real Estate, Inc.
*10.22	Commercial Lease, dated April 1, 1992, between Billy J. Wilson et al and Wilson/Malasoma, Inc. relating to facility in Vacaville, California.
10.23	Agreement for Purchase and Sale of Business Assets, between the Company and Magnussen-Barbee Ford, Lincoln-Mercury, Inc., dated February 21, 1997.
11	Statement re Computation of Per Share Earnings
*21	Subsidiaries of Lithia Motors, Inc.
23	Consent of KPMG Peat Marwick LLP relating to Lithia Motors, Inc.
27	Financial Data Schedule

* Incorporated by reference to the Company's Registration Statement on Form S-1, Registration Statement No. 333-14031, as declared effective by the Securities and Exchange Commission on December 18, 1996.

- (1) Substantially identical agreements exist between Chrysler Corporation and Lithia Chrysler Plymouth Jeep Eagle, Inc., and between Chrysler Corporation and Lithia's Grants Pass Auto Mart, with respect to Jeep, Eagle, Dodge and Plymouth sales and service, and between Chrysler Corporation and Medford Dodge, and between Chrysler Corporation and Lithia DC, Inc. with respect to Dodge sales and service.
- (2) A substantially identical agreement exists between the same parties with respect to Lincoln Sales and Services.
- (3) Substantially identical leases exist between Lithia Properties L.L.C. and (i) Lithia MTLM, Inc., relating to the properties located in Medford, Oregon at 360 E. Jackson St., 400 N. Central Ave., 325 E. Jackson St., 343-345 Apple St., 440-448 Front St., 3rd & Front St. and 344 Bartlett, 315 & 321 Apple St., and 401 E. 4th St., collectively at a lease rate of \$33,728 per month; (ii) Lithia Auto Services, Inc. dba Lithia Body and Paint, relating to the properties in Medford, Oregon, located at 401 E. 4th St., 4th & Bartlett, 235 Bartlett, 220 N. Bartlett, and 275 E. 5th; and in Grants Pass, Oregon, at 1470 N.E. 7th, and 801 N. Riverside Ave., collectively at a lease rate of \$17,439 per month; (iii) Lithia Rentals, Inc., dba Discount Auto and Truck Rental, relating to properties located in Medford, Oregon, at 971 Gilman Rd., and in Grants Pass, Oregon, at 1470 N.E. 7th, collectively at a lease rate of \$962 per month; (iv) Lithia Dodge, L.L.C. and Lithia DM, Inc., relating to properties located in Medford, Oregon, at 322 E. 4th, 315 & 324 E. 5th St., 225, 319 & 323 E. 6th, Riverside & 4th, Riverside & 6th, and 129 N. Riverside, collectively at a lease rate of \$53,490 per month;
- (v) LGPAC, Inc., relating to the property located in Grants Pass, Oregon, at 1421 N.E. 6th and 1470 N.E. 7th, collectively at a lease rate of \$18,023 per month; (vi) Lithia SSO, Inc., relating to properties located in Medford, Oregon, at 400, 705-717 N. Riverside Ave., collectively at a lease rate of \$16,364 per month; (vii) Lithia DM, Inc., relating to properties located at Medford, Oregon, at 324 E. 5th, 319 & 323 E. 6th St., 6th & Riverside, 129 N. Riverside, 4th & Riverside, 225 E. 6th, 315 E. 5th, 322 E. 4th, 201 N. Riverside, 309, 315, 333 and 329 N. Riverside, 334 & 346 Apple St. and 401 E. 4th, collectively at a lease rate of \$30,557 per month; and (viii) Lithia Motors, Inc., relating to properties located in Medford, Oregon, at 360 E. Jackson, 325 E. Jackson, 345 E. Bartlett, and 401 E. 4th St., collectively at a lease rate of \$5,309 per month.
- (4) Substantially identical notes exist between the same parties in amounts of \$2.0 million, \$2.5 million, and \$5.0 million.
- (5) A substantially identical note exists between the same parties in the amount of \$400,000.
- (6) Substantially identical notes exist between the same parties in amounts of \$750,000, and \$1.0 million.
- (7) A substantially identical note exists between Lithia Motors, Inc. and Manfred L. Heimann in the same amount
- (8) A substantially identical agreement exists between Lithia Motors, Inc. and Manfred L. Heimann
- (9) Substantially identical agreements exist between United States National Bank of Oregon and each of Lithia TLM, LLC, Lithia Dodge, L.L.C., Lithia's Grants Pass Auto Center, L.L.C., and Lithia Leasing, Inc.
- (10) A substantially identical guarantee exists under which Lithia's Grants Pass Auto Center, L.L.C. is the Guarantor.
- (11) A substantially identical guaranty exists under which Manfred L. Heimann is the Guarantor of Lithia Motors, Inc.
- (12) A substantially identical agreement exists between Toyota Motor Sales, USA, Inc. and Lithia TKV, Inc.

REPORTS ON FORM 8-K

No reports on Form 8-K have been filed by the Registrant during the quarter ended December 31, 1996.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 19, 1997

LITHIA MOTORS, INC.

By /s/ SIDNEY B. DEBOER

Sidney B. DeBoer
Chairman of the Board, President
and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities on March 19, 1997:

<i>Signature</i> -----	<i>Title</i> -----
<i>/s/ SIDNEY B. DEBOER</i> ----- Sidney B. DeBoer	<i>Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)</i>
<i>/s/ BRIAN R. NEILL</i> ----- Brian R. Neill	<i>Chief Financial Officer (Principal Financial and Accounting Officer)</i>
<i>/s/ M. L. DICK HEIMANN</i> ----- M. L. Dick Heimann	<i>Director, Executive Vice President and Chief Operating Officer</i>
<i>/s/ R. BRADFORD GRAY</i> ----- R. Bradford Gray	<i>Director and Vice President, Acquisitions</i>
<i>/s/ THOMAS BECKER</i> ----- Thomas Becker	<i>Director</i>
<i>/s/ WILLIAM J. YOUNG</i> ----- William J. Young	<i>Director</i>

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
Lithia Motors, Inc. and Subsidiaries:

We have audited the accompanying consolidated balance sheets of Lithia Motors, Inc. and Subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lithia Motors, Inc. and Subsidiaries as of December 31, 1996 and 1995, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1996, in conformity with generally accepted accounting principles.

Portland, Oregon
February 19, 1997

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 1996 and 1995

(In thousands)

ASSETS	1996	1995
	-----	-----
Current assets:		
Cash and cash equivalents	\$15,413	9,706
Trade receivables	2,260	1,744
Other receivables, current portion	414	267
Receivable from related parties	308	-
Inventories	28,152	17,700
Vehicles leased to others, current portion	524	727
Prepaid expenses and other current assets	372	273
Deferred tax assets	1,646	-
	-----	-----
Total current assets	49,089	30,417
	-----	-----
Property, plant and equipment, net	4,616	3,234
Vehicles leased to others, less current portion	4,500	4,599
	-----	-----
Other assets:		
Other receivables, less current portion	377	456
Other noncurrent assets	1,071	872
Goodwill, net	4,101	-
	-----	-----
	5,549	1,328
	-----	-----
	\$63,754	39,578
	-----	-----
	-----	-----

See accompanying notes to consolidated financial statements.

LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS' EQUITY	1996	1995
	-----	-----
Current liabilities:		
Notes payable	\$ 500	625
Flooring notes payable	19,645	19,590
Current maturities of long-term debt	1,855	2,085
Trade payables	2,434	1,455
Accrued liabilities	2,482	1,280
Payable to related parties	1,952	356
	-----	-----
Total current liabilities	28,868	25,391
Long-term debt, less current maturities	6,160	10,743
Deferred revenue	3,250	1,782
Other long-term liabilities	-	62
Deferred tax liability	740	-
	-----	-----
Total liabilities	39,018	37,978
	-----	-----
Commitments and contingencies		
Minority interest	-	749
Shareholders' equity:		
Preferred stock - no par value; authorized 15,000 shares; issued and outstanding none at December 31, 1996 and 1995	-	-
Class A common stock - no par value; authorized 100,000 shares; issued and outstanding 2,500 at December 31, 1996 and none at December 31, 1995	24,172	-
Class B common stock - no par value; authorized 25,000 shares; issued and outstanding 4,110 at December 31, 1996 and 1995	511	801
Retained earnings	53	50
	-----	-----
Total shareholders' equity	24,736	851
	-----	-----
	\$63,754	39,578
	-----	-----

LITHIA MOTORS, INC.
AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended December 31, 1996, 1995 and 1994

(In thousands, except per share data)

	Years ended December 31,		
	1996	1995	1994
Sales:			
Vehicle	\$123,703	97,338	93,535
Service, body, parts and other	19,141	16,858	15,888
Net sales	142,844	114,196	109,423
Cost of sales:			
Vehicle	109,082	81,786	81,141
Service, body, parts and other	9,565	11,346	9,183
Cost of sales	118,647	93,132	90,324
Gross profit	24,197	21,064	19,099
Selling, general and administrative	20,277	16,735	15,174
Operating income	3,920	4,329	3,925
Other income (expense):			
Equity in income of affiliate	44	67	55
Interest income	193	179	99
Interest expense	(1,353)	(1,390)	(954)
Other, net	1,112	968	847
Income before minority interest and income tax benefit	3,916	4,153	3,972
Minority interest	(687)	(778)	(458)
Net income before income tax benefit	3,229	3,375	3,514
Income tax benefit	813	-	-
Net income	\$4,042	3,375	3,514
Net income per share	\$0.81		
Pro forma net income data (unaudited):			
Income before income taxes and minority interest, as reported	\$3,916	4,153	3,972
Pro forma income taxes	(1,521)	(1,598)	(1,521)
Pro forma net income before minority interest	2,395	2,555	2,451
Pro forma minority interest	(421)	(479)	(283)
Pro forma net income	\$1,974	2,076	2,168
Pro forma net income per share	\$0.40	0.42	
Shares used in computing per share amounts	4,973	4,893	

See accompanying notes to consolidated financial statements.

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Consolidated Statements of Changes in Shareholders' Equity

Years ended December 31, 1996, 1995 and 1994

(In thousands)

	Common stock				Retained earnings	Total
	Class A		Class B			
	Shares	Amount	Shares	Amount		
Balance, December 31, 1993	-	\$ -	2,492	\$ 824	360	1,184
Net income	-	-	-	-	3,514	3,514
Issuance of Class B common stock	-	-	743	70	-	70
Cancellation of Class B common stock	-	-	(218)	(143)	143	-
Dividends	-	-	-	-	(1,965)	(1,965)
Balance, December 31, 1994	-	-	3,017	751	2,052	2,803
Net income	-	-	-	-	3,375	3,375
Issuance of Class B common stock	-	-	1,093	50	-	50
Dividends	-	-	-	-	(5,377)	(5,377)
Balance, December 31, 1995	-	-	4,110	801	50	851
Net income	-	-	-	-	4,042	4,042
Dividends	-	-	-	-	(4,460)	(4,460)
Contribution of minority interest to Class B common stock pursuant to restructuring	-	-	-	131	-	131
Restructuring in connection with initial public offering	-	-	-	(421)	421	-
Issuance of Class A common stock, net of offering expenses of \$3,328	2,500	24,172	-	-	-	24,172
Balance, December 31, 1996	2,500	\$24,172	4,110	\$511	53	24,736

See accompanying notes to consolidated financial statements.

