LITHIA MOTORS INC
Form 10-Q
July 27, 2018

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-14733

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

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

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

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

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

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

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

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

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

Class A common stock without par value	23,206,001
Class B common stock without par value	1,000,000
(Class)	Outstanding at July 27, 2018

LITHIA MOTORS, INC.
FORM 10-Q
INDEX

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

	June 30, 2018	December 31, 2017
Assets		
Current Assets:		
Cash and cash equivalents	$29,991	$ 57,253
Accounts receivable, net of allowance for doubtful accounts of $7,733 and $7,386	483,995	521,938
Inventories, net	2,333,112	2,132,744
Other current assets	46,231	70,847
Total Current Assets	2,893,329	2,782,782
Property and equipment, net of accumulated depreciation of $219,271 and $197,802	1,232,054	1,185,169
Goodwill	280,954	256,320
Franchise value	197,111	186,977
Other non-current assets	560,714	271,818
Total Assets	$5,164,162	$ 4,683,066
Liabilities and Stockholders' Equity		
Current Liabilities:		
Floor plan notes payable	$142,606	$ 116,774
Floor plan notes payable: non-trade	1,875,462	1,802,252
Current maturities of long-term debt	24,098	18,876
Trade payables	115,061	111,362
Accrued liabilities	254,984	251,717
Total Current Liabilities	2,412,211	2,300,981
Long-term debt, less current maturities	1,295,077	1,028,476
Deferred revenue	112,601	103,111
Deferred income taxes	58,583	56,277
Other long-term liabilities	124,822	111,003
Total Liabilities	4,003,294	3,599,848
Stockholders' Equity:		
Preferred stock - no par value; authorized 15,000 shares; none outstanding	—	—
Class A common stock - no par value; authorized 100,000 shares; issued and outstanding 23,433 and 23,968	94,386	149,123
Class B common stock - no par value; authorized 25,000 shares; issued and outstanding 1,000 and 1,000	124	124
Additional paid-in capital	43,470	11,309
Retained earnings	1,022,888	922,662
Total Stockholders' Equity	1,160,868	1,083,218
Total Liabilities and Stockholders' Equity	$5,164,162	$ 4,683,066

See accompanying condensed notes to consolidated financial statements.

2

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
New vehicle	$1,726,803	$1,384,055	$3,181,528	$2,594,359
Used vehicle retail	804,098	633,635	1,519,672	1,235,858
Used vehicle wholesale	85,335	69,512	161,290	141,015
Finance and insurance	114,492	94,851	220,997	181,628
Service, body and parts	311,407	246,005	597,104	478,579
Fleet and other	54,402	38,978	75,625	71,698
Total revenues	3,096,537	2,467,036	5,756,216	4,703,137
Cost of sales:				
New vehicle	1,625,309	1,303,516	2,993,087	2,443,702
Used vehicle retail	716,997	559,129	1,358,960	1,092,569
Used vehicle wholesale	83,409	67,800	158,438	137,786
Service, body and parts	157,700	123,525	304,989	242,905
Fleet and other	52,395	37,795	71,904	69,252
Total cost of sales	2,635,810	2,091,765	4,887,378	3,986,214
Gross profit	460,727	375,271	868,838	716,923
Selling, general and administrative	333,350	257,290	630,844	500,062
Depreciation and amortization	18,821	14,031	35,675	26,770
Operating income	108,556	103,950	202,319	190,091
Floor plan interest expense	(15,634)	(9,332)	(29,168)	(17,384)
Other interest expense, net	(13,829)	(7,169)	(25,635)	(13,840)
Other income, net	1,659	387	3,033	10,232
Income before income taxes	80,752	87,836	150,549	169,099
Income tax provision	(20,092)	(34,636)	(37,828)	(65,172)
Net income	$60,660	$53,200	$112,721	$103,927
Basic net income per share	$2.45	$2.12	$4.52	$4.14
Shares used in basic per share calculations	24,793	25,053	24,930	25,116
Diluted net income per share	$2.44	$2.12	$4.50	$4.13
Shares used in diluted per share calculations	24,882	25,106	25,028	25,177
Cash dividends paid per Class A and Class B share	$0.29	$0.27	$0.56	$0.52

See accompanying condensed notes to consolidated financial statements.

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

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income	$ 112,721	$ 103,927
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35,675	26,770
Stock-based compensation	6,837	5,432
(Gain) loss on disposal of other assets	(78)	256
Loss on disposal of franchise	380	—
Deferred income taxes	345	(1,156)
(Increase) decrease (net of acquisitions and dispositions):		
Accounts receivable, net	47,915	70,908
Inventories	(35,530)	(36,078)
Other assets	20,588	479
Increase (decrease) (net of acquisitions and dispositions):		
Floor plan notes payable	15,056	1,330
Trade payables	2,929	414
Accrued liabilities	5,463	(3,684)
Other long-term liabilities and deferred revenue	24,030	9,957
Net cash provided by operating activities	236,331	178,555
Cash flows from investing activities:		
Capital expenditures	(72,373)	(32,266)
	1,803	2,870

Proceeds from sales of assets		
Cash paid for other investments	(7,066)	(7,748)
Cash paid for acquisitions, net of cash acquired	(374,664)	(88,075)
Proceeds from sales of stores	839	—
Net cash used in investing activities	(451,461)	(125,219)
Cash flows from financing activities:		
Borrowings (repayments) on floor plan notes payable, net: non-trade	85,763	(32,124)
Borrowings on lines of credit	1,353,290	773,500
Repayments on lines of credit	(1,254,127)	(808,846)
Principal payments on long-term debt and capital leases, scheduled	(9,565)	(8,825)
Principal payments on long-term debt and capital leases, other	(5,305)	(35,765)
Proceeds from issuance of long-term debt	62,140	74,065
Payments of debt issuance costs	(205)	—
Proceeds from issuance of common stock	4,514	3,519
Repurchase of common stock	(33,927)	(24,913)
Dividends paid	(13,938)	(13,052)
Payments of contingent consideration related to acquisitions	(772)	—
Net cash provided by (used in) financing activities	187,868	(72,441)
Decrease in cash and cash equivalents	(27,262)	(19,105)
Cash and cash equivalents at	57,253	50,282

beginning of period				
Cash and cash equivalents at end of period	$	29,991	$	31,177
Supplemental disclosure of cash flow information:				
Cash paid during the period for interest	$	54,675	$	33,476
Cash paid during the period for income taxes, net	2,296		62,274	
Floor plan debt paid in connection with store disposals	5,158		—	
Supplemental schedule of non-cash activities:				
Debt issued in connection with acquisitions	$	125,055	$	1,748
Debt assumed in connection with acquisitions	10,766		11,837	
Issuance of Class A common stock in connection with acquisitions	—		2,137	

See accompanying condensed notes to consolidated financial statements.

