

25-Jul-2024

LKQ Corp. (LKQ)

Q2 2024 Earnings Call

CORPORATE PARTICIPANTS

Joseph P. Boutross
Vice President-Investor Relations

Rick Galloway
Chief Financial Officer & Senior Vice President

Justin L. Jude
President, Chief Executive Officer & Director

OTHER PARTICIPANTS

Scott L. Stember
ROTH MKM

Jash Patwa
JPMorgan Securities LLC

Craig R. Kennison
Robert W. Baird & Co., Inc.

Brian Joseph Butler
Stifel, Nicolaus & Co., Inc.

Gary Frank Prestopino
Barrington Research Associates, Inc.

John Healy
Northcoast Research Partners LLC

Bret Jordan
Jefferies LLC

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

- I am deeply honored and excited to be able to speak with you today as the CEO of LKQ, a company where I've spent the last 20 years working with dedicated colleagues to build a strong and vital business
- Before diving into the results for the quarter, I want to start by laying out my overarching priorities for our company and the plans we are executing to enhance performance and drive value for LKQ shareholders
- LKQ is a strong company with market-leading businesses

- We have been successful by leaning into our operational excellence strategy with a focus on profitable revenue growth, margin enhancement and cash flow generation
- Under my leadership, we will prioritize these strategic pillars, which are an integral part of LKQ's culture
 - However, this doesn't mean we'll follow the exact same playbook

North American Wholesale Segment

- I expect my team to challenge the status quo to be innovative, to set goals and communicate them so we hold each other accountable, and to learn from mistakes
- Rick and I have years of experience operating successful businesses, of which for we're together running our North American Wholesale segment
- We will work together with our global team to run an efficient organization, one that is focused on growing market share, while driving productivity and actively managing the cost structure

Capital Allocation

- In terms of capital allocation, our guiding principle is to direct our resources to the most value-enhancing opportunities
- From our vantage point today, share repurchases will be a priority and a means of driving shareholder value
- As you can see from our repurchase activity in Q2, we believe our shares are trading below their intrinsic value, and repurchases represent our best use of funds
 - We see attractive return metrics in our shares

ACQUISITIONS

- And through our capital allocation priorities, you should expect to see ongoing programmatic share repurchasing activity
- We have paused any large-scale acquisitions and raised the hurdle rate for approving synergistic tuck-in transactions
- In fact, we have walked away from deals in recent months because the returns on investment did not meet our new criteria

Asset Base

- Rationalizing the asset base has been a key element of our strategic framework
- We have routinely examined our assets from individual locations up to lines of business to determine if the assets align with our future plans
- As part of this process, we identified certain lines of business that did not fit our strategic objectives, and we took action, divesting 14 businesses in the last five years, which represented over \$600mm in low-margin revenue
 - These transactions were done judiciously and following a disciplined process to achieve a favorable outcome
- And we will continue to carefully evaluate whether we are the right owners for any of our businesses, while we focus on our core strengths

Cash Flow

- Finally, cash flow generation will remain central to our business

- Delivering strong cash flow allows us to invest in our future through capital projects and to return value to shareholders through dividends and share repurchases, while maintaining a manageable debt level and our investment-grade rating
- I'll now provide some comments on our results, and then Rick will discuss our financials and guidance
- Our second quarter results did not meet expectations on the top line

Backlog and Revenue

- In Q1, we faced revenue headwinds from a decrease in repairable claims in North America, which was influenced by mild and dry winter weather conditions
- In our Q1 commentary, we noted there would be a carryover effect in Q2 as shops had lighter backlogs than normal going into April, and we acknowledged a further risk to revenue if repairable claims didn't rebound as we were projecting
- As you can see from our second quarter results, the revenue trends moved in an unfavorable direction in North America, as well as our other three segments
- On a per-day basis, organic parts and revenue was down 2.9% overall and was negative in each segment

North America

- Drilling down and starting with North America, organic revenue decreased by 5.3%, with the largest drop coming from aftermarket collision parts
- Similar to Q1, repairable claims were down in Q2 by 7%, proving to be a headwind
- Although not material, access to aftermarket inventory following the Panama Canal disruption and delays with inbound deliveries also had a negative effect
- As we continued to see a reduction in repairable claims during Q2, we dug deeper into the market to further understand the drivers of this sequential decrease
 - While weather was a contributing factor to the reduction in Q1's repairable claims, as we mentioned on the last call, we further researched the impact of rising insurance cost and declining used car values on the consumer's decision to repair their vehicle

