

17-Feb-2022

# LKQ Corp. (LKQ)

Q4 2021 Earnings Call

## CORPORATE PARTICIPANTS

**Joseph P. Boutross**  
*Vice President-Investor Relations*

**Varun Laroyia**  
*Chief Financial Officer & Executive Vice President*

**Dominick P. Zarcone**  
*President, Chief Executive Officer & Director*

## OTHER PARTICIPANTS

**Stephanie Moore**  
*Truist Securities, Inc.*

**Bret Jordan**  
*Jefferies LLC*

**Daniel Imbro**  
*Stephens, Inc.*

**Scott L. Stember**  
*C.L. King & Associates, Inc.*

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

## 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

**Dominick P. Zarcone**  
*President, Chief Executive Officer & Director*

### BUSINESS HIGHLIGHTS

#### Opening Remarks

- This morning, I will provide some high-level comments related to our performance in the quarter and full year 2021 and then Varun will dive into the financial details and discuss our 2022 outlook before I come back with a few closing remarks
- Before I begin, on behalf of everyone at LKQ, I again want to express our sincere thanks to all those on the front lines who are working hard to keep our communities and our citizens safe and healthy
- I also extend condolences to all those who have suffered a personal loss during this unfortunate pandemic

- It seems like everyone knows someone who has been seriously impacted by COVID.
  - While we've made great strides across the globe combating the pandemic, it is still a harsh reality that we all have to confront in our daily lives

#### Strategy

- As most of you know, LKQ spent two decades consolidating fragmented markets into centralized businesses and in the process, we created the largest and best-in-class operators in each of our major markets
- Then in 2019, we pivoted our strategy to focus on operational excellence
- Some folks may have been skeptical about this pivot but they may not have had a true understanding of our culture; a culture that is centered on outcomes, not obstacles; a culture that is agile and nimble, and a culture that is LKQ proud
- It is with great pride that I can say our teams across all of our segments embraced and delivered on our operational excellence initiatives throughout all of 2021

#### Q4 RESULTS

##### North America EBITDA and EBITDA Margin

- Before I move on to fourth quarter results, let me highlight just a few of the milestones we achieved in 2021
- We had record corporate-wide revenue and profitability
- North America EBITDA and EBITDA margins reached their highest full-year level in the history of the company
- Europe had full-year double-digit EBITDA margins for the first time in over five years and reached the upper end of the expectations we set forth a year ago, and there is more runway ahead
- Specialty realized record full-year revenue and EBITDA margins
  - We generated our second year of FCF of over \$1B.
- We maintained net leverage well below our target of two times
- We achieved an investment-grade rating from Fitch
  - We purchased 17.2mm shares of stock for a total of \$877mm
- We issued the first dividend in the history of the company, and we issued our inaugural Corporate Sustainability Report and received an ESG rating of AA from MSCI, which puts LKQ in the top 19% of our index group
- These achievements are the result of the combined effort of each individual at LKQ; and for that, I extend a great big thank you to my entire organization

##### Revenue

- Now on to the quarter
- Revenue in Q4 2021 was \$3.2B, an increase of 7.9% as compared to the \$3B in Q4 2020
- For Q4, parts and services organic revenue increased 6.6% on a reported basis and 7.3% on a per-day basis, while the net impact of acquisitions and divestitures increased revenue 1.7% and foreign exchange rates decreased revenue eight-tenths of 1% for total parts and services revenue increase of 7.5%

#### Net Income and Diluted EPS

- Net income for Q4 2021 was \$236mm as compared to \$180mm for the same period of last year, an increase of 30.6%
- Diluted EPS for Q4 was \$0.81, compared to \$0.59 for the same period of 2020, an increase of 37.3%
- On an adjusted basis, net income in Q4 was \$254mm compared to \$212mm in the same period of last year, a 20% increase
- Adjusted diluted EPS for Q4 was \$0.87, as compared to \$0.69 for the same period of 2020, a 26.1% increase

#### Adjusted Basis

- Net income for the full year of 2021 was \$1.1B as compared to \$639mm for 2020, an increase of 70.7%
- Diluted EPS for the full year of 2021 was \$3.66 as compared to \$2.09 for 2020, an increase of 75.1%
- On an adjusted basis, net income for the full year of 2021 was \$1.2B, compared to \$777mm last year, a 51.8% increase
- Adjusted diluted EPS for the full-year 2021 was \$3.96 as compared to \$2.55 for 2020, a 55.3% increase
  - These net income numbers represent a tremendous achievement for the company as we achieved net income in excess of \$1B in 2021 for the first time in our history

#### SEGMENT HIGHLIGHTS

##### North American Segment

- Let's turn to some of the quarterly segment highlights
- As you will note from slide 6, organic revenue for parts and services in the quarter for our North American segment increased 8.3% on a reported basis and 9.9% on a per-day basis compared to Q4 2020
- When comparing to pre-pandemic levels, organic revenue for parts and services for our North American segment in Q4 of 2021 declined around 5% on a per-day basis relative to 2019 levels
- Industry data indicates repairable claims declined mid-teens relative to 2019, so it was another quarter of outperformance for our North American operations