4

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

Note 1. Interim Financial Statements

Basis of Presentation
These condensed Consolidated Financial Statements contain unaudited information as of June 30, 2018 and for the three and six-months ended June 30, 2018 and 2017. The unaudited interim financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by accounting principles generally accepted in the United States of America for annual financial statements are not included herein. In management's opinion, these unaudited financial statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the information when read in conjunction with our 2017 audited Consolidated Financial Statements and the related notes thereto. The financial information as of December 31, 2017 is derived from our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 23, 2018. The interim condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in our 2017 Annual Report on Form 10-K. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

In May 2014, the Financial Accounting Standards Board ("FASB") issued accounting standards update ("ASU") 2014-09, "Revenue from Contracts with Customers," which amends the accounting guidance related to revenues. We adopted this standard utilizing a cumulative effect transition method effective January 2018. Except for the changes below, we have consistently applied the accounting policies to all periods presented in these consolidated financial statements. See Notes 2 and 13.

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

Note 2. Revenue Recognition

The following describes our major product lines, which represent the disaggregation of our revenues to transactions that are similar in nature, amount, timing, uncertainties and economic factors.

New Retail Vehicle and Used Retail Vehicle Sales
Revenue from the retail sale of a vehicle is recognized at a point in time, as all performance obligations are satisfied when a contract is signed by the customer, financing has been arranged or collectibility is probable and the control of the vehicle is transferred to the customer. The transaction price for a retail vehicle sale is specified in the contract with the customer and includes all cash and non-cash consideration. In a retail vehicle sale, customers often trade in their current vehicle. The trade-in is measured at its stand-alone selling price in the contract, utilizing various third-party pricing sources. There are no other non-cash forms of consideration related to retail sales. All vehicle rebates are applied to the vehicle purchase price at the time of the sale, and are therefore incorporated into the price of the contract at the time of the exchange. We do not allow the return of new or used vehicles, except where mandated by state law.

Service, Body and Parts Sales
Revenue from service, body and parts sales is recognized upon the transfer of control of the parts or service to the customer. We allow for customer returns on sales of our parts inventory up to 30 days after the sale. Most parts returns

generally occur within one to two weeks from the time of sale and are not significant.

We are the obligor on our lifetime oil contracts. Revenue is allocated to these performance obligations and is recognized over time as services are provided to the customer. The amount of revenue recognized is calculated, net of cancellations, using an input method, which most closely depicts performance of the contracts. Our contract liability balances were $138.5 million and $126.1 million as of June 30, 2018 and December 31, 2017, respectively; and we recognized $6.0 million and $11.7 million of revenue in the three and six months ended June 30, 2018, related to our opening contract liability balance.

Finance and Insurance Sales

Revenue from finance and insurance sales is recognized, net of estimated charge-backs, at the time of the sale of the related vehicle. As a part of the vehicle sale, we seek to arrange financing for customers and sell a variety of add-ons, such as extended warranty service contracts. These products are inherently attached to the governing vehicle and performance of the obligation cannot be performed without the underlying sale of the vehicle. We act as an agent in the sale of these contracts as the pricing is set by the third-party provider and our commission is preset. A portion of the transaction price related to sales of finance and insurance contracts is considered variable consideration and is estimated and recognized upon the sale of the contract under the new standard. We recognized a $9.2 million asset associated with future estimated variable consideration on January 1, 2018 related to contracts sold on or before December 31, 2017. Our contract asset balance was $9.2 million as of June 30, 2018 and is included in trade receivables and other non-current assets.

Note 3. Accounts Receivable and Contract Assets

Accounts receivable consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Contracts in transit	$239,698	$ 286,578
Trade receivables	51,403	45,895
Vehicle receivables	57,795	60,022
Manufacturer receivables	97,173	96,141
Auto loan receivables	67,402	75,052
Other receivables	4,920	14,634
	518,391	578,322
Less: Allowance for doubtful accounts	(7,733)	(7,386)
Less: Long-term portion of accounts receivable, net	(26,663)	(48,998)
Total accounts receivable, net	$483,995	$ 521,938

Accounts receivable classifications include the following:

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

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

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

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

Note 4. Inventories

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

	June 30, 2018	December 31, 2017
New vehicles	$1,694,026	$ 1,553,751
Used vehicles	553,248	500,011
Parts and accessories	85,838	78,982
Total inventories	$2,333,112	$ 2,132,744

Note 5. Goodwill and Franchise Value

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

	Domestic	Import	Luxury	Consolidated
Balance as of December 31, 2016 [1]	$114,839	$106,179	$38,381	$ 259,399
Adjustments to purchase price allocations [2]	(817)	(1,006)	(391)	(2,214)
Reductions through divestitures	—	(865)	—	(865)
Balance as of December 31, 2017 [1]	114,022	104,308	37,990	256,320
Adjustments to purchase price allocations [3]	7,726	15,674	1,271	24,671
Reductions through divestitures	—	(37)	—	(37)
Balance as of June 30, 2018 [1, 4]	$121,748	$119,945	$39,261	$ 280,954

[1] Net of accumulated impairment losses of $299.3 million recorded during the year ended December 31, 2008.
[2] Our purchase price allocation for the acquisition of the Carbone Auto Group was finalized in the third quarter of 2017. As a result, we reclassified $2.2 million of value from goodwill to franchise value.
[3] Our purchase price allocation for the acquisition of the Baierl Auto Group was finalized in the second quarter of 2018. As a result, we added $24.7 million of goodwill.
[4] Our purchase price allocation is preliminary for the acquisitions of the Downtown LA Auto Group, Albany CJD Fiat, Crater Lake Ford Lincoln, Crater Lake Mazda, Ray Laks Honda, Ray Laks Acura, Day Auto Group, Prestige Auto Group, Broadway Ford, and Buhler Ford and the associated goodwill has not been allocated to each of our segments. See also Note 11.

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

	Franchise Value
Balance as of December 31, 2016	$184,268
Additions through acquisitions	495
Adjustments to purchase price allocations [1]	2,214
Balance as of December 31, 2017	186,977
Adjustments to purchase price allocations [2]	10,134
Balance as of June 30, 2018 [3]	$197,111

[1] Our purchase price allocation for the acquisition of the Carbone Auto Group was finalized in the third quarter of 2017, resulting in a reclassification of $2.2 million from goodwill to franchise value.
[2] Our purchase price allocation for the acquisition of the Baierl Auto Group was finalized in the second quarter of 2018. As a result, we added $10.1 million of franchise value.
[3]Our purchase price allocation is preliminary for the acquisitions of the Downtown LA Auto Group, Albany CJD Fiat, Crater Lake Ford Lincoln, Crater Lake Mazda, Ray Laks Honda, Ray Laks Acura, Day Auto Group, Prestige Auto Group, Broadway Ford, and Buhler Ford and have not been included in the above franchise value additions. See also Note 11.

Note 6. Credit Facilities and Long-term Debt

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

(Dollars in thousands)	June 30, 2018	December 31, 2017
Floor plan notes payable: non-trade	$1,875,462	$1,802,252
Floor plan notes payable	142,606	116,774
Total floor plan debt	$2,018,068	$1,919,026
Used vehicle inventory financing facility	$50,000	$177,222
Revolving lines of credit	320,953	94,568
Real estate mortgages	642,602	469,969
5.25% Senior Notes due 2025	300,000	300,000
Other debt	12,195	12,512
Total long-term debt outstanding	1,325,750	1,054,271
Less: unamortized debt issuance costs	(6,575)	(6,919)
Less: current maturities (net of current debt issuance costs)	(24,098)	(18,876)
Long-term debt	$1,295,077	$1,028,476

Credit Facility

Effective June 25, 2018, we amended our syndicated credit facility, which is comprised of 20 financial institutions, including seven manufacturer-affiliated finance companies. Prior to this amendment, the credit facility, with an aggregate total financing commitment of $2.4 billion, would have matured in August 2022. With this amendment, the aggregate total financing commitment has been increased to $2.6 billion and the term of the credit facility has been extended to July 2023.