INSURANCE PREMIUM AND REPAIR COSTS

- We found the combination of these economic factors, rising insurance premiums and repair costs relative to the declining used car prices, had the largest aggregate effect
- In parallel, we also engaged a leading global consulting firm to conduct an independent assessment of the market, and their findings lined up with our deep-dive analysis
- Based on these findings, we believe that most of these factors are temporary, as weather conditions will fluctuate from year-to-year and economic conditions should normalize over time, allowing for insurance costs to moderate and used car prices to stabilize

ADAS Technology

- We believe that an improvement in economic conditions will contribute to more cars being repaired
- The smaller impact to repairable claims is the ongoing effect of ADAS technology, entering the car park, and we estimate that headwind to approximately be a 1% decrease in repairable claims per year

- This is further supported by research from the Insurance Institute for Highway Safety and the Highway Loss Data Institute that states there is little evidence that partial automation systems are preventing collisions
- However, the ADAS impact is not news to us, and it doesn't change our near- and long-term outlook on the collision market as we believe there will continue to be offsets to collision volumes with revenue opportunities from an increase in parts per estimate, the cost of more complex replacement parts, expanding our services of calibration and diagnostics, and continued growth in APU.
- Rick will discuss in more detail how we are factoring these temporary effects into our guidance
 - We've taken decisive cost actions to address the revenue shortfall

FinishMaster Integration

- As we discussed on the last call, we accelerated the FinishMaster integration and announced a global restructuring program in Q1
- With revenue remaining soft in Q2, we implemented a further cost reduction plan, and I am pleased with the progress the North American team has made
- Just as the team proved throughout the COVID pandemic, we know how to drive cost out of the business, and we exited Q2 with \$60mm in run rate savings on the cost reductions
- By making these actions quick, North America was able to generate a segment EBITDA margin above 17%, in line with our previous guidance
- Our actions have been careful and deliberate, and we believe we are well-positioned to scale back up again as demand increases

Europe Segment

- Switching to our Europe segment, organic parts and services revenue increased by 0.3% on a reported basis, but declined 1.3% on a per-day basis due to volume reductions
- There were several factors behind the negative trend with economic conditions being the most significant component
- Modest economic growth and high inflation across many of our markets, including the UK and Germany, have impacted demand, contributing to a y-over-y decline in overall volume
- Like North America, we expect the unfavorable economic conditions to be a temporary headwind, but one that will likely persist through H2 2024

Consumer Demand

- Other factors impacting revenue include the strike activity in Germany and heightened competition from small distributors
- With the pressure coming from soft consumer demand, we are seeing some of our smaller competitors aggressively lowering prices
- LKQ has been a price leader, but we are also very disciplined
- By resisting price decreases, we lost some volume in the quarter
 - However, we do not think the short-term pricing behavior of these competitors is sustainable or a rational strategy, and we believe our compelling value proposition will continue to be a key competitive advantage

Cost Take-Out and Productivity Initiatives

- Europe has also taken actions to mitigate the revenue decline, including cost take-outs and productivity initiatives
- Given local regulations, these efforts require more time to implement and, thus, the benefits weren't fully realized in Q2
- We expect to see greater cost savings as the year progresses and into 2025
 - Additionally, the European team continues to advance our SKU rationalization project
- The team has reviewed product groups representing about a third of our revenue, and we believe there is an opportunity to reduce about 30% of the current SKUs in these groups
- The SKUs would be delisted over a three-year period starting in 2025, with the large majority coming in the first two years

ELIT Polska Divestiture

- As I noted in my introductory remarks, we continue to review our portfolio and look for opportunities to divest non-core businesses
- In Q2, we reached an agreement to sell our operations in Poland to Mekonomen, and the transaction is expected to close in Q3
- Combined with the previously announced sales of our Bosnian and Slovenian businesses, the ELIT Polska divestiture reflects our ongoing efforts to streamline and simplify our operations, while improving our margin profile
 - This sale represents a good strategic fit as both LKQ and Mekonomen operated in Poland, but neither had the scale to compete effectively with the larger players in the market
- The combined operation will be better positioned to compete, and we will share in the upside potential through our investment in Mekonomen

Specialty

- Shifting to Specialty, organic revenue was down 2.1% for the quarter, roughly in line with Q1 change
- Softness in RV demand continues to be a headwind with uncertain economic conditions and high interest rates contributing to pressure on retail volume
 - We are seeing growth in some product lines, including marine
- Consistent with the rest of the organization, Specialty has taken cost actions to protect margins and is narrowing the gap in the y-over-y margin change
- I want to mention some other noteworthy items for the past several months
- In May, we received a favorable ruling from the Federal Circuit Court related to design patents
 - We believe the ruling is a win for the aftermarket industry and consumers who benefit from the value proposition offered by aftermarket products

