LITHIA MOTORS INC
Form 10-Q
April 26, 2019

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-14733

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act. Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller reporting company [ ] Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

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

Class A common stock without par value	22,349,676
Class B common stock without par value	800,000
(Class)	Outstanding at April 26, 2019

LITHIA MOTORS, INC.
FORM 10-Q
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LITHIA MOTORS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In millions)
(Unaudited)

	March 31, 2019	December 31, 2018
Assets		
Current Assets:		
Cash and cash equivalents	$ 45.0	$ 31.6
Accounts receivable, net of allowance for doubtful accounts of $6.9 and $7.2	491.0	529.4
Inventories, net	2,441.0	2,365.3
Other current assets	50.9	65.1
Total Current Assets	3,027.9	2,991.4
Property and equipment, net of accumulated depreciation of $250.0 and $240.5	1,454.4	1,448.0
Operating lease right-of-use assets	250.0	—
Goodwill	456.8	434.9
Franchise value	308.1	288.7
Other non-current assets	194.8	221.0
Total Assets	$ 5,692.0	$ 5,384.0
Liabilities and Stockholders' Equity		
Current Liabilities:		
Floor plan notes payable	$ 359.0	$ 324.4
Floor plan notes payable: non-trade	1,767.2	1,733.3
Current maturities of long-term debt	24.6	25.9
Trade payables	119.3	126.3
Accrued liabilities	315.1	283.6
Total Current Liabilities	2,585.2	2,493.5
Long-term debt, less current maturities	1,295.7	1,358.2
Deferred revenue	124.4	121.7
Deferred income taxes	96.4	91.2
Noncurrent operating lease liabilities	235.2	—
Other long-term liabilities	104.6	122.2
Total Liabilities	4,441.5	4,186.8
Stockholders' Equity:		
Preferred stock - no par value; authorized 15.0 shares; none outstanding	—	—
Class A common stock - no par value; authorized 100.0 shares; issued and outstanding 22.3 and 22.0	9.7	—
Class B common stock - no par value; authorized 25.0 shares; issued and outstanding 0.8 and 1.0	0.1	0.1
Additional paid-in capital	28.0	35.0
Retained earnings	1,212.7	1,162.1
Total Stockholders' Equity	1,250.5	1,197.2
Total Liabilities and Stockholders' Equity	$ 5,692.0	$ 5,384.0

See accompanying condensed notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2019	2018
Revenues:		
New vehicle	$1,461.1	$1,454.7
Used vehicle retail	827.9	715.6
Used vehicle wholesale	77.4	76.0
Finance and insurance	117.5	106.5
Service, body and parts	317.4	285.7
Fleet and other	48.4	21.2
Total revenues	2,849.7	2,659.7
Cost of sales:		
New vehicle	1,375.2	1,367.8
Used vehicle retail	743.3	642.0
Used vehicle wholesale	76.5	75.0
Service, body and parts	157.9	147.3
Fleet and other	46.1	19.5
Total cost of sales	2,399.0	2,251.6
Gross profit	450.7	408.1
Asset impairments	0.5	—
Selling, general and administrative	321.8	297.5
Depreciation and amortization	19.8	16.8
Operating income	108.6	93.8
Floor plan interest expense	(18.1)	(13.5)
Other interest expense, net	(15.3)	(11.8)
Other income, net	2.6	1.3
Income before income taxes	77.8	69.8
Income tax provision	(21.4)	(17.7)
Net income	$56.4	$52.1
Basic net income per share	$2.43	$2.08
Shares used in basic per share calculations	23.2	25.1
Diluted net income per share	$2.42	$2.07
Shares used in diluted per share calculations	23.2	25.2
Cash dividends paid per Class A and Class B share	$0.29	$0.27

See accompanying condensed notes to consolidated financial statements.

