Joseph P. Boutross
Vice President-Investor Relations, LKQ Corp.

Thank you, operator. Good morning, everyone, and welcome to LKQ's Third Quarter 2026 earnings conference call.

To kick off the call, we have a pre-recorded message from John Mendel, LKQ's Chairman of the Board that provides some additional context related to our recent press release regarding changes to our leadership team and an update on the Company's strategic review. Following Johns message, Rick will provide some high-level comments on each of our segments followed by a detailed overview of our financials in the quarter and then we will open the call for questions. I kindly ask that you focus your questions solely on the Company's performance during the quarter.

Please refer to the LKQ website at lkqcorp.com, for our earnings release issued this morning, as well as the accompanying slide presentation for this call.

Now let me quickly cover the Safe Harbor. Some of the statements that we make today may be considered forward-looking. These include statements regarding our expectations, beliefs, hopes, intentions or strategies. Actual events or results may differ materially from those expressed or implied in the forward-looking statements as a result of various factors. We assume no obligation to update any forward-looking statements.

For more information, please refer to the risk factors discussed in our Form 10-K and subsequent reports filed with the SEC.

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.

Hopefully everyone has had a chance to look at our 8K which we filed with the SEC earlier today. As normal, we are planning to file our 10-Q in the coming days.

Operator we are ready to begin the call.

John Mendel
Chairman of the Board of Directors, LKQ Corp.

Thank you, Joe, and good morning, everyone. We appreciate you joining us.

Following last Friday's announcements, the Board felt it was important that you hear from us directly before Rick takes you through the quarter. I'll keep my remarks brief, but I want to share some perspective on the decisions we made and why. The Board's focus is on delivering results for our shareholders, and that is what guided the changes we announced.

LKQ is an exceptional business. We have unmatched scale, leading market positions in multiple regions, a unique global distribution network, and talented teams across the Company. But our financial and operating performance has not reflected the strength of this business, and that has been disappointing, both to our stakeholders and to this Board.

We have been operating in a challenging environment and our execution, particularly in Europe, has not met the standards we expect of ourselves.

The Board has been actively engaged on these issues for some time now, and the strategic review we began earlier this year was one part of that work. We believe that LKQ has significant strengths that are not currently reflected in its operating performance, and our focus is on ensuring those strengths translate into improved results for shareholders. Last week, we announced three actions:

First, we made a change at the top of the Company. The Board has appointed Sal Abbate as President and Chief Executive Officer, effective December 15. He succeeds Justin Jude, who departed the Company on October 23. We thank Justin for his years of service and contributions to LKQ. Until Sal joins, the Company is being led by an interim Office of the Chief Executive Officer, made up of Sue Gove, Chair of our Audit Committee, and me. We are working closely with LKQ's leadership team to oversee the Company's operations during this period.

After a thorough search, the Board concluded that Sal is the right leader for LKQ at this moment. He has spent more than three decades leading large, complex distribution and industrial businesses. As CEO of Veritiv, a high-volume, multi-site distribution business, he led a significant transformation of the company, with its share price increasing more than 13-fold during his tenure, culminating in its $2.6 billion sale to Clayton, Dubilier & Rice in 2023. He also brings public-company and international experience.

Sal knows what it takes to win in a business like ours, and he brings the operating rigor, commercial instincts and sense of urgency we need to sharpen execution and manage change with greater discipline.

Second, we made a leadership change in Europe and engaged Alvarez & Marsal to advise the Company on its European business on an interim basis. A&M has a mandate to stabilize operations, including the ERP-related issues, and restore service levels across the region. The team is also helping ensure continuity for customers and suppliers across the region while supporting our efforts to improve operational discipline and performance.

Third, we suspended our full-year 2026 guidance in light of the Company's recent performance and leadership transition, and while Sal completes his review of the business.

Finally, I want to update you on our strategic review. The Board's commitment to unlocking value for shareholders has not changed. We made changes in leadership and brought in A&M to advise with respect to our European operations because of this. Now, in light of the appointment of Sal and the other leadership changes we announced on Friday, the Board has decided to suspend the strategic review, including the Specialty sales process. This will give Sal the opportunity to assess the business and the full range of paths to value creation. The Board remains committed to overseeing strategic direction, protecting shareholder interests and ensuring accountability, including evaluating opportunities that it believes could enhance shareholder value and optimize the Company's strategic positioning over the long term. We believe that is the right sequencing for shareholders, and we will provide updates when appropriate.

