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LKQ Corp. (LKQ)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Joseph P. Boutross
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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

Dominick Paul Zarcone
President, Chief Executive Officer & Director

Q4 HIGHLIGHTS

Opening Remarks

- As many of you know, in late November, we announced my intention to retire as CEO effective June 30, 2024 and that the board unanimously selected Justin as my successor, following an intensive planning process that had been initiated well over a year ago
- In the interim, Justin is serving as our Global COO, I look forward to working with him and our segment teams to ensure the continuation of our operational excellence program that we started late in 2018
- Nowhere has this program been more evident than in our wholesale North America segment, which under Justin's direction has significantly expanded margins, improved cash flow, all while enhancing our leading market position

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- Time and again, Justin has proven himself as both a strong operating executive and an effective leader who definitively embodies LKQ's values
    - It is a pleasure having Justin on the call today in his well-deserved new role
- I'm going to start by providing some high level comments related to our performance in the quarter and the full-year 2023; followed by Rick, who will dive into the financial details and discuss our 2024 guidance; and then Justin will provide some initial thoughts and commentary on our businesses, the path forward and an update on our Uni-Select integration

Performance

- Let me start with what LKQ accomplished in the last year, a year where operational excellence remained at the forefront of our efforts, as we look to drive organic revenue growth, productivity and excellent FCF.
- I am proud to say that the LKQ team delivered

Accomplishments

ORGANIC REVENUE GROWTH, UNI-SELECT ACQUISITION, FCF AND DEBT

- Here are some of the 2023 accomplishments worth noting
- LKQ delivered strong full year organic revenue growth for parts and services of 4.7% on a reported basis, and 5.1% on a per day basis
- In February, we announced the highly synergistic Uni-Select acquisition and closed the transaction on August 1
- We used our FCF to begin paying down debt as we strive to reduce our total leverage ratio to 2.0 times
- We're well on our way with net debt pay-downs of over $375mm since the transaction closing and the total leverage ratio at yearend was just 2.3 times

CASH AND SHARE REPURCHASING

- We returned about $300mm of cash to our shareholders through dividends and increased the quarterly amount by 9% in October
- We also continued our share repurchase program with $38mm outlay during the year of which $30mm was completed in Q4

Cash Flow and EBITDA

- And finally, we sustained a positive momentum in terms of cash flow generation with FCF of approximately $1B in 2023
    - This represents the fourth consecutive year at or above $1B and the 2023 results reflect a solid conversion ratio of 59% of adjusted EBITDA

Revenues and Foreign Exchange Rates

- Now, onto the quarterly results
- Revenue for Q4 2023 was $3.5B, an increase of 16.6% as compared to $3B for Q4 2022
- Parts and services' organic revenue increased 2.8% on a reported basis and 3.4% on a per day basis
- Foreign exchange rates increased revenue by 2.7% and the net impact of acquisitions and divestitures increased revenue by 13.1% y-over-y for a total parts and services revenue increase of 18.7%

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- Other revenue fell 16.4%, primarily due to weaker precious metal prices relative to the same period in 2022

North America Segment

ORGANIC REVENUES, CCC AND APU

- Let's turn to some of the quarterly segment highlights
- Organic revenue for parts and services for our North America segment increased 5.3% compared to Q4 2022
- We continue to perform well in North America, especially when you consider that, according to CCC, collision and liability-related auto claims were down 7.9% y-over-y
- We believe the significant outperformance is due to several factors, including an industrywide increase in alternative part usage, or APU, which was in part driven by the continued progress of the State Farm rollout, the remaining positive impact of the UAW strikes, and lastly, LKQ continuing to take market share

ORDER FILL RATES, CAR PARC, LOSS RATE AND SALVAGE BUSINESS

- The upward trend in our aftermarket volumes and the ongoing improvement in our order fill rates continued with fill rates reaching close to 95% in Q4, the highest level in 2023
- As the supply chain recovered and fill rates increased, APU trended in our favor, particularly when looking at vehicles in our sweet spot
- While total APU was about 36% in 2023, when looking at vehicles 4- to 6-years old, it was approximately 40%
- And for vehicles more than 7-years-old, it was 51.6%
    - Both results represent meaningful increases over the 2022 levels
- The aging car parc will increase demand for the types of parts we sell into the collision repair industry
- The salvage business had solid organic growth largely driven by volume
- Total loss rates increased a bit in 2023 to 20.8%
    - But, as you can see, it had no impact on our organic growth
- Importantly, the increase in total loss rates is largely being driven by vehicles 10 years and older, which is a population of vehicles at the very tail end of our sweet spot
- For perspective, today, the average model year of a vehicle being repaired in a collision bay is a 2017 model with the total loss rate for that cohort of vehicles being just 18.4% in 2023
    - That further supports our thesis that total loss rates will not materially impact our growth
- Industry experts believe the total loss rate will edge down a bit in 2024
- As we have always stated, fluctuations in total loss rates are largely net neutral events for LKQ.
    - During the quarter, we realized a slight revenue uplift from the UAW strikes, which has now leveled off and no further benefit is expected