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

	Common Stock				Additional	Retained	Total
	Class A		Class B		Paid-In	Earnings	Stockholders'
	Shares	Amount	Shares	Amount	Capital		Equity
Balance at December 31, 2017	23.9	$ 149.1	1.0	$ 0.1	$ 11.3	$ 922.7	$ 1,083.2
Net income	—	—	—	—	—	265.7	265.7
Issuance of stock in connection with employee stock plans	0.1	10.1	—	—	—	—	10.1
Issuance of restricted stock to employees	0.1	—	—	—	—	—	—
Repurchase of Class A common stock	(2.1)	(168.5)	—	—	19.6	—	(148.9)
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	9.3	—	—	4.1	—	13.4
Dividends paid	—	—	—	—	—	(27.7)	(27.7)
Adjustment to adopt ASC 606	—	—	—	—	—	1.4	1.4
Balance at December 31, 2018	22.0	—	1.0	0.1	35.0	1,162.1	1,197.2
Net income	—	—	—	—	—	56.4	56.4
Issuance of stock in connection with employee stock plans	—	2.3	—	—	—	—	2.3
Issuance of restricted stock to employees	0.1	—	—	—	—	—	—
Repurchase of Class A common stock	—	(3.1)	—	—	—	—	(3.1)
Class B common stock converted to Class A common stock	0.2	—	(0.2)	—	—	—	—
Compensation for stock and stock option issuances and excess tax benefits from option exercises	—	10.5	—	—	(7.0)	—	3.5
Dividends paid	—	—	—	—	—	(6.7)	(6.7)
Prior year retained earnings adjustment for adoption of ASC 842	—	—	—	—	—	0.9	0.9
Balance at March 31, 2019	22.3	$ 9.7	0.8	$ 0.1	$ 28.0	$ 1,212.7	$ 1,250.5

See accompanying condensed notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2019	2018
Cash flows from operating activities:		
Net income	$56.4	$52.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Asset impairments	0.5	—
Depreciation and amortization	19.8	16.8
Stock-based compensation	3.5	3.6
Gain on disposal of franchise	0.1	—
Deferred income taxes	5.2	2.7
(Increase) decrease (net of acquisitions and dispositions):		
Accounts receivable, net	49.9	42.6
Inventories	(81.4)	(98.9)
Other assets	9.0	14.7
Increase (decrease) (net of acquisitions and dispositions):		
Floor plan notes payable	34.6	17.7
Trade payables	(6.4)	6.9
Accrued liabilities	(14.5)	(13.6)
Other long-term liabilities and deferred revenue	0.5	4.3
Net cash provided by operating activities	77.2	48.9
Cash flows from investing activities:		
Capital expenditures	(29.1)	(42.0)
Proceeds from sales of assets	0.4	0.1
Cash paid for other investments	(6.6)	(7.6)
Cash paid for acquisitions, net of cash acquired	—	(324.4)
Proceeds from sales of stores	—	0.4
Net cash used in investing activities	(35.3)	(373.5)
Cash flows from financing activities:		
Borrowings on floor plan notes payable, net: non-trade	43.5	47.8
Borrowings on lines of credit	570.0	894.0
Repayments on lines of credit	(625.0)	(586.7)
Principal payments on long-term debt and capital leases, scheduled	(6.2)	(4.7)
Principal payments on long-term debt and capital leases, other	(3.3)	—
Payments of debt issuance costs	—	—
Proceeds from issuance of common stock	2.3	1.9
Repurchase of common stock	(3.1)	(8.3)
Dividends paid	(6.7)	(6.8)
Payments of contingent consideration related to acquisitions	—	(0.8)
Net cash (used in) provided by financing activities	(28.5)	336.4
Increase in cash and cash equivalents	13.4	11.8
Cash and cash equivalents at beginning of period	31.6	57.2

Cash and cash equivalents at end of period	$45.0	$69.0
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$37.9	$30.3
Cash paid during the period for income taxes, net	0.2	1.2
Floor plan debt paid in connection with store disposals	4.8	3.8
Supplemental schedule of non-cash activities:		
Debt assumed in connection with acquisitions	$—	$10.7
ROU assets obtained in exchange for lease liabilities [1]	257.0	—

[1] Amounts for the three months ended March 31, 2019 include the transition adjustment for the adoption of Topic 842.