##### Salvage Business

- Our salvage business and the growth in our major mechanical product groups continued its solid performance during the quarter
- Although fill rates for aftermarket collision parts have been challenged, we are again witnessing a positive offset from our quote conversion rates on salvage parts
- Given the supply chain disruptions, it's no surprise that our aftermarket parts business lagged the results of our recycling and remanufacturing businesses

##### North America Salvage Operations

- In 2021, our North America salvage operations continued its leadership as the largest recycler of vehicles by processing over 783,000 vehicles, resulting in, among other things, the recycling of 3.9mm gallons of fuel, 2.2mm gallons of waste oil, 2.1mm tires, 740,000 batteries, and 1.2mm tons of scrap metal

#### European Segment

- Moving to our European segment, organic revenue for parts and services increased 5.7% on a reported basis and 5.4% on a per-day basis in the quarter
- Demand trends strengthened sequentially in Q4 across all of our European regions
- Most of our regional operations experienced similar levels of revenue growth, with standout performance from our Fource business in the Benelux region and solid contributions from Germany, the UK, and Central and Eastern Europe
- On a full-year basis, these businesses performed quite well, both on revenue and profitability
- Italy, again, lags relative to our other markets

#### Specialty Segment

- Now, let's move on to our Specialty segment
- During Q4, Specialty reported organic revenue growth of 5.7% on a reported basis and 7.3% on a per-day basis
- Considering the tough comparison to an exceptionally strong 2020, this organic growth exceeded our expectations and reflected a tremendous effort by our Specialty team
- A few Specialty operational highlights would include the fact that, due to the Specialty segment's Department of Transportation safety scores and positive inspection history, the team is now eligible to participate in the department's PrePass program
  - This program allows our drivers to bypass weigh stations and certain ports of entry
- The benefits of this program will include faster travel time to the docks, less idling time, and higher driver retention
- Importantly, this program highlights that health and safety of our employees and our other stakeholders is paramount within our organization

#### DIGITAL FORMAT

- Secondly, during the quarter, our Specialty segment moved their industry-leading product catalog to a digital format
- At the peak, Specialty printed over 300,000 copies of these catalogues, each consisting of over 1,000 pages
- So, this represents a savings of 300mm printed pages
  - This green focus and shift to a digital catalog is another example of how our teams across all segments are driving our environmental leadership into all facets of the business

#### Revenue Growth

- Looking ahead, we expect solid revenue growth across all three of our segments in 2022, as we creep back to pre-pandemic volumes, get some relief from the aftermarket supply chain in the back half of the year, and utilize strategic pricing initiatives
- Specifically, we are still running behind 2019 revenue in North America, but we are closing the gap and expect to approach pre-pandemic revenue levels as we exit 2022
- Europe is back to pre-pandemic revenue levels, and we look forward to continuing the positive momentum from Q4 as we move forward in 2022
- And Specialty is obviously already running well ahead of pre-pandemic revenue levels

#### Corporate Development

- On the corporate development front, as mentioned in our last call, in the first week of October, we completed the acquisition of Hamu, one of the leading independent car parts wholesalers in the Netherlands; and SeaWide Marine Distribution, a nationwide electronics wholesale distributor that supplies electrical and electronic products for the marine, outdoor, and personal navigation markets

#### ESG Program

- During Q4, we continued the buildout of our ESG program by implementing various social initiatives
- In December, the company launched our LKQ Cares Holiday Vote, a unique program in which all employees had a voice in determining how LKQ's donations are allocated
- With this program, LKQ donated funds to 10 separate nonprofit organizations across the globe during the holiday period
- Also in December, the LKQ Community Foundation donated monies to assist various nonprofits with relief and recovery efforts from the long-track tornado that produced severe catastrophic damage in several states in numerous communities

#### Inflationary Environment

- Let's now turn to the inflationary environment, a key item of interest for most listeners on this call
- Inflation was a harsh reality across each of our segments, especially during Q4 when inflation climbed to a 39-year high in December
- The rise in prices is fairly straightforward: A combination of unprecedented supply chain and labor disruptions which choked output, and monetary and fiscal stimulus which accelerated demand
- Global disruptions of this size and velocity do not reset overnight and we suspect it will continue to be a headwind throughout 2022
  - But make no mistake, we are not resting and waiting for this to reset

#### Segment Team

- Our segment teams have implemented processes with our supplier and customer partners to deal with price changes in a more planned and structured way, ultimately staying ahead of the inflationary trends
- Of course, the success of these ongoing processes will depend on the timing of the recovery in the supply chain, including some relief in ocean freight costs

#### North American Operations

- Related to labor, by the end of December 2021, there were 11mm job openings in the United States
- Simply stated, there is a battle to hire and retain talent at all levels of the organization and prospective hires clearly have leverage and that comes at a cost
- Our North American operations have over 1,000 open positions, which represents roughly a 6% vacancy rate
- In 2021, we witnessed 5% to 7% net increase in wages for our business in North America
- We are working diligently to develop creative ways to recruit potential candidates beyond just compensation

#### Recruiting Efforts

- To expand recruiting efforts, we are building partnerships that focus on the skills needed for the open positions and exploring how we can attract talent
- In 2021, we invested in the benefit plans provided to our employees, including, but not limited to, enhancements to our core behavioral health and paid parental leave programs
- Our European operations are facing the same challenges, and are currently running at a 3.5% vacancy rate, with wages increasing between 3% and 5% in 2021

