

LITHIA MOTORS INC  
Form DEF 14A  
March 31, 2006

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

**SCHEDULE 14A INFORMATION**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement  
 **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**  
 Definitive Proxy Statement  
 Definitive Additional Materials  
 Soliciting Material Pursuant to §240.14a-12

LITHIA MOTORS, INC.  
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.  
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**LITHIA MOTORS, INC.**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**To Be Held On May 11, 2006**

To the Shareholders of Lithia Motors, Inc.:

I am pleased to invite you to the Annual Meeting of Shareholders of LITHIA MOTORS, INC., which will be held at the Ashland Springs Hotel, 212 E. Main Street, Ashland, Oregon 97520, on Thursday, May 11, 2006, at 4:00 p.m., Pacific Daylight Time for the following purposes.

1. To elect six (6) directors to serve for the ensuing year;
2. To approve the 2006 Discretionary Support Services Bonus Plan; and
3. To approve an amendment to the Lithia Motors, Inc. 1998 Employee Stock Purchase Plan to increase the number of shares issuable under the plan and to extend the term of the plan.

We will also consider and act on such other matters as may properly come before the meeting.

The Board of Directors has fixed the close of business on March 8, 2006 as the record date. Only holders of record of our common stock at the close of business on the record date will be entitled to notice of and to vote at the meeting and any adjournment thereof. Further information regarding voting rights and the matters to be voted upon is presented in this proxy statement.

The proxy statement, the proxy card, a return envelope and a copy of the Annual Report to Shareholders describing our operations for the year ended December 31, 2005 are enclosed.

I hope that you will be able to attend the meeting in person. Whether or not you plan to attend the meeting, please sign and return the enclosed proxy card promptly. Your shares will be voted at the meeting in accordance with your instructions.

Very truly yours,

March 31, 2006

SIDNEY B. DeBOER  
*Chairman of the Board and  
Chief Executive Officer*

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**LITHIA MOTORS, INC.**

**PROXY STATEMENT**

**General**

This proxy statement and the accompanying 2005 Annual Report to Shareholders, the Notice of Annual Meeting and the proxy card are being furnished to the shareholders of Lithia Motors, Inc., an Oregon corporation, in connection with the solicitation of proxies by our Board of Directors for use at our 2006 Annual Meeting of Shareholders (the Annual Meeting). The Annual Meeting will be held at the Ashland Springs Hotel, 212 E. Main Street, Ashland, Oregon 97520 on Thursday, May 11, 2006, at 4:00 p.m. Pacific Daylight Savings Time and any adjournment thereof. These proxy materials and our 2005 Annual Report to Shareholders are being mailed on or about March 31, 2006 to shareholders of record as of March 8, 2006.

**Solicitation and Revocation of Proxies**

The Board of Directors is soliciting proxies for use at the Annual Meeting. All expenses associated with this solicitation will be borne by Lithia Motors, Inc.

The Board of Directors has designated Sidney B. DeBoer and M. L. Dick Heimann as the proxy holders for the Annual Meeting. All properly executed proxies will be voted (except to the extent that authority to vote has been withheld) and where a choice has been specified by the shareholder as provided in the proxy card, it will be voted in accordance with any specification made. Proxies submitted without specification will be voted to elect the nominees for directors proposed by the Board of Directors and for each of the proposals listed on the Notice of Annual Meeting.

A proxy may be revoked by a shareholder prior to its exercise by written notice to the Secretary of Lithia Motors, Inc., by submission of another proxy bearing a later date or by voting in person at the Annual Meeting. Such notice or later dated proxy will not affect a vote on any matter taken prior to its receipt by us.

Our principal executive office and mailing address is at 360 E. Jackson Street, Medford, Oregon 97501.

**Voting at the Meeting**

Our Class A common stock and Class B common stock constitute the only classes of securities entitled to notice of and to vote at the meeting. As of the record date, there were 15,725,272 shares of Class A common stock and 3,762,231 shares of Class B common stock outstanding and entitled to vote. All shares will vote together as a single voting group on all matters submitted to a vote of the shareholders at this year's Annual Meeting. Our executive officers and directors hold a total of approximately 2.5% of the Class A common stock and 100% of the Class B common stock.

At the annual meeting, each share of Class A common stock outstanding is entitled to one vote per share and each share of Class B common stock outstanding is entitled to ten votes per share. For a quorum to exist, there must be represented at the meeting in person or by proxy shares representing a majority of the votes entitled to vote at the meeting.

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Proxies that expressly indicate an abstention as to a particular proposal and broker non-votes will be counted for purposes of determining whether a quorum exists at the Annual Meeting.

Directors are elected by a plurality of the votes cast and only votes cast in favor of a nominee will be counted. Proposals No. 2 and No. 3 will be approved if more votes are cast in favor of the proposal than cast against it. Therefore, abstention from voting and non-voting by brokers will have no effect.