See accompanying condensed notes to consolidated financial statements.

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LITHIA MOTORS, INC. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Interim Financial Statements

Basis of Presentation
These condensed Consolidated Financial Statements contain unaudited information as of March 31, 2019, and for the three-months ended March 31, 2019 and 2018. The unaudited interim financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by accounting principles generally accepted in the United States of America for annual financial statements are not included herein. In management’s opinion, these unaudited financial statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the information when read in conjunction with our 2018 audited Consolidated Financial Statements and the related notes thereto. The financial information as of December 31, 2018, is derived from our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 22, 2019. The unaudited interim condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in our 2018 Annual Report on Form 10-K. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

In 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842),” which requires leases with durations greater than twelve months to be recognized on the balance sheet, as right-of-use assets with corresponding operating lease liabilities. In July 2018, the FASB issued ASU No. 2018-11, "Targeted Improvements - Leases (Topic 842)." This update provides an optional transition method that allows entities to elect to apply the standard using the modified retrospective approach at its effective date, versus recasting the prior periods presented. If elected, an entity would recognize a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. We adopted the new standard as of January 1, 2019 using the transition method that provides for a cumulative-effect adjustment to retained earnings upon adoption. The Consolidated Financial Statements for the three months ended March 31, 2019 are presented under the new standard, while comparative years presented are not adjusted and continue to be reported in accordance with our historical accounting policy. We elected the 'package of practical expedients,' which permits us to not reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We elected the short-term lease recognition exemption for all leases that qualify. We have both real estate leases and equipment leases that are impacted by the new guidance. Most of our leases do not provide an implicit rate, therefore we use our incremental borrowing rate at the commencement date in determining the present value of lease payments. Adoption of the new standard resulted in the derecognition of a deferred gain from prior completed sale-leaseback transactions. This adjustment, net of tax, was recorded as $0.9 million increase in retained earnings. See Note 10.

The impact of adopting Topic 842 on the accompanying Condensed Consolidated Balance Sheet as of January 1, 2019 was as follows (in millions):

Impact on Consolidated Balance Sheets	December 31, 2018	Adjustments	January 1, 2019
Operating lease right-of-use assets	$ —	$ 256.4	$ 256.4
Total Assets	5,384.0	256.4	5,640.4
Operating lease liabilities:			
Accrued liabilities	283.6	26.1	309.7
Deferred revenue	121.7	(1.3)	120.4
Noncurrent operating lease liabilities	—	241.0	241.0

Other long-term liabilities	122.2	(10.3)	111.9
Total Liabilities	4,186.8	255.5	4,442.3
Retained earnings	1,162.1	0.9	1,163.0
Total Liabilities and Stockholders' Equity	5,384.0	256.4	5,640.4

Reclassifications

Certain immaterial reclassifications of amounts previously reported have been made to the accompanying condensed Consolidated Financial Statements to maintain consistency and comparability between periods presented.

Note 2. Contract Liabilities and Assets

Contract Liabilities
We are the obligor on our lifetime oil contracts. Revenue is allocated to these performance obligations and is recognized over time as services are provided to the customer. The amount of revenue recognized is calculated, net of cancellations, using an input method, which most closely depicts performance of the contracts. Our contract liability balances were $154.5 million and $149.6 million as of March 31, 2019, and December 31, 2018, respectively; and we recognized $5.9 million of revenue in the three months ended March 31, 2019, related to our contract liability balance at December 31, 2018. Our contract liability balance is included in accrued liabilities and deferred revenue.

