HORIZON PHARMA, INC.
Form 10-K
March 18, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

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 001-35238

HORIZON PHARMA, INC.

(Exact name of Registrant as specified in its charter)

Delaware	27-2179987
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
520 Lake Cook Road, Suite 520	
Deerfield, Illinois	60015
(Address of principal executive offices)	(zip code)

(224) 383-3000

(Registrant s telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.0001 per share	The NASDAQ Global Market

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

None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x.

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

The aggregate market value of the registrant s voting common stock held by non-affiliates of the registrant, based upon the $7.13 per share closing sale price of the registrant s common stock on June 29, 2012 (the last business day of the registrant s most recently completed second quarter), was approximately $150,877,787. Solely for purposes of this calculation, the registrant s directors and executive officers and holders of 10% or more of the registrant s outstanding shares of common stock have been assumed to be affiliates and an aggregate of 12,585,513 shares of the registrant s voting common stock held by such persons on June 29, 2012 are not included in this calculation.

As of March 13, 2013, the registrant had outstanding 61,947,247 shares of its common stock.

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HORIZON PHARMA, INC.

FORM 10-K ANNUAL REPORT

For the Fiscal Year Ended December 31, 2012

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PART I

Special Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements that is, statements related to future, not past, events as defined in Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, that reflect our current expectations regarding our future growth, results of operations, financial condition, cash flows, performance, business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. Forward-looking statements include any statement that does not directly relate to a current or historical fact. The Company has tried to identify forward-looking statements by using words such as believe, may, could, will, estimate, continue, anticipate, intend, seek, plan, expect, should, or would. Among the factors that could cause actual results to d from those indicated in the forward-looking statements are risks and uncertainties inherent in our business including, without limitation: the rate and degree of market acceptance of, and our ability and our distribution and marketing partners ability to obtain reimbursement for, any approved products; our ability to successfully execute our sales and marketing strategy, including to continue to successfully recruit and retain sales and marketing personnel in the U.S., and to successfully commercialize DUEXIS® and RAYOS® in the U.S.; our ability to obtain additional financing; our ability to maintain regulatory approvals for DUEXIS and RAYOS, known as LODOTRA® outside the U.S.; the accuracy of our estimates regarding expenses, future revenues and capital requirements; our ability to manage our anticipated future growth; the ability of our products to compete with generic products, especially those representing the active pharmaceutical ingredients in DUEXIS and RAYOS/LODOTRA, as well as new products that may be developed by our competitors; our ability and our distribution and marketing partners ability to comply with regulatory requirements regarding the sales, marketing and manufacturing of our products and product candidates; the performance of our third-party distribution partners and manufacturers, over which we have limited control; our ability to obtain and maintain intellectual property protection for our products and our product candidates; our ability to operate our business without infringing the intellectual property rights of others; the success and timing of our clinical development efforts; the loss of key management, sales and marketing, regulatory, clinical affairs, medical affairs or development personnel; regulatory developments in the U.S. and foreign countries; our ability to either acquire or develop and commercialize other product candidates in addition to DUEXIS and RAYOS/LODOTRA; and other risks detailed below in Part I Item 1A. Risk Factors.

Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee future results, events, levels of activity, performance or achievement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

Item 1. Business

Overview

We are a specialty pharmaceutical company that has developed and is commercializing DUEXIS and RAYOS/LODOTRA, both of which target unmet therapeutic needs in arthritis, pain and inflammatory diseases. Our strategy is to develop, acquire, in-license and/or co-promote additional innovative medicines where we can execute a targeted commercial approach in specific therapeutic areas while taking advantage of our commercial strengths and the infrastructure we have put in place.

On April 23, 2011, the U.S. Food and Drug Administration, or FDA, approved DUEXIS (formerly HZT-501), a proprietary tablet formulation containing a fixed-dose combination of ibuprofen and famotidine in a single pill. DUEXIS is indicated for the relief of signs and symptoms of rheumatoid arthritis, or RA, and osteoarthritis, or OA, and to decrease the risk of developing upper gastrointestinal, or GI, ulcers in patients who are taking ibuprofen for these indications. In the second-half of 2011, we hired our initial commercial organization, including approximately eighty sales representatives, completed sales force training and began detailing DUEXIS to physicians in December 2011. In the third quarter of 2012, we expanded our sales force to

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approximately one hundred fifty representatives and under a co-promotion agreement with Mallinckrodt LLC, or Mallinckrodt, the pharmaceutical business of Covidien plc, or Covidien, Mallinckrodt began calling on twenty five thousand exclusive physician targets. Our sales force expansion, along with the Mallinckrodt co-promotion agreement, expanded our called-on physician targets for DUEXIS from approximately ten thousand to approximately fifty thousand. In June 2012, we licensed DUEXIS rights in Latin America to Grünenthal S.A., or Grünenthal, a private company focused on the promotion of pain products. In March 2013, we announced that the United Kingdom, or UK, Medicines and Healthcare products Regulatory Agency, or MHRA, granted a National Marketing Authorization, or MA, for DUEXIS in the UK. We will seek to license rights to DUEXIS in Europe to a commercial partner or partners. Given the current state of the market in Europe for pain products and the revenue being generated there by existing branded non-steroidal anti-inflammatory drugs, or NSAIDs, we do not expect a material level of sales from DUEXIS in European markets.

Our other lead product, RAYOS, known as LODOTRA outside the U.S., is a proprietary delayed-release formulation of low-dose prednisone for the treatment of moderate to severe, active RA in adults, particularly when accompanied by morning stiffness. On July 26, 2012, the FDA approved RAYOS for the treatment of RA, polymyalgia rheumatica, or PMR, psoriatic arthritis, or PsA, ankylosing spondylitis, or AS, asthma and chronic obstructive pulmonary disease, or COPD, and a number of other conditions. We plan to focus our promotion of RAYOS in the U.S. on rheumatology indications, including RA and PMR. We began detailing RAYOS to a subset of U.S. rheumatologists in December 2012 and began the full launch in late January 2013 to the majority of rheumatologists and high-value primary care physicians. LODOTRA is currently marketed in Europe by our distribution partner, Mundipharma International Corporation Limited, or Mundipharma.

We were incorporated as Horizon Pharma, Inc. in Delaware on March 23, 2010. We are a holding company that operates primarily through our two wholly-owned subsidiaries, Horizon Pharma USA, Inc., a Delaware corporation, and Horizon Pharma AG, a company organized under the laws of Switzerland. Horizon Pharma AG owns all of the outstanding share capital of its wholly-owned subsidiary, Horizon Pharma GmbH, a company organized under the laws of Germany through which Horizon Pharma AG conducts most of its European operations.

Our principal executive offices are located at 520 Lake Cook Road, Suite 520, Deerfield, Illinois 60015 and our telephone number is (224) 383-3000. Our website address is *www.horizonpharma.com*. The information contained in or that can be accessed through our website is not part of this report.

Unless the context indicates otherwise, as used in this report, the terms Horizon, Horizon Pharma, we, us and our refer to Horizon Pharma, I a Delaware corporation, and its subsidiaries taken as a whole. Also, unless the context indicates otherwise, for historical periods prior to April 1, 2010, the terms Horizon, Horizon Pharma USA, we, us and our refer to Horizon Therapeutics, Inc.

Horizon Pharma, Horizon Therapeutics, a stylized letter H, DUEXIS , RAYOS and LODOTRA are registered trademarks in the U.S. and/ certain other countries. This report also includes references to trademarks and service marks of other entities and those trademarks and service marks are the property of their respective owners.

Our Strategy

Our strategy is to utilize the commercial strengths and the infrastructure that we have put in place in creating a fully-integrated U.S.-focused specialty pharmaceutical company to successfully commercialize DUEXIS and RAYOS in the U.S. market and also to expand and leverage these capabilities by developing, acquiring, in-licensing or co-promoting additional products where we can execute a targeted commercial approach in specific therapeutic areas. We intend to enter into licensing or additional distribution arrangements for commercialization of our products outside the U.S., such as our relationship with Mundipharma for the commercialization of LODOTRA in Europe, Asia and Latin America and our relationship with Grünenthal for the commercialization of DUEXIS in Latin America.

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Our Strategic Partnerships

We have entered into several strategic partnerships with respect to the manufacturing, distribution and marketing of LODOTRA. We entered into separate transfer, license and supply agreements with Merck Serono GmbH, or Merck Serono, and Merck GesmbH for the commercialization of LODOTRA in each of Germany and Austria, respectively, and we subsequently consented to assignment of the agreements with respect to Germany and Austria to Mundipharma Laboratories GmbH, or Mundipharma Laboratories. We also entered into distribution agreements with Mundipharma for the exclusive distribution and marketing rights pertaining to LODOTRA for Europe (originally excluding Germany and Austria) and certain Asian, Latin American and other countries and a manufacturing and supply agreement with Mundipharma Medical Company, or Mundipharma Medical, pursuant to which we supply LODOTRA to Mundipharma Medical. We have also entered into a manufacturing and supply agreement with Jagotec AG, or Jagotec, an affiliate of SkyePharma AG, or SkyePharma, from whom we purchase LODOTRA. In May 2011, we entered into a manufacturing and supply agreement with sanofi-aventis U.S. to manufacture and supply DUEXIS. In August 2011, SkyePharma leased its entire pharmaceutical manufacturing business to Aenova France SAS, or Aenova, with our consent to allow Jagotec to subcontract the manufacture of LODOTRA to Aenova. In addition, we have entered into an exclusive agreement with Grünenthal for the commercialization of DUEXIS in Latin America.

Our Products and Product Candidates

We believe that our products and product candidates address unmet therapeutic needs in arthritis, pain and/or inflammatory diseases. We have developed DUEXIS and RAYOS/LODOTRA to provide significant advantages over existing therapies.

Our current product portfolio consists of the following:

Products and Product Candidates	Disease	Phase of Development	Marketing Rights	Territory
DUEXIS	Signs and symptoms of osteoarthritis and rheumatoid arthritis	NDA approved April 23, 2011; UK National MA approved in March 2013	Horizon	Worldwide excluding Latin America
		Registration	Grünenthal	Latin America
RAYOS/LODOTRA	Rheumatoid arthritis	NDA approved July 26, 2012, approved and marketed in Europe	Horizon	Worldwide, excluding Europe and certain Asian, Latin American and other countries
			Mundipharma	Europe and certain Asian, Latin American and other countries
	Polymyalgia rheumatica and other indications	NDA approved July 26, 2012	Horizon	Worldwide, excluding Europe and certain Asian, Latin American, and other countries

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Market Overview

Pain is a serious and costly public health concern affecting more people in the U.S. than diabetes, heart disease and cancer combined. In 2010, the U.S. National Center for Health Statistics reported that approximately 30% of U.S. adults 18 years of age and over reported recent symptoms of pain, aching or swelling around a joint within the past 30 days.

Some of the most common and debilitating chronic inflammation and pain-related diseases are OA, RA and acute and chronic pain. According to National Health Interview Survey data analyzed by the Centers for Disease Control and Prevention, 50 million U.S. adults 18 years of age and over had reported being diagnosed with some form of arthritis. With the aging of the U.S. population, the prevalence of arthritis is expected to rise by approximately 40% by 2030, impacting 67 million people in the U.S. People with these diseases may become increasingly debilitated as the disease progresses, experiencing not only significant pain but also loss of mobility, independence and the ability to work, thereby potentially placing a significant burden on family caregivers and healthcare and social services. In addition, patients suffering from chronic inflammatory diseases tend to have shortened life expectancies as a direct result of these diseases. According to the American Pain Foundation Fact Sheet and the U.S. Centers for Disease Control and Prevention:

- the annual cost of chronic pain in the U.S., including healthcare expenses, lost income and lost productivity is estimated to be $100 billion;
- arthritis and related conditions, such as OA, cost the U.S. economy nearly $128 billion per year in medical care and indirect expenses, including lost wages and productivity; and
- pain is the second leading cause of medically related work absenteeism, resulting in more than 50 million lost workdays each year.

In addition, the Arthritis Foundation reports 992,000 hospitalizations and 44 million office visits in the U.S. annually for arthritis alone.

Osteoarthritis

OA is a type of arthritis that is caused by the breakdown and eventual loss of the cartilage of one or more joints. Cartilage is a protein substance that serves as a cushion between the bones of the joints. OA is also known as degenerative arthritis. Among the over 100 different types of arthritis conditions, OA is the most common and occurs more frequently with age. Before age 45, OA occurs more frequently in males. After age 50, it occurs more frequently in females. OA commonly affects the hands, feet, spine and large weight-bearing joints, such as the hips and knees. Most cases of OA have no known cause and are referred to as primary OA.

Symptoms of OA manifest in patients as joint pain, tenderness, stiffness, limited joint movement, joint cracking or creaking (crepitation), locking of joints and local inflammation. OA can also lead to joint deformity in later stages of the disease. Many drugs are now used to treat the inflammation and pain associated with OA, including aspirin and other NSAIDs, such as ibuprofen and naproxen, that have a rapid analgesic and anti-inflammatory response.

Rheumatoid Arthritis

RA is a chronic disease that causes pain, stiffness and swelling, primarily in the joints. According to DataMonitor, 3.0 million people in the U.S. suffer from RA, of which 1.7 million are diagnosed and treated with various drugs. RA has no known cause, but unlike OA, RA is not associated with factors such as aging. RA occurs when the body s immune system malfunctions, attacking healthy tissue and causing inflammation, which leads to pain and swelling in the joints and may eventually cause permanent joint damage and painful disability. The primary symptoms of RA include progressive immobility and pain, especially in the morning, with long-

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term sufferers experiencing continual joint destruction for the remainder of their lives. There is no known cure for RA. Once the disease is diagnosed, treatment is prescribed for life to alleviate symptoms and/or to slow or stop disease progression.