**BUSINESS TO BE CONDUCTED AT THE MEETING**

**Proposal No. 1**

**Election of Directors**





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Our bylaws provide for not less than two and not more than seven directors. The Board of Directors has currently established the number of directors at six. Directors are elected by the shareholders at our Annual Meeting and serve until the next annual meeting or until their successors are elected and qualified.

**The Board of Directors recommends a vote FOR each of the nominees named below.**

Nominee Name	Age	Has Been a Director Since
Sidney B. DeBoer	62	1968
Thomas Becker	54	1997
M. L. Dick Heimann	62	1970
Maryann N. Keller	62	2005
Gerald F. Taylor	65	2000
William J. Young	63	1997

Each of these nominees is presently serving on our board. Mr. DeBoer is the father of our executive officers Bryan B. DeBoer and Jeffrey B. DeBoer. There are no other family relationships among our executive officers and directors.

Certain biographical information is as follows:

**Sid DeBoer** has served as our Chairman, Chief Executive Officer and Secretary since 1968. He also is a member of various automobile industry organizations, including the President's Club of the National Automobile Dealers Association, state auto dealers associations and the DaimlerChrysler National Dealer Council. Mr. DeBoer has earned several awards including the *Time Magazine Quality Dealer Award* in 1997, the *Sports Illustrated All-Star Dealer Award* in 1990 and Medford Chamber of Commerce Awards in 1986, 1991, 1993, 1998 and 2000. Mr. DeBoer is active with several community and charitable organizations, including Southern Oregon University Foundation Board, Medford Rogue Rotary, Medford Rogue Rotary Foundation (Treasurer), Oregon Community Foundation and Oregon Shakespeare Festival. Mr. DeBoer attended Stanford University and the University of Oregon.

**Tom Becker** became a director in March 1997. Mr. Becker is the Chief Executive Officer of Pacific Retirement Services, Inc. and Rogue Valley Manor, a continuing care retirement community, in Medford, Oregon. Pacific Retirement Services, Inc. is the parent corporation of over 30 retirement, senior housing and healthcare facilities in Oregon, California and Texas and provides management, operations and development services to non-profit retirement committees owned by others. Mr. Becker began his career with Rogue Valley Manor in January 1978. Mr. Becker holds a B.S. degree from the University of Oregon and serves on the Board of Directors of PremierWest Bancorp, Medford, Oregon.

**Dick Heimann** became a director in 1970 and has served as our President of Corporate Affairs since January 2006. Prior to this, Mr. Heimann served as our Chief Operating Officer since 1996 and was appointed President in 1997. Mr. Heimann joined Lithia in 1970 as General Sales Manager, and later was promoted to General Manager and Partner of our first Dodge stores in Medford and Ashland, Oregon. He held various positions with us prior to becoming Vice President of Operations in 1979. Prior to joining us, he served as a service representative and district manager of Chrysler Corporation from 1967 to 1970. He has been a member of various state and national automobile industry

organizations and community charities. Mr. Heimann is a graduate of the University of Colorado with a B.S. in Biology and Languages.

*Maryann N. Keller* became a director in May 2005. Ms. Keller currently serves as the principal of Maryann Keller and Associates, a firm providing consulting services to automotive clients. From July 1999 to November 2000, Ms. Keller served as the President of the Automotive Services unit of Priceline.com. She joined Priceline.com from Furman Selz, an investment banking firm, where she served as a managing director of the firm from 1986 to 1999. Prior to joining Furman Selz, Ms. Keller was portfolio manager with Vilas-Fischer Associates from 1983 to 1986, and served as automotive industry analyst with Kidder Peabody & Co. Inc. and Paine Webber from 1972 to 1983. Ms. Keller also served as Chairman of the Society of Automotive Analysts from 1994 to 1999. She is currently a director of Dollar Thrifty Automotive Group, Inc., a publicly-traded rental car company.

*Jerry Taylor* became a director in April 2000. Mr. Taylor served as Vice President and Chief Financial Officer of Applied Materials, Inc., a manufacturer of semi-conductor equipment, from June 1984 until 1990, as Senior Vice President and Chief Financial Officer from 1990 until 1998 and as a senior advisor to the CEO from 1998 until 2000. Mr. Taylor serves as a member of the Board of Directors of Electro Scientific Industries, Inc. and the Oregon Shakespeare Festival.

*Bill Young* became a director in March 1997. Currently, Mr. Young is an Executive Director at J.D. Power and Associates, a global marketing information firm specializing in consumer research for the automotive industry. From 1994 through July 2000, Mr. Young was the Chairman of the Board, President and Chief Executive Officer of Advanced Machine Vision Corporation, operating in the machine vision industry. Prior to 1994, Mr. Young served with Volkswagen of America in various capacities for a period of 18 years, most recently as its President and Chief Executive Officer. Mr. Young also has extensive experience as an independent automotive marketing consultant.