Contract Assets
Revenue from finance and insurance sales is recognized, net of estimated charge-backs, at the time of the sale of the related vehicle. We act as an agent in the sale of these contracts as the pricing is set by the third-party provider, and our commission is preset. A portion of the transaction price related to sales of finance and insurance contracts is considered variable consideration and is estimated and recognized upon the sale of the contract. Our contract asset balances associated with future estimated variable consideration were $9.0 million and $9.2 million as of March 31, 2019 and December 31, 2018, respectively; and is included in trade receivables and other non-current assets.

Note 3. Accounts Receivable and Contract Assets

Accounts receivable consisted of the following (in millions):

	March 31, 2019	December 31, 2018
Contracts in transit	$ 259.5	$ 294.0
Trade receivables	54.0	54.3
Vehicle receivables	49.9	51.6
Manufacturer receivables	95.2	105.5
Auto loan receivables	62.1	61.5
Other receivables	14.8	6.8
	535.5	573.7
Less: Allowance for doubtful accounts	(6.9)	(7.2)
Less: Long-term portion of accounts receivable, net	(37.6)	(37.1)
Total accounts receivable, net	$ 491.0	$ 529.4

Accounts receivable classifications include the following:

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

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

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

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

Note 4. Inventories

The components of inventories, net, consisted of the following (in millions):

	March 31, 2019	December 31, 2018
New vehicles	$ 1,784.9	$ 1,700.1
Used vehicles	568.6	576.8
Parts and accessories	87.5	88.4
Total inventories	$ 2,441.0	$ 2,365.3

Note 5. Goodwill and Franchise Value

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

	Domestic	Import	Luxury	Consolidated
Balance as of December 31, 2017 [1]	$ 114.0	$ 104.3	$ 38.0	$ 256.3
Additions through acquisitions [2]	51.4	85.8	43.5	180.7
Reductions through divestitures	(0.9)	(1.2)	—	(2.1)
Balance as of December 31, 2018 [1]	164.5	188.9	81.5	434.9
Adjustments to purchase price allocations [3]	1.6	1.6	1.9	5.1
Additions through acquisitions [3]	5.9	8.8	2.1	16.8
Balance as of March 31, 2019 [1, 4]	$ 172.0	$ 199.3	$ 85.5	$ 456.8

[1] Net of accumulated impairment losses of $299.3 million recorded during the year ended December 31, 2008.

[2] Our purchase price allocation for the 2017 acquisitions of the Baierl Auto Group, the Downtown LA Auto Group, Crater Lake Ford Lincoln, Crater Lake Mazda, Albany CJD Fiat and the 2018 acquisition of Broadway Ford were finalized in 2018. Also, our purchase price allocation for the 2018 acquisition of Prestige Auto Group was preliminary and was allocated to our segments in 2018. As a result, we added $180.7 million of goodwill.

[3] Our purchase price allocation for the acquisitions of the Ray Laks Honda, Ray Laks Acura, Day Auto Group, and Prestige Auto Group were finalized in 2019. As a result, we added $21.9 million of goodwill.

[4] Our purchase price allocation is preliminary for the 2018 acquisition of Buhler Ford and has not been included in the above goodwill additions.

The changes in the carrying amounts of franchise value are as follows (in millions):

	Franchise Value
Balance as of December 31, 2017	$ 187.0
Additions through acquisitions [1]	103.5
Reductions through divestitures	(1.8)
Balance as of December 31, 2018	288.7
Adjustments to purchase price allocations [2]	3.5
Additions through acquisitions [2]	18.9
Reductions through divestitures	(3.0)
Balance as of March 31, 2019 [3]	$ 308.1

[1] Our purchase price allocation for the 2017 acquisitions of the Baierl Auto Group, the Downtown LA Auto Group, Crater Lake Ford Lincoln, Crater Lake Mazda, Albany CJD Fiat and the 2018 acquisition of Broadway Ford were finalized in 2018. Also, our purchase price allocation for the 2018 acquisition of Prestige Auto Group was preliminary and was allocated to our segments in 2018. As a result, we added $103.5 million of franchise value.

