LITHIA MOTORS INC
Form 10-K
March 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-K

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

For the Fiscal Year Ended: December 31, 2006

OR

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

Commission File Number: 001-14733

LITHIA MOTORS, INC.

(Exact name of registrant as specified in its charter)

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

541-776-6899

(Registrant s telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Class A common stock, without par value

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

(Title of Class)

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

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

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 o

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. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was $467,158,129, computed by reference to the last sales price ($30.32) as reported by the New York Stock Exchange for the Registrant s Class A common stock, as of the last business day of the Registrant s most recently completed second fiscal quarter (June 30, 2006).

The number of shares outstanding of the Registrant s common stock as of March 6, 2007 was: Class A: 15,855,801 shares and Class B: 3,762,231 shares.

Documents Incorporated by Reference

The Registrant has incorporated into Part III of Form 10-K, by reference, portions of its Proxy Statement for its 2007 Annual Meeting of Shareholders.

LITHIA MOTORS, INC.
2006 FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS

PART I

Item 1. Business

Forward Looking Statements

Some of the statements under the sections entitled Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business and elsewhere in this Form 10-K constitute forward-looking statements. In some cases, you can identify forward-looking statements by terms such as may, will, should, expect, plan, intend, forecast, anticipate, believe, estimate, p continue or the negative of these terms or other comparable terminology. The forward-looking statements contained in this Form 10-K involve known and unknown risks, uncertainties and situations that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. Some of the important factors that could cause actual results to differ from our expectations are discussed in Item 1A. to this Form 10-K.

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

Where You Can Find More Information

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 as amended (the Exchange Act). You can inspect and copy our reports, proxy statements, and other information filed with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The SEC maintains an Internet Web site at http://www.sec.gov where you can obtain some of our SEC filings. We also make available, free of charge on our website at www.lithia.com, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are filed electronically with the SEC. The information found on our website is not part of this Form 10-K. You can also obtain copies of these reports by contacting Investor Relations at 541-776-6591.

Compliance with Section 303A of the NYSE Listed Company Manual

As required by the NYSE Corporate Governance Standards, we filed the appropriate certifications with NYSE in 2006 confirming that our CEO is not aware of any violations of the NYSE Corporate Governance Standards and we also filed with the SEC in 2006 the Chief Executive Officer and Chief Financial Officer certifications required under Section 302 of the Sarbanes-Oxley Act.

Overview

We are a leading operator of automotive franchises and retailer of new and used vehicles and services. As of March 6, 2007, we offered 30 brands of new vehicles through 193 franchises in 108 stores in the Western United States and over the Internet. As of December 31, 2006 we operated 16 stores in Oregon, 15 in California, 14 in Texas, 12 in Washington, 8 in Iowa, 7 in Idaho, 7 in Colorado, 7 in Alaska, 7 in Montana, 6 in Nevada, 3 in Nebraska, 2 in South Dakota, 2 in North Dakota, 1 in New Mexico and 1 in Wisconsin. We sell new and used cars and light trucks; sell replacement parts; provide vehicle maintenance, warranty, paint and repair services; and arrange related financing, service contracts, protection products and credit insurance for our automotive customers.

We currently achieve gross profit margins above industry averages by selling a higher ratio of retail used vehicles to new vehicles and by arranging finance and extended warranty contracts for a greater percentage of our customers than the industry on average. In 2006, we achieved a gross profit margin of 17.0%.

We were founded in 1946 and incorporated in 1968. Our two senior executives have managed the company for more than 35 years. Since our initial public offering in 1996, we have grown from 5 to 108 stores as of March 6, 2007, primarily through an aggressive acquisition program that has been accretive to our earnings, increasing annual revenues from $143 million in 1996 to $3.2 billion in 2006. In addition, since our initial public offering through December 31, 2006, we have achieved compound annual growth rates of 36% per year for revenues, 32% per year for net income from continuing operations and 15% per year for earnings per share, together with a 3% average annual same store sales increase.

The Industry

At approximately $1.0 trillion in annual sales, automotive retailing is the largest retail trade sector in the United States and comprises roughly 10% of the GDP. The industry is highly fragmented with the 100 largest automotive retailers generating approximately 17% of total industry revenues in 2005. The number of franchised stores in the U.S. has declined in the last 10 years from approximately 22,427 stores in 1997 to approximately 22,089 in 2006. The average price of a new vehicle sold in the past ten years increased 18.8% from $18,542 in 1996 to $22,021 in 2005. In addition to these new vehicle outlets, used vehicles are sold by approximately 53,000 independent used vehicle dealers and through casual (person to person) transactions. New vehicles can only be sold through automotive retail stores franchised by automotive manufacturers. These franchise stores have designated trade territories under state franchise law protection, which limits the number of new stores that can be opened in any given area.

Consolidation is expected to continue as many smaller automotive retailers are now considering selling or joining forces with larger retailer groups, given the large capital requirements necessary to operate in today s retail environment. With many owners reaching retirement age, often without clear succession plans, larger, well-capitalized automotive retailers provide an attractive exit strategy. We believe these factors provide an attractive environment for continuing consolidation.

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

Sales in the automotive sector are affected by general economic conditions including rates of employment, income growth, interest rates and consumer sentiment.

U.S. new vehicle sales were 16.6 million units in 2006 compared to 17.0 million units in 2005. Although manufacturer incentives were lower in 2006 than in 2005, we expect that manufacturers will continue to offer incentives on new vehicle sales during 2007 through a combination of repricing strategies, rebates, lease programs, early lease cancellation programs and low interest rate loans to consumers. To complement the manufacturers incentive strategy, we employ a volume-based strategy for our new vehicle sales. New vehicle sales usually decline during a weak economy; however, the higher margin service and parts business typically benefits in the same environment, particularly if extended, because consumers tend to keep their vehicles longer. Strong sales of new vehicles in recent years have provided a population of vehicles for future service and parts revenues. Automotive retailers benefit from their designation as an exclusive warranty and recall service provider of a manufacturer. For the typical manufacturer s warranty, this provides an automotive retailer with a period of at least 3 years of repeat business for service covered by warranty. Extended warranties can add two or more years to this repeat servicing period.

Profitability amongst automotive retailers will vary and depends in part on local economic conditions, competition and product mix, effective management of inventory, marketing, quality control and responsiveness to customers. In the industry, new vehicles sales typically account for an estimated 60% of a store s revenues, used vehicles sales typically account for approximately 28% of revenues and the remaining 12% is typically derived from service and parts sales. Finance and insurance sales are included in the new and used vehicle sales numbers. Industry gross profit margins were 13.3% in 2005. Our gross profit margin was 17.0% and 17.2% in 2006 and 2005, respectively.

Automotive retailers have much lower fixed overhead costs than automobile manufacturers and parts suppliers. Variable and discretionary costs, such as sales commissions and personnel, advertising and inventory finance expenses, can be adjusted to more closely match new vehicle sales. Variable and discretionary costs account for an estimated 60-65% of the industry s total expenses. Moreover, an automotive retailer can enhance its profitability from sales of higher margin products and services. Gross profit margins for the parts and service business are significantly higher at approximately 48%, given the labor-intensive nature of the product category. Gross profit margins for finance and insurance are virtually 100% as they are fee driven income items. These supplemental, high margin products and services provide substantial incremental revenue and net income, decreasing reliance on the highly competitive new vehicle sales.

Store Operations

Each of our stores is its own profit center and is managed by a general manager who has primary responsibility for pricing, personnel and advertising. In order to provide additional support for improving performance, we make available to each store a team of specialists in new vehicle sales, used vehicle sales, finance and insurance, service and parts, and back-office administration.

The following tables set forth information about our stores as of December 31, 2006:

State	**Number of Stores**	**Number of Franchises**	**Percent of Annualized 2006 Revenue**	
Texas	14	23	17	%
Oregon	16	30	16	
California	15	28	15	
Washington	12	18	11	
Idaho	7	14	8	
Colorado	7	12	6	
Alaska	7	10	5	
Montana	7	13	5	
Nevada	6	10	5	
Iowa	4	7	3	
Nebraska	3	5	3	
South Dakota	2	2	2	
North Dakota	2	9	2	
New Mexico	1	3	1	
Wisconsin	1	3	1	
Total	104	187	100	%

New Vehicle Sales

In 2006, we sold 28 domestic and imported brands ranging from economy to luxury cars, sport utility vehicles, minivans and light trucks.

Manufacturer	Percent of Total Revenue	Percent of New Vehicle Sales in 2006
DaimlerChrysler (Chrysler, Dodge, Jeep)	24.0 %	41.0 %
General Motors (GMC, Chevrolet, Buick, Saturn, Cadillac, Hummer)	11.2	19.4
Toyota, Scion	6.3	10.9
Ford (Ford, Lincoln, Mercury)	4.2	7.3
Honda	2.6	4.5
BMW	2.4	4.1
Hyundai	1.7	3.0
Nissan	1.7	2.9
Subaru	1.5	2.7
Volkswagen, Audi	1.0	1.6
Mercedes	0.8	1.3
Mazda	0.3	0.6
Suzuki	0.3	0.5
Saab	*	0.1
Porsche	*	0.1
Kia	*	*
Isuzu	*	*
	58.0 %	100.0 %

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* Less than 0.1%

Our unit and dollar sales of new vehicles from continuing operations were as follows:

	Year Ended December 31, 2006	2005	2004	2003	2002
New vehicle units	66,224	58,372	53,169	51,258	45,551
New vehicle sales (in thousands)	$ 1,841,463	$ 1,631,316	$ 1,495,442	$ 1,374,359	$ 1,186,846
Average selling price	$ 27,807	$ 27,947	$ 28,126	$ 26,813	$ 26,055

The year over year average new vehicle sales price decreased by $140 to $27,807 in 2006 due primarily to our strategy of selling volume and driving same store sales growth in the year, as well as a mix shift away from higher-priced trucks and SUVs.

We purchase our new car inventory directly from manufacturers, who generally allocate new vehicles to stores based on the number of vehicles sold by the store on a monthly basis and by the store s market area. Accordingly, we rely on the manufacturers to provide us with vehicles that consumers desire and to supply us with such vehicles at suitable locations, quantities and prices. However, high demand vehicles often are in short supply. We attempt to exchange vehicles with other automotive retailers (and amongst our own stores) to accommodate customer demand and to balance inventory.

We post the manufacturer s suggested retail price (MSRP) on every vehicle, as required by law. We negotiate the final sales price of a new vehicle individually with the customer. We sell many of our higher volume vehicles under our Promo Price program. This program markets vehicles at a more affordable price that is significantly less than MSRP.

In 2006, we implemented several initiatives that we expect will improve our operations in future periods. Such initiatives included the following:

- A Customer Centric Sales Process, which will help leverage the benefits of our Lithia Store Management System (LSMS) which allows us to track advertising and increase the productivity of the sales staff by providing daily work plans and focused training. Under this program,

5

showrooms will have interactive personal computers, which will allow the salesperson to quickly and efficiently enter data and interact with the customer to speed up the sales process;

- A Finance and Insurance (F&I) Certification Program for our F&I managers;

- Improved functionality of our centralized inventory control and procurement process;

- An Internet initiative, which involves developing a centralized department that will be staffed with brand specialists capable of communicating with customers by phone or live chat;

- IT initiatives related to automating our offices, centralizing certain office functions and establishing independent used vehicle operations;

- An Assured Used Vehicle program and an independent used vehicle strategy. We began the Assured Used Vehicle program in the Tri-Cities, Abilene and Reno markets during the second quarter of 2006. We expect to have our first independent used vehicle outlet operating by late summer of 2007; and

- Used Vehicle First Look Technology has been fully integrated across the entire network of stores. We continue to train and optimize the usage of this technology in our stores. The First Look Technology provides a Trade Analyzer, Inventory Management Center, Purchasing Center, Redistribution Center and other functions that will help improve our used vehicle operations over time.

Used Vehicle Sales

At each new vehicle store, we also sell used vehicles. Used vehicle sales are an important part of our overall profitability. In 2006, retail used vehicle sales generated a gross profit margin of 14.9% compared with a gross profit margin of 7.7% for new vehicle sales.

Since the beginning of 2002, the used vehicle market has been negatively impacted by strong competition from the new vehicle market, with heavy manufacturer incentives in the form of cash rebates, discounted pricing and low interest financing. This trend continued in 2006 and, with the focus on new vehicle sales, same store used vehicle sales only increased by 0.6% in 2006 compared to 2005.

We implemented a number of procedures in the used vehicle business, which have lead to industry leading used vehicle margins and that we expect will continue to generate positive results for this important business line:

- We conduct our own local used vehicle auctions in select markets and manage the disposal of used vehicles at larger auctions. The process is centralized and controlled at the management level; and

- We are implementing an Assured Used Vehicle strategy (the Assured Program) in many of our stores. The Assured Program sales process is about selling vehicles at a low-haggle price very similar to our Promo-pricing strategy on new vehicles. The Assured Program also provides a 60-day/3,000 mile if it breaks, we fix it at no cost limited warranty on all used vehicles. Each vehicle receives a rigorous 160-point inspection, extensive detailing and reconditioning and a vehicle history report. The Assured Program allows all customers to return the vehicle within 3 days or 500 miles of the purchase. The customer can exit the deal and receive their trade-in back, at no cost to the customer and with no questions asked.