#### **DIRECTOR INDEPENDENCE**

Under the New York Stock Exchange ( NYSE ) rules, a director is not independent if he or she has a direct or indirect material relationship with Lithia. The Corporate Governance Committee reviews the independence of all directors at least annually and reports its finding to the full Board of Directors, which makes a determination about the independence of each director. In assessing the independence of the directors, the Board of Directors considers transactions and relationships between each director or any member of his or her immediate family and Lithia and its consolidated subsidiaries and affiliates in connection with the elements of independence as identified by the NYSE to determine whether there were any relationships or transactions that were inconsistent with a determination that the director is independent.

As a result of this review, the Board of Directors affirmatively determined that Messrs. Becker, Taylor and Young and Ms. Keller are each an independent director under NYSE listing standards. The Board of Directors has also determined that each member of the three committees of the Board of Directors meets the independence requirements applicable to those committees prescribed by the NYSE listing standards and the Securities and Exchange Commission, including Rule 10A-3(b)(1) under the Exchange Act related to audit committee member independence. Further, our Board of Directors has determined that at least one member of our Audit Committee, Jerry Taylor, has the qualifications to be an audit committee financial expert as defined in the SEC's rules and regulations.

The Board of Directors acknowledges that Sidney B. DeBoer and M. L. Dick Heimann are considered non-independent directors because of their employment as executive officers of Lithia.



**MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS**

The Board of Directors held five regular meetings during the year ended December 31, 2005 and took action pursuant to one unanimous written consent. During 2005, no director, other than Mr. Heimann, attended fewer than 75% of the meetings of the board of directors and any committees of which the director was a member. Mr. Heimann was attending to company business matters on those meeting dates and was excused. Throughout 2005, the standing committees of our Board of Directors were the Audit Committee, the Compensation Committee and the Corporate Governance Committee.

The directors are expected to attend our annual meeting of shareholders, but are not required to do so. All of our directors attended our 2005 Annual Meeting of Shareholders.

**The Compensation Committee** consisted of Messrs. Becker, Taylor and Young (Chairman) during 2005. Ms. Keller became a member of the Compensation Committee in May 2005 upon being elected to the Board. In addition, Mr. Philip Romero, a former director, was a member of the Compensation Committee until May 2005. All of the committee members are independent under NYSE listing standards. The Compensation Committee reviews the performance of Sidney DeBoer, our Chief Executive Officer, and establishes his base salary and incentive compensation. The Compensation Committee also approves the compensation for the other executive officers. The Compensation Committee also administers our 2003 Stock Incentive Plan, our 1998 Employee Stock Purchase Plan and our Executive Bonus Plan. The Compensation Committee held four meetings during 2005.

**The Audit Committee** consisted of Messrs. Becker (Chairman), Taylor and Young during 2005. Ms. Keller became a member of the Audit Committee in May 2005 upon being elected to the Board. All of the members are independent as required by the NYSE listing standards. The Audit Committee is responsible for selecting and hiring our independent auditors and for overseeing our accounting functions, our system of internal control established by management and the processes to assure compliance with applicable laws, regulations and internal policies. The Audit Committee held eight meetings during 2005.

The Audit Committee Charter was attached as Appendix A to our proxy statement for our 2004 Annual Meeting. Pursuant to the charter, each committee member, as determined in the business judgment of the Board, will be (a) independent, as that term is defined by the applicable securities regulations and listing standards; and (b) be financially literate and have the ability to read and understand basic financial statements. The Board has determined that all of the committee members satisfy these requirements. Further, our Board of Directors has determined that at least one member of our Audit Committee, Jerry Taylor, has the qualifications to be an audit committee financial expert as defined in the SEC's rules and regulations.

**The Corporate Governance Committee** consisted of Messrs. Becker, Taylor (Chairman) and Young during 2005. Ms. Keller became a member of the Corporate Governance Committee in May 2005 upon being elected to the Board. In addition, Mr. Philip Romero (former Chairman), a former director, was a member of the Corporate Governance Committee until May 2005. The primary objective of the Corporate Governance Committee is to assist the Board of Directors in:

identifying qualified individuals to become board members and recommending to the Board nominees for each annual meeting of the stockholders;

determining the composition of the Board and its committees;

developing and implementing a set of effective corporate governance policies and procedures;

developing and enforcing a Code of Business Conduct;

monitoring a process to assess the effectiveness of the Board, its members and its committees; and

ensuring compliance with the NYSE listing standards.

The Corporate Governance Committee held two meetings during 2005.