[2] Our purchase price allocation for the acquisitions of the Ray Laks Honda, Ray Laks Acura, Day Auto Group, and Prestige Auto Group were finalized in 2019. As a result, we added $22.4 million of franchise value.
[3]Our purchase price allocation is preliminary for the 2018 acquisition of Buhler Ford and has not been included in the above franchise value additions.

Note 6. Fair Value Measurements

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

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

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

We have fixed rate debt primarily consisting of amounts outstanding under our senior notes and real estate mortgages. We calculated the estimated fair value of the senior notes using quoted prices for the identical liability (Level 1) and calculated the estimated fair value of the fixed rate real estate mortgages using a discounted cash flow methodology with estimated current interest rates based on a similar risk profile and duration (Level 2). The fixed cash flows are discounted and summed to compute the fair value of the debt. As of March 31, 2019, our real estate mortgages and other debt, which includes capital leases, had maturity dates between May 1, 2020, and August 31, 2038.

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

There were no changes to our valuation techniques during the three-month period ended March 31, 2019.

A summary of the aggregate carrying values, excluding unamortized debt issuance cost, and fair values of our long-term fixed interest rate debt is as follows (in millions):

	March 31, 2019	December 31, 2018
Carrying value		
5.25% Senior notes due 2025	$ 300.0	$ 300.0
Real estate mortgages and other debt	441.8	445.8
	$ 741.8	$ 745.8
Fair value		
5.25% Senior notes due 2025	$ 301.1	$ 278.6
Real estate mortgages and other debt	435.2	448.7
	$ 736.3	$ 727.3

Below are our long-lived assets that are measured at fair value (in millions):

Fair Value at March 31, 2019

	Level 1	Level 2	Level 3
Measured on a non-recurring basis:			
Long-lived assets held and used:			
Certain buildings and improvements	$ —	$ —	$ 5.7

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Fair Value at December 31, 2018	Level 1	Level 2	Level 3
Measured on a non-recurring basis:			
Long-lived assets held and used:			
Certain buildings and improvements	$ —	$ —	$ 2.3

Long-lived assets held and used are reviewed for impairment whenever events or circumstances indicate that the carrying amount of the assets may not be recoverable. During the first quarter of 2019, we evaluated the future undiscounted net cash flows associated with certain properties and determined the carrying value was not recoverable and exceeded the estimated fair value. As a result of this evaluation, we recorded $0.5 million of impairment charges associated with these properties in the first quarter of 2019.

Note 7. Net Income Per Share of Class A and Class B Common Stock

We compute net income per share of Class A and Class B common stock using the two-class method. Under this method, basic net income per share is computed using the weighted average number of common shares outstanding during the period excluding common shares underlying equity awards that are unvested or subject to forfeiture. Diluted net income per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of the common shares issuable upon the net exercise of stock options and unvested RSUs and is reflected in diluted earnings per share by application of the treasury stock method. The computation of the diluted net income per share of Class A common stock assumes the conversion of Class B common stock, while the diluted net income per share of Class B common stock does not assume the conversion of those shares.

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

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

Three Months Ended March 31,	2019		2018	
(in millions, except per share data)	Class A	Class B	Class A	Class B
Net income applicable to common stockholders - basic	$54.4	$2.0	$50.0	$2.1
Reallocation of net income due to conversion of Class B to Class A common shares outstanding	0.3	—	0.3	—
Conversion of Class B common shares into Class A common shares	1.7	—	1.8	—
Net income applicable to common stockholders - diluted	$56.4	$2.0	$52.1	$2.1
Weighted average common shares outstanding – basic	22.3	0.8	24.1	1.0
Conversion of Class B common shares into Class A common shares	0.8	—	1.0	—
Effect of dilutive stock options on weighted average common shares	0.1	—	0.1	—
Weighted average common shares outstanding – diluted	23.2	0.8	25.2	1.0

Net income per common share - basic	$2.43	$2.43	$2.08	$2.08
Net income per common share - diluted	$2.42	$2.42	$2.07	$2.07

The effect of antidilutive securities on Class A and Class B stock was evaluated for the three month periods ended March 31, 2019 and 2018 and was determined to be immaterial.