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended December 31, 1996, 1995 and 1994

(In thousands)

	Year ended December 31,		
	1996	1995	1994
Cash flows from operating activities:			
Net income	\$ 4,042	3,375	3,514
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,756	1,907	1,954
Gain on sale of assets	(239)	(305)	(146)
Deferred income taxes	(906)	-	-
Minority interest in income	687	778	458
Equity in income of affiliate	(44)	(67)	(55)
Changes in operating assets and liabilities:			
Trade and installment contract receivables	(852)	(692)	1,659
Inventories	(6,807)	1,432	(2,085)
Prepaid and other current assets	(19)	30	(116)
Other noncurrent assets	(196)	(277)	(20)
Trade payables	979	609	(1,793)
Accrued liabilities	797	306	1,002
Other liabilities	3,095	677	358
Proceeds from sale of vehicles leased to others	5,760	4,757	5,239
Expenditures for vehicles leased to others	(6,537)	(6,308)	(6,764)
	1,516	6,222	3,205
Cash flows from investing activities:			
Notes receivable issued	(540)	(190)	(142)
Principal payments received on notes receivable	500	83	309
Proceeds from sale of assets	765	10	3
Capital expenditures	(395)	(524)	(164)
Acquisitions	(6,937)	-	-
	(6,607)	(621)	6
Cash flows from financing activities:			
Net borrowings (repayments) on notes payable	(625)	235	(2,312)
Net borrowings (repayments) on flooring notes payable	(3,283)	(1,628)	2,170
Principal payments on long-term debt	(25,336)	(8,070)	(9,084)
Proceeds from issuance of long-term debt	21,635	12,529	11,300
Proceeds from issuance of common stock and minority interest	24,172	50	(73)
Proceeds from minority interest share receivable	676	142	144
Dividends and distributions	(6,441)	(6,105)	(2,263)
	10,798	(2,847)	(118)
Net cash provided by (used in) financing activities			
	5,707	2,754	3,093
Cash and cash equivalents at beginning of period	9,706	6,952	3,859
Cash and cash equivalents at end of period	\$15,413	9,706	6,952
Supplemental disclosures of cash flow information:			
Cash paid during the period for interest	\$ 1,823	1,828	1,335
Supplemental schedule of noncash investing and financing activities:			
Cancellation of common stock	\$ -	-	143
Issuance of notes receivable - minority interest	-	678	-
Debt extinguishment upon transfer of property	1,112	-	-
Contribution of minority interest in S Corporation earnings upon Restructuring to Class B common stock	131	-	-
Contribution of excess S Corporation retained earnings upon Restructuring to Class B common stock	421	-	-

See accompanying notes to consolidated financial statements.

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) ORGANIZATION AND BUSINESS

Lithia Motors, Inc. and subsidiaries (the Company) operates in Medford, Eugene and Grants Pass, Oregon and Vacaville, California. The Company serves customers located principally in southern Oregon and northern California. The Company offers a broad range of products and services including a wide selection of new and used cars and light trucks, vehicle financing and insurance and replacement parts and service. At its eight locations, the Company offers, collectively, sixteen makes of new vehicles including Chrysler, Toyota, Plymouth, Dodge, Jeep/Eagle, Honda, Saturn, Mazda, Pontiac, Lincoln, Mercury, Isuzu, Suzuki, Kia and Volkswagen.

(b) PRINCIPLES OF CONSOLIDATION

The accompanying financial statements reflect the results of operations, the financial position, and the cash flows for Lithia Motors, Inc. and its directly and indirectly wholly-owned subsidiaries. All significant intercompany accounts and transactions, consisting principally of intercompany sales, have been eliminated upon consolidation.

The financial results presented for periods prior to the Restructuring (see note 13) have been restated to reflect the consolidated results of operations, financial position and cash flows of the Company's dealerships and those of its affiliated entities under common control whose operations were combined under the Restructuring, using "as if" pooling of interest basis of accounting.

Lithia TLM LLC, Lithia Dodge LLC and Lithia Grants Pass Auto Center LLC were limited liability corporations majority owned by Lithia Motors, Inc. The 20%, 25% and 25% minority interests in Lithia TLM LLC, Lithia Dodge LLC and Lithia Grants Pass Auto Center LLC, respectively, have been recorded in the accompanying financial statements to the date of Restructuring.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(c) CASH AND CASH EQUIVALENTS

For purposes of reporting cash flows, the Company considers contracts in transit and all highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents.

(d) INVENTORIES

New vehicle, used vehicle and parts and accessories inventories are stated at the lower of cost or market. Cost is determined by using the last-in, first-out (LIFO) method.

(e) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost and being depreciated over their estimated useful lives, principally on the straight-line basis. The range of estimated useful lives are as follows:

Building and improvements	40 years
Service equipment	5 to 10 years
Furniture, signs and fixtures	5 to 10 years

The cost for maintenance, repairs and minor renewals is expensed as incurred, while significant renewals and betterments are capitalized. When an asset is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the account, and any gain or loss is credited or charged to income.

(f) INVESTMENT IN AFFILIATE

The Company has a 20% interest in Lithia Properties, LLC, of which the other members are Sidney DeBoer (35%), M.L. Dick Heimann (30%) and three of Mr. DeBoer's children (5% each). The investment is accounted for using the equity method, with a carrying value of \$571 and \$491 at December 31, 1996 and 1995, respectively.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(g) INCOME TAXES

Prior to the Offering (see note 13), the Company was an S Corporation for federal and state income tax reporting purposes. Federal and state income taxes on the income of an S Corporation were payable by the individual stockholders rather than the corporation.

The Company's S Corporation status terminated immediately prior to the effectiveness of the initial public offering of its common stock. At that time the Company established a net deferred tax asset and recorded an accompanying credit to income tax expense. The accompanying statements of operations for the years ended December 31, 1996, 1995 and 1994, reflect provisions for income taxes on an unaudited pro forma basis, using the asset and liability method, as if the Company had been a C Corporation, fully subject to federal and state income taxes for the entire year.

Under the asset and liability method, deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of changes in tax rates is recognized in income in the period that includes the enactment date.

(h) ENVIRONMENTAL LIABILITIES AND EXPENDITURES

Accruals for environmental matters, if any, are recorded in operating expenses when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Accrued liabilities are exclusive of claims against third parties and are not discounted.

In general, costs related to environmental remediation are charged to expense. Environmental costs are capitalized if the costs increase the value of the property and/or mitigate or prevent contamination from future operations.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(i) COMPUTATION OF PER SHARE AMOUNTS

Net income per share is computed using the weighted average number of shares of common stock outstanding and common equivalent shares from stock options outstanding using the treasury stock method. In accordance with certain Securities and Exchange Commission (SEC) Staff Accounting Bulletins, such computations include all common and common equivalent shares issued within 12 months of the offering date as if they were outstanding for all periods presented using the treasury stock method. In addition, the calculation includes shares deemed issued to fund S Corporation distributions.

(j) FINANCIAL INSTRUMENTS

The carrying amount of cash equivalents, trade receivables, trade payable, accrued liabilities and short term borrowing approximate fair value because of the short-term nature of these instruments. The fair value of long-term debt was estimated by discounting the future cash flows using market interest rates and does not differ significantly from that reflected in the financial statements.

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

(k) ADVERTISING

The Company expenses production and other costs of advertising as incurred. Advertising expense was \$1,297, \$1,136, and \$946 for the years ended December 31, 1996, 1995 and 1994, respectively.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(l) INTANGIBLE ASSETS AND GOODWILL

Intangible assets of \$199 and \$-0-, net of accumulated amortization of \$23 and \$-0-, at December 31, 1996 and 1995, respectively, represents a non-compete agreement being amortized on a straight-line basis over 5 years. This intangible asset is included in other noncurrent assets and is evaluated for impairment each period by determining its net realizable value.

Goodwill, which represents the excess purchase price over fair value of net assets acquired, is amortized on the straight-line basis over the expected period to be benefited of forty years. The Company assesses the recoverability of this intangible asset by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operation. The assessment of the recoverability of goodwill will be impacted if estimated future operating cash flows are not achieved.

(m) CONCENTRATIONS OF CREDIT RISK

Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the Company's customer base.

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash deposits. The Company generally limits its exposure to credit risk from balances on deposit in financial institutions in excess of the FDIC-insured limit.

(n) USE OF ESTIMATES

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

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(o) REVENUE RECOGNITION

Revenue from service contract insurance sold by the Company is recorded as deferred revenue upon initial receipt and recognized as income on a prorated basis over the term of the policy. Finance fees represent revenue earned by the Company for notes placed with financial institutions in connection with customer vehicle financing. Finance fees are recognized in income upon acceptance of the credit by the financial institution. Insurance income represents commissions earned on credit life, accident and disability insurance sold in connection with the vehicle on behalf of third-party insurance companies. Insurance commissions are recognized in income upon customer acceptance of the insurance terms as evidenced by contract execution. Finance fees and insurance commissions, net of chargebacks, are classified as other operating revenue in the accompanying consolidated statement of operations.

Revenue from the sale of cars is recognized upon delivery, when the sales contract is signed and down payment has been received. Fleet sales of vehicles whereby the Company does not take title are shown on a net basis in other revenue.

(p) MAJOR SUPPLIER AND DEALER AGREEMENT

The Company purchases substantially all of its new vehicles and inventory from various manufacturers at the prevailing prices charged by the automaker to all franchised dealers. The Company's overall sales could be impacted by the automaker's inability or unwillingness to supply the dealership with an adequate supply of popular models.

The Company enters into agreements (Dealer Agreements) with the manufacturer. The Dealer Agreement generally limits the location of the dealership and retains automaker approval rights over changes in dealership management and ownership. The automaker is also entitled to terminate the agreement if the dealership is in material breach of the terms.

The Company's ability to expand operations depends, in part, on obtaining consents of the manufacturer to the acquisition of additional dealerships.

(q) RECLASSIFICATIONS

Certain items previously reported in specific financial statement captions have been reclassified to conform with the 1996 presentation.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(2) INVENTORIES AND RELATED NOTES PAYABLE

The new and used vehicle inventory, collateralizing related notes payable, and other inventory were as follows:

	December 31			
	1996		1995	
	Inventory cost	Notes payable	Inventory cost	Notes payable
New and demonstrator vehicles	\$19,402	19,645	13,972	15,346
Used vehicles	12,199	-	7,532	4,244
Parts and accessories	1,761	-	1,092	-
Inventories at FIFO	33,362	19,645	22,596	19,590
Less LIFO reserve for new and used vehicles and parts inventories	5,210	-	4,896	-
Inventories at LIFO	\$28,152	19,645	17,700	19,590

If the first-in, first-out (FIFO) method of inventory accounting were used by the Company, net income would have been higher (lower) by \$314, \$(426) and \$615 for the years ended December 31, 1996, 1995 and 1994, respectively.

Flooring notes payable consist of 8.25% to 8.75% flooring notes from a bank secured by new and used vehicles. The flooring arrangements permit the Company to borrow up to \$27,900 in 1996 and \$21,900 in 1995, restricted by new and used vehicle levels. The notes are due within 5 days of the vehicle being sold or after the vehicle has been in inventory for 1 year for new vehicles, 6 months for program vehicles, and on a revolving basis for used vehicles.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(3) PROPERTY, PLANT AND EQUIPMENT

	December 31	
	1996	1995
Buildings and improvements	\$1,131	1,445
Service equipment	1,641	1,431
Furniture, signs and fixtures	2,545	1,607
	5,317	4,483
Less accumulated depreciation	2,073	1,840
	3,241	2,643
Land	1,272	591
Construction in progress	100	-
	\$4,616	3,234

(4) VEHICLES LEASED TO OTHERS AND RELATED LEASE RECEIVABLES

	December 31	
	1996	1995
Vehicles leased to others	\$6,378	6,678
Less accumulated depreciation	(1,354)	(1,352)
	5,024	5,326
Less current portion, net	524	727
	\$4,500	4,599

Vehicles leased to others are stated at cost and depreciated over their estimated useful lives (5 years) on a straight-line basis. Lease receivables result from customer, employee and fleet leases of vehicles under agreements which qualify as operating leases. Leases are cancelable at the option of the lessee after providing 30 days written notice.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(5) NOTES PAYABLE

Notes payable consist of a 9.0% credit line with a bank for the in-house financing of vehicle sales and leases. The Company may borrow up to \$1,000 or 75% of the total in-house vehicle receivables under 60 days past due. No amounts were outstanding as of December 31, 1996.

The Company incurred a \$500 8.5% note payable in connection with the acquisition of Roberts Dodge, Inc. in Eugene, Oregon. The note became due and payable upon the consummation of the Restructuring and Offering.

(6) LINES OF CREDIT

The Company has a \$7.5 million line of credit to finance the purchase of vehicles used in the Company's fleet leasing and automobile rental businesses. The borrowings under this line of credit, \$5,196 at December 31, 1996, are secured by the leased vehicles and bear interest at prime plus .25% to 1.5% (8.5% to 9.75% at December 31, 1996).