Committee charters for the Compensation Committee, Audit Committee and the Corporate Governance Committee, as well as our Corporate Governance Guidelines and Code of Business Conduct, are all available on our website at [www.lithia.com](http://www.lithia.com). You can also obtain any of these documents by writing to us at Investor Relations Department, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501.

## **DIRECTOR QUALIFICATIONS AND NOMINATIONS**

The Corporate Governance Committee is responsible for identifying and evaluating potential director nominees to fill any vacancies on the Board. We believe that the backgrounds and qualifications of our directors, considered as a group, should provide a composite mix of experience, knowledge and abilities that will allow the Board to fulfill its responsibilities. As a result, the Corporate Governance Committee annually reviews the composition of the Board and evaluates the qualifications and contributions of the current directors in the context of the desired composition of the Board, our operating requirements and the long-term interests of our shareholders. Consequently, the qualifications required of individuals for consideration as a board nominee will vary according to the particular areas of expertise being sought as a complement to our existing Board composition at the time of any vacancy. Potential candidates are identified from various sources, including management, other board members, legal counsel, business leaders and other industry executives and directors. The Board has not used in the past, and does not anticipate using in the future, an outside director search firm to identify potential director nominees.

The Corporate Governance Committee evaluates potential nominees based on certain established criteria which include the individual's diversity, age, skills, experience and other factors it deems appropriate given our needs and the needs of the Board in order to maintain a desired balance of knowledge, experience and capabilities. Qualified director nominees should possess high moral character and personal integrity, high level of leadership or managerial experience, knowledge relative to matters affecting our business, the ability and willingness to contribute to the Board, the ability to exercise sound, independent business judgment, a long-term commitment to the interests of shareholders and our growth, the ability

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to dedicate sufficient time to Board activities and duties and, for independent directors, the absence of any conflicts of interest or material affiliations with the company.

We require all of our directors to sign, annually, a Confidentiality Agreement with the company to reinforce their commitment to protect our confidential information and our business reputation and to comply with applicable securities laws.

We seek to attract and retain qualified candidates for board membership, regardless of the origin of recommendation. The Corporate Governance Committee will consider potential nominees recommended by any record or beneficial shareholder. Shareholders may recommend individuals to the Corporate Governance Committee for consideration as potential director nominees by submitting a written recommendation to the Chairman of the Corporate Governance Committee in accordance with our Shareholder Communication Policy. To be considered for nomination to the following year's board of directors, the written recommendation must be received at our principal executive office not less than 120 days prior to the first anniversary of the mailing of the preceding year's proxy materials. For our 2007 Annual Meeting, the recommendation must be received no later than December 1, 2006.

The written recommendation must include the candidate's name, together with appropriate biographical information, qualifications and background materials, a statement that the person submitting the recommendation is a shareholder entitled to vote in the election of directors and a consent to serve as director signed by the recommended individual. If the necessary information is received in a timely manner, the Corporate Governance Committee will evaluate the shareholder-recommended candidate using substantially the same process, and applying substantially the same criteria, as it uses to evaluate all other candidates. All qualified candidates are submitted to the Board for approval as director nominees. If the Board determines to nominate a shareholder-recommended candidate, the candidate's name will be included in our proxy and submitted to shareholders for election.

Under Oregon law, shareholders also have the right to directly nominate director nominees at the meeting, without any action or recommendation on the part of the Corporate Governance Committee or the Board of Directors, by delivering written notice of the proposed nomination to the Secretary of Lithia Motors, Inc. at 360 E. Jackson Street, Medford, Oregon 97501, and the inclusion of a statement that such shareholder intends to attend the meeting to make the nomination. If the shareholder wants the nominee included in our proxy statement, the notice must be received at above address not less than 120 days prior to the first anniversary of the mailing of the preceding year's proxy materials and must set forth all information required by Rule 14a-8 of the Securities Exchange Act of 1934, including, without limitation, the name, age, business address and residence address of each person being nominated, the principal occupation, or employment of such person, the class and number of shares of capital stock beneficially owned by the person, and all other information relating to such person that is or would be required to be disclosed in a solicitation of proxies pursuant to the rules and regulations under the Securities Exchange Act of 1934. In addition, certain information must be provided about the shareholder or shareholder group making a nomination. Finally, a shareholder or shareholder group making a nomination must comply with all other applicable requirements of the Exchange Act, including providing a nominee's consent to being named in a proxy statement and to serve as a director if elected.

