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LKQ Corp. (LKQ)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Joseph P. Boutross
Vice President-Investor Relations

GAAP AND NON-GAAP FINANCIAL MEASURES

- During this call, we will present both GAAP and non-GAAP financial measures
- A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release and slide presentation

Justin L. Jude
President, Chief Executive Officer & Director

BUSINESS HIGHLIGHTS

Opening Remarks

- Shifting now to the quarter, last month we held an Investor Day where I laid out my management style and priorities
- As a reminder, I stated that my priorities would focus on operational excellence and maximizing total shareholder return
- In Q3, we evidenced this focus by taking action to simplify, integrate and rationalize the business while returning value to our stakeholders

Capital Allocation and Shareholder Returns

- Let's start with the capital allocation and shareholder returns
- At recent trading levels, we believe the best use of our capital is repurchasing our shares
- We were active in the quarter repurchasing 3mm shares for approximately \$125mm
- With \$800mm left on our authorization and plans to remain active in the market in the coming years, I am pleased to announce our board of directors approved a resolution to increase the authorization amount under our share repurchase program by an additional \$1B, with an extension through October 2026
- Management's recommendation to increase and extend the authorization and the board's approval thereof is evidence of our confidence in LKQ's future and our ability to generate robust FCF
- In August, we paid a quarterly dividend totaling \$79mm and our board approved a quarterly cash dividend of \$0.30 per share to be paid in November

Operational Excellence Initiatives

- Moving to our operational excellence initiatives
- The simplification of our portfolio and operations is a key pillar to drive better returns
- As part of our portfolio review, we completed the sale of our Poland operation to Mekonomen in July and recently finalized the sale of our Bosnia business
- Additionally, we have another small transaction nearing completion in the coming weeks
- But while this transaction is a very small component of our North America operation, the sale will eliminate a loss-making business while freeing up management's time

Integration

- On the integration front, we continue to work on merging our recent acquisitions into existing LKQ operations
- While most of the heavy lifting is done on Uni-Select's footprint rationalization, the teams are identifying additional efficiencies and have selected seven more locations for closure
- Andy Hamilton talked about the SKU rationalization effort in Europe, and I'm pleased to report the team pushed this project forward in the quarter and have now reviewed over 25 product groups representing 425,000 SKUs or more than 50% of our project scope
- Also in Europe, we are working on restructuring activities to reduce costs and increase efficiencies related to our logistics network
- We will have more details on these efforts in 2025

Specialty Business

- And lastly, our Specialty business recently completed the combining of two warehouses near Dallas, a legacy facility and a facility we acquired as part of a 2023 transaction into a new more efficient single location
- Our commitment to lean operating culture is critically important, especially in a period when the top line is facing headwinds

COST ACTIONS

- In addition to the substantial cost actions we have already taken this year, all of our businesses are undertaking another review of the cost structures as part of our annual budget process

- Additionally, we are conducting a benchmark study on our overhead costs to determine where we have opportunities to be more productive and cost effective growth

ORGANIC REVENUE AND MARGINS

- Growth is our final operational excellence pillar, and we strive to grow organic revenue and increase operating margins
- We were not wholly successful in this regard during Q3 as many of the economic and industry headwinds we faced in H1 2024 continued to have a negative impact on our results
- While parts and services revenue was down roughly 4% organically on a per day basis, there were some positives to take away
- North America declined 7.5% on a per day basis with aftermarket down to a greater extent than salvage
- Q3 extended the trend of y-over-y repairable claims decreases, with claims falling 9.5% following a 7% drop in Q2

COLLISION VOLUMES

- Our collision volumes were down only 6%, showing that despite the drop in claims, we did not lose share
- We believe the decrease in claims are still tied to the economic factors we discussed the last quarter, such as the rising insurance premiums and the decrease in used car pricing
- While we anticipated claims volumes would not rebound quickly in H2, Q3 decrease was higher than we projected and it contributed to an underperformance of revenue relative to guidance
- Q3 claims figures suggest the possibility of a longer recovery period than we previously thought, and we are working through this evaluation with our strategy and operations teams as part of our 2025 budget process

