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LKQ Corp. (LKQ)

Q2 2025 Earnings Call

CORPORATE PARTICIPANTS

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Vice President-Investor Relations

Rick Galloway
Chief Financial Officer & Senior Vice President

Justin L. Jude
President, Chief Executive Officer & Director

OTHER PARTICIPANTS

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Gary Frank Prestopino
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Craig Kennison
Robert W. Baird & 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, as well as slide presentation

Justin L. Jude
President, Chief Executive Officer & Director

BUSINESS HIGHLIGHTS

Opening Remarks

- The year has presented some macro challenges and some short-term operational obstacles, but also opportunities for longer-term value creation
- Alongside my leadership team, we have made some tough but necessary decisions to fundamentally reshape how we operate and put us back to a path of consistent value creation
- The decisions made are aligned with our overarching strategy, a multiyear transformation to simplify our portfolio, sharpen our focus and position us as a high performing company centered on our core business segments

- Our global team is laser-focused on growing our market share while driving productivity and efficiently managing our cost structure
- At our September 2024 Investor Day, we set our strategic priorities, simplify our business portfolio and operations, expand our lean operating model globally with a focus on margin enhancement, invest and grow organically, and pursue a disciplined capital allocation strategy
- And so, as we move forward, we are going to share how we are doing against each of these, a scorecard, if you will, that makes it clear for the investment community to see how we are doing
- I can't sugarcoat that today the results are yet to show this progress and the macro headwinds necessitated our revised guidance
- We are not where we need to be
- And so we are going to push harder and move faster

Cost-Cutting Measures and Capital Allocation Priorities

- To that end, we are focused on two immediate things
- One, additional cost-cutting measures, primarily in Europe, but also in North America, with a goal of cutting another \$75mm in costs
- Two, a heightened emphasis on the strategic review of our business units and operations that may result in the sale of assets that further accelerate our simplification strategy and capital allocation priorities
- We are seeing a turn in the market for strategic activity, with credit markets opening, momentum behind mid-sized transactions and private equity actively seeking to deploy capital
- While this will not be a linear process, I remain confident that we are on track to realize the full benefits of this strategy by 2027, as outlined at our September 2024 Investor Day

MACROECONOMIC ENVIRONMENT

- It is worth noting that we are doing these things at a time when there are broader challenges in the overall auto industry and macroeconomic environment
- It is a dynamic and fluid environment
- Given amongst other factors, the rising input costs and the uncertainties around tariffs are creating confusion
- We are not alone in the industry in facing these challenges, but you can either complain and make excuses or focus on your business and operating model to deliver the best possible results
- Our team has chosen to focus on executing our plan, controlling the things we can such as being efficient in managing our costs and looking for opportunities to take advantage of the current dislocations and disruptions in our core markets to gain market share and expand margins
- We know in a challenging earnings environment cost discipline is paramount, which is why we've taken actions to remove \$125mm of cost in the past 12 months without compromising our ability to execute and service our customers
- This is just a first step
- And as I mentioned, we are going to continue to scrutinize our cost structure and find additional ways to enhance our margins

North America

- Next, I will discuss our business segments
- North America is first

- North America's organic revenue fell by 2.2% per day, which is less of a decline than the last five quarters and an outperformance of repairable claims by over 650BPS, well above our historical 450BPS outperformance
- Importantly, our aftermarket collision parts business witnessed slight growth in the quarter
- We are still seeing consistent demand across our hard parts business in Canada and margin enhancement as we convert from three-step to two-step
- Lastly, as an update to the issue of repairable claims resulting from declining used car pricing and rising insurance premiums, we previously said that the comps will start to ease as we progress into 2025
- However, the June numbers were weaker than anticipated, and at this juncture, we think it is prudent to assume minimal market recovery in the back half of the year

Europe

ORGANIC REVENUE

- Moving on to Europe
- Europe's organic revenue decreased 4.9% or 3.8% on a per day basis, primarily driven by difficult economic conditions, increased competition in certain markets, and some temporary headwinds due to operational challenges
- We expect the economic conditions to continue throughout the balance of the year, along with the competitive pressures, which has led to price concessions
- As an example, in the UK, we've renegotiated several dozen national account agreements and re-signed all but one, validating the strong value proposition we offer to our customers