## SHAREHOLDER COMMUNICATIONS WITH DIRECTORS

*The Board of Directors has adopted a Shareholder Communication Policy to promote more efficient shareholder communications with the Board and management. Our Investor Relations Department is responsible for receiving and routing all shareholder communications. Corporate governance issues are the responsibility of the Corporate Governance Committee. Our Audit Committee handles concerns or allegations regarding possible violations of accounting or financial reporting matters. Management is the more appropriate group for handling all other matters and we encourage you to contact them accordingly.*

*All correspondence with the Board of Directors or its members must be in writing, directed to the attention of either the Board of Directors or an individual director and delivered to: Investor Relations Department, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501. A complete copy of our Shareholder Communications Policy is available on our website at [www.lithia.com](http://www.lithia.com).*



**COMPENSATION OF DIRECTORS**

Directors who are not employees are paid cash compensation for their 2005-2006 service as follows:

\$18,000 retainer;

\$1,000 for each Board meeting attended;

\$500 for each Audit Committee meeting attended the same day as a Board meeting; and

\$1,000 for attendance at one or more committee meetings attended on a day other than a day with a Board meeting (\$500 if attended by teleconference).

Stock-based compensation for 2005-2006 service is as follows:

an option grant covering 2,000 shares of our Class A common stock;

a 700 share Class A common stock grant for Board service;

a 200 share Class A common stock grant for being a member of the Audit Committee; and

a 100 share Class A common stock grant for chairing the Audit Committee.

Stock options were granted March 10, 2006. Stock grants will be made promptly following their year of service coincident with the annual meeting to be held on May 11, 2006. Pursuant to the current compensation plan, directors are required to hold the shares issued for the lesser of 3 years from the date of grant or one year following their last date of board service.

Based on the above, each of the outside directors has received, or will receive, the following for their 2005-2006 year of service:

<b>Director</b>	<b>Cash</b>	<b>Number of Restricted Shares to be Granted(1)</b>	<b>Number of Stock Options Granted(2)</b>
Thomas Becker	\$ 25,000	1,000	2,000
Maryann Keller	25,000	900	2,000
Gerald F. Taylor	25,000	900	2,000
William J. Young	25,000	900	2,000

(1) Value is based on the fair market value of our Class A common stock on the date of grant and, accordingly, can not be determined at this time.

(2) Exercise price was \$31.67, the fair market value of our Class A common stock on the date of the option grant on

March 10, 2006.

Under the Outside Directors Nonqualified Deferred Compensation Plan adopted by the Board on November 22, 2005, non-employee directors may elect to defer receipt of compensation. If stock compensation is deferred, the director's deferral account, which is maintained for accounting purposes only, will be credited with the stock and any cash or stock dividends, stock splits or the like that would have been paid or issuable with respect to the deferred shares. The cash component of the deferral account, including all deferred cash compensation and other cash interest and dividends credited to the account, will accrue interest at an annual rate equal to the interest rate on our used car flooring line of credit, by reference to such rate as of the last business day of the preceding year. The deferred compensation will be paid to the director beginning within one month following termination of the director's service on the board, either in a lump sum or installments, based on the director's election prior to the deferral.

**Proposal No. 2**

**Approval of the 2006 Discretionary Support Services Bonus Program**

Based on the recommendation of the Compensation Committee, the Board of Directors adopted the 2006 Discretionary Support Services Bonus Plan (the Bonus Plan ) on February 24, 2006, subject to approval by the shareholders at the Annual Meeting. Shareholder approval of the Bonus Plan is required for performance based compensation payments to executive officers to be exempt from the deduction limitations contained in Section 162(m) of the Internal Revenue Code and related regulations. The Bonus Plan would replace the 2005 Discretionary Executive Bonus Plan.

**Summary of the Bonus Plan**

*Participants.* The following executive officers are eligible to participate in the Bonus Plan for 2006: Sidney B. DeBoer, Chief Executive Officer; Bryan B. DeBoer, President and Chief Operating Officer; M. L. Dick Heimann, President of Corporate Affairs; R. Bradford Gray, Executive Vice President; Jeffrey B. DeBoer, Senior Vice President and Chief Financial Officer; and Don Jones, Jr., Senior Vice President, Retail Operations. Certain other officers and managers are also eligible to participate in the Bonus Plan for a total of approximately 57 employees, including the six executive officers.

*Administration.* The Compensation Committee, which is comprised solely of independent board members, is responsible for administering the Bonus Plan.

*Bonuses.* The Bonus Plan provides for the payment of an annual bonus. Under the Bonus Plan, each participant will have a Maximum Bonus Potential based on a percentage of that participant's annual salary. The participant's bonus received under the Bonus Plan will be a percentage of the participant's Maximum Bonus Potential, determined based on the accomplishment of certain shared company objectives, measured as a December year-end. The specific performance targets and the percentage of the potential bonus attributed to each performance objective, if any, may change each year and will be determined by the Compensation Committee before March 31 of each year.

*Performance Objectives.* The following are the general performance objectives for the Bonus Plan and the maximum percentage of the participant's Maximum Bonus Potential that may be achieved under each such performance objective for 2006. For each year, the Board of Directors may change which of these performance objectives will be considered, the specific targets, and the applicable percentages for each of the performance objectives.