#### Europe Team

- Focusing on retention and recruiting as well, at the end of Q4, our Europe team launched a comprehensive employee engagement survey with WorkBuzz to further understand the employee experience and how we can be their employer of choice
- The team invested in development for their leadership team and mental well-being training for all colleagues across Europe

#### Labor Impact

- The labor impact is an industry-wide issue
- In Q4, the national average scheduling backlog for collision repair shops was 3.4 weeks vs. pre-pandemic levels of just 1.7 weeks
- The doubling of the backlog is predominantly due to technician shortages, and to a lesser extent, parts availability

#### Headwind

- Based on the milestones we achieved throughout 2021, clearly our teams have been judicious with quickly driving change
- And I am confident we will operate with the same level of vigor to combat the headwinds we face with the supply chain and labor and freight costs, all against the backdrop of the ongoing pandemic

#### Cash Dividend

- Lastly, before I turn the discussion over to Varun who will run through the details of the segment results and discuss our outlook for 2022, I am pleased to announce that on February 15, 2022, our Board of Directors approved our second quarterly cash dividend of \$0.25 per share payable on March 24, 2022 to all stockholders of record at the close of business on March 3, 2022

---

### Varun Laroyia

*Chief Financial Officer & Executive Vice President*

## FINANCIAL HIGHLIGHTS

---

#### Opening Remarks

- Before I go into details on Q4, I'd like to spend a moment to reflect on the last two years operating in the pandemic

- Since the world was turned upside down in March of 2020, we leveraged LKQ's core strengths, mainly our best-in-class inventory availability and service reliability, extensive distribution network, rock solid balance sheet, and most importantly, our people to be successful in adverse conditions

#### Operational Excellence Program

- We accelerated our operational excellence program to make the business more resilient and have delivered record annual results yet again, while creating a strong position for the company to participate in the demand recovery
- The performance over the past three years since the pivot to operational excellence, and in 2021 in particular, highlights the benefits of our operating initiatives

#### Adjusted Diluted EPS

- By many measures, 2021 was an outstanding year
- In terms of profitability, we generated record full-year adjusted diluted EPS of \$3.96, an increase of 55% compared to 2020, our previous high-water mark
- During the September 2020 Investor Day, I set the expectation that LKQ aimed to be a double-digit EPS compounder, with about half coming from organic growth and productivity, and the rest from judicious capital allocation
- With our 2021 results, we surpassed this expectation and picked up about three years of EPS growth in a single year

#### EBITDA

- We have sustained the momentum built in recent years around cash flow generation, with FCF of \$1.1B in 2021, and successfully reset the business model to operate at this higher level going forward
- At the conversion ratio of 60% of EBITDA, we are delivering FCF in line with our long-term expectation
- Generating significant and sustainable FCF has accelerated various capital allocation options, including our share repurchase program, maintaining investment grade credit metrics, and initiating a regular quarterly dividend

#### ROIC

- With a focus on operational excellence, including integrating our acquisitions and converting profits to cash, we have made significant progress in improving our return on invested capital
- By our internal measure of ROIC, which essentially ignores the amortization of intangibles, we exceeded 15% in 2021 after running at approximately 10% just a few years ago
- All of this reflects our commitment to delivering long-term value to our various stakeholders

#### LKQ Team

- I'd also like to take this opportunity to extend my sincere thanks to the entire LKQ team for their dedication and hard work
- It takes all 45,000 of us rowing in the same direction to deliver such outcomes
  - We have raised the bar on what LKQ can be, and we have more to come

#### Gross Margin

- Now, shifting to Q4, our fourth quarter results reflect a solid finish to the year, with improving revenue, net income and EPS y-over-y, despite, as expected, the negative impact of metals, challenges to inflation, the global supply chain and the Omicron variant
- Gross margin remained a y-over-y benefit, with improvement in Europe offsetting metals-driven softness in North America margins
- Unlike the first three quarters of 2021, commodity prices had a negative effect on margins in Q4

#### Segment EBITDA

- We estimate that scrap steel and precious metal prices produced y-over-y decreases of approximately \$16mm in segment EBITDA and \$0.04 in adjusted EPS in Q4
- In 2020, we benefited from significant sequential increases in scrap steel and precious metal prices during Q4, while 2021 showed roughly flat to declining sequential changes

#### Overhead Expenses

- Overhead expenses as a percentage of revenue increased 130BPS y-over-y with over half driven by personnel costs
- The tight labor market has pushed wages higher in many of our markets
  - Additionally, strong performance across all three segments contributed to increased levels of incentive compensation in 2021, which, of course, resets with new targets for 2022

#### SEGMENT OPERATING RESULTS

##### North America

- I'll now turn to segment operating results
- Starting on slide number 10, North America produced an EBITDA margin of 15.1% for the quarter
- Adjusted gross margin was unfavorable by 50BPS, primarily related to the metals effect, which had a negative 210 basis point effect on gross margin in Q4
- The benefits from ongoing margin initiatives in the wholesale business and improved pricing partially offset the metals impact
- Segment overhead expenses increased by 230BPS with the largest change going to personnel expenses
- Roughly half of the 140-basis point increase in personnel expenses is attributable to higher incentive compensation with the remainder related to wages, temporary labor, and medical costs
- Higher freight and fuel cost drove a further 80 basis point increase in overhead expenses