OPERATIONAL CHALLENGES

- Regarding the operational challenges impacting revenue, in a nutshell, we unintentionally created negative customer experiences and ultimately, top line erosion
- We have resolved these service issues and are in the process of regaining the customer's confidence and ultimately, our share of wallet back
- One thing I would like to emphasize here is that Europe represents a significant opportunity for us
- As I mentioned in the past, we need the right leaders in place to truly drive the change and achieve the benefits of scale that Europe represents

LEADERSHIP CHANGES

- After recently making significant leadership changes, we now believe we have the right people
- This revamped team is now focused on process and performance, both of which have been lagged in certain areas of our European business
- This lack of focus from previous leaders played a role in the underperformance in the quarter and it will take some time to manage these legacy issues
- However, we are confident that we are on track with the three-year targets presented at our September 2024 Investor Day
- I was in Europe the last week of June to meet with our management teams, and we will be focused on ensuring we are moving quickly to implement our strategy in that market
- Europe is a competitive marketplace and our focus is on key geographies where we have the ability to be a top player
- We continue to make progress on our SKU rationalization goals

SKU RATIONALIZATION PROJECT

- Our SKU rationalization project in Europe aims to reduce complexity and simplify our distribution network across all markets
- We have reviewed over 70% of our product brands and reduced stocking by an additional 13,000 SKUs
- Our private label penetration was flat sequentially, but up 20BPS YTD, keeping us on track to hit our 2027 target of 27%
- In addition to our SKU rationalization, we are streamlining our operations and reducing costs through back office and systems rationalization programs, as well as greater utilization of our global competency centers
- Moreover, we believe we're now positioned to expand our market share, and we feel confident we can continue as the leading European player
- We started executing on this goal as we recently announced our partnership with SYNETIQ Limited, which is a critical building block in the development of LKQ Europe's salvage channel, a market that will benefit from the full service salvage intellectual capital in North America

Specialty

- Moving on to Specialty
- Specialty has turned the corner and is seeing improved results
- Specialty's organic revenue was largely flat y-over-y, which is the best quarterly y-over-y revenue performance since Q4 2021
- We are cautiously optimistic this segment is starting to show green shoots as our July revenue has continued to show positive trends we saw in June

Self Service

- Lastly, Self Service
- Self Service's organic revenue was soft in the quarter from lower part volumes, but still managed to deliver a 10% EBITDA margin
- Disciplined vehicle procurement, combined with overhead cost controls continued to help drive profitable quarterly results in this segment
- I want to stress that people are our greatest assets
- Ensuring we have the most talent and effective team is critical to our success

Global Talent Development

- As a result, we have created an executive position focused on global talent development
- We think this will be an important role, and we are excited about how it will support our overall business around the globe
- A few facts that I think are important to share on talent
- Since I took over the CEO role last July, we have taken difficult, bold and necessary steps to reshape our leadership team
- Over 25% of the roles at the VP level and above have been refreshed with new talent or redefined responsibilities

TRANSFORMATION

- This level of transformation reflects our commitment to building a high performing, agile organization
- We're focused on getting the right people on the bus and just as importantly, ensuring they're in the right seats
- These changes, while not without challenges, are foundational to driving sustainable growth and consistent performance, which yield long-term value creation for shareholders
- Equally important is the strength of our talent pipeline
- Over 50% of it now comes from external hires with a high focus on our European operations to lead us through business transformation
- This infusion of fresh perspectives and different experiences is accelerating innovation, bringing a clearer lens on growing the business, finding efficiencies and positioning us for the future
- We're not just evolving, we're focused on fixing, repairing and building momentum

CLOSING REMARKS

- I'm going to hand it over to Rick now, but I want to emphasize the following
- We have size, scale and an unmatched distribution network
- We know the current results are yet to reflect the value we are creating, and we share your frustration
- But we are solidifying our foundation and ensuring when the cycle turns in this sector that we will be in the strongest position to capitalize on it to deliver results for our customers, partners, and importantly, our shareholders
- That is our mission and we are hell bent on accomplishing it