Objectives	Maximum Percentage of Maximum Bonus Potential (2006)
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**Financial Performance:**

1. Pre-Tax Net Profit (per share targets)	20%
2. Return on Average Equity (quarter-end averages)	8%
3. Pre-Tax Net Margin Retention (pre-tax net profit/total revenue)	8%
4. Overall Company Growth Rate (based equally on same-store revenue growth and net profit growth)	5%

5. Used Vehicle Department Growth Rate (based equally on same-store revenue growth and net profit growth)	3%
6. Fixed Departments Growth (based equally on same-store revenue growth and net profit growth)	3%

**Non-Financial Performance:**

7. Approved to Purchase Stores (satisfy specific manufacturer criteria to purchase stores)	10%
8. Minimum Sales Requirement (% of seasoned stores at or above threshold set by specified manufacturers)	5%
9. Sales Satisfaction Scores (% of seasoned stores equaling or exceeding specified manufacturers criteria)	3%
10. Service Satisfaction Scores (% of seasoned stores equaling or exceeding specified manufacturers criteria)	3%

**Project Related Objectives:** Implementation of the following programs:

11. Human Resources Development (external and internal recruiting, Multi-store Manager Development Plan, training, core competencies review program targets)	10%
12. Used Vehicle Inventory Management (hiring and implementation goals)	5%
13. Office Automation (automation of specific systems and related confirming studies)	4%
14. Internet Sales Process (implementation of identified aspects of internet sales plan)	3%
15. Service Department Follow-Up Systems (development and targeted implementation of systems)	2%
16. Departmental Action Plans and Tracking Systems (development and implementation)	2%
17. Car Deal Process Automation (implementation of specific improvements)	2%
18. New Business Development (achievement of specific new business development objectives)	4%
	100%

The Compensation Committee has determined that any details regarding the performance objectives, other than such information which is disclosed herein, is confidential commercial or business information, the disclosure of which would have a material adverse effect on the company. As such, we are not disclosing certain confidential information which may be a material term of the performance objectives.

The payment of any bonuses is in the negative discretion of the Board of Directors. Performance achievement of each objective is determined in the sole judgment of the Compensation Committee. In making such judgment, the Compensation Committee disregards the impact (whether positive or negative) resulting from a changes in accounting rules. Further, with respect to managers, the Compensation Committee may disregard the impacts resulting from a material change from the current

core business model, a major acquisition or series of acquisitions, or a disposition of a major portion of our business.

The highest Maximum Bonus Potential authorized under the plan is equal to 150% of salary. If the highest threshold is attained for all objectives, the maximum amount of the bonuses payable related to performance in 2006 to the CEO and the other five named executive officers would be \$5,454,000. The total bonus paid out in 2005, 2004, 2003, 2002 and 2001 under similar plans was 71.5%, 63.3%, 40.0%, 40.0%, and 73.3%, respectively, of each participant's Maximum Bonus Potential.

*Federal Tax Consequences.* For federal income tax purposes, Section 162(m) of the Internal Revenue Code generally prohibits us from deducting employee compensation that otherwise would be deductible to the extent such compensation exceeds \$1 million for any covered employees in any fiscal year. Compensation that is performance-based, as defined in Section 162(m), is not subject to the deductibility limitations if the Bonus Plan satisfies certain criteria. The Bonus Plan is intended to address the limitation on deductibility by providing for compensation that qualifies as performance-based compensation.

Compensation paid under the Bonus Plan will not be subject to the deduction limit if:

It is payable on account of the attainment of pre-established, objective performance goals set forth within the Bonus Plan;

The Compensation Committee, which is comprised solely of outside directors, approves the maximum individual awards on or near the beginning of each performance period;

The Bonus Plan, which sets forth the material terms of the compensation and performance goals, is disclosed to and approved by shareholders before payment; and

The Compensation Committee certifies that the performance goals have been satisfied before payment.

The Bonus Plan contains provisions for each of the above requirements. It is believed that most if not all goals can be objectively determined.

#### **New Plan Benefits**

The following table summarizes estimated compensation that would have been earned under the 2006 Bonus Plan based on 2006 salaries but using 2005 operating results and company performance.