RA treatments include medications, physical therapy, exercise, education and sometimes surgery. Early, aggressive treatment of RA can delay joint destruction. Treatment of RA usually includes multiple drug therapies taken concurrently. Disease-modifying anti-rheumatic drugs, or DMARDs, are the current standard of care for the treatment of RA, in addition to rest, exercise and anti-inflammatory drugs such as NSAIDs. Methotrexate is the most commonly prescribed DMARD for the treatment of RA. Other common agents for the treatment of RA include corticosteroids and biologic agents. Corticosteroids, such as prednisone, effectively reduce joint swelling and inflammation and have been shown to slow the progression of RA, but at high doses are associated with potential for significant long-term adverse side effects such as osteoporosis, cardiovascular disease and weight gain. An additional limitation of RA treatment with corticosteroids is related to the time at which patients pro-inflammatory cytokines are at peak levels. Increased levels of pro-inflammatory cytokines during the early morning hours are a known cause of morning stiffness and decreased mobility of RA. Interleukin 6, or IL-6, levels are substantially increased in patients with RA in general and show a significant circadian variation in these levels. Over the last decade, the advent of biologic agents has transformed the treatment of RA. Tumor necrosis factor, or TNF, inhibitors are the primary biologic agents used today to treat RA. Although effective for treatment of RA, these agents are costly and, because they are very potent immunosuppressants, may increase the risk of infection.

Because RA has the potential to cause serious damage to joints and bones, physicians typically treat patients aggressively, including with combination therapies to reduce pain and inflammation and to slow the progression of the disease. Recent research sponsored by Mundipharma and conducted by Ipsos MORI involving 750 RA patients from 11 European countries found that 60% of surveyed patients with RA indicated that pain and morning stiffness controls their lives. Additionally, 74% of people with pain and morning stiffness as a result of their RA indicated that they are either unemployed, retired early or are on sick leave as a result of RA and 58% say they are frustrated emotionally because they find it difficult to do everyday tasks due to morning stiffness caused by their RA.

Polymyalgia Rheumatica

PMR is an inflammatory disorder that causes significant muscle pain and stiffness. The pain and stiffness often occur in the shoulders, neck, upper arms and hip with pronounced morning stiffness lasting at least one hour. Symptoms of PMR usually begin within two weeks. Most people who develop PMR are older than 65 years of age. It rarely affects people younger than 50. There are approximately 1.1 million patients with PMR in the U.S. and it afflicts one in every 133 people over the age of 50. Prednisone is the standard of care for treating PMR and treatment is generally initiated at a relatively high dose (e.g., 10-20 mg per day) and reduced as clinical improvement is seen. Treatment usually lasts 18-24 months. Similar to RA, PMR is associated with circadian patterns of IL-6 elevation in early morning hours.

DUEXIS

DUEXIS is a proprietary single tablet formulation containing a fixed-dose combination of ibuprofen, one of the most widely prescribed NSAIDs, and famotidine, a well-established GI agent used to treat dyspepsia, gastroesophageal reflux disease, or GERD, and active ulcers, in one pill. Ibuprofen has proven anti-inflammatory and analgesic properties and famotidine reduces the stomach acid secretion that can cause upper GI ulcers. Both ibuprofen and famotidine have well-documented and excellent long-term safety profiles and both products have been used for many years by millions of patients worldwide. Based on our clinical study results, DUEXIS has been shown to both provide effective pain relief and decrease stomach acidity, thus reducing the risk of NSAID-induced upper GI ulcers.

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Market Opportunity and Limitations of Existing Treatments

NSAIDs are very effective at providing pain relief, including pain associated with OA and RA; however, there are significant upper GI-associated adverse events that can result from the use of NSAIDs. As a result, COX-2 inhibitor drugs (i.e., Vioxx™, Merck & Co., Inc.; Celebrex and Bextra™, Pfizer Inc.) were introduced to the market in order to provide pain and arthritis relief with reduced risk of significant upper GI-associated adverse events. The COX-2 drugs generated approximately $6.3 billion in sales at their peak in 2004. However, safety concerns associated with COX-2 inhibitor drugs led to the withdrawal of Vioxx and Bextra from the market in 2004 and a significant decline in the use of Celebrex. In the U.S. alone, over $3 billion in sales of COX-2 inhibitor drugs were lost. As a result, demand for traditional prescription NSAIDs, such as ibuprofen and meloxicam, has increased dramatically.

U.S. Total Prescriptions - Major NSAIDs and COX-2 Products

Source: IMS National Prescription Audit and Source Healthcare Analytics (formerly Wolters Kluwer Pharmaceutical) Audit Suite Total Rx s 2002-2012 (National Level Retail and Institutional, Source Healthcare Analytics is a source of data only and does not endorse the views, opinions and/or findings expressed or otherwise published by Horizon)

According to a 2004 article published in Alimentary Pharmacology & Therapeutics, significant GI side effects, including serious ulcers, afflict up to approximately 25% of all chronic arthritis patients treated with NSAIDs for three months, and OA and RA patients are two to five times more likely than the general population to be hospitalized for NSAID-related GI complications. It is estimated that NSAID-induced GI toxicity causes over 16,500 related deaths in OA and RA patients alone and over 107,000 hospitalizations for serious GI complications each year. In more than 80% of patients with these serious GI complications, there are no prior symptoms.

Despite the fact that GI ulcers are one of the most prevalent adverse events resulting from the use of NSAIDs in the U.S., according to a 2006 article published in BMC Muskoskeletal Disorders, eleven

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observational studies indicated that physicians do not commonly co-prescribe GI protective agents to high-risk patients. Physicians prescribe concomitant therapy to only 24% of NSAID users, and studies show sub-optimal patient compliance with concomitant prophylaxis therapy. According to a 2003 article published in Alimentary Pharmacology & Therapeutics, in a study of 784 patients, 37% of patients were non-compliant, a rate increasing to 61% in patients treated with three or more drugs. This noncompliance results in a substantial unmet clinical need, which we believe can be appropriately addressed with DUEXIS, creating a simple solution for both patients and physicians.

DUEXIS Solution

Ibuprofen: One of the World s Most Widely Prescribed NSAIDs

Ibuprofen continues to be one of the most widely prescribed NSAIDs worldwide. According to Wolters Kluwer, in the U.S. alone, there were over 31 million prescriptions written for ibuprofen in 2011. Ibuprofen prescription volumes in Europe approximately equal those in the U.S. In the U.S., both the 600 mg and 800 mg doses together account for approximately 90% of total ibuprofen prescriptions. In addition, ibuprofen s flexible three times daily dosing allows it to be used for both chronic conditions such as arthritis and chronic back pain, and acute conditions such as sprains and strains.

Famotidine: A Safe and Effective GI Agent

Famotidine, the most potent marketed drug in the class of histamine-2 receptor antagonists, a class of drugs used to block the action of histamine on the cells in the stomach that secrete gastric acid, was chosen as the ideal GI protectant to be combined with ibuprofen as it is a well-studied compound with an estimated 18.8 million patients treated worldwide that provides distinct advantages including:

- rapid onset of action;
- significant reduction in gastric acid levels in the GI tract for the treatment of dyspepsia, GERD and NSAID-induced upper GI ulcers;
- well tolerated with a low incidence of adverse drug reactions and a demonstrated safety margin of up to eight times the approved prescription dose for an extended period of greater than 12 months; and

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lower incidence of long-term adverse events, such as bone fracture, *Clostridium difficile* diarrhea and drug-drug interactions, reported recently with another class of GI agents referred to as proton pump inhibitors, or PPIs.

Despite these advantages, famotidine had not yet been approved to reduce the incidence of NSAID-induced upper GI ulcers in patients taking NSAIDs. As a result, we conducted two pivotal Phase 3 clinical trials demonstrating that treatment with DUEXIS significantly reduced the incidence of NSAID-induced upper GI ulcers in patients with mild to moderate pain or arthritis compared to ibuprofen alone. Based on the data from our Phase 3 clinical trials of DUEXIS, in March 2010 we submitted a new drug application, or NDA, requesting approval to market DUEXIS in the U.S. On April 23, 2011, the FDA approved DUEXIS for the relief of signs and symptoms of RA and OA and to decrease the risk of developing upper GI ulcers in patients who are taking ibuprofen for these indications.

Benefits of a Fixed-Dose Combination Therapy

Numerous studies have demonstrated that fixed-dose combination therapy provides significant advantages over taking multiple pills. Specifically, fixed-dose combinations can reduce the number of pills, ensure that the correct dosage of each component is taken at the correct time and improve compliance, often associated with better treatment outcomes. DUEXIS has been formulated to provide an optimal dosing regimen of ibuprofen and famotidine together in the convenience of a single pill.

Phase 3 Clinical Trial Results

We have completed two large-scale Phase 3 clinical trials of DUEXIS. These trials, named the Registration Endoscopic Study to Determine Ulcer Formation of DUEXIS (HZT-501) Compared to Ibuprofen: Efficacy and Safety Study, or REDUCE-1 and REDUCE-2, were randomized, double-blind, controlled trials that enrolled 1,533 patients in the U.S. with chronic pain or arthritis. Patients were randomly assigned, in approximately a 2:1 ratio, to receive DUEXIS (800 mg ibuprofen and 26.6 mg famotidine in a single pill) or ibuprofen (800 mg) alone, orally three times daily for a 24-week treatment period or until patients developed either an endoscopically diagnosed upper GI ulcer and/or prohibitive toxicity.

REDUCE-1 and REDUCE-2

The primary endpoint of REDUCE-1 was to show a reduction in the cumulative incidence of gastric ulcers during the six month treatment period. The primary endpoint of REDUCE-2 was to show a reduction in the cumulative incidence of upper GI (defined as gastric and/or duodenal) ulcers during the six month treatment period. In REDUCE-1, DUEXIS demonstrated a statistically significant reduction in the incidence of gastric ulcers versus treatment with ibuprofen alone (8.7% versus 17.6%, p-value = 0.0004). In REDUCE-2, DUEXIS demonstrated a statistically significant reduction in the incidence of upper GI ulcers versus treatment with ibuprofen alone (10.5% versus 20.0%, p-value = 0.002). The overall relative risk reduction of upper GI ulcers with DUEXIS versus ibuprofen was consistent across key subgroups including: age (under and over 65), history of prior ulcer, low dose aspirin use, gender and presence of baseline upper GI erosions although the studies were not powered for those individual subgroups.

In the REDUCE-1 and REDUCE-2 combined patient population, the most common adverse reactions (at least 1% and greater than ibuprofen alone) were nausea, diarrhea, constipation, upper abdominal pain and headache. The incidence of dyspepsia with DUEXIS was statistically significantly lower than ibuprofen alone (4.7% vs. 8%, p-value = 0.009). Overall, the discontinuation rate in the REDUCE-1 and REDUCE-2 studies due to adverse events for patients receiving DUEXIS and ibuprofen alone were similar.

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Commercial and Regulatory Status

On April 23, 2011, the FDA approved DUEXIS (formerly HZT-501), a proprietary tablet formulation containing a fixed-dose combination of ibuprofen and famotidine in a single pill. DUEXIS is indicated for the relief of signs and symptoms of RA and OA and to decrease the risk of developing GI ulcers in patients who are taking ibuprofen for these indications. In the second-half of 2011, we hired our initial commercial organization, including approximately eighty sales representatives, completed sales force training and began detailing DUEXIS to physicians in December 2011. In the third quarter of 2012, we expanded our sales force to approximately one hundred fifty representatives and under a co-promotion agreement with Mallinckrodt, the pharmaceutical business of Covidien, Mallinckrodt began calling on twenty five thousand exclusive physician targets. Our sales force expansion, along with the Mallinckrodt co-promotion agreement, expanded our called-on physician targets for DUEXIS from approximately ten thousand to approximately fifty thousand. In June 2012, we licensed DUEXIS rights in Latin America to Grünenthal, a private company focused on the promotion of pain products. In March 2013, we announced that the UK MHRA granted a MA for DUEXIS in the UK. We will seek to license rights to DUEXIS in Europe to a commercial partner or partners. Given the current state of the market in Europe for pain products and the revenue being generated there by existing branded NSAIDs, we do not expect a material level of sales from DUEXIS in European markets.

RAYOS/LODOTRA

RAYOS, known as LODOTRA outside the U.S., is a proprietary delayed-release formulation of low-dose prednisone that is currently marketed in Europe by our distribution partner, Mundipharma, for the treatment of moderate to severe, active RA in adults particularly when accompanied by morning stiffness. On July 26, 2012, the FDA approved RAYOS for the treatment of RA, PMR, PsA, AS, asthma, COPD and a number of other conditions. We plan to focus our promotion of RAYOS in the U.S. on rheumatology indications, including RA and PMR. We began detailing RAYOS to a subset of U.S. rheumatologists in December 2012 and began the full launch in late January 2013 to the majority of rheumatologists and high-value primary care physicians. LODOTRA is currently marketed in Europe by our distribution partner, Mundipharma.

Market Opportunity and Limitations of Existing Treatments

According to DataMonitor, there are approximately 4.5 million RA patients in the U.S., Japan, France, Italy, Spain, Germany and the United Kingdom, of which approximately 3.0 million are diagnosed. Common agents for the treatment of RA include NSAIDs, DMARDs, biologic agents and corticosteroids such as prednisone. Physicians are increasingly supportive of prescribing multiple therapies as some RA patients are able to achieve a clinical remission with multiple treatments. A Medical Marketing Economics May 2008 study of 150 RA patients in the U.S., which we sponsored, showed that despite the use of a combination of currently available treatments for RA, over 90% of the patients reported suffering from morning stiffness, pain and immobility.