Rick Galloway

Chief Financial Officer & Senior Vice President

FINANCIAL HIGHLIGHTS

Opening Remarks

- I want to begin by reinforcing Justin's remarks on our continued commitment to execute on our multiyear transformation strategy that includes, simplifying the business and reshaping our focus on core segments
- We are and will continue to be relentless in our pursuit of these goals

Revenues, Earnings and FCF

- Now turning to Q2 results
- As Justin said in his remarks, our results are yet to reflect all of these efforts and Q2 results were below our expectations
- While our initiatives are underway, revenue declines overall have created margin pressure driving down our earnings and FCF
- We reported total revenues of \$3.6B
- Diluted EPS were \$0.75, \$0.05 increase compared to Q2 2024
- On an adjusted diluted EPS basis, we reported \$0.87, a decrease of \$0.11 per share vs. prior year primarily due to lower operating results

Share Repurchases, FX Rate and Dividend

- On a positive note, execution on our balanced capital allocation strategy benefited EPS by \$0.03 from share repurchases and another \$0.01 for interest
- FX rates added another \$0.03
- FCF during the quarter was \$243mm despite a nearly \$35mm headwind from tariffs, bringing the YTD cash flows to \$186mm
- We anticipate generating positive FCF in the next two quarters, but tariffs will present a working capital challenge in the back half of the year that I will discuss shortly
- We returned \$117mm to shareholders, including \$39mm to repurchase 1mm shares and \$78mm for our quarterly dividend
- We remain focused on deploying capital in a way that maximizes shareholder value while supporting growth
- In North America, we are pleased with our top line performance, given the market pressure, as we work through the continued decline in repairable claims
- We are confident we are increasing our market share in a declining market
- However, increasing competition and market dynamics contributed to a 100 basis point decline in gross margins

Segment EBITDA Margin

NORTH AMERICA AND EUROPE

- North America posted a segment EBITDA margin of 15.8%, a 150 basis point decrease relative to last year, or roughly 10BPS better than Q1
- The decline in gross margins and leverage effect from lower revenue on overheads contributed to the decline in EBITDA margins
- In Europe, segment EBITDA was 9.4%, a 120 basis point decrease from last year
- If you will recall, in last year's Q2 call, I discussed a reduction in labor related accruals previously recorded after a successful conclusion to the union negotiations in Germany
 - This benefited the prior year by roughly 70BPS
- Excluding this non-recurring prior year benefit, EBITDA margins declined by 50BPS
- We were pleased to see the y-over-y gross margin improvement resulting from procurement initiatives and ongoing productivity measures that outpaced inflation
- However, the organic revenue decline put pressure on overhead expense leverage, resulting in the decrease to segment EBITDA margins

SPECIALTY AND SELF SERVICE

- Specialty's EBITDA margin of 8.5% is 40BPS below the prior year, due to a slight uptick in overhead costs related to inflationary cost increases
- With organic revenue being largely flat y-over-y and positive in June and thus far in July, we're encouraged by these recent trends heading into the back half of the year
- Self Service reported EBITDA margin of 10% consistent with the prior year

BALANCE SHEET

Debt and EBITDA

- Turning now to the balance sheet, we repaid approximately \$111mm of debt in the quarter
- As of June 30, we had total debt of \$4.5B with a total leverage ratio of 2.6 times EBITDA
- We remain committed to maintaining a manageable debt level and our investment grade ratings
- As of June 30, 2025, our current debt maturities were \$34mm, a reduction from the \$558mm on March 31, 2025 as we extended the maturity date of the \$500mm US term loan by one year to Q1 2027

Capital Structure

- As normal practice, we actively manage our capital structure and we are working through our options with our lending group, regarding the Canadian term loan due in Q3 2026
- We think in a high interest rate environment, ensuring our cost of capital is reasonable and managing the timing of our maturities is an important piece of prudent financial management

