

LITHIA MOTORS INC  
Form 10-Q/A  
December 18, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q/A**

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended **June 30, 2006**

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**

(State or other jurisdiction of  
incorporation or organization)

**93-0572810**

(I.R.S. Employer Identification No.)

**360 E. Jackson Street, Medford, Oregon**

(Address of principal executive offices)

**97501**

(Zip Code)

Registrant's telephone number, including area code: **541-776-6899**

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

Indicate by check mark 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  Accelerated filer

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Non-accelerated filer

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

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**

**15,912,400**

**Class B common stock without par value**

**3,762,231**

(Class)

(Outstanding at August 2, 2006)

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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 10-Q/A amends our quarterly report on Form 10-Q for the quarter ended June 30, 2006, which was filed on August 9, 2006.

The amendment is a result of the restatement of our unaudited consolidated financial statements for quarters ended June 30, 2006 and 2005.

We are restating our previously reported financial information for these periods to correct an error in those financial statements relating to our derivative accounting under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities. In addition, we are restating for other errors that were previously deemed to be immaterial. The restatements are **described in more detail in Note 2 of Notes to Consolidated Financial Statements included elsewhere in this report.**

We are also filing an amended Annual Report on Form 10-K for the year ended December 31, 2005 and an amended Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 to reflect the restatements.

We have amended each item of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 that has been affected by the restatement. This Amendment No. 1 does not reflect events occurring after the August 9, 2006 filing of our Form 10-Q or modify or update the disclosures set forth therein in any way, except as required to reflect the effects of the restatement.

We have reassessed our disclosure controls and procedures as shown in Item 4 related to the material weakness in our internal control over financial reporting with respect to accounting for derivative instruments and the application of hedge accounting under the short cut method.

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**LITHIA MOTORS, INC.**

**FORM 10-Q/A**

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## PART I - FINANCIAL INFORMATION

**Item 1. Financial Statements**

## LITHIA MOTORS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	June 30, 2006 (Restated)	December 31, 2005 (Restated)
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 23,435	\$ 48,566
Contracts in transit	52,599	52,453
Trade receivables, net of allowance for doubtful accounts of \$407 and \$406	61,313	53,990
Inventories, net	881,990	606,047
Vehicles leased to others, current portion	7,028	6,296
Prepaid expenses and other	6,029	8,800
Deferred income taxes		685
Assets held for sale		27,411
Total Current Assets	1,032,394	804,248
Land and buildings, net of accumulated depreciation of \$13,562 and \$11,358	282,032	255,372
Equipment and other, net of accumulated depreciation of \$35,815 and \$31,622	84,008	77,805
Goodwill	276,731	260,899
Other intangible assets, net of accumulated amortization of \$107 and \$89	57,210	50,247
Other non-current assets	7,614	4,143
Total Assets	\$ 1,739,989	\$ 1,452,714
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities:		
Floorplan notes payable	\$ 695,937	\$ 476,322
Floorplan notes payable: non-trade	67,144	54,130
Current maturities of long-term debt	7,587	6,868
Trade payables	33,898	30,917
Accrued liabilities	65,455	57,177
Deferred income taxes	481	
Liabilities held for sale		22,388
Total Current Liabilities	870,502	647,802
Used vehicle flooring facility	18,000	
Real estate debt, less current maturities	168,508	154,046
Other long-term debt, less current maturities	142,609	136,505
Other long-term liabilities	11,273	10,440
Deferred income taxes	46,471	43,690
Total Liabilities	1,257,363	992,483
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 15,855 and 15,629	227,797	224,775
Class B common stock - no par value authorized 25,000 shares; issued and outstanding 3,762 and 3,762	468	468

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Additional paid-in capital	4,232	2,559
Unearned compensation		(1,132 )
Retained earnings	250,129	233,561
Total Stockholders' Equity	482,626	460,231
Total Liabilities and Stockholders' Equity	\$ 1,739,989	\$ 1,452,714

The accompanying notes are an integral part of these consolidated statements.