<b>Name and Position</b>	<b>Dollar Value(1)</b>
Sidney B. DeBoer, Chief Executive Officer	\$ 516,600
M. L. Dick Heimann, President and Chief Operating Officer	383,760
Bryan B. DeBoer, Senior Vice President, Mergers and Acquisitions/Operations	383,760
R. Bradford Gray, Executive Vice President	346,860
Don Jones, Jr., Senior Vice President, Retail Operations	346,860

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Jeffrey B. DeBoer, Senior Vice President and Chief Financial Officer	258,300
All Current Executive Officers as a Group (6 people)	2,236,140
All Non-Executive Officer Directors as a Group (4 people)	
All Eligible Non-Executive Officer Employees as a Group (approximately 67 people)	1,318,264

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(1) Amounts are not indicative of amounts to be earned under the 2006 Bonus Plan during 2006 because such amounts were based on the application of 2006 bonus criteria to 2005 operating results and company performance. Project related objectives under the Bonus Plan, which account for 32% of the potential bonus, were considered not to have been achieved in 2005 because they represent new performance objectives. The dollar amounts reflect 41% of the executives' Maximum Bonus Potential. The listed executives have a Maximum Bonus Potential of 150% of base salary.

**Vote Required**

The affirmative vote of a majority of the votes cast at the meeting and entitled to vote on this matter is necessary to approve the 2006 Discretionary Executive Bonus Plan.

**The Board of Directors has approved the adoption of the 2006 Discretionary Support Services Bonus Plan and unanimously recommends a vote FOR this proposal.**

**Proposal No. 3**  
**Approval of Amendments to the 1998 Employee Stock Purchase Plan to Increase the**  
**Number of Shares Issuable Under the Plan and Extend the Term of the Plan**

The Board of Directors approved, subject to shareholder approval, amendment of the 1998 Employee Stock Purchase Plan (the "ESPP") to increase the number of shares issuable under the ESPP to 2.45 million and to extend the plan until December 31, 2012.

Our shareholders previously approved the 1998 Employee Stock Purchase Plan (the "ESPP") which permits eligible employees to purchase our Class A common stock via payroll deductions at a price equal to 85% of the lesser of the fair market value at the beginning or end of the purchase period. As of April 1, 2005, the Plan was amended by the Board of Directors to set the purchase price at 85% of the market price of such shares on the last day of the quarter.

**Amendment to Extend Term of the ESPP**

The ESPP currently expires on December 31, 2007. We recommend extending the term of the ESPP, which has proven to be an effective tool to encourage widespread employee ownership of our stock. We believe that increased stock ownership heightens our employees' commitment and efforts. Based on a review of employee stock ownership as a result of the ESPP, we believe the ESPP has been successful in achieving its desired results. Since its commencement in 1998, 1,514,215 shares have been sold to employees under the ESPP. During 2005, 2,092 employees (approximately 20% of those eligible) participated in the ESPP and purchased a total of 256,036 shares.

**Amendment to Increase the Number of Shares Under the ESPP**

Currently, the ESPP authorizes the sale of 1.75 million shares. Prior to the sale of shares on April 1, 2006, there were only 235,785 shares available for purchase under the ESPP. In addition, we anticipate that approximately 50,000 shares will be issued pursuant to the ESPP on April 1, 2006, the first purchase date in the calendar year. The Board of Directors has approved an amendment to the ESPP to increase the total shares available under the ESPP from 1.75 million to 2.45 million. Assuming our shareholders approve the amendment, we would have 935,785 million shares available for purchases prior to the sale of shares on April 1, 2006.

The following table summarizes shares purchased under the ESPP from January 1, 2005 through December 31, 2005.

Name and Position	Number of Shares
Sidney B. DeBoer, Chairman, Chief Executive Officer and Secretary	
M. L. Dick Heimann, President, Chief Operating Officer and Director	
R. Bradford Gray, Executive Vice President and Director	
Don Jones, Jr., Senior Vice President, Retail Operations	958
Bryan DeBoer, Executive Vice President, Mergers and Acquisitions/Operations	
Jeffrey B. DeBoer, Senior Vice President and Chief Financial Officer	
Thomas Becker, Director	



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Gerald F. Taylor, Director

William J. Young, Director

All Current Executive Officers as a Group (6 people)

958

All Non-Executive Officer Directors as a Group (4 people)

All Non-Executive Officer Employees as a Group (2,091 participants)

255,078

## **Summary of Plan**

### ***Administration***

The ESPP is intended to qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Code of 1986, as amended, and is administered by the Compensation Committee.

### ***Eligibility***

Employees of Lithia Motors, Inc. and its subsidiaries are eligible to participate in the ESPP after they have completed at least 90 days of continuous employment and work at least 20 hours per week. Participation in the ESPP is voluntary and is dependent on each eligible employee's election to participate and his or her determination as to the level of payroll deductions. Payroll deductions are limited to 10% of a participant's base pay but no more than an amount sufficient to purchase shares having a fair market value of \$25,000 in any plan year. Employees may end their participation in the ESPP at any time during the calendar quarter and their participation ends automatically on the termination of their employment.