In addition, according to DataMonitor, approximately 50% of RA patients in the U.S., Japan, France, Italy, Spain, Germany and the United Kingdom are prescribed combination therapy which often includes corticosteroids, with prednisone being one of the most common. Corticosteroids, including prednisone, are used to suppress various autoimmune, inflammatory and allergic disorders by inhibiting the production of various pro-inflammatory cytokines, such as IL-6 and TNF-alpha. Joint inflammation in RA is driven by excessive production of inflammatory mediators and cytokines such as IL-6 and TNF-alpha. While corticosteroids are potent and effective agents to treat patients with RA, they are often used at high doses to treat RA flares or significant inflammation. High-dose oral corticosteroid treatment is not a viable long-term treatment option due to adverse side effects such as osteoporosis, cardiovascular disease and weight gain. However, clinical studies have shown that the long-term use of low-dose prednisone (<10 mg per day) does not dramatically increase total adverse events. In addition, low-doses, typically less than 10 mg daily, of corticosteroids such as prednisone have been shown to treat the symptoms of RA while slowing the overall progression of the disease.

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An additional limitation of RA treatment with corticosteroids is related to the time at which patients pro-inflammatory cytokines are at peak levels. Increased levels of pro-inflammatory cytokines during the early morning hours are a known cause of morning stiffness and decreased mobility of RA. IL-6 levels are substantially increased in patients with RA in general and show a significant circadian variation in these levels. As reflected in the chart below, peak IL-6 levels tend to occur in the early morning hours and low levels typically occur in the afternoon and evening. Therefore, we believe an optimal treatment would reduce IL-6 levels in the early morning hours.

RAYOS/LODOTRA Solution

The proprietary formulation technology of RAYOS/LODOTRA enables a delayed-release of prednisone approximately four hours after administration. As reflected in the chart below, RAYOS/LODOTRA proprietary delivery system synchronizes the prednisone delivery time with the patient s elevated cytokine levels, thereby taking effect at a physiologically optimal point to inhibit cytokine production, and thus significantly reduces the signs and symptoms of RA and PMR.

RAYOS/LODOTRA was developed utilizing SkyePharma s proprietary GeoClock and GeoMatrix technologies, for which we hold an exclusive worldwide license for the delivery of corticosteroids. RAYOS/LODOTRA is comprised of an active core containing prednisone, which is encapsulated by an inactive porous shell. The inactive shell acts as a barrier between the product s active core and a patient s GI fluids. RAYOS/LODOTRA is intended to be administered at bedtime. At approximately four hours following bedtime administration of RAYOS/LODOTRA, water in the digestive tract diffuses through the shell, causing the active core to expand, which leads to a weakening and breakage of the shell and allows the release of prednisone from the active core.

Our pharmacokinetic studies have shown that the blood concentration of prednisone from RAYOS/LODOTRA is similar to immediate release prednisone except for the intended time delay of product release after administration. The administration of RAYOS/LODOTRA (5 mg) provides equivalent exposure, or area under curve, and maximum blood concentration to an immediate release prednisone 5 mg formulation. The following chart shows mean plasma levels of prednisone after a single dose of RAYOS/LODOTRA (5 mg) compared to an immediate release prednisone 5 mg tablet.

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Clinical Trial Results

We have successfully completed two pivotal Phase 3 clinical trials evaluating RAYOS/LODOTRA for the treatment of RA. The Circadian Administration of Prednisone in Rheumatoid Arthritis-1, or CAPRA-1 trial, investigating the efficacy of RAYOS/LODOTRA in the treatment of RA, supported the marketing authorization application approval in Europe. The second pivotal Phase 3 clinical trial, Circadian Administration of Prednisone in Rheumatoid Arthritis-2, or CAPRA-2 trial, along with the CAPRA-1 study, supported U.S. marketing approval.

CAPRA-1

The primary endpoint of CAPRA-1 was reduction of the duration of morning stiffness associated with RA. CAPRA-1 was a 12-week, randomized, double-blind, placebo-controlled trial that enrolled 288 RA patients comparing bedtime administration of RAYOS/LODOTRA with morning administration of immediate release prednisone at the same individual dose (an average dose of 6.7 mg). All patients continued on existing DMARD and NSAID treatment at stable doses. At the conclusion of the 12-week period, patients taking RAYOS/LODOTRA were permitted to continue RAYOS/LODOTRA treatment and patients taking immediate release prednisone were permitted to switch to RAYOS/LODOTRA for a nine-month open label extension study for a total of 12 months. There were a total of 219 patients who completed the open label extension study.

The trial results demonstrated that bedtime administration of RAYOS/LODOTRA was superior to immediate release prednisone in reducing the duration of morning stiffness associated with RA. As shown in the chart below, the duration of morning stiffness was significantly reduced in the RAYOS/LODOTRA treatment group compared to the group treated with immediate release prednisone, where no change in morning stiffness was shown. The mean relative change in duration of morning stiffness of joints from baseline was approximately 23% in patients taking RAYOS/LODOTRA compared to approximately 0.4% for patients taking immediate release prednisone (p-value = 0.045) after 12 weeks.

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RAYOS/LODOTRA reduced IL-6 levels by approximately 29% (relative median change), which was statistically significant (p-value < 0.0001), while corresponding IL-6 levels following treatment with immediate release prednisone remained constant. In addition, RAYOS/LODOTRA was as effective as treatment with immediate release prednisone for other markers of disease activity, including disease activity scores in 28 joints typically impacted by RA, and American College of Rheumatology 20, or ACR20, response rate, which measures the percentage of patients who have achieved a 20% improvement in tender or swollen joint counts as well as a 20% improvement in three of five other criteria of disease activity, and all other efficacy parameters investigated. In the initial 12-week period of the study, the most commonly reported treatment-emergent adverse events were a flare in RA-related symptoms (7.6% for RAYOS/LODOTRA compared to 9.0% for immediate release prednisone), abdominal pain (3.5% for RAYOS/LODOTRA compared to 5.6% for immediate release prednisone), nasopharyngitis, or inflammation of the nasal passages (2.8% for RAYOS/LODOTRA compared to 5.6% for immediate release prednisone) headache (4.2% for RAYOS/LODOTRA compared to 2.8% for immediate release prednisone), and flushing (2.8% for RAYOS/LODOTRA and 4.2% for immediate release prednisone).

At the conclusion of the nine-month open label extension period, patients who continued treatment with RAYOS/LODOTRA experienced a 55% reduction in the duration of morning stiffness. In addition, patients who were newly assigned to RAYOS/LODOTRA exhibited a 45% reduction in the duration of morning stiffness over the nine-month course of this extension study. These patients also experienced a 50% median reduction in IL-6 levels which also corresponded to improvements in the duration of morning stiffness following daily administration of RAYOS/LODOTRA at bedtime. In the open label phase, the most commonly reported treatment-emergent adverse events were a flare in RA-related symptoms (14.5%), flushing (5.2%), upper respiratory tract infections (2.8%), back pain (2.8%) and weight increase (2.8%). Adverse events indicative of aggravated hypothalamic-pituitary-adrenal, or HPA, axis suppression, typical of high dose prednisone administration, were not observed.

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CAPRA-2

The primary endpoint of CAPRA-2 was to show that RAYOS/LODOTRA significantly improved the ACR20 response rate in patients with RA as compared to placebo. This primary endpoint is the standard used in approval of RA products in the U.S. by the FDA. CAPRA-2 was a 12-week, randomized, double-blind, placebo-controlled Phase 3 clinical trial conducted in centers in both the U.S. and Europe involving 350 RA patients. All patients were inadequate responders to DMARD therapy and were randomized into one of two arms to receive either RAYOS/LODOTRA (5 mg) or placebo once daily at bedtime in addition to their existing therapy. Results showed that patients treated with RAYOS/LODOTRA experienced a statistically significant improvement in ACR20 response criteria compared to patients in the placebo group (48.5% vs. 28.6%; p-value = 0.0002), which met the primary endpoint.

In addition, patients taking RAYOS/LODOTRA experienced a statistically significant improvement in the more stringent American College of Rheumatology 50, or ACR50, response criteria (22.7% vs. 9.2%; p-value = 0.0027), which was the secondary endpoint. ACR50 response rate measures the percentage of patients who have achieved a 50% improvement in tender or swollen joint counts as well as a 50% improvement in three of five other criteria of disease activity. Patients taking RAYOS/LODOTRA also experienced an improvement in the more stringent American College of Rheumatology 70, or ACR70, response criteria (7.0% vs. 2.5%; p-value = 0.0955), which is another measure of treatment response. ACR70 response rate measures the percentage of patients who have achieved a 70% improvement in tender or swollen joint counts as well as a 70% improvement in three of five other criteria of disease activity. Importantly, patients treated with RAYOS/LODOTRA also experienced a statistically significant reduction in morning stiffness compared to patients in the placebo group (56.5% vs. 33.3%; p-value = 0.0008).

In this study, the most commonly reported treatment-emergent adverse events were joint pain (10.4% for RAYOS/LODOTRA compared to 20.2% for placebo), RA flare (6.5% for LODOTRA compared to 9.2% for placebo), nasopharyngitis (4.8% for RAYOS/LODOTRA compared to 3.4% for placebo) and headache (3.9% for LODOTRA compared to 4.2% for placebo).

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PMR

In PMR, blood concentrations of the pro-inflammatory cytokine IL-6 have been shown to increase and reach a peak during the early hours of the morning, in parallel to patients symptoms of pain and stiffness. This is similar to results in RA, another inflammatory condition with marked circadian variation in symptoms. RAYOS/LODOTRA has been shown to better control the symptoms of RA than taking the same dose of prednisone in the morning and also to suppress the nocturnal rise in IL-6. Also, 7 mg of RAYOS/LODOTRA was shown to more successfully suppress the nocturnal rise in IL-6 in PMR than 7 mg of prednisolone taken in the morning.

Mean (95% CI) plasma IL-6 concentrations over 24 hours in 10 untreated patients with PMR, and in 6 of these patients treated for 2 weeks with 7 mg of prednisolone in the morning and 4 treated for 2 weeks with 7 mg of RAYOS/LODOTRA at night.

Further, although only a small study, symptoms of morning stiffness were also better suppressed with RAYOS/LODOTRA almost as well as 15 mg of prednisolone taken in the morning.

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Morning stiffness and plasma IL-6 as a proportion of baseline (Night A) after 2 weeks of treatment with 7 mg of prednisolone in the morning or 7 mg MR RAYOS/LODOTRA at night (Night B) and after a further 2 weeks of treatment with prednisolone 15 mg in the morning (Day C) ($P<0.05$ for differences at Night B).

This study suggested that 7 mg of RAYOS/LODOTRA had a similar efficacy to 15 mg of prednisolone in the morning, a standard treatment for PMR. This raises the possibility of using lower doses of RAYOS/LODOTRA to treat PMR, which would have profound implications for the reduction of adverse effects and the simplification of treatment regimens in clinical practice.

Additionally, pursuant to a March 2011 letter agreement and in connection with our waiver of certain milestone payments, Mundipharma has agreed to conduct a separate clinical trial for RAYOS/LODOTRA for the potential treatment for PMR outside the U.S, which we expect will be a Phase 3 clinical trial, beginning in the first quarter of 2013.

Regulatory and Commercial Status

LODOTRA received its first approval in Europe in March 2009 and is currently approved for marketing in 20 countries outside the U.S. where it is being commercialized by Mundipharma. RAYOS was approved in the U.S. in July 2012 where it is being commercialized by Horizon.

RAYOS/LODOTRA in Other Indications

We also conducted a small Phase 2 clinical trial to evaluate the potential use of RAYOS/LODOTRA to treat severe asthma compared to immediate-release prednisone. Severe asthma sufferers are frequently prescribed very high doses of oral corticosteroids. However, high-dose oral corticosteroid treatment is limited by side effects which include, among others, osteoporosis and its various negative effects. Data from seven patients who had been treated with 5 to 45 mg of daily immediate release prednisone in accordance with the study protocol showed improvements in nocturnal symptoms, asthma control and asthma-related quality of life when switched to an equivalent dose of RAYOS/LODOTRA. We currently do not have plans at this time to pursue commercialization of RAYOS for the treatment of severe asthma

Commercial Agreements

Merck Serono License Agreements (Assigned to Mundipharma Laboratories)

In December 2006 and March 2009, we entered into separate transfer, license and supply agreements with Merck Serono and Merck GesmbH, an affiliate of Merck Serono, for the commercialization of LODOTRA in Germany and Austria, respectively. The agreement covering Germany was amended in December 2008 to allow

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co-promotion of LODOTRA in Germany. Under the agreements, we granted Merck Serono and Merck GesmbH exclusive distribution and marketing rights pertaining to LODOTRA for each of Germany and Austria, respectively, and an exclusive license to use the trademark for LODOTRA in Germany and Austria. The transfer, license and supply agreements related to Germany and Austria were assigned to Mundipharma Laboratories from Merck Serono and Merck GesmbH in April 2011 and September 2011, respectively, with our consent. Mundipharma Laboratories is obligated to commercialize LODOTRA in Germany and Austria, as applicable, exclusively under the LODOTRA trademark. Mundipharma Laboratories is obligated to use commercially reasonable efforts to market LODOTRA in Germany and Austria, and is prohibited from launching other oral corticosteroids for the treatment of RA for the first three years following the launch of LODOTRA. With respect to the agreement covering Germany, if Mundipharma Laboratories does not meet specified minimum sales targets over specified periods of time, the marketing rights to LODOTRA will become nonexclusive unless Mundipharma Laboratories pays us the shortfall. With respect to the agreement covering Austria, if Mundipharma Laboratories does not meet specified minimum sales targets over specified periods of time, after good faith discussions to modify the agreement, we have the right to terminate the agreement.

Mundipharma Laboratories has agreed to purchase LODOTRA commercial product exclusively from us. We supply LODOTRA to Mundipharma Laboratories at the price which is the higher of (1) a percentage of the list price of LODOTRA sold to final purchasers of LODOTRA from Mundipharma Laboratories (excluding any discounts) and (2) the costs we incur for the production and delivery of LODOTRA to a Mundipharma Laboratories supply depot, as applicable, plus a profit mark-up.