In addition, as a complement to our ongoing used vehicle operation at each store, we use specialists in our support services group to increase the acquisition of used vehicles. We believe that this will help bolster sales volumes in the 3 to 7 year old vehicle market.

Our used vehicle operations give us an opportunity to:

- generate sales to customers financially unable or unwilling to purchase a new vehicle;
- increase new and used vehicle sales by aggressively pursuing customer trade-ins; and
- increase service contract sales and provide financing to used vehicle purchasers.

In 2006, we sold approximately 1.04 used vehicles (retail and wholesale combined) for every retail new vehicle sold.

In addition to selling late model used cars, as do other new vehicle dealers, our stores emphasize sales of used vehicles three to seven years old. These vehicles sell for lower prices, but normally generate greater margins. We believe that selling a larger number of used vehicles makes us less susceptible to the effects of changes in the volume of new vehicle sales that result from economic conditions.

We acquire most of our used vehicles through customer trade-ins, but we also buy them at closed auctions, attended only by new vehicle automotive retailers with franchises for the brands offered. These auctions offer off-lease, rental and fleet vehicles. We also buy used vehicles at open auctions of repossessed vehicles and vehicles being sold by other automotive retailers.

In addition to selling used vehicles to retail customers, we wholesale to other automotive retailers and to wholesalers used vehicles that are in poor condition and vehicles that have not sold promptly.

Our used vehicle sales from continuing operations were as follows:

	Year Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Retail used vehicle units.	43,424	42,831	40,312	40,389	40,198
Retail used vehicle sales (in thousands)	$ 707,378	$ 666,627	$ 609,692	$ 589,262	$ 586,753
Average selling price	$ 16,290	$ 15,564	$ 15,124	$ 14,590	$ 14,597
Wholesale used vehicle units	25,282	23,608	21,905	25,181	24,135
Wholesale used vehicle sales (in thousands)	$ 155,019	$ 138,821	$ 116,852	$ 119,159	$ 119,590
Average selling price.	$ 6,132	$ 5,880	$ 5,334	$ 4,732	$ 4,955
Total used vehicle units	68,706	66,439	62,217	65,570	64,333
Total used vehicle sales (in thousands)	$ 862,397	$ 805,448	$ 726,544	$ 708,421	$ 706,343
Average selling price.	$ 12,552	$ 12,123	$ 11,678	$ 10,804	$ 10,979

Vehicle Financing, Extended Warranty and Insurance

We believe that arranging financing is critical to our ability to sell vehicles and related products and services. We provide a variety of financing and leasing alternatives to meet customer needs. Offering customer financing on a same day basis gives us an advantage, particularly over smaller competitors who do not generate enough sales to attract our breadth of finance sources.

We try to arrange financing for every vehicle we sell. Our finance and insurance managers possess extensive knowledge of available financing alternatives and receive training in determining each customer s financing needs so that the customer can purchase or lease a vehicle. The finance and insurance managers work closely with financing sources to quickly determine a customer s credit status and to confirm the type and amount of financing available to each customer.

In 2006, we provided financing or other insurance products for 77% of our new vehicle sales and 76% of our retail used vehicle sales. Our average finance and insurance revenue per retail vehicle totaled $1,094 in 2006.

We earn a portion of the financing charge by discounting each finance contract we write and subsequently sell to a lender. We normally arrange financing for customers by selling the contracts to outside sources on a non-recourse basis to avoid the risk of default. During 2006, we did not directly finance any of our vehicle sales.

Our finance and insurance managers also market third-party extended warranty contracts and insurance contracts to our new and used vehicle buyers. These products and services yield higher profit margins than vehicle sales and contribute significantly to our profitability. Extended warranty contracts provide additional coverage for new vehicles beyond the duration or scope of the manufacturer s warranty. The service contracts we sell to used vehicle buyers provide coverage for certain major repairs.

We also offer our customers third party credit life and health and accident insurance when they finance an automobile purchase. We receive a commission on each policy sold. We also offer other products, such as protective coatings and automobile alarms.

Service, Body and Parts

Our automotive service, body and parts operations are an integral part of establishing customer loyalty and contribute significantly to our overall revenue and profits. We provide parts and service primarily for the new vehicle brands sold by our stores, but we also service other vehicles. In 2006, our service, body and parts operations generated $343.7 million in revenues, or 10.8% of total revenues. We set prices to reflect the difficulty of the types of repair and the cost and availability of parts. Our focus on service advisor training in past couple of years, as well as a number of pricing and cost saving initiatives across the entire service and parts business lines, led to improvements in same-store service, body and parts sales in 2006 compared to 2005, as well as improvements in gross profit margins achieved.

The service, body and parts business provides important repeat revenues to the stores. We market our parts and service products by notifying the owners of vehicles when their vehicles are due for periodic service. This encourages preventive maintenance rather than post-breakdown repairs. We offer a lifetime oil and filter service, which, in 2006, was purchased by 39% of our new and used vehicle buyers. This service helps us retain customers, and provides opportunities for repeat parts and service business. Revenues from the service, body and parts departments are particularly important during economic downturns as owners tend to repair their existing used vehicles rather than buy new vehicles during such periods. This limits the effects of a drop in new vehicle sales that may occur in a prolonged slow economic environment.

We operate nineteen collision repair centers: four in Texas, three in Oregon and two each in Idaho and Alaska and one each in Washington, Montana, Colorado, Nevada, South Dakota, Nebraska, Wisconsin and Iowa.

Marketing

We market ourselves as America s Car & Truck Store and as Driving America. We use most types of advertising, including television, newspaper, radio, direct mail, and an Internet web site. Advertising expense, net of manufacturer credits, was $20.7 million during 2006, with 30% of the total amount used for print media, 22% for television, 16% for radio, 9% for Internet and 23% for direct mail and other sources. We advertise to develop our image as a reputable automotive retailer, offering quality service, affordable automobiles and financing for all qualified buyers. The automobile manufacturers pay for some of our advertising and marketing expenditures. The manufacturers also provide us with market research, which assists us in developing our own advertising and marketing campaigns. In addition, our stores advertise special discounts or other targeted promotions to attract customers. By owning a cluster of stores in a particular market, we save money from volume discounts and other media concessions. We also participate as a member of advertising cooperatives and associations, whose members pool their resources and expertise with manufacturers to develop advertising campaigns.

We maintain a web site (www.lithia.com) that generates leads and provides information for our customers. We use the Internet site as a marketing tool to familiarize customers with us, our stores and the products we sell, rather than to complete purchases. Although many customers use the Internet to research information about new vehicles, nearly all ultimately visit a store to complete the sale and take delivery of the vehicle. Our web site enables a customer to:

- locate our stores and identify the new vehicle brands sold at each store;
- view new and used vehicle inventory;
- schedule service appointments;
- view Kelley Blue Book values;
- visit our investor relations site; and
- view employment opportunities.

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

Management Information System

We consolidate, process and maintain financial information, operational and accounting data, and other related statistical information on centralized computers. We have a fully operational intranet with each store directly connected to headquarters. Our systems are based on an ADP platform for the main database, and information is processed and analyzed utilizing customized financial reporting software from Hyperion Solutions. Senior management can access detailed information from all of our locations regarding:

- inventory;
- cash balances;
- total unit sales and mix of new and used vehicle sales;
- lease and finance transactions;
- sales of ancillary products and services;
- key cost items and profit margins; and
- the relative performance of the stores.

Each store s general manager has access to this same information. With this information, we can quickly analyze the results of operations, identify trends and focus on areas that require attention or improvement. Our management information system also allows our general managers to respond quickly to changes in consumer preferences and purchasing patterns, maximizing our inventory turnover.

Our management information system is particularly important to successfully operating new stores. Following each acquisition, we immediately install our management information system at each location. This quickly makes financial, accounting and other operational data easily available throughout the company. With this information, we can more efficiently execute our operating strategy at each new store.

Franchise Agreements

Each of our store subsidiaries signs a franchise (or dealer sales and service) agreement with each manufacturer of the new vehicles it sells.

The typical automobile franchise agreement specifies the locations within a designated market area at which the store may sell vehicles and related products and perform certain approved services. The designation of such areas and the allocation of new vehicles among stores are at the discretion of the manufacturer. Franchise agreements do not guarantee exclusivity within a specified territory, but do have some protection under state laws.

A franchise agreement may impose requirements on the store with respect to:

- the showroom;
- service facilities and equipment;
- inventories of vehicles and parts;
- minimum working capital;
- training of personnel; and
- performance standards for sales volume and customer satisfaction.

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

Most franchise agreements are generally renewed after one to five years, and, in practice, have indefinite lives. Some franchise agreements, including those with DaimlerChrysler, have no termination date. Historically, all of our agreements have been renewed and we expect that manufacturers will continue to renew them in the future. In addition, state franchise laws limit the ability of manufacturers to terminate or fail to renew automotive franchises. Each franchise agreement authorizes at least one person to manage the store s operations.

The typical franchise agreement provides for early termination or non-renewal by the manufacturer upon:

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

We sign master framework agreements with most manufacturers that impose additional requirements on our stores. See Item 1A. Risk Factors for further details.

Competition

The retail automotive business is highly competitive, consisting of a large number of independent operators, many of whom are individuals, families and small retail groups. We compete primarily with other automotive retailers, both publicly and privately-held, near our store locations. In addition, regional and national car rental companies operate retail used car lots to dispose of their used rental cars.

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

We are larger and have more financial resources than most private automotive retailers with which we currently compete in most of our regional markets. We compete directly with retailers like ourselves in our metropolitan markets like Denver, Colorado, Seattle, Washington and Concord, California. If we enter other metropolitan markets, we may face competitors that are larger or have access to greater financial resources. We do not have any cost advantage in purchasing new vehicles from manufacturers. We rely on advertising and merchandising, sales expertise, service reputation and location of our stores to sell new vehicles.

In addition to competition for the sale of vehicles, we expect increased competition for the acquisition of other stores. With respect to each brand of vehicles we market, we have faced only limited competition with respect to our acquisitions to date, primarily from privately-held automotive retailers. Other publicly-owned automotive retailers with significant capital resources may enter our current and targeted market areas in the future.

Regulation

Our business is subject to extensive regulation, supervision and licensing under federal, state and local laws, ordinances and regulations. State and federal regulatory agencies, such as the Department of Motor Vehicles, the Occupational Safety and Health Administration, the EEOC (Equal Employment Opportunity Commission) and the U.S. Environmental Protection Agency, have jurisdiction over the operation of our stores, service centers, collision repair shops and other operations. They regulate matters such as consumer protection, employment practices, workers safety and air and water quality.

Laws also protect franchised automotive retailers from the unequal bargaining power held by the manufacturers. Under those laws, a manufacturer may not:

- terminate or fail to renew a franchise without good cause; or
- prevent any reasonable changes in the capital structure or financing of a store.

Manufacturers may object to a sale of a store or change of management based on character, financial ability or business experience of the proposed new operator.

Automotive retailers and manufacturers are also subject to laws to protect consumers, including so-called Lemon Laws. Most Lemon Laws require a manufacturer to replace a new vehicle or accept it for a full refund within a set time period after initial purchase if:

- the vehicle does not conform to the manufacturer s express warranties; and
- the automotive retailer or manufacturer, after a reasonable number of attempts, is unable to correct or repair a defect.

We must provide written disclosures on new vehicles of mileage and pricing information. Financing and insurance activities are subject to credit reporting, debt collection, truth-in-lending and insurance industry regulation.

Our business, particularly parts, service and collision repair operations, involves hazardous or toxic substances or wastes, 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. Federal, state and local authorities establishing health and environmental quality standards regulate the handling, storage, treatment, recycling and disposal of hazardous substances and wastes and remediation of contaminated sites, both at our facilities and at sites to which we send hazardous or toxic substances or wastes for treatment, recycling or disposal. We are aware of limited contamination at certain of our current and former facilities, and we are in the process of conducting investigations and/or remediation at some of these properties. Based on our current information, any costs or liabilities relating to such contamination, other environmental matters or compliance with environmental regulations are not expected to have a material adverse effect on our results of operations or financial condition. There can be no assurances, however, that (i) additional environmental matters will not arise or that new conditions or facts will not develop in the future at our current or formerly owned or operated facilities, or at sites that we may acquire in the future, or that (ii) these matters, conditions or facts will not result in a material adverse effect on our results of operations or financial condition.

Employees

As of December 31, 2006, we employed approximately 6,261 persons on a full-time equivalent basis. We believe we have good relationships with our employees.

Item 1A. Risk Factors

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

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

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

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

We have financed our past acquisitions from a combination of the cash flow from our operations, borrowings under our credit arrangements, issuances of our common stock and proceeds from our private debt offering. We expect cash on hand together with our other financing resources to be sufficient for our currently anticipated acquisition program through 2008. If we are unable to obtain financing on acceptable terms, we may be required to slow the pace of our acquisition plans, which may materially and adversely affect our acquisition growth strategy.

Generally, we use cash and available credit facilities for acquisitions. However, on occasion, we have financed acquisitions by issuing shares of our common stock as partial consideration for acquired stores. The viability of using common stock for acquisitions will depend on our willingness to issue shares, the market price of our common stock and the willingness of potential acquisition candidates to accept our common stock as part of the consideration for the sale of their businesses. Accordingly, our ability to make acquisitions could be adversely affected if the price of our common stock declines or, alternatively, is perceived as fully valued. If potential acquisition candidates are unwilling to accept our common stock as partial consideration, we will be forced to rely solely on available cash from operations or debt financing, which could limit our acquisition and expansion plans.