Europe

- Europe's revenue was flat on a per day basis, but was an improvement from the 1.3% decrease we reported in Q2
- Certain markets showed single-digit growth, while others declined in a similar range
- Economic conditions remained challenging across most markets in Europe, notably in Germany and the UK.
- Competition is also contributing to the challenging condition, as consistent with last quarter, some of the smaller players are aggressively pushing price

North America

REVENUE

- The North American revenue decline of 7.5% per day was larger than what we reported in the first two quarters
- The sequential change is attributable to repairable claims in Q3 and the mix impact of incremental paint revenue in the organic calculation
- We passed the one-year mark since the Uni-Select acquisition on August 1, 2024
- And as a result, the FinishMaster revenue became part of the organic calculation for part of Q3
- Organic paint revenue was down by a greater percentage than the segment as a whole, resulting from softness in FinishMaster's direct sales

- There were some revenue loss post-acquisition, as customers reevaluated their supplier situation and sales reps left to join competitors
- As we integrated the business and aligned our sales teams, we believe the situation has stabilized and the team is working to win back business with LKQ's combination of superior availability and service
- Specialty took a step backward in Q3 with organic revenue down 10% on a per day basis compared to 2% in H1
- Economic conditions, including higher interest rates and relatively low consumer confidence having contributed to lower vehicle and RV sales, thus creating a significant headwind for our parts sales
- We expect the challenging conditions to continue through Q4

Profitability Measures

- Shifting to our profitability measures, adjusted diluted EPS increased by 2% compared to Q3 last year, and the segment EBITDA margin improved by 30BPS
- Rick will provide further details on these numbers in his remarks

CLOSING REMARKS

- Before turning the call to Rick, I want to mention a few noteworthy items for the quarter
- Hurricanes Helene and Milton have affected our operations in North America as some of our locations and many of our customers were shut down as a result of the storms and the after effects
- To give an idea of the impact on LKQ's operations, Helene forced four closures of nearly 25% of our locations in the Southeast and these locations were down between one and six days
- Milton forced closures of nearly 75% of our [ph] Florida (00:10:14) locations for between one and four days
- Thankfully, we didn't incur any significant property damage, so the impact will be mostly related to lost revenue
- Earlier this month, dock workers on the East and Gulf Coast went to strike for three days
- A tentative agreement got them back to work as negotiations continue on a final contract
- We expect the strike days to have an impact on our inventory as each day off was estimated to require a week to catch up
- We were already experiencing delays for shipments brought into the East Coast
- And while we believe our current inventory levels are adequate to support the business, there could be some minor impacts to our fill rates over the coming months
- We are also contingency planning in case a final contract isn't agreed to by January
- Last quarter, we reported that we reached an agreement with the trade union, representing a number of our employees in Germany, and we are pleased with the progress in restoring normal operating performance and branch availability improved in the quarter, rising to nearly 95%

Rick Galloway

Chief Financial Officer & Senior Vice President

FINANCIAL HIGHLIGHTS

Performance

- Third quarter results reflect solid overall performance, but with some variability across the business

- Europe performed well in the face of challenging macroeconomic conditions, while revenue in our North America and Specialty segments came in lower than expected due to factors mentioned by Justin
- As discussed during the Investor Day, we were experiencing softer-than-anticipated revenue in North America in July and August numbers
- The softness continued into September with preliminary repairable claims data indicating a larger than expected decrease in total Q3 y-over-y repairable claims
- Additionally, Hurricane Helene had a small but negative impact on the final week of the quarter
- These challenging economic conditions, including further declines in collision claims from Q2 to Q3 were difficult to overcome
- But we are proud of all of our 48,000 employees who remain focused on delivering solid operating performance through our lean operating model