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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,	
	2006	2005	2006	2005
	(Restated)	(Restated)	(Restated)	(Restated)
<b>Revenues:</b>				
New vehicle sales	\$ 496,121	\$ 438,375	\$ 923,871	\$ 797,994
Used vehicle sales	230,909	200,769	439,987	398,091
Finance and insurance	32,776	27,204	60,330	51,820
Service, body and parts	85,736	75,417	168,209	149,682
Fleet and other	939	9,064	2,269	12,168
Total revenues	846,481	750,829	1,594,666	1,409,755
Cost of sales	702,256	623,817	1,319,660	1,165,610
Gross profit	144,225	127,012	275,006	244,145
Selling, general and administrative	107,536	93,323	208,253	182,455
Depreciation - buildings	1,114	886	2,204	1,714
Depreciation and amortization - other	3,098	2,520	6,054	5,080
Income from operations	32,477	30,283	58,495	54,896
<b>Other income (expense):</b>				
Floorplan interest expense	(8,502 )	(7,865 )	(14,096 )	(9,633 )
Other interest expense	(3,641 )	(3,036 )	(6,972 )	(5,841 )
Other income, net	314	247	742	531
	(11,829 )	(10,654 )	(20,326 )	(14,943 )
Income from continuing operations before income taxes	20,648	19,629	38,169	39,953
Income taxes	(8,706 )	(7,781 )	(15,538 )	(15,673 )
Income before discontinued operations	11,942	11,848	22,631	24,280
Loss from discontinued operations, net of income tax benefit of \$153, \$285, \$882 and \$592	(51 )	(430 )	(1,372 )	(916 )
Net income	\$ 11,891	\$ 11,418	\$ 21,259	\$ 23,364
<b>Basic income per share from continuing operations</b>				
Basic income per share from continuing operations	\$ 0.61	\$ 0.62	\$ 1.16	\$ 1.27
Basic loss per share from discontinued operations		(0.02 )	(0.07 )	(0.05 )
Basic net income per share	\$ 0.61	\$ 0.60	\$ 1.09	\$ 1.22
Shares used in basic per share calculations	19,501	19,142	19,464	19,085
<b>Diluted income per share from continuing operations</b>				
Diluted income per share from continuing operations	\$ 0.56	\$ 0.57	\$ 1.07	\$ 1.16
Diluted loss per share from discontinued operations		(0.02 )	(0.07 )	(0.04 )
Diluted net income per share	\$ 0.56	\$ 0.55	\$ 1.00	\$ 1.12
Shares used in diluted per share calculations	22,150	21,749	22,109	21,710

The accompanying notes are an integral part of these consolidated statements.

## LITHIA MOTORS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	<b>Six months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Restated)</b>	<b>(Restated)</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 21,259	\$ 23,364
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,258	6,794
Depreciation and amortization of discontinued operations		155
Stock-based compensation	1,692	278
Loss on sale of assets	85	224
Gain on sale of franchise		(44 )
Deferred income taxes	3,771	1,527
Excess tax benefits from share-based payment arrangements	(366 )	
(Increase) decrease, net of effect of acquisitions:		
Trade and installment contract receivables, net	(7,188 )	(10,191 )
Contracts in transit	(146 )	(11,745 )
Inventories	(250,019 )	(103,530 )
Vehicles leased to others	(1,341 )	(498 )
Prepaid expenses and other	2,821	1,057
Other non-current assets	(3,471 )	745
Increase (decrease), net of effect of acquisitions:		
Floorplan notes payable	197,517	85,638
Trade payables	2,943	3,267
Accrued liabilities	8,514	5,501
Other long-term liabilities and deferred revenue	832	49
Net cash provided by (used in) operating activities	(14,839 )	2,591
<b>Cash flows from investing activities:</b>		
Capital expenditures:		
Non-financeable	(8,962 )	(12,769 )
Financeable	(23,175 )	(13,797 )
Proceeds from sale of assets	302	258
Cash paid for acquisitions, net of cash acquired	(28,015 )	(26,007 )
Proceeds from sale of dealerships	3,926	6,577
Net cash used in investing activities	(55,924 )	(45,738 )
<b>Cash flows from financing activities:</b>		
Floorplan notes payable: non-trade	13,014	3,629
Net borrowings (repayments) on lines of credit	18,000	29,314
Principal payments on long-term debt and capital leases	(4,548 )	(3,757 )
Proceeds from issuance of long-term debt	19,723	13,334
Repurchase of common stock		(9 )
Proceeds from issuance of common stock	3,768	4,322
Excess tax benefits from share-based payment arrangements	366	
Dividends paid	(4,691 )	(3,064 )
Net cash provided by financing activities	45,632	43,769
Increase (decrease) in cash and cash equivalents	(25,131 )	622
<b>Cash and cash equivalents:</b>		
Beginning of period	48,566	28,869