Everything we are doing is in the best interests of our customers, our employees and our shareholders. I want to thank our more than 42,000 employees around the world for their resilience over these past several months, and our customers and shareholders for their continued support. Sal looks forward to sharing his priorities with you after he joins.

With that, I'll turn the call over to Rick to walk through the quarter in more detail. Rick will be handling the questions and answers today with a focus on the operating and financial performance in the quarter. We will not be able to comment on the strategic review process beyond what I shared here today.

Rick Galloway
Chief Financial Officer, LKQ Corp.

Thank you, John, and good morning, everyone.

As you've just heard, this is an important moment for our company. We recognize the significance of the leadership changes announced last Friday and the disappointment in our third-quarter results. Neither the executive leadership team nor the Board is satisfied with where we are, and we are taking decisive action. Our execution has fallen short, particularly in Europe, and we need to address those issues with urgency, focus and accountability.

I want to be equally clear that we remain confident in the fundamental strength of our business. We have strong market positions, differentiated capabilities and dedicated teams around the world.

My goal this morning is to speak candidly with you about what happened during the quarter, what we believe drove our performance, and where we are focusing our attention going forward. I'll start with our operating performance by segment and then walk you through the financial results.

Let's begin with North America.

In North America, organic revenue declined 2.4% compared with a decline in repairable claims of 1% to 3% during the quarter.

Auto insurance pricing continues to decrease, making our parts offerings even more attractive to carriers seeking cost efficient repair solutions. The CPI for Motor Vehicle Insurance declined 5.0% year over year in September 2026, its lowest level since December 2024. In addition, self pay repairs are approaching historical highs, and our parts provide a strong trade down option that helps consumers manage out of pocket costs without sacrificing quality or availability. These favorable trends helped drive alternative part utilization to a record of nearly 41% for the quarter, surpassing the previous high set in Q2.

Total loss rates were stable year over year, with used car prices modestly lower in the quarter. Total losses remain elevated by historical standards, but that trend largely reflects the aging vehicle fleet, particularly vehicles beyond our four to twelve year sweet spot, rather than any shift in underlying demand for our parts.

The hard parts team posted its third consecutive quarter of organic revenue growth, resulting in a low single digit year over year improvement in Q3.

Turning to Europe.

We are clearly not satisfied with our performance in Europe. Many of the challenges we faced were self-inflicted, and we take full ownership of them. Simply put, we had too many operational initiatives underway at the same time, which pulled our attention inward and caused us to lose focus on the customer.

These challenges manifested in several ways during the quarter, including disruptions to category management and product availability, gaps in our branch profiling and assortment, and service-level issues in certain markets.

These issues affected our ability to consistently deliver the parts availability, service levels and competitive pricing our customers expect from us. We are moving with urgency and discipline to address them and strengthen our execution across the region.

Turning to Specialty.

Specialty continued to grow, but at a lower rate than we saw in the last several quarters. We experienced some modest external pressure during the quarter, primarily from higher fuel prices and interest rates affecting the automotive portion of the business, as well as softer demand in Canada tied to geopolitical trade tensions and retaliatory tariffs. None of these factors were material on their own, but even against that backdrop, Specialty delivered organic revenue growth of 90 basis points in the quarter.

The RV and Marine division of Specialty continued to grow in the quarter, and we're pleased with that performance given the challenging market conditions. RV results stood out in particular, with retail dealers seeing low double digit revenue declines and industry wide wholesale shipments down over 16% year over year in August, according to RV Industry Association data. Our ability to deliver growth in that environment highlights the strength of our team, our customer relationships and the durability of our value proposition.

Now turning to our financial results.

Beginning with our consolidated results, our reported numbers are consistent with the preliminary ranges we provided on October 23.

Third quarter revenue was approximately $3.3 billion, a decrease of 5.1% compared with $3.5 billion in the prior-year period. Parts and services organic revenue declined 5.4%, foreign exchange reduced revenue by 0.7%, and acquisitions and divestitures, net, added 0.6%.

Diluted earnings per share was a loss of $0.09, compared with earnings of $0.69 in the prior-year period. Our GAAP results include pretax non-cash charges of $111 million, including $88 million related to goodwill impairment on our Specialty segment and $23 million related to impairment on net assets held for sale for our operations in Romania, both of which are excluded from our adjusted results.

Adjusted diluted earnings per share was $0.50, compared with $0.84 in the prior-year period. As in the second quarter, the year-over-year decline largely reflects lower revenue and profitability in Europe.