EBITDA Margins, EPS and Share Repurchase Program

- Turning now to Q3 consolidated results
- Our actions to simplify the business and align cost structures to demand levels contributed to improvement in our segment EBITDA margins by 30BPS y-over-y
- Adjusted diluted EPS of \$0.88 was \$0.02 higher than the prior year figure
- Lower share counts due to our ongoing share repurchase program and lower taxes contributed to a y-over-y improvement in adjusted EPS of approximately \$0.04
- These were offset by roughly \$0.02 of a net decline in operating results
- We saw significant improvements in EBITDA in both our Europe and self-service segments
- Europe posted double-digit EBITDA margins for the second straight quarter despite a challenging macroeconomic environment
- Self-service benefited from their focus on improved vehicle procurement costs and productivity, with some additional help from more favorable movements in scrap steel prices during the quarter
- However, organic revenue declines in North America, driven largely by aftermarket and paint volumes, contributed to a mix decrease and ultimately lower EBITDA for the North America segment
- Difficult economic conditions in the auto and RV markets also led to a decline in organic revenue and earnings in our Specialty segment

GLOBAL RESTRUCTURING PROGRAM

- As noted in Q1, we implemented a global restructuring program focused on enhancing profitability
- In Q3, we expanded the 2024 restructuring plan to simplify the business and to align with current demand, including additional footprint rationalization and streamlining our logistics models
- Given the persistent market demand pressures and macroeconomic challenges, we are continuing to execute on our restructuring plans in North America and Europe to reduce head count and exit underperforming locations
- As a result, we incurred \$14mm in charges for the quarter
- Further charges are expected in future periods for severance, lease termination costs and other related expenses

North America

EBITDA MARGINS AND OVERHEAD EXPENSES

- Now for segment results, going to slide 8

- North America posted a segment EBITDA margin of 16.1%, a 90 basis point decrease relative to last year
- Last quarter, we projected the full year margin would be around 17% with the full year impact of Uni-Select dilution
- The reported margin for Q3 was below our expectations as the cost actions taken, including Uni-Select synergies from integration and other restructuring efforts, were not enough to offset the lower aftermarket revenue with the related mix effect on gross margins, as aftermarket collision revenue has a higher margin than our other wholesale product lines
- Relative to the prior year, salvage margins were also down reflecting more favorable revenue, vehicle cost trends and commodity prices in the prior year period
- Overhead expenses decreased 90BPS in North America, reflecting lower personnel costs primarily related to incentive compensation, with the Uni-Select synergies and productivity initiatives largely offsetting significant inflationary pressures and the leverage effect of the organic revenue decline
- With the headwinds on repairable claims and salvage margins as well as the impact from the hurricanes, we estimate North America's EBITDA margins will be in the low to mid-16s for the full year

Europe

EBITDA AND GROSS MARGIN

- Looking at slide 9, Europe reported a segment EBITDA margin of 10.2%, a 90 basis point improvement over last year
- Gross margin rose slightly despite the difficult economic conditions as we're able to pass along some pricing to help offset input cost increases in certain markets
- Overhead expenses were favorable by 70BPS compared to the prior year period
- While productivity measures largely offset inflationary pressures, our prior year SG&A expenses included a 70 basis point charge related to a non-recurring value-added tax audit matter in Italy
- We remain focused on productivity measures to offset the ongoing inflationary pressures on overhead expenses and cost of goods sold and have expanded the 2024 restructuring plan in Europe to support these efforts
- Many of these actions have been initiated and are in process, but the benefits will be more notable in Q4 and heading into 2025
- When we talked 90 days ago, we expected EBITDA margins in Europe to be in the mid-to-high 9s
- With current volume expectations and the actions we've taken to address productivity, we believe EBITDA margins will fall in line with this range
- On a long-term basis, we expect to deliver double-digit EBITDA margins in Europe

Specialty

EBITDA MARGIN, PRICING AND EXPENSES

- Moving to slide 10
- Specialty's EBITDA margin of 7.3% declined 130BPS compared to the prior year, primarily driven by a decline in organic revenue and resulting leverage effect on overhead costs
- Demand softness in the auto and RV product lines and competitive pricing pressures remain challenges for the business
- We have been implementing changes to improve our net pricing and saw sequential quarterly improvement in gross margin in the last three quarters