The Company has a \$6.0 million line of credit to finance acquisitions which bears interest at prime plus .75% and secured by the Company's inventory, receivables, equipment and real property. During the first year in which the line is used, interest only is payable monthly. After the first year, monthly payments are based on a ten-year amortization, with final payment due five years from the first draw. As of December 31, 1996, no borrowings were outstanding under this line.

An additional line of credit of \$2.15 million is available for the purchase of equipment, \$1.4 million of which is available for the purchase of equipment associated with acquisitions. The borrowings under this line of credit, \$126 at December 31, 1996, are secured by the equipment and bear interest at prime plus 0.5% (8.75% at December 31, 1996). The borrowings are payable in monthly installments, maturing at various dates through 2000.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(7) LONG-TERM DEBT

Long-term debt consists of the following:

	December 31	
	1996	1995
	-----	-----
Notes payable to officer and director, interest at prime plus 0.5%; due in ten equal annual installments beginning one year and ten days subsequent to demand by the note holder	\$ -	3,865
Notes payable to related parties other than officer and director, interest at prime plus or minus 0.5%; due in ten equal annual installments beginning at various times subsequent to demand by the note holder	-	1,234
Notes payable in monthly installments, including interest at 8.75%; maturing at various dates through 2000; secured by equipment	1,019	1,404
Notes payable in monthly installments, including interest at prime plus .25% to 1.5% (8.5% to 9.75% at December 31, 1996); maturing at various dates through 2000; secured by vehicles leased to others	5,196	5,466
Mortgages payable in monthly installments of \$105, including interest at 7.5% to 12%; maturing at various dates through 2013; secured by land and buildings	-	858
Notes payable in monthly installments of \$14, including interest at 8.27%, maturing December 2008; secured by land and buildings	1,800	-
Other	-	1
	-----	-----
	8,015	12,828
Less current maturities	1,855	2,085
	-----	-----
	\$6,160	10,743
	-----	-----

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

The schedule of future principal payments on long-term debt after December 31, 1996 is as follows:

Year ending December 31:	
1997	\$1,855
1998	3,877
1999	388
2000	142
2001	88
2002 and thereafter	1,665

	\$8,015

(8) MINORITY INTEREST

At December 31, 1995, the Company held notes receivable of \$678, from minority owners of the Company. These notes were secured by the minority owners' interest in the Company and bore interest at .5% over prime rate. The notes receivable were presented as a reduction to minority interest. In connection with the Restructuring and Offering, the notes receivable were paid by the minority interest shareholders.

(9) SHAREHOLDERS' EQUITY

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

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

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(10) INCOME TAXES

At the date of the Restructuring, the Company terminated its S Corporation election and is now taxed as a C Corporation. Income taxes on the Company's earnings from the date of the Restructuring to December 31, 1996 is as follows:

Current:		
Federal		\$(77)
State		(16)

	Total current income tax expense	(93)
Deferred:		
Federal		750
State		156

	Total deferred income tax benefit	906

	Total income tax benefit	\$813

The significant components of deferred income tax benefit for the year ended December 31, 1996 are as follows:

Deferred tax expense (exclusive of the effects of other components listed below) \$ - Adjustment to deferred tax assets and liabilities for conversion from S Corporation to C Corporation status 906

\$906

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets and liability as of December 31, 1996, are presented below:

Deferred tax assets:	
Allowance and accruals	\$ 277
Deferred revenue	1,244

Total deferred tax assets	1,521
Deferred tax liability:	
Property and equipment, principally due to differences in depreciation	(615)

Net deferred tax assets	\$ 906

The unaudited pro forma provision for income taxes reflects the income tax expense that would have been reported if the Company had been subject to Federal and state income taxes as a C Corporation for the entire year and for all periods presented. The components of unaudited pro forma income taxes are as follows:

	Year ended December 31		
	1996	1995	1994
	-----	-----	-----
Pro forma income taxes:			
Current:			
Federal	\$1,860	1,487	1,292
State	387	309	269
	-----	-----	-----
Total current	2,247	1,796	1,561
	-----	-----	-----
Deferred:			
Federal	(601)	(164)	(33)
State	(125)	(34)	(7)
	-----	-----	-----
Total deferred	(726)	(198)	(40)
	-----	-----	-----
Total pro forma income taxes	\$1,521	1,598	1,521
	-----	-----	-----
	-----	-----	-----

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

The following tabulation reconciles the expected corporate federal income tax expense (computed by multiplying the Company's income before minority interest by 34%) to the Company's unaudited pro forma income tax expense:

	Year ended December 31		
	1996	1995	1994
Expected pro forma income tax expense	\$1,331	1,412	1,350
State income taxes, net of federal tax effect	171	181	173
Other, net	19	5	(2)
	\$1,521	1,598	1,521

The Company intends to change its tax basis method of valuing inventories from the LIFO method to the FIFO and specific identification methods in 1997. The balance of the LIFO reserve as of December 31, 1996 will be amortized into taxable income over a two to six year period, thereby increasing current taxes payable. This amortization will create a corresponding reduction in the deferred tax liability related to inventory and will not impact the Company's effective tax rate.

(11) COMMITMENTS AND CONTINGENCIES

(a) RECOURSE PAPER

The Company is contingently liable to banks for recourse paper from the financing of vehicle sales. The contingent liability at December 31, 1996, 1995 and 1994 was approximately \$88, \$206 and \$77, respectively.

(b) OPERATING LEASES

Substantially all of the Company's operations are conducted in leased facilities under noncancelable operating leases. These leases expire at various dates through 2012. Beginning in 1998, certain lease commitments are subject to escalation clauses of an amount equal to the cost of living based on the "Consumer Price Index - U.S. Cities Average - All stems for all Urban Consumers" published by the U.S. Department of Labor.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

The minimum rental commitments under operating leases after December 31, 1996 are as follows:

Year ending December 31:	
1997	\$ 2,253
1998	2,253
1999	2,251
2000	2,229
2001	1,882
2002 and thereafter	17,471

	\$28,339

Rental expense for all operating leases was \$2,353 \$1,993 and \$1,888 for the years ended December 31, 1996, 1995 and 1994, respectively.

(c) LITIGATION

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations or liquidity.

(12) PROFIT SHARING PLAN

The Company has a defined contribution plan and trust covering substantially all full-time employees. The annual contribution to the plan is at the discretion of the Board of Directors of Lithia Motors, Inc. Contributions of \$100, \$84 and \$100 were recognized for the years ended December 31, 1996, 1995 and 1994, respectively. Employees may contribute to the plan under certain circumstances.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(13) RESTRUCTURING AND OFFERING

On December 18, 1996, the Company offered 2,500 shares of its Class A common stock to the public (the Offering). Prior to the public stock offering, the Company consummated a restructuring (the Restructuring) which resulted in each of the Company's dealerships and operating divisions becoming direct or indirect wholly-owned subsidiaries of the Company with Lithia Holding Company, LLC owning all the outstanding Class B common stock of the Company. All shareholders prior to the Restructuring exchanged their interests in the Company and its affiliated entities for shares of Lithia Holding Company, LLC with the exception of (i) one shareholder who exchanged his interest in one entity for cancellation of a note due to Lithia TLM, LLC and cash and (ii) Lithia TKV, Inc. whose stock was purchased by the Company from the Company's principals subsequent to the public stock offering.

(14) STOCK INCENTIVE PLAN

In April 1996, the Board of Directors (the Board) and the Company's shareholders adopted the Company's 1996 Stock Incentive Plan (the Plan), which provides for the granting of incentive and nonqualified stock options to officers, key employees, and non-employee consultants of the Company and its subsidiaries. The Plan is administered by the Board or by a Compensation Committee of the Board and permits accelerated vesting of outstanding options upon the occurrence of certain changes in control of the Company.

During 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 ACCOUNTING FOR STOCK-BASED COMPENSATION (SFAS 123), which defines a fair value based method of accounting for an employee stock option and similar equity instrument. As permitted under SFAS 123, the Company has elected to continue to account for its stock-based compensation plan under Accounting Principal Board Opinion No. 25 ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES (APB 25), and related interpretations. Accordingly, no compensation expense has been recognized for the Plan. The Company has computed, for pro forma disclosure purposes, the value of options granted under the Plan, using the Black-Scholes option pricing model as prescribed by SFAS 123, using the weighted average assumptions for grants as follows: a risk free interest rate of 6.5%, an expected divided yield of 0%, expected lives of 6.5 years, and expected volatility of 60%.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

Using the Black-Scholes methodology, the total value of options granted during 1996 was \$709, which would be amortized on a pro forma basis over the vesting period of the options. The weighted average fair value of options granted during 1996 was \$1.62 per share. If the Company had accounted for its stock-based compensation plan in accordance with SFAS 123, the Company's net income and net income per share would approximate the pro forma disclosures below:

	1996	
	As reported	Pro forma
Net income	\$4,042	3,612
Net income per share	\$0.81	0.73

The effects of applying SFAS 123 in this pro forma disclosure are not indicative of future amounts. SFAS 123 does not apply to awards prior to January 1, 1995, and additional awards are anticipated in future years.

Options become exercisable over a period of up to ten years from the date of grant as determined by the Board, at prices generally not less than the fair market value at the date of grant. At December 31, 1996, options for 167 shares were exercisable, with a weighted average exercise price of \$3.27. 685 shares were reserved for issuance and 246 shares were available for future grant.

The following table summarizes stock options outstanding at December 31, 1996:

	Shares	Weighted - average price
Outstanding options at December 31, 1995	-	\$ -
Granted	439	3.11
Exercised	-	-
Canceled	-	-
Outstanding options at December 31, 1996	439	\$3.11

At December 31, 1996, the weighted average remaining contractual life of outstanding options was 6.3 years.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(15) RELATED PARTY TRANSACTIONS

Substantially all of the real property on which the Company's business is located is owned by Lithia Properties, LLC. The Company, leases its facilities under various lease agreements from Lithia Properties, LLC (note 11). Recorded in other current assets are deposits relating to these operating leases of \$-0- and \$175 as of December 31, 1996 and 1995, respectively. Selling, general and administrative expense includes rental expense of \$2,132, \$1,929 and \$1,808 for the years ended December 31, 1996, 1995 and 1994, respectively.

The Company provides management services to Lithia Properties, LLC. Other income includes management fees of \$408, \$288 and \$288 for the years ended December 31, 1996, 1995 and 1994, respectively.

The Company has notes payable included in long-term debt of \$-0- and \$3,865 as of December 31, 1996 and 1995, respectively, to certain officers and directors. These notes accrue interest at 9% and are due in ten equal annual installments beginning one year and ten days subsequent to demand by the noteholder.

The Company has guaranteed certain indebtedness of Lithia Properties, LLC incurred in connection with purchases of real property which secures the loan. This indebtedness amounts to approximately \$13,000.

The Company and Lithia Properties, LLC share a "pooled" cash account in the Company's name. At December 31, 1996 and 1995, amounts due to Lithia Properties, LLC related to this arrangement amounted to \$1,703 and \$356, respectively, and are included in payable to related parties. Also included in payable to related parties at December 31, 1996 is \$249 due to former S Corporation minority interest shareholders for distributions of their investment in the Company prior to the Restructuring.

Receivable from related parties at December 31, 1996 represents amounts due to the Company for overpayments on distributions to shareholders in connection with the Restructuring.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

(16) ACQUISITIONS

During the fourth quarter of 1996, the Company acquired two new and used car dealerships, Roberts Dodge, Inc. and Melody Vacaville, Inc., now Lithia TKV and Lithia DE, respectively. For each acquisition, the Company acquired certain assets, set forth below each of which was accounted for as a purchase. Accordingly, the consolidated statement of operations include the operating results from the date of purchase.

	Roberts Dodge, Inc.	Melody Vacaville, Inc.
	-----	-----
Assets acquired	\$6,233	3,309
Goodwill	1,900	2,201
Less liabilities assumed or incurred	(3,390)	(2,816)
	-----	-----
Total consideration	\$ 4,743	2,694
	-----	-----

The pro forma results shown below reflect accounting adjustments assuming the acquisitions described above occurred as of the beginning of each of the periods presented:

	1996	1995
	-----	-----
	(Unaudited)	
Revenues	\$208,236	173,900
Net income	2,704	1,435
Net income per share	0.54	0.29

The pro forma results are not necessarily indicative of what actually would have occurred had the acquisitions been in effect for the entire periods presented. In addition, they are not intended to be a projection of future results that may be achieved from the combined operations.