INTEREST RATE

- Our effective interest rate was 5.2% at the end of Q2, consistent with Q1
- We have \$1.8B in variable rate debt, of which \$700mm has been fixed with interest rate swaps, which effectively provides a fixed rate on approximately 75% of our debt
- Given the confluence of macroeconomic factors in both North America and Europe, coupled with the results this quarter, we are lowering our full year outlook
- In North America, we are anticipating a delayed recovery in repairable claims, ongoing tariff disruptions and competitive market dynamics
- In Europe, persistent economic softness, geopolitical unrest and ongoing US trade negotiations are all drivers of an uncertain environment

REPAIRABLE CLAIM

- To provide more detail, June's repairable claim numbers were down the most of all three months in the quarter, despite our anticipated recovery
- Based on current industry data and recent trends, we no longer expect these declines to rebound in 2025
- Auto insurance prices are still rising and are expected to increase an average of 7.5% this year
- According to a recent survey, nearly one in four people have downgraded or dropped their auto insurance to free up cash
- To help further depict the economic factors driving the current market dynamics around repairable claims, we included a slide in the appendix on page 17 with data derived from our proprietary analysis
- The ever-changing tariff landscape further erodes consumer confidence and also complicates the views toward a more linear recovery

PRICING AND REVENUE

- While we have been pricing in the impact from tariffs, our market remains competitive, and it may be difficult to maintain margins at the same levels in the short-term
- In Europe, with the persistent softness in many of our markets and increased geopolitical unrest, we are no longer anticipating market improvements

- To mitigate the lower revenue expectations, we have taken corrective action, including leadership changes and productivity initiatives, and are targeting additional cost removal in the back half of the year
- However, these actions will not be enough to offset the full year impact of lower revenue

2025

- Turning back to 2025
- Our revised outlook and assumptions are included on slide 13
- We expect reported organic parts and services revenue in the range of negative 150BPS to negative 350BPS.
- As a result of the revenue headwinds, we expect adjusted diluted EPS to be in the range of \$3 to \$3.30, a decrease of \$0.40 from the midpoint from the previous guidance
- Approximately half of the decrease is from our North American segment, 40% from Europe and the remainder is largely from higher interest expense
- FCF will be impacted by the anticipated decrease in earnings and the impact of tariffs on working capital that will be on the balance sheet at year-end
- To partially mitigate these headwinds, we are reducing our anticipated capital spend by approximately \$50mm
- We will continue to diligently manage our trade working capital in order to mitigate the lower earnings and tariff impact to drive EBITDA conversion to the extent possible
- FCF is expected to be in the range of approximately \$600mm to \$750mm

Justin L. Jude

President, Chief Executive Officer & Director

CLOSING REMARKS

- As stated at the outset, we have made some tough but necessary decisions to fundamentally reshape how we operate and put us back on the path toward consistent value creation
- We need to set ourselves up for success and be able to deliver on what we say we are going to do
- We are implementing our strategic plan and we are holding ourselves accountable to deliver that plan
- In closing, I want to reiterate our key strategic priorities
- Simplify our business portfolio and operations; expand our lean operating model globally with a focus on margin enhancement; invest and grow organically; and pursue a disciplined capital allocation strategy
- Our foot is on the accelerator to deliver these strategic initiatives and create value for our shareholders
- We expect to see the results and we know you do, too

QUESTION AND ANSWER SECTION

Scott L. Stember

ROTH MKM

Q

Could you maybe, yeah, talk about some of the – in North America, some of the increased competition that you're talking about, and last quarter we were talking about used car pricing starting to increase, that might be helping. Are you not seeing that anymore as a driver towards a recovery in claims?

Justin L. Jude

President, Chief Executive Officer & Director

A

On the used car pricing, when we – if you look at Q2, the beginning of it, April and May, we started to see some improvements and used car prices, it kind of looked to be bottoming out. Some of that, we're kind of uncovering that, there was a kind of some pulled-up demand of new car sales, which drove up some used car pricing. So we haven't necessarily seen coming into June or even into July that those numbers are starting to grow fast enough. We're seeing, in some cases, y-over-y growth, but not necessarily month-over-month.