Manufacturers may restrict our ability to make new acquisitions. We are required to obtain consent from the applicable manufacturer prior to the acquisition of a franchised store. In determining whether to approve an acquisition, a manufacturer considers many factors, including our financial condition, ownership structure, the number of stores currently owned and our performance with those stores. Most major manufacturers have now established limitations or guidelines on the:

- number of such manufacturers stores that may be acquired by a single owner;
- number of stores that may be acquired in any market or region;
- percentage of total sales that may be controlled by one automotive retailer group;
- ownership of stores in contiguous markets;
- frequency of acquisitions; and
- requirement that no other manufacturers brands be sold from the same store location. In addition, each manufacturer has site control agreements in place that limit out ability to change the use of the facility without their approval.

DaimlerChrysler has issued a policy statement to all of its dealers stating that it may disapprove any acquisition if the buyer would own stores representing more than (i) 10% of any Business Center s Annual Planning Potential; (ii) 5% of the Annual Planning Potential of the United States; or (iii) 20% of a Metro Market s Annual Planning Potential. While we have reached these limits in certain local markets, there are many other markets available to us. There are approximately 4,300 Chrysler stores nationwide.

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

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

Toyota restricts the number of stores that we may own and the time frame over which we may acquire them, and imposes specific performance criteria on existing stores as a condition to any future acquisitions. In 2006, we entered into a framework agreement with Toyota to permit us to acquire additional stores nationwide if our performance at existing stores satisfies the minimum criteria. The maximum number of stores may not exceed 5% of Toyota s aggregate national annual retail sale volume. In addition, Toyota restricts the number of Toyota stores that we may acquire in any Toyota-defined region and Metro market, as well as any contiguous market. Toyota has approximately 1,200 stores nationwide.

With respect to other manufacturers, we do not believe existing numerical limitations will materially restrict our acquisition program for many years.

A manufacturer also considers our past performance as measured by their customer satisfaction index, or CSI, scores and sales performance at our existing stores. At any point in time, some of our stores may have CSI scores below the manufacturers sales zone averages or have achieved sales performances below the targets manufacturers have set. Our failure to maintain satisfactory CSI scores and to achieve sales performance goals could restrict our ability to complete future acquisitions. We currently have, and at any point in the future may have, manufacturers that restrict our ability to complete future acquisitions.

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

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

- improve inventory, accounts receivable and other controls.

13

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

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

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

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

We place substantial responsibility on our general managers for the profitability of their stores. We have increased our number of stores from 5 in 1996 to 108 as of March 6, 2007. Many stores are offered for sale to us to enable the owner/manager to retire. These potential acquisitions are viable to us only if we are able to obtain replacement management. This has resulted in the need to hire many additional managers. As we continue to expand, the need for additional experienced managers will become even more critical. The market for qualified general managers is highly competitive. The loss of the services of key management personnel or the inability to attract additional qualified general managers could have a material adverse effect on our business and the execution of our acquisition growth strategy.

Our stores depend on vehicle sales and, therefore, our success depends in large part upon the overall demand for the particular lines of vehicles that each of our stores sell and the ability of the manufacturers to continue to deliver such vehicles.

Our DaimlerChrysler, GM, Ford and Toyota stores represent over three-fourths of our total new vehicle retail sales. Chrysler alone accounted for over half of those sales. Demand for our primary manufacturers vehicles as well as the financial condition, management, marketing, production and distribution capabilities of these manufacturers can significantly affect our business. Events that adversely affect a manufacturer s ability to timely deliver new vehicles, such as labor disputes and other production disruptions, including delays that sometimes occur during periods of new product introductions, may adversely affect us by reducing our supply of popular new vehicles and leading to lower sales in our stores during those periods than would otherwise occur. Further, any event that causes adverse publicity involving any of our manufacturers or their vehicles could reduce sales of those vehicles and adversely affect our sales and profits.

Certain manufacturers, including DaimlerChrysler, GM and Ford, have incurred substantial operating losses in recent periods that could jeopardize their ability to develop new competitive models. Further, DaimlerChrysler has announced that management is considering the sale or spin-off of its U.S. Dodge Chrysler Jeep operations. Moreover, if the financial conditions of the domestic manufacturers do not improve, they may be forced to seek protection from creditors in bankruptcy. Any reorganization or restructuring might result in an elimination of certain makes or models, a disruption in vehicle deliveries, a delay in the introduction of new models, the elimination of certain dealership locations or a combination of these consequences. Without a successful reorganization, continued sustained losses could result in the cessation of operations. The bankruptcy, substantial downsizing or restructuring of one of our major manufacturing partners would likely have a material adverse affect on our results of operations.

Cyclical downturns in the automobile industry that reduce our vehicle sales may adversely affect our profitability.

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

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

Hostilities in the Middle East or other factors that significantly increase gasoline prices can be expected to reduce vehicle sales.

Historically, in times of rapid increase in crude oil and gasoline prices, sales of vehicles have dropped, particularly in the short term, as consumer confidence wanes and fuel costs become more prominent to the consumer s buying decision. In sustained periods of higher fuel costs, consumers who do purchase vehicles tend to prefer smaller, more fuel efficient vehicles or hybrid powered vehicles currently in limited supply.

The majority of our new vehicle sales are of domestic manufacture and are predominately SUVs and light trucks. These vehicles generally provide us with higher gross profit margins. A significant drop in sales volume in these vehicles, which was experienced in 2006, would adversely affect our level of profits.

The ability of our stores to make new vehicle sales depends in large part upon the manufacturers and, therefore, any disruption or change in our relationships with manufacturers may materially and adversely affect our profitability.

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

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

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

Our franchise agreements also specify that, in certain situations, we cannot operate a franchise by another manufacturer in the same building as the manufacturer s franchised store. This may require us to build new facilities at a significant cost. In addition, some manufacturers are in the process of realigning their stores along defined channels, such as combining Chrysler and Jeep in one location. As a result, manufacturers may require us to move or sell certain stores. Moreover, our manufacturers generally require that the store meet defined image standards. All of these commitments could require us to make significant capital expenditures.

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

We are developing a stand-alone used vehicle store model whose profitability is unproven.

We are incurring significant costs to develop software, processes and marketing strategies to open and successfully operate stand-alone used vehicle stores. To this end, we have hired a team of employees committed to this effort, purchased a number of sites, designed facilities and are commencing construction. The start-up costs are significant and will reduce earnings until these stores become profitable.

The business model is new to us and involves developing and successfully implementing a sales process and strategy different from that currently used in our new vehicle stores. Further, there will be many competitors in the markets our stores will be in, including, in some markets, national used vehicle store chains with name familiarity and proven business models. If our efforts are not as successful as we anticipate, our financial results could be reduced.

With the breadth of our operations and volume of transactions, compliance with the many federal and state consumer protection and motor vehicle laws cannot be assured. Fines and administration sanctions can be severe.

We are subject to numerous consumer protection and department of motor vehicles laws in each of the 15 states in which we have stores, as well as federal consumer protection laws. With the number of stores we operate, the number of personnel we employ and the large volume of transactions we handle, it is likely that technical mistakes will be made. If there are unauthorized activities of serious magnitude, the state and federal authorities have the power to impose civil monetary penalties and sanctions, suspend or withdraw dealer licenses or take other actions that could materially impair our activities or our ability to acquire new stores in those states where violations occurred.

Import product restrictions and foreign trade risks may impair our ability to sell foreign vehicles profitably.

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

Environmental, health or safety regulations could have a material adverse effect on our results of operations or financial condition or cause us to incur significant expenditures.

We are subject to various federal, state and local environmental, health and safety regulations governing, among other things, the generation, storage, handling, use, treatment, recycling, transportation, disposal and remediation of hazardous material and the emission and discharge of hazardous material into the environment. Under certain environmental regulations, we could be held responsible for all of the costs relating to any contamination at our present or our predecessors past facilities and at third party waste disposal sites. We are aware of contamination at certain of our facilities, and we are in the process of conducting investigations and/or remediation at some of these properties. In certain cases, the current or prior property owner is conducting the investigation and/or remediation or we have been indemnified by either the current or prior property owner for such contamination. There can be no assurances that these owners will remediate or continue to remediate these properties or pay or continue to pay pursuant to these indemnities. We are also required to obtain permits from governmental authorities for certain operations. If we violate or fail to fully comply with these regulations or permits, we could be fined or otherwise sanctioned by regulators.

Environmental, health and safety regulations are becoming increasingly more stringent. There can be no assurances that the costs of compliance with these regulations will not result in a material adverse effect on our results of operations or financial condition or that additional environmental, health or safety matters will not arise or new conditions or facts will not develop in the future at our currently or formerly owned or operated facilities, or at sites that we may acquire in the future, which will require us to incur significant expenditures.

The sole voting control of our company is held by Sidney B. DeBoer who may have interests different from your interests.

Lithia Holding Company, LLC, of which Sidney B. DeBoer, our Chairman and Chief Executive Officer, is the sole managing member, holds all of the outstanding shares of our Class B common stock. A holder of Class B common stock is entitled to ten votes for each share held, while a holder of Class A common stock is entitled to one vote per share held. On most matters, the Class A and Class B common stock vote together as a single class. As of March 6, 2007, Lithia Holding controlled approximately 70% of the aggregate number of votes eligible to be cast by stockholders for the election of directors and most other stockholder actions. Therefore, Lithia Holding will control the election of our Board of Directors and will be in a position to control the policies and operations of the company. In addition, because Mr. DeBoer is the managing member of Lithia Holding, he currently controls and will continue to control, all of the outstanding Class B common stock, thereby allowing him to control the company. So long as at least 16 2/3% of the total number of shares outstanding are shares of Class B common stock, the holders of Class B common stock will be able to control all matters requiring approval of 66 2/3% or less of the aggregate number of votes. Absent a significant increase in the number of shares of Class A common stock outstanding or conversion of Class B common stock into Class A common stock, the holders of shares of Class B common stock will be entitled to elect all members of the Board of Directors and control all matters subject to stockholder approval that do not require a class vote.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our stores and other facilities consist primarily of automobile showrooms, display lots, service facilities, nineteen collision repair and paint shops, supply facilities, automobile storage lots, parking lots and offices. We believe our facilities are currently adequate for our needs and are in good repair. We own some of our properties, but also lease many properties, providing future flexibility to relocate our retail stores as demographics change. Most leases give us the option to renew the lease for one or more lease extension periods. We also hold some undeveloped land for future expansion.

Item 3. Legal Proceedings

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

On November 25, 2003, Aimee Phillips filed a lawsuit in the U.S. District Court for the District of Oregon (Case No. 03-3109-HO) against Lithia Motors, Inc. and two of its wholly-owned subsidiaries alleging violations of state and federal RICO laws, the Oregon Unfair Trade Practices Act (UTPA) and common law fraud. Ms. Phillips seeks damages, attorney s fees and injunctive relief. Ms. Phillips complaint stems from her purchase of a Toyota Tacoma pick-up truck on July 6, 2002. On May 14, 2004, we filed an answer to Ms. Phillips Complaint. This case was consolidated with the Allen case described below and has a similar current procedural status.

On April 28, 2004, Robert Allen and 29 other plaintiffs (Allen Plaintiffs) filed a lawsuit in the U.S. District Court for the District of Oregon (Case No. 04-3032-HO) against Lithia Motors, Inc. and three of its wholly-owned subsidiaries alleging violations of state and federal RICO laws, the Oregon UTPA and common law fraud. The Allen Plaintiffs seek damages, attorney s fees and injunctive relief. The Allen Plaintiffs Complaint stems from vehicle purchases made at Lithia dealerships between July 2000 and April 2001. On August 27, 2004, we filed a Motion to Dismiss the Complaint. On May 26, 2005, the Court entered an Order granting Defendants Motion to Dismiss plaintiffs state and federal RICO claims with prejudice. The Court declined to exercise supplemental jurisdiction over plaintiffs UTPA and fraud claims. Plaintiffs filed a Motion to Reconsider the dismissal Order. On August 23, 2005, the Court granted Plaintiffs Motion for Reconsideration and permitted the filing of a Second Amended Complaint (SAC). On September 21, 2005, the Allen Plaintiffs, along with Ms. Phillips, filed the SAC. In this complaint, the Allen plaintiffs seek actual damages that total less than $500,000, trebled, approximately $3.0 million in mental distress claims, trebled, punitive damages of $15.0 million, attorney s fees and injunctive relief. The SAC added as defendants certain officers and employees of Lithia. In addition, the SAC added a claim for relief based on the Truth in Lending Act (TILA). On November 14, 2005 we filed a second Motion to Dismiss the Complaint and a Motion to Compel Arbitration. On April 27, 2006, the court granted our motion to dismiss a number of the claims but permitted others to proceed. In particular, all TILA claims were dismissed, some of the RICO claims have been eliminated and any claims for non-economic damages for the alleged fraud have been dismissed. We believe the actions of the court have significantly narrowed the claims and potential damages sought by the plaintiffs. Lithia s motion to Compel Arbitration on Plaintiffs remaining claims is still pending.