European Segment

ORGANIC REVENUES

- Moving to our European segment
- Europe organic revenue for parts and services in the quarter increased 3.9% on a reported basis and 5.1% on a per day basis

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- All the regions produced solid organic growth in the quarter with a particularly strong performance in the Benelux and Eastern European markets, as well as with our private label and salvage product lines

GERMAN OPERATIONS

- During Q4, our operations in Germany were again impacted by employee strikes at our large distribution center in Bavaria, while the ongoing discussions and negotiations between the works council and employers association continued
- Throughout this process, our European team has worked diligently to mitigate the day-to-day impact of the strikes, and their efforts have begun to offset some of the challenges that have impacted our German operations
    - Although, the strikes continue, we have been able to temporarily add some short-term capacity to operate our business and service our customers
- Additionally, to foster a resolution, we recently initiated an incremental and unique approach and propose terms of an LKQ-only offer to the works council
- We have also communicated those terms to our employees and are cautiously optimistic that we are making positive progress towards a resolution
- Rick will provide you with the financial impact shortly

Specialty Segment

ORGANIC REVENUES, RV SPACE

- Now, let's move on to our Specialty segment
- During Q4, Specialty reported a decrease in organic revenue of 7%, which was under our expectations
- Specialty, again, confronted headwinds specific to RV and towing products
- Within the RV space, RV wholesale shipments of new units from the OEs to the dealers ended 2023 on a positive note with an increase of 8.1% in December
- This was the second consecutive month of y-over-y growth
- Full-year shipments, however, were down 36.5%
- The general sense in the industry is that the RV headwinds have bottomed out, but we are not yet out of the woods as the dealers are still reluctant to fully restock accessories until they see the demand for new units increase

TRUCK ACCESSORIES

- Truck accessories were also under some pressure in the quarter due to the drop in new vehicle production specific to the pickup and jeep categories
    - While marine and off road product lines generated positive growth

Self Service Segment

ORGANIC REVENUES AND PRICING

- Now to our Self Service segment
- Organic revenue for parts and services for our Self Service segment decreased 5.6% in Q4
- Self Service was again challenged by soft commodity pricing as seen in the other revenue decline, which impacted our expectations

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- The soft, precious metal prices have continued into 2024 and in the short term, we expect little relief from commodities as we have modeled accordingly

Red Sea Crisis

- Briefly on the Red Sea crisis
- As far as we can predict, there will be minimal impact on parts availability in our key segments
- In Europe, our procurement team has seen some disruption with the shipping lines having to divert their vessels via the Cape of Good Hope around South Africa, increasing lead times and freight costs
- The freight cost is expected to soften once the Chinese New Year four-weeks from mid-January ends
  - As one would expect, if the crisis persists, then we will potentially witness an increase in freight costs

Orders and GSF Car Parts Business

- Our supply chain team is taking precautionary measures by adding additional orders to address the extra lead times, especially with our private label product
- Lastly, on October 25, 2023, as I mentioned on the last earnings call, we completed the divestment of GSF Car Parts formerly owned by Uni-Select
- Since the GSF Car Parts business was held separately and never integrated into our business, we classified the business as discontinued operations upon acquisition

Cash Dividend

- Before I turn over to Rick, who will run through the details of the segment results and discuss our outlook for 2024, I am pleased to announce that on February 20, 2024, our board of directors approved a quarterly cash dividend of $0.30 per share of common stock that will be payable on March 28, 2024 to shareholders of record at the close of business on March 14, 2024

Rick Galloway

Chief Financial Officer & Senior Vice President

FINANCIAL HIGHLIGHTS

- Before I address Q4, I would like to reflect on what LKQ accomplished throughout 2023
- We were optimistic about our prospects going into 2023 despite macroeconomic challenges, inflation and declining commodity prices
- With our operational excellence focus and strong balance sheet, we concentrated on the things we could control
- And in those areas, we were very pleased with our performance