The total commitment is allocated as $135 million to used vehicle inventory floor plan financing, $450 million to revolving loans for acquisitions and other general corporate purposes, and the remaining $2.0 billion for new vehicle inventory floor plan financing. We have the option to reallocate the commitments, provided that the used vehicle inventory floor plan financing commitment does not exceed 16.5% of aggregate commitments, the revolving loan commitment does not exceed 18.75% of aggregate commitments, and the sum of these commitments plus the new vehicle inventory floor plan financing commitment does not exceed the aggregate total financing commitment of $2.6 billion. Additionally, we may request an increase in the aggregate new vehicle floor plan commitment of up to $400 million provided that the aggregate commitment does not exceed $3.0 billion. All borrowings from, and repayments to, our lending group are presented in the Consolidated Statements of Cash Flows as financing activities.

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

We have the ability to deposit up to $50 million in cash in Principal Reduction (PR) accounts associated with our new vehicle inventory floor plan commitment. The PR accounts are recognized as offsetting credits against outstanding amounts on our new vehicle floor plan commitment and would reduce interest expense associated with the outstanding principal balance. As of June 30, 2018, we had no balances in our PR accounts.

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

The interest rate on the credit facility, as amended, varies based on the type of debt, with the rate of one-month LIBOR plus 1.25% for new vehicle floor plan financing, one-month LIBOR plus 1.50% for used vehicle floor plan financing and a variable interest rate on the revolving financing ranging from the one-month LIBOR plus 1.25% to 2.25% depending on our leverage ratio. The annual interest rate associated with our new vehicle floor plan commitment was 3.34% at June 30, 2018. The annual interest rate associated with our used vehicle inventory financing facility and our revolving line of credit was 3.59% at June 30, 2018.

5.25% Senior Notes Due 2025
On July 24, 2017, we issued $300 million in aggregate principal amount of 5.25% Senior Notes due 2025 ("the Notes") to eligible purchasers in a private placement under Rule 144A and Regulation S of the Securities Act of 1933. Interest accrues on the Notes from July 24, 2017 and is payable semiannually on February 1 and August 1. The first interest payment was paid on February 1, 2018. We may redeem the Notes in whole or in part at any time prior to August 1, 2020 at a price equal to 100% of the principal amount plus a make-whole premium set forth in the Indenture and accrued and unpaid interest. After August 1, 2020, we may redeem some or all of the Notes subject to the redemption prices set forth in the Indenture. If we experience specific kinds of changes of control, as described in the Indenture, we must offer to repurchase the Notes at 101% of their principal amount plus accrued and unpaid interest to the date of purchase.

Note 7. Stockholders' Equity

Repurchases of Class A Common Stock
Repurchases of our Class A Common Stock occurred under a repurchase authorization granted by our Board of Directors and related to shares withheld as part of the vesting of restricted stock units ("RSUs"). In February 2016, our Board of Directors authorized the repurchase of up to $250 million of our Class A common stock. Share repurchases under this authorization were as follows:

	Repurchases Occurring in the Six Months Ended June 30, 2018		Cumulative Repurchases as of June 30, 2018	
	Shares	Average Price	Shares	Average Price
2016 Share Repurchase Authorization	640,586	$ 99.89	1,683,311	$ 89.96

As of June 30, 2018, we had $98.6 million available for repurchases pursuant to our 2016 share repurchase authorization.

In addition, during the first six months of 2018, we repurchased 29,710 shares at an average price of $112.36 per share, for a total of $3.3 million, related to tax withholdings associated with the vesting of RSUs. The repurchase of shares related to tax withholdings associated with stock awards does not reduce the number of shares available for repurchase as approved by our Board of Directors.

Note 8. Fair Value Measurements

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

We have fixed rate debt primarily consisting of amounts outstanding under our senior notes and real estate mortgages. We calculated the estimated fair value of the senior notes using quoted prices for the identical liability (Level 1) and calculated the estimated fair value of the fixed rate real estate mortgages using a discounted cash flow methodology with estimated current interest rates based on a similar risk profile and duration (Level 2). The fixed cash flows are discounted and summed to compute the fair value of the debt. As of June 30, 2018, our real estate mortgages and other debt, which includes capital leases, had maturity dates between September 27, 2019 and December 31, 2050.

There were no changes to our valuation techniques during the six-month period ended June 30, 2018.

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

	June 30, 2018	December 31, 2017
Carrying value		
5.25% Senior Notes due 2025	$300,000	$ 300,000
Real Estate Mortgages and Other Debt	451,950	376,880
	$751,950	$ 676,880
Fair value		
5.25% Senior Notes due 2025	$291,750	$ 312,750
Real Estate Mortgages and Other Debt	450,686	385,337
	$742,436	$ 698,087

Note 9. Net Income Per Share of Class A and Class B Common Stock

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

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

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

Three Months Ended June 30,	2018		2017	
(in thousands, except per share data)	Class A	Class B	Class A	Class B
Net income applicable to common stockholders - basic	$58,213	$2,447	$50,520	$2,680
Reallocation of net income as a result of conversion of dilutive stock options	1	(1)	1	(1)
Reallocation of net income due to conversion of Class B to Class A common shares outstanding	289	—	340	—
Conversion of Class B common shares into Class A common shares	2,149	—	2,334	—
Effect of dilutive stock options on net income	8	(8)	5	(5)
Net income applicable to common stockholders - diluted	$60,660	$2,438	$53,200	$2,674
Weighted average common shares outstanding – basic	23,793	1,000	23,791	1,262
Conversion of Class B common shares into Class A common shares	1,000	—	1,262	—
Effect of dilutive stock options on weighted average common shares	89	—	53	—
Weighted average common shares outstanding – diluted	24,882	1,000	25,106	1,262
Net income per common share - basic	$2.45	$2.45	$2.12	$2.12
Net income per common share - diluted	$2.44	$2.44	$2.12	$2.12

Three Months Ended June 30,	2018		2017	
Diluted EPS	Class A	Class B	Class A	Class B
Antidilutive Securities				
Shares issuable pursuant to stock options not included since they were antidilutive	30	—	22	—

Six Months Ended June 30,	2018		2017	
(in thousands, except per share data)	Class A	Class B	Class A	Class B
Net income applicable to common stockholders - basic	$108,199	$4,522	$98,337	$5,590
Reallocation of distributed net income as a result of conversion of dilutive stock options	2	(2)	2	(2)
Reallocation of distributed net income due to conversion of Class B to Class A common shares outstanding	557	—	700	—
Conversion of Class B common shares into Class A common shares	3,947	—	4,876	—
Effect of dilutive stock options on net income	16	(16)	12	(12)
Net income applicable to common stockholders - diluted	$112,721	$4,504	$103,927	$5,576
Weighted average common shares outstanding – basic	23,930	1,000	23,765	1,351
Conversion of Class B common shares into Class A common shares	1,000	—	1,351	—
Effect of employee stock purchases and restricted stock units on weighted average common shares	98	—	61	—
Weighted average common shares outstanding – diluted	25,028	1,000	25,177	1,351
Net income per common share - basic	$4.52	$4.52	$4.14	$4.14
Net income per common share - diluted	$4.50	$4.50	$4.13	$4.13