On September 23, 2005, Maria Anabel Aripe and 19 other plaintiffs (Aripe Plaintiffs) filed a lawsuit in the U.S. District Court for the District of Oregon (Case No. 05-3083-HO) against Lithia Motors, Inc., 12 of its wholly-owned subsidiaries and certain officers and employees of Lithia, alleging violations of state and federal RICO laws, the Oregon UTPA, common law fraud and TILA. The Aripe Plaintiffs seek actual damages of less than $600,000, trebled, approximately $3.7 million in mental distress claims, trebled, punitive damages of $12.6 million, attorney s fees and injunctive relief. The Aripe Plaintiffs Complaint stems from vehicle purchases made at Lithia dealerships between May 2001 and August 2005 and is substantially similar to the allegations made in the Allen case. We expect certain of the rulings in the Allen case to apply equally to this case and proceedings in this matter are awaiting rulings in the Allen case. Once resolved, we further expect to file motions directed at all claims.

On May 30, 2006 four of our wholly owned subsidiaries located in Alaska were served with a lawsuit alleging that the dealerships failed to comply with Alaska law relating to various disclosures required to be made during the sale of a used vehicle. The complaint was filed by Jackie Lee Neese et al v. Lithia Chrysler Jeep of Anchorage, Inc. et al in the Superior Court for the State of Alaska at Anchorage, case number 3AN-06-04815CI. The complainants seek to represent other similarly situated customers. The court has not certified the suit as a class action.

We intend to vigorously defend all of the above matters and management believes that the likelihood of a judgment for the amount of damages sought in any of the cases is remote.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of our shareholders during the quarter ended December 31, 2006.

PART II

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

Stock Prices and Dividends

Our Class A common stock trades on the New York Stock Exchange under the symbol LAD. The following table presents the high and low sale prices for our Class A common stock, as reported on the New York Stock Exchange Composite Tape for each of the quarters in 2005 and 2006:

	High	Low
2005		
Quarter 1	$ 29.95	$ 24.99
Quarter 2	29.25	23.60
Quarter 3	31.43	28.29
Quarter 4	32.04	25.10
2006		
Quarter 1	$ 36.80	$ 29.32
Quarter 2	36.01	28.50
Quarter 3	30.59	23.33
Quarter 4	29.58	21.75

The number of shareholders of record and approximate number of beneficial holders of Class A common stock at March 6, 2007 was 1,383 and 3,300, respectively. All shares of Lithia s Class B common stock are held by Lithia Holding Company LLC.

Dividends declared and paid on our Class A and Class B common stock during 2005 and 2006 were as follows:

Quarter related to:	Dividend amount per share	Total amount of dividend (in thousands)
2004		
Fourth quarter	$ 0.08	$ 1,528
2005		
First quarter	0.08	1,536
Second quarter	0.12	2,312
Third quarter	0.12	2,322
Fourth quarter	0.12	2,338
2006		
First quarter	0.12	2,354
Second quarter	0.14	2,754
Third quarter	0.14	2,738

We currently intend to continue paying quarterly dividends similar to those paid in the second half of 2006. In January 2007, the Board of Directors approved a quarterly dividend of $0.14 per share with respect to the fourth quarter of 2006. The payment of any dividends is subject to the discretion of our Board of Directors. In addition, our $225 million working capital, acquisition and used vehicle flooring credit facility with U.S. Bank National Association, DaimlerChrysler Financial Services Americas LLC and Toyota Motor Credit Corporation limits our cash dividends to $15 million per fiscal year and limits our repurchases of our common stock to $20 million per fiscal year. Dividends paid in 2006 totaled $10.2 million and stock repurchased in 2006 totaled $4.7 million.

Repurchases of Class A Common Stock

We repurchased the following shares of our Class A common stock during the fourth quarter of 2006:

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan	Maximum number of shares that may yet be purchased under the plan
October 1 to October 31	113,600	$ 23.92	256,831	743,169
November 1 to November 30				
December 1 to December 31				
Total	113,600	23.92	256,831	743,169

The publicly announced plan to repurchase up to a total of 1.0 million shares of our Class A common stock was approved by our Board of Directors in June 2000 and renewed in August 2005 and does not have an expiration date.

Equity Compensation Plan Information

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

Stock Performance Graph

The following line-graph shows the annual percentage change in the cumulative total returns for the past five years on an assumed $100 initial investment and reinvestment of dividends, on (a) Lithia Motors, Inc. s Class A common stock; (b) the Russell 2000; and (c) a peer group index composed of United Auto Group, Inc., Auto Nation, Sonic Automotive, Inc., Group 1 Automotive, Inc. and Asbury Automotive Group, the only other comparable publicly traded automobile dealerships in the United States as of December 31, 2006. The peer group index utilizes the same methods of presentation and assumptions for the total return calculation as does Lithia Motors and the Russell 2000. All companies in the peer group index are weighted in accordance with their market capitalizations.

	Base Period	**Indexed Returns for the Year Ended**				
Company/Index	**12/31/01**	**12/31/02**	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**
Lithia Motors, Inc.	$ 100.00	$ 75.80	$ 122.51	$ 131.96	$ 156.91	$ 146.10
Auto Peer Group	100.00	84.97	136.82	137.07	154.42	177.49
Russell 2000	100.00	79.52	117.09	138.55	144.86	171.47

Item 6. Selected Financial Data

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

(In thousands, except per share amounts)	**Year Ended December 31, (1)**				
Consolidated Statement of Operations Data:	**2006**	**2005**	**2004**	**2003**	**2002**
Revenues:					
New vehicle	$ 1,841,463	$ 1,631,316	$ 1,495,442	$ 1,374,359	$ 1,186,846
Used vehicle	862,397	805,448	726,544	708,421	706,343
Finance and insurance	119,936	107,564	94,991	84,143	73,496
Service, body and parts	343,747	302,960	273,630	238,656	211,601
Fleet and other	5,351	4,410	7,679	6,485	38,811
Total revenues	3,172,894	2,851,698	2,598,286	2,412,064	2,217,097
Cost of sales	2,634,417	2,359,999	2,163,585	2,028,897	1,869,959
Gross profit	538,477	491,699	434,701	383,167	347,138
Selling, general and administrative(1)	406,569	357,617	326,168	296,438	273,316
Depreciation and amortization	17,071	13,975	12,491	9,235	7,011
Income from operations	114,837	120,107	96,042	77,494	66,811
Floorplan interest expense(2)	(34,636)	(17,580)	(12,221)	(11,685)	(11,206)
Other interest expense	(15,453)	(11,891)	(8,667)	(5,830)	(5,746)
Other income, net	958	953	739	1,092	1,201
Income from continuing operations before income taxes	65,706	91,589	75,893	61,071	51,060
Income taxes	(25,369)	(35,610)	(29,397)	(24,258)	(19,789)
Income from continuing operations	40,337	55,979	46,496	36,813	31,271
Income (loss) from discontinued operations, net of tax	(3,033)	(2,352)	(884)	(938)	402
Net income	$ 37,304	$ 53,627	$ 45,612	$ 35,875	$ 31,673
Basic income per share from continuing operations	$ 2.07	$ 2.92	$ 2.48	$ 2.01	$ 1.81
Basic income (loss) per share from discontinued operations	(0.16)	(0.12)	(0.05)	(0.05)	0.03
Basic net income per share	$ 1.91	$ 2.80	$ 2.43	$ 1.96	$ 1.84
Shares used in basic per share	19,485	19,175	18,773	18,289	17,233
Diluted income per share from continuing operations	$ 1.91	$ 2.65	$ 2.31	$ 1.98	$ 1.78
Diluted income (loss) per share from discontinued operations	(0.14)	(0.11)	(0.04)	(0.05)	0.02
Diluted net income per share	$ 1.77	$ 2.54	$ 2.27	$ 1.93	$ 1.80
Shares used in diluted per share	22,102	21,807	20,647	18,546	17,598

(In thousands)	**As of December 31,**				
Consolidated Balance Sheet Data:	**2006**	**2005**	**2004**	**2003**	**2002**
Working capital	$ 149,701	$ 156,446	$ 124,277	$ 158,682	$ 125,637
Inventories	603,306	606,047	535,347	444,130	445,743
Total assets	1,579,357	1,452,714	1,255,720	1,101,767	942,049
Flooring notes payable	595,293	530,452	450,860	435,229	427,635
Current maturities of long-term debt	16,557	6,868	6,565	14,299	4,466
Long-term debt, less current maturities	296,769	290,551	267,311	178,467	104,712
Total stockholders equity	493,393	460,231	405,246	357,542	319,323
Cash dividends declared per common share	0.54	0.44	0.31	0.21	

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(1) Includes stock-based compensation of $3.5 million in 2006 as a result of the adoption of Statement of Financial Accounting Standards No. 123R, Share-Based Payment, effective January 1, 2006. Stock-based compensation recognized was $0.5 million in 2005, $240,000 in 2004, $185,000 in 2003 and $169,000 in 2002.

(2) Floorplan interest expense includes gains (losses) related to our interest rate swaps of $(1.9) million, $4.1 million, $3.7 million, $1.7 million and $(0.7) million, respectively, in 2006, 2005, 2004, 2003 and 2002.

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

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

Overview

We are a leading operator of automotive franchises and retailer of new and used vehicles and services. As of March 6, 2007, we offered 30 brands of new vehicles through 193 franchises in 108 stores in the Western United States and over the Internet. As of December 31, 2006 we operated 16 stores in Oregon, 15 in California, 14 in Texas, 12 in Washington, 8 in Iowa, 7 in Idaho, 7 in Colorado, 7 in Alaska, 7 in Montana, 6 in Nevada, 3 in Nebraska, 2 in South Dakota, 2 in North Dakota, 1 in New Mexico and 1 in Wisconsin. We sell new and used cars and light trucks; sell replacement parts; provide vehicle maintenance, warranty, paint and repair services; and arrange related financing, service contracts, protection products and credit insurance for our automotive customers.

We currently achieve gross profit margins above industry averages by selling a higher ratio of retail used vehicles to new vehicles and by arranging finance and extended warranty contracts for a greater percentage of our customers.

Our acquisition model is focused on acquiring new vehicle stores where the store is the only franchise of that brand in the market. Our goal is to improve the operations of all four departments of every store we acquire. We have had success with this strategy since our initial public offering in 1996. Since 1996, our ability to integrate and improve the stores that we acquire has increased dramatically. We have also developed a better process for identifying acquisition targets that fit our operating model. Our cash position, substantial lines of credit, plus an experienced and well-trained staff are all available to facilitate our continued growth as the opportunities develop.

In keeping with this model, we acquired 19 stores in 2006 and in the first two months of 2007 combined with total estimated annual revenues of approximately $570 million. At December 31, 2006, we had 2 stores held for sale and listed as discontinued operations with combined revenues of approximately $49 million.

Manufacturer incentives were generally lower and less effective in 2006 than in 2005. However, we expect that manufacturers will continue to offer incentives on new vehicle sales during 2007 through a combination of repricing strategies, rebates, lease programs, early lease cancellation programs and low interest rate loans to consumers. To complement the manufacturers incentive strategy, we employ a volume-based strategy for our new vehicle sales.

We are currently working on several initiatives that we expect will improve our operations in future periods. Such initiatives include the following:

- A Customer Centric Sales Process, which will help leverage the benefits of our Lithia Store Management System (LSMS) which allows us to track advertising and increase the productivity of the sales staff by providing daily work plans and focused training. Under this program, showrooms will have interactive personal computers, which will allow the salesperson to quickly and efficiently enter data and interact with the customer to speed up the sales process;

- A Finance and Insurance (F&I) Certification Program for our F&I managers;

- Improved functionality of our centralized inventory control and procurement process;

- An Internet initiative, which involves developing a centralized department that will be staffed with brand specialists capable of communicating with customers by phone or live chat;

- IT initiatives related to automating our offices, centralizing certain office functions and establishing independent used vehicle operations;

- An Assured Used Vehicle program and an independent used vehicle strategy. We began the Assured Used Vehicle program in the Tri-Cities, Abilene and Reno markets during the second

23

quarter of 2006. We expect to have our first independent used vehicle outlet operating by late summer of 2007; and

- Used Vehicle First Look Technology has been fully integrated across the entire network of stores. We continue to train and optimize the usage of this technology in our stores. The First Look Technology provides a Trade Analyzer, Inventory Management Center, Purchasing Center, Redistribution Center and other functions that will help improve our used vehicle operations over time.

Results of Continuing Operations

Certain revenue, gross profit margin and gross profit information by product line was as follows for 2006, 2005 and 2004:

2006	**Percent of Total Revenues**	**Gross Profit Margin**	**Percent of Total Gross Profit**
New vehicle	58.0 %	7.7 %	26.2 %
Used vehicle(1)	27.2	12.7	20.2
Finance and insurance(2)	3.8	100.0	22.3
Service, body and parts	10.8	48.5	31.0
Fleet and other	0.2	29.7	0.3

2005	**Percent of Total Revenues**	**Gross Profit Margin**	**Percent of Total Gross Profit**
New vehicle	57.2 %	8.0 %	26.5 %
Used vehicle(1)	28.2	13.4	21.8
Finance and insurance(2)	3.8	100.0	21.9
Service, body and parts	10.6	47.8	29.5
Fleet and other	0.2	32.3	0.3

2004	**Percent of Total Revenues**	**Gross Profit Margin**	**Percent of Total Gross Profit**
New vehicle	57.6 %	7.8 %	27.0 %
Used vehicle(1)	27.9	12.6	21.0
Finance and insurance(2)	3.7	100.0	21.9
Service, body and parts	10.5	47.4	29.8
Fleet and other	0.3	15.9	0.3

(1) Includes retail and wholesale used vehicles.