And so, if you take that used car pricing change y-over-y relative to repair costs, it hasn't necessarily grown at the same rate, which is once again creating that gap between repairable claims.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

What we are seeing, we're seeing a decent increase in APU. We're seeing quite a bit of opportunity for us to expand better than what we are seeing on the overall repairable claims. So, the business is really picking up a fair amount of market share, proven by the 650BPS of better than the repairable claims. What we're not seeing, Scott, is the improvement on the overall repairable claims. So, what we're saying is, look, the repairable claims number is going to have slight improvements, but the business is operating very, very well. Continues to drive performance, continues to pick up share, continues to diversify the portfolio, so all good news on that side of what we can control.

Scott L. Stember

ROTH MKM

Q

Got you. And then last in Europe, one of your biggest competitors over there yesterday reported some relatively or at least flattish results for Europe. And now you're talking about some competition. It sounds like were you guys just not properly priced in the market or are you saying it's a combination of the market being increasingly weak plus the competitive nature picking up?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. I mean, I guess, you're probably talking about GPC. I mean, if you really back out some of those conflicted issues we talked about, we're pretty much in line with them. But isn't necessarily always a good compare because we operate in different markets.

For example, France, we know that market overall is up, we operate in France, but we're very small, we grew. They're larger in France. Spain was up, we don't operate in Spain, but they do. And so it's not necessarily a great compare. But the markets that – the primary issue we're seeing still is that the market is just soft.

In some cases, as I mentioned in the past, pricing becomes a problem with the smaller competitors. But as I mentioned, specifically in the UK, we renegotiated several dozen different contracts with our national accounts and we lost one and we lost because we weren't going to chase the price all the way down. It did not make sense.

So, when you really look at the value proposition that we offer to our customers, when it comes to service levels, fill rate, we have to sharpen our pencils a little bit, but with that down in market, but we still feel that we're maintaining market share.

Bret Jordan

Jefferies LLC

Q

The European topic, I guess, is GSF, obviously the UK pricing issue and are they abating on the price competition or does that remain as hot as ever? And then, I guess you'd also mentioned negative customer experiences. Could you talk about the relatively weaker markets, where did you see the real softness?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah, in UK in particular, I mean, GSF is still there. Other folks are expanding as well. We're the largest today. We've got the most covered so as some of our competitors open branches, they create a little bit of noise, but GSF is still a big one. I think it's slowing down somewhat. I mean, when we look at some of the pricing that we won't necessarily chase down, I know how good we buy based on our scale and it doesn't necessarily make sense. So – and we're winning the customers still, Bret, in that market. Even if you look at the national accounts, it's really good for us.

I was just there, as I mentioned in my script at the end of June, meeting with the team, talking about not only the long-term strategy plan to integrate that business, transform that business, to really deliver significant opportunity for us and they're working on that. If you look at the simplification of operations, SKU rationalization, they're working on implementing lean operating model. They have cost cutting measures, \$35mm of cost cutting that I mentioned primarily will be in Europe and they've already started on that.

And in addition, as we announced, we did a partnership in the UK where we're pretty strong in the collision market with SYNETIQ. So we're now expanding into salvage product lines into that to really fill in the portfolio for us on products.

Bret Jordan

Jefferies LLC

Q

Okay. And on the North American collision, I think you mentioned some price increase. Can you tell us what you took for price increase?

Justin L. Jude

President, Chief Executive Officer & Director

A

We don't disclose the overall price increase, but we have been pushing price. Obviously, the tariffs are forcing that. We're seeing the OEMs push price. I know last time you asked the question, we didn't see it. Obviously, if you read the headlines on a big – on some of the big OEMs, they're feeling the pain of tariffs. I don't think they have any choice but to continue to push price. They're pushing it, we're pushing it.

The good news is, obviously, the most tariffed product line that we have is aftermarket. And with repairable claims being down 9%, our actual volume on aftermarket was positive in the quarter. So, even though we push price, we maintained service levels which with the leverage impacted our margin somewhat, but we wanted to make sure we maintain our service levels. It allowed us to outperform the market. I mean, we grew 650BPS, as Rick mentioned, over the repairable claim decline. And we really want to just be poised from a service level and availability standpoint to gain that leverage when the market recovers.