(Continued)

**LITHIA MOTORS, INC.
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Notes to Consolidated Financial Statements

(In thousands)

(17) OTHER INCOME

	December 31		
	1996	1995	1994
Management fees	\$477	288	288
Hail damage settlement	206	-	-
Lawsuit settlement	-	160	-
Miscellaneous, net	429	520	559
Other income, net	\$1,112	968	847

(18) SUBSEQUENT EVENTS

(a) EXERCISE OF OVER-ALLOTMENT OPTIONS

On January 20, 1997, the underwriters for the Company's initial public offering exercised an option to purchase 375 shares of Class A common stock to cover over-allotments. Gross proceeds to the Company was approximately \$4,125.

(b) PENDING ACQUISITIONS

The Company has signed definitive agreements to purchase two dealerships described below. These purchases are subject to normal closing conditions and the approval of the change in ownership by the manufacturers. The Company will account for these acquisitions as purchases and consolidate the respective results of operations from the date of consummation of the purchase.

(Continued)

**LITHIA MOTORS, INC.
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(In thousands)

The Company has agreed to acquire the assets of Magnussen-Barbee Ford, Lincoln-Mercury, including the new and used vehicles, in a cash and debt transaction valued at \$6.9 million. The dealership's sales facility and real estate will be leased. Closing is expected to occur in the second quarter of 1997.

The Company has agreed to pay \$2.25 million plus the fair value of the operating assets to acquire Magnussen Dodge, a Dodge and Isuzu dealer in Concord, California. The dealership's sales facilities and real estate will be leased. Closing is expected to occur in the second quarter of 1997.

AGREEMENT FOR PURCHASE AND SALE OF BUSINESS ASSETS

THIS AGREEMENT is entered into by and between MAGNUSSEN-BARBEE FORD, LINCOLN-MERCURY, INC., a California corporation, (hereinafter referred to as "Seller"), and LITHIA MOTORS, INC., an Oregon corporation, (hereinafter referred to as the "Buyer").

RECITALS:

Seller is a California business corporation engaged in the business of selling and servicing Ford and Lincoln-Mercury motor vehicles and related parts and accessories from premises located at 300 Soscol Avenue, Napa, California 94559 (the Business Real Property), under franchises issued by the Ford Motor Company.

Buyer wishes to purchase from Seller, and Seller is willing to sell to Buyer, all assets relating to Seller's Ford and Lincoln-Mercury franchises, conditioned upon the granting to Buyer of exclusive franchises for the sale of new Ford and Lincoln-Mercury motor vehicles in the same geographical area as Seller's current franchises in Napa, California.

Buyer also wishes to assume the Lease of the Business Real Property, and the purchase of Seller's business assets shall be conditioned upon the assignment to Buyer of the Lease of the Business Real Property.

NOW, THEREFORE, IN CONSIDERATION OF the mutual premises set forth herein, the parties agree as follows:

1. DEFINITIONS. In this Agreement, the following words shall have the indicated meanings:

(a) "CLOSING" shall refer to the consummation of the transaction contemplated under this Agreement in accordance with the terms hereof, and "CLOSING DATE" shall refer to the actual date of Closing. "TARGET CLOSING DATE" shall refer to May 1, 1997 "FINAL CLOSING DATE" shall refer to the earlier of (i) May 30, 1997, or (ii) the 10th business day after the condition precedent set forth in subparagraph 17(a) (the issuance of Franchisors' approvals) has been satisfied.

(b) "SELLER'S BUSINESS" shall refer to any and all activities conducted by Seller in Napa County, California, relating to the marketing and sale of new Ford and Lincoln-Mercury vehicles and associated parts and accessories, and the repair and servicing of new or used Ford and Lincoln-Mercury vehicles.

(c) "PURCHASED ASSETS" shall refer to those assets which are identified in Paragraph 2 as being purchased and sold by the parties hereunder.

(d) Seller's "EQUIPMENT" shall refer to all non-inventory items of tangible personal property presently owned or used by Seller in connection with Seller's business, including all of Seller's machinery, tools, signs, office equipment, computer equipment computer programs, microfiches, parts lists, repair manuals, sales or service brochures, furniture and fixtures, and further including all assets listed on Seller's financial statements as of December 31, 1996. Seller's leasehold improvements to the Business Real Property also shall be included with the definition of Seller's "Equipment".

(e) Seller's "INTANGIBLE ASSETS" shall refer to Seller's name ("Magnussen-Barbee Ford, Lincoln-Mercury, Inc."), telephone and fax numbers, service customer lists, sales customer lists, vehicle sales records, vehicle service records, all rights of Seller under contracts assigned to and assumed by Buyer pursuant to this Agreement, all goodwill associated with Seller's business, and all other intangible rights and interests of any value relating to Seller's business.

(f) "BUSINESS REAL PROPERTY" shall refer to the real property located at 300 Soscol Avenue, Napa, California, which has been used in connection with Seller's business.

(g) "FRANCHISOR" or "FRANCHISORS" shall refer to the Ford Motor Company.

(h) "NEW VEHICLE" shall refer to a Ford and Lincoln-Mercury motor vehicle which: (i) is unregistered and unused, (ii) is from the 1996 or 1997 model year, and (iii) may be represented or warranted to consumers as "new" under California law. "ROLLBACK VEHICLE" shall mean an unregistered vehicle which has been sold to a customer by Seller but returned because of the customer's inability to obtain financing for the purchase. "DEMONSTRATOR VEHICLE" shall mean an unregistered vehicle used and operated by Seller on dealer plates for sales demonstration purposes. "USED VEHICLE" shall mean any vehicle which is not a new vehicle, a demonstrator vehicle or rollback vehicle.

(i) "DATE OF THIS AGREEMENT" shall refer to the first date upon which this Agreement has been signed by all of the parties.

2. PURCHASED ASSETS. Seller agrees to sell to Buyer, and the Buyer agrees to purchase from Seller, the assets identified in Paragraphs 3, 4, 5, 6, 7, 8, 9, 10 and 11 of this Agreement (the "Purchased Assets"). Excluded from this transaction are Seller's cash, accounts receivable, notes receivable, banking accounts and deposits, and all other assets not identified in Paragraphs 3, 4, 5, 6, 7, 8, 9, 10, and 11 of this Agreement.

3. INVENTORY OF NEW VEHICLES. Buyer shall purchase Seller's entire inventory of new Ford and Lincoln-Mercury vehicles, as that inventory exists on the Closing Date. Buyer also shall purchase Seller's entire inventory of demonstrator vehicles and (up to five) rollback vehicles, as that inventory exists on the Closing Date.

(a) PRICE OF NEW VEHICLES. The purchase price for each of the new vehicles shall be equal to Seller's factory invoice cost, reduced by any factory holdbacks, factory rebates, factory incentives, carry-over model allowances, floor plan allowances, finance cost

allowances, advertising allowances, and further reduced by the actual net cost for any and all accessories, equipment and parts which are missing from a vehicle. Seller's actual net cost for the new vehicles shall include Seller's actual net cost for any and all parts and accessories reasonably installed by Seller to new vehicles in the ordinary course of business, but shall not include any other vehicle preparation charges, labor charges or other dealer charges of any kind.

(b) **DEDUCTION FOR DAMAGE TO NEW VEHICLES.** Immediately prior to Closing, Buyer and seller shall jointly inspect Seller's inventory of new vehicles. If any new vehicle purchased by Buyer from Seller is damaged, the price for that vehicle, as determined under subparagraph 3(a), shall be reduced by the actual net cost to Buyer of repairing that damage. If Buyer and Seller are unable to agree upon the actual net cost to Buyer of repairing the damage to a vehicle, then Buyer and seller shall select an independent third party to determine that repair cost, which determination shall be binding upon both Buyer and Seller.

(c) **PAYMENT FOR NEW VEHICLES.** The aggregate purchase price for all new vehicles purchased by Buyer from Seller shall be paid in full at Closing.

(d) **PURCHASE ORDERS FOR NEW VEHICLES.** Immediately prior to Closing, Buyer and seller shall jointly review Seller's outstanding purchase orders for new vehicles ordered from Seller by customers but not delivered prior to Closing. At Closing, Seller shall assign to Buyer, and Buyer shall assume from Seller, all of Seller's rights (including customer deposits) and obligations (including sales commissions) under such purchase orders; provided, however, that Buyer shall not be obligated to assume Buyer's rights or obligations with respect to any new vehicle purchase order which is at a price less than factory invoice, or which provides for a trade-in at a price or under terms not acceptable to Buyer. At Closing, Seller shall turn over to Buyer all customer deposits on ordered but undelivered new vehicles.

(e) **PRICE FOR DEMONSTRATORS AND ROLLBACKS.** Regarding 1996 demonstrators, the price for each vehicle shall be determined as above less \$500 per vehicle and 30 CENTS per mile for miles in excess of 4,000 miles. Regarding 1997 demonstrators, the price for each vehicle will be determined as above less 30 CENTS per mile for all miles in excess of 4,000. miles. Regarding rollbacks, the purchase price for each such vehicle shall be determined as above less 30 CENTS per mile for miles in excess of 200 miles. The purchase price so determined for the demonstrators and rollbacks shall be paid at Closing.

4. INVENTORY OF USED VEHICLES. Buyer intends to purchase Seller's entire inventory of used vehicles, as that inventory exists at Closing. However, Buyer shall not be obligated to purchase any used vehicle for which Buyer and Seller are unable to agree upon a purchase price.

(a) Seller shall be obligated to: (i) disclose to Buyer any and all facts concerning each used vehicle which Seller would be legally obligated to disclose to a consumer (including but not limited to known damage and usage history), and (ii) provide to Buyer legal odometer statements and free and clear title for each of the used vehicles.

(b) **PRICE FOR USED VEHICLES.** Used vehicles shall be purchased on an individual basis. It is Buyer's intention to purchase all of the used vehicles, however, in the event Buyer and Seller cannot agree on a value as to one or more vehicles, then those vehicles whose value is not agreed upon, shall remain the property of the Seller and Buyer shall not be obligated to purchase same. Buyer and Seller agree to establish the proposed purchase price for seller's used vehicles at least three business days prior to the anticipated Closing Date. Regarding any used vehicles not purchased by Buyer, Seller shall have 14 days subsequent to Closing to remove same from the Business Real Property. So long as Buyer stores Seller's used vehicles on the Business Real Property in accordance with standard business practices, Seller shall have sole and exclusive risk and liability for any damage or loss to Seller's used vehicles while so stored on the Business Real Property after Closing, and Buyer shall have no liability or obligation of any kind by reason of such damage or loss.

(c) **PAYMENT FOR USED VEHICLES.** The aggregate purchase price for Seller's inventory of used vehicles shall be paid in full at Closing.

5. INVENTORY OF NEW PARTS AND ACCESSORIES. Buyer shall purchase Seller's entire inventory of new, current (non-obsolete), undamaged Ford and Lincoln-Mercury vehicle parts and accessories manufactured by Franchisors and/or third party suppliers, as that inventory exists on the Closing Date. Buyer shall have no obligation to purchase from Seller any parts or accessories which are used, damaged or obsolete. For purposes of this Paragraph 5, a part or accessory shall be "obsolete" on the Closing Date if not then returnable to the supplier from which that part was originally purchased, or if not then listed in the supplier's then current price and parts books. Prior to Closing, Seller shall maintain Seller's inventory of parts and accessories at a level consistent with good business practices and Seller's normal and regular course of business.

(a) **PRICE FOR PARTS AND ACCESSORIES.** The purchase price for each item in Seller's inventory of new, current and undamaged parts and accessories for Ford and Lincoln-Mercury vehicles (whether manufactured by a Franchisor or third party suppliers) shall be the net cost for that item as set forth in the then most recent price book published by the supplier of that item, reduced by any discounts, rebates, incentives or allowances which should reasonably be taken into account in order to establish what Buyer's net cost for that item would be if that item was purchased by Buyer directly from that supplier at the time of Closing.