(2) Commissions reported net of anticipated cancellations.

The following table sets forth selected condensed financial data expressed as a percentage of total revenues for the periods indicated below.

Lithia Motors, Inc. (1)	Year Ended December 31, 2006		2005		2004	
Revenues:						
New vehicle	58.0	%	57.2	%	57.6	%
Used vehicle	27.2		28.2		27.9	
Finance and insurance	3.8		3.8		3.7	
Service, body and parts	10.8		10.6		10.5	
Fleet and other	0.2		0.2		0.3	
Total revenues	100.0	%	100.0	%	100.0	%
Gross profit	17.0		17.2		16.7	
Selling, general and administrative expenses	12.8		12.5		12.6	
Depreciation and amortization	0.5		0.5		0.5	
Income from continuing operations	3.6		4.2		3.7	
Floorplan interest expense	1.1		0.6		0.5	
Other interest expense	0.5		0.4		0.3	
Other income, net	0.0		0.0		0.0	
Income from continuing operations before taxes	2.1		3.2		2.9	
Income tax expense	0.8		1.2		1.1	
Income from continuing operations	1.3	%	2.0	%	1.8	%

(1) The percentages may not add due to rounding.

The following tables set forth the changes in our operating results from continuing operations in 2006 compared to 2005 and in 2005 compared to 2004:

(In Thousands)	Year Ended December 31, 2006		2005		Increase (Decrease)		% Increase (Decrease)	
Revenues:								
New vehicle	$ 1,841,463		$ 1,631,316		$ 210,147		12.9	%
Used vehicle	862,397		805,448		56,949		7.1	
Finance and insurance	119,936		107,564		12,372		11.5	
Service, body and parts	343,747		302,960		40,787		13.5	
Fleet and other	5,351		4,410		941		21.3	
Total revenues	3,172,894		2,851,698		321,196		11.3	
Cost of sales:								
New vehicle	1,700,481		1,501,062		199,419		13.3	
Used vehicle	753,256		697,908		55,348		7.9	
Service, body and parts	176,920		158,043		18,877		11.9	
Fleet and other	3,760		2,986		774		25.9	
Total cost of sales	2,634,417		2,359,999		274,418		11.6	
Gross profit	538,477		491,699		46,778		9.5	
Selling, general and administrative	406,569		357,617		48,952		13.7	
Depreciation and amortization	17,071		13,975		3,096		22.2	
Income from operations	114,837		120,107		(5,270	)	(4.4	)
Floorplan interest expense	(34,636	)	(17,580	)	17,056		97.0	
Other interest expense	(15,453	)	(11,891	)	3,562		30.0	
Other expense, net	958		953		5		0.5	
Income from continuing operations before income taxes	65,706		91,589		(25,883	)	(28.3	)
Income tax expense	(25,369	)	(35,610	)	(10,241	)	(28.8	)
Income from continuing operations	$ 40,337		$ 55,979		$ (15,642	)	(27.9	)%

2

	Year Ended December 31, 2006	2005	Increase (Decrease)	% Increase (Decrease)
New units sold	66,224	58,372	7,852	13.5 %
Average selling price per new vehicle	$ 27,807	$ 27,947	$ (140)	(0.5)%
Used units sold	68,706	66,439	2,267	3.4 %
Average selling price per used vehicle	$ 12,552	$ 12,123	$ 429	3.5 %
Finance and insurance sales per retail unit	$ 1,094	$ 1,063	$ 31	2.9 %

(In Thousands)	Year Ended December 31, 2005	2004	Increase (Decrease)	% Increase (Decrease)
Revenues:				
New vehicle	$ 1,631,316	$ 1,495,442	$ 135,874	9.1 %
Used vehicle	805,448	726,544	78,904	10.9
Finance and insurance	107,564	94,991	12,573	13.2
Service, body and parts	302,960	273,630	29,330	10.7
Fleet and other	4,410	7,679	(3,269)	(42.6)
Total revenues	2,851,698	2,598,286	253,412	9.8
Cost of sales:				
New vehicle	1,501,062	1,378,188	122,874	8.9
Used vehicle	697,908	635,031	62,877	9.9
Service, body and parts	158,043	143,905	14,138	9.8
Fleet and other	2,986	6,461	(3,475)	(53.8)
Total cost of sales	2,359,999	2,163,585	196,414	9.1
Gross profit	491,699	434,701	56,998	13.1
Selling, general and administrative	357,617	326,168	31,449	9.6
Depreciation and amortization	13,975	12,491	1,484	11.9
Income from operations	120,107	96,042	24,065	25.1
Floorplan interest expense	(17,580)	(12,221)	5,359	43.9
Other interest expense	(11,891)	(8,667)	3,224	37.2
Other expense, net	953	739	214	29.0
Income from continuing operations before income taxes	91,589	75,893	15,696	20.7
Income tax expense	(35,610)	(29,397)	6,213	21.1
Income from continuing operations	$ 55,979	$ 46,496	$ 9,483	20.4 %

	Year Ended December 31, 2005	2004	Increase (Decrease)	% Increase (Decrease)
New units sold	58,372	53,169	5,203	9.8 %
Average selling price per new vehicle	$ 27,947	$ 28,126	$ (179)	(0.6)%
Used units sold	66,439	62,217	4,222	6.8 %
Average selling price per used vehicle	$ 12,123	$ 11,678	$ 445	3.8 %
Finance and insurance sales per retail unit	$ 1,063	$ 1,016	$ 47	4.6 %

Revenues

Total revenues increased 11.3% and 9.8%, respectively, in 2006 compared to 2005 and in 2005 compared to 2004.

The increase in 2006 compared to 2005 was a result of acquisitions, as well as a 3.7% increase in same-store sales, excluding fleet. We believe that our strong operating systems, integrated store network and regional market focus contributed to our same-store sales increase, especially in the new vehicle sales. During 2006, we focused on new vehicle sales to gain market share and create long-term parts and services business, which resulted in a 4.8% increase in same-store new vehicle retail sales in 2006 compared to 2005 and compared to an approximately 2.6% decrease in the industry during the same period. These industry figures include a large number of fleet sales, so industry retail figures were down substantially more. Improvements in same-store used vehicle sales were minor as a result of the heightened focus on new vehicle sales in the year. The increases in unit sales are also benefiting our parts and service business. The improvements in finance and insurance same-store sales resulted primarily from the unit increases in sales of both new and used vehicles during 2006 compared to 2005.

The increase in 2005 compared to 2004 was primarily a result of acquisitions and a 1.9% increase in same-store sales, which was driven by an increase in units sold. The increase in same store sales was driven by same-store sales increases across all business lines. The employee pricing programs offered by the domestic manufacturers during the second and third quarters of 2005, as well as a mix shift away from trucks and SUVs, resulted in a decrease in average selling prices but an increase in new units sold, the combination of which resulted in higher same-store new vehicle sales. The same programs also contributed to improvements in same-store used vehicle sales due to the large number of good quality used vehicle trade-ins associated with the high volume of new vehicle purchases. The improvement in same-store service, body and parts revenue in 2005 compared to 2004 was a result of our continued focus on service-advisor training and our Lifetime Oil Program. In addition, pricing and cost saving initiatives across the service, body and parts business lines contributed to the improvement in 2005 compared to 2004.

Same-store sales percentage increases (decreases) were as follows:

	2006 compared to 2005	**2005 compared to 2004**
New vehicle retail, excluding fleet	4.8 %	0.9 %
Used vehicle, including wholesale	0.6	3.7
Total vehicle sales, excluding fleet	3.4	1.8
Finance and insurance	5.1	1.7
Service, body and parts	5.3	2.9
Total sales, excluding fleet	3.7	1.9

Same store sales are calculated for stores that were operation as of December 31, 2005, and only including the months of operations for both comparable periods. For example, a store acquired in June 2005 would be included in same store operating data beginning in July 2006, after its first full complete comparable month of operation. Thus, operating results for same store comparisons would include only the periods of July through December of both comparable years.

Fleet and other sales include both fleet sales and fees received for delivering vehicles on behalf of the manufacturer, the U.S. military, rent-a-car companies or leasing companies.

Penetration rates for certain products were as follows:

	2006	**2005**	**2004**
Finance and insurance	77 %	76 %	77 %
Service contracts	42	43	43
Lifetime oil change and filter	39	38	36

The decrease in the finance and insurance penetration rate in 2005 compared to 2004 was due to reduced availability of manufacturer subsidized low-interest rate loans during the second and third quarters of 2005 when the manufacturers offered their employee pricing programs.

Gross Profit

Gross profit increased $46.8 million in 2006 compared to 2005 and increased $57.0 million in 2005 compared to 2004 due primarily to increased total revenues. An increase in the overall gross profit margin also contributed to the increase in 2005 compared to 2004.

Gross profit margins achieved were as follows:

	Year Ended December 31, 2006		**2005**		**Lithia Margin Change***
New vehicle	7.7	%	8.0	%	(30)bp
Retail used vehicle	14.9		15.6		(70)
Wholesale used vehicles	2.4		2.7		(30)
Finance and insurance	100.0		100.0		
Service, body and parts	48.5		47.8		70
Overall	**17.0**		**17.2**		**(20)**

	Year Ended December 31, 2005		**2004**		**Lithia Margin Change***
New vehicle	8.0	%	7.8	%	20bp
Retail used vehicle	15.6		14.4		120
Wholesale used vehicles	2.7		3.2		(50)
Finance and insurance	100.0		100.0		
Service, body and parts	47.8		47.4		40
Overall	**17.2**		**16.7**		**50**

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

The decrease in new vehicle gross profit margin in 2006 compared to 2005 was due to our focus on selling volume and gaining market share in 2006. Our historical average gross profit margin achieved on new vehicles over the past five years was 8.0%.

The decrease in retail used vehicle gross profit margin in 2006 compared to 2005 was due to a comparison to unusually high gross margins achieved in 2005, which resulted primarily from a healthy supply of good-quality trade-ins during the employee pricing programs. Our historical average gross profit margin achieved on retail used vehicles over the past five years was 14.3%.

The decrease in wholesale used vehicle gross profit margin in 2006 compared to 2005 was due to wholesale market conditions, a focus on retailing more used vehicles and bringing in trade-ins nearer to true market value. Our ability to provide customers with a better value for their trade-ins, bringing them in closer to their true market value, has been improved by our use of the first look technology. This, however, lowers the gross profit margin we are able to achieve on the re-sale of these trade-ins. In addition, as we focus on retailing more used vehicles, we are left with the lower-quality used vehicles for wholesaling, which also contributed to lower gross profit margins. We dispose of our wholesale used vehicles by using centralized controls, holding our own local used vehicle auctions and managing the disposal of units at larger third party auctions.

The increases in service, body and parts gross profit margin in 2006 compared to 2005 and in 2005 compared to 2004 were due to our continued focus on service advisor training, which has led to gains in the sale of higher margin service items and increases in customer-pay business, as well as a number of pricing and cost saving initiatives. Higher penetration rates for our lifetime oil change and filter service also contributed to these gross profit margin increases.

In addition to the reasons discussed above, the decline in the overall gross profit margin during 2006 compared to 2005 was also due to our focus on increased new vehicle sales, which carry a lower margin than the other business lines.

In the new vehicle business, margins remained relatively constant in 2005 compared to 2004 as a result of strategic initiatives and internal directives in 2004 and early 2005 that increased gross profit per vehicle

sold. These margin raising initiatives were partially offset in 2005 by manufacturers employee pricing programs, which created a higher volume, lower margin environment during the second and third quarters of 2005.

Retail used vehicle margins improved in 2005 compared to 2004 as a result of a stronger pricing and retail environment for used vehicles in combination with a large quantity of good quality used vehicle trade-ins.

Margins in our wholesale used vehicle business declined in 2005 compared to 2004 as a result of aggressive wholesaling in the third and fourth quarters of 2005 designed to clear inventories going into the seasonally slower winter months. Gross profits per unit remained positive.

Same-store gross profit increased 2.1% in 2006 compared to 2005 and increased 3.2% in 2005 compared to 2004, mainly due to increases in same store revenues.

Selling, General and Administrative Expense

Selling, general and administrative expense (SG&A) includes salaries and related personnel expenses, facility lease expense, advertising (net of manufacturer cooperative advertising credits), legal, accounting, professional services and general corporate expenses.

SG&A increased $49.0 million in 2006 compared to 2005 and increased $31.4 million in 2005 compared to 2004. SG&A as a percentage of revenue increased by 30 basis points in 2006 compared to 2005 and decreased by 10 basis points in 2005 compared to 2004.

The increases in dollars spent in 2006 compared to 2005 and in 2005 compared to 2004 were due primarily to increased selling, or variable, expenses related to the increases in acquisition revenues and the number of locations. Approximately $33.3 million and $30.4 million of the increase in SG&A was due to these factors in 2006 compared to 2005 and in 2005 compared to 2004, respectively. In addition, stock-based compensation included in SG&A increased to $3.5 million in 2006 compared to $0.5 in 2005 and $240,000 in 2004 as a result of the adoption of SFAS No. 123R in January 2006.