Six Months Ended June 30,	2018		2017	
Diluted EPS	Class A	Class B	Class A	Class B
Antidilutive Securities				
Shares issuable pursuant to stock options not included since they were antidilutive	56	—	11	—

Note 10. Segments

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

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

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Domestic				
New vehicle	$597,596	$528,649	$1,111,125	$1,013,906
Used vehicle retail	283,408	251,214	548,235	496,212
Used vehicle wholesale	33,913	30,700	67,519	62,986
Finance and insurance	43,083	37,354	83,083	73,562
Service, body and parts	113,472	96,515	220,614	189,917
Fleet and other	23,596	10,517	35,109	18,124
	1,095,068	954,949	2,065,685	1,854,707
Import				
New vehicle	771,987	643,404	1,439,590	1,195,286
Used vehicle retail	335,629	269,512	643,317	516,788
Used vehicle wholesale	30,983	27,283	59,178	54,120
Finance and insurance	54,866	45,282	106,562	85,855
Service, body and parts	116,386	96,964	226,041	185,626
Fleet and other	12,879	12,794	18,475	29,036
	1,322,730	1,095,239	2,493,163	2,066,711
Luxury				
New vehicle	361,913	220,388	640,434	396,705
Used vehicle retail	184,941	112,032	327,845	222,637
Used vehicle wholesale	20,263	11,473	34,463	23,696
Finance and insurance	15,934	9,525	28,185	17,519
Service, body and parts	76,883	50,326	141,676	98,358
Fleet and other	17,596	15,419	21,422	24,052
	677,530	419,163	1,194,025	782,967
	3,095,328	2,469,351	5,752,873	4,704,385
Corporate and other	1,209	(2,315)	3,343	(1,248)
	$3,096,537	$2,467,036	$5,756,216	$4,703,137
Segment income[1]:				
Domestic	$28,545	$27,857	$54,163	$53,299
Import	30,244	32,238	53,265	54,411
Luxury	11,939	10,315	18,826	15,027
	70,728	70,410	126,254	122,737
Corporate and other	41,015	38,239	82,572	76,740
Depreciation and amortization	(18,821)	(14,031)	(35,675)	(26,770)
Other interest expense	(13,829)	(7,169)	(25,635)	(13,840)
Other income, net	1,659	387	3,033	10,232
Income before income taxes	$80,752	$87,836	$150,549	$169,099

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

	June 30, 2018	December 31, 2017
Total assets:		
Domestic	$1,380,823	$1,224,276
Import	1,244,218	1,032,665
Luxury	690,774	604,023
Corporate and other	1,848,347	1,822,102
	$5,164,162	$4,683,066

Note 11. Acquisitions

In the first six months of 2018, we completed the following acquisitions:
- On January 15, 2018, Ray Laks Honda in Orchard Park, New York and Ray Laks Acura in Buffalo, New York.
- On February 26, 2018, Day Auto Group, a seven store platform based in Pennsylvania.
- On March 1, 2018, Prestige Auto Group, a six store platform based in New Jersey and New York.
- On April 2, 2018, Broadway Ford in Idaho Falls, Idaho.
- On April 23, 2018, Buhler Ford in Eatontown, New Jersey.

Revenue and net loss contributed by the 2018 acquisitions subsequent to the date of acquisition were as follows (in thousands):

Revenue	$360,442
Net loss	$(946)

In 2017, we completed the following acquisitions:
- On May 1, 2017, we acquired Baierl Auto Group, an eight store platform based in Pennsylvania.
- On August 7, 2017, we acquired Downtown LA ("DTLA") Auto Group, a seven store platform based in California.
- On November 11, 2017, we acquired Albany CJD Fiat in Albany, New York.
- On November 15, 2017, we acquired Crater Lake Ford Lincoln and Crater Lake Mazda in Medford, Oregon.

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

The following tables summarize the consideration paid for the 2018 acquisitions and the amount of identified assets acquired and liabilities assumed as of the acquisition date (in thousands):

	Consideration
Cash paid, net of cash acquired	$ 374,664
Debt issued	125,055
	$ 499,719

The purchase price allocations for the Downtown LA Auto Group, Albany CJD Fiat, Crater Lake Ford Lincoln, Crater Lake Mazda, Ray Laks Honda, Ray Laks Acura, Day Auto Group, Prestige Auto Group, Broadway Ford, and Buhler Ford acquisitions are preliminary and we have not obtained and evaluated all of the detailed information necessary to finalize the opening balance sheet amounts in all respects. We recorded the purchase price allocations based upon information that is currently available. Unallocated items are recorded as a component of other non-current assets in the Consolidated Balance Sheets.

	Assets Acquired and

	Liabilities Assumed
Accounts receivable	$732
Inventories, net	180,035
Property and equipment, net	9,850
Other non-current assets	322,006
Floor plan notes payable	(10,776)
Other long-term liabilities	(2,128)
	$499,719

14

In the three and six-month periods ended June 30, 2018, we recorded $3.3 million and $4.2 million in acquisition related expenses as a component of selling, general and administrative expense. Comparatively, we recorded $2.1 million and $2.2 million, respectively, of acquisition related expenses in the same periods in 2017.

The following unaudited proforma summary presents consolidated information as if all acquisitions in the three and six-month periods ended June 30, 2018 and 2017 had occurred on January 1, 2017 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	$3,101,600	$3,054,987	$5,956,427	$5,906,047
Net income	60,678	56,126	111,419	109,162
Basic net income per share	2.45	2.24	4.47	4.35
Diluted net income per share	2.44	2.24	4.45	4.34

These amounts have been calculated by applying our accounting policies and estimates. The results of the acquired stores have been adjusted to reflect the following: depreciation on a straight-line basis over the expected lives for property and equipment; accounting for inventory on a specific identification method; and recognition of interest expense for real estate financing related to stores where we purchased the facility. No nonrecurring proforma adjustments directly attributable to the acquisitions are included in the reported proforma revenues and earnings.

Note 12. Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requires disclosing key information about leasing arrangements. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We will adopt this accounting standard update effective January 1, 2019. A modified retrospective transition approach is required for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. We have both real estate leases and equipment leases that will be impacted by the new guidance. We continue to evaluate the effect this pronouncement will have on our consolidated financial statements and related disclosures.

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

Note 13. Changes in Accounting Policies

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which amends the accounting guidance related to revenues. This amendment replaced most of the existing revenue recognition guidance. The new standard, as amended in July 2015, is effective for fiscal years beginning after December 15, 2017, and interim periods therein. The standard permits the use of either the retrospective or cumulative effect transition method. We adopted this standard utilizing a cumulative effect transition method effective January 2018. While the adoption of the new standard did not have a significant effect on earnings or on the timing of our most significant types of transactions, we made the following changes to our revenue policies:

- A portion of the transaction price related to sales of finance and insurance contracts is considered variable consideration and subject to accelerated recognition under the new standard. Accordingly, we recognized a $9.2 million asset associated with future estimated variable consideration and a net of tax increase to retained earnings of $6.5 million. We do not believe there will be a significant impact to future revenue recognized.