##### EBITDA MARGIN

- With some of the overhead leverage benefit from higher revenue dollars offsetting a portion of the gross margin impact, metals had a negative 170BPS effect on the reported 15.1% segment EBITDA margin
- This result is consistent with our expectations for a mid to high 16% baseline without the metals impact
- For the full year, the reported North America segment EBITDA margin of 18.3% benefited by roughly 100BPS from metals prices, mostly in H1

#### Europe

- Moving to Europe, Europe continued its strong performance with an 8.9% EBITDA margin, the highest fourth quarter figure since 2015, and finished the full year with 10.2%
- As you can see on slide 11, gross margin was the primary driver of Q4 improvement with better net pricing
- We're pleased with Europe's progress in delivering a double-digit full-year segment EBITDA margin, and we're confident that there's further opportunity ahead

#### Specialty

- Moving to slide 12, Specialty held gross margin roughly flat despite inflationary pressures in the segment's [ph] won (00:26:44) operations and a negative mix effect from the SeaWide acquisition with offsetting benefits in net pricing
- Operating expenses increased by 80BPS, driven mostly by personnel expenses, higher wages, medical costs, and incentive compensation, which, of course, some of it will be reset to reflect 2022 targets
- The Specialty team made great progress on the SeaWide integration plan during Q4 by moving all inventory into existing facilities in December and subsequently has exited three of the four acquired facilities in January, which, of course, will create cost savings going forward

#### Income Tax

- Income taxes in Q4 2021 included discrete benefits of \$0.07 primarily related to the reversal of certain valuation allowances and true ups related to prior-year tax return filings
- There was a benefit of \$0.025 reflecting the change in estimate of our effective tax rate as we closed out our 2021 financials
  - While the discrete benefits in the 2021 rate are nonrecurring, we expect to benefit from a lower effective tax rate going forward and have included 25.1% in our 2022 guidance assumptions

#### Liquidity and Capital Allocation

- Shifting to liquidity and capital allocation, we have been foreshadowing a cash outflow for inventory all year as we've looked to rebuild our inventory levels in anticipation of demand recovering
- The outflow has been delayed by supply chain issues, but we began to see some real progress in Q4

#### Inventory Balance

- As you can see on slide 31, we were able to grow our inventory balances in all three segments in Q4, an opportunity which drove a higher-than-expected cash outflow of \$182mm
- While there are still some challenges getting aftermarket products to our locations given the challenges with ocean freight and ongoing congestion at the ports here in North America, we saw robust activity at the auctions and grew our salvage inventory to support the strong growth in this category
  - We were also successful in increasing the inventory for our Specialty segment ahead of the key selling season with a number of shows that take place in Q1
- We are confident that our inventory positions will enable each segment to continue to offer best-in-class availability and service relative to our competitors despite the ongoing supply chain challenges

### Capital Spending

- Our capital spending for the quarter was higher than what we've seen in recent years with a backdrop of inflation continuing for the foreseeable future, the increase was driven by strategic capital deployment during the quarter as we identified a series of opportunities, mostly related to our salvage business in North America, to invest in real estate
- These investments, which include site expansions and the purchase of a new facility for our Denver operation, will provide room for growth in our salvage business
  - Additionally, we identified other high-return investments related to vehicles, equipment and systems to undertake in Q4 given the long lead times with the ongoing supply chain disruptions

### Real Estate and Other Strategic

- In total, the real estate and other strategic purchases totaled about \$90mm for the quarter, which accounts for much of the growth in capital spending
- Full-year FCF, as I mentioned previously, was \$1.1B, our second year in a row being above the \$1B mark
- At a 60% conversion ratio for FCF to EBITDA for the year, this was roughly \$275mm above our original guidance floor of \$800mm when we gave guidance for 2021 last February

### Capital Allocation

- Following our balanced capital allocation philosophy, we repurchased 5.3mm shares in the quarter for \$297mm and issued our first quarterly dividend with \$73mm payment in December
- We also acquired businesses in Q4; SeaWide in our Specialty segment and a tuck-in business in the Benelux market, for a total consideration of \$57mm

### Net Leverage Ratio

- Our net leverage ratio came in at 1.4 times EBITDA and increased coverage now exceeds 28 times compared to the credit facility requirements of 4 times and 3 times respectively
- We are well positioned with our credit metrics which are consistent with an investment grade profile, and we remain committed to achieving an investment grade rating
- As our earnings release of this morning indicated, the board has approved the quarterly cash dividend of \$0.25 per share which will be paid to stockholders on record as of March 3

### End Markets

- I will wrap up my prepared comments with our thoughts on 2022
- Over the past two years of living with the once-in-a-hundred-year health crises, what has become clear is the resiliency of our end markets and our team's ability to deliver solid results utilizing the operational excellence toolkit
- This, in effect, gives us the confidence to reinstate full-year guidance including organic revenue growth for the coming year
- Our guidance assumes that:
  - One, there are no significant negative developments related to the COVID-19 in our major markets
  - Two, foreign exchange rates hold near recent levels for the remainder of the year
  - Three, scrap and precious metal prices trend lower than what we're currently seeing in the month of February, and an effective tax rate of 25.1%