After salaries and wages, the next four largest expense categories, sales compensation, payroll taxes, rent and advertising, all improved or were flat as a percentage of gross profit in 2006 compared to 2005. SG&A in 2006 also included expenses for certain initiatives that we expect will lead to operating efficiencies in future periods as discussed in Overview above.

SG&A as a percentage of gross profit is an industry standard and a better gauge for measuring performance relative to SG&A expense. As a result of the charges related to our operating initiatives and the other charges detailed above, SG&A as a percentage of gross profit increased by 280 basis points in 2006 compared to 2005. The change in stock-based compensation and the charge for the worker s compensation claim resulted in a 75 basis point increase out of the 280 basis point total increase. We expect to continue to incur charges in 2007 related to our operating initiatives and also expect our health and benefit plan costs to increase materially in 2007 compared to 2006.

SG&A as a percentage of gross profit improved by 230 basis points in 2005 compared to 2004 as we continued to realize the positive results of multiple cost saving initiatives at our corporate headquarters and in the stores.

Depreciation and Amortization

Depreciation and amortization increased $3.1 million and $1.5 million, respectively, in 2006 compared to 2005 and in 2005 compared to 2004 due to the addition of property and equipment primarily related to our acquisitions, as well as leasehold improvements to existing facilities.

Income from Operations

Operating margins decreased by 60 basis points to 3.6% in 2006 compared to 4.2% in 2005, due to the decrease in overall gross profit margin and the increase in SG&A as discussed above. Operating margins improved by 50 basis points in 2005 compared to 3.7% in 2004, primarily due to improved overall gross profit margin as discussed above. In addition, in 2005, operating expenses as a percentage of revenue improved by 10 basis points compared to 2004.

Floorplan Interest Expense

Floorplan interest expense increased $17.1 million in 2006 compared to 2005. An increase of $9.6 million resulted from increases in the average interest rates on our floorplan facilities, an increase of $4.8 million resulted from increases in the average outstanding balances of our floorplan facilities and an increase of $2.7 million related to our interest rate swaps.

Floorplan interest expense increased $5.4 million in 2005 compared to 2004. An increase of $7.8 million resulted from increases in the average interest rates on our floorplan facilities and an increase of $1.3 million resulted from increases in the average outstanding balances of our floorplan facilities. These increases were partially offset by a $3.7 million decrease related to our interest rate swaps.

Other Interest Expense

Other interest expense includes interest on our senior subordinated convertible notes, debt incurred related to acquisitions, real estate mortgages, our used vehicle line of credit and equipment related notes.

Other interest expense increased $3.6 million in 2006 compared to 2005. Changes in the weighted average interest rate on our debt in 2006 compared to 2005 increased other interest expense by approximately $0.5 million and changes in the average outstanding balances resulted in an increase of approximately $3.1 million. Interest expense related to the $85.0 million of senior subordinated convertible notes that were issued in May 2004 totals approximately $765,000 per quarter, which consists of $611,000 of contractual interest and $154,000 of amortization of debt issuance costs.

Other interest expense increased $3.2 million in 2005 compared to 2004. Changes in the weighted average interest rate on our debt in 2005 compared to 2004 increased other interest expense by approximately $1.4 million and changes in the average outstanding balances resulted in an increase of approximately $1.8 million.

Other interest expense excludes $1.5 million, $0.9 million and $0.5 million, respectively, of capitalized interest in 2006, 2005 and 2004.

Income Tax Expense

Our effective tax rate was 38.6% in 2006, 38.9% in 2005 and 38.7% in 2004. Our federal income tax rate is 35% and our state income tax rate is currently 3.05%, which varies with the mix of states where our stores are located. We also have certain non-deductible expenses and other adjustments that increased our effective rate at for 2006 to 38.6%. Our effective tax rate may be affected in the future by the mix of asset acquisitions compared to corporate acquisitions, as well as by the mix of states where our stores are located. The increase in our effective tax rate in 2005 compared to 2004 was due primarily to an increase in revenue in some of our higher tax rate states.

Income from Continuing Operations

Income from continuing operations as a percentage of revenue decreased in 2006 compared to 2005 as a result of the decreased overall gross profit margin, increased SG&A and increased interest expense as discussed above.

Income from continuing operations as a percentage of revenue increased in 2005 compared to 2004 as a result of improvements in gross profit margins and operating expenses as discussed above.

Discontinued Operations

We continually monitor the performance of each of our dealerships and make determinations to sell based primarily on return on capital criteria. When a dealership meets the criteria of held for sale, as defined in SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the results of operations are reclassified into discontinued operations. All dealerships included in discontinued operations have been, or will be, eliminated from our on-going operations upon completion of the sale. We anticipate the completion of the sale for each dealership to occur within 12 months from the date of determination.

During 2006, we disposed of two of our dealerships that were held for sale at December 31, 2005 and, at December 31, 2006, two dealerships were held for sale.

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

Year Ended December 31,	**2006**	**2005**	**2004**
Revenue	$ 60,044	$ 129,602	$ 181,484
Pre-tax loss	(4,991)	(3,894)	(1,442)
Gain (loss) on disposal of discontinued operations, net of tax	(554)	16	186
Amount of goodwill and other intangible assets disposed of	3,552	4,406	1,900

Interest expense is allocated to stores classified as discontinued operations for actual flooring interest expense directly related to the new vehicles in the store. Interest expense related to our used vehicle line of credit is allocated based on total used vehicle inventory of the store, and interest expense related to our equipment line of credit is allocated based on the amount of fixed assets.

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

December 31,	**2006**	**2005**
Inventories	$ 11,594	$ 22,703
Property, plant and equipment	2,949	817
Goodwill and other intangible assets	942	3,891
	$ 15,485	$ 27,411

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

December 31,	**2006**	**2005**
Floorplan notes payable	$ 9,605	$ 22,388
Real estate debt	2,005	
	$ 11,610	$ 22,388

Selected Consolidated Quarterly Financial Data

The following tables set forth our unaudited quarterly financial data(1).

	Three Months Ended, March 31 (in thousands, except per share data)	June 30	September 30	December 31
2006				
Revenues:				
New vehicle sales	$ 420,395	$ 487,457	$ 506,394	$ 427,217
Used vehicle sales	206,506	228,741	236,868	190,282
Finance and insurance	27,231	32,384	33,564	26,757
Service, body and parts	81,084	84,216	88,448	89,999
Fleet and other	1,155	798	1,832	1,566
Total revenues	736,371	833,596	867,106	735,821
Cost of sales	608,593	692,654	723,453	609,717
Gross profit	127,778	140,942	143,653	126,104
Selling, general and administrative	97,564	104,273	106,147	98,585
Depreciation and amortization	3,983	4,148	4,348	4,592
Income from operations	26,231	32,521	33,158	22,927
Floorplan interest expense	(5,405)	(8,223)	(12,866)	(8,142)
Other interest expense	(3,299)	(3,607)	(3,782)	(4,765)
Other, net	378	263	128	189
Income from continuing operations before income taxes	17,905	20,954	16,638	10,209
Income taxes	(6,969)	(8,839)	(5,941)	(3,620)
Income before discontinued operations	10,936	12,115	10,697	6,589
Discontinued operations, net of tax	(1,568)	(224)	(181)	(1,060)
Net income	$ 9,368	$ 11,891	$ 10,516	$ 5,529
Basic income per share from continuing operations	$ 0.56	$ 0.62	$ 0.55	$ 0.34
Basic loss per share from discontinued operations	(0.08)	(0.01)	(0.01)	(0.06)
Basic net income per share	$ 0.48	$ 0.61	$ 0.54	$ 0.28
Diluted income per share from continuing operations	$ 0.52	$ 0.57	$ 0.51	$ 0.32
Diluted loss per share from discontinued operations	(0.07)	(0.01)	(0.01)	(0.05)
Diluted net income per share	$ 0.45	$ 0.56	$ 0.50	$ 0.27

	Three Months Ended, March 31 (in thousands, except per share data)	June 30	September 30	December 31
2005				
Revenues:				
New vehicle	$ 346,752	$ 425,078	$ 498,264	$ 361,222
Used vehicle	194,263	197,201	223,446	190,538
Finance and insurance	24,069	26,686	31,928	24,881
Service, body and parts	72,463	73,672	79,006	77,819
Fleet and other	876	1,700	987	847
Total revenues	638,423	724,337	833,631	655,307
Cost of sales	524,913	601,073	694,770	539,243
Gross profit	113,510	123,264	138,861	116,064
Selling, general and administrative	86,003	90,029	95,104	86,481
Depreciation and amortization	3,322	3,342	3,559	3,752
Income from operations	24,185	29,893	40,198	25,831
Floorplan interest expense	(1,576)	(7,628)	(3,159)	(5,217)
Other interest expense	(2,771)	(3,001)	(2,999)	(3,120)
Other, net	224	195	132	402
Income from continuing operations before income taxes	20,062	19,459	34,172	17,896

Income taxes	(7,791)	(7,713)	(13,982)	(6,124)
Income before discontinued operations	12,271	11,746	20,190	11,772
Discontinued operations, net of tax	(325)	(328)	(417)	(1,282)
Net income	$ 11,946	$ 11,418	$ 19,773	$ 10,490
Basic income per share from continuing operations	$ 0.64	$ 0.61	$ 1.05	$ 0.61
Basic loss per share from discontinued operations	(0.01)	(0.01)	(0.02)	(0.07)
Basic net income per share	$ 0.63	$ 0.60	$ 1.03	$ 0.54
Diluted income per share from continuing operations	$ 0.59	$ 0.56	$ 0.94	$ 0.56
Diluted loss per share from discontinued operations	(0.02)	(0.01)	(0.02)	(0.06)
Diluted net income per share	$ 0.57	$ 0.55	$ 0.92	$ 0.50

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

Seasonality and Quarterly Fluctuations

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

Liquidity and Capital Resources

Our principal needs for capital resources are to finance acquisitions and capital expenditures, as well as for working capital and the funding of our cash dividend payments. We have relied primarily upon internally generated cash flows from operations, borrowings under our credit agreements and the proceeds from public equity and private debt offerings to finance operations and expansion. We believe that our available cash, cash equivalents, available lines of credit and cash flows from operations will be sufficient to meet our anticipated operating expenses, capital requirements, projected acquisitions and current level of cash dividends for at least the next 24 months from December 31, 2006.

Our inventories decreased to $603.3 million at December 31, 2006 from $606.0 million at December 31, 2005. We slowed ordering vehicles in the third and fourth quarters of 2006 and worked to sell down our new vehicle inventory. As a result, our days supply of new vehicles at December 31, 2006 was 8 days below our average historical December 31 balances and more than 30 days below our December 31, 2005 levels. In addition, by the end of January 2007, we had reduced our new vehicles inventory by another 11 days, which positioned us well going into the remainder of 2007.

Our focus on new vehicle unit sales in 2006 led to more trade-ins, which resulted in increased used vehicle inventories. As a result, our days supply of used vehicles at December 31, 2006 was 4 days above average levels for December 31.

Our new and used flooring notes payable increased to $595.3 million at December 31, 2006 from $530.5 million at December 31, 2005. New vehicles are financed at approximately 100% and used vehicles are financed at approximately 80% of cost. Used vehicles are financed as needed, utilizing our used vehicle flooring credit facility.

Our Board of Directors declared dividends of $0.12 per share on our Class A and Class B common stock, which were paid in March and May of 2006, and totaled approximately $2.3 million and $2.4 million, respectively. In addition, our Board of Directors approved an increase in our dividend to $0.14 per share for both the second and third quarters 2006, which totaled approximately $2.8 million and $2.7 million, respectively. A dividend of $0.14 per share was also paid on our Class A and Class B common stock in January 2007 for the fourth quarter of 2006, which totaled $2.7 million. We anticipate recommending to the Board of Directors the approval of a cash dividend each quarter.

In June 2000, our Board of Directors authorized the repurchase of up to 1,000,000 shares of our Class A common stock. Through December 31, 2006, we have purchased a total of 256,831 shares under this program, of which 196,600 were purchased during 2006. We may continue to repurchase shares from time to time in the future as conditions warrant. The recent change in the tax law tends to equalize the benefits of dividends and share repurchases as a means to return capital or earnings to shareholders. As a result, we believe it is now advantageous to shareholders to have a dividend in place. With the dividend, we are able to offer an immediate and tangible return to our shareholders without reducing our already limited market float, which occurs when we repurchase shares. However, when we believe that repurchases present an attractive use of our capital, we would expect to make strategic repurchases.

We have a working capital, acquisition and used vehicle flooring credit facility with U.S. Bank National Association, DaimlerChrysler Financial Services Americas LLC (DCFS) and Toyota Motor Credit Corporation (TMCC), totaling up to $225 million, which expires August 31, 2009. Loans are guaranteed by all of our subsidiaries and are secured by new vehicle inventory, used vehicle and parts inventory, equipment other than fixtures, deposit accounts, accounts receivable, investment property and other intangible personal property. Stock and other equity interests of our subsidiary dealerships and certain other subsidiaries are excluded. The lenders security interest in new vehicle inventory is subordinated to the interests of floorplan financing lenders, including DCFS and TMCC. The agreement for this facility provides for events of default that include nonpayment, breach of covenants, a change of control and certain cross-defaults with other indebtedness. In the event of a default, the agreement provides that the lenders may declare the entire principal balance immediately due, foreclose on collateral and increase the applicable interest rate to the revolving loan rate plus 3 percent, among other remedies.