New Collective Bargaining Agreement

- In June, the Verdi Trade Union and Employers Association in Germany entered into a new collective bargaining agreement
- The new contract, which runs through April 2026, covers approximately 5,000 of our employees and puts an end to the strike activity we experienced over the last year
- We remain dedicated to providing the industry's best service to our customers, and this agreement will improve our ability to deliver on this commitment

- We've already seen an improvement in branch availability following the agreement, and we expect to get back to prestrike levels in H2 this year

deprioritizing M&A

- In the quarter, we did a handful of tuck-in acquisitions, mostly by our Bumper to Bumper business in Canada where a tax law change provided an incentive to finish deals prior to June 30
- As I noted earlier, we are deprioritizing M&A as we shift focus to share repurchase and other more accretive uses of capital
- On that note, we returned over \$200mm to our shareholders through both dividends and share repurchases in the quarter
 - This included the highest number of shares repurchased in a quarter in the past 18 months, and we are continuing to repurchase shares in Q3

Cash Dividend

- Our board of directors approved a quarterly cash dividend of \$0.30 per share to be paid in August
- Finally, from a governance standpoint, we regularly review the composition of our board and ensure that we have members with the relevant experience and skills to support our mission
- As part of this process last week, we added Andy Clarke as a new board member
- Andy is a former public company CFO and financial expert, and we are excited to add his expertise to the board

Rick Galloway

Chief Financial Officer & Senior Vice President

FINANCIAL HIGHLIGHTS

North America

- Q2 results reflect lower-than-forecasted revenue for Q2, as discussed by Justin
- On a consolidated basis, gross margin also fell short of target as the lower aftermarket volumes in North America contributed to an overall mix decrease and pricing in Europe did not fully cover input cost increases
 - While our second quarter performance did not meet expectations on the top line, we took swift and impactful cost actions and dug deep on the operational excellence principles that drove our growth and margin expansion over the last five years
- Those actions, including accelerating the FinishMaster integration and implementing a restructuring plan, helped improve our margins despite the lower revenue

EBITDA Margin Expansion

- We saw sequential EBITDA margin expansion of 140BPS on a consolidated basis, including 100BPS in North America, which brought us back up above 17%
- With the expectation of continuing headwinds impacting top line performance, we are updating our full-year guidance
 - While each of the segment teams has detailed action plans in place to maximize their performance for the remainder of the year and rightsize the business for current volume trends,

the ongoing revenue challenges across the business and persistent inflationary pressures in Europe expected in the back half of the year will result in lower revenue and earnings

Adjusted Diluted EPS

- Turning now to Q2 consolidated results
- Adjusted diluted EPS of \$0.98 was \$0.11 lower than the prior-year figure
- Movements in commodity prices, primarily precious metals, contributed to \$0.04 y-over-y decrease
- The balance of the decrease was predominantly driven by operating results that did not offset the higher y-over-y interest expense resulting from the Uni-Select acquisition
- Operating results were negatively impacted by decreases in organic revenue, including the lower North American aftermarket collision volumes and the resulting overall mix decrease and margin pressure stemming from the difficult macroeconomic conditions in Europe

SEGMENT RESULTS.....

North America

- Now, for segment results
- Going to slide 11, North America posted a segment EBITDA margin of 17.3%, a 330-basis-point decrease relative to last year
- Last quarter, we projected that the full-year margin would be around 17% due to the dilution impact from Uni-Select
- The reported margin for Q2 met our expectation as the cost actions offset the lower aftermarket revenue and the related mix effect on gross margins resulting from lower aftermarket collision revenue, which has a higher margin than our other wholesale product lines

GROSS MARGIN AND OVERHEAD EXPENSES

- Relative to the prior year, in addition to the Uni-Select dilution effect on gross margin, salvage margins were down, reflecting less favorable revenue and vehicle cost trends and lower catalytic converter prices in Q2 2024
- Overhead expenses partially offset the gross margin reduction with lower costs as a percentage of revenue for personnel, including lower incentive compensation and lower freight
- With the swift cost actions taken in response to the lower volumes being largely completed, we are reiterating our expectation of 17% EBITDA margin for the full year

Europe

- Looking at slide 12, Europe reported a segment EBITDA margin of 10.6%, down 90BPS from last year
- Gross margin, including restructuring costs, declined by 130BPS, driven largely by pricing challenges to offset input cost increases, given the difficult economic conditions in Europe
- As Justin noted, our smaller competitors were aggressive in lowering prices, which limited our ability to push price to cover higher input costs
- Overhead expenses were favorable by 30BPS.