Profitability and Variances

- We encountered headwinds that set back the overall profitability, but we believe many of these are transitory and will be minimal in 2024
- The non-discretionary nature of the majority of our business and the resiliency of our industry allows us to perform well in almost any market environment
- Referring to the walk on slide 4, I want to highlight the key y-over-y variances in our full year results

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EPS and Operational Performance

- We reported diluted EPS of $3.51 and adjusted diluted EPS of $3.83, the latter of which was $0.02 decrease relative to 2022
- Our operational performance was a strong positive, delivering $0.27 y-over-y improvement with exceptional growth in North America, partially offset by softness in precious metal prices and difficult market conditions impacting our Specialty and Self Service segments
- Europe also contributed to the improvement with solid revenue growth and productivity benefits, helping to offset the effects of the German strikes and the value-added tax matter in Italy

Share Repurchasing and Prices

- We benefited by $0.10 due to lower share count resulting from our share repurchases in 2022
- We experienced y-over-y headwinds from market conditions, the most notable of which were $0.19 from the impact of metal prices as shown on slide 28 and $0.13 in higher interest expense resulting from rate increases excluding Uni-Select costs

Acquisition and Divestiture Activities

- Acquisition and divestiture activities had a negative effect, including $0.04 of dilution from the Uni-Select acquisition
- Important to note, this result was $0.01 better than we anticipated in our Q4 guidance and $0.02 of reduced earnings related to the PGW divestiture in April 2022

Foreign Exchange Rates and Tax Provision

- Foreign exchange rates were favorable on average in 2023, which contributed to $0.02 benefit
- The tax provision represented $0.06 benefit driven mostly by favorable impacts from discrete items

EPS

- We have also included a fourth quarter EPS walk on slide 5
- The main variances are similar to the full year drivers but with income taxes representing the largest variance from 2022
- The 2023 provision included favorable discrete items and a slight full year effective rate reduction, while 2022 reflected a negative provision effect from increasing our full year effective rate and unfavorable discrete items
    - To expand on the operating performance for the quarter, I will provide additional detail on the segment results

Wholesale North America

EBITDA MARGINS, UNI-SELECT AND EBITDA

- Going to slide 12, Wholesale North America continued its strong performance with the segment EBITDA margin of 16.3%
- Q4 was the first full quarter with Uni-Select, and as communicated, the transaction was dilutive to the segment margin by 220BPS.

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- Without Uni-Select, North America margins would have been comparable to Q4 2022 and would have delivered a record full year EBITDA margin of 19.7%

SALES AND UNI-SELECT INTEGRATION

- Q4 2023 benefited from some incremental sales in October, November attributed to effects of the UAW strike and we don't expect further upside in 2024
- The Uni-Select integration is progressing ahead of schedule and with FinishMaster and LKQ locations merging, it's becoming increasingly difficult to determine a standalone Uni-Select impact
- Therefore, we will not provide specific Uni-Select impacts on the North American results going forward, but we'll instead report just on synergy achievement
    - We expect the 2024 North American full year EBITDA margin including Uni-Select to be around 17%

Europe Segment

EBITDA MARGINS AND UNUSUAL ITEMS

- As shown on slide 13, Europe reported segment EBITDA margin of 8.3%, down 170BPS from the prior year period
- There were several unusual items which had a negative effect of 110BPS on the results
- First, the strikes at our primary distribution center in Germany continued in Q4 and we estimated the lost revenue a negative effect on the segment EBITDA margin of 50BPS.
- Second, we booked a non-recurring compensation charge for $6mm, which impacted the margin by 40BPS.
- Finally, we recorded a reserve for value-added tax matter, which lowered the margin by 20BPS.
- The remaining margin variance is attributable to inflationary cost effects in SG&A expenses, primarily in personnel costs

OUTLOOK

- Looking ahead to 2024, we project a return to a double-digit margin as we work past the strikes and the transitory effects that drop the segment below a 10% margin in 2023

Specialty

EBITDA MARGINS, GROSS MARGINS AND SG&A EXPENSES

- Moving to slide 14
- Specialty's EBITDA margin of 5.7% decreased 50BPS compared to the prior year
- Gross margin, which was down 290BPS y-over-y, is under pressure from increased price competition, as inventory availability continues to improve for our competitors in addition to unfavorable product mix as the lower margin line such as auto and marine have been less affected by revenue reductions than the RV market
- I am pleased to report our SG&A expenses were favorable by 210BPS, mostly related to personnel and primarily coming from management restructuring efforts in the last 12 months to align the cost structure with revenue trends and lower benefits in insurance costs
- 2023 was a tough year for Specialty