Craig Kennison

Robert W. Baird & Co., Inc.

Q

Really appreciate appendix one, slide 17 and trying to understand that even better. Your unrepaired vehicle metric seems to be one of the top issues that you face. How do you see that unfolding? Some of those trends look to be very long-term while they may be cyclical, insurance rates are still high and that behavior may persist for some time. So, I'm curious when you think that will ultimately find a bottom?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah, it's hard for me to speculate. I mean, we tried to – we saw some green shoots in used car pricing as we mentioned early on and we expected the market to recover. We haven't seen that yet necessarily. If you look at the big overall picture, Craig, on the just the industry in general, I mean, as I mentioned earlier, the OEMs are under tremendous pressure, a lot of tariff impact for them.

Lost profits, they are going to have no choice but to pass on pricing increase, new car sales to offset the volume. Those will be good for us, right. If the OEMs have a strong presence in the market, that's good for us. It leads to higher used car pricing, higher cart part – higher part pricing, more car sales on a new side leads into our sweet spot.

And so the repair – well the unrepaired vehicles, that number has grown. That is cyclical as you mentioned our – what we don't know is when it's going to turn around, Craig. I mean, we've got to see abatement of high insurance rates and I think we've seen the growth of that slowdown. The question is will insurance rates start to drop as insurance companies want to gain market share. Used car pricing at some point will start to rebound to grow at the same rate of repair cost and so at some point we see that unrepaired vehicles coming back to more of a normal number.

But the team there is really, I mean in North America, as you saw, we're still executing. I mean, even though in a down market, repairable claims being down 9%, the team was down 2%. I mean, it's just phenomenal growth. So in some cases, if you look at that chart you mentioned, you look at self-pay repairs. I mean, we're the trade down alternative on the OEM side. So we're gaining share on that self-pay. I mean overall, just with our service levels and our fill rate, we're doing really well.

In addition to help offset, or create revenue opportunities, our hard parts business in Canada is performing really well as well as we convert that from three-step to two-step. So, we're don't – we're not just sitting with our – sitting on our hands, I guess, letting the market dictate to us what we're going to do. We're still looking at revenue opportunities. And once again, Craig, we're definitely outperforming the market.

Craig Kennison

Robert W. Baird & Co., Inc.

Q

And I think it was Rick who mentioned APU being stronger. I'm wondering if you could share that metric.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah, I know the number went up about 150BPS. I don't know the exact...

Rick Galloway

Chief Financial Officer & Senior Vice President

A

We're up really close to 39%, Craig, is where the number is sitting right now.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. And when you see Craig, the OEs, as I mentioned, they're pushing price, that's creating even more value proposition for alternative parts, and we're the alternative parts leader. I mean, obviously, we have no tariff impact on our salvage. So, it pushes towards salvage. It pushes more towards aftermarket. And so that APU growth is just – really just, in a lot of cases, possible because of LKQ's, just national coverage that we have.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

In your narrative, like you mentioned what's going on in Europe, you had to change out some people, you're going to focus on cost cuts there. I mean, I think you basically said that you would also been going through some change in personnel over there since the start of the year. Are you where you need to be and – as far as personnel? And then, what they're doing over there, coupled with the cost cuts that you're envisioning? When should we start seeing that impact come into the P&L?

Justin L. Jude

President, Chief Executive Officer & Director

A

I was over there in June meeting with that team. We've – I feel pretty confident in the team that we have. We've – we brought on new skill-set, new mindsets. I mean, quite honestly, we've been after some of these initiatives for a while in Europe. And so we're making sure we have the right team that is going to execute against that. I mentioned in our Investor Day, our three-year plan. It's not a linear progression, Gary. It's a – mean, it's really, truly a three-year plan that the team has to execute.