Personnel Costs

- Personnel costs as a percentage of revenue were lower y-over-y as the reduction in labor-related accruals previously recorded for the ongoing union negotiations in Germany were partially offset by wage inflation in most markets
- We have not fully covered the ongoing overhead and cost of goods sold input cost increases, and we have more work to do on pricing and productivity to boost the margin percentage
- Many of these actions have been initiated and are in process, but the benefits will be more notable in the back half of the year and heading into 2025
- With the macroeconomic environment in Europe and timing of the cost action benefit, we expect EBITDA margin in Europe to be in the mid- to high-9s for the full-year 2024
 - However, on a long-term basis, we continue to believe in our ability to deliver double-digit EBITDA margins in Europe

Specialty's EBITDA Margin and Overhead Expenses

- Moving to slide 13
- Specialty's EBITDA margin of 8.9% declined 60BPS compared to the prior year, driven by a decrease in gross margin
- Demand softness in the 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 two quarters
- Overhead expenses were roughly flat, but did include duplicative operating costs related to a distribution center consolidation project, which are nonrecurring
- We believe the full-year segment EBITDA margin will be slightly lower than the 8% we saw last year as we work through the lingering gross margin pressures
- As you can see on slide 14, Self Service generated roughly 10% margin in Q2 compared to 4% last year

Segment EBITDA

- In dollar terms, segment EBITDA increased by \$6mm, despite \$7mm headwind from commodities
- The efforts to manage vehicle costs helped mitigate the commodities' impact, combined with overhead cost controls produced a y-over-y benefit
- We have seen y-over-y improvement in segment EBITDA margins for H1 2024, and we are pleased to reach near double-digit margins this quarter

Global Restructuring Program

- As noted last quarter, we implemented a global restructuring program, focused on enhancing profitability
- The largest portion of the activity comes from the 2024 divestitures in the Europe segment, as discussed by Justin
 - These divestitures represented approximately \$140mm in combined annual revenue
- In addition, we incorporated restructuring actions in North America to reduce head count, exit underperforming locations, and other related actions
- In total, we recorded \$43mm in charges in the quarter, including \$29mm in asset impairments and \$6mm in inventory write-downs

- Further charges are expected in future periods for severance, lease termination costs and other related expenses

CASH FLOW AND BALANCE SHEET ITEMS

FCF and Share Repurchasing

- Shifting to cash flows and the balance sheet
- We produced \$133mm in FCF during the quarter, bringing our YTD total to \$320mm
- In Q2, we deployed \$125mm for share repurchases and paid a quarterly dividend totaling \$80mm, returning value to our shareholders
- Over the life of our share repurchase program, we have repurchased 59mm shares for \$2.6B.

Debt and Leverage Ratio

- And as of June 30, there was \$921mm remaining on the authorization
- As of June 30, we had total debt of \$4.3B, with a total leverage ratio of 2.3 times EBITDA
 - We remain committed to maintaining a manageable debt level and our investment-grade rating
- Our effective borrowing rate was 6.1% for the quarter, an increase of 10BPS relative to Q1 2024
- We have \$1.7B in variable rate debt, of which \$700mm has been fixed with interest rate swaps at 4.6% and 4.2% over the next one to two years, respectively

Projected 2024 Results

- I will conclude with our current thoughts on projected 2024 results
- When we provided guidance on Q1 call, we viewed the prior quarter's performance as largely temporary and expected a rebound in repairable claims in Q2
- Given the sustained declines in overall volumes due to the lower repairable claims in North America and the volume decreases in Europe, given the difficult macroeconomic conditions, we are lowering our full-year guidance
- As mentioned previously, we view the volume declines as largely temporary, but now expect the impact to continue into H2
 - While we have taken actions to mitigate these effects through cost controls and margin actions, those will not be enough to offset the full impact of lower revenue expectations

MARKET CONDITIONS

- Our guidance is based on current market conditions and recent trends and assumes that scrap and precious metal prices hold near June prices and the Ukraine-Russia conflict continues without further escalation or major additional impact on the European economy and miles driven
- On foreign exchange, our guidance includes rates roughly in line with Q2
- The global tax rate remains unchanged at 26.8%