- Overhead expenses were roughly flat in dollar terms, but were higher as a percentage of revenue, primarily due to lower operating leverage on the organic revenue decline
- We believe the full year's segment EBITDA margin will be closer to 7% given the continued organic revenue declines
- Self Service generated a 7.3% segment EBITDA margin in Q3, which is an almost 800 basis point improvement from last year
- In dollar terms, segment EBITDA increased by \$11mm
- Efforts to manage vehicle procurement costs combined with overhead cost controls and favorable movements in scrap steel prices, helped drive an improvement in profitability

BALANCE SHEET.....

Cash Flows

- Shifting to cash flows and the balance sheet
- We produced \$341mm in FCF during the quarter, bringing our YTD total to \$661mm
- We invested approximately \$16mm in two small tuck-in acquisitions, including one in Canada and one in Europe
- In addition, we paid down approximately \$35mm in outstanding debt

Dividends and Share Repurchases

- In Q3, we continued to return value to our shareholders with \$125mm for share repurchases and our quarterly dividend totaling \$79mm
- We will also continue with our \$0.30 per share quarterly dividend into 2025
- At this level, the dividend payout aligns with our stated capital allocation policy and allows us to retain strategic flexibility for capital allocation
- We have committed to allocating at least 50% of our FCF towards dividends and share repurchases, and our third quarter activity kept us on pace to deliver on this commitment
- On a YTD basis, we have generated FCF of \$661mm and invested \$520mm for share repurchases and dividends, or almost 80% of our FCF

Debt to Leverage Ratio

- As of September 30, we had total debt of \$4.4B with a total leverage ratio of 2.4 times EBITDA, a slight increase from the prior quarter but within our range of expectations
- We remain committed to maintaining a manageable debt level and our investment grade rating
- Our effective borrowing cost was 5.5% at the end of Q3, slightly down from Q2 as a result of recently lowered benchmark rates
- We have \$1.7B in variable rate debt, of which \$700mm has been fixed with interest rate swaps which effectively provide a fixed rate on over 75% of our debt

GUIDANCE.....

- I will close with an update on our full year 2024 guidance
- We expected in our prior guidance the drop in repairable claims volumes in North America would remain at the same level of y-over-y decline into the back half of the year

Organic Revenue, Volume, Pricing, Foreign Exchange and Tax Rate

- Given the greater-than-anticipated drop in Q3 weighing down organic revenue combined with lower-than-expected volumes in our Specialty business and headwinds from hurricanes in the Southeastern portion of the US, we are adjusting our full year guidance
- As mentioned previously, we view the market driven volume declines will abate, but expect them to impact us in Q4 and eventually level-off in 2025
- While we have taken action to mitigate these effects through cost controls and margin actions, those will not be enough to offset the full year impact of the lower revenue expectations
- Our guidance is based on current market conditions and recent trends and assumes that scrap and precious metal prices hold near September prices
- On foreign exchange, our guidance includes rates roughly in line with Q3
- The global tax rate edged up slightly to 27.0% due to shifts in our geographical mix of earnings
- Our full year guidance metrics on slide 12 have been updated from Q2 earnings call
- We expect reported organic parts and services revenue in the range of negative 275BPS to negative 175BPS
- At the negative 2.25% midpoint, this is a decrease of 175BPS from the prior guidance
- The continued softness in Q3 organic revenue in North America in Specialty, along with the impacts of the hurricanes in the US, drove the decision to lower the full year range