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- But by focusing on controllable costs, the team was able to mitigate some of the negative leverage effect on margin caused by the revenue decline

ORGANIC REVENUE GROWTH

- Going into 2024, the segment still faces challenging conditions and we expect low single-digit organic revenue growth
    - However, we are optimistic about our ability to improve EBITDA margins by 10 to 30BPS through productivity

Self Service

EBITDA MARGINS, PRICES AND OTHER REVENUES

- As you can see on slide 15, Self Service profitability improved sequentially to EBITDA margins of 6.0% this quarter from a loss of 0.6% in Q3 and increased relative to the 5.2% reported in Q4 2022
- Metals prices had a net negative effect on results of $6mm, with lower precious metal prices representing $13mm reduction in EBITDA and lag effects from sequential scrap steel price changes driving $7mm improvement
- Other revenue decreased by 25% in total contributing to a reduction in operating leverage of 620BPS.
- As part of the actions taken earlier in 2023, our average car cost decreased by 6% and 18% in Q4 relative to Q3 and Q2, respectively, which provided some margin relief and contributed to the y-over-y improvement
    - We are pleased with the return to profitability in Q4 and expect to improve our 2024 segment EBITDA in dollar terms compared to 2023

CASH FLOWS AND BALANCE SHEET ITEMS

- Shifting to cash flows and the balance sheet
- We produced $87mm in FCF during the quarter, bringing the YTD total to $1.0B.
- As expected, FCF was relatively light in the quarter as we had $96mm of interest payments, including the first payment on the US bonds issued in May and $125mm of CapExs

CapEx, Cash Conversion Ratio and Capital Spending

- At $358mm of CapEx for the year, we exceeded our prior guidance by $58mm as we took advantage of our strong cash flow and liquidity position to make strategic purchases, some of which were pulled forward from our 2024 plan
- For the year, the cash conversion ratio was 59% conversion of EBITDA to FCF, in line with our targeted range of 55% to 60%
- With the future headwinds related to interest expense and capital spending requirements, we were widening our cash conversion target range to 50% to 60%
- While we have opportunities to drive trade working capital lower such as with the supply chain finance program, these opportunities are not as abundant as they were years ago when we began our operational excellence journey

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FCF, Debt and Leverage Ratio

- The team has done terrific work to lower working capital levels over the last five years and the effects were seen in the strong FCF figures
    - We believe we can continue to generate FCF in the range of $1B on a recurring basis by converting earnings growth into cash flow, being efficient in our deployment of trade working capital and expanding our supply chain finance program
- As of December 31, we had total debt of $4.3B with a total leverage ratio of 2.3 times EBITDA
- We paid down over $375mm in debt between the acquisition of Uni-Select at the beginning of August and yearend, a portion of which came from the sale proceeds related to the GSF business we divested in October

Leverage Ratio and Borrowing Rate

- We remain committed to reducing our total leverage ratio to 2.0 times within 18 months of the Uni-Select acquisition or more specifically during Q1 2025
- Our current maturities include the €500mm senior notes due on April 1
    - We're working on refinancing options and expect to have a refinancing in place in the near term
- Our effective borrowing rate was 5.8% for the quarter, as market rates remained relatively high in the US and Europe
    - We have $1.2B in unhedged variable rate debt, so 100 basis point rise in interest rates would increase annual interest expense by $12mm

GUIDANCE

Foreign Exchange and Revenue Growth

- I will conclude with our thoughts on projected 2024 results as shown on slides 6 and 7
- Our guidance is based on current market condition, recent trends and assumes scrap and precious metal prices hold near December prices
- On foreign exchange, our guidance includes recent European rates with balance of the year rates for the euro of $1.09, the pound sterling at $1.27 and the Canadian dollar at $0.74
- We expect organic parts and services revenue growth between 3.5% and 5.5%
- Please note that we have one to two more selling days in 2024 depending on the market with the increase coming in H2
    - Europe will be down a selling day in Q1 due to the timing of Easter

Growth and EPS

- Our 2024 estimate includes growth associated with the expansion of aftermarket parts volume resulting from State Farm and the impact of Uni-Select, which will be included in organic parts and services revenue beginning on August 1
- We are projecting full year adjusted diluted EPS in the range of $3.90 to $4.20 with a midpoint of $4.05
    - This is an increase of $0.22, or 6% at the midpoint relative to the 2023 actual figure
- Looking at slide 6 in the presentation, you can see how we get from the 2023 actual EPS to our 2024 guidance