FY Guidance Metrics

- Our full-year guidance metrics on slide 5 have been updated from Q1 earnings call
- We expect reported organic parts and services revenue in the range of negative 125BPS to positive 25BPS
- At the negative 0.5% midpoint, this is a decrease of 400BPS from the prior guidance

- The softness in Q2 organic revenue growth, along with the expectation that we will not see a swift recovery in repairable claims in North America, drove the decision to lower the full-year range
 - We believe the factors Justin described led to the revenue softness in North America and will remain a temporary headwind

Europe

- In Europe, while we anticipate some improvements in Germany, following the successful conclusion of the union negotiations, the challenging macroeconomic backdrop leads us to believe that we will not see a quick rebound of volumes compared to their Q2 performance
- As a result of the revenue headwinds, we expect adjusted diluted EPS in the range of \$3.50 to \$3.70, a decrease of \$0.45 from the midpoint for the previous guidance

Operating Results

- The primary drivers of the decrease in midpoint are explained on slide 6 and include \$0.37 from lowering operating results, including the reduction in revenue expectations and persistent inflationary pressures outpacing market pricing, partially offset by cost savings, productivity, and restructuring initiatives; \$0.08 from non-EBITDA-related items including investment performance, depreciation, interest, and taxes; and \$0.03 from lower FX rates and commodity prices
- These are partially offset by \$0.03 benefit from share repurchases
 - While we continue to see variability in revenue trends, the team is doing an excellent job in addressing controllable factors to align to the current market environment and adjust for the short-term economic headwinds
- The FCF target of 50% to 60% annual EBITDA conversion remains in place
- But with the lower earnings expectations, we now expect FCF of approximately \$850mm
- Diligent balance sheet management should support achievement of the full-year target, while continuing to balance trade working capital needs heading into 2025

Justin L. Jude

President, Chief Executive Officer & Director

Q2 HIGHLIGHTS

LKQ Strategy

- Before we move to your questions, as we've communicated on recent calls, we are hosting our Investor Day on September 10 at the headquarters in Nashville and also via webcast
- I hope you can all join us to discuss how we are charting our future
- Rick and I will cover the overall LKQ strategy and then we will focus on our two largest businesses, the Wholesale North American and Europe segments
- Our senior management from these segments will present business overviews and targets for growth and margin expansion

CLOSING REMARKS

- To close out, in H1, we faced obstacles that have tested our resolve and resilience
- Through it all, I have seen the unwavering dedication and hard work that define our LKQ culture

- I am inspired by the LKQ team's commitment to excellence and perseverance in the face of adversity
 - We are well positioned to navigate the road ahead, seize new opportunities, and accelerate our work to create value for our shareholders.

QUESTION AND ANSWER SECTION

Scott L. Stember

ROTH MKM

Q

In North America, you talked about – last quarter, you talked about weather and the emerging trend, I guess, of lower repairable claims because of the economy. And it seems like that part of it has become a bigger piece. Just trying to get a sense of if you had to frame out how much of the weakness is due to weather and just more – just underlying economic issues in the country. Just trying to get a sense of how cyclical this business is starting to become.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. So if you look at the weather piece, it was a large item in there. But if we looked at that economic factor, it was the majority of the headwinds that we faced in repairable claims. As I mentioned on the call, we did a deep dive, we talked to a lot of our customers, insurance carriers. We also engaged a third party, which was BCG, to do that deep dive in Q1 and part of Q2. And so whether it's the weather side, whether it's the economic factor, we see all those things as being temporary in nature. Hard to say when some of those economic factors start to reverse. But by far, the majority of all of the issue with repairable claims we saw was just temporary in nature.

Scott L. Stember

ROTH MKM

Q

All right. And the \$60mm that you talked about in the cost cuts, I assume that was for North America. That's YTD. Did you put out a goal for the full year? And how much of that is going to stick? I imagine some of it is just related to pay and stock comp and things like that, but just trying to get a sense of how much will stay.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah. So good question, Scott. You're correct. Most of that came through from North America. The North American business can make the impact much quicker. So as far as the target goes, one of the things that we look at as we look at the overall performance, we look at it on a daily basis, there's a lot of other metrics that we go to. So there wasn't a specific dollar threshold target. What it was is trying to get us back to the point that we talked about a few minutes ago within getting North America back up above 17% and really driving overall performance.