(b) **DETERMINATION OF INVENTORY OF PARTS AND ACCESSORIES.** Seller's inventory of new, current and undamaged Ford and Lincoln-Mercury parts and accessories shall be determined immediately prior to Closing (or on whatever earlier date shall be selected by mutual agreement of the parties) by a third party inventory service selected by mutual agreement of the parties. Buyer and Seller each shall be responsible for 50% of the fees charged by the inventory service for conducting the inventory.

(c) **PAYMENT FOR INVENTORY OF NEW PARTS AND ACCESSORIES.** The purchase price for Seller's inventory of parts and accessories shall be paid in full at Closing.

(d) In addition to the vehicle accessories being purchased by Buyer, Buyer agrees to purchase a quantity of other non-factory accessories the amount of which shall be determined by the price of same which shall not exceed \$_____.

6. EQUIPMENT. Buyer shall purchase Seller's Equipment. Buyer acknowledges that Seller is retaining, and is not selling to Buyer, those personal items of Seller's Equipment, if any, which are listed on Exhibit "A" attached hereto.

(a) PRICE FOR EQUIPMENT. The aggregate purchase price for Seller's Equipment shall be determined by a mutually agreed upon appraiser whose cost shall be equally shared by the parties. This purchase price for the Equipment shall be paid at the Closing.

7. SUPPLIES. Buyer shall purchase all of the gas, oil, nuts, bolts, and other automotive supplies which are held for use in Seller's business. The price for all such supplies shall be Seller's actual net cost, and shall be paid to Seller at Closing.

8. CONTRACTUAL RIGHTS AND OBLIGATIONS. At Closing, Buyer shall assume all rights and obligations of Seller under those certain equipment leases and other contracts identified on Exhibit "B" attached hereto. Seller warrants that all of Seller's obligations under the contracts listed on Exhibit "B" shall be current at the time of Closing. Seller agrees to indemnify Buyer against all obligations under the contracts identified on Exhibit "B" which relate to periods prior to Closing. Buyer agrees to indemnify Seller against all obligations under the contracts identified on Exhibit "B" which relate to periods after Closing.

9. REPAIR WORK IN PROGRESS. Buyer shall purchase all of Seller's vehicle repair work in progress (in-house and subcontracted), at a price equal to Seller's actual net cost, (before profit and overhead) for all work completed prior to Closing. The purchase price for work in progress shall be paid at Closing.

10. PREPAID EXPENSES WHICH ACCRUE TO BUYER'S BENEFIT. Buyer agrees to reimburse Seller for those prepaid expenses which accrue to Buyer's benefit which shall be at Seller's cost and shall be paid at closing.

11. INTANGIBLE ASSETS. Buyer shall purchase all of Seller's Intangible Assets.

(a) The aggregate purchase price for Seller's Intangible Assets shall be Two Million Seven Hundred Thousand and 00/100 Dollars (\$2,700,000), \$2,100,000 of which shall be paid outside of Escrow at the Closing. The \$600,000 balance of the purchase price for the Intangible Assets (\$2,700,000 minus \$2,100,000) shall be amortized and paid by Buyer to Seller as follows:

(1) During the period beginning on the Closing Date and ending when the entire deferred balance of this purchase price has been paid in full, interest shall accrue on the outstanding balance of this purchase price at nine percent (9%) per annum. The interest accruing on the outstanding balance of this purchase price shall be due and payable in

quarter annual installments, with the first interest payment being due and payable on the date which is three calendar months after the Closing Date, and with subsequent interest payments being due and payable at regular three month intervals thereafter.

(2) The \$600,000 deferred principal balance of this purchase price shall be due and payable in four equal annual installments of One Hundred Fifty Thousand and 00/100 Dollars (\$150,000) each, with the first installment being due and payable on April 1, 1998, and with subsequent installments being due and payable at regular one year intervals thereafter.

(A) Buyer shall have the right at any time to prepay all or any portion of the unpaid balance of this purchase price, without penalty or premium. Any prepayment shall be applied against the last maturing installment of principal then due (with the principal balance being reduced accordingly), and shall not excuse Buyer from making the regular installment payments subsequently due until the principal balance has been paid in full.

(B) If Buyer fails to pay any amount of principal or interest upon the due date or within ten (10) days thereof, and if thereafter Seller notifies Buyer in writing of said default and Buyer fails to cure said default within ten (10) days after receipt of that written notice from Seller, then Seller shall have the right, at any time prior to the moment when Buyer cures that default, to declare (and thereby cause) the entire unpaid balance of the purchase price to be immediately due and payable.

(C) Buyer's deferred payment obligation as set forth in this paragraph 11 shall be evidenced by a negotiable promissory note (hereinafter the "Promissory Note") to be executed by Buyer and delivered to Seller at Closing. The Promissory Note shall be unsecured and shall contain an attorney's fee clause.

(b) In order for Buyer to receive the full benefit of the intangible good will being purchased by Buyer, it will be necessary for Buyer to perform no-charge repair work with respect to vehicles repaired or sold by Seller prior to Closing. In partial consideration of the \$2,700,000 amount being paid by Buyer for the Intangible Assets, Seller agrees to reimburse Buyer for Fifty percent (50%) of the net cost to Buyer of repair service which are not covered by factory warranty and which are performed by Buyer within two (2) months after Closing with said reimbursement not exceeding a maximum of \$4,000 in order to satisfy customers who are dissatisfied with repair services provided by Seller prior to Closing. Seller agrees to reimburse Buyer pursuant to the preceding sentence on a monthly basis, with payment to be made within ten (10) days after Buyer submits a billing for the cost of repair services performed during the preceding calendar month.

12. BULK TRANSFERS. It is the intention of the parties that this transaction comply with Division Six of the California Uniform Commercial Code, more commonly known as Uniform Commercial Code - Bulk Transfers. As a result thereof, upon the execution of this agreement the parties shall immediately open an escrow at Capitol City Escrow, Inc., 2720 Gateway Oaks Drive, # 140, Sacramento, California, for this purpose. At this same time, Buyer shall deliver to said escrow the sum of \$250,000 (the deposit), which amount shall

immediately be placed into an interest bearing account. The deposit plus interest shall be credited to Buyer and shall be applied against the purchase price for the Purchased Assets, other than the Intangible Assets, at the closing or if the closing fails to occur, then the deposit shall be disbursed as set forth hereinafter.

13. **LIMITATION ON LIABILITIES ASSUMED.** Except as provided in subparagraph 3(c), Paragraph 8 and Paragraph 9, Buyer shall not, by reason of this Agreement or Buyer's purchase of the Purchased Assets, take responsibility for any liabilities, debts or obligations, is of Seller (including Seller's trade payables, account payables, obligations to employees, or tax liabilities).

14. **WARRANTIES OF SELLER.** Seller makes the following warranties to Buyer, with the intent that Buyer rely thereon:

(a) **CORPORATE ORGANIZATION.** Seller is a corporation organized, validly existing, and in good standing under the laws of the State of California. Seller is qualified to do business in the State of California and has full power and authority to own, use, and sell its assets.

(b) **CORPORATE AUTHORITY.** Seller's board of directors and shareholders have authorized the execution and delivery of this Agreement to Buyer and the carrying out of its provisions. This agreement will not violate any judicial, governmental or administrative decree, order, writ, injunction, or judgment, and will not conflict with or constitute a default under Seller's bylaws, or any contract, agreement, or other instrument to which Seller is a party or by which it may be bound.

(c) **EMPLOYEE ISSUES.** Within 10 days after the date of this Agreement Seller shall provide to Buyer the following: (i) a census of Seller's employees, (ii) a written disclosure of all benefits made available to Seller's employees (including qualified and non-qualified retirement plans), and (iii) access to all personnel files for seller's employees. All employee benefit plans maintained by seller for its employees shall be fully funded prior to Closing. Seller shall pay all wages, commissions, accrued vacation pay and other accrued compensation earned by Seller's employees prior to Closing (together with all accrued FICA and withholding taxes). Seller shall terminate the employment of all of Seller's employees effective as of the close of business on the Closing Date. Buyer will consider any of Seller's employees who apply for employment on an equal basis with all other applicants. Employment will be offered to Buyer's selected applicants on terms and conditions to be established by Buyer. Seller agre

(d) **FINANCIAL.** Seller shall furnish to Buyer such financial and operating data and other information as to the business and properties of Seller's business as Buyer shall request. The review of such materials will be at Buyer's expense, including a certified audit, if Buyer deems it to be necessary.

(e) **UNDISCLOSED LIABILITIES AND CONTRACTUAL COMMITMENTS.** Except as otherwise disclosed in this Agreement (or in an attached Exhibit): (i) Seller does not have any liabilities which might have a material impact on Buyer's use of the Purchased Assets, (ii) Seller is not a party to any contracts or commitments which might have a material impact on Buyer's use of the Purchased Assets, and (iii) no law suit or action, administrative proceeding, arbitration proceeding, governmental investigation, or other legal or equitable proceedings of any kind is pending or threatened against Seller which might adversely affect the value of the Purchased Assets. If any claim is asserted against Buyer after Closing with respect to any obligation of seller which Seller has failed to disclose to Buyer in writing, or which Seller has disclosed but failed to pay, then Buyer shall give prompt, written notice of that claim to Seller. Seller shall indemnify Buyer with respect to all such obligations.

(f) **CONDITION OF EQUIPMENT.** Each item of the equipment shall be in good operating condition at Closing. Seller will continue to perform routine maintenance and repairs with respect to the Equipment prior to Closing. In addition, the roof, ventilation (including the air conditioning), heating, plumbing, electrical systems and structural members, collectively referred to as the "Structural Building Systems" of the buildings located on the Business Real Property, are in good working order and condition and shall be so on the Closing Date. Buyer shall have thirty (30) days from the Closing Date to advise Seller in writing if any of the foregoing assets were not in good working order on the Closing Date.

(g) **GOOD TITLE.** Seller has, and shall transfer to Buyer at Closing, good and marketable title to all of the Purchased Assets, free and clear of all security interests, liens, equitable interests, leases, assessments, restrictions, reservations, or other burdens of any kind. All current and accrued taxes which may become a lien against any of the Purchased Assets prior to closing shall have been paid by Seller prior to Closing (including property taxes, sales taxes and excise taxes).

(h) **TOXIC MATERIALS.** Upon the execution of this agreement, Seller at its cost shall engage an appropriate environmental firm to conduct an investigation and who will thereafter produce a Phase One Environmental Report regarding the Business Real Property. In addition, Seller shall make available to Buyer copies of all other environmental reports and certificates (of which Seller has knowledge) with respect to the Business Real Property. Regarding any deficiencies set forth in the Phase One Environmental Report, Buyer can waive same or Seller shall have until the Closing Date to remedy same. In the event it is apparent that a remedy can not be completed by the Closing Date, then in such event, Seller can either elect to rescind the transaction in its entirety or place sufficient funds into the escrow at the Closing Date to cover the expense of the required remedy.

Except as disclosed by Seller on Exhibit "C" attached hereto, (i) no activity in connection with Seller's business prior to Closing shall have produced any toxic materials, the presence or use of which upon the Business Real Property would violate any federal, state, local or other governmental law, regulation or order or would require reporting to any governmental authority and (ii) the Business Real Property is otherwise free and clear of any toxic materials. For purposes of this subparagraph (h), the phrase "toxic materials" shall include but not be limited to any and all substances deemed to be pollutants, toxic materials or hazardous materials under any state or federal law.

(i) **FRANCHISERS' CONSENT.** Seller shall take all actions which are reasonably necessary on Seller's part to obtain the consent of the Franchisors to the issuance to Buyer of exclusive franchises for the sale of new Ford and Lincoln-Mercury vehicles in the same geographical area as Seller's current franchises in Napa, California.

(j) **INDEMNIFICATION FOR BREACH OF WARRANTIES.** Seller shall indemnify Buyer against all losses, damages and costs (including attorney fees and court costs) relating to any warranty made by Seller in this Agreement which is false, misleading, incomplete or inaccurate (either on the date of this Agreement or at the time of Closing). If at any time prior to Closing Buyer determines that any warranty made by Seller in this Agreement is incorrect, incomplete or misleading, then Buyer shall advise Seller of that fact and Seller shall provide to Buyer in writing whatever other information shall be necessary to cause that warranty to be correct, complete and not misleading.