Turning to segment results. North America parts and services organic revenue declined 2.4%. Despite lower revenue, we were pleased that North America delivered segment EBITDA of $203 million and EBITDA margin of 14.4%, 40 basis points higher than the prior-year period. This was slightly ahead of our expectations. Gross margin improved to 42.3%, supported by an expanded deployment of our strategic pricing model. At the same time, the team remained disciplined on costs, lowering SG&A despite higher freight and fuel expenses, with personnel costs approximately $7 million below the prior year.

Europe parts and services organic revenue declined 9.8%, an improvement from the 12.6% decline in the second quarter but still well below our expectations. In Germany, branch availability has returned to near pre-implementation levels, and on-time-in-full delivery reached 95% across the region. However, the revenue recovery has lagged, and it has been slower than we expected when we spoke with you in July, as revenue loss in the region due to the ERP was approximately $95 million. Outside of Germany, the execution issues I mentioned earlier affected our competitiveness and contributed to market share losses in the UK and Benelux.

Europe segment EBITDA was $68 million, a margin of 4.6% compared with 10.0% in the prior-year period, a year-over-year decline of $94 million. We estimate that the ERP-related disruption in Germany reduced EBITDA by approximately $43 million in the quarter. Most of the remainder reflects lower volumes, with negative leverage effect and lower vendor rebates tied to reduced purchase volumes. Gross margin declined approximately 220 basis points year over year, and SG&A as a percentage of revenue increased approximately 350 basis points, reflecting deleverage on lower volumes, higher freight and fuel costs and higher professional fees related to ongoing technology initiatives.

As John noted, we have engaged Alvarez & Marsal to advise us on our European operations, with an initial focus on improving customer service levels, stabilizing operations and strengthening performance and cost discipline across the region.

Specialty segment EBITDA was $25 million, with an EBITDA margin of 5.5%, approximately 180 basis points lower than the prior-year period. This mainly reflected higher freight and fuel costs and integration-related challenges associated with the acquisition we completed in the second quarter.

Moving to cash flow and the balance sheet, third quarter operating cash flow was $411 million, and free cash flow was $372 million, reflecting improved working capital management and continued strong cash conversion in North America. For the first nine months of the year, operating cash flow was $466 million, and free cash flow was $336 million.

As of September 30, total debt was $3.7 billion, and total leverage, as defined in our credit facility, was 2.8 times EBITDA, consistent with the end of the second quarter. Total liquidity was approximately $1.7 billion. As previously noted, in late July we prepaid our $500 million term loan originally due in January 2027, using borrowings under our revolving credit facility. We currently have no significant borrowings coming due until 2028.

During the quarter, we repurchased approximately 1.2 million shares for $30 million and extended our share repurchase program through October 2028. We also paid $76 million in dividends And on October 27th, the Board declared a quarterly cash dividend of $0.30 per share. Year to date, we have returned $313 million to shareholders.

Our capital allocation priorities are unchanged. We remain committed to maintaining a strong balance sheet, while continuing to invest in the business and return capital to shareholders.

Turning to our outlook, as we announced on October 23rd, we have suspended our full-year 2026 guidance, and our previous guidance should no longer be relied upon. Given the leadership changes we announced last Friday and the ongoing challenges in our Europe segment, we believe suspending guidance for the remainder of 2026 was the appropriate approach.

Let me close by reiterating that we fully acknowledge the issues that affected our results, and we are taking immediate action to address them. Our near-term priorities are to stabilize the business, strengthen our operations and improve financial and operational performance.

We are examining the business closely, establishing clear action plans and accountability, and moving decisively on opportunities to deliver near-term improvement. The Board's decision to suspend the Strategic Alternatives review reinforces that focus. We have a strong business, leading market positions and competitive advantages that we have built over decades. We are sharpening our attention on execution, serving our customers, and delivering improved results.

As John discussed, we look forward to welcoming Sal and working closely with him as we enter this next chapter. In the interim, the Office of the CEO will remain closely engaged with our leadership team and the Board, maintain focus on our priorities, and ensure a smooth transition so that Sal can move quickly when he joins us.

I also want to thank our employees around the world, many of whom are listening today. I recognize that the recent leadership transition represents a significant change for our organization, and I am grateful for your continued focus, commitment, and dedication to our customers.

Thank you for joining us today. Operator, you may now open the call for questions.