Headwinds, Adjusted EPS and Revenue

- We expect the top line headwinds in North America will linger into 2025
- We are working through our budgeting process for next year and we'll update you on the expectations during our Q4 earnings release in February
- In Europe, the top line recovery from the difficult economic environment in several markets is slower than originally anticipated, and we expect Q4 organic growth to be similar to what we saw in Q3
- As a result of these headwinds, we expect adjusted diluted EPS to be slightly lower and in the range of \$3.38 to \$3.52, a decrease of \$0.15 from our previous midpoint
- The primary driver of the decrease includes the market-driven demand dynamics in North America and Specialty
- While we expect to see volatility in these revenue trends, the team is focusing on addressing those items within our control, including our cost structure
- And we'll continue to execute on productivity and restructuring initiatives, which will partially offset these revenue trends in Q4 and will further benefit us heading into 2025

FCF, EBITDA, CapEx and Working Capital

- The FCF targets of 50% to 60% annual EBITDA conversion and approximately \$850mm remain unchanged from prior guidance
- Diligent balance sheet and CapEx management will help deliver the full year target despite the lower expected profitability while continuing to balance trade working capital needs heading into 2025

Justin L. Jude

President, Chief Executive Officer & Director

CLOSING REMARKS

- As I close the book on my first quarter as CEO, I want to thank all of my LKQ colleagues for what they do each and every day to make LKQ an exceptional company
- Things won't always go according to plan and Q3 threw us a few curveballs, but the LKQ team immediately went to work addressing these issues
- Their knowledge, resilience and work ethic are second to none, and we will help us emerge even stronger from the challenging conditions facing our industry
- I am very proud to work with this team and I am excited about LKQ's future

QUESTION AND ANSWER SECTION

Craig R. Kennison

Robert W. Baird & Co., Inc.

Q

I just wondered if you could shed more light on the issue with respect to paint and the competition that you're seeing there. What's going on in that category? And do you think it's a change in the competitive landscape or just a tactical move by your competitors?

Justin L. Jude

President, Chief Executive Officer & Director

A

I'd say maybe a mixture of both, Craig. This is Justin. Thanks for the question. If you remember, last year, we announced the intent to acquire Uni-Select, and then it went six months, we were kind of in a quiet period. We couldn't talk to FinishMaster folks. We couldn't talk to the customers. And at that time that quiet period created some unsureness, and FinishMaster was – had lost some accounts pre-acquisition or pre-closing and leading into post-acquisition. As you know, some of those contracts get worked on six months in advance.

Additionally, there was a larger MSO that had been lost by FinishMaster and that business was being migrated away after we acquired and closed on FinishMaster. So, obviously, we talked about rapidly integrating the footprint, integrating the sales teams. And so, we kind of started off with a – at a loss position of where we expected to be. But the teams have aligned the sales, refocused the groups collectively. And right now, we think that we're showing that we've moderated the loss and started to grow share. And really, we don't think there's anybody that can compete with us on our service and availability.

Craig R. Kennison

Robert W. Baird & Co., Inc.

Q

Maybe just, Justin, if you could shed light on the value proposition LKQ has with respect to having paint as part of your overall portfolio and whether that's persuasive to your customers? Thank you.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. I mean, as you guys may know, the margin on paint is lower than typically on parts. And so a lot of the paint competitors that we deal with, even FinishMaster prior to LKQ acquiring them, would cut their cost from the service level to make sure that they can maintain their profit, such as delivering once a week or delivering twice a week. So now, when we've integrated the warehouses, FinishMaster into the LKQ footprint, we're delivering to

our body shops two times a day in some markets, same day, every day of the week. And so, we're able to put paint on that vehicle.

So from a service level, from an inventory depth standpoint and availability, it's hard for any of these other paint distribution businesses to compete with us on a like-for-like just because our cost structure. We already have the truck going there, once again once a day or twice a day with parts both used and aftermarket, and then for us to add paint out of the same warehouses is just a marginal increase in cost. So from a service level and cost to serve, it's my opinion, it's very hard for our competition to compete with that.

Scott L. Stember

ROTH MKM

Q

Within North America, trying to parse out what happened in aftermarket, I remember last year you guys caught lightning in a bottle because of State Farm coming back into the market and the availability of aftermarket parts increased. Is this more a function of tough comparisons for aftermarket or is there something going on where customers are shifting their focus and preference back to salvage?