15. CONDUCT OF BUSINESS PENDING CLOSING. Seller warrants that during the period beginning on the date of this Agreement and ending at Closing: (i) Seller shall continue to operate Seller's Business in the usual ordinary course, and in substantial conformity with all applicable laws, ordinances, regulations, rules or orders, (ii) Seller shall not allow any liens to be placed against any of the Purchased Assets unless those liens are discharged prior to Closing; (iii) Seller shall not take any action which may cause a material adverse change in the operations of Seller's Business; (iv) Seller shall not conduct any sale which shall use the words or phrases "Going Out of Business Sale" or "Change of Ownership Sale" or other words or phrases having similar meanings and; (v) Seller shall use its best efforts to preserve the value of the Ford and Lincoln-Mercury franchises in Napa, California.

16. REPRESENTATIONS AND WARRANTIES OF BUYER. Buyer hereby makes the following representations and warranties to Seller, with the intent that Seller rely thereon:

(a) **ORGANIZATION.** Lithia Motors, Inc. is a corporation organized, validly existing and in good standing under the laws of the State of Oregon, and has been qualified by the appropriate California authorities to own property and to carry on its business.

(b) **AUTHORITY.** This Agreement has been authorized by the board of directors of Lithia Motors, Inc. This agreement will not violate the provisions of any judicial, governmental or administrative decree, order, writ, injunction, or judgment, or conflict with or constitute a default under, the Article or bylaws of Lithia Motors, Inc. or any contract, agreement, or other instrument to which Lithia Motors, Inc. is a party.

17. ADDITIONAL CONDITIONS PRECEDENT TO BUYER'S OBLIGATIONS. The obligation of Buyer to close this transaction is subject to each of the following conditions (each of which is for the benefit of Buyer and may be waived by Buyer), and Buyer shall have the right to rescind this Agreement if any of the following conditions is not satisfied in accordance with its terms:

(a) Buyer shall have obtained from Franchisors, prior to the Final Closing Date, exclusive franchises to sell new Ford and Lincoln-Mercury vehicles in the same

geographical area as Seller's current franchises in Napa, California (as evidenced by the issuance to Buyer by Franchisors of appropriate Dealership Sales and Service Agreement, and the approval of Buyer as the publicly owned Dealer-Operator of the franchises), and Buyer agrees to use its best reasonable efforts to obtain those Franchises.

(b) Buyer shall be reasonably satisfied with any facility improvement requirement which are imposed by Franchisors which have an aggregate cost of more than \$25,000.

(c) The lease assigned to Buyer, or a related entity, of the Business Real Property shall occur prior to or concurrently with this transaction.

(d) All of Seller's agreements and warranties set forth in this Agreement shall be correct, complete and not misleading at Closing; provided that Buyer's decision to close this transaction shall not release Seller from liability to Buyer for any warranty which is subsequently determined to be incorrect, incomplete or misleading.

(e) The Phase One Environmental Report must indicate that there are no toxic materials present on, under, or about the Business Real Property or if such toxic materials are so indicated Seller must have cured same either by completing the required remedy by the Closing Date or by placing sufficient funds into Escrow at the Closing Date to cover the expense of the required remedy.

18. CLOSING. The parties shall make all reasonable effort to close the purchase and sale under this Agreement at or before 5:00 PM, Pacific Standard Time, on or before the Final Closing Date, at the offices of Capitol City Escrow, Inc. in Sacramento, California, or at some other location as shall be selected by mutual agreement of the parties.

(a) The parties agree to establish a closing escrow account at Capitol City Escrow, Inc. in Sacramento, California, (the "Closing Escrow Agent"). Buyer and Seller each shall pay one-half (1/2) of the escrow fees. Buyer and Seller agree to execute whatever reasonable escrow instructions may be required by Closing Escrow Agent in connection with this transaction. In the event of any conflict between those escrow instructions and this Agreement, the terms of this Agreement shall prevail.

(b) In all events, the Closing of the transaction contemplated under this Agreement shall occur (if at all) on or before the Final Closing Date.

(c) If this transaction closes as provided herein, then actual possession and all risk of loss, damage or destruction with respect to the Purchased Assets, shall be deemed to have been delivered to Buyer at 11:59 PM, Pacific Standard Time, on the Closing Date.

(d) At Closing, and coincidentally with the performance of the obligations to be performed by Buyer at Closing, Seller shall deliver to Buyer the following: (i) all bills of sale, assignments and other instruments of transfer, in form and substance reasonably satisfactory to Buyer, which shall be necessary to convey the Purchased Assets to Buyer, and (ii) all other documents required under this Agreement.

(e) At Closing, and coincidentally with the performance of all obligations required of Seller at Closing, Buyer shall deliver to Seller the following: (i) payment for the Purchased Assets; and (ii) all other payments and documents required under this Agreement. Buyer shall be responsible for all sales taxes payable in connection with the transaction. All amounts payable by Buyer to Seller at closing shall be paid by certified check drawn against a bank of Buyer's choice having offices located in Jackson County, Oregon, or by whatever other means shall be acceptable to Seller.

(f) If Closing does not take place on or before the Final Closing Date because there has been a failure of any condition precedent set forth in Paragraph 17 or because Seller has elected to rescind the agreement pursuant to paragraph 14(h), then: (i) all rights and obligations of both parties under this Agreement shall terminate, (ii) Buyer shall be entitled to a refund of the entire \$250,000 deposit (and interest earned thereon) which is referred to in paragraph 12, and (iii) this Agreement and all predecessor agreements shall thereafter be void and of no effect.

(g) If Closing does not take place on or before the Final Closing Date because of Buyer's material breach of this Agreement, then the \$250,000 deposit delivered by Buyer to the Closing Escrow Agent together with all interest earned thereon while held by the Closing Escrow Agent shall be forfeited to Seller as Seller's sole and exclusive remedy for Buyer's breach, and seller shall have no other rights or remedies against Buyer by reason of that breach. THIS SUM REPRESENTS A REASONABLE ESTIMATE BY BUYER AND SELLER OF SELLER'S DAMAGES IN THE EVENT OF SUCH A DEFAULT, IT BEING EXTREMELY DIFFICULT TO ASCERTAIN SELLER'S PRECISE DAMAGES. IF CLOSING DOES NOT OCCUR ON OR BEFORE THE CLOSING DATE FOR ANY REASON OTHER THAN BUYER'S DEFAULT, SELLER AND BUYER IRREVOCABLY AUTHORIZE AND INSTRUCT THE CLOSING ESCROW AGENT TO IMMEDIATELY DELIVER TO BUYER, ON DEMAND, BUYER'S DEPOSIT TOGETHER WITH THE INTEREST EARNED THEREON, LESS ESCROW CANCELLATION COSTS.

(h) Both parties agree to make a good faith effort to execute and deliver all documents and complete all actions necessary to consummate this transaction.

19. **BOOKS AND RECORDS.** Seller shall have the right at any time and from time to time, for a period of five (5) years after the Closing Date, to examine and make copies of all books and records acquired by Buyer hereunder. In addition, Buyer agrees to store for a period of five (5) years all books and records of Seller which Buyer is not acquiring hereunder. Lastly, Buyer agrees to make its staff available to Seller for a period of five (5) days subsequent to the Closing Date so that Seller can close out its books.

20. **SELLER'S ACCOUNTS RECEIVABLE.** For a period of six (6) months after Closing, Buyer shall, on Seller's behalf, and at no charge to Seller, accept any payment with respect to Seller's customer receivables and other receivables arising out of the operation of Seller's Business prior to Closing. All collected receivables from vehicles sales shall be delivered to Seller within ten (10) days after collection, and all other collected receivables shall be

delivered to Seller on a monthly basis. Buyer shall have no obligation to undertake collection efforts with respect to Seller's receivables, and Buyer's only obligation shall be to account for and pay over Seller's receivables which are actually received by Buyer.

21. SURVIVAL OF REPRESENTATIONS. All representations, warranties, indemnification obligations and covenants made in this Agreement shall survive the Closing, and shall remain in effect until the expiration of the latest period allowable in any applicable statute of limitations.

22. ASSIGNMENT BY BUYER. Lithia Motors, Inc. shall have the right to assign all rights and obligations of Lithia Motors, Inc. as "Buyer" under this agreement. In the event of any such assignment, the assignee shall assume all rights and obligations of the Buyer under this agreement, and Lithia Motors, Inc. shall remain jointly and severally liable for all obligations of the Buyer. In addition and in this event, Lithia Motors, Inc. will unconditionally guarantee the promissory note referred to in paragraph 11 above.

23. MISCELLANEOUS,

(a) There are no oral agreements or representations between the parties which affect this transaction, and this Agreement supersedes all previous negotiations, warranties, representations and understandings between the parties. True copies of all documents referenced in this Agreement are attached hereto. If any provision of this Agreement shall be determined to be void by any court of competent jurisdiction, then that determination shall not affect any other provision of this Agreement, and all other provisions shall remain in full force and effect. If any provision of this Agreement is capable of two constructions, only one of which would render the provision valid, then the provision shall have the meaning which renders it valid. The paragraph headings in this Agreement are for convenience purposes only, and do not in any way define or construe and contents of this Agreement.

(b) This Agreement shall be governed and performed in accordance with the laws of the State of California. Each of the parties hereby irrevocably submits to the jurisdiction of the courts of Napa County, California, and agrees that any legal proceedings with respect to this Agreement shall be filed and heard in the appropriate court in Napa County, California.

(c) This Agreement may be executed in multiple counterparts, each of which shall be an original, and all of which shall constitute a single instrument when signed by both of the parties. This Agreement shall inure to the benefit of and shall be binding upon the successors and assigns of the respective parties.

(d) Waiver by either party of strict performance of any provision of this Agreement shall not be a waiver of, and shall not prejudice the party's right to subsequently require strict performance of the same provision or any other provision. The consent or approval of either party to any act by the other party of a nature requiring consent or approval; shall not render unnecessary the consent to or approval of any subsequent similar act.

(e) All notices provided for herein shall be in writing and shall be deemed to be duly given when mailed by United States certified mail, postage prepaid, to the last known address of the party entitled to receive the notice, or when personally delivered to that party.

(f) Time is of the essence to this Agreement.

(g) Should any party hereto institute any action or proceedings to enforce or interpret any provision hereof, or for damages by reason of any alleged breach of any provision of this Agreement, the prevailing party shall be entitled to recover from the losing party or parties such amount as the court may adjudge to be reasonable attorney's fees for services rendered to the prevailing party in such action or proceeding. The term "prevailing party" as used in this section shall include, without limitation, any party who is made a defendant in litigation in which damages and/or other relief may be sought against such party and a final judgment or dismissal or decree is entered in such litigation in favor of such party defendant.

IN WITNESS WHEREOF, the parties have executed this Agreement on the dates indicated below:

SELLER: MAGNUSSEN-BARBEE FORD, LINCOLN-MERCURY, INC.

BY: /s/ Bernard L. Magnussen

2/18/97

Bernard L. Magnussen, President

Dated

BUYER: LITHIA MOTORS, INC.

BY: /s/ Sidney B. DeBoer

2/21/97

Sidney B. Deboer, President

Dated

EXHIBIT "A"

List of Equipment Seller is Retaining pursuant to Paragraph 6 above.

NONE

EXHIBIT "B"

List of Leases and Agreements being assumed by Buyer pursuant to Paragraph 8 above.

EXHIBIT "C"

Activities in connection with Seller's business prior to Closing which produced toxic material which violated governmental law, regulations or orders or would require reporting to any governmental authority - pursuant to paragraph 14h) above.

NONE

EXHIBIT 10.5.3
SUPPLEMENTAL AGREEMENT TO
DEALER SALES AND SERVICE AGREEMENT
(PUBLICLY TRADED COMPANY)

THIS SUPPLEMENTAL AGREEMENT (this "Supplemental Agreement"), dated as of December 27, 1996, is entered into among Lithia HPI, Inc. ("Dealer"). Lithia Motors, Inc. ("Public Company") and American Isuzu Motors Inc. ("Distributor").