#### Organic Parts and Services Revenue Growth

- So with that, we expect organic parts and services revenue growth of between 3% and 5%, with higher growth rates in H2 than H1
- With ongoing inflationary pressures exacerbated by the supply chain challenges, we remain confident in our ability to positively work through pricing changes as needed
- Second, we are projecting full-year adjusted diluted EPS in the range of \$3.72 to \$4.02 with a midpoint of \$3.87
  - This is a decrease of \$0.09 or 2% at the midpoint relative to the 2021 actual figure

#### Fource Service Operating Unit

- Looking at slide number 19, you can see how we get from the 2021 actual EPS to our 2022 expectation
- We've been transparent about the commodities benefit on our 2021 results
- And with lower prices anticipated for 2022, we will face a headwind of roughly \$0.27 related to scrap steel and precious metal prices, predominantly in the Fource service operating unit
- The favorable discrete tax adjustments in 2021 will not reoccur, which will lower EPS by a further \$0.06
  - Additionally, lower average foreign exchange rates will have \$0.04 negative effect y-over-y, and we had a preset pickup of fair value adjustments related to certain equity investments that we're not projecting to reoccur in 2022

#### Long-Term Growth

- Taking these factors into account, we're looking at a baseline EPS figure of \$3.56
- On a two-year stack, we remain well above our long-term growth expectations in 2022, and we expect annual growth rates to normalize in 2023
- The operational excellence initiatives have created a significantly stronger and more resilient business, which we believe will support our ability to improve operating results despite the current inflationary environment and supply chain challenges

#### Balance Sheet

- And finally, our balance sheet is solid
- We continue to generate outstanding FCF through strong profitability and judicious use of [ph] creative (00:35:15) working capital
- We are projecting to generate FCF of at least \$1B in 2022 as we sustain a healthy conversion of EBITDA to FCF

#### SUMMARY .....

- Before I turn it back to Nick, I want to inform everyone that we are contemplating breaking out the self-service operating unit as a separate reportable segment in 2022
  - While we're not planning any changes in how self-service is operated or how it interacts with the wholesale business, we would like to provide investors even greater transparency into the North America business, especially as it relates to the metals impact
    - We will provide further information on the decision ahead of our first quarter earnings call in late April
- .....

## Dominick P. Zarcone

*President, Chief Executive Officer & Director*

### Q4 HIGHLIGHTS.....

#### Global Team

- In closing, 2021 was a banner year for LKQ and I could not be prouder of the collective efforts of my global teams
- Let me restate our key strategic pillars, which continue to be central to our culture and objectives as we've entered 2022
  - First, we will continue to integrate our businesses and simplify our operating model
  - Second, we will continue to focus on profitable revenue growth and sustainable margin expansion
  - Third, we will continue to drive high levels of cash flow which, in turn, will give us the flexibility to maintain a balanced capital allocation strategy

#### Operating Results

- And last, but not least, we will continue to invest in our future
- With these pillars in place, coupled with our industry-leading teams, we are well positioned to face the challenges in H1 and we'll continue to deliver positive y-over-y operating results for our shareholders
- As always, I want to thank the over 45,000 people who work at LKQ for all they do to advance our business each and every day
  - They are truly our greatest asset

## QUESTION AND ANSWER SECTION

**Stephanie Moore**

*Truist Securities, Inc.*

Q

My first question is really just a clarification question. As you look to your 2022 EPS guidance, does that – does the guide EPS range include incremental share repurchases?

**Varun Laroyia**

*Chief Financial Officer & Executive Vice President*

A

Good morning, Stephanie. It's Varun. No, it does not. Really, what you see on slide 19 of the earnings deck reflects the annualized benefit of all the share repurchases that we did in 2021. And obviously, that flows through into 2022. So no, the guidance does not include anything incremental that we may do in 2022.

**Stephanie Moore**

*Truist Securities, Inc.*

Q

Great. No, that's helpful. Switching to the North America business, obviously there's been, across all segments, tremendous work over the course of the last two years to just improve operating performance, reduce costs, whether it be around labor, et cetera. So maybe if you wanted to kind of bridge what you expect would be incremental expenses in North America – I think you noted, and we're all aware of, labor, wage pressure, towing. And then, also, kind of what will be done to offset that from just overall efficiency gains? Thank you – as well as pricing. Thanks.

**Varun Laroyia**

*Chief Financial Officer & Executive Vice President*

A

Thank you, Stephanie. Let me answer that one. So I think your question is specifically regarding North America margins in Q4. And again, if you kind of go back to the earnings deck on slide number 10, where we actually break that piece out, first of all, I think just to be cognizant of is that we have a seasonal trend within our business. And so, Q4 typically is lighter, in any case. But as you rightly point out, yes, some of the inflationary pressures have certainly been picking up.