Non-employee directors are not eligible to participate. Employees who own or as a result of participation would own stock possessing five percent or more of the combined voting power or value of all classes of our stock are not eligible. Messrs. Sidney DeBoer, M. L. Dick Heimann and R. Bradford Gray are not currently eligible to participate in the ESPP. Further, Messrs. Jeffrey DeBoer, Bryan DeBoer and Mark DeBoer, officers of the company, are not able to participate because of their family relationship with Sidney DeBoer.

### ***Purchase Price***

The price of shares purchased under the ESPP will be 85% of the fair market value of the Class A common stock at the end of each fiscal quarter.

### ***Amendment of the Purchase Plan***

The Board may amend or terminate the ESPP at any time but may not increase the number of shares covered by the ESPP or amend the eligibility requirements without subsequent shareholder approval.

### ***Federal Tax Effects***

A participant acquiring stock pursuant to a qualified employee stock purchase plan receives favorable tax treatment in that the participant does not recognize any taxable income at the time of the grant of the option to purchase or upon exercise of such option to purchase. The tax treatment of the disposition of the stock depends upon whether the stock is disposed of within the holding period, which is two years from the date of grant. If the participant disposes of the stock after completion of the holding period, the lesser of (a) the sales price less the purchase price, or (b) 15 percent of the market value of the shares on the last day of the offering period, is taxable as ordinary income, and any further profit is taxable as long-term capital gain. If the participant disposes of the stock before the holding period expires (disqualifying disposition), the difference between the price paid by the employee and the market value of the shares at the date of purchase is taxable as ordinary income, and the difference between the amount received by the employee on the disposition of the shares and the market value of the shares at the date of purchase is treated as a capital gain or loss.

Upon a disqualifying disposition of the stock, Lithia may deduct from taxable income in the year of the disqualifying disposition an amount equal to the difference between the price paid by the employee and the market value of the shares at the date of purchase.

A copy of the amended and restated ESPP, as approved by the Board of Directors, was filed with the Securities and Exchange Commission as an exhibit to a Form 8-K on March 21, 2006. A copy of the ESPP can also be obtained upon request to Investor Relations, Lithia Motors, Inc., 360 E. Jackson Street, Medford, Oregon 97501.

**The Board of Directors unanimously recommends that the shareholders vote in favor of the amendments to the 1998 Employee Stock Purchase Plan.**

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of March 15, 2006, certain information with respect to ownership of our common stock of (i) each director, (ii) each executive officer, (iii) all persons known by us to be beneficial owners of more than 5% of any class of our common stock, and (iv) all current executive officers and directors as a group.

Shareholder	Class(1)	Number of Shares(2) (3)	Percent of Shares Outstanding(3)
Lithia Holding Company, LLC(4) (5)	Class B	3,762,231	100%
Sidney B. DeBoer(4) (5)	Class A	199,094	1.3%
	Class B	3,762,231	100%
FMR Corp. (6) 82 Devonshire Street Boston, Massachusetts 02109	Class A	1,933,347	12.2%
Wasatch Advisors, Inc. (7) 150 Social Hall Avenue Salt Lake City, Utah 84111	Class A	1,659,172	10.5%
Dimensional Fund Advisors Inc. (8) 1299 Ocean Avenue, 11th Floor Santa Monica, California 90401	Class A	1,362,324	8.6%
M. L. Dick Heimann (4) (5)	Class A	247,138	1.6%
R. Bradford Gray (4) (5)	Class A	93,712	*
Don Jones, Jr. (4)	Class A	78,428	*
Jeffrey B. DeBoer(4) (5)	Class A	54,429	*
Bryan B. DeBoer (4) (5)	Class A	45,715	*
Thomas Becker (4)	Class A	23,200	*
Gerald F. Taylor (4)	Class A	19,700	*
William J. Young (4)	Class A	9,700	*
Maryann N. Keller (4)	Class A		
All current executive officers and directors as a group (10 persons)	Class A	771,116	4.8%
	Class B	3,762,231	100%

\*Less than one percent

(1) The Class A common stock is entitled to one vote per share and the Class B common stock is entitled to 10 votes per share and is convertible into Class A common stock on a share for share basis at the option of the holder thereof or under certain other circumstances.

(2) Includes shares subject to options exercisable within 60 days of March 16, 2005, shares held in 401(k) accounts and shares held by spouses as follows:

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<b>Name</b>	<b>Options exercisable within 60 days</b>	<b>Shares held in 401(k) account</b>	<b>Shares held by spouse</b>
Sidney B. DeBoer	69,798		
M. L. Dick Heimann	69,798	26,256	15,964
R. Bradford Gray	48,000		
Don Jones, Jr.	32,000	11,381	
Jeffrey B. DeBoer	36,000	2,718	
Bryan B. DeBoer	36,000		
Thomas Becker	8,000		
Gerald F. Taylor	8,000		