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Operating Performance

- Operating performance is expected to generate growth of $0.22 relative to the 2023 results with growth coming from all four segments
- We expect Europe and North America, including the Uni-Select contribution to generate more y-over-y growth than Specialty and Self Service
    - The transitory items in Europe noted in the last few quarters are expected to be a lesser impact in 2024 and thus will add $0.09 compared to 2023

Exchange Rate Benefits

- The exchange rate benefit is nominal
- Commodity prices are expected to be a headwind of $0.09 as the current precious metal prices used in the guidance are below the 2023 average
- Excluding the impact of Uni-Select, interest expense is projected to be a nominal impact with a higher average rate mitigated by debt pay-downs
    - Consistent with past practices, we have not anticipated future share repurchases beyond the call date of our guidance

Tax Rate, FCF and Cash

- We have included an effective tax rate of 26.8% in our 2024 guidance in line with the final 2023 rate
- We expect to deliver approximately $1B of FCF for the year, achieving an EBITDA conversion to FCF in the low 50 percentage range
    - There are various puts and takes in this estimate, including higher cash payments for interest and building inventory offset by improved earnings and increased payables

Capital Spending and Capital Allocation Strategy

- Capital spending is expected to be at the high end of our target range, again at $350mm, which includes key investments in salvage capacity and specialty distribution to support productivity and margin enhancement initiatives
- We feel good about the projected full year cash flow estimate and the conversion ratio generating $1B in FCF provides flexibility to continue a balanced capital allocation strategy, including debt pay-downs, our quarterly dividend, share repurchases and investments in high synergy tuck-in acquisitions

Earnings Growth

- In terms of quarterly phasing, we expect the earnings growth to be weighted more heavily to the back half of the year
- Q1 has been affected by extreme weather conditions in certain markets and very low catalytic converter prices, which in recent weeks were running near 50% of the price in the same period of 2023
- Q1 will also be affected by the timing of Easter, resulting in a loss selling day in Europe
    - The balance of the year will benefit from the additional selling days mentioned previously and a ramp-up of Uni-Select synergies as the year progresses

Justin L. Jude
Chief Operating Officer & Executive Vice President

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OPERATING HIGHLIGHTS

Management Team

- First, I'm honored to be chosen to succeed Nick later this year as the next CEO of LKQ.
- And I'm humbled to be able to lead our talented team into the future
- I'd like to thank Nick for his mentorship and leadership, our board for trusting me to lead LKQ through this next chapter
    - And most importantly, I'd like to thank my wife and kids for their love, patience and support, because without them, I wouldn't be where I am today
- As I prepare to step into the CEO role in July, I'm filled with enthusiasm and a deep sense of responsibility
- My vision for LKQ is rooted in three fundamental principles, people, growth and operational excellence
    - People are at the heart of LKQ
- My first and foremost commitment is to each of my fellow team members across our global organization who are the backbone and essence of LKQ.
    - LKQ's employee-focused culture centered around communication, accountability, integrity, and respect is not just a goal, it's a necessity for our collective success

Service and Products

- Growing our business, delivering excellent service and products to our customers is a part of who we are
- We will drive revenue organically by growing share of wallet with our customers and being opportunistic on tuck-in acquisitions

Operational Excellence

- And lastly, operational excellence
- We will continue to hone our culture of lean management throughout our operations
- This will not only improve our financial metrics but will also provide a consistent and repeatable operating rhythm where our customers will see continual improvements in our service levels

Priorities

- Alongside these principles, we will focus on four key priorities
- First, integrate our businesses and simplify our operating model
- Second, focus on profitable revenue growth and sustainable margin expansion
- Third, drive high levels of FCF, which in turn will give us the flexibility to maintain a balanced capital allocation strategy and return capital back to our shareholders
- And finally, invest in our future

Integration of Uni-Select Acquisition

- In the short-term, the North American wholesale team is focused on the integration of our Uni-Select acquisition and taking full advantage of the tremendous synergies that exist within our global footprint
- I'm extremely proud of how the team is performing with the integration

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SYNERGY PLAN

- As of today, we have integrated a total of 75 of the 151 FinishMaster locations representing over 52% of the consolidated revenue
- Corporate synergies are largely complete and on pace to slightly exceed our expectations
- The overall synergy plan is on track to deliver above our previously stated targets well ahead of schedule