The facility agreement includes financial and restrictive covenants typical of such agreements. Financial covenants include requirements to maintain a minimum total net worth and imposes minimum current ratio, fixed charge coverage ratio and cash flow leverage ratio requirements. The covenants restrict us from incurring additional indebtedness, making investments, selling or acquiring assets and granting security interests in our assets. At December 31, 2006, we were in compliance with all of the financial and restrictive covenants.

In addition, cash dividends are limited to $15 million per fiscal year and repurchases by us of our common stock are limited to $20 million per fiscal year.

Ford Motor Credit, General Motors Acceptance Corporation (GMAC), Volkswagen Credit and BMW Financial Services NA, LLC have agreed to floor all of our new vehicles for their respective brands with DaimlerChrysler Financial Services Americas LLC and Toyota Motor Credit Corporation serving as the primary lenders for substantially all other brands. These new vehicle lines are secured by new vehicle inventory of the relevant brands. Vehicles financed by lenders not directly associated with the manufacturer are classified as floorplan notes payable: non-trade and are included as a financing activity in our statements of cash flows. Vehicles financed by lenders directly associated with the manufacturer are classified as floorplan notes payable and are included as an operating activity.

On November 30, 2006, General Motors (GM) completed the sale of a majority equity stake in GMAC to an investment consortium. Although GMAC will continue to be the exclusive provider of GM financial products and services and continues to have the relationships with GM, a majority equity stake in GMAC has been sold to an independent third-party and GM has indicated in its public filings that it no longer controls the GMAC entity. As a result, we will be treating new vehicles financed by GMAC after the change in ownership control as floorplan notes payable: non-trade and related changes as a financing activity in our statements of cash flows. Vehicles financed prior to this change in control will continue to be classified as floorplan notes payable: trade, with related changes reflected as operating activities in our statements of cash flows, since these GMAC vehicle financings occurred while GM retained control of GMAC as its captive finance subsidiary.

We expect to be in compliance with the covenants for all of our debt agreements in the foreseeable future. In the event that we are unable to meet such requirements, and any available cure period has passed, the lender may require an acceleration of payment, increase the interest rate or limit our ability to borrow or pay cash dividends.

Interest rates on all of the above facilities ranged from 6.47% to 7.50% at December 31, 2006. Amounts outstanding on the lines at December 31, 2006, together with amounts remaining available under such lines were as follows (in thousands):

	Outstanding at December 31, 2006	Remaining Availability as of December 31, 2006	
New and program vehicle lines	$ 499,679	$	(1)
Working capital, acquisition and used vehicle line	144,000	80,089	(2)
	$ 643,679	$ 80,089	

(1) There are no formal limits on the new and program vehicle lines with certain lenders.

(2) Reduced by $911,000 for outstanding letters of credit.

We also have outstanding $85.0 million of 2.875% senior subordinated convertible notes due 2014. We will also pay contingent interest on the notes during any six-month interest period beginning May 1, 2009, in which the trading price of the notes for a specified period of time equals or exceeds 120% of the principal amount of the notes. The notes are convertible into shares of our Class A common stock at a price of $37.69 per share upon the satisfaction of certain conditions and upon the occurrence of certain events as follows:

- if, prior to May 1, 2009, and during any calendar quarter, the closing sale price of our common stock exceeds 120% of the conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding calendar quarter;

- if, after May 1, 2009, the closing sale price of our common stock exceeds 120% of the conversion price;

- if, during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of notes for each day of such period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of $1,000 principal amount of the notes;

- if the notes have been called for redemption; or

- upon certain specified corporate events.

A declaration and payment of a dividend in excess of $0.08 per share per quarter will result in an adjustment in the conversion rate for the notes if such cumulative adjustment exceeds 1% of the current conversion rate. We declared dividends of $0.14 per share for the quarters ended June 30, September 30 and December 31, 2006 and dividends of $0.12 per share for each of the four preceding quarters. Effective January 17, 2007, we exceeded the 1% threshold required for a change in the conversion rate. With this change, the conversion rate per $1,000 of notes increased to 26.8556 from 26.5331.

The notes are redeemable at our option beginning May 6, 2009 at the redemption price of 100% of the principal amount plus any accrued interest. The holders of the notes can require us to repurchase all or some of the notes on May 1, 2009 and upon certain events constituting a fundamental change or a termination of trading. A fundamental change is any transaction or event in which all or substantially all of our common stock is exchanged for, converted into, acquired for, or constitutes solely the right to receive, consideration that is not all, or substantially all, common stock that is listed on, or immediately after the transaction or event, will be listed on, a United States national securities exchange. A termination of trading will have occurred if our common stock is not listed for trading on a national securities exchange or the Nasdaq National Market.

Our earnings to fixed charge coverage ratio, as defined in the senior subordinated convertible notes, was 2.11 for the quarter ended December 31, 2006.

Contractual Payment Obligations

A summary of our contractual commitments and obligations as of December 31, 2006 was as follows (in thousands):

	Payments Due By Period				
Contractual Obligation	**Total**	**2007**	**2008 and 2009**	**2010 and 2011**	**2012 and beyond**
Floorplan Notes	$ 499,679	$ 499,679	$	$	$
Lines of Credit and Long-Term Debt	408,940	16,557	206,563	32,834	152,986
Interest on Scheduled Debt Payments	60,489	11,539	17,674	12,119	19,157
Capital Commitments	64,273	46,639	17,634		
Operating Leases	184,620	23,911	41,415	28,556	90,738
	$ 1,218,001	$ 598,325	$ 283,286	$ 73,509	$ 262,881

We had capital commitments of $62.7 million at December 31, 2006 for the construction of nine new facilities and additions to two existing facilities. Of the new facilities, five are replacing existing facilities. We have already incurred $6.1 million for these projects and anticipate incurring an additional $45.0 million in 2007 and $17.7 million in 2008. We expect to pay for the construction out of existing cash balances until completion of the projects, at which time we anticipate securing long-term financing and general borrowings from third party lenders for 70% to 90% of the amounts expended.

We also had capital commitments of $1.6 million for the acquisition and development of hardware and software for several information technology initiatives. We anticipate incurring these amounts during 2007.

In addition to the above, we have approximately $112.3 million in planned capital expenditures under consideration for various new facilities and remodeling projects. These projects are still in the planning stage or are awaiting approvals from governmental agencies or manufacturers. We feel that these projects are a critical part of our future growth strategy.

We have also recorded a reserve for our estimated contractual obligations related to potential charge-backs for vehicle service contracts, lifetime oil change contracts and other various insurance contracts that are terminated early by the customer. At December 31, 2006, this reserve totaled $14.5 million. Based on past experience, we estimate that the $14.5 million will be paid out as follows: $8.8 million in 2007; $3.8 million in 2008; $1.4 million in 2009; $0.4 million in 2010; and $0.1 million thereafter.

Critical Accounting Policies and Use of Estimates

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

Our most critical accounting estimates include service contract and lifetime oil contract income recognition, workers compensation insurance premium accrual, discretionary employee bonus accrual, assessment of recoverability of goodwill and other intangible assets, and used vehicle inventory valuations. We also have other key accounting policies, such as our policies for valuation of accounts receivable, expense accruals and other revenue recognition. However, these policies either do not meet the definition of critical accounting estimates described above or are not currently material items in our financial statements. We review our estimates, judgments and assumptions periodically and reflect the effects of revisions in the period that they are deemed to be necessary. We believe that these estimates are reasonable. However, actual results could differ from these estimates.

Service Contract and Lifetime Oil Change Contract Income Recognition

We receive fees from the sale of vehicle service contracts and lifetime oil contracts to customers. The contracts are sold through an unrelated third party, but we may be charged back for a portion of the fees in the event of early termination of the contracts by customers. We have established a reserve for estimated future charge-backs based on an analysis of historical charge-backs in conjunction with estimated lives of the applicable contracts. If future cancellations are different than expected based on historical experience, we could have additional expense or income related to the cancellations in future periods. At December 31, 2006 and 2005, this reserve totaled $13.2 million and $12.2 million, respectively, and is included in accrued liabilities and other long-term liabilities on our consolidated balance sheets. We may also participate in future underwriting profit pursuant to retrospective commission arrangements, which would be recognized as income upon receipt.

Workers Compensation Insurance Premium Accrual

Insurance premiums are paid for under a three-year retrospective cost policy, whereby premium cost depends on experience. We accrue premiums based on our historical experience rating, although the actual claims can be something greater or less than the historical experience, which could create our estimated liability to either be under or over accrued. As of December 31, 2006 and 2005, the accrual for insurance premiums was $3.1 million and $2.3 million, respectively, and is included in accrued liabilities and other long-term liabilities on our consolidated balance sheets. We expect that the retrospective cost policy, as opposed to a guaranteed cost with a flat premium, will be the most cost efficient over time.

Discretionary Employee Bonus Accrual

We make certain estimates, judgments and assumptions regarding the likelihood of our attainment, and the level thereof, of the annual bonus criteria under our 2006 Discretionary Support Services Bonus Program in order to record bonus expense on a quarterly basis. We accrue the estimated year-end expense on a pro-rata basis throughout the year based on bonus attainment expectations. These estimates, judgments and assumptions are made quarterly based on available information and take into consideration the historical seasonality of our business and current trends. If actual year-end results differ materially from our estimates, the amount of bonus expense recorded in a particular quarter could be significantly over or under estimated. The bonus accrual at the end of any given year is accurate and reflective of actual results attained and amounts to be paid.

Intangible Assets

We review our goodwill and other identifiable non-amortizable intangible assets for impairment at least annually by applying a fair-value based test using discounted estimated cash flows. Discounted future cash flows are prepared by applying a growth rate to historical revenues. Growth rates are calculated individually for each region with data derived from the U.S. Census Bureau on population growth and the U.S. Department of Labor, Bureau of Labor Statistics for historical consumer price index data. The discount rate applied to the future cash flows is derived from a hybrid Capital Asset Pricing Model which factors in an equity risk premium and a risk free rate, combined with a weighted average cost of capital model. The review is conducted more frequently than annually if events or circumstances occur that warrant a review. Our other identifiable intangible assets primarily include the franchise value of the business unit, which is considered to have an indefinite life and not subject to amortization, but rather is included in the fair-value based testing. Impairment could occur if the operating business unit book value is greater than the determined fair-value. At such point, an impairment loss would be recognized to the extent that the carrying amount exceeds the assets fair value. We have determined that we operate as one business unit. During 2006 and 2005, we concluded that there was no impairment to the carrying value of our intangible assets. At December 31, 2006 and 2005, goodwill and other identifiable non-amortizable intangible assets totaled $376 million and $311 million, respectively.

Used Vehicle Inventory

Used vehicle inventories are stated at cost plus the cost of any equipment added, reconditioning and transportation. We select a sampling of dealerships throughout the year to perform quarterly testing of book values against market valuations utilizing the Kelly Blue Book and NADA guidelines. Used vehicle inventory values are cyclical and could experience impairment when market valuations are significantly below inventory carrying values. Historically, we have not experienced significant write-downs on our used vehicle inventory. If the book value of our used vehicles is actually more than fair value, we could experience lower gross margins on our used vehicles in future periods.

Service Work Performed for Vehicles in Inventory

Many of our vehicles currently in inventory include a mark up for gross profit due to service work performed on those vehicles. The service work performed includes charges to recondition used vehicles, accessories added to the vehicles and work performed to ready the vehicle for sale. We defer an estimate of the gross profit on vehicles in inventory based on a historical analysis of actual charges to inventory. At December 31, 2006 and 2005, the estimate of deferred gross profit was $4.0 million and $3.3 million, respectively. If the actual gross profit on an individual vehicle is more or less than the estimated deferred amount, we could potentially have deferred an amount different than the actual service work performed. Any differences in estimates compared to actual would be reflected in the gross margins in future periods.

Recent Accounting Pronouncements

See Note 19 of Notes to Consolidated Financial Statements.

Off-Balance Sheet Arrangements

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Variable Rate Debt

We use variable-rate debt to finance our new and program vehicle inventory and certain real estate holdings. The interest rates on our variable rate debt are tied to either the one or three-month LIBOR or the prime rate. These debt obligations therefore expose us to variability in interest payments due to changes in these rates. The flooring debt is based on open-ended lines of credit tied to each individual store from the various manufacturer finance companies. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases.

Our variable-rate flooring notes payable, variable rate mortgage notes payable and other credit line borrowings subject us to market risk exposure. At December 31, 2006, we had $689.7 million outstanding under such agreements at interest rates ranging from 6.47% to 9.36% per annum. A 10% increase in interest rates would increase annual interest expense by approximately $2.3 million, net of tax, based on amounts outstanding at December 31, 2006.

Fixed Rate Debt

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

Based on open market trades, we determined that our $85.0 million of long-term convertible fixed interest rate debt had a fair market value of approximately $81.2 million at December 31, 2006. In addition, at December 31, 2006, we had $133.9 million of other long-term fixed interest rate debt outstanding with maturity dates of between October 2007 and May 2022. Based on discounted cash flows, we have determined that the fair market value of this long-term fixed interest rate debt was approximately $132.3 million at December 31, 2006.