That team, when there's tough economic conditions, I think, everyone realized that the North American team is fantastic at operating in a cyclical environment, if you look back a couple of years ago. And so most of those actions were completed by quarter-end, and then we'll start seeing that come through through the rest of the year. We also have similar actions over in Europe. Obviously, there's some different requirements, regulatory requirements that will delay us, but we will start seeing some of those come in in Q4, and then, pretty much a full benefit as we go into 2025.

Scott L. Stember

ROTH MKM

Q

And as far as how much will stick?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah. So as far as how much will stick, the full amount will stick. These are permanent cost reductions that we're looking at. We're not sitting there trying to figure out this much is going to be a temporary basis, and we're somewhat robbing Peter to pay Paul. These are permanent cost actions. And that's one of the things that Justin talked about is that we need to make sure we're operationally excellent and looking at overall permanent reductions, and these items will stick.

Craig R. Kennison

Robert W. Baird & Co., Inc.

Q

Justin, regarding the SKU count reduction plan in Europe, how do you ensure that it doesn't impact your fulfillment rates?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. So our goal is kind of twofold. One, we want to simplify the business in our operations. We have a lot of SKUs that are duplicated if you think of application. So when a customer calls for a specific year, make and model, we have several brands of those. We have a large team within our Europe operations across all countries, working to analyze the whole SKU rationalization project.

As of today, we've really not non-stocked any part or removed any SKUs from the application – or removed any SKUs from our DCs. It's very small. We're very cognizant that we want to make sure we have better application coverage. So right now, there's definitely some holes where when a customer calls us for a part, we don't have it. So we want to improve the availability of the application level.

When it comes down to brands, obviously, there are certain brands in certain countries across Europe that we need to have and we will have. And so we have, once again, a large team focused on this project to make sure we don't make the wrong decisions.

The other thing that we're going to be pushing also towards that the team is excited about is driving our private label throughout the rest of our Europe operations, which, as you guys can imagine, the private label brings the best gross margin for LKQ.

Craig R. Kennison

Robert W. Baird & Co., Inc.

Q

Is there a way to frame your private label penetration today and where it could be?

Justin L. Jude

President, Chief Executive Officer & Director

A

We have some countries that are in the 30%, other countries that are in the single digits. We'll hear from Andy Hamilton at the Investor Day, and we'll talk a little bit about some of our strategy to drive that even higher at our Investor Day once again in Nashville on September 10.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

Couple of quick questions. Number one, the FCF generation that we're expecting for this year, I would expect, given what you've said, Justin, about share repurchases, the priority is share repurchases and you're fairly happy with your debt levels at this point.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah, Gary, good morning. I can take that one, speak for Justin and I. Yes, we are content with where our debt levels are right now, and we will have a primary focus, and Justin kind of laid it out during his presentation/prepared remarks, that a priority is focusing on total shareholder return and there will be a large focus on share repurchases, particularly as we see the opportunities with our current stock prices.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

Okay. And then, a second quick question. You gave us a number for repairable claims being down. But do you have any numbers on what frequencies were in the quarter?

Justin L. Jude

President, Chief Executive Officer & Director

A

We don't have an exact number on that, Gary, but I will tell you, the actual frequency was not as bad as the repairable claims. For an example, weather brought down frequency and, obviously, brought down repairable claims. That economic situation, there were accidents out there, and as we reached out to customers' insurance carriers, we found these accidents just weren't getting repaired. And so, we don't have an exact number of that. But I would say, the majority – maybe not. So the majority was temporary, as I said earlier. A large chunk was what I would say, the frequency was there, they just weren't getting repaired.

Bret Jordan

Jefferies LLC

Q

On the BCG study, I guess, the economic factor, are they projecting that this lost volume is forever lost, or is this deferred? I guess, sort of what was the takeaway from the impact?

Justin L. Jude

President, Chief Executive Officer & Director

A

They kind of thought that there's some pent-up demand in this piece, but then there's also some volume of frequency that occurred that just probably won't ever get repaired. It's hard to speculate on how much will actually come through eventually into the mix. But just with the rising insurance cost, the deductible cost, the repair cost climbing, and then the consumers' vehicle value dropping, it'll be – we'll have to see what happens with the economic if it changes that consumers' behavior. But we do think there is some pent-up demand, but nothing that shows that it's going to start coming in relatively quickly.

Bret Jordan

Jefferies LLC

Q

And I guess, you commented about price competition from smaller players in Europe. Are you seeing any price competition from smaller collision players in North America like Empire, [ph] Cosmopolitan (00:35:41), any of them?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. And I would say, that's nothing new. It probably slowed down a bit during the pandemic and the supply chain issue where we had a lot of inventory and a lot of our smaller folks didn't. As they started getting their inventory back in, they kind of went back to their old ways of offering price more than service. And so, it's not necessarily anything new for us. So, yeah, we still see it.