Bumper to Bumper Business

- The Bumper to Bumper business in Canada completed two tuck-in acquisitions in October of 2023, representing a total of 14 locations as we convert some of that market from three step to two step
    - And Bumper to Bumper is working closely with our North American and European procurement teams to maximize additional revenue and cost synergies
- In January, Bumper to Bumper placed their first purchase order with our Europe's private label team and we are confident these synergistic orders will increase over time, enhancing our offering and our competitiveness

Uni-Select

- Importantly, I want to again emphasize that Uni-Select was a unique opportunity that will enable us to widen the moat around our North American business and capitalize on revenue synergies both in the paint and the hard parts side that weren't there prior to this acquisition

North American Teams

- Our North American teams have the best operators, motivators and integrators in the industry and the results since starting our operational excellence journey in 2019 speaks for itself
    - I am confident of their ability to generate positive operational and financial returns with our Uni-Select business integration
- Long-term in North America, we will continue to invest both in recycled and remanufactured EV battery process as we are a natural fit to become the market leader in this growing space

Europe

- Turning to Europe, over the last 45 days, I spent time with our European leadership team, diving into multiple aspects of their business
- Andy Hamilton, our new CEO of Europe and I agree that there are many levers to pull in Europe
    - Our primary objective is to accelerate the integration of One LKQ Europe to fully leverage the network of our inventory, which today is still largely country specific

Objective

- By linking the geographical and regional distribution network across our European footprint, we will drive high levels of productivity, leading to improved fulfilment rates, enhanced customer service and improved trade working capital
- Achieving this objective will allow us to profitably grow and increase our market-leading position
- Additionally, in Europe, there is an opportunity to grow our offerings in such areas as private label, collision components, diagnostic and calibration, recycling, remanufacturing and EV aftermarket parts

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Academy and Facility Consolidation

- We also have the ability to expand our LKQ Academy, a program that we offer to independent garages to enhance their EV knowledge base and capabilities, allowing these shops to see the changing technology as an opportunity
- Lastly, I believe we have an opportunity to rationalize certain areas of our business through facility consolidation and fleet and logistics network optimization, which will allow us to create efficiencies across geographies and product groups

Integration

- As we work through our ongoing integration efforts, we will continue to assess our mix of businesses and take decisive action to determine if we are the right owners of certain assets prior to integrating

CLOSING REMARKS

- In closing, I'm extremely excited about driving our mission forward and expanding a lean operating model across our entire organization with a primary objective to move swiftly
- LKQ has an extraordinary history and importantly, an extremely bright future

Dominick Paul Zarcone

President, Chief Executive Officer & Director

CLOSING REMARKS

- Justin for your thoughtful perspective and comments and Rick for that detailed financial overview
- Our organization has once again proven to be incredibly resilient in any operating environment
- Our global teams have worked with agility and urgency to continuously achieve positive results with our operational excellence strategy and establishing One LKQ, a unified and globally focused team
    - This success is a direct result of a shared mission amongst our over 49,000 employees, which is simply being the leading global value-added and sustainable distributor of vehicle parts and accessories by offering our customers the most comprehensive, available and cost effective selection of parts and service solutions while building strong partnerships with our employees and the communities in which we operate
- I'm confident LKQ will live that mission in 2024 and excel through this leadership transition
- LKQ's future is very bright with Justin at the helm

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QUESTION AND ANSWER SECTION

Daniel Imbro
Stephens, Inc.

Q

...maybe on – good morning. I want to start on the North American side. Rick, Justin, I know you guys aren't guiding to growth by segment, but obviously, it's been holding in there nicely this year. Would the 3.5% to 5.5% kind of organic growth guide be a fair range for North America as well? And can you break out maybe your expectations, what you plan on seeing within pricing and then traffic growth as we head through the new year here on the North America side?

Rick Galloway
Chief Financial Officer & Senior Vice President

A

The way to think about it, I talked a little bit about it in the prepared remarks. Specialty is going to be in the low single-digits, so that's going to be on the downside of it, whereas North America and Europe will actually be on a little bit of a higher side. When you think about both of them, it's going to be primarily driven by volumes as far as where that's going to come out for our North American operations. And then I did talk a little bit about the EBITDA percentage with Uni-Select included 17% is the number that we're guiding towards for our North American operations.

Daniel Imbro
Stephens, Inc.

Q

And then for the follow-up. One question on the balance sheet, obviously, free cash generation remains strong. I want to focus on the vendor financing over in Europe. Is there still room to drive that higher? Can you provide any quantification on maybe the progress you've made, Rick, over the last few years? And then, in terms of uses of cash, good to see the buyback restart here in Q4. Are you comfortable with that being a more ratable part of capital allocations moving forward?