In my prepared comments, I did call out where the single biggest piece was, which was within the personnel costs. I think everyone understands that there's a tremendous amount of labor shortage here in North America. And arguably, the other one is that – how much of that is our higher incentive compensation, also. Clearly, from an incentive compensation perspective, that does get reset with new targets in 2022. So that entire number that you see, that really is not the true exit run rate. So, that's kind of an important piece to think through. But with regards to medical costs or, for that matter, what we're paying from a talent perspective, that is real, and we do expect our ability to get positive price associated with that.

I think the other piece really, which maybe is kind of more fundamental, is at the gross margin level, while it seems that gross margins were down by about, what, 40 to 50BPS year-on-year, really, they were down by 210BPS going to the metals piece. Right? So, the metals is the single biggest piece in our North America margins. And if you go back to the October earnings call, we were aware that metals would impact our North America segment margins. So, that really is where it shows up. The work that the team has done on positive pricing has been able to offset some of that.

And then, the final point, really, I'd like to highlight is, the 15.1% that North America reported for Q4 is impacted by about 170BPS associated with metals. You add those two pieces together and it is right where our expectations are, which is the mid to high 16%s without the metals impact. So I hope that helps answer. We're happy with the way the Europe – the North American business is performing. We are aware of the supply chain challenges and also the inflationary pressures. But the team is doing an outstanding job and really hitting its marks excluding the metals volatility.

---

**Daniel Imbro**

*Stephens, Inc.*

. Congrats on the [indiscernible] (00:42:03).

---

**Dominick P. Zarcone**

*President, Chief Executive Officer & Director*

Good morning, Daniel.

---

**Daniel Imbro**

*Stephens, Inc.*

I wanted to follow up on the thoughts around long-term efficiencies. Varun, you kind of mentioned I think the words productivity improvement could offset some of these inflationary headwinds this year to drive that improvement. Could you add some more color around what specifically you see an opportunity to improve? I think you mentioned freight and supply chain. Can you kind of quantify any of those savings buckets? And then, taking a step back, as we look out 2023, 2024 and beyond, I know you're not giving long-term targets now, but how should we think about the pace or the cadence of margin expansion in out years given what you see on the productivity opportunity side?

---

**Varun Laroyia**

*Chief Financial Officer & Executive Vice President*

Yeah. Thank you, Daniel. So let me just try and summarize your question. Yeah. And that really is in terms of where we see margin expansion and then really further productivity gains. So let me start with the margin side first.

As you saw in our quarterly earnings in the earnings deck, Europe has been doing an outstanding job on the pricing side. And you certainly see that gross margin expanding for our European business. That accounts for close to half of our business. And as part of the 1 LKQ Program that we had called out in September of 2019, that business has in September of 2019, that business has hit every single mark that it had suggested. As Nick has previously also called out, we are not done with the 1 LKQ Europe Program. We're making tremendous progress, but there's a lot further opportunity yet to come. So, when you see the full-year 10.2% segment EBITDA margin, we expect 2022 to continue to improve from there on. So, that's kind of one piece I certainly wanted to highlight.

The second one is, I think from a North America margin perspective, I think folks get a little bit confused about the metals piece. And really with that, as I mentioned, Q4 gross margin, owing to metals was impacted by 210BPS in the quarter, which we had largely anticipated. And excluding the metals benefit – rather, the metals impact in Q4, that would have been a mid- to high-16%s. The metals impact was 170BPS. So, that may seem to kind of color some of the views, but that business is hitting its marks. And whether it be the permanent cost savings that had been called out at the September 2020 Investor Day, that business is exceeding those at this point in time. And as we've talked about, whether it be route optimization, overall network setup that we have across our North

America business, each of those pieces continues to deliver. Those are multiyear goals and the business continues to find further opportunity.

So, without belaboring the point further, we are excited about where our North America and our European business is, and the same for our Specialty business. It's easy to forget it at the times, but that business has just been outstanding from its execution perspective. They are not immune, like other businesses and other industries with regards to inflationary pressures. But really, that specific segment, while our smallest segment, has just done an outstanding job really picking up the strong demand that continues to come through and then executing flawlessly on that front.

The final point I should kind of highlight is that when you talked about multiyear views, we are contemplating our biannual Investor Day setup. And that is currently expected to be late spring, early summer, but certainly after Q1 earnings. So, we're thinking of a May timeframe at this point in time.

---

**Daniel Imbro**

*Stephens, Inc.*

Q

Varun, thanks for that color. Nick, I wanted to follow up with a bit of a longer-term question. You mentioned some of the ESG initiatives, and clearly that's a focus for the company with the recycling. But as EVs grow across the country and just over the next decade, how is the infrastructure, in your opinion, on EV battery recycling? Is that something you could be a larger player in since there's a demand for it and you're already ingrained in the auto recycling ecosystem? Just kind of curious how LKQ can capitalize on that opportunity given where you sit today.

---

**Dominick P. Zarcone**

*President, Chief Executive Officer & Director*

A

Yes, Daniel. Great question. As we announced last quarter, we made an acquisition probably four or five months ago of a company called Green Bean that got us into the entire battery remanufacturing. Not recycling, but remanufacturing business. We are looking to make further investments in battery technology just so we can make sure that we are able to address the opportunities that are going to come along with a very slow shift of the car park to EVs. Within there, there will be plenty of opportunities for LKQ. Just like the engine is the most expensive and most valuable part of a car today, the battery is the most valuable part on a EV. And that provides a number of different opportunities for a company like LKQ.