Obviously, they've got to navigate through the existing market conditions today, work on the cost cutting initiatives, but they are truly laser-focused, working on the three-year strat plan, integrating that business, transforming it to really unlock the significant potential that I feel we have over there.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

I think the target that Justin gave out, \$75mm, the vast majority of that is coming from our European operations. As you know, Gary, it takes a little while to get some of those implemented. I would expect those to be primarily implemented by the end of Q4. And so you should see the full benefit of that in 2026.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

Okay. And did you quantify on EPS and what the impact of the tariffs was on the bottom line?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah. So, Gary, we think we have the ability to pass through all of our tariff costs. And so we're expecting to pass those through. What we are seeing as well, as what Justin talked about as far as the competitiveness in the marketplace. So it's a combination of the two. So, for us, the tariff piece, we're pushing through all of that through pricing, through – when we net out the cost.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

Okay. So you're not having any issues with passing that through?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

No, not so far. Justin talked about – saw in Q2, OEs started raising their prices and we started doing the same. And the value proposition is strong. We're not losing anything there. So really optimistic looking in the back half of the year of what we've got coming up.

Gary Frank Prestopino

Barrington Research Associates, Inc.

Q

And then just let me sneak in one more quick one and I'll jump off. Was there – in the slide that you put in 17, has there been any change in the impact of ADAS on accident volumes from where you talked about during your Investor Day last year? Is there any change in that outlook that's been de-minimis due to ADAS?

Justin L. Jude

President, Chief Executive Officer & Director

A

I mean the long-term outlook remains the same. If you compare on this chart, we're comparing 2022 – or 2022 to 2025. And so ADAS, the technology did have an impact on overall accidents. It was offset by just some of that kind of, what I would call, COVID snapback, more people getting back into the office, more miles traveled, more vehicles in operation. So, actuality, we saw the true accidents increase. Long-term, we still see ADAS having a slight headwind on overall accidents.

But once again, I think we've talked during Investor Day is even with the reduction in accidents from ADAS, the overall market we're still seeing on the collision side growing for the next 10 years. When you look at APU growth opportunity, you look at just part proliferation, more parts on the estimate, the ability for us to gain share and push price. So, we still see the overall collision market being very strong for us.

Jash Patwa

JPMorgan Securities LLC

Q

I was hoping to just talk to the right to appraisal legislation in some key states like Texas and New Jersey. Could you maybe talk about the implications from a repairable claim standpoint and whether this could move the needle on total loss frequencies if adopted by more states? Thanks and I have a follow up.

Justin L. Jude

President, Chief Executive Officer & Director

A

I mean, obviously, those are pretty new in Texas and in New Jersey. It's kind of [ph] too difficult (00:35:55) for us to tell. At the end of the day, it's creating a benefit to consumers to dispute concerns with the insurance company

on the appraisal to your point or the total loss value. So, my guess is most consumers would want a higher total loss. And typically when there is higher total loss amount that leads to more repairable claims.

So as of now, we haven't seen any impact to that. I will say we do have our own government affairs department that helps us navigate through some of these things, making sure that consumers have a choice in getting their vehicle repaired with alternative parts and so we're pretty actively monitoring that. But nothing that we've seen so far, Jash, has any impact to us.

Jash Patwa

JPMorgan Securities LLC

Q

Could you maybe talk about the production flexibility of some of your key suppliers? Many aftermarket peers have shared their intentions to relocate production to Mexican facilities and mitigate the tariff impact from USMCA compliance. Is that something you are seeing with their vendor base? And if you could just provide some more flavor on those conversations you are having?

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah. I mean, a lot of the aftermarket collision has historically always been in Taiwan. We do have some of those Taiwanese manufacturers that have production in the States. Some have looked at Mexico. The real benefit we've got, obviously, if you look at salvage we have no tariff on that. So there's no impact on that, it's creating a good opportunity for us and better value proposition. But as of now, I think in some cases a lot of the manufacturers are waiting to see what happens with the final tariff. So, no major movement yet.