Subject to early termination, the terms of the agreements are 15 years from the launch of LODOTRA in Germany and 10 years from the launch of LODOTRA in Austria. Thereafter, the agreements automatically renew until terminated by a party by giving specified prior written notice to the other party to the agreement. Under both agreements a party may also terminate an agreement in the event of a bankruptcy of the other party, certain events beyond the parties control that impair performance under an agreement, or upon material uncured breach by a party.

For the years ended December 31, 2012 and 2011, Merck Serono accounted for 0% and 20% of total gross revenues, respectively.

Mundipharma Agreements

In March 2009, we entered into a distribution agreement with Mundipharma for the commercialization of LODOTRA in Europe, excluding Germany and Austria, and a manufacturing and supply agreement with Mundipharma Medical. The distribution agreement, which was amended in July 2009 and March 2011, provides for an upfront payment of 5.0 million Euros, all of which has been paid by Mundipharma, and aggregate potential milestone payments of up to an additional 11.0 million Euros, which includes a credit in the amount of 1.0 million Euros we agreed to provide to Mundipharma to be applied towards certain future milestone payments in connection with the March 2011 amendment.

Under the distribution agreement, we granted Mundipharma the exclusive distribution and marketing rights pertaining to LODOTRA for: Albania, Belgium, Bosnia-Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Greece, Hungary, Iceland, Ireland, Israel, Italy, Latvia, Liechtenstein, Lithuania, Luxemburg, Macedonia, Malta, Montenegro, Netherlands, Norway, Poland, Portugal, Romania, Serbia, former Soviet Union countries, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and the United Kingdom. We also granted to Mundipharma an exclusive license to use our trademark for LODOTRA in these countries, and Mundipharma is allowed to commercialize LODOTRA under the LODOTRA trademark. Mundipharma is obligated to use commercially reasonable efforts to market LODOTRA in the territory and is prohibited from launching other oral corticosteroids during the term of the distribution agreement. If Mundipharma does not meet specified minimum sales targets, which range from single digit millions of Euros to

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tens of millions of Euros on a country by country basis, over specified periods of time, the marketing rights granted under the distribution agreement will become nonexclusive with respect to the applicable country unless Mundipharma pays us the shortfall.

Under the manufacturing and supply agreement, which was subsequently amended in March 2011, Mundipharma Medical agreed to purchase LODOTRA exclusively from us with respect to the territory. We supply LODOTRA to Mundipharma Medical at the price which is a specified percentage of the average net selling price for sales in a given country.

Subject to early termination, the terms of both of the March 2009 agreements extend to March 2024. Thereafter, the agreements automatically renew until terminated by either party giving specified prior written notice to other party. Either party may also terminate either of the agreements in the event of a bankruptcy of the other party or upon an uncured material breach by the other party. In addition, Mundipharma has the right to terminate the distribution agreement in the event of material risk of personal injury to third parties or immediately by written notice with respect to any country if the market authorization for LODOTRA is cancelled in such country.

In November 2010, we entered into a second distribution agreement with Mundipharma for the commercialization of LODOTRA in several Asian countries, Australia, New Zealand and South Africa, and a second manufacturing and supply agreement with Mundipharma Medical. Under the distribution agreement, we received an upfront payment of $3.5 million and may be entitled to additional aggregate milestone payments of up to $4.4 million. In March 2012, we amended the distribution agreement and the manufacturing and supply agreement to include certain Latin American countries. Under the amendment to the distribution agreement, we may receive aggregate up-front and milestone payments of up to $2.0 million.

Under the distribution agreement, as amended, we granted Mundipharma the exclusive distribution and marketing rights pertaining to LODOTRA for: Australia, China, Hong Kong, Indonesia, Korea, Malaysia, New Zealand, the Philippines, Singapore, South Africa, Taiwan, Thailand, Vietnam, Mexico, Brazil, Argentina, Colombia, Venezuela, Peru, Chile, Ecuador, Dominican Republic, Guatemala, Costa Rica, Uruguay, Bolivia, Panama, Nicaragua, El Salvador and Honduras. Mundipharma will be responsible for obtaining regulatory approvals in these countries. We also granted to Mundipharma an exclusive license to use our trademark for LODOTRA in these countries, and Mundipharma is allowed to commercialize LODOTRA under the LODOTRA trademark. Mundipharma is obligated to use commercially reasonable efforts to obtain regulatory approval for and market LODOTRA and is prohibited from launching other oral corticosteroids in these countries during the term of the distribution agreement. If Mundipharma does not meet specified minimum volume targets, which range from thousands of tablets of product to millions of tablets of product on a country by country basis, over specified periods of time, the marketing rights granted under the distribution agreement will become nonexclusive with respect to the applicable country unless Mundipharma pays us the shortfall.

Under the manufacturing and supply agreement, as amended, Mundipharma Medical agreed to purchase LODOTRA exclusively from us with respect to the territory. We supply bulk product of LODOTRA to Mundipharma Medical at an adjustable price per tablet and Mundipharma is responsible for final packaging and distribution in the territory.

Subject to early termination, the terms of both of the November 2010 agreements are 15 years from the first product launch on a country by country basis. Thereafter, the agreements automatically renew until terminated by either party by giving specified prior written notice to other party. Either party may terminate either of the agreements early in the event of a change in control of the other party, bankruptcy of the other party, or upon an uncured material breach by the other party. Either party has the right to terminate the distribution agreement with respect to any country upon prior written notice if the volume target is not met in such country for reasons beyond its control. In addition, Mundipharma has the right to terminate the distribution agreement in the event of material risk of personal injury to third parties or immediately by written notice with respect to any country if the

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market authorization for LODOTRA is cancelled, withdrawn or suspended in such country. We also have the right, subject to certain conditions, to terminate the distribution agreement with respect to any country in the territory if within a specified period of time, Mundipharma fails to submit appropriate filings to obtain marketing authorization in the country or fails to initiate a clinical trial required for marketing authorization in the country.

For the years ended December 31, 2012, 2011 and 2010, Mundipharma and Mundipharma Laboratories accounted for approximately 39%, 79% and 0%, respectively, of our consolidated gross sales.

Grünenthal Agreement

In June 2012, we entered into a collaboration, license and supply agreement with Grünenthal for the potential commercialization of DUEXIS in certain Latin American and Caribbean countries. Under the terms of the agreement, we will supply DUEXIS to Grünenthal exclusively in the territory at an agreed upon price and they will have the exclusive right to distribute DUEXIS in the territory. Subject to early termination, the term of the agreement is 10 years from launch with certain automatic 2-year renewal provisions.

Mallinckrodt Agreement

In June 2012, we entered into a co-promotion agreement with Mallinckrodt, the pharmaceutical business of Covidien, pursuant to which we engaged Mallinckrodt on a non-exclusive basis to promote DUEXIS in the United States, excluding any territories or possessions and excluding Puerto Rico. Under the terms of the Mallinckrodt agreement, Mallinckrodt has agreed to use commercially reasonable efforts to promote DUEXIS to an agreed list of physician promotion targets. Mallinckrodt is required to achieve minimum levels of prescriptions from targeted physicians on a quarterly basis during the term of the Mallinckrodt agreement, and we agreed not to grant to any third party the right to co-promote DUEXIS to those targeted physicians in the agreed upon territory during the term, other than an existing third party agreement that has since been terminated. Under the terms of the Mallinckrodt agreement, we are responsible for the manufacture, supply and distribution of DUEXIS.

The term of the Mallinckrodt agreement continues through December 31, 2014 subject to automatic six-month renewals unless either party provides advance notice that it does not wish to renew, unless the agreement is terminated early. Either party may terminate the agreement early if any governmental authority takes any action that would prevent performance or make performance illegal, if any third party asserts that commercialization of DUEXIS infringes an issued U.S. patent, upon a change of control of the other party or upon an uncured material breach by the other party. In addition, Mallinckrodt may terminate the agreement upon notice if a third party launches a generic version of DUEXIS, upon specified supply failures that are not cured, or upon breach of our agreement not to grant rights to co-promote DUEXIS to targeted physicians. In addition, each party may terminate the agreement upon certain failures to achieve minimum levels of prescriptions for a specified period of time. Under certain circumstances, we may owe Mallinckrodt a residual fee payment upon termination.

SkyePharma and Jagotec Agreements

Development and License Agreement

In August 2004, we entered into a development and license agreement with SkyePharma and Jagotec, a wholly-owned subsidiary of SkyePharma, regarding certain proprietary technology and know-how owned by SkyePharma for the delayed release of corticosteroids. The agreement replaced a similar agreement entered into between Merck and SkyePharma in 1998, which Merck assigned to us.

Under the agreement, which was amended in August 2007, we received an exclusive, sub-licensable worldwide license to the oral formulation of any corticosteroid, including prednisone, prednisolone, methylprednisolone and/or cortisone, with delayed release technology covered by intellectual property rights and

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know-how owned by SkyePharma. We were also granted an option to acquire a royalty-free, exclusive and sub-licensable right to license and manufacture RAYOS/LODOTRA which we can exercise any time upon specified prior written notice, expiring no earlier than five years after the first launch of RAYOS/LODOTRA. We have exercised the option to acquire the manufacturing license, which license will become effective in April 2014.

In return for the grant of the license, Jagotec has the right to manufacture, package and supply RAYOS/LODOTRA to us in accordance with terms and conditions of a separate manufacturing and supply agreement we entered into with Jagotec. In addition, Jagotec is entitled to receive a single digit percentage royalty on net sales of RAYOS/LODOTRA and on any sub-licensing income, which includes any payments not calculated based on the net sales of RAYOS/LODOTRA, such as license fees, and lump sum and milestone payments.

The agreement expires on the later of August 20, 2014 or, on a country-by-country basis, upon the expiration of the last patent rights for RAYOS/LODOTRA. In the event of expiration, the licenses under the agreement will be perpetual, fully paid-up and royalty-free. Either party may also terminate the agreement in the event of a liquidation or bankruptcy of the other party or upon an uncured breach by the other party.

Manufacturing and Supply Agreement

In August 2007, we entered into a manufacturing and supply agreement with Jagotec, an affiliate of SkyePharma AG, from whom we purchase RAYOS/LODOTRA. Under the agreement, which was amended in March 2011, Jagotec or its affiliates manufacture and supply RAYOS/LODOTRA to us in bulk. In August 2011, SkyePharma leased their entire pharmaceutical manufacturing business to Aenova, a large contract manufacturing organization. As such, Aenova is now a subcontractor for Jagotec for the manufacture of RAYOS/LODOTRA, with our consent. We are required to purchase RAYOS/LODOTRA exclusively from Jagotec for an agreed period of time, after which we will be able to purchase RAYOS/LODOTRA from other manufacturers if we choose. As of December 31, 2012 our total remaining minimum purchase commitment was approximately $3.2 million based on tablet pricing under the agreement as of that date, which amount is subject to volume and price adjustments due to, among other things, inflation, order quantities and launch and approval in certain European Union countries. We also supply the active pharmaceutical ingredient prednisone to Jagotec at our expense for use in the manufacture of RAYOS/LODOTRA.

We pay Jagotec, exclusive of any value added tax or similar governmental charges, a price for RAYOS/LODOTRA representing a negotiated mark-up over manufacturing costs. After a short initial period, the price will be adjusted annually to reflect changes in both manufacturing and materials costs as measured by the Ensemble price index.

If Jagotec makes a major capital expenditure during the contract term to fulfill increased orders forecast by us, the price per unit will increase if the actual order falls short of the forecast.

The agreement term extends until the end of the fifth year after the first launch of RAYOS/LODOTRA and automatically extends on a yearly basis unless terminated by either party upon prior written notice. Either party may also terminate the agreement in the event of insolvency, liquidation or bankruptcy of the other party or upon an uncured breach by the other party. We have the right to receive a continuing supply of RAYOS/LODOTRA from Jagotec for a period of 24 months after termination by Jagotec, regardless of the reason for termination.

Pursuant to a letter agreement between Jagotec and us, Jagotec agreed to allow us to give Bayer Pharma AG, or Bayer, the right to manufacture, test and release quantities of LODOTRA in order to establish and maintain Bayer as a manufacturer of LODOTRA. Under certain circumstances, we may also purchase shortfall quantities of LODOTRA from Bayer to the extent Jagotec is unable to supply us. We have entered into an agreement with Bayer effective March 1, 2013 to allow us to purchase quantities of LODOTRA for these purposes. After our manufacturing license from Jagotec becomes effective, we may also purchase quantities of LODOTRA from Bayer pursuant to our agreement with Bayer.

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Manufacturing and Supply Agreement with sanofi-aventis U.S. LLC

In May 2011, we entered into a manufacturing and supply agreement with sanofi-aventis U.S. Pursuant to the agreement, sanofi-aventis U.S. is obligated to manufacture and supply DUEXIS to us in final, packaged form, and we are obligated to purchase DUEXIS exclusively from sanofi-aventis U.S. for our commercial requirements of DUEXIS in North America and certain countries and territories in Europe, including the European Union member states and Scandinavia, and South America. Sanofi-aventis U.S. is obligated to acquire the components necessary to manufacture DUEXIS, including the active pharmaceutical ingredients DC85, which is ibuprofen in a direct compression blend, and famotidine, and is obligated to acquire all DC85 under the terms of any agreements we may have with suppliers for the supply of DC85. We expect ess days after such holders or the representative of such designated senior indebtedness receive notice of such acceleration and, thereafter, may pay the notes only if the subordination provisions of the indenture otherwise permit payment at that time.

By reason of the subordination provisions of the indenture, in the event of insolvency, our creditors who are holders of senior indebtedness may recover more, ratably, than the holders of the notes, and our creditors who are not holders of senior indebtedness or holders of senior subordinated indebtedness (including the notes) may recover less, ratably, than holders of senior indebtedness.

Limitation on Liens

The indenture provides that we may not incur any secured indebtedness that is not senior indebtedness unless contemporaneously therewith effective provision is made to secure the notes equally and ratably with (or on a senior basis to, in the case of indebtedness subordinated in right of payment to the notes) such secured indebtedness for so long as such secured indebtedness is secured by a lien.