- The adoption of the new standard clarifies the determination and capitalization of direct costs incurred. As a result, we reassessed the method used to capitalize and amortize direct costs associated with the sale of lifetime lube, oil and filter contracts, which resulted in a $7.2 million reduction in prepaid commissions and a net of tax $5.1 million reduction to retained earnings.

These changes had an immaterial effect on our Consolidated Statements of Operations and the following impact on our Consolidated Balance Sheets (in thousands):

Impact on Consolidated Balance Sheets	As Reported June 30, 2018	Adjustments	Balances without the adoption of Topic 606
Accounts receivable, net	$483,995	$ (3,631)	$480,364
Other current assets	46,231	(1,237)	44,994
Other non-current assets	560,714	3,653	564,367
Total Assets	5,164,162	(1,215)	5,162,947
Accrued Liabilities	254,984	208	255,192
Deferred income taxes	58,583	(599)	57,984
Total Liabilities	4,003,294	(391)	4,002,903
Retained earnings	1,022,888	(824)	1,022,064
Total Liabilities and Stockholders' Equity	5,164,162	(1,215)	5,162,947

Note 14. Subsequent Events

Common Stock Dividend

On July 23, 2018, our Board of Directors approved a dividend of $0.29 per share on our Class A and Class B common stock related to our second quarter 2018 financial results. The dividend will total approximately $7.0 million and will be paid on August 29, 2018 to shareholders of record on August 15, 2018.

Repurchase of Class A Common Stock

Since June 30, 2018, we repurchased 226,910 shares at a weighted average price of $86.65 per share and as of July 27, 2018, under our existing share repurchase authorization, $78.9 million million remained available for share repurchases.

16

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

Forward-Looking Statements and Risk Factors
Certain statements under the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" and elsewhere in this Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Generally, you can identify forward-looking statements by terms such as "project", "outlook," "target", "may," "will," "would," "should," "seek," "expect," "plan," "intend "anticipate," "believe," "estimate," "predict," "potential," "likely," "goal," "strategy," "future," "maintain," and "continue" or t these terms or other comparable terms. Examples of forward-looking statements in this Form 10-Q include, among others, statements we make regarding:

- Future market conditions, including anticipated national new car sales levels;
- Expected operating results, such as improved store performance; continued improvement of SG&A as a percentage of gross profit and all projections;
- Anticipated continued success of acquisitions;
- Anticipated ability to capture additional market share;
- Anticipated ability to find accretive acquisitions;
- Anticipated additions of dealership locations to our portfolio in the future;
- Anticipated availability of liquidity from our unfinanced operating real estate; and
- Anticipated levels of capital expenditures in the future.

The forward-looking statements contained in this Form 10-Q involve known and unknown risks, uncertainties and situations that may cause our actual results to materially differ from the results expressed or implied by these statements. Certain important factors that could cause actual results to differ from our expectations are discussed in Part II - Other Information, Item 1A in this Form 10-Q and in the Risk Factors section of our 2017 Annual Report on Form 10-K, as supplemented and amended from time to time in Quarterly Reports on Form 10-Q and our other filings with the Securities and Exchange Commission. Such factors include, but are not limited to:

- Changing economic conditions, including changes in consumer demand, the availability of credit, fuel prices and interest rates;
- Natural disasters, adverse weather conditions, acts of God or other incidents;
- Increasing competition in our industry;
- Adverse conditions affecting one or more key manufacturers whose brands we sell;
- Availability of manufacturer incentives, warranty and other promotional programs;
- Manufacturers relationships and our ability to renew or enter into new franchise agreements on acceptable terms;
- Changes in laws and regulations;
- Breaches in our data security systems or in systems used by our vendor partners; and
- Our ability to acquire and successfully integrate additional stores

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

Overview
Lithia Motors, Inc. is one of the largest providers of personal transportation solutions in the United States and is among the fastest growing companies in the Fortune 500 (#294-2018). Consumers can buy, sell and service vehicles digitally or through our 188 coast to coast locations. Our mission statement, Growth Powered by People, drives us to continuously improve and to give back to our communities.

We believe that the fragmented nature of the automotive dealership sector provides us with the opportunity to achieve growth through consolidation. In 2017, the top ten automotive retailers, as reported by Automotive News, represented approximately 7% of the stores in the United States. Our dealerships are located across the United States. We seek domestic, import and luxury franchises in cities ranging from mid-sized regional markets to metropolitan markets. We evaluate all brands for expansion opportunities provided the market is large enough to support adequate new vehicle sales to justify the required capital investment. Our acquisition strategy has been to acquire dealerships at prices that meet our internal investment targets and, through the application of our centralized operating structure, leverage costs and improve store profitability. We believe our disciplined approach and the current economic environment provides us with attractive acquisition opportunities.

We also believe that we can continue to improve operations at our existing stores. By promoting entrepreneurial leadership within our general and department managers, we strive for continuous improvement to drive sales and capture market share in our local markets. Our goal is to retail an average of 85 used vehicles per store per month and we believe we can make additional improvements in our used vehicle sales performance by offering lower-priced value vehicles and selling brands other than the new vehicle franchise at each location. Our service, body and parts operations provide important repeat business for our stores. We continue to grow this business through increased marketing efforts, competitive pricing on routine maintenance items and diverse commodity product offerings.

During the second quarter of 2018, we continued to integrate recently acquired stores. The second quarter experienced strong performance in revenue and gross profit growth contributed by our recent acquisitions. Newly acquired stores generally have a lower operating efficiency than our other stores and can negatively impact our operating margin. We continue to focus on accelerating the integration of acquired stores to leverage our cost structure and increase incremental profitability.

Key Revenue and Gross Profit Metrics

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

Three Months Ended June 30, 2018	Revenues	Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
New vehicle	$1,726,803	55.8 %	$ 101,494	5.9 %	22.0 %
Used vehicle retail	804,098	26.0	87,101	10.8	18.9
Used vehicle wholesale	85,335	2.8	1,926	2.3	0.4
Finance and insurance [1]	114,492	3.7	114,492	100.0	24.9
Service, body and parts	311,407	10.1	153,707	49.4	33.4
Fleet and other	54,402	1.6	2,007	3.7	0.4
	$3,096,537	100.0 %	$ 460,727	14.9 %	100.0%

Three Months Ended June 30, 2017	Revenues	Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
New vehicle	$1,384,055	56.1 %	$ 80,539	5.8 %	21.5 %
Used vehicle retail	633,635	25.7	74,506	11.8	19.9
Used vehicle wholesale	69,512	2.8	1,712	2.5	0.5
Finance and insurance [1]	94,851	3.8	94,851	100.0	25.3
Service, body and parts	246,005	10.0	122,480	49.8	32.6
Fleet and other	38,978	1.6	1,183	3.0	0.2
	$2,467,036	100.0 %	$ 375,271	15.2 %	100.0%

[1] Commissions reported net of anticipated cancellations.