Rick Galloway
Chief Financial Officer & Senior Vice President

A

You're spot on. The vendor financing program, supplier financing program, we're very pleased with what we saw. We ended the year at $411mm in the vendor financing program. That includes $71mm related to Uni-Select with the acquisition that we did. That's compared to $244mm that we had at the end of 2022. Obviously, there's going to be some ups and downs. We finished a little bit on the high end from what we expected, but very good usage. We'll continue to see a little bit more going into that, particularly for our European, but also for our Uni-Select operations, helping to drive a little bit of more FCF.

But it's not going to be at those same levels, it's not going to be a 20% increase going into 2024. So I'd caution you to not put too much in there as far as that goes. And then on the share repurchases, we're pleased with where we are turning out on FCF. We hit the $1B that we had talked about, that's inclusive of the $30mm that we purchased in Q4 on shares.

And then, again, we were active in Q1 and we think that this will be a regular piece of it. Obviously, there's a significant commitment that we made on the leverage ratios getting down to 2 times within the first 18 months, so that's technically January or Q1 of 2025. So there'll be a significant overweighting on the debt payments throughout the year, but we will be active as we see opportunities.

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Michael E. Hoffman
Stifel, Nicolaus & Co., Inc.

Q

I know you've got one more earnings call, but you do get to leave the business better than you found it. So, well done.

Michael E. Hoffman
Stifel, Nicolaus & Co., Inc.

Q

So my question is back to the free cash. I think you're getting a lot of these today probably. And there's two parts of it. When do we get back to a compounded growth rate in the cash? And then, the European question part of that is, what's the remaining gap between payables and inventory in Europe that is an opportunity to capture that would drive some of that compounding?

Rick Galloway
Chief Financial Officer & Senior Vice President

A

As far as the FCF goes, if you think about the last couple years, and I talked briefly about this in the prepared remarks, we were able to drive a significant portion of some of our lower hanging fruit on trade working capital. And then in addition to that, we did have a little bit of a benefit in the last couple of years, not 2023, but prior to that, if you're looking back a little bit, on CapEx as well, where we did – we had some supply chain financing – or not supply chain financing, but supply chain issues and getting some of those materials. And so, CapEx was a little bit lower.

If you think back to like 2020 when we had a high – we only delivered – we only had about $172mm of CapEx, whereas we had $358mm this year. So, there's pretty significant catch-up, if you will, on that portion. So what I would say is we're at a normalized level and the compound you're talking about with EBITDA, and then driving overall earnings, and then driving FCF, that's what we should start expecting as we've just now normalized that amount.

As far as the opportunity in Europe goes, we think that there's still opportunity. I wouldn't put necessarily a number to it, Michael. I think we had about a 20% improvement – little over 20% improvement in our vendor financing program in 2023, which is great. It's not going to be 20% in 2024. It's going to be lower than that, but it's still going to be positive and still going to be cash generation coming out of our trade working capital going into 2024.

Michael E. Hoffman
Stifel, Nicolaus & Co., Inc.

Q

And then my second question, Justin alluded to the possibility of portfolio optimization. And I'll get very specific – I get that self-serve was the start of the company. But at this point, do you need to own the self-serve business to be the LKQ you are today going forward?

Justin L. Jude
Chief Operating Officer & Executive Vice President

A

So, first off, I would say our self-serve team managed very well through some challenging conditions in 2023. But I'll give you an answer on my overall thoughts on portfolio management, which really hasn't changed from the company standpoint, from mix standpoint. Our job is always to look at whether we're the right owners of the businesses, whether it's product lines, whether it's businesses that operate in different geographies, and if they fit in our long term operating model, if they hit our financial metrics, it's something we'll look at keeping on

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optimizing, and if not, we'll optimize it and look to supply. But I would say that's just my general idea on portfolio management. Historically, self-serve has been a decent business for us too.

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

Q

I think you talked Europe and some levers that you and Andy might pull. Maybe you could dig into that a little more, especially on the private label side. But any other levers that you can pull to drive margin expansion?

Justin L. Jude
Chief Operating Officer & Executive Vice President

A

I have spent several weeks over in Europe meeting the teams over there, the leaders of our different businesses. I'm very optimistic about our future, spent quite a bit of time with Andy Hamilton, our new CEO. Andy did run our ECP operations in the UK, which was our highest profitable and one of our highest businesses that drive private label.