As the EV population grows in the United States, we fully anticipate that the cars that we buy at auction coming out of the whole total loss process, that there will be a higher percentage of electric vehicles in that population of cars that we buy. And that will provide a number of opportunities for us on the remanufacturing and potentially recycling side of the EV battery business. So, we view it as a big opportunity. It's going to take some time to develop because the impact of EVs on the car park is going to be very slow and very evolutionary. But we are thinking ahead and trying to get ahead of the curve.

---

**Brian Joseph Butler**

*Stifel, Nicolaus & Co., Inc.*

Q

Just the first one, can we kind of maybe summarize the segment margins that are kind of built into the 2022 outlook, and also kind of how that might flow seasonally through the year?

---

**Dominick P. Zarcone**

*President, Chief Executive Officer & Director*

A

Yeah. So, we generally don't provide segment by segment margins, but as we've talked about in this call already, right, long-term sustainable margins for the North American business will be in the mid to high 16% range. And that's where we were in Q4 in North America if you exclude the impact of the metals. So we're very comfortable in the mid to high 16% in North America. Again, we posted up 10.2% in Europe for the year in 2021. We do anticipate another 30 to 50 basis point improvement in Europe during the next year. And Specialty has been very strong, and we don't expect a tremendous amount of upside in Specialty margins, but they're going to more than hold their own. So when you put it all together on a corporate level, you're going to be shaking out probably somewhere in that 13% range from an EBITDA margin perspective. Again, that all assumes no significant movements in metals pricing and the like.

---

**Brian Joseph Butler**

*Stifel, Nicolaus & Co., Inc.*

Q

Okay. Great, that's helpful. And then follow-up question on the cash flow side. Can you talk a little bit about maybe capital spending in 2022 and how that should trend, what's keeping that at a higher level, as well as how should we think about working capital in the year? How much of that \$1.3B of cash from operations is benefiting or being impacted by the working capital side?

---

**Varun Laroyia**

*Chief Financial Officer & Executive Vice President*

A

Yeah, Brian, it's Varun. Actually, let me take those two questions. So, firstly, with regards to capital spending, we are back to our normal cadence, which is between 2% and 2.25% of revenue. Right? So between 2% and 2.25% on a revenue perspective. And this really is a bounce-back from what took place in 2020. Our ability to quickly act and pull down that CapEx number is what we delivered during the height of the pandemic a couple of years ago. You saw 2021 come in at the 2.2% and we expect a similar number in 2022 also. So roughly call it between the \$285mm to \$300mm is what we're expecting from a CapEx. And that then fits into our top line revenue guidance also. Okay, so that's kind of point number one.

With regards to the overall FCF number, we're essentially targeting that 55% to 60% EBITDA conversion. This is what we've been talking about for the past couple of years; and really through 2020, where you saw a significantly higher conversion rate as the business was essentially finding as to where the demand was, we certainly flexed the balance sheet; and really on a go-forward basis, we're stabilizing the FCF at that higher level.

So, the 55% to 60% EBITDA conversion piece, and really if anyone's looking for the math associated with that as to why that is a strong conversion factor for a distribution business, really start from an EBITDA perspective. There are cash taxes to be paid. So, in our case, call it roughly about \$350mm of cash taxes. CapEx, as I just mentioned, roughly 2.2%, so the \$285mm to \$300mm. Interest expense, which was about \$72mm in 2021, call it marginally down in 2022. And then finally, restructuring, and restructuring will be at a similar number to what we did in 2021, so roughly about \$20mm. That really is your conversion from a cash basis, EBITDA down to what we see coming through from a FCF perspective. I hope that gives you the math. I certainly hope that it makes sense and it's been very consistent to what we've been talking about now for the past couple of years.

---

**Brian Joseph Butler**

*Stifel, Nicolaus & Co., Inc.*

Q

Okay, great. And if I could slip in maybe one last one, just on the metals side, when you talk about metals coming down, are we really talking about kind of what's built in the 2022 guidance is metal prices getting back to that 2020 level? I mean, when you take out the full \$0.27 impact? I'm just trying to understand the magnitude of how much pricing has – how much metal prices have to come down to just show that impact.

**Varun Laroyia**

*Chief Financial Officer & Executive Vice President*

A

Yeah. So, if you think about where we – where the metals benefit came through in 2021, that's the starting point, right? And from that perspective, we could think about where catalytic converters, and that really is where the precious metals group really sits. That was at an all-time high. I think it touched an all-time high of close to about \$285 to \$290 per cat converter on an average quarterly basis. So, that number has come down significantly.

And really, if you think about, we had called this piece out in September because we'd seen it at the end of August and September of last year. And then again, we saw that piece, from a volatility perspective, in December and also in early January. So, we're looking at numbers which are significantly lower than the full-year average of about \$255 on a cat converter; call it about 20% lower than that. And then, really, I think over the past couple of weeks, really with the geopolitical tensions, there has been a slight uptick associated with that. But really, when we are purchasing salvage vehicles and as to how we're processing them, there's always a lag associated with it. So that really is how you should think about it more than anything else. And that's the underlying assumption of what we have pinned our overall full-year guidance on. So I hope that gives you a sense in terms of how we're thinking about the volatility associated with metals.