WHEREAS, contemporaneously herewith, Distributor and Dealer are entering into a Dealer Sales and Service Agreement (the "Dealer Agreement") which authorizes Dealer to conduct dealership operations from the Dealership locations identified in the Dealer Agreement;

WHEREAS, the organization and ownership of Dealer is such that the terms of the Dealer Agreement are not wholly adequate to address the legitimate business needs and concerns of Distributor and Dealer; and

WHEREAS, Distributor and Dealer have entered into the Dealer Agreement in consideration for and in reliance upon certain understandings, assurances and representations which the parties wish to document.

NOW, THEREFORE, in consideration of the premises and mutual covenant contained herein, the parties hereby agree as follows:

1. LIMITATIONS UPON CHANGE OF EXECUTIVE MANAGER

A. DESIGNATION OF EXECUTIVE MANAGER. As set forth in Section 4 of the Dealer Agreement, Sidney B. DeBoer shall Executive Manager of Dealer. Dealer agrees that Executive Manager shall have complete and irrevocable authority to make all decisions, and enter into any and all necessary business commitments, required in the normal course of conducting dealership operations on behalf of Dealer. Dealer shall not revoke, modify or otherwise impose limitations upon such authority without the prior written consent of Distributor.

B. CHANGE OF EXECUTIVE MANAGER. Without limiting the restrictions set forth in the Dealer Agreement, the removal or withdrawal of Executive Manager with Distributor's prior written consent shall constitute grounds for termination of the Dealer Agreement, subject to applicable law.

2. LIMITATIONS UPON CHANGES IN OWNERSHIP

A. CHANGE IN OWNERSHIP. Dealer and Public Company hereby represent and warrant that (i) Dealer is a wholly-owned subsidiary of Public Company, (ii) at least 55% of the capital stock of Public Company is owned by Lithia Holding, LLC (Holding Company), and (iii) the membership interests in Holding Company are held as follows: M.L. Dirk Heimann - 34.875%, Sidney B. DeBoer -58.125%, and R. Bradford Gray - 7%. Given the control of Public Company over Dealer, the control of Holding Company over Public Company, and the control of the above-named individuals over Holding Company, and Distributor's strong interest in assuring that those who own and control Distributor's dealerships have interests consistent with those of Distributor, Dealer and Public Company agree that (i) any change in the ownership of Dealer or Holding Company, or (ii) the acquisition by any person or entity (other than Holding Company) of more than 20% of the issued and outstanding capital stack of Public. Company, shall be consider a change in ownership of Dealer under the terms of the Dealer Agreement, and shall be subject to the provisions of the Dealer Agreement and subparagraph B below.

B. DISTRIBUTOR'S RIGHTS UPON CHANGE IN OWNERSHIP. Upon the occurrence of any event described in subparagraph A above, if Distributor reasonably concludes that the transferee or acquiring person or entity does not have interests compatible with those of Distributor or is otherwise not qualified to have an ownership interest in the dealerships at the Dealership Locations, then within 90 days of receipt of written notice from Distributor, Dealer agrees to: (i) transfer the assets associated with Dealer to a third party acceptable to the Distributor, (ii) voluntarily terminate the Dealer Agreement, or (iii) provide evidence to Distributor that such person or entity no longer has such an ownership interest in Public Company. In the event that Dealer enters into an agreement to transfer its assets to a third party as set forth in (i) above, Distributor shall have a right of person or entity no longer has such an ownership interest in Public Company. In the event that Dealer enters into an agreement to transfer its assets to a third party as set forth in (i) above, Distributor shall have a right of

first refusal to purchase such assets in accordance with the terms and procedures set forth in subparagraph C below. Dealer and Public Company agree that if an ownership interest is acquired in Public Company by a person or entity which notifies Public Company via Schedule 13D filed with the Securities and Exchange Commission, Dealer shall advise Distributor in writing, and attach a copy of that Schedule.

C. EXERCISE OF RIGHT OF FIRST REFUSAL. Prior to exercising its right of first refusal pursuant to subparagraph B above, Distributor shall have a reasonable opportunity to inspect the assets, including real estate, before making its decision. If Dealer has entered into a bona fide written buy/sell agreement, the purchase price and other terms of sale shall be those set forth in such agreement and any related documents, unless Dealer and Distributor agree to other terms. Upon Distributor request, Dealer agrees to provide all documents relating to the proposed transfer. If Dealer refuses to provide such documentation or states that such documents do not exist, it will be presumed that the agreement is not bona fide. In the absence of a bona fide written buy/sell agreement, the purchase price of the dealership assets will be determined by good faith negotiations by Dealer and Distributor. If agreement cannot be reached within a reasonable time, the price and other terms of sale shall be established by arbitration according to the rules of the American Arbitration Association. Dealer agrees to transfer the assets by Warranty Deed where possible, conveying marketable title free and clear of liens and encumbrances. The Deed will be in proper form for recording and Dealer will deliver complete possession of the assets when the Deed is delivered. Dealer will also furnish copies of any easements, licenses or other documents affecting the property and assign any permit or licenses necessary for the conduct of Dealers operations. Distributor's rights under this section may be assigned to any third party and in connection with any such assignment, Distributor will guarantee full payment of the purchase price by the assignee.

3. LIMITATIONS UPON NUMBER AND LOCATIONS OF DEALERSHIPS

Dealer and Public Company agree to be bound by the provisions of Distributors standard policies in effect from time to time which limit the number and locations of Distributor's dealerships which may be owned by Dealer and/or its parent companies, subsidiary companies and companies under common control with it. Dealer shall provide such documentation as is reasonably requested by Distributor regarding the ownership interests of all such persons and entities in Distributor's dealerships. In the event that Dealer or Public Company shall acquire ownership or control of more than one of Distributor's dealerships, then Dealer and/or Public Company shall obtain separate motor vehicle licenses, and shall maintain separate financial statements for each dealership.

4. WORKING CAPITAL REQUIREMENTS

Dealer shall maintain, at all times, sufficient working capital to meet or exceed the minimum net working capital standards for Dealer as determined from time to time by Distributor consistent with its standard policies. Dealer shall provide such documentation as is reasonably requested by Distributor to assure compliance with this requirement. Public Company agrees to submit an annual consolidated balance sheet for the combined dealership operations of Public Company. Public Company agrees, upon Distributor's request, to provide Distributor with copies of the materials filed by Public Company with the Securities and Exchange Commission.

5. INDEMNITY

Public Company agrees to indemnify and hold Distributor harmless from and against any and all claims, liabilities, losses, damages, costs and expenses arising out of or in connection with the sale of stock in Public Company. Public Company further agrees to indemnify and hold Distributor harmless from and against any and all claims of the shareholder of Public Company, and all liabilities, losses, damages, costs and expenses incurred in connection therewith, unless a final determination is made that Distributor was in fact liable for such claims, liabilities, losses, damages, costs or expenses.

6. MISCELLANEOUS

A. EFFECT OF SUPPLEMENTAL AGREEMENT. The parties agree that this Supplemental Agreement is intended to supplement the terms of the Dealer Agreement and not to limit the rights and obligations of the parties contained therein. This Supplemental Agreement is hereby incorporated into the Dealer Agreement and made a part thereof. In the event that any of the provisions of this Supplemental Agreement are in actual conflict with other provisions of the Dealer Agreement, the provisions of contained in this Supplemental Agreement shall govern. In the event that the policies of Distributor with regard to the issues

address herein are hereinafter modified, the parties agree to review such modifications to determine whether modifications of this Supplemental Agreement are appropriate.

B. CONSTRUCTION. This Supplemental Agreement shall be governed by and construed in accordance with the laws of the State of California. The failure of either party to enforce any of the provisions of this Supplemental Agreement or the failure to exercise any election provided for herein shall in no way be considered to be a waiver of such provisions or elections. All capitalized terms used herein and not defined herein shall have the meanings set forth in the Dealer Agreement.

C. ALTERNATIVE DISPUTE RESOLUTION. In the event of any dispute between the parties regarding the Dealer Agreement or this Supplemental Agreement, Dealer and Public Company agrees to participate in any alternative dispute resolution procedures specified in the standard policies of Distributor. Upon final determination through such dispute resolution, each party shall have recourse to a review de novo by the appropriate state court or administrative agency consistent with the provisions of state law. The parties agree that should a party making such appeal lose the issues presented on appeal, then that party shall pay the reasonable expenses, including reasonable attorneys' fees, of the other party for the defense of such de novo review.

D. NO THIRD PARTY BENEFICIARIES. Nothing in this Supplemental Agreement or the dealer Agreement shall be construed to confer any rights upon any person not a party hereto or thereto, nor shall it create in any party an interest as a third party beneficiary of this Supplemental Agreement or the Dealer Agreement. Dealer and Public Company agree to indemnify and hold harmless Distributor, its affiliates, subsidiaries, directors, officers, employees, agents and representatives from and against all claims, actions, liabilities, damages, costs and expenses (including reasonable attorneys' fees) arising from or in connection with any action by a third party in its capacity as a stockholder of Public Company other than through a derivative stockholder suit authorized by the Board of Directors of Public Company.

E. CONDITION PRECEDENT. Notwithstanding anything to the contrary contained herein, the parties acknowledge that the provisions of this Supplemental Agreement shall not be applicable until such time a Public Company completes a public offering of its stock.

IN WITNESS WHEREOF, THE PARTIES HAVE EXECUTED THIS SUPPLEMENTAL AGREEMENT EFFECTIVE AS OF THE DATE SET FORTH IN THE INTRODUCTORY PARAGRAPH HEREOF.

AMERICAN ISUZU MOTORS INC.

LITHIA HPI, INC.

By: _____
 J.T. Maloney
Title: _____

By: _____
 Sidney B. DeBoer
Title: _____

By: _____
 Manfred L. Heimann
Title: _____

LITHIA MOTORS, INC.

By: _____
 Sidney B. DeBoer
Title: _____

By: _____
 Manfred L. Heimann
Title: _____

EXHIBIT 10.10.4
ADDENDUM TO SECTION X - ADDITIONAL PROVISIONS

These Additional Provisions to Toyota Dealer Agreement ("Additional Provisions") are entered into as of DECEMBER 23, 1996 among DISTRIBUTOR, DEALER, LITHIA MOTORS, INC., an Oregon corporation, (hereinafter "LITHIA"), LITHIA HOLDING COMPANY, L.L.C., an Oregon limited liability company ("hereinafter "HOLDING") and SIDNEY B. DEBOER (hereinafter "DeBoer") and form a part of and are incorporated into the Dealer Agreement.

RECITALS

1. DISTRIBUTOR and DEALER have entered Into a Toyota Dealer Agreement (the "Dealer Agreement") dated as of NOVEMBER 15, 1996.
2. LITHIA is the 100% shareholder of DEALER, HOLDING is the controlling (defined below) shareholder of LITHIA, DeBoer is the controlling manager of HOLDING. For the purposes of these Additional Provisions, the terms "control", "controlling" and "controlled" have meanings given to them in Rule 405 under the Rules and Regulations of the Securities Act of 1933, as amended.
3. The current ownership of the outstanding stock of LITHIA is as follows:

	Share of Total Outstanding Stock	Type of Stock	Votes Per Share	Share of Total
HOLDING	NOT LESS THAN 55%	COMMON CLASS B	10	NOT LESS THAN 93.75%
OTHERS	NOT MORE THAN 45%	COMMON CLASS A	1	NOT MORE THAN 6.25%

4. The Members of HOLDING are as follows:

	Share of Units -----
Sidney B. DeBoer	58.125%
Manfred L. Heimann	34.875%
R. Bradford Gray	7.000%

The controlling Manager of HOLDING Is:

Sidney B. DeBoer

5. HOLDING, DEALER, DeBoer and LITHIA are hereinafter collectively referred to as the "LITHIA Parties". DISTRIBUTOR and the LITHIA Parties are hereinafter referred to as the "Parties".

6. The Parties wish to enter into these Additional Provisions for the purpose of agreeing to be bound by the terms of these Additional Provisions, which are a part of and are incorporated into the Dealer Agreement.

NOW THEREFORE, in consideration for the mutual agreements contained herein and in the Dealer Agreement, the Parties agree as follows:

A. GENERAL

1. DISTRIBUTOR and LITHIA have entered into an Agreement dated SEPTEMBER 30, 1996 (the "Agreement") relating, among other matters, to the number of Toyota and Lexus dealerships which may be acquired by LITHIA and its affiliates and to certain aspects of the management of Toyota and Lexus dealerships owned by LITHIA. The LITHIA Parties agree that the Agreement is incorporated into and forms a part of the Dealer Agreement and these Additional Provisions. To the extent that any provision of the Agreement is inconsistent with the Dealer Agreement or these Additional Provisions, the provisions of the Agreement shall be controlling.