Justin L. Jude

President, Chief Executive Officer & Director

A

I'm going to use that line by the way, lightning in a bottle. I like that, Scott. Yeah. I would say, it's really tied to the repairable claims piece. I mean, if you look at our aftermarket business, it's 100% tied to collision. And so, when you see the claims drop, that puts a lot of downward pressure on the aftermarket piece. Like any time – we talked about in the last call, any time the market drops, our competitors don't necessarily, whether that's OEM or whether that's other aftermarket distributors, our competitors don't necessarily know if it's the market or if they're losing share. So they get a little bit more aggressive on price, trying to get some share. So we don't chase price down, but it does create some pressure on the margin a little bit. But aftermarket – but the lion issue with the drop in aftermarket would be tied to repairable claims piece.

Scott L. Stember

ROTH MKM

Q

Okay.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Scott, just to add on to that, just a minute. The other thing to think about is with State Farm coming up last year and you look at that compared to the repairable claims, there was a significant difference between the downgrade and the repairable claims in the back half of last year vs. where revenue was. That plus the strike that happened at the OEs last year did help our overall revenue. So the comps, you're correct on the aftermarket piece, there are tougher comps when you're looking at what happened within the industry last year as well.

Scott L. Stember

ROTH MKM

Q

And then just last question. There was lot of things, lot of transitory items which impacted this quarter and probably Q4 as well from storms and strikes. Is there any way to quantify the impact from the storms for the full year or how much of your guidance coming down was because of that and the strike?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah. So let me take that one, Scott. As far as Q3 impact, there was minimal impact on the storms. There was, Helene had hit at the very end and I talked about it just briefly that there was a little bit of an impact on the last week of the quarter. Going into Q4, we did see, obviously, Milton hit the southeast as well and there were significant clean-up and there were still significant clean-up on Helene that we're still trying to quantify. We didn't receive very much, as Justin talked about, property damage, but we are still seeing the impacts of revenue.

So part of what we're doing within our revenue and our overall EPS guidance, if you think about what we talked about at Investor Day. Investor Day I talked about as being below our previous midpoint. I think when we look back to where consensus was, was below \$3.50 – \$3.53, I think is where it was for the year. So if you think about the only thing that's really happened since then, is a little bit further decline in repairable claims than what we had expected. We were expecting about what we saw in Q2 which was around 7%, and now it's little north of 9%. And so, we're framing that out, and then additionally those two hurricanes and a strike that happened. So that's how we get essentially that \$0.07 dropping from that roughly \$3.53 consensus down towards the \$3.45.

Brian Joseph Butler

Stifel, Nicolaus & Co., Inc.

Q

When you're looking at 2025 and you talk about macro pressures abating at some point, what gives you confidence? I mean, what – that you will see some kind of abatement of the claims issue into 2025 and is that a H2 2025 or is that kind of a H1? Just trying to get a sense of what you're thinking about from a perspective of timing on that.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah, Brian. I mean, if you – on the repairable claims piece that I talked about, it's really an output of how the insurance cost is affecting the consumers, whether that's in their premiums or whether that's in deductible that they may have raised than relative to what their used car value is after that vehicle is fixed. I think we've seen, there have been a couple increases with a couple of months here and there, but we've also seen two years of declining used car pricing. And so, we kind of and as we talked to people in the industry and outside of the industry, we kind of forecast that used car pricing at some point should moderate over the back half of 2025 and start to show some improvement. As those used car values start to increase, it makes it more economical for consumers to repair their vehicles, whether it's from a collision or even general maintenance. So we think, overall, some of the headwind of used car pricing should start subsiding, I would say, in mid-2025 and start to show some improvements in the back half of next year.

Brian Joseph Butler

Stifel, Nicolaus & Co., Inc.