Bret Jordan

Jefferies LLC

Q

Okay. And I guess, a housekeeping, what was the total loss rate in the quarter?

Justin L. Jude

President, Chief Executive Officer & Director

A

I don't know if I have that number handy on it.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Bret, we can get back to you. I think it was roughly 21-ish, but we can get back to you on that one.

Jash Patwa

JPMorgan Securities LLC

Q

Could you help us unpack the – yeah, thank you. Could you help us unpack the \$0.37 impact to operating results embedded within the bridge to the updated EPS guide, mainly in terms of the contribution from weaker revenue growth outlook and mix shift related margin headwinds as opposed to the benefits from ongoing cost initiatives. Thanks. And I have a follow-up.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah. It's a good question. When we're looking at the overall \$0.37, it's a significant amount of volume. North of \$0.50 would be volume and then there's some other pricing impacts that would be in addition to that. And then, we're looking at a pretty substantial productivity initiative in the back half, which is what I was talking about a few minutes ago on the \$60mm cost reductions that are working to offset that to bring us to the \$0.37. But if you think about it, we're somewhere north of, call it, \$0.60 with some negativity on volume and pricing, and then, clawing back a fair amount of that through productivity initiatives.

Jash Patwa

JPMorgan Securities LLC

Q

Understood. That's very helpful. As a follow-up, just curious if the organic revenue growth metrics are reflecting impacts from the recent CDK outage at dealers that may have perhaps led to a backlog at the collision repair shops in the US as OE parts shipments were delayed. And, separately, wondering if you could share with us any impact LKQ observed from the Hurricane Beryl into July?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. I caught on the CDK comment, so I will tell you, I think there was what – roughly, what, 15,000 dealerships. Not all of those were automotive. There is some volume that we gained from that CDK when some of the OE

dealerships could not necessarily service the parts. Obviously, though, when we saw a headwind of repairable claims coming down 7.1%, it wasn't enough to – the volume from CDK wasn't enough to offset that. A lot of the dealers that – I mean, we still [ph] have sort of (00:38:49) dealers today that have body shops and service centers. A lot of those are – kind of have gone through the repair, or they've either fixed the issue, or they're off a CDK. So we had a little bit of a volume pickup there, but nothing meaningful.

Jash Patwa

JPMorgan Securities LLC

Q

Any color on Hurricane Beryl?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

We had some shutdowns within a couple of our facilities as far as the cost side goes. We haven't seen any type of volume changes. We're still kind of going through that as far as the hurricane goes, but nothing material that we've seen at this point.

Brian Joseph Butler

Stifel, Nicolaus & Co., Inc.

Q

Just starting out, I guess, when you look at Q1 result or H1 results, and kind of then pair that with the guidance revision that you gave, it feels like the repairable claim outlook is definitely still on a downward trajectory into third quarter and maybe into fourth quarter. So what gives you the confidence that this is just temporary in nature? And maybe is there any historical precedent that we can look at that gives you some comfort, again, that this isn't a much longer-term secular trend?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. So if you look at our last year Q1, we had very tough comps, Q2 tough comps; and in the guide, a little bit softer Q3 and Q4. If we look at our – so our thought is over a prior year, we see that getting better throughout the back half of the year, meaning not as bad as what we saw in Q1 and Q2. If we look at just our run rate of revenue, from month to month, from May to June to July, I mean, obviously, we had a week there with 4th of July that slowed down. If you look at our normalized daily run rate of revenue, we're seeing that kind of flat.

And what we don't have how repairable claims are shaking out in July yet, or any part of Q2, our volume is staying flat, if that makes sense. So we think we've kind of hit bottom. There may be some still negative on y-over-y trends, because last year was – there was a decent amount of repairable claims to – I'm sorry, there was a decent amount of cars getting fixed because of – if you think about it, used car pricing was climbing pretty aggressively last year.

Now, the opposite is happening where used car pricing is dropping, and do consumers want to spend that money out of their pocket to fix that vehicle when the used car value has dropped? So we're pretty confident in the new guidance on what we see on revenue for LKQ for the back half of the year.

Brian Joseph Butler

Stifel, Nicolaus & Co., Inc.

Q

And I guess, so if you think about that guidance and the way the market should view that, it feels like that's got to be, as you say, kind of you're starting to flatten out almost the bottom. Is that almost a worst-case scenario?