**Bret Jordan**

*Jefferies LLC*

Q

On the 2022 outlook for growth, could you sort of carve out what is price vs. units in that, particularly in the parts and service, the 3% to 5%?

**Dominick P. Zarcone**

*President, Chief Executive Officer & Director*

A

Yeah, Bret. Great question. The answer is it depends. It's really different, business by business and product line by product line. But I assure you that all of our segments are expecting an increase in demand, an increase in volume, if you will. A portion of the 3% to 5% is anticipation that we're going to be able to move prices up, but certainly not all of it. It's a good balance between volume and price.

The reality is we look at prices on our products literally daily across the globe. And we're always adjusting something up or down. It's a balance, right? On the one hand, we want to make sure we're driving the price to make sure we're doing whatever we can do to protect our gross margins, to cover the cost – the incremental costs associated with labor and freight and all the rest. On the other hand, you don't want to take your prices up so much that you start impacting our ability to sell product and impact volumes.

So it's a balance. We think we have a – strike a good balance. Again, we're working with our suppliers; we're working with our customers. And embedded in that 3% to 5% is volume growth for all three of the segments and some pricing improvements as well.

**Bret Jordan**

*Jefferies LLC*

Q

Okay. Great. And then, one question on in-stocks. Yeah, I think you called out that supply chain's still an issue. Could you talk about both Europe and North America, sort of where your fill rates are vs. where you'd hope they'd be? And maybe the cadence of the supply chain, are you seeing improvement in those fill rates?

**Dominick P. Zarcone**

*President, Chief Executive Officer & Director*

A

Yeah. So, the real challenge that we have is the aftermarket collision parts in North America, because that's where we pull the better part of 16,000 containers a year over from the Far East, Taiwan specifically, and that's been the most impacted by the supply chain disruption. And again, we were able to build inventories in each of the segments. We're feeling reasonably good with our current positions in Europe. Though it's not perfect, it's better than it was. The same with Specialty; it's not perfect, but it's better than it was.

Again, we've gotten great conversion on the salvage side. And so, the sticky wicket, if you will, is in the North American aftermarket business, where normally we would be in fulfillment rates well north of 90%; and we're below the 90% level right now. Our goal is to get back to our historical levels and that's all tied to having product on the shelf in order to sell. It's not necessarily a demand issue. It's truly a supply issue.

We saw a little bit of relief towards the end of the year in getting product over. Now, everyone needs to understand that, while on the balance sheet, the value of the inventory, even in North America, was up, the – it's basically our inventory. It's on our books when it hits the ports in Taiwan; and with the extended shipping time, it doesn't mean that our saleable inventory sitting in our warehouses was up by the full amount of the increase in North American inventory. It's still a challenge. I mean, what used to take four to six weeks to get product into our warehouses is taking months. And we did everything we could to pull product in before the Chinese New Year, which has an impact on the shipping times, and we were able to get a bit of product in and now it's slowing back down a little bit.

Overall, we think the supply chain challenges are going to be with us, basically, through most of the year. We're working hard to do what we can to make sure we've got the product that we need where we need it, so we can sell it and deliver it to our customers.

**Scott L. Stember**

*C.L. King & Associates, Inc.*

Q

Most of my questions have been answered, but maybe, Nick, you could talk about, on the Specialty side, again, maybe a little more granularity on this pass that the drivers get, the level of benefit you could see in 2022. And also, why is this just limited to the Specialty delivery side?

**Dominick P. Zarcone**

*President, Chief Executive Officer & Director*

A

Yeah. So, you're talking about the Department of Transportation program?

**Scott L. Stember**

*C.L. King & Associates, Inc.*

Q

Yes.

**Dominick P. Zarcone**

*President, Chief Executive Officer & Director*

A

Yes. So every year, every organization has to submit information to the DoT and the like. Our Specialty business, which executes incredibly well, has an incredible focus on safety as their number one priority and goal. And it's coming through because their results were quite good. We don't anticipate it to have a huge impact on Specialty's margins or ability to – certainly, it has nothing to do with sales. But on the fringe, on the margin, right, it means

that a little bit less waiting time for the drivers, which makes them a little bit more productive; the ability to save some time and money on labor.

Again, you probably won't be able to see it because it's not a big item, but we wanted to highlight it just to demonstrate the focus that we have on the health and safety of our employees and the other constituents that are important to us. And it's a little bit of a blue ribbon issued by the government saying that we're doing a good job.

---

## Dominick P. Zarcone

*President, Chief Executive Officer & Director*

## Q4 HIGHLIGHTS

---

### Performance

- We know that this earnings season is always, like always is a busy one
- We appreciate your focus on LKQ
- Again, we are incredibly proud of what we delivered in 2021
  - We are incredibly excited about what lays in front of us in 2022
- We believe we're going to be able to deliver and execute on our plan and create value for all of our shareholders and all the other constituents
- So we look forward to chatting with you again in late April after Q1
- And then, as Varun indicated, we'll get everyone together for our longer-term strategic view of the business in the late spring, early summer at our Investor Day, and we'll be coming out with an exact date in the near term here.

### 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 2022 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.