Note 8. Segments

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

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

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

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

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

	Three Months Ended March 31, 2019	2018
Revenues:		
Domestic		
New vehicle	$492.4	$513.5
Used vehicle retail	300.4	264.8
Used vehicle wholesale	29.6	33.6
Finance and insurance	41.8	40.0
Service, body and parts	115.4	107.2
Fleet and other	17.1	11.5
	996.7	970.6
Import		
New vehicle	632.6	667.6
Used vehicle retail	341.3	307.7
Used vehicle wholesale	27.9	28.2
Finance and insurance	54.8	51.7
Service, body and parts	117.7	109.6
Fleet and other	17.3	5.6
	1,191.6	1,170.4
Luxury		
New vehicle	339.4	278.5
Used vehicle retail	186.3	142.9
Used vehicle wholesale	19.9	14.2
Finance and insurance	16.5	12.3
Service, body and parts	79.1	64.8
Fleet and other	13.7	3.8
	654.9	516.5
	2,843.2	2,657.5
Corporate and other	6.5	2.2
	$2,849.7	$2,659.7
Segment income[1]:		
Domestic	$19.8	$25.6
Import	30.0	23.0
Luxury	8.0	6.9
	57.8	55.5
Corporate and other	52.5	41.6
Depreciation and amortization	(19.8)	(16.8)
Other interest expense	(15.3)	(11.8)
Other income, net	2.6	1.3
Income before income taxes	$77.8	$69.8

[1]Segment income for each of the segments is defined as income before income taxes, depreciation and amortization, other interest expense and other income, net.

	March 31, 2019	December 31, 2018
Total assets:		
Domestic	$ 1,506.3	$ 1,488.0
Import	1,317.1	1,224.2
Luxury	898.0	934.6
Corporate and other	1,970.6	1,737.2
	$ 5,692.0	$ 5,384.0

Note 9. Recent Accounting Pronouncements

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

Note 10. Leases

Lease Accounting

We lease certain dealerships, office space, land and equipment. Leases with an initial term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term. We have elected not to bifurcate lease and nonlease components related to leases of real property.

Most leases include one or more options to renew, with renewal terms that can extend the lease term from one to 26 years or more. The exercise of lease renewal options is at our sole discretion. Certain leases also include options to purchase the leased property. The depreciable life of assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise.

Certain of our lease agreements include rental payments based on a percentage of retail sales over contractual levels and others include rental payments adjusted periodically for inflation. Our lease agreements do no contain any material residual value guarantees or material restrictive covenants.

We rent or sublease certain real estate to third parties.

As described further in "Note 1. Interim Financial Statements," we adopted Topic 842 as of January 1, 2019. Prior period amounts have not been adjusted and continue to be reported in accordance with our historic accounting under Topic 840.

The table below presents the lease-related liabilities recorded on the balance sheet (in millions):

	March 31, 2019	December 31, 2018
Operating lease liabilities:		
Current portion included in accrued liabilities	$ 25.5	$ —
Long-term portion of lease liabilities	235.2	—
Total operating lease liabilities	260.7	—
Financing lease liabilities:		
Current portion included in Current maturities of long-term debt	1.0	2.0
Long-term portion of lease liabilities in other debt	29.9	28.8
Total financing lease liabilities [1]	30.9	30.8
Total lease liabilities	$ 291.6	$ 30.8
Weighted-average remaining lease term:		
Operating leases	13 years	
Finance leases	14 years	
Weighted-average discount rate:		
Operating leases	5.07 %	
Finance leases	5.81 %	

[1] Corresponding finance lease assets are not material and are included in property, plant and equipment, net of accumulated depreciation.