Obviously, there's, I'm sure, scenarios where it can get worse, but is this kind of a one of the low-case scenarios where you put this guidance with the expectation of kind of resetting expectations going forward from there?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. We hope it's – the volume is level. I don't know if it was worst-case necessarily. Obviously, it's hard for us to predict what happens with the economy and used car pricing and some of these other dynamics that affect us. I got to imagine, at some point – we say it's temporary because, at some point, used car pricing has to stabilize, normalize, and then start to increase. But...

Rick Galloway

Chief Financial Officer & Senior Vice President

A

So, Brian, part of the way that we look at this in the forecast is the economic factors that we looked at ourselves and then further validated with the study that we did started to indicate when the insurance companies have increased their pricing. And so you get essentially a one-time change within the behavior with significant increases in insurance premium costs moving from one deductible to another deductible.

And that impact started sort of in late Q2, early Q3 of last year, which we think will then bleed through at least through the end of the year. And that's what we've put in is that y-over-y impact going through the end of the year. But then, once you annualize that, the change from one deductible to another deductible, we don't expect that to continue. We expect moderating within the insurance premiums and the behavior from the consumer will be back to a more normalized behavior.

Brian Joseph Butler

Stifel, Nicolaus & Co., Inc.

Q

Okay. And so, again, not to belabor the point, but I guess, then does – the 2024 guidance is kind of the starting point to where you think growth comes – starts to return, there's not a big rebound somewhere in here in 2025.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

No, we don't. Yeah, that's correct. We don't think that there's some sort of big rebound. There's nothing that indicates to us that there'll be a significant bump-up one way or the other. But it will be the new starting point, if you will, in the back half of the year that will grow from there.

John Healy

Northcoast Research Partners LLC

Q

I know this has been talked about a lot already, but I just want to maybe ask the question differently. Related to the accident frequency dynamic, what did the BCG's study kind of say about, if they said anything, just kind of accident frequency potentially over the long term? And can you guys kind of flesh out what the scenario where maybe the decline in claims is maybe some form of accident avoidance technology and vehicle starting to proliferate through the car park, like did they address that? And, if they did, how did they refute that as maybe potentially kind of what's starting to change here?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah, I'll answer that. This is Justin. The second part of your question on the technology, the – of accident avoidance, I kind of made a comment in my script on ADAS. So ADAS is not a new phenomenon for us. We've seen the – as the car park really starting in 2016 getting introduced with more of these features for ADAS or accident avoidance systems, we see that reduction in overall repairable claims.

We think, right now, it's around 1%, BCG confirmed that. That's what we would call as more kind of constant. Now, while that may be a reduction of accidents by 1%, we see the overall market still growing for the future because of more parts per estimate. The complexity of those parts are higher, which means higher prices. Also there's more business going in for calibration and services. And we also see a continual opportunity to improve APU.

But to your question on the technology, it's been there. It's been in the car park for quite a while, and we see that as about as a 1% reduction – 1% y-over-y reduction in the repairable claims.

When we talk about the future, the forecast, in nature, the majority by far was these temporary items, whether it was weather or whether it was these economic factors. They did not and we didn't necessarily speculate as to when do – obviously, the weather is the weather, and it happens, and it could be – year-to-year, it could be different. But they – and LKQ is not going to speculate on when some of these economic factors are going to start to improve and help drive higher repairable claims.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

And, Justin, maybe I'll just add back on to one thing that Bret was asking a few minutes ago. The repairable claims, we did see the peak in Q1, 21.4% start dropping, Bret, to 20.7% in Q2. So it's starting to make its way back down on total losses, I'm sorry, total losses.

Justin L. Jude

President, Chief Executive Officer & Director

Q2 HIGHLIGHTS

North America and Europe

- First, I want to thank our team out in the field, both in North America and Europe and the other countries for which we operate
- We all face challenges
- We face headwinds in the overall market, but very proud of the team and how they reacted, getting our business rightsized or how they're working still to rightsize that business, so very much appreciative of that team
- And for everybody on the call and for all of our employees and investors, as we talked about some of these headwinds, it's not an LKQ problem, it's a market issue right now
 - We're making sure we have the cost structure in place, and we'll be ready to go when the volume starts to recover
- And we have quite a bit of initiatives and we'll share some of those at our investor Day on September 10, once again in Nashville, about how we're – we have opportunities to continue to grow market share
- And that will help us as the market continues to recover.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2024 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.