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End of period	\$ 23,435	\$ 29,491
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for interest	\$ 22,081	\$ 17,253
Cash paid during the period for income taxes	7,029	6,207
<b>Supplemental schedule of non-cash investing and financing activities:</b>		
Debt issued in connection with acquisitions	\$ 6,111	\$
Flooring debt assumed in connection with acquisitions	25,857	23,352
Flooring debt paid by purchaser in connection with dealership disposals	4,713	

The accompanying notes are an integral part of these consolidated statements.

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**LITHIA MOTORS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. Basis of Presentation**

The financial information included herein as of June 30, 2006 and December 31, 2005 and for the three and six-month periods ended June 30, 2006 and 2005 is unaudited; however, such information reflects all adjustments, consisting only of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The unaudited balance sheets at June 30, 2006 and December 31, 2005 reflect restated balances as a result of the restatement described in Note 2 and, therefore, the previously issued audited financial statements as of and for the years ended December 31, 2005, 2004 and 2003 should not be relied upon. We are filing an amended Form 10-K for the year ended December 31, 2005 and amended Form 10-Qs for the first and second quarters of 2006. The income statement data for the six-month period ended June 30, 2006 is not necessarily indicative of the results that we may achieve for the full year.

**Note 2. Restatement**

We are restating our previously reported financial information for the second quarter of 2006 to correct an error in those financial statements relating to our derivative accounting under Statement of Financial Accounting Standards ( SFAS ) No. 133, Accounting for Derivative Instruments and Hedging Activities. In addition, we are restating for other errors that were previously deemed to be immaterial.

We account for our derivative financial instruments in accordance with SFAS No. 133 as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities-an amendment of FASB Statement No. 133 and SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities (collectively, the Standards ). The Standards require that all derivative instruments (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or liability measured at its fair value, and that changes in the derivatives fair value be recognized currently in earnings unless specific hedge accounting criteria are met. From inception of the hedging program, we applied a method of cash flow hedge accounting under SFAS No. 133 to account for the interest rate swap transactions that allowed us to assume the effectiveness of such transactions (the so-called short-cut method). We recently concluded that the interest rate swap transactions did not qualify for the short-cut method in prior periods because of the prepayment clauses in the debt agreements. Furthermore, although management believes that the interest rate swaps would have qualified for hedge accounting under SFAS No. 133, hedge accounting under SFAS No. 133 is not allowed retrospectively because the hedge documentation required was not in place at the inception of the hedge. Eliminating the application of cash flow hedge accounting reverses the fair value adjustments that were made on our balance sheet in other comprehensive income into floorplan interest expense on our income statement.

Although the swaps do not retrospectively qualify for hedge accounting under SFAS No. 133, there is no effect on cash flows from operating, investing or financing activities for these changes. The effectiveness of the swaps as hedge transactions has not been affected by these changes in accounting treatment.

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In addition, we are restating our previously reported financial information for other items that were individually deemed, and are currently deemed, to be immaterial. Because the interest rate swap adjustment has required a restatement, we have elected to record these adjustments in the proper periods.

These adjustments include the following:

- **Intra-company gross profit elimination:** We recorded adjustments to inventory and cost of sales in order to reflect the elimination of intra-company gross profit recognized on service work performed on new vehicle inventory.
- **Income tax expense:** We recorded an adjustment to accrued liabilities and income tax expense related to a tax contingency reserve.

The following tables detail the restatements (in thousands, except per share amounts):

	<b>December 31, 2005</b>		
	<b>As Originally Reported</b>	<b>Adjustments</b>	<b>As Restated</b>
Accrued liabilities	\$ 57,775	\$ (598 )	\$ 57,177
Accumulated other comprehensive income	3,316	(3,316 )	
Retained earnings	229,647	3,914	233,561
Total stockholders' equity	459,633	598	460,231