Q

And then, on the FCF, you maintained that \$850mm for 2024. What capital spending is either being pushed out or foregone kind of to hit that \$850mm number? And how do we think about that again coming back online in 2025?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah, Brian. I can start off and take that. What I talked about, I think it is important just – cash is king, right? So if we look at \$850mm which is what we had all year long, talking about our FCF, the team has done a tremendous job managing trade working capital. Trade working capital, the usage of our supply chain. Financing has been

going up. The extension of terms, a large focus on trade working capital is the bulk of how we're able to achieve this even with decline in overall EBITDA dollars.

When you look at some of the CapEx items that we're pushing off, there's always a need for, but what we're saying, look, let's make sure that there's nothing that's going to impact our overall earnings. Nothing is going to impact our growth. And so, there's some of the things that you can delay for three months, six months, something like that, that we're looking at the overall returns. And keep in mind as well, when Justin came on, he looked at the hurdle rates and he wasn't just talking about acquisitions or divestitures, he's looking at overall hurdle rate. So there's some items that just quite honestly don't pass the hurdle rate that we've got in there.

And so there's been a little bit of a change of, look, it's not going to pass the hurdle rate there's a better use of our cash. And so, that's the way to think of that. It's not delaying repairs or anything like that that would come in sort of increase the number next year because we delayed it this year. It's more of, it just doesn't pass the hurdle rate, and it's a project that we're probably not just going to do.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

Justin, you mentioned that in Europe, you reviewed 25 product categories, 425,000 SKUs, about 50% of what you want to do. Will this be completed by the end of 2024? And then you would start implementing changes that would benefit going into 2025?

Justin L. Jude

President, Chief Executive Officer & Director

A

We do not forecast we're going to be completed by the end of 2024. Our expectation is, I mean you're talking obviously hundreds of thousands of SKUs needing to understand the market dynamics of what those brands may, whether they're relevant in those markets or not, making sure that we have coverage by an application more so than coverage by a brand. We're projecting that the complete analysis will be done in early 2025, and we'll start to be able to make changes on our SKU, our stocking level of certain SKUs and start to show some of those improvements, although small, in the back half of 2025, but it won't be done by the end of this year, but it should be done by the early Q1 – early 2025, sorry.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

And then just lastly, with the exit of operations in Poland and Bosnia, I mean, in Europe, do you have any other small operations that you're considering closing in these various countries that – or are you basically done with all that with these smaller cats and dog operations?

Justin L. Jude

President, Chief Executive Officer & Director

A

Our review of the portfolio, it's a constant and ongoing. There are other smaller operations, both in North America and in Europe, that we're always analyzing. There may be some more on the horizon. Any time we do divestitures or something like that, my preference is to show you, don't tell you about it. So, once again, our portfolio review is constant and ongoing, and we'll continue to look at that.

Jash Patwa

JPMorgan Securities LLC

Q

Justin, with industry headwinds weighing on top line growth in the near term and visibility around recovery timeline seemingly low as of now in both North America and Europe, do you expect to see incremental acquisition opportunities in the market as relatively less sophisticated peers start to face the profitability front of these broader headwinds, especially given their lack of pricing discipline? Just trying to gauge if the current environment could provide a conducive environment for accelerated industry consolidation and whether LKQ would be willing to lean incrementally into M&A if the opportunity arises? Thanks, and I have a quick follow-up.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. I guess, I mean, mainly around the acquisition piece, we have definitely come out and publicly said we're not looking after any large acquisitions. With the way our stock price is right now, we're heavily weighted towards share repurchase. There are acquisitions that we'll bring into the company, but these are smaller synergistic, highly synergistic tuck-in acquisitions that bring returns in the mid- to upper teens over a short period of time.

Think of acquisitions where we may have a market that has three-step distribution. One of our customers is a wholesale distributor and we can acquire that wholesale distributor that may be our customer and convert that market from three step to two step. So there are some better opportunities and we've done some. We'll continue to look at those, but they're going to be small and highly synergistic.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

I think just to add on to one of the things, I think, I heard you talking about was consolidation within the overall marketplace. One of the things with LKQ having so many acquisitions over the last 25 years, we're involved with a lot of the discussions. And there's not anything that we're overly concerned about or something that we're seeing that is a major change in the overall market conditions that we won't be able to combat with the footprint that we have and something we're pretty confident on.