Events of Default; Notice and Waiver

The following will be events of default under the indenture:

- we fail to pay principal when due upon redemption or otherwise on the notes, whether or not such payment is prohibited by the subordination provisions of the indenture;

we fail to pay any interest, including contingent interest and additional interest, if any, on the notes, when due and such failure continues for a period of 30 days, whether or not such payment is prohibited by the subordination provisions of the indenture;

we fail to convert the notes upon exercise of a holder's conversion right;

we fail to perform our obligation to provide notice of a designated event within 10 days after it has occurred;

we fail to perform or observe any of the covenants in the indenture for 60 days after notice from the trustee or holders of at least 25% in principal amount of the notes then outstanding (other than a failure to provide timely notice of a designated event);

we fail to perform or observe any of the covenants described under " Limitation of Liens" above for 30 days;

certain events involving our bankruptcy, insolvency or reorganization; or

default in the payment of principal when due at stated maturity of other indebtedness or acceleration of such other indebtedness for borrowed money where the aggregate principal amount with respect to which the default or acceleration has occurred exceeds $5 million, and such acceleration has not been rescinded or annulled within a period of 30 days after written notice as provided in the indenture.

The trustee may withhold notice to the holders of the notes of any default, except defaults in payment of principal, interest, including contingent interest or additional interest, if any, on the notes. However, the trustee must consider it to be in the interest of the holders of the notes to withhold this notice.

If an event of default occurs and continues, the trustee or the holders of at least 25% in principal amount of the outstanding notes may declare the principal, and accrued interest, including contingent interest and additional interest, if any, on the outstanding notes to be immediately due and payable. In case of certain events of bankruptcy or insolvency involving us, the principal, and accrued interest, including contingent interest and additional interest, if any, on the notes will automatically become due and payable. However, if we cure all defaults, except the nonpayment of principal, interest, including contingent interest and additional interest, if any, that became due as a result of the acceleration, and meet certain other conditions, with certain exceptions, this declaration may be cancelled and the holders of a majority of the principal amount of outstanding notes may waive these past defaults.

Payments of principal and accrued interest, including contingent interest and additional interest, if any, on the notes that are not made when due will accrue interest at the annual rate of 1% above the then applicable interest rate from the required payment date.

The holders of a majority of outstanding notes will have the right to direct the time, method and place of any proceedings for any remedy available to the trustee, subject to limitations specified in the indenture.

No holder of the notes may pursue any remedy under the indenture, except in the case of a default in the payment of principal or interest on the notes, unless:

the holder has given the trustee written notice of an event of default;

the holders of at least 25% in principal amount of outstanding notes make a written request, and offer reasonable indemnity, to the trustee to pursue the remedy;

the trustee does not receive an inconsistent direction from the holders of a majority in principal amount of the notes; and

the trustee fails to comply with the request within 60 days after receipt.

Modification and Waiver

The consent of the holders of a majority in principal amount of the outstanding notes is required to modify or amend certain provisions of the indenture. However, a modification or amendment requires the consent of the holder of each outstanding note if it would:

- extend the fixed maturity of any note;
- reduce the rate or extend the time for payment of interest, including contingent interest, or additional interest, if any, on any note;
- reduce the principal amount of any note;
- reduce any amount payable upon redemption or repurchase of any note;
- adversely change our obligation to repurchase any note at the option of a holder or upon a designated event;
- impair the right of a holder to institute suit for payment on any note;
- change the currency in which any note is payable;
- impair the right of a holder to convert any note or reduce the number of shares or the amount of any other property receivable upon conversion;
- reduce the quorum or voting requirements under the indenture;
- change any obligation of ours to maintain an office or agency in the places and for the purposes specified in the indenture;
- modify the subordination provisions of the indenture in a manner adverse to the holders;
- subject to specified exceptions, modify certain of the provisions of the indenture relating to modification or waiver of provisions of the indenture in a manner adverse to the holders; or
- reduce the percentage of notes required for consent to any modification of the indenture.

We are permitted to modify certain provisions of the indenture without the consent of the holders of the notes.

Form, Denomination and Registration

The notes are issued:

- in fully registered form;
- without interest coupons; and
- in denominations of $1,000 principal amount and multiples of $1,000.

Global Note, Book-Entry Form

The notes are evidenced by a global note that is deposited with DTC and registered in the name of Cede & Co. as DTC's nominee. Except as set forth below, the global note may be transferred, in whole or in part, only to another nominee of DTC or to a successor of DTC or its nominee.

Beneficial interests in the global note may be held through organizations that are participants in DTC (called "participants"). Transfers between participants will be effected in the ordinary way in accordance with DTC rules and will be settled in clearing house funds. The laws of some states require that certain persons take physical delivery of securities in definitive form. As a result, the ability to transfer beneficial interests in the global note to such persons may be limited.

Beneficial interests in a global note held by DTC may be held only through participants, or certain banks, brokers, dealers, trust companies and other parties that clear through or maintain a custodial relationship with a participant, either directly or indirectly (called "indirect participants"). So long as Cede & Co., as the nominee of DTC, is the registered owner of the global note, Cede & Co. for all purposes will be considered the sole holder of such global note. Except as provided below, owners of beneficial interests in the global note:

- are not be entitled to have certificates registered in their names;
- will not receive physical delivery of certificates in definitive registered form; and
- are not be considered holders of the global note.

We will pay interest, including contingent interest, if any, on and the redemption price and the repurchase price of the global note to Cede & Co., as the registered owner of the global note, by wire transfer of immediately available funds on each interest payment date or the redemption or repurchase date, as the case may be. Neither we, the trustee nor any paying agent will be responsible or liable:

- for the records relating to, or payments made on account of, beneficial ownership interests in a global note; or
- for maintaining, supervising or reviewing any records relating to the beneficial ownership interests.

Neither we, the trustee, registrar, paying agent nor conversion agent will have any responsibility for the performance by DTC or its participants or indirect participants of their respective obligations under the rules and procedures governing their operations. DTC has advised us that it will take any action permitted to be taken by a holder of notes, including the presentation of notes for conversion, only at the direction of one or more participants to whose account with DTC interests in the global note are credited, and only in respect of the principal amount of the notes represented by the global note as to which the participant or participants has or have given such direction.

DTC has advised us that it is:

- a limited purpose trust company organized under the laws of the State of New York, and a member of the Federal Reserve System;
- a "clearing corporation" within the meaning of the Uniform Commercial Code; and
- a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes to the accounts of its participants. Participants include securities brokers, dealers, banks, trust companies and clearing corporations and other organizations. Some of the participants or their representatives, together with other entities, own DTC. Indirect access to the DTC system is available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly.

DTC has agreed to the foregoing procedures to facilitate transfers of interests in the global note among participants. However, DTC is under no obligation to perform or continue to perform these procedures, and may discontinue these procedures at any time.

We will issue notes in fully registered definitive certificate form only if:

DTC notifies us that it is unwilling or unable to continue as depositary or DTC ceases to be a clearing agency registered under the Securities and Exchange Act of 1934, as amended, and a successor depositary is not appointed by us within 90 days; or

an event of default shall have occurred and the maturity of the notes shall have been accelerated in accordance with the terms of the notes and any holder shall have requested in writing the issuance of definitive certificated notes.

The notes represented by the global securities are eligible to trade in DTC's Same-Day Funds Settlement System, and any permitted secondary market trading activity in such notes will, therefore, be required by DTC to be settled in immediately available funds. We expect that secondary trading in any certificated securities will also be settled in immediately available funds.

Listing and trading

We have not applied, and do not intend to apply, for listing of the notes on any securities exchange. Our common stock is listed on the New York Stock Exchange under the symbol "LAD."

Registration Rights of the Noteholders

We entered into a registration rights agreement with the initial purchasers for the benefit of the holders of the notes and the common stock issuable on common stock issuable on conversion of the notes. We filed a registration statement with the SEC covering resale of the registrable securities within 90 days after the closing date. Under this agreement, we have agreed to use our best efforts to cause the shelf registration statement to become effective within 180 days of the closing date. We further agreed to use our best efforts to keep the shelf registration statement effective until the date there are no longer any registrable securities.

When we use the term "registrable securities" in this section, we are referring to the notes and the common stock issuable upon conversion of the notes until the earliest of:

the effective registration under the Securities Act and the resale of such securities in accordance with the registration statement;

the sale of such securities to the public pursuant to Rule 144 under the Securities Act, or any similar provision then in force; and

the expiration of the holding period under Rule 144(k) under the Securities Act, or any successor provision.

We may suspend the use of the prospectus under certain circumstances relating to pending corporate developments, public filings with the SEC and similar events. Any suspension period shall not exceed:

30 days in any three-month period; or

an aggregate of 90 days for all periods in any 12-month period.

Notwithstanding the foregoing, we will be permitted to suspend the use of the prospectus for up to 60 days in any three-month period or an aggregate of 120 days for all periods in any 12-month period under certain circumstances relating to possible acquisitions, financings or other similar transactions or reviews by the SEC of our periodic reports.

We will pay predetermined additional interest if the shelf registration statement is not timely made effective or if the prospectus is unavailable for periods in excess of those permitted above:

on the notes at an annual rate equal to 0.25% of the aggregate principal amount of the notes outstanding for the first 90-day period immediately following the failure to keep effective a shelf registration statement or the failure to make the prospectus available for periods described above, and such rate will increase to 0.50% per annum thereafter until the registration statement is filed or made effective or until the prospectus is available; and

on the common stock that has been converted, at an annual rate equal to 0.25% of an amount equal to $1,000 divided by the conversion rate during such periods for the first 90-day period immediately following the failure to keep effective a shelf registration statement or the failure to make the prospectus available for periods described above, and such rate will increase to 0.50% per annum thereafter until the registration statement is filed or made effective or until the prospectus is available.

In no event will additional interest accrue at a rate per annum exceeding 0.50%.

A holder who elects to sell registrable securities pursuant to the shelf registration statement of which this prospectus forms a part is required to:

be named as a selling stockholder in this prospectus;

deliver a prospectus to purchasers; and

be subject to the provisions of the registration rights agreement, including indemnification provisions.

Under the registration rights agreement we will:

pay all customary expenses of the shelf registration statement;

provide each registered holder copies of this prospectus;

notify holders when the shelf registration statement has become effective; and

take other reasonable actions as are required to permit unrestricted resales of the registrable securities in accordance with the terms and conditions of the registration rights agreement.

Information Concerning the Trustee

We have appointed U.S. Bank National Association, the trustee under the indenture, as paying agent, conversion agent, note registrar and custodian for the notes. Except for the contents of this section, the trustee has not reviewed or participated in the preparation of this prospectus and does not assume any responsibility for the nature, completeness, contents or accuracy of this document.

The trustee or its affiliates may provide banking and other services to us in the ordinary course of their business. The indenture contains certain limitations on the rights of the trustee, if it or any of its affiliates is then our creditor, to obtain payment of claims in certain cases or to realize on certain property received on any claim as security or otherwise. The trustee and its affiliates will be permitted to engage in other transactions with us. However, if the trustee or any affiliate continues to have any conflicting interest and a default occurs with respect to the notes, the trustee must eliminate such conflict or resign.

Additional information about the trustee may be found at U.S. Bank's website at http://www.usbank.com/corporatetrust. The U.S. Bank website is not incorporated into this prospectus by such reference and is not a part hereof.

Governing Law

The notes and the indenture will be governed by, and construed in accordance with, the laws of the State of New York.

DESCRIPTION OF CAPITAL STOCK

Our authorized capital stock consists of 100,000,000 shares of Class A common stock, 25,000,000 shares of Class B common stock and 15,000,000 shares of preferred stock, each with no par value.

Common Stock

Each share of common stock is designated as either Class A common stock or Class B common stock. As of June 30, 2004, there were 14,986,742 shares of Class A common stock outstanding and 3,762,231 shares of Class B common stock outstanding. All of the outstanding Class B common stock is held by Lithia Holding Company, LLC.

Voting

Holders of Class B common stock are entitled to ten votes for each share held, while holders of Class A common stock are entitled to one vote for each share held. The Class A common stock and Class B common stock vote together as a single class on all matters submitted to a vote of stockholders including the election of directors.

The Oregon Business Corporation Act, however, entitles either the Class A common stock or the Class B common stock to vote as a separate voting group on any proposed amendment of our Articles of Incorporation otherwise requiring stockholder approval if the proposed amendment would:

increase or decrease the aggregate number of authorized shares of the class;

effect an exchange or reclassification of all or part of the shares of the class into shares of another class or create a right to do so;

change the shares of all or part of the class into a different number of shares of the same class;

create a new class having rights or preferences with respect to distributions or dissolution that are prior to superior or substantially equal to shares of the class; or

otherwise alter the rights, preferences or limitations of all or part of the shares of the class.

Shares of the two classes of common stock do not have cumulative voting rights with respect to the election of directors.

Lithia Holding Company, LLC holds shares of Class B common stock controlling 71.5% of the aggregate number of votes eligible to be cast by stockholders for the election of directors and on all other actions to be taken by the stockholders, except as noted above. Therefore, Lithia Holding controls the election of the Board of Directors and will be in a position to control the policies and operations of our company. Currently, Sidney B. DeBoer is the sole manager of Lithia Holding and can direct the voting of all Class B common stock.

Dividends and Other Rights

Subject to the preferences applicable to any preferred stock outstanding at the time, holders of shares of common stock are entitled to dividends if, when and as declared by the Board of Directors from funds legally available therefor, and are entitled, in the event of liquidation, to share ratably in all assets remaining after payment of liabilities and preferred stock preferences, if any. Each share of Class A common stock and Class B common stock will be treated equally with respect to dividends and distributions.