Hedging Strategies

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

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

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

As of December 31, 2006, we had outstanding the following interest rate swaps with U.S. Bank Dealer Commercial Services:

- effective January 26, 2003 a five year, $25 million interest rate swap at a fixed rate of 3.265% per annum, variable rate adjusted on the 26th of each month

- effective February 18, 2003 a five year, $25 million interest rate swap at a fixed rate of 3.30% per annum, variable rate adjusted on the 1st and 16th of each month

- effective November 18, 2003 a five year, $25 million interest rate swap at a fixed rate of 3.65% per annum, variable rate adjusted on the 1st and 16th of each month

- effective November 26, 2003 a five year, $25 million interest rate swap at a fixed rate of 3.63% per annum, variable rate adjusted on the 26th of each month

- effective March 9, 2004 a five year, $25 million interest rate swap at a fixed rate of 3.25% per annum, variable rate adjusted on the 1st and 16th of each month;

- effective March 18, 2004 a five year, $25 million interest rate swap at a fixed rate of 3.10% per annum, variable rate adjusted on the 1st and 16th of each month; and

- effective June 16, 2006 a ten year, $25 million interest rate swap at a fixed rate of 5.587% per annum, variable rate adjusted on the 1st and 16th of each month.

We earn interest on all of the interest rate swaps at the one-month LIBOR rate. The one-month LIBOR rate at December 31, 2006 was 5.32% per annum.

The fair value of our interest rate swap agreements represents the estimated receipts or payments that would be made to terminate the agreements. These amounts are recorded as a component of floorplan interest expense. The difference between interest earned and the interest obligation results in a monthly settlement which is also recorded as a component of floorplan interest expense.

Additional interest expense, net of tax, on un-hedged debt as a result of changing interest rates, based on interest rates effective as of January 1, 2004 was approximately $10.7 million, $4.5 million and $0.6 million, respectively, in 2006, 2005 and 2004. Interest expense, net of tax, on un-hedged debt increased during 2006, 2005 and 2004 by approximately $2.1 million, $2.1 million and $0.6 million, respectively, as a result of increasing interest rates during those periods. As of December 31, 2006, approximately 57% of our total debt outstanding was subject to un-hedged variable rates of interest.

Based on current interest rates, we expect that our interest rate swaps will result in interest savings of approximately $1.7 million in 2007.

Risk Management Policies

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

We maintain risk management control systems to monitor interest rate cash flow attributable to both our outstanding and forecasted debt obligations as well as our offsetting hedge positions. The risk management control systems involve the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on our future cash flows.

Item 8. Financial Statements and Supplementary Financial Data

The financial statements and notes thereto required by this item begin on page F-1 as listed in Item 15 of Part IV of this document. Quarterly financial data for each of the eight quarters in the two-year period ended December 31, 2006 is included in Item 7.

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

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our President and Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure and that such information is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a 15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2006.

Management s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, as well as our consolidated financial statements, have been audited by KPMG LLP, an independent registered public accounting firm, as stated in their reports, which are included herein.

Changes in Internal Control Over Financial Reporting

Other than as discussed below, there has been no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

During the fourth quarter of 2006 we took remediation actions to address our previously disclosed material weakness in internal control over financial reporting with respect to adequate technical expertise to ensure the proper application, at inception, of the criteria for the short-cut method within the provisions of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, for our interest rate swaps. The changes in internal control over financial reporting included:

- improving training and education and accounting reviews to ensure all relevant personnel involved in derivative transactions understand and apply hedge accounting requirements in accordance with U.S. generally accepted accounting principles; and

- ongoing monitoring and review controls to ensure the continuing qualification for hedge accounting, including revising our documentation requirements for hedge accounting in accordance with generally accepted accounting principles with the assistance of outside experts, as appropriate.

As a result, management, with the participation of the Chief Executive Officer and Chief Financial Officer, has determined that these actions constitute a change in internal control over financial reporting that is reasonably likely to materially affect our internal control over financial reporting. We believe these steps have remediated the previously identified material weakness.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information required by this item will be included under the captions *Election of Directors, Meetings and Committees of the Board of Directors*, *Audit Committee Financial Expert*, *Code of Ethics, Executive Officers* and *Section 16(a) Beneficial Ownership Reporting Compliance* in our Proxy Statement for our 2007 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item will be included under the captions *Compensation of Directors, Compensation Committee Report, Compensation Discussion and Analysis, Executive Compensation, Potential Payments Upon Termination or Change-in-Control,* and *Compensation Committee Interlocks and Insider Participation* in our Proxy Statement for our 2007 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Equity Compensation Plan Information

The following table summarizes equity securities authorized for issuance as of December 31, 2006.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a) (c)
Equity compensation plans approved by shareholders	1,228,157	$ 20.23	1,948,590
Equity compensation plans not approved by shareholders			
Total	1,228,157	$ 20.23	1,948,590 (1)

(1) Includes 1,191,990 shares available pursuant to our 2003 Stock Incentive Plan and 756,600 shares available pursuant to our Employee Stock Purchase Plan.

The additional information required by this item will be included under the caption *Security Ownership of Certain Beneficial Owners and Management* in our Proxy Statement for our 2007 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

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

The information required by this item will be included under the captions *Certain Relationships and Related Transactions* and *Director Independence* in our Proxy Statement for our 2007 Annual Meeting of Shareholders and, upon filing is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information required by this item will be included under the caption *Independent Registered Public Accounting Firm* in the Proxy Statement for our 2007 Annual Meeting of Shareholders and, upon filing, is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

Financial Statements and Schedules

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

There are no schedules required to be filed herewith.

Exhibits

The following exhibits are filed herewith and this list is intended to constitute the exhibit index. An asterisk (*) beside the exhibit number indicates the exhibits containing a management contract, compensatory plan or arrangement, which are required to be identified in this report.

Exhibit		**Description**
3.1	(a)	Restated Articles of Incorporation of Lithia Motors, Inc., as amended May 13, 1999.
3.2	(b)	Bylaws of Lithia Motors, Inc.
4.1	(b)	Specimen Common Stock certificate
4.2	(j)	Indenture dated May 4, 2004, between Lithia Motors, Inc. and U.S. Bank National Association, as Trustee, relating to 2.875% Convertible Senior Subordinated Notes due 2014.
10.1*	(b)	1996 Stock Incentive Plan
10.2*	(c)	Amendment No. 1 to the Lithia Motors, Inc. 1996 Stock Incentive Plan
10.2.1*	(b)	Form of Incentive Stock Option Agreement (1)
10.3*	(b)	Form of Non-Qualified Stock Option Agreement (1)
10.4*	(d)	1997 Non-Discretionary Stock Option Plan for Non-Employee Directors
10.5*	(l)	1998 Employee Stock Purchase Plan, as amended
10.6*	(f)	Lithia Motors, Inc. 2001 Stock Option Plan
10.6.1*	(g)	Form of Incentive Stock Option Agreement for 2001 Stock Option Plan
10.6.2*	(g)	Form of Non-Qualified Stock Option Agreement for 2001 Stock Option Plan

10.7.1*	(k)	2003 Stock Incentive Plan, as amended and restated
10.7.2*	(k)	Form of Restricted Share Grant for 2003 Stock Incentive Plan, as amended and restated

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Exhibit		**Description**
10.8*	(k)	Summary 2006 Discretionary Support Services Bonus Program
10.9	(a)	Chrysler Corporation Sales and Service Agreement General Provisions
10.9.1	(h)	Chrysler Corporation Chrysler Sales and Service Agreement, dated September 28, 1999, between Chrysler Corporation and Lithia Chrysler Plymouth Jeep Eagle, Inc. (Additional Terms and Provisions to the Sales and Service Agreements are in Exhibit 10.9) (2)
10.10	(b)	Mercury Sales and Service Agreement General Provisions
10.10.1	(e)	Supplemental Terms and Conditions agreement between Ford Motor Company and Lithia Motors, Inc. dated June 12, 1997.
10.10.2	(e)	Mercury Sales and Service Agreement, dated June 1, 1997, between Ford Motor Company and Lithia TLM, LLC dba Lithia Lincoln Mercury (general provisions are in Exhibit 10.10) (3)
10.11	(e)	Volkswagen Dealer Agreement Standard Provisions
10.11.1	(a)	Volkswagen Dealer Agreement dated September 17, 1998, between Volkswagen of America, Inc. and Lithia HPI, Inc. dba Lithia Volkswagen. (standard provisions are in Exhibit 10.11) (4)
10.12	(b)	General Motors Dealer Sales and Service Agreement Standard Provisions
10.12.1	(a)	Supplemental Agreement to General Motors Corporation Dealer Sales and Service Agreement dated January 16, 1998.
10.12.2	(i)	Chevrolet Dealer Sales and Service Agreement dated October 13, 1998 between General Motors Corporation, Chevrolet Motor Division and Camp Automotive, Inc. (5)
10.13	(b)	Toyota Dealer Agreement Standard Provisions
10.13.1	(a)	Toyota Dealer Agreement, between Toyota Motor Sales, USA, Inc. and Lithia Motors, Inc., dba Lithia Toyota, dated February 15, 1996. (6)
10.14	(e)	Nissan Standard Provisions
10.14.1	(a)	Nissan Public Ownership Addendum dated August 30, 1999 (identical documents executed by each Nissan store).
10.14.2	(e)	Nissan Dealer Term Sales and Service Agreement between Lithia Motors, Inc., Lithia NF, Inc., and the Nissan Division of Nissan Motor Corporation In USA dated January 2, 1998. (standard provisions are in Exhibit 10.14) (7)
10.15	(a)	Lease Agreement between CAR LIT, L.L.C. and Lithia Real Estate, Inc. relating to properties in Medford, Oregon.(8)
10.16	(l)	2006 Board of Directors Compensation Package
10.17	(k)	Form of Outside Director Nonqualified Deferred Compensation Agreement
21		Subsidiaries of Lithia Motors, Inc.
23		Consent of KPMG LLP, Independent Registered Public Accounting Firm
31.1		Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.

Exhibit	Description
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

(a) Incorporated by reference from the Company s Form 10-K for the year ended December 31, 1999 as filed with the Securities and Exchange Commission on March 30, 2000.

(b) Incorporated by reference from the Company s Registration Statement on Form S-1, Registration Statement No. 333-14031, as declared effective by the Securities Exchange Commission on December 18, 1996.

(c) Incorporated by reference from the Company s Form 10-Q for the quarter ended June 30, 1998 as filed with the Securities and Exchange Commission on August 13, 1998.

(d) Incorporated by reference from the Company s Registration Statement on Form S-8, Registration Statement No. 333-45553, as filed with the Securities Exchange Commission on February 4, 1998.

(e) Incorporated by reference from the Company s Form 10-K for the year ended December 31, 1997 as filed with the Securities and Exchange Commission on March 31, 1998.

(f) Incorporated by reference from Appendix B to the Company s Proxy Statement for its 2001 Annual Meeting as filed with the Securities and Exchange Commission on May 8, 2001.

(g) Incorporated by reference from the Company s Form 10-K for the year ended December 31, 2001 as filed with the Securities and Exchange Commission on February 22, 2002.

(h) Incorporated by reference from the Company s Form 10-Q for the quarter ended September 30, 2001 as filed with the Securities and Exchange Commission on November 14, 2001.

(i) Incorporated by reference from the Company s Form 10-K for the year ended December 31, 1998 as filed with the Securities and Exchange Commission on March 31, 1999.

(j) Incorporated by reference from the Company s Form 10-Q for the quarter ended March 31, 2004 as filed with the Securities and Exchange Commission on May 10, 2004.

(k) Incorporated by reference from the Company s Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on March 8, 2006.

(l) Incorporated by reference from the Company s Form 8-K filed May 18, 2006.

(1) The board of directors adopted the new stock option agreement forms when it adopted the 2001 Stock Option Plan; and, although no longer being used to grant new stock options, these option agreements remain in effect as there are outstanding stock options issued under these stock option agreements.

(2) Substantially identical agreements exist between DaimlerChrysler Motor Company, LLC and those other subsidiaries operating Dodge, Chrysler, Plymouth or Jeep dealerships.

(3) Substantially identical agreements exist for its Ford and Lincoln-Mercury lines between Ford Motor Company and those other subsidiaries operating Ford or Lincoln-Mercury dealerships.

(4) Substantially identical agreements exist between Volkswagen of America, Inc. and those subsidiaries operating Volkswagen dealerships.

(5) Substantially identical agreements exist between Chevrolet Motor Division, GM Corporation and those other subsidiaries operating General Motors dealerships.

(6) Substantially identical agreements exist (except the terms are all 2 years) between Toyota Motor Sales, USA, Inc. and those other subsidiaries operating Toyota dealerships.

(7) Substantially identical agreements exist between Nissan Motor Corporation and those other subsidiaries operating Nissan dealerships.

(8) Lithia Real Estate, Inc. leases all the property in Medford, Oregon sold to CAR LIT, LLC under substantially identical leases covering six separate blocks of property.

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 8, 2007	LITHIA MOTORS, INC.
	By /s/ SIDNEY B. DEBOER Sidney B. DeBoer Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 8, 2007:

Signature	Title
/s/ SIDNEY B. DEBOER Sidney B. DeBoer	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
/s/ JEFFREY B. DEBOER Jeffrey B. DeBoer	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ LINDA A. GANIM Linda A. Ganim	Vice President and Chief Accounting Officer (Principal Accounting Officer)
/s/ M. L. DICK HEIMANN M. L. Dick Heimann	Vice Chairman
/s/ THOMAS BECKER	