Six Months Ended June 30, 2018	Revenues	Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
New vehicle	$3,181,528	55.3 %	$ 188,441	5.9 %	21.7 %
Used vehicle retail	1,519,672	26.4	160,712	10.6	18.5
Used vehicle wholesale	161,290	2.8	2,852	1.8	0.3
Finance and insurance [1]	220,997	3.8	220,997	100.0	25.4
Service, body and parts	597,104	10.4	292,115	48.9	33.6
Fleet and other	75,625	1.3	3,721	4.9	0.5

$5,756,216	100.0 %	$ 868,838	15.1 %	100.0%

Six Months Ended June 30, 2017	Revenues	Percent of Total Revenues	Gross Profit	Gross Profit Margin	Percent of Total Gross Profit
New vehicle	$2,594,359	55.2 %	$ 150,657	5.8 %	21.0 %
Used vehicle retail	1,235,858	26.3	143,289	11.6	20.0
Used vehicle wholesale	141,015	3.0	3,229	2.3	0.5
Finance and insurance [1]	181,628	3.9	181,628	100.0	25.3
Service, body and parts	478,579	10.2	235,674	49.2	32.9
Fleet and other	71,698	1.4	2,446	3.4	0.3
	$4,703,137	100.0 %	$ 716,923	15.2 %	100.0%

[1] Commissions reported net of anticipated cancellations.

Same Store Operating Data

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

Same store measures reflect results for stores that were operating in each comparison period and only include the months when operations occurred in both periods. For example, a store acquired in May 2017 would be included in same store operating data beginning in June 2018, after its first full complete comparable month of operation. The second quarter operating results for the same store comparisons would include results for that store in only the period of June for both comparable periods.

New Vehicle Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Three Months Ended June 30, 2018	2017	Increase (Decrease)	% Increase (Decrease)
Reported				
Revenue	$1,726,803	$1,384,055	$342,748	24.8 %
Gross profit	$101,494	$80,539	$20,955	26.0
Gross margin	5.9 %	5.8 %	10 bp [1]	
Retail units sold	49,027	40,876	8,151	19.9
Average selling price per retail unit	$35,221	$33,860	$1,361	4.0
Average gross profit per retail unit	$2,070	$1,970	$100	5.1
Same store				
Revenue	$1,380,947	$1,375,444	$5,503	0.4
Gross profit	$79,141	$79,830	$(689)	(0.9)
Gross margin	5.7 %	5.8 %	(10)bp	
Retail units sold	39,619	40,655	(1,036)	(2.5)
Average selling price per retail unit	$34,856	$33,832	$1,024	3.0
Average gross profit per retail unit	$1,998	$1,964	$34	1.7

[1] A basis point is equal to 1/100th of one percent

19

(Dollars in thousands, except per unit amounts)	Six Months Ended June 30, 2018	2017	Increase (Decrease)	% Increase (Decrease)
Reported				
Revenue	$3,181,528	$2,594,359	$587,169	22.6 %
Gross profit	$188,441	$150,657	$37,784	25.1
Gross margin	5.9 %	5.8 %	10 bp [1]	
Retail units sold	90,524	76,492	14,032	18.3
Average selling price per retail unit	$35,146	$33,917	$1,229	3.6
Average gross profit per retail unit	$2,082	$1,970	$112	5.7
Same store				
Revenue	$2,563,814	$2,576,578	$(12,764)	(0.5)
Gross profit	$147,226	$148,887	$(1,661)	(1.1)
Gross margin	5.7 %	5.8 %	(10)bp	
Retail units sold	73,489	76,031	(2,542)	(3.3)
Average selling price per retail unit	$34,887	$33,889	$998	2.9
Average gross profit per retail unit	$2,003	$1,958	$45	2.3

[1] A basis point is equal to 1/100th of one percent

New vehicle sales increased 24.8% and 22.6% in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, primarily driven by increases in volume related to acquisitions.

On a same store basis, new vehicle sales were flat in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. This was primarily due to a 2.5% decrease in unit sales, offset by a 3.0% increase in average selling price and a 3.3% decrease in unit sales, partially offset by a 2.9% increase in average selling price per unit for the three and six-month periods ended June 30, 2018, respectively, compared to the same periods of 2017. The national new vehicle sales market experienced 1.8% and 2.0% growth, respectively, during the three and six-month periods ended June 30, 2018 compared to the same periods of 2017.

Same store unit sales decreased as follows:

	Three months ended June 30, 2018 compared to the same period of 2017	National increase (decrease) in the three months ended June 30, 2018 compared to the same period of 2017 [1]	Six months ended June 30, 2018 compared to the same period of 2017	National increase in the six months ended June 30, 2018 compared to the same period of 2017 [1]
Domestic brand same store unit sales change	(0.8)%	3.7 %	(3.3)%	2.3 %
Import brand same store unit sales change	(3.6)	(0.6)	(4.0)	1.0

Luxury brand same store unit sales change	(2.2)	6.5	(0.3)	7.2
Overall	(2.5)	1.8	(3.3)	2.0

[1] National auto unit sales and seasonally adjusted annual rate ("SAAR") data obtained from Stephens Auto Unit Sales and SAAR report as of June 2018.

The unit volume decreases for our domestic brands exceeded the national average for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. Our performance, compared to the national trend for domestic brands, was mainly driven by General Motors and Chrysler. Our General Motors stores had same store unit sales decreases of 1.7% and 4.3%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. This performance compares to national market increases of 4.7% and 4.2% for the same periods. Our Chrysler stores had same store unit sales decreases of 0.4% and 3.0%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. This performance compares to national market increases of 8.1% and 4.7% for the same periods.

The unit volume decreases for our import brands exceeded the national average for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. These decreases were primarily driven by our Honda stores, which comprised 20.7% and 19.9%, respectively, of our total same store new vehicle unit sales in the three and six-month periods of 2018. Our Honda stores had same store unit decreases of 2.2% and 6.5%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, while the national average unit volume decreases were 0.3% and 0.5%, respectively, for Honda for the same periods. Our Toyota stores, which comprised 17.9% and 18.4%, respectively, of our same store new vehicle unit sales in the three and six-month periods of 2018, had a same store unit decrease of 4.6% and was flat, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods in 2017, while the national market for Toyota decreased by 0.8% and increased 3.0%, respectively, for the same periods.

Our luxury brand unit volume decreased 2.2% and was flat in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, which underperformed the national trend for luxury brands, and was primarily associated with our BMW stores, which comprised 3.6% of our same store new vehicle unit sales in the each of the three and six-month periods ended June 30, 2018. Our BMW stores had same store unit sales decreases of 2.3% and 4.5%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, while the national average was an increase for BMW of 2.6% and 2.8%, respectively, for the same periods. Our Mercedes stores, accounting for 0.9% of our same store new vehicle unit sales in each of the three and six-month periods ended June 30, 2018, had a same store unit decrease of 8.8% and an increase of 6.4% for the three and six-month periods ended June 30, 2018, respectively, compared to the same periods of 2017, while the national average was a decrease for Mercedes of 2.9% and 1.9%, respectively, for the same periods. The growth in our luxury brands was less than the national average due to decreases in our local markets. We are concentrated in areas such as Seattle and New Jersey, where new vehicle registrations were down. Additionally, our BMW stores lost market share.