	<b>June 30, 2006</b>		
	<b>As Originally Reported</b>	<b>Adjustments</b>	<b>As Restated</b>
Accrued liabilities	\$ 65,431	\$ 24	\$ 65,455
Other long-term liabilities	11,272	1	11,273
Additional paid in capital	4,226	6	4,232
Accumulated other comprehensive income	4,223	(4,223 )	-
Retained earnings	245,937	4,192	250,129
Total stockholders' equity	482,651	(25 )	482,626

	<b>Three Months Ended June 30, 2006</b>		
	<b>As Originally Reported</b>	<b>Adjustments</b>	<b>As Restated</b>
Floorplan interest expense	\$ 8,931	\$ (429 )	\$ 8,502
Other income, net	315	(1 )	314
Income tax expense	8,503	203	8,706
Loss from discontinued operations	50	1	51
Net income	11,667	224	11,891
Basic net income per share	0.60	0.01	0.61
Diluted net income per share	0.55	0.01	0.56

	<b>Three Months Ended June 30, 2005</b>		
	<b>As Originally Reported</b>	<b>Adjustments</b>	<b>As Restated</b>
Cost of sales	\$ 623,584	\$ 233	\$ 623,817
Floorplan interest expense	6,000	1,865	7,865
Income tax expense	8,622	(841 )	7,781
Net income	12,675	(1,257 )	11,418
Basic net income per share	0.66	(0.06 )	0.60
Diluted net income per share	0.60	(0.05 )	0.55

**Six Months Ended June 30, 2006**

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	As Originally Reported	Adjustments	As Restated
Floorplan interest expense	\$ 15,546	\$ (1,450 )	\$ 14,096
Income tax expense	14,373	1,165	15,538
Loss from discontinued operations	1,371	1	1,372
Net income	20,975	284	21,259
Basic net income per share	1.08	0.01	1.09
Diluted net income per share	0.99	0.01	1.00

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	Six Months Ended June 30, 2005		
	As Originally Reported	Adjustments	As Restated
Cost of sales	\$ 1,165,278	\$ 332	\$ 1,165,610
Floorplan interest expense	11,102	(1,469 )	9,633
Other income, net	532	(1 )	531
Income tax expense	15,236	437	15,673
Net income	22,665	699	23,364
Basic net income per share	1.19	0.03	1.22
Diluted net income per share	1.09	0.03	1.12

**Note 3. Inventories**

Inventories are valued at the lower of market value or cost, using the specific identification method for vehicles and parts. The cost of new and used vehicle inventories includes the cost of any equipment added, reconditioning and transportation. Inventories consisted of the following (in thousands):

	June 30, 2006	December 31, 2005
New and program vehicles	\$ 732,832	\$ 491,486
Used vehicles	121,292	87,853
Parts and accessories	27,866	26,708
	\$ 881,990	\$ 606,047

**Note 4. Earnings Per Share**

Following is a reconciliation of the income from continuing operations 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,	2006 (Restated)		2005 (Restated)		2005 (Restated)	
	Income from Continuing Operations	Shares	Per Share Amount	Income from Continuing Operations	Shares	Per Share Amount
<b>Basic EPS</b>						
Income from continuing operations available to common stockholders	\$ 11,942	19,501	\$ 0.61	\$ 11,848	19,142	\$ 0.62
<b>Effect of Dilutive Securities</b>						
2 7/8% convertible senior subordinated notes	438	2,255	(0.04 )	459	2,255	(0.04 )
Stock options and unvested restricted stock		394	(0.01 )		352	(0.01 )
<b>Diluted EPS</b>						
Income from continuing operations available to common stockholders	\$ 12,380	22,150	\$ 0.56	\$ 12,307	21,749	\$ 0.57
<b>Antidilutive Securities</b>						
Shares issuable pursuant to stock options not included since they were antidilutive					392	



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Six Months Ended June 30,	2006 (Restated) Income from Continuing Operations	Shares	Per Share Amount	2005 (Restated) Income from Continuing Operations	Shares	Per Share Amount
<b>Basic EPS</b>						
Income from continuing operations available to common stockholders	\$ 22,631	19,464	\$ 1.16	\$ 24,280	19,085	\$ 1.27
<b>Effect of Dilutive Securities</b>						
2 7/8% convertible senior subordinated notes	931	2,255	(0.07 )	927	2,255	(0.09 )
Stock options and unvested restricted stock		390	(0.02 )		370	(0.02 )
<b>Diluted EPS</b>						
Income from continuing operations available to common stockholders	\$ 23,562					