No additional shares of Class B common stock can be issued without the prior approval of stockholders holding a majority of all Class A common stock outstanding, except in conjunction with stock splits, stock dividends, reclassification and similar transactions and events regarding the Class A

common stock that would otherwise have the effect of changing conversion rights of the Class B common stock relative to the Class A common stock.

Holders of common stock have no preemptive rights nor rights to subscribe for additional securities. Shares of common stock are not redeemable and there are no sinking fund provisions. Shares of Class A common stock are not convertible into any other series or class of our securities. Subject to adjustments for stock splits, stock dividends, reclassification and similar transactions and events, each share of Class B common stock is freely convertible into one share of Class A common stock at the option of the holder. Each share of Class B common stock shall automatically convert to shares of Class A common stock on a share-for-share basis on the earliest record date for an annual meeting of our stockholders on which the number of shares of Class B common stock outstanding is less than 1% of the total number of shares of common stock outstanding.

Shares of Class B common stock may not be transferred to third parties except for transfers to certain family members and in other limited circumstances. Any purported transfer of Class B common stock to a person who is not a permitted transferee under our Articles of Incorporation is automatically void.

Preferred Stock

The Board of Directors may, without further action of our stockholders, issue shares of preferred stock in one or more series and fix the rights and preferences thereof, including the dividend rights, dividend rates, conversion rights, voting rights, rights and terms of redemption and sinking fund provisions, redemption price or prices, liquidation preferences and the number of shares constituting any series or the designations of such series, and increase or decrease the number of shares of any such series (but not below the number of such shares then outstanding). The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of holders of any preferred stock that may be issued in the future. Issuance of preferred stock provides desirable flexibility in connection with possible acquisitions and other corporate purposes. However, the Board of Directors, without further stockholder approval, can issue preferred stock with voting and conversion rights that would adversely affect the voting power and other rights of the holders of common stock. In addition, the Board of Directors can issue and sell shares of preferred stock to designated persons, the impact of which could make it more difficult for a holder of a substantial block of common stock to remove incumbent directors or otherwise gain control of Lithia. We have no present plans to issue any shares of preferred stock.

Oregon Corporate Law

We are subject to the Oregon Control Share Act, under which a person who acquires voting stock in a transaction which results in such person holding more than 20%, 33 1/3% or 50% of the total voting power cannot vote the shares it acquires in the acquisition unless voting rights are accorded to such control shares by the holders of a majority of the outstanding voting shares, excluding the control shares held by such person and shares held by our officers and inside directors, and by the holders of a majority of the outstanding voting shares, including shares held by our officers and inside directors. This vote would be required at the time an acquiring person's holdings exceed 20% of the total voting power, and again at the time the acquiring person's holdings exceed 33 1/3% and 50%, respectively. An acquiring person can include persons acting as a group. A transaction in which voting power is acquired solely by receipt of an immediately revocable proxy does not constitute an acquisition covered by the provisions of the Oregon Business Corporation Act described here. The acquiring person may, but is not required to, submit to us an "Acquiring Person Statement" setting forth certain information about the acquiring person and its plans with respect to us. The Acquiring Person Statement may also request that we call a special meeting of stockholders to determine whether the control shares will be allowed to retain voting rights. If the acquiring person does not request a special meeting of stockholders, the

issue of voting rights of control shares will be considered at the next annual meeting or special meeting of stockholders that is held more than 60 days after the date of the acquisition of control shares. If the acquiring person's control shares are accorded voting rights and represent a majority or more of all voting power, stockholders who do not vote in favor of the restoration of such voting rights will have the right to receive the appraised "fair value" of their shares, which may not be less than the highest price paid per share by the acquiring person for the control shares.

We are also subject to the Oregon Business Combination Act, which generally provides that in the event a person or entity acquires 15% or more of our voting stock, we and such person or entity, or any affiliated entity, may not engage in the following business combination transactions for a period of three years following the date the person became acquired 15% or more of the voting stock:

- a merger or plan of share exchange;
- any sale, lease, mortgage or other disposition of the assets of the corporation where the assets have an aggregate market value equal to 10% or more of the aggregate market value of our assets or outstanding capital stock; and
- transactions that result in the issuance of our capital stock to the stockholder that acquired 15% or more of the voting stock.

These restrictions do not apply if:

- the stockholder that acquired 15% or more of the voting stock, as a result of such acquisition, owns at least 85% of our outstanding voting stock disregarding shares owned by directors who are also officers and certain employee benefit plans;
- the Board of Directors approves the share acquisition or business combination before the stockholder acquired 15% or more of our voting stock; or
- the Board of Directors and the holders of at least two-thirds of our outstanding voting stock, disregarding shares owned by the Interested Stockholder, approve the transaction after the stockholder acquires 15% or more of our voting stock.

The Oregon Control Share Act and the Oregon Business Combination Act will have the effect of encouraging any potential acquirer to negotiate with our Board of Directors and will also discourage potential acquirers unwilling to comply with the provisions of these laws. An Oregon corporation may provide in its articles of incorporation or bylaws that the laws described above do not apply to its shares. We have not adopted such a provision and do not currently intend to do so. These laws may make us less attractive for takeover, and thus stockholders may not benefit from a rise in the price of our Class A common stock that a takeover could cause.

Limitation of Liability and Indemnification

As allowed by the Oregon Business Corporation Act, our Articles of Incorporation provide that the liability of our directors for monetary damages will be eliminated to the fullest extent permissible under Oregon law. This is intended to eliminate the personal liability of a director for monetary damages in an action brought by or in the right of our company for breach of a director's duties to us or our stockholders except for liability:

- for any breach of the director's duty of loyalty to us or our stockholders;
- for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- for any unlawful distribution to stockholders; or
- for any transaction from which the director derived an improper personal benefit.

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This provision does not limit or eliminate our rights or any stockholder's rights to seek non-monetary relief, such as an injunction or rescission, in the event of a breach of a director's duty of care. This provision also does not affect the director's responsibilities under any other laws, such as the federal or state securities or environmental laws.

Our Articles of Incorporation and the Bylaws also provide that we shall indemnify, to the fullest extent permitted under Oregon law, any person who has been made, or is threatened to be made, a party to an action, suit or legal proceeding by reason of the fact that the person is or was a director or officer of ours. Our Articles provide that we shall indemnify directors and officers against certain liabilities that may arise by reason of their status or service as a director or officer and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified.

Transfer Agent

The transfer agent and registrar for the Class A common stock is Computershare Trust Company, Inc., Golden, Colorado.

MATERIAL UNITED STATES FEDERAL TAX CONSIDERATIONS

General

This is a summary of certain material U.S. federal income tax consequences relevant to holders of the notes. This summary is based upon the Internal Revenue Code of 1986, as amended (the "Code"), administrative pronouncements, judicial decisions and existing and proposed Treasury regulations now in effect, all of which are subject to change (possibly with retroactive effect) or differing interpretations. The discussion below deals only with notes held as capital assets and does not purport to deal with persons in special tax situations, such as financial institutions, insurance companies, regulated investment companies, dealers in securities or currencies, certain U.S. expatriates, entities generally exempt from U.S. federal income tax, persons holding notes in a tax deferred or tax-advantaged account, as a position in a "straddle" or as part of a "hedge," "conversion" or other risk-reduction transaction for tax purposes, or persons who have ceased to be U.S. citizens or to be taxed as resident aliens. Persons considering the purchase of the notes should consult their own tax advisors concerning the application of the U.S. federal income tax laws to their particular situations as well as any consequences of the purchase, ownership and disposition of the notes arising under the laws of any state, local, foreign or other taxing jurisdiction.

We do not address all of the tax consequences that may be relevant to a holder of notes. In particular, we do not address:

- the U.S. federal income tax consequences to stockholders in, or partners or beneficiaries of, an entity that is a holder of notes;
- the U.S. federal estate, gift or alternative minimum tax consequences of the purchase, ownership or disposition of notes;
- any state, local or foreign tax consequences of the purchase, ownership or disposition of notes; and
- any U.S. federal, state, local or foreign tax consequences of owning or disposing of common stock.

The U.S. federal income tax treatment of a partner in a partnership (or other entity classified as a partnership for U.S. federal income tax purposes) that holds the notes generally will depend on such partner's particular circumstances and on the activities of the partnership. Partners in such partnerships should consult their own tax advisors.

We urge prospective investors to consult their own tax advisors with respect to the tax consequences to them of the purchase, ownership and disposition of notes in light of their own particular circumstances, including the tax consequences under state, local, foreign and other tax laws and the possible effects of changes in U.S. federal or other tax laws.

Classification of the Notes

Pursuant to the terms of the indenture, we and every holder agree (in the absence of administrative pronouncement or judicial ruling to the contrary), for U.S. federal income tax purposes, to treat the notes as debt instruments that are subject to the Treasury regulations governing contingent payment debt instruments (the "contingent debt regulations") and to be bound by our application of the contingent debt regulations to the notes, including our determination of the rate at which interest will be deemed to accrue on the notes and the related "projected payment schedule" determined by us as described below, and our treatment of the fair market value of any common stock received upon conversion of a note as a contingent payment.

No statutory or judicial authority directly addresses the treatment of the notes or instruments similar to the notes for United States federal income tax purposes. The Internal Revenue Service (the "IRS") has issued a revenue ruling with respect to instruments having certain features similar to the notes. To the extent the ruling addresses the issue, this ruling supports certain aspects of the treatment as described below. Notwithstanding the issuance of this ruling, the proper application of certain aspects of the contingent debt regulations to the notes is not entirely certain. In addition, no ruling has been or is expected to be sought from the IRS with respect to the U.S. federal income tax consequences discussed below. The IRS would not be precluded from taking contrary positions. As a result, no assurance can be given that the IRS will agree with all of the tax characterizations and the tax consequences described below. You should be aware that different treatment from that described below could affect the amount, timing, source and character of income, gain or loss with respect to an investment in the notes. For example, a holder might be required to accrue interest income at a higher or lower rate, might not recognize income, gain or loss upon conversion of a note into common stock, and might recognize capital gain or loss upon a taxable disposition of a note. Holders should consult their tax advisors concerning the tax treatment of holding a note.

The remainder of this discussion assumes that the notes are treated as indebtedness subject to the contingent debt regulations.

U.S. Holders

For purposes of this discussion, a U.S. Holder is a beneficial owner of the notes who or which is for U.S. federal income tax purposes:

- a citizen or individual resident of the United States;
- a corporation, including any entity treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate if its income is subject to U.S. federal income taxation regardless of its source; or
- a trust if (a) a U.S. court can exercise primary supervision over its administration and (b) one or more U.S. persons have the authority to control all of its substantial decisions.

Notwithstanding the preceding sentence, certain trusts in existence on August 20, 1996, and treated as U.S. persons prior to such date, may also be treated as U.S. Holders.

Accrual of Interest on the Notes

Pursuant to the contingent debt regulations, U.S. Holders of the notes are required to accrue interest income on the notes on a constant-yield basis, based on a comparable yield to maturity as described below, regardless of whether such holders use the cash or accrual method of tax accounting. As such, U.S. Holders generally will be required to include interest in income each year in excess of any stated interest payments actually received in that year.

The contingent debt regulations provide that a U.S. Holder must accrue an amount of ordinary interest income, as original issue discount for U.S. federal income tax purposes, for each accrual period prior to and including the maturity date of the notes that equals:

1. the product of (a) the adjusted issue price (as defined below) of the notes as of the beginning of the accrual period and (b) the comparable yield to maturity (as defined below) of the notes, adjusted for the length of the accrual period;

2. divided by the number of days in the accrual period; and

3. multiplied by the number of days during the accrual period that the U.S. Holder held the notes.

A note's issue price is the first price at which a substantial amount of the notes is sold to the public, excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers. The adjusted issue price of a note is its issue price increased by any interest income previously accrued, determined without regard to any adjustments to interest accruals described below, and decreased by the projected amount of any payments (in accordance with the projected payment schedule described below) previously made with respect to the notes.

The term "comparable yield" as used in the contingent debt regulations means the annual yield we would pay, as of the issue date, on a fixed-rate, nonconvertible debt instrument with no contingent payments, but with terms and conditions otherwise comparable to those of the notes. We have determined that the comparable yield for the notes is 9.0%, compounded semi-annually. The precise manner of calculating the comparable yield is not entirely clear. If our determination of the comparable yield were successfully challenged by the IRS, the redetermined yield could be materially greater or less than the comparable yield determined by us.

The contingent debt regulations require that we provide to U.S. Holders, solely for U.S. federal income tax purposes, a schedule of the projected amounts of payments (which we refer to as "projected payments") on the notes. This schedule must produce a yield to maturity that equals the comparable yield. The projected payment schedule includes estimates for contingent interest payments and an estimate for a payment at maturity taking into account the conversion feature. In this connection, the fair market value of any common stock (and cash, if any) received by a holder upon conversion will be treated as a contingent payment. The comparable yield and the projected payment schedule will be set forth in the indenture. U.S. Holders also may obtain the projected payment schedule by submitting a written request for such information to us at: Lithia Motors, Inc., Investor Relations Department, 360 E. Jackson Street, Medford, Oregon 97501.

By purchasing the notes, U.S. Holders agree in the indenture to be bound by our determination of the comparable yield and projected payment schedule and agree to use the comparable yield and projected payments schedule in determining its interest accruals, and the adjustments thereto described below, in respect of the notes for U.S. federal income tax purposes.

The comparable yield and the projected payment schedule are not used for any purpose other than to determine a holder's interest accruals and adjustments thereto in respect of the notes for U.S.

federal income tax purposes. They do not constitute a projection or representation regarding the actual amounts payable on the notes.

We may be required to make payments of additional interest if we do not file or cause to be declared effective a registration statement, as described under "Description of the Notes Registration Rights of the Noteholders." We intend to take the position for U.S. federal income tax purposes that any payments of additional interest should be taxable to U.S. Holders as additional ordinary income when received or accrued, in accordance with their method of tax accounting. If we do fail to file or cause to be declared effective a registration statement, U.S. Holders should consult their tax advisers concerning the appropriate tax treatment of the payment of additional interest with respect to the notes.