We seek to grow our new vehicle sales organically by gaining share in the markets we serve. To increase awareness and customer traffic, we use a combination of traditional, digital and social media advertisements to reach customers. We have established a company-wide target of achieving 25% higher sales than the national OEM average. For the six-month period ended June 30, 2018, our sales were 7% higher than the national OEM average, down from achieving 9% higher sales for the same period of 2017.

New vehicle gross profit increased 26.0% and 25.1%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. On a same store basis, new vehicle gross profit decreased 0.9% and 1.1%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. These decreases were driven by decreases in new vehicle unit sales of 2.5% an 3.3%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, offset by increases in gross profit per unit of 1.7% and 2.3%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. The same store average gross profit per unit for new vehicles increased $34 and $45, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017.

Under our business strategy, we believe that our new vehicle sales create incremental profit opportunities through certain manufacturer incentive programs, arranging of third party financing, vehicle service and insurance contracts, future resale of used vehicles acquired through trade-in and parts and service work.

Used Vehicle Retail Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Three Months Ended June 30, 2018	2017	Increase (Decrease)	% Increase (Decrease)
Reported				
Retail revenue	$804,098	$633,635	$170,463	26.9 %
Retail gross profit	$87,101	$74,506	$12,595	16.9
Retail gross margin	10.8 %	11.8 %	(100)bp	
Retail units sold	39,096	32,171	6,925	21.5
Average selling price per retail unit	$20,567	$19,696	$871	4.4
Average gross profit per retail unit	$2,228	$2,316	$(88)	(3.8)
Same store				
Retail revenue	$673,955	$629,198	$44,757	7.1
Retail gross profit	$76,447	$74,102	$2,345	3.2
Retail gross margin	11.3 %	11.8 %	(50)bp	
Retail units sold	33,328	31,933	1,395	4.4
Average selling price per retail unit	$20,222	$19,704	$518	2.6
Average gross profit per retail unit	$2,294	$2,321	$(27)	(1.2)

(Dollars in thousands, except per unit amounts)	Six Months Ended June 30, 2018	2017	Increase (Decrease)	% Increase (Decrease)
Reported				
Retail revenue	$1,519,672	$1,235,858	$283,814	23.0 %
Retail gross profit	$160,712	$143,289	$17,423	12.2
Retail gross margin	10.6 %	11.6 %	(100)bp	
Retail units sold	75,210	62,954	12,256	19.5
Average selling price per retail unit	$20,206	$19,631	$575	2.9
Average gross profit per retail unit	$2,137	$2,276	$(139)	(6.1)
Same store				
Retail revenue	$1,296,344	$1,224,239	$72,105	5.9
Retail gross profit	$142,323	$142,359	$(36)	—
Retail gross margin	11.0 %	11.6 %	(60)bp	
Retail units sold	65,005	62,337	2,668	4.3
Average selling price per retail unit	$19,942	$19,639	$303	1.5
Average gross profit per retail unit	$2,189	$2,284	$(95)	(4.2)

Used vehicle retail sales are a strategic focus for organic growth. We offer three categories of used vehicles: manufacturer certified pre-owned ("CPO") vehicles; core vehicles, or late-model vehicles with lower mileage; and value autos, or vehicles with over 80,000 miles. We have established a company-wide target of achieving a per store average of 85 used retail units per month. Strategies to achieve this target include reducing wholesale sales and selling the full spectrum of used units, from late model CPO models to vehicles over ten years old.

22

Same store sales of used vehicles increased (decreased) as follows:

	Three months ended June 30, 2018 compared to the same period of 2017	Six months ended June 30, 2018 compared to the same period of 2017
Manufacturer CPO vehicles	(1.1)%	(3.6)%
Core vehicles	12.2	12.4
Value autos	7.2	2.9
Overall	7.1	5.9

The increases in same store used vehicle sales were primarily driven by increased unit sales in our core and value auto vehicles categories. For core vehicles, same store unit sales increased 7.1% and 9.1%, respectively, and average selling price increased 4.7% and 3.2%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. Our value auto vehicle category increased same store unit sales 4.3% and 0.7%, respectively, and average selling prices increased 2.8% and 2.1%, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. The growth in our core and value auto vehicles categories was offset by decreases in our CPO vehicles. The decreases in CPO vehicle sales were driven by 0.7% and 1.5% decreases, respectively, in same store unit sales and 0.3% and 2.0% decreases, respectively, in average selling price for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017.

On an annualized average, as of June 30, 2018 , each of our stores sold 67 retail used vehicle units per month, consistent with the same period a year ago.

Used retail vehicle gross profit increased 16.9% and 12.2%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. On a same store basis, gross profit increased 3.2% and was flat, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, primarily driven by increases in units sold and average selling price, partially offset by decreases in average gross profit per unit. The same store gross profit per unit decreased $27 and $95, respectively, for the three and six-month periods ended June 30, 2018 compared to the same periods of 2017.

Our used vehicle operations provide an opportunity to generate sales to customers unable or unwilling to purchase a new vehicle, sell brands other than the store’s new vehicle franchise(s) and increase sales from finance and insurance and parts and service.

Used Vehicle Wholesale Revenue and Gross Profit

(Dollars in thousands, except per unit amounts)	Three Months Ended June 30, 2018	2017	Increase (Decrease)	% Increase (Decrease)
Reported				
Wholesale revenue	$85,335	$69,512	$15,823	22.8 %
Wholesale gross profit	$1,926	$1,712	$214	12.5
Wholesale gross margin	2.3 %	2.5 %	(20)bp	

Wholesale units sold	12,908	10,906	2,002	18.4
Average selling price per wholesale unit	$6,611	$6,374	$237	3.7
Average gross profit per retail unit	$149	$157	$(8)	(5.1)

(Dollars in thousands, except per unit amounts)	Six Months Ended June 30, 2018	2017	Increase (Decrease)	% Increase (Decrease)
Reported				
Wholesale revenue	$161,290	$141,015	$20,275	14.4 %
Wholesale gross profit	$2,852	$3,229	$(377)	(11.7)
Wholesale gross margin	1.8 %	2.3 %	(50)bp	
Wholesale units sold	24,595	21,746	2,849	13.1
Average selling price per wholesale unit	$6,558	$6,485	$73	1.1
Average gross profit per retail unit	$116	$148	$(32)	(21.6)

Wholesale transactions are vehicles we have purchased from customers or vehicles we have attempted to sell via retail that we elect to dispose of due to age or other factors. Wholesale vehicles are typically sold at or near cost and do not comprise a meaningful component of our gross profit.

Finance and Insurance

(Dollars in thousands, except per unit amounts)	Three Months Ended June 30, 2018	2017	Increase	% Increase
Reported				
Revenue	$114,492	$94,851	$19,641	20.7 %
Average finance and insurance per retail unit	$1,299	$1,298	$1	0.1 %
Same store				
Revenue	$95,177	$94,244	$933	1.0 %
Average finance and insurance per retail unit	$1,305	$1,298	$7	0.5 %

(Dollars in thousands, except per unit amounts)	Six Months Ended June 30, 2018	2017	Increase	% Increase
Reported				
Revenue	$220,997	$181,628	$39,369	21.7 %
Average finance and insurance per retail unit	1,333	1,302	31	2.4
Same store				
Revenue	$185,668	$180,322	$5,346	3.0 %
Average finance and insurance per retail unit	1,341	1,303	38	2.9

We believe that arranging timely vehicle financing is an important part of our ability to sell vehicles and we attempt to arrange financing for every vehicle we sell. We also offer related products such as extended warranties, insurance contracts and vehicle and theft protection.