The components of lease costs, which were included in Selling, general and administrative in our Consolidated Statements of Operations, were as follows (in millions):

	Three Months Ended March 31, 2019
Operating lease cost [1]	$ 12.0
Variable lease cost [2]	0.8
Sublease income	(1.0)
Total lease costs	$ 11.8

[1] Includes short-term and month-to-month lease costs, which are immaterial.
[2] Variable lease cost generally includes reimbursement for actual costs incurred by our lessors for common area maintenance, property taxes and insurance on leased real estate.

As of March 31, 2019, the maturities of our operating lease liabilities were as follows (in millions):

	Operating Leases
Remainder of 2019	$ 28.7
Year Ending December 31,	
2020	35.7
2021	32.5
2022	30.0
2023	25.0
Thereafter	216.3

Total minimum lease payments	368.2
Less:	
Present value adjustment	(107.5)
Operating lease liabilities	$ 260.7

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements and Risk Factors

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

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

The forward-looking statements contained in this Form 10-Q involve known and unknown risks, uncertainties and situations that may cause our actual results to materially differ from the results expressed or implied by these statements. Certain important factors that could cause actual results to differ from our expectations are discussed in Part II - Other Information, Item 1A in this Form 10-Q and in the Risk Factors section of our 2018 Annual Report on Form 10-K, as supplemented and amended from time to time in Quarterly Reports on Form 10-Q and our other filings with the Securities and Exchange Commission (SEC).

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

Overview

Lithia Motors, Inc. is one of the largest automotive retailers and providers of personal transportation solutions in the United States, and, in 2018, was ranked #294 on the Fortune 500. As of March 31, 2019, we operated 182 stores representing 28 brands in 18 states. We offer convenient, personalized service complemented by the reach and scale of a nationwide network, one of the largest online inventories and competitive pricing on vehicles and service. Our vision to create personal transportation solutions wherever, whenever and however consumers desire, combined with our mission, "Growth Powered by People," focuses us on our customers and our teams, creating our competitive advantage.

We offer a wide range of products and services including new and used vehicles, finance and insurance products and automotive repair and maintenance. We strive for diversification in our products, services, brands and geographic locations to reduce dependence on any one manufacturer, reduce susceptibility to changing consumer preferences, manage market risk and maintain profitability.

Our values guide us in serving our customers, developing our people, reaching our potential and growing our Company. Our stores create a welcoming and highly-responsive environment to proactively engage customers wherever, whenever and however they desire. We strive to create an omni-channel retail experience that provides our customers with freedom, selection and choice throughout the ownership life cycle.

We build long-term value for our customers, employees and shareholders through the following strategies:

Driving operational excellence and unlocking store potential
We remain focused on improving performance at existing locations. Operations are structured to promote an entrepreneurial environment at the dealership level. Each store's general manager and department managers, with assistance from regional and corporate management, are responsible for developing successful retail plans in their local markets. They drive dealership

operations, personnel development, manufacturer relationships, store culture and financial performance. Strong performance creates synergistic benefits such as increased vehicle trade-ins resulting in additional used vehicle sales, incremental finance and insurance sales and ultimately, increased units in operation and customer retention, which generate additional service revenues.

In order to mitigate fluctuations in vehicle sales and general economic conditions, we link compensation to performance for the majority of our management and sales personnel. We develop pay plans that are measured based upon various factors such as dealership and department profitability, customer satisfaction and individual performance metrics. These plans also serve to reward personnel for meeting their annual operating plans and achieving store potential.

We have centralized many administrative functions to drive efficiencies and streamline store-level operations. The reduction of administrative functions at our stores allows our local managers to focus on customer-facing opportunities to increase revenues and gross profit. Our operations are supported by our dedicated training and personnel development program, which shares best practices across our dealership network and seeks to develop management talent.