And one thing, the line was a little bit shaky when you were talking, if there's anything that we missed on there, just let us know and we can respond to that.

Jash Patwa

JPMorgan Securities LLC

Q

I just wanted to get – just get – if you could give us an update on the Elitek diagnostics and calibration business. Any color around how that business has scaled over the past couple years? How are you anticipating go forward growth here? And how should we think about the scope and potential implications of the ongoing lawsuit with Repairify? Thanks.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. On the Elitek piece, majority of our business there is mobile, where we actually have technicians going and augmenting body shops work to make sure they can calibrate the vehicle and do technical repairs. That business was growing pretty strong for us for a while. But with the repairable claims coming down as of now, it's kind of given some extra free time to body shops. In some cases, some of the MSOs to figure out how to do it internally right now. That business is still strong, good margins for us. The growth has slowed down, but it's still growing.

On the Repairify side, any – once again, not much of our business is on the mobile- I'm sorry, is on the remote piece, but we don't have any concerns with the IP on that case.

Bret Jordan

Jefferies LLC

Q

On the working capital cash flow that you're seeing, could you talk about sort of what inning you're at there and how much you'll see still available after you generate cash from working capital this year?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah. Bret, we've been seeing about a 10% improvement when we look at our overall trade working capital, particularly the payables and as well as the supply chain financing. We're seeing that again this year. If I look at our European operations, we're up almost 12% vs. year end on our supply chain financing program. I would expect we probably have another year or two to be able to go with those. And then it starts to weigh in. And as far as the working capital goes, we're obviously making a really big push this year, especially with what's going on in the overall market dynamics to drive FCF and make sure that we deliver on the FCF commitment that we made within the year.

And so, the team is doing a tremendous job of doing that. I think we have a little bit more time to be able to enhance that going into 2025 and then it starts tapering off, probably the back end of 2026.

Bret Jordan

Jefferies LLC

Q

And then I think in your prepared remarks, you talked about your competition in Europe. Is that primarily GSF in the UK or is there other competition in other regional European markets? And could you maybe sort of parse out dispersion in Europe, you called out Germany and UK as weak or was Benelux and Italy relatively stronger, or all sort of in the same bucket?

Justin L. Jude

President, Chief Executive Officer & Director

A

I would say that the worst economic ones were the UK and Germany, economic slowdown in the Benelux area. Going back to your comment on competition, I mean, obviously, GSF is in the UK market but we have competitors in every market for which we operate in. So any time there's some of those headwinds or market dynamics, sometimes those smaller competitors react differently. But I would say, every market we have several different competitors that we compete with day in and day out.

Bret Jordan

Jefferies LLC

Q

Okay. Great. Thank you.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

One thing – I think we're getting close to the end of the overall questions. One of the things that came in through a couple of the analysts, I just want to make sure we're there. In the effort of doing our simplification and simplifying our new document that we put out for the press release and then also for the earnings presentation, we did pull our gross margin by segment. Let me give that to you, that's something that we don't have a problem giving, I just had pulled it out of the overall document. So I know there's a couple of questions. Craig, I know you had mentioned that as well.

In North America, we had 42.8% in Q3. In Europe, we had 38.4%. In Specialty, we had 26.0%. And then in Self Service, we had 41.7%. So if that helps you guys with your models, I just want to make sure you have the data on the call.

Justin L. Jude

President, Chief Executive Officer & Director

CLOSING REMARKS

- I want to give a huge shout and a huge thanks to our over 50,000 employees for what they do every day
- I know our industry has faced challenges right now
- It's not the first time
- It won't be the last time. But I'm extremely proud of each and every one of our employees on how they reacted on the cost structure, how they reacted on making sure that we grew share or did not lose share
- Our company, LKQ is with our size and scale and, quite honestly, our winning culture, there's nobody that can beat us in the future

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