The increases in finance and insurance revenue in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to increased volume related to acquisitions, combined with expanded product offerings. Third-party extended warranty and insurance contracts yield higher profit margins than vehicle sales and contribute significantly to our profitability. Same store finance and insurance revenues increased 1.0% and 3.0%, respectively, for the three and six-month periods ended June 30, 2018 as compared to the same periods of 2017.

These increases were driven by increases in finance and insurance revenues per retail unit, combined with increases in used vehicle unit volume, offset by decreases in new vehicle unit volume. On a same store basis, our finance and insurance revenues per retail unit increased $7 and $38, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, primarily due to increased penetration rates related to finance and insurance contracts.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Finance and insurance	73%	71%	72%	71%
Service contracts	45	44	46	45
Lifetime lube, oil and filter contracts	24	25	25	25

We seek to increase our penetration of vehicle financing on the number of vehicles that we sell and to offer a comprehensive suite of products. We target an average F&I per retail unit of $1,450. We believe improved performance from sales training and revised compensation plans will be critical factors in achieving this target.

Service, Body and Parts Revenue and Gross Profit

	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
(Dollars in thousands)	2018	2017		
Reported				
Customer pay	$172,333	$135,851	$ 36,482	26.9 %
Warranty	72,561	56,703	15,858	28.0
Wholesale parts	45,310	35,631	9,679	27.2
Body shop	21,203	17,820	3,383	19.0
Total service, body and parts	$311,407	$246,005	$ 65,402	26.6 %
Service, body and parts gross profit	$153,707	$122,480	$ 31,227	25.5 %
Service, body and parts gross margin	49.4 %	49.8 %	(40) bp	
Same store				
Customer pay	$141,173	$134,406	$ 6,767	5.0 %
Warranty	56,897	56,296	601	1.1
Wholesale parts	36,082	35,255	827	2.3
Body shop	17,297	17,646	(349)	(2.0)
Total service, body and parts	$251,449	$243,603	$ 7,846	3.2 %
Service, body and parts gross profit	$124,751	$121,368	$ 3,383	2.8 %
Service, body and parts gross margin	49.6 %	49.8 %	(20) bp	

(Dollars in thousands)	Six Months Ended June 30, 2018	2017	Increase (Decrease)	% Increase (Decrease)
Reported				
Customer pay	$322,181	$258,471	$63,710	24.6 %
Warranty	140,869	111,202	29,667	26.7
Wholesale parts	90,919	72,333	18,586	25.7
Body shop	43,135	36,573	6,562	17.9
Total service, body and parts	$597,104	$478,579	$118,525	24.8 %
Service, body and parts gross profit	$292,115	$235,674	$56,441	23.9 %
Service, body and parts gross margin	48.9 %	49.2 %	(30) bp	
Same store				
Customer pay	$266,433	$255,452	$10,981	4.3 %
Warranty	112,518	110,233	2,285	2.1
Wholesale parts	72,680	71,430	1,250	1.7
Body shop	35,629	35,872	(243)	(0.7)
Total service, body and parts	$487,260	$472,987	$14,273	3.0 %
Service, body and parts gross profit	$240,773	$233,025	$7,748	3.3 %
Service, body and parts gross margin	49.4 %	49.3 %	10 bp	

We provide service, body and parts for the new vehicle brands sold by our stores, as well as service and repairs for most other makes and models. Our parts and service operations are an integral part of our customer retention and the largest contributor to our overall profitability. Earnings from service, body and parts have historically been more resilient during economic downturns, when owners have tended to repair their existing vehicles rather than buy new vehicles.

Our service, body, and parts revenue grew in all areas in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. The growth experienced in the three and six-month periods ended June 30, 2018 was primarily due to acquisitions, combined with more late-model units in operation from 2010 to 2016 and a plateauing new vehicle market. We believe the increased number of units in operation will continue to benefit our service, body and parts revenue in the coming years as more late-model vehicles age, necessitating repairs and maintenance.

We focus on retaining customers by offering competitively-priced routine maintenance and through our marketing efforts. We increased our same store customer pay revenue 5.0% and 4.3%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017.

Same store warranty revenue increased 1.1% and 2.1%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. Warranty sales growth was primarily driven by increases in domestic segment recalls, particularly Chrysler, which had increases of 17.9% and 16.1%, respectively, and Ford, which had increases of 4.3% and 8.7%, respectively. These increases were offset by decreases in Honda of 26.5% and 25.1%, respectively, and decreases of 11.6% and 19.4%, respectively, in Nissan warranty work in the three and six-month periods ended June 30, 2018 as compared to the same periods of 2017.

The increase (decrease) in same-store warranty work by segment was as follows:

	Three months ended June 30, 2018 compared to the same period of 2017		Six months ended June 30, 2018 compared to the same period of 2017	
Domestic	11.2	%	11.5	%
Import	(5.5	)	(4.6	)
Luxury	(1.8	)	0.5	

26

Same store wholesale parts revenue increased 2.3% and 1.7%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. We target independent repair shops, competing new vehicle dealers and wholesale accounts to expand parts sales to other repair shops.

Same store body shop revenue decreased 2.0% and 0.7%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. These decreases were primarily due to milder winter weather in areas in which our body shops are located.

Same store service, body and parts gross profit increased 2.8% and 3.3%, respectively, in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017. Our gross margins have increased as our mix shifts towards customer pay, which has higher margins than other service work.

Segments

Certain financial information by segment is as follows:

	Three Months Ended June 30,		Increase	% Increase
(Dollars in thousands)	2018	2017		
Revenues:				
Domestic	$1,095,068	$954,949	$140,119	14.7 %
Import	1,322,730	1,095,239	227,491	20.8
Luxury	677,530	419,163	258,367	61.6
	3,095,328	2,469,351	625,977	25.3
Corporate and other	1,209	(2,315)	3,524	NM
	$3,096,537	$2,467,036	$629,501	25.5 %

NM - not meaningful

	Six Months Ended June 30,		Increase	% Increase
(Dollars in thousands)	2018	2017		
Revenues:				
Domestic	$2,065,685	$1,854,707	$210,978	11.4 %
Import	2,493,163	2,066,711	426,452	20.6
Luxury	1,194,025	782,967	411,058	52.5
	5,752,873	4,704,385	1,048,488	22.3
Corporate and other	3,343	(1,248)	4,591	NM
	$5,756,216	$4,703,137	$1,053,079	22.4 %

NM - not meaningful

	Three Months Ended June 30,		Increase (Decrease)	% Increase (Decrease)
(Dollars in thousands)	2018	2017		
Segment income[1]:				
Domestic	$28,545	$27,857	$ 688	2.5 %
Import	30,244	32,238	(1,994)	(6.2)
Luxury	11,939	10,315	1,624	15.7
	70,728	70,410	318	0.5
Corporate and other				