2. The LITHIA Parties acknowledge and agree that if any provision of these Additional Provisions is violated in any material respect by any of the LITHIA Parties, DISTRIBUTOR will have the right to terminate the Dealer Agreement on sixty (60) days' written notice to DEALER, if DEALER fails to cure such violation prior to the expiration of such sixty (60) days.

3. The LITHIA Parties agree to comply with all Toyota policies, including all Market Representation policies.

B. PROVISIONS RELATING TO THE STRUCTURE OF DEALER

1. SINGLE PURPOSE ENTITY. DEALER will be maintained as a separate legal entity, and will not engage in any business other than the operation of this Toyota Kia dealership and activities related hereto.

2. NO MERGER, CONSOLIDATION, ETC. DEALER will not be merged with or into, or be consolidated with, or acquire substantially all of the assets of, any other entity, without the prior written consent of DISTRIBUTOR, in its sole discretion.

C. PROVISIONS RELATING TO MANAGEMENT

1. **ROLE OF DEBOER.** DeBoer will remain actively involved in the management of all aspects of the operations of DEALER. The LITHIA Parties have identified DeBoer as the LITHIA contact official set forth in paragraph 8 of the Agreement.

a). DeBoer will be an officer of DEALER. DeBoer, in consultation with management of LITHIA, will have complete control over all management decisions of DEALER or relating to DEALER.

b). The General Manager will report directly to and be responsible to DeBoer.

c). DISTRIBUTOR may rely on oral or written communications and agreements from DeBoer as being the binding agreements of DEALER, without any duty of the DISTRIBUTOR to confirm that such communication or agreement has been duly authorized by the Board of Directors of DEALER, LITHIA, or any other individual or entity.

2. **SUCCESSORS TO DEBOER.** In the event that DeBoer wishes to discontinue his role in the management of DEALER as set forth in Section C.1., such action may be taken only with the prior written consent of DISTRIBUTOR. Such consent of DISTRIBUTOR may be conditioned on transfer of DeBoer's management responsibilities to an individual or individuals approved by DISTRIBUTOR, taking into account such factors as DISTRIBUTOR reasonably deems to be relevant and are consistent with all applicable laws.

3. ROLE OF THE GENERAL MANAGER.

a). STEPHEN R. PHILLIPS or any subsequent General Manager of DEALER approved by DISTRIBUTOR, will serve exclusively as General Manager of the Toyota operation and any other line-make that DISTRIBUTOR has consented may be dueled with Toyota, on a full time basis and will not have any management responsibilities with respect to any other dealership or business.

b). The General Manager will have responsibility for and authority with respect to the day-to-day operations of DEALER in the ordinary course of business, under the supervision of LITHIA, and the General Manager will have the following authority, without the need for obtaining the prior approval

of any other person:

- (i) the authority to hire or terminate and employee of DEALER.
- (ii) the authority to order vehicles and other products.
- (iii) the authority to place advertising.
- (iv) the authority to communicate with DISTRIBUTOR with respect to all aspects of the business of DEALER,
- (v) the authority to approve expenditure by DEALER in the ordinary course of business in amounts of less than \$50,000 per item.

D. PROVISIONS RELATING TO CAPITALIZATION AND ACCOUNTING

1. No distributions will be made by DEALER to LITHIA if such distributions would cause DEALER to fail to meet any of DISTRIBUTOR's capitalization requirements, including but not limited to net working capital requirements.
2. The operations and financial results of DEALER will be reported to DISTRIBUTOR separately from those of any other entity, business or activity, including but not limited to any of the LITHIA Parties and any other dealerships directly or Indirectly owned or controlled by any of the LITHIA Parties.
3. DEALER is currently dueled with KIA. There should be no change in the line makes operating in DEALER's facility without the prior written consent of DISTRIBUTOR. DEALER will maintain a separate and permanent personnel staff and separate retail operations from other dealerships directly or Indirectly owned by any of the LITHIA Parties.
4. DEALER shall not combine Its used car operation with that of any other entity, including any other dealerships direct or indirectly owned by any of the LITHIA Parties.

E. PROVISIONS RELATING TO OWNERSHIP

1. CHANGES IN INDIRECT OWNERSHIP. In addition to the right of DISTRIBUTOR to approve changes in ownership of DEALER, as Set forth in the Dealer Agreement and the Agreement, DISTRIBUTOR shall also have the right, in compliance with applicable laws, to approve transfers In ownership in LITHIA by HOLDING, will have the

right to approve any transfer in management or ownership of HOLDING which results in DeBoer no longer being the controlling manager of HOLDING, and will have the right to approve any change in this ownership or capital structure of LITHIA which results in DeBoer's no longer having a majority of the voting power of LITHIA.

2. DIRECTORS. LITHIA shall provide a list of all current members of its Board of Directors, and resumes for each Director, to DISTRIBUTOR, and provide such Information for each now member.

3. SUCCESSORS AND ASSIGNS. In the event there is a request for transfer of any interest of the LITHIA Parties in accordance with the provisions of the Dealer Agreement, the Agreement and these Additional Provisions, as a condition to such transfer, the transferee must agree, in writing, to be bound by all of the terms and provisions of the Dealer Agreement, the Agreement and these Additional Provisions, such agreement to be in form and substance reasonably acceptable to DISTRIBUTOR.

F. FACILITIES

1. DEALER acknowledges that its current facility, designated in Section VII of this Agreement, is deficient in the following respects:

Service Dept. (3,375) Service Stalls (5)

DEALER understands and agrees that, to the extent DISTRIBUTOR has permitted or will permit DEALER to continue Toyota operations without full compliance with Toyota facility national minimum standards or DISTRIBUTOR directives, or both, such conduct by the DISTRIBUTOR shall not constitute a waiver of such standards or directives.

Further, DISTRIBUTOR may, at any time, amend this Agreement to establish a timetable for DEALER to fully comply with DISTRIBUTOR's minimum facility requirements.

2. DEALER acknowledges that the facility designated In Section VII of this Toyota Dealer Agreement is severely deficient in its appearance and does not project Toyota's #1 image, nor does it most Image USA requirements. DEALER agrees to rectify these deficiencies in accordance with the following timetable:

ACTION -----	DATE OF COMPLETION -----
Complete an exterior/fascia upgrade utilizing the Image USA theme.	12/01/97
Complete an interior modernization/	12/01/97

upgrade utilizing the Image USA themes.

DEALER understands and agrees that any provision set forth above that contemplate action to be taken by DEALER after the expiration of this Agreement are advisory only and that DISTRIBUTOR shall have no obligation to extend this Agreement or to offer DEALER a subsequent Toyota Dealer Agreement. DISTRIBUTOR does intend, however, to grant a subsequent Toyota Dealer Agreement to DEALER provided that DEALER is in full compliance with all of the terms and conditions of this Agreement, as well as any reasonable requirements imposed by DISTRIBUTOR from time to time.

IN WITNESS WHEREOF, the Parties have executed these Additional Provisions as of the date first above written.

<i>TOYOTA MOTOR SALES, USA., INC.</i>	<i>LITHIA MOTORS, INC.</i>
<i>By: /s/JIM LENTZ</i> -----	<i>By: /s/SIDNEY B. DEBOER</i> -----
<i>Jim Lentz</i>	
<i>Title: General Manager</i> -----	<i>Title: President</i> -----

LITHIA HOLDING CO., L.L.C.

<i>By: /s/SIDNEY B. DEBOER</i> -----	<i>/s/SIDNEY B. DEBOER</i> -----
<i>Title: _____</i>	<i>Sidney B. DeBoer</i>

LITHIA TKV, INC.

By: /s/SIDNEY B. DEBOER

Title: President

TOYOTA MOTOR SALES, USA., INC.

By: /s/YOSHIO ISHIZAKA

Mr. Yoshio Ishizaka
Title: President

FIRST AMENDMENT TO LEASE AGREEMENT EXHIBIT 10.12.2

This Amendment is made as of February 7, 1997, to that certain Lease Agreement (the "Lease Agreement"), dated December 13, 1996, between Lithia Properties, L.L.C., an Oregon limited liability company ("Landlord") and Lithia Motors, Inc., an Oregon corporation ("Tenant") relating to the real property located in Medford, Oregon, at the following addresses:

360 E. Jackson St. 401 E. 4th St. 325 E. Jackson St. 326 N. Bartlett 345 E. Bartlett St.

Whereas Landlord and Tenant desire to modify certain provisions of the Lease Agreement, and Section 13.16 of such Lease Agreement provides that any change to the Lease Agreement must be in writing executed by the parties thereto;

The undersigned Landlord and Tenant hereby agree as follows:

1. Section 1.3 of the Lease Agreement is amended to read as follows:

"EXPIRATION DATE. December 31, 2011."

2. Section 1.9 of the Lease Agreement is amended to read as follows:

"TERM. Fifteen-year period commencing on the Commencement Date and expiring December 31, 2011, if not terminated earlier pursuant to the terms of this Lease."

3. The last sentence of the first paragraph of Section 3.3 of the Lease Agreement is amended to read:

"As soon as the monthly rent for the ensuing year is established, Landlord shall give Tenant notice of the amount of monthly rent therefor."

4. All other provisions of the Lease Agreement are hereby ratified and confirmed and remain in full force and effect.

Landlord and Tenant have executed this First Amendment as of February 7, 1997.

Landlord:

LITHIA PROPERTIES, L.L.C.

By /s/ Sidney B. DeBoer, Managing Member

Tenant:

LITHIA MOTORS, INC.

By /s/ Sidney B. DeBoer

Its President

LITHIA MOTORS, INC.

CALCULATIONS OF NET INCOME PER SHARE

(In thousands, except per share amounts)

	Year Ended December 31,			
	1996		1995	
	Primary	Fully Diluted	Primary	Fully Diluted
Weighted Average Shares				
Outstanding for the Period:				
Class A Common Stock	96	96	-	-
Class B Common Stock	4,110	4,110	4,110	4,110
S Corp. termination (note 1)	451	451	467	467
Dilutive Common Stock				
Options Using the Treasury				
Stock Method	316	316	316	316
Total Shares Used for Per				
Share Calculations	4,973	4,973	4,893	4,893
Net Income	4,042	4,042	\$ 3,375	\$ 3,375
Net Income Per Share	\$ 0.81	\$ 0.81	\$ 0.69	\$ 0.69

Note 1: Reflects shares issued to pay S Corporation earnings dividends of

approximately \$5,150 to shareholders through the date of the Company's initial public offering on December 18, 1996.

EXHIBIT 23

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

Board of Directors
Lithia Motors, Inc. and subsidiaries:

We consent to incorporation by reference in the registration statement (No. 333-21673) on Form S-8 of Lithia Motors, Inc. of our report dated February 19, 1997, relating to the consolidated balance sheets of Lithia Motors, Inc. and Subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1996, which report appears in the December 31, 1996 annual report on Form 10-K of Lithia Motors, Inc.

KPMG PEAT MARWICK LLP

Portland, Oregon,
March 21, 1997

ARTICLE 5

PERIOD TYPE	12 MOS
FISCAL YEAR END	DEC 31 1996
PERIOD END	DEC 31 1996
CASH	15,413
SECURITIES	0
RECEIVABLES	2,260
ALLOWANCES	13
INVENTORY	28,152
CURRENT ASSETS	49,089
PP&E	4,616
DEPRECIATION	2,073
TOTAL ASSETS	63,754
CURRENT LIABILITIES	28,868
BONDS	27,660
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	24,683
OTHER SE	53
TOTAL LIABILITY AND EQUITY	63,754
SALES	142,844
TOTAL REVENUES	142,844
CGS	118,647
TOTAL COSTS	118,647
OTHER EXPENSES	20,277
LOSS PROVISION	29
INTEREST EXPENSE	1,353
INCOME PRETAX	3,916
INCOME TAX	(813)
INCOME CONTINUING	4,042
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	4,042
EPS PRIMARY	0.81
EPS DILUTED	0.81

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