Growth through acquisition and network optimization
Our value-based acquisition strategy targets underperforming stores with strong franchises in desirable markets. As we integrate these stores into our existing network, we focus on improving performance. Our success is measured by achieving profitability through increasing market share and retaining customers while controlling costs. With our performance management strategy, standardized information systems and centrally- and regionally-performed administrative functions, we seek to gain economies of scale from our dealership network.

We target acquiring domestic, import and luxury franchises in cities ranging from mid-sized regional markets to metropolitan markets. We evaluate all brands for expansion opportunities provided the market is large enough to support adequate new vehicle sales to justify the required capital investment. We focus on successfully integrating acquired stores to achieve targeted returns. Platform acquisitions may include one or more locations which do not meet our criteria. We regularly optimize and balance our network through strategic divestitures to ensure continued high performance. The divestiture of these underperforming stores increases availability of capital and personnel resources and reduces future capital expenditures for facility improvements. We believe our disciplined approach and the current economic environment provide us with attractive acquisition opportunities and expanded coast to coast coverage.

Innovation and diversification
Driving growth and achieving earnings potential generates the free cash flow that allows us to invest in innovation, diversification and digital initiatives, thereby providing more ways to meet consumers' personal transportation needs. Through innovation and technology, we strive to provide a personalized customer experience wherever, whenever and however consumers desire. In 2018, we entered into a strategic partnership with Shift Technologies, Inc. ("Shift"), a San Francisco-based digital retailer, and became their largest shareholder. Shift provides an innovative platform to consumers for a digital vehicle purchase and selling experience, providing vehicle pickup and delivery at the customer's location. We have successfully collaborated in three areas, resulting in Lithia receiving additional equity ownership in Shift. In October 2018, we assisted in Shift securing a credit line for acquiring used vehicle inventory. In December 2018, we entered into a lease agreement to provide Shift with use of one of our retail locations for inventory storage and reconditioning. In March 2019, we announced the beginning of our national data sharing partnership with Shift. The strategic partnership with Shift allows both companies to share and scale technology, data, inventory and business relationships, allowing us to capture more of the approximately 40 million used vehicles sold in the United States annually.

Thoughtful capital allocation

We constantly evaluate how to allocate capital, including returning cash to our investors and investing in our stores. During the first quarter of 2019, we paid $6.7 million in dividends and invested $29.1 million in our stores through capital expenditures. We continue to manage our liquidity and available cash to prepare for future acquisition and innovation opportunities. As of March 31, 2019, we had $279.5 million in available funds in cash and availability on our credit facilities, with an estimated additional $247.5 million available if we financed our unencumbered owned real estate.

Key Revenue and Gross Profit Metrics

Key performance metrics for revenue and gross profit were as follows (dollars in millions):

	Three Months Ended March 31,			
	2019	2018	Change	
Revenues				
New vehicle	$1,461.1	$1,454.7	0.4	%
Used vehicle retail	827.9	715.6	15.7	
Finance and insurance	117.5	106.5	10.3	
Service, body and parts	317.4	285.7	11.1	
Total Revenues	2,849.7	2,659.7	7.1	
Gross profit				
New vehicle	$85.9	$86.9	(1.2)	%
Used vehicle retail	84.6	73.6	14.9	
Finance and insurance	117.5	106.5	10.3	
Service, body and parts	159.5	138.4	15.2	
Total Gross Profit	450.7	408.1	10.4	
Gross profit margins				
New vehicle	5.9 %	6.0 %	(10	) bps
Used vehicle retail	10.2	10.3	(10	)
Finance and insurance	100.0	100.0	—	
Service, body and parts	50.2	48.4	180	
Total Gross Profit Margin	15.8	15.3	50	
Retail units sold				
New vehicles	39,695	41,497	(4.3)	%
Used vehicles	40,675	36,114	12.6	
Average selling price per retail unit				
New vehicles	$36,809	$35,056	5.0	%
Used vehicles	20,353	19,814	2.7	
Average gross profit per retail unit				