Some of the things that him and I have talked about and he's laser focused on is category management, and that includes driving more private label, which will bring us better margins, really leveraging our inventory and logistics with our borders. Today, we're very optimized within the countries in which we operate, but we're still independent within those countries.

So, we're going to continue to accelerate the One LKQ Europe to leverage that inventory, freeing up free capital. In addition, it'll give us better fulfillment rates, which will drive organic revenue and also looking at labor productivity. And so, these are things that Andy has been once again laser focused on with his team and him and I are aligned on that pretty well. So I'm very optimistic about the opportunities in Europe.

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

Q

As a follow up, is there a way to frame your fulfillment rates in Europe and contrast them with what you can achieve in the US or North America?

Justin L. Jude
Chief Operating Officer & Executive Vice President

A

It's a lot of different product lines today. We're heavily collision-focused in the US and North America vs. hard parts over there. We're grabbing some of that – I would say, the best practices to track fulfillment rates. We have a lot of orders, and our European operations are not necessarily on the phone like they are in the US, so a lot of online, a lot of e-commerce with businesses.

But one of the things, when we look at category management and we rationalize some of the different excess product lines that we may carry, still carrying an application for what the customer is looking for, but maybe not so many different brands, that will actually allow us to drive our fulfillment rates up.

Bret Jordan
Jefferies LLC

Q

You talked about bumper-to-bumper doing some purchasing from European vendors. Could you talk about how much supply chain synergy there is there? How much bumper-to-bumper product could come from existing vendors?

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Rick Galloway
Chief Financial Officer & Senior Vice President
A

We've got – so, Bret, I'll start, and then if you want to chime in, Justin. So we've identified within the $55mm some procurement synergies. It's less than $10mm number as far as the overall opportunities on that portion of it that we have been already active talking back and forth with our European operations in driving some of that. And it's been real small thus far as far as the opportunity goes, getting into the P&L, but it is progressing nicely. So, Justin, I don't know if you want to add anything.

Justin L. Jude
Chief Operating Officer & Executive Vice President
A

I'd point, we have started leveraging our European supply chain, bringing in some private label that we already operated on or already carried in at bumper-to-bumper in Canada. Our next phase is looking at new product lines that today bumper-to-bumper does not carry. So it's not only a cost of goods play there but also a revenue generation and margin improvement with new brands and new product lines offering within the private label, so.

Dominick Paul Zarcone
President, Chief Executive Officer & Director
A

You recall that when we announced the transaction back in February 2023, one of the opportunities we saw actually related to European mix models which is today up in Canada that cohort [ph] occurs (00:45:49) represents 10% of the car parc, but bumper-to-bumper historically has distributed almost zero product for European mix models. And we know somebody who knows a lot about the European marketplace. And that's where the focus will be, will be to bring in product lines to service that 10% of the market up in Canada.

Bret Jordan
Jefferies LLC
Q

And then you talked about EV battery recycling. And I guess, what does that mean? Are you talking about extracting them or actually processing like Redwood Materials? Is that North America or Europe? And is that a capital investment to get into that business?

Dominick Paul Zarcone
President, Chief Executive Officer & Director
A

So our primary focus right now, Bret, is on the remanufacturing of the batteries, taking a battery that's not operating at normal levels, taking out the cells that are defective, putting in new cells, and getting that battery back on the road, essentially extending the life of the [ph] parts train (00:46:48).

We have is – we know that last year we're talking with some third parties about recycling, not where we would be operating facilities but where we could be a partner, because nobody has access to the battery. None of the big three folks trying to do the recycling really have access to the supply chain. And with our salvage operations, we are the perfect entity to help partner. So we are taking a hard look at key partnerships that could help us move forward on the recycling side. But we would not be necessarily owning and operating large recycling facilities.

Dominick Paul Zarcone
President, Chief Executive Officer & Director

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CLOSING REMARKS

- Just a couple of key dates for everyone to keep in the back of their mind
- First, our first quarter call is going to be on Tuesday, April 23. Normally, we host our calls on Thursday, but this year, that week in April is an overlap with our annual leadership conference in North America, which begins on Thursday 25
    - So Q1 reporting will be on Tuesday, April 23
- Second, we'd like everyone to mark their calendars for our 2024 Investor Day, and that's going to take place on September 10 and will be held at our North American headquarters down in Nashville, Tennessee
    - So April 23 and September 10
- And with that, I'd like to thank everybody on the call for your time and attention
    - And as always, I extend my sincere thanks to the 49,000 strong LKQers who make it happen every day

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