Adjustments to Interest Accruals on the Notes

If, during any taxable year, a U.S. Holder of notes receives actual payments with respect to such notes that, in the aggregate, exceed the total amount of projected payments for that taxable year, the U.S. Holder will incur a "net positive adjustment" under the contingent debt regulations equal to the amount of such excess. The U.S. Holder will treat a net positive adjustment as additional interest income in that taxable year. For the purpose, the payment in a taxable year include the fair market value of property (including common stock received upon conversion or repurchase of the notes) received in that year.

If a U.S. Holder receives in a taxable year actual payments with respect to the notes that, in the aggregate, are less than the amount of projected payments for that taxable year, the U.S. Holder will incur a "net negative adjustment" under the contingent debt regulations equal to the amount of such deficit. This net negative adjustment will (a) reduce the U.S. Holder's interest income on the notes for that taxable year, and (b) to the extent of any excess after the application of (a), give rise to an ordinary loss to the extent of the U.S. Holder's interest income on the notes during prior taxable years, reduced to the extent such interest was offset by prior net negative adjustments.

A net negative adjustment is not subject to the two percent floor limitation on miscellaneous itemized deductions under Section 67 of the Code. Any net negative adjustment in excess of the amounts described in (a) and (b) will be carried forward as a negative adjustment to offset future interest income with respect to the notes or to reduce the amount realized on a sale, exchange, conversion or retirement of the notes.

Since amounts of contingent interest payments with respect to the notes will become fixed more than six months prior to the date that such interest is payable, the U.S. Holder will be required under the contingent debt regulations to take the adjustment into account at the time the contingent interest payment becomes fixed. The amount of the U.S. Holder's adjustment will be measured by the difference between the present value of the amount of contingent interest that becomes fixed and the present value of the projected contingent interest payment, with present values being determined by discounting each amount from the date that the contingent interest is due to the date that the contingent interest becomes fixed using a discount rate equal to the comparable yield, as discussed above. The adjustment will be treated as a positive or negative adjustment, as appropriate. Any positive or negative adjustment required will increase or decrease, respectively, the adjusted issue price and basis of the U.S. Holder's notes at the time the contingent interest becomes fixed. On the date a contingent payment is fixed, the projected payment schedule for the debt instrument is modified prospectively to reflect the fixed amount of the payment such that upon receipt of the contingent interest payment, the adjusted issue price and basis of the U.S. Holder's note will effectively be reduced by the amount of the contingent interest payment.

Sale, Exchange, Conversion or Redemption of Notes

Generally the sale, exchange, conversion, repurchase or redemption of a note will result in taxable gain or loss to a U.S. Holder. As described above, our calculation of the comparable yield and the projected payment schedule for the notes includes the receipt of stock upon conversion as a contingent payment with respect to the notes. Accordingly, we intend to treat the receipt of common stock by a U.S. Holder upon the conversion of a note as a payment under the contingent debt regulations. As described above, a U.S. Holder agrees to be bound by our determination of the comparable yield and projected payment schedule. Under this treatment, a conversion of a note into common stock also will result in taxable gain or loss to a U.S. Holder. The amount of gain or loss on a sale, exchange, conversion or redemption of a note will be equal to the difference between (a) the amount of cash plus the fair market value of any other property received by the U.S. Holder, including the fair market value of any common stock received, and (b) the U.S. Holder's adjusted tax basis in the note.

A U.S. Holder's adjusted tax basis in a note generally will be equal to the U.S Holder's original purchase price for the note, increased by any interest income previously accrued by the U.S. Holder (determined without regard to any adjustments to interest accruals described above) and decreased by the amount of any projected payments that previously have been scheduled to be made in respect of the notes (without regard to the actual amount paid).

Gain recognized by a U.S. Holder upon a sale, exchange, conversion or redemption of a note generally will be treated as ordinary interest income; any loss will be ordinary loss to the extent of total net interest previously included in income by the U.S. Holder in respect of the note, and thereafter capital loss (which will be long-term if the note is held for more than one year). The deducibility of capital losses is subject to limitations.

A U.S. Holder's tax basis in common stock received upon a conversion of a note will equal the then current fair market value of such common stock. The U.S. Holder's holding period for the common stock received will commence on the day immediately following the date of conversion.

If a U.S. Holder purchases a note at a discount or premium to the adjusted issue price, so that such Holder's tax basis in the note differs from the adjusted issue price of the note at the time of the acquisition, the normal rules for accrual of premium or discount generally will not apply. Instead, the U.S. Holder must reasonably allocate such difference to (i) daily portions of interest, or (ii) the projected payment at maturity. An allocation to daily portions of interest should be reasonable to the extent that the difference is due to a change in the yield, at such acquisition date, at which we could issue a nonconvertible fixed rate debt instrument with no contingent payments, but with terms otherwise similar to those of the notes. An allocation to the projected payment at maturity should be reasonable to the extent that the anticipated value of our common stock at maturity, determined on the basis of the market conditions at the acquisition date, differs from the anticipated value of our common stock as it has been determined on the basis of market conditions which prevailed at the time of original issuance.

If a U.S. Holder's tax basis in a note is greater than the adjusted issue price of the note, the amount of the difference allocated to a daily portion of interest or to the projected payment will be treated as a negative adjustment on the date the daily portion accrues or the payment is made. On the date of the adjustment, the U.S. Holder's adjusted tax basis in the note will be reduced by the amount the U. S. Holder treats as a negative adjustment. If a U.S. Holder's tax basis in a note is less than the adjusted issue price of the note, the amount of the difference allocated to a daily portion of interest or to the projected payment will be treated as a positive adjustment on the date the daily portion accrues or the payment is made. On the date of the adjustment, the U.S. Holder's adjusted tax basis in the note will be increased by the amount the U.S. Holder treats as a positive adjustment.

A U.S. Holder who purchases notes for an amount that is more or less than the adjusted issue price of the notes should consult its tax advisor regarding the adjustments described above.

Constructive Dividends to Holders of Notes

If at any time we were to make a distribution of cash or property to our stockholders that would be taxable to the stockholders as a dividend for U.S. federal income tax purposes and, in accordance with the anti-dilution provisions of the notes, the conversion rate of the notes were increased, such increase will be deemed to be the payment of a taxable dividend to holders of the notes to the extent of our current and accumulated earnings and profits, notwithstanding the fact that the holders do not receive a cash payment.

If the conversion rate is increased at our discretion or in certain other circumstances, such increase also may be deemed to be the payment of a taxable dividend to holders, notwithstanding the fact that the holders do not receive a cash payment. In certain circumstances the failure to make an adjustment of the conversion rate under the indenture may result in a taxable distribution to holders of our common stock. Any deemed distribution will be taxable as a dividend, return of capital or capital gain in accordance with the tax rules applicable to corporate distributions, but may not be eligible for the reduced rates of tax applicable to certain dividends paid to individual holders nor to the dividends-received deduction applicable to certain dividends paid to corporate holders.

Backup Withholding Tax and Information Reporting

Payments of principal, premium, if any, and interest (including original issue discount and a payment in common stock pursuant to a conversion of a note) on, and the proceeds of dispositions of, the notes or shares of our common stock may be subject to information reporting and U.S. federal backup withholding tax (currently, at the rate of 28%) if the U.S. Holder thereof fails to supply an accurate taxpayer identification number or otherwise fails to comply with applicable U.S. information reporting or certification requirements. Backup withholding is not an additional tax. Any amounts so withheld will be allowed as a credit against a U.S. Holder's U.S. federal income tax liability and may entitle a holder to a refund, provided the required information is timely furnished to the IRS.

SELLING SECURITYHOLDERS

The notes were originally issued by us and sold by Morgan Stanley & Co. Incorporated, Stephens Inc., Raymond James & Associates, Inc., and Jefferies & Company, Inc. (the "initial purchasers") in transactions exempt from the registration requirements of the Securities Act to persons reasonably believed by the initial purchasers to be "qualified institutional buyers" as defined by Rule 144A under the Securities Act. The selling securityholders may from time to time offer and sell pursuant to this prospectus any or all of the notes listed below and the shares of common stock issued upon conversion of such notes. When we refer to the "selling securityholders" in this prospectus, we mean those persons listed in the table below, as well as the pledgees, donees, assignees, transferees, successors and others who later hold any of the selling securityholders' interests.

The table below sets forth the name of each selling securityholder, the principal amount at maturity of notes that each selling securityholder may offer pursuant to this prospectus and the number of shares of common stock into which such notes are convertible. To our knowledge, none of the selling securityholders has, or within the past three years has had, any material relationship with us or any of our predecessors or affiliates or beneficially owns in excess of 1% of the outstanding common stock.

The principal amounts of the notes provided in the table below is based on information provided to us by each of the selling securityholders and the percentages are based on $85 million principal amount at maturity of notes outstanding. The number of shares of common stock that may be sold is calculated based on the current conversion price of $37.69 per share.

Since the date on which each selling securityholder provided this information, each selling securityholder identified below may have sold, transferred or otherwise disposed of all or a portion of its notes in a transaction exempt from the registration requirements of the Securities Act. Information concerning the selling securityholders may change from time to time and any changed information will be set forth in supplements to this prospectus to the extent required. In addition, the conversion ratio, and therefore the number of shares of our common stock issuable upon conversion of the notes, is subject to adjustment. Accordingly, the number of shares of common stock issuable upon conversion of the notes may increase or decrease.

Any or all of the notes or shares of our common stock listed below may be offered for sale pursuant to this prospectus by the selling securityholders from time to time. Accordingly, no estimate

can be given as to the amounts of notes or our common stock that will be held by the selling securityholders upon consummation of any such sales.

Name	Original Principal Amount of Notes Beneficially Owned That May Be Sold	Percentage of Notes Oustanding Before Offering	Number of Shares of Common Stock Held Before Offering(1)	Number of Shares of Common Stock Offered for Sale(1)	Number of Shares of Common Stock Held After Offer(2)
Alexandra Global Master Fund, Ltd	$ 5,000,000	5.88%	132,665	132,665	
Argent Classic Convertible Arbitrage Fund (Bermuda) Ltd.	2,000,000	2.35%	53,066	53,066	
Bear, Stearns & Co., Inc.	1,500,000	1.76%	39,799	39,799	
Calamos® Market Neutral Fund Calamos® Investment Trust	2,800,000	3.29%	74,292	74,292	
CIBC World Markets	757,000	*	20,085	20,085	
CNH CA Master Account, LP	500,000	*	13,266	13,266	
Consulting Group Capital Markets Funds	200,000	*	5,306	5,306	
Context Convertible Arbitrage Fund LP	1,450,000	1.71%	38,472	38,472	
Context Convertible Arbitrage, Offshore, Ltd	3,250,000	3.82%	86,232	86,232	
CQS Convertible And Quantitative Strategies Master Fund Ltd	1,500,000	1.76%	39,799	39,799	
DBAG London	8,311,000	9.78%	220,516	220,516	
Deephaven Domestic Convertible Trading Ltd.	3,113,000	3.66%	82,597	82,597	
DKR SoundShore Oasis Holding Fund Ltd	500,000	*	13,266	13,266	
DKR SoundShore Opportunity Holding Fund Ltd.	1,750,000	2.06%	46,432	46,432	
Geode U.S. Convertible Arbitrage Fund	3,500,000	4.12%	92,865	92,865	
Global Bermuda Limited Partnership	700,000	*	18,573	18,573	
Grace Convertible Arbitrage Fund, CTA	4,000,000	4.71%	106,132	106,132	
Highbridge International LLC	8,000,000	9.41%	212,264	212,264	
Institutional Benchmark Master Fund	1,000,000	1.18%	26,533	26,533	
Institutional Benchmarks Master Fund Ltd	2,000,000	2.35%	53,066	53,066	
Lakeshore International, Ltd.	2,800,000	3.29%	74,292	74,292	
Lighthouse Multi-Strategy Master Fund Ltd.	50,000	*	1,326	1,326	
Lyxor/Quest Fund Ltd.	150,000	*	3,979	3,979	
McMahan Securities Co. L.P.	500,000	*	13,266	13,266	
Mellon HBV Master Convertible Arbitrage Fund LP	255,000	*	6,765	6,765	
Mellon HBV Master Leveraged Multi-Strategy Fund LP	35,000	*	928	928	
Mellon HBV Master Multi-Strategy Fund LP			1,326	1,326	
Mint Master Fund Ltd.	50,000	*	1,326	1,326	
National Bank of Canada	600,000	*	15,919	15,919	
National Bank of Canada c/o Putnam Lovell NBK Securities, Inc.	3,000,000	3.53%	79,599	79,599	
Polaris Vega Fund L.P.	250,000	*	6,633	6,633	
Quest Global Convertible Fund Ltd.	300,000	*	7,959	7,959	
Sphinx Convertible Arbitrage Fund SPC	137,000	*	3,635	3,635	
Sunrise Partners Limited Partnership	250,000	*	6,633	6,633	19,460
Univest Convertible Arbitrage Fund II Ltd (Norshield)	200,000	*	5,306	5,306	
Vicis Capital Master Fund	565,000	*	14,991	14,991	
Victus Capital, LP	2,260,000	2.66%	59,964	59,964	
White River Securities LLC	1,500,000	1.76%	39,799	39,799	
Whitebox Diversified Convertible Arbitrage Partners LP	1,500,000	1.76%	39,799	39,799	
Zazore Convertible Arbitrage Fund L.P.	2,000,000	2.35%	53,066	53,066	
All other holders of notes or future transferees, pledges or donees or their successors(3)	16,767,000	(3)	(3)	444,880	(3)
Total	$ 85,000,000	100%	2,274,773(4)	2,255,313(4)	19,460

*

Represents less than 1.0%.

(1)

The number of conversion shares shown in the table above assumes conversion of the full amount of notes held by such holder at the initial conversion rate of 26.5331 shares per $1,000 principal amount at maturity of notes. This conversion rate is subject to certain adjustments. Accordingly, the number of shares of common stock issuable upon conversion of the notes

may increase or decrease from time to time. Under the terms of the indenture, fractional shares will not be issued upon conversion of the notes. Cash will be paid instead of fractional shares, if any.

(2) Except as noted in the table, assumes all of the notes and shares of common stock issuable upon their conversion are sold in the offering.

(3) Information about additional selling securityholders will be set forth in an amendment to the registration statement of which this prospectus forms a part.

(4) Because fractional shares that would otherwise be issuable upon conversion of notes will be paid in cash, the sum of the number of shares listed in the column does not equal the total.

PLAN OF DISTRIBUTION

The notes and the underlying common stock are being registered to permit the resale of such securities by the holders of such securities from time to time after the date of this prospectus. We will not receive any of the proceeds from the sale by the selling securityholders of the notes or the underlying common stock. We will bear the fees and expenses incurred in connection with our obligation to register the notes and the underlying common stock. However, the selling securityholders will pay all underwriting discounts, commissions and agent's commissions, if any.

The selling securityholders may offer and sell the notes and the underlying common stock from time to time in one or more transactions at fixed prices, at prevailing market prices at the time of sale, at varying prices determined at the time of sale or at negotiated prices. These prices will be determined by the selling securityholder or by agreement between such holder and underwriters or dealers who may receive fees or commissions in connection with such sale. Such sales may be effected by a variety of methods, including the following:

- in market transactions;
- in privately negotiated transactions;
- through the writing of options;
- in a block trade in which a broker-dealer will attempt to sell a block of securities as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- if we agree to it prior to the distribution, through one or more underwriters on a firm commitment or best-efforts basis;
- through broker-dealers, who may act as agents or principals;
- directly to one or more purchasers;
- through agents; or
- in any combination of the above or by any other legally available means.

In connection with the sales of the notes and the underlying common stock, the selling securityholders may enter into hedging transactions with broker-dealers, who may in turn engage in short sales of the offered securities, deliver the notes and the underlying common stock to close out such short positions, or loan or pledge the notes and the underlying common stock to broker-dealers that in turn may sell such securities.

If a material arrangement with any underwriter, broker, dealer or other agent is entered into for the sale of any notes and the underlying common stock through a secondary distribution or a purchase by a broker or dealer, or if other material changes are made in the plan of

distribution of the notes and the underlying common stock, a prospectus supplement will be filed, if necessary, under the Securities Act disclosing the material terms and conditions of such arrangement. The underwriter or underwriters with respect to an underwritten offering of notes and the underlying common stock and the other material terms and conditions of the underwriting will be set forth in a prospectus

supplement relating to such offering and, if an underwriting syndicate is used, the managing underwriter or underwriters will be set forth on the cover of the prospectus supplement. In connection with the sale of the notes and the underlying common stock, underwriters will receive compensation in the form of underwriting discounts or commissions and may also receive commissions from purchasers of notes and underlying common stock for whom they may act as agent. Underwriters may sell to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters or commissions from the purchasers for whom they may act as agent.

To our knowledge, there are currently no plans, arrangements or understandings between any selling securityholders and any underwriter, broker-dealer or agent regarding the sale of the notes or the underlying common stock by the selling securityholders. Selling securityholders may decide to sell all or a portion of the notes or the underlying common stock offered by them pursuant to this prospectus or may decide not to sell notes or the underlying common stock under this prospectus. In addition, any selling securityholder may transfer, devise or give the notes or the underlying common stock by other means not described in this prospectus. Any notes or underlying common stock covered by this prospectus that qualify for sale pursuant to Rule 144 or Rule 144A of the Securities Act may be sold under Rule 144 or Rule 144A rather than pursuant to this prospectus.

The selling securityholders and any underwriters, broker-dealers or agents participating in the distribution of the notes and the underlying common stock may be deemed to be "underwriters" within the meaning of the Securities Act, and any profit on the sale of the notes or common stock by the selling securityholders and any commissions received by any such underwriters, broker-dealers or agents may be deemed to be underwriting commissions under the Securities Act. If the selling securityholders were deemed to be underwriters, the selling securityholders may be subject to statutory liabilities including, but not limited to, those of Sections 11, 12 and 17 of the Securities Act and Rule 10b-5 under the Exchange Act.

The selling securityholders and any other person participating in the distribution will be subject to the applicable provisions of the Exchange Act and the rules and regulations under the Exchange Act, including, without limitation, Regulation M, which may limit the timing of purchases and sales of any of the notes and the underlying common stock by the selling securityholders and any other relevant person. Furthermore, Regulation M may restrict the ability of any person engaged in the distribution of the notes and the underlying common stock to engage in market-making activities with respect to the particular notes and the underlying common stock being distributed. All of the above may affect the marketability of the notes and the underlying common stock and the ability of any person or entity to engage in market-making activities with respect to the notes and the underlying common stock.

Under the securities laws of certain states, the notes and the underlying common stock may be sold in those states only through registered or licensed brokers or dealers. In addition, in certain states the notes and the underlying common stock may not be sold unless the notes and the underlying common stock have been registered or qualified for sale in the state or an exemption from registration or qualification is available and complied with.

We have agreed to indemnify the selling securityholders against certain civil liabilities, including certain liabilities arising under the Securities Act, and the selling securityholders will be entitled to contribution from us in connection with those liabilities. The selling securityholders will indemnify us against certain civil liabilities, including liabilities arising under the Securities Act, and will be entitled to contribution from the selling securityholders in connection with those liabilities.

We are permitted to suspend the use of this prospectus under certain circumstances relating to corporate developments, public filings with the SEC and similar events for a period not to exceed 60 days in any three-month period and not to exceed an aggregate of 120 days in any 12-month period.

If the duration of such suspension exceeds any of the periods above-mentioned, we have agreed to pay additional interest.

LEGAL MATTERS

Certain legal matters relating to the notes and the shares of common stock issuable upon conversion will be passed upon for Lithia by Foster Pepper Tooze LLP, Portland, Oregon.

EXPERTS

The consolidated financial statements of Lithia Motors, Inc. and Subsidiaries as of December 31, 2003 and 2002 and for each of the years in the three-year period ended December 31, 2003, have been incorporated herein and by reference in the registration statement from Lithia's Annual Report on Form 10-K for the year ended December 31, 2003, in reliance upon the report of KPMG LLP, independent registered public accounting firm, which is incorporated herein by reference and upon their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). You may read and copy materials that we have filed with the SEC at the SEC public reference room located at 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

Our common stock is listed on the New York Stock Exchange under the symbol "LAD," and our SEC filings can be read at the New York Stock Exchange, 20 Broad Street, New York, NY 10005. Our SEC filings are also available to the public on the SEC's Internet website at http://www.sec.gov as well as our own website at *http://www.lithia.com*.

We have filed with the Securities and Exchange Commission a registration statement on Form S-3 under the Securities Act with respect to the notes and the common stock issuable upon conversion of the notes offered by the selling securityholders. This prospectus does not contain all of the information set forth in the registration statement and the exhibits and schedules thereto. Please refer to the registration statement and its exhibits and schedules for further information with respect to our company, the notes and the common stock. Statements contained in this prospectus as to the contents of any contract or other document referred to are not necessarily complete and in each instance, if such contract or other document filed as an exhibit to the registration statement, each statement being qualified in all respects by such reference. You may read and obtain a copy of the registration statement and its exhibits and schedules from the SEC, as described above.

DOCUMENTS INCORPORATED BY REFERENCE

We incorporate by reference into this prospectus the documents listed below and any future filings we make with the SEC (other than on Form 8-K under Items 9 and 12) under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, including any filings after the date of this prospectus, until the selling securityholders have sold all of the notes and shares of common stock to which this prospectus relates or the offering is otherwise terminated. The information incorporated by reference is an important part of this prospectus. Any statement in a document incorporated by reference into this prospectus will be deemed to be modified or superseded to the extent a statement contained in (1) this prospectus or (2) any other subsequently filed document that is incorporated by reference into this prospectus, modifies or supersedes such statement.

Our Annual Report on Form 10-K for our fiscal year ended December 31, 2003.

Our Quarterly Reports on Form 10-Q for our fiscal quarters ended March 31, and June 30, 2004.

Our Current Reports on Form 8-K filed May 3, 2004.

You may request a copy of these filings, at no cost, by writing to or telephoning us at the following address:

Lithia Motors, Inc.
Investor Relations Dept.
360 E. Jackson Street
Medford, Oregon 97501
Telephone: (541) 776-6591

PART II INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other Expenses of Issuance and Distribution.

The following is an itemized statement of the costs and expenses, other than underwriting discounts and commissions, incurred and to be incurred by us in connection with the issuance and distribution of the securities registered hereby. All amounts are estimates except the SEC registration fee and NYSE listing fee.

		Amount
SEC Registration Fee	$	10,769.50
Printing and Engraving Fees and Expenses	$	85,000.00
Legal and Consulting Fees and Expenses	$	175,000.00
Accounting Fees and Expenses	$	100,000.00
Trustee Fees	$	9,000.00
Miscellaneous	$	5,230.50
Total	$	385,000.00

The foregoing, other than the SEC Registration Fee, are estimates.

Item 15. Indemnification of Directors and Officers.

Under the Oregon Business Corporation Act (Oregon Revised Statutes Sections 60.387 to 60.414), a person who is made a party to a proceeding because such person is or was an officer or director of a corporation may be indemnified by the corporation against liability incurred by such person in connection with the proceeding if (1) the person's conduct was in good faith and in a manner he or she reasonably believed was in the corporation's best interest or at least not opposed to its best interests and (2) if the proceeding was a criminal proceeding, the Indemnitee had no reasonable cause to believe his or her conduct was unlawful. Indemnification is not permitted if the person was adjudged liable to the corporation in a proceeding by or in the right of the corporation, or if the Indemnitee was adjudged liable on the basis that he or she improperly received a personal benefit. Unless a company's Articles of Incorporation provide otherwise, such indemnification is mandatory if the Indemnitee is wholly successful on the merits or otherwise, or if ordered by a court of competent jurisdiction.

The Oregon Business Corporation Act also provides that a company's articles of incorporation may limit or eliminate the personal liability of a director to the corporation or its shareholders for monetary damages for conduct as a director, provided that no such provision shall eliminate the liability of a director for (1) any breach of the directors' duty of loyalty to the corporation or its shareholders; (2) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (3) any unlawful distribution; or (4) any transaction from which the director derived an improper personal benefit.

Our Articles of Incorporation provide that we will indemnify our directors and officers to the fullest extent permissible under the Oregon Business Corporation Act against all expense liability and loss (including attorney fees) incurred or suffered by reason of service as a director or officer or service at our request as a director, officer, partner, trustee, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise.

The effect of these provisions is to limit the liability of directors for monetary damages, and to indemnify our directors and officers for all costs and expenses for liability incurred by them in connection with any action, suit or proceeding in which they may become involved by reason of their

affiliation with us, to the fullest extent permitted by law. These provisions do not limit our rights or any shareholder's rights to seek non-monetary relief, and do not affect a director's or officer's responsibilities under any other laws, such as securities or environmental laws.

We have obtained a directors' and officers' liability insurance policy insuring our directors and officers against certain losses resulting from wrongful acts committed by them as our directors and officers, including liabilities arising under the Securities Act.

Item 16. Exhibits

The following exhibits are filed herewith or incorporated by reference herein:

Exhibit Number	Exhibit Name
4.1*	Registration Rights Agreement dated May 4, 2004, among the registrant and Morgan Stanley & Co. Incorporated, Stephens Inc., Raymond James & Associates, Inc., and Jefferies & Company, Inc.
4.2*	Indenture between the registrant and U.S. Bank National Association, including the form of Note
5.1*	Opinion of Foster Pepper Tooze LLP
10.1*	Third Amendment dated as of June 30, 2004 to Credit Agreement dated February 25, 2003, among the Registrant, various financial institutions and DaimlerChrysler Services North America LLC, as agent for the Lenders
12.1	Statement of Computation of Ratio of Earnings to Fixed Charges
23.1	Consent of Independent Registered Public Accounting Firm
23.2*	Consent of Foster Pepper Tooze LLP (included in 5.1)
24.1*	Power of Attorney
25.1*	Statement of Eligibility of Trust (Form T-1)

* Previously filed

Item 17. Undertakings

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrants pursuant to the foregoing provisions, or otherwise, the registrants have been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by a registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrants will, unless in the opinion of their counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by them is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information in the registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

Provided, however, that paragraphs (i) and (ii) do not apply if the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed by the registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) That, for purposes of determining any liability under the Securities Act, each filing of the registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in this registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, Lithia Motors, Inc. certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Medford, State of Oregon, on October 21, 2004.

LITHIA MOTORS, INC.

By: /s/ SIDNEY B. DEBOER

Sidney B. DeBoer, Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed below by the following persons in the capacities and on the dates indicated.

By:	/s/ SIDNEY B. DEBOER	Date: October 21, 2004
	Sidney B. DeBoer, Chief Executive Officer and Chairman of the Board of Directors (principal executive officer)	
By:	*	Date: October 21, 2004
	Thomas Becker, Director	
By:	*	Date: October 21, 2004
	Philip Romero, Director	
By:	*	Date: October 21, 2004
	William Young, Director	
By:	*	Date: October 21, 2004
	Gerald F. Taylor, Director	
By:	*	Date: October 21, 2004
	M.L. Dick Heimann, Director	
By:	*	Date: October 21, 2004
	R. Bradford Gray, Director	

By: /s/ JEFFREY B. DEBOER Date: October 21, 2004

Jeffrey B. DeBoer, Senior Vice President and Chief Financial Officer (principal financial officer)

*By: /s/ JEFFREY B. DEBOER

Jeffrey B. DeBoer, as *Attorney-in-Fact*

Exhibit Index

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