Jash Patwa

JPMorgan Securities LLC

Q

Got it. If I could just sneak one more in. Could you maybe just provide a breakdown of the collision vs. non-collision organic revenue growth in North America? I believe you called out non-collision revenue to be strong in Q2. Just wondering if you could put some numbers around that, please?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah, Jash, we haven't typically given numbers out specifically for that. What Justin talked about was volume for aftermarket parts was actually up in the quarter. So aftermarket volume was up a bit. What we are seeing is on the downside, things that are kind of the last thing to do within the repair which is paint, as a good example. That's down greater than what even the repairable claims are because that is essentially the last piece of the overall repair. So, if you think about the repair cycle and what we've got going on, you can look at hard parts. Hard parts is better than the negative 2.5% or 2.2% that we put in for the quarter.

And then you've got also things like aftermarket parts are better, but we are seeing a little bit in some of our major mechanicals that are down a bit more than what we had expected before. And typically that happens when used car prices have flatlined and some of the car part is getting a little bit older. The decision to actually repair that engine is something that the consumers weigh.

Bret Jordan

Jefferies LLC

Q

A follow up on the IAA SYNETIQ partnership in the UK. Is there a CapEx involved in that, do you need to build the dismantling yards to create alternative collision parts? Or is that on their infrastructure?

Justin L. Jude

President, Chief Executive Officer & Director

A

That's on their existing infrastructure. The partnership is great for us. I mean, they're – they need a sales arm, they need a good distribution model. We provide that in the UK and we're the best in that. We're the number one collision parts provider on the aftermarket side. So, being able to take some of those products and move into our network, and it was – so really no CapEx. It was already set up on the infrastructure side.

Bret Jordan

Jefferies LLC

Q

And can you remind us what you're doing in collision revenues in the UK now so we can benchmark that?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

We haven't provided that in the past, but it's something less than \$100mm I think is what we've got. It's...

Justin L. Jude

President, Chief Executive Officer & Director

A

Parts alone, yeah...

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Parts alone on the market of this.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah, it would be well over \$100mm, yeah.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

Yeah.

Justin L. Jude

President, Chief Executive Officer & Director

A

Yeah, okay.

Rick Galloway

Chief Financial Officer & Senior Vice President

A

With paint and everything, it's a little bit different, Bret.

Scott L. Stember

ROTH MKM

Q

Just a follow up on tariffs. I'm not sure if you said, but I think you said \$35mm was the headwind in the quarter. Is that what you needed to offset? And just trying to get a sense of coming out of last quarter, the narrative was that you guys could more or less offset or it would be very, very manageable for you. Are you changing that narrative at this point right now?

Rick Galloway

Chief Financial Officer & Senior Vice President

A

The \$35mm – I'll take the first part and then you can take the second. The \$35mm, Scott, was what is sitting in inventory at the end of Q2. So that's not what went through the P&L. It was minimal impact within the P&L as far as the cost side goes and we've offset that with pricing.

So, we think that that'll happen in the back half. So nothing's changed as far as what we talked about before. The numbers are roughly about the same as what we disclosed back in Q1 and then we'll continue to monitor. And the one thing that we need to figure out and are going to continue to drive is the impact of trade working capital with the increase in tariffs is something we're going to have to mitigate and figure out how to do that in the back half of the year.

Justin L. Jude

President, Chief Executive Officer & Director

A

But from pushing it through pricing, Scott, there's been no issue. What we talked about last quarter was we're confident we can mitigate it, at least push the price to cover the tariffs. Historically, what we've always done is made margin on top of that. And so that's kind of yet to be known, there's some uncertainty there, but there's no concern for us on the tariff increase on the cost side, being able to pass that through.

Justin L. Jude

President, Chief Executive Officer & Director

CLOSING REMARKS

- In closing, even with the challenge that we talked about on repairable claims in North America, I just want to give a shout out to the team in North America. I mean, they absolutely crushed it, outperformed the market by 650BPS
- There was no team better than ours globally, and we're set up and poised to take advantage once the market recovers
- And our Europe team, once again, I was just over there a month ago, really enjoyed meeting with some of our new key leaders, working with them on some of the cost cutting actions
- They're focused on executing against the three-year strat plan, but the integration and trend transformation of that company is hard, a lot of work to do but they've got the right skill-set and mindset and I'm excited to see what they can deliver and unlock that significant opportunity
- From overall on the strategy plan for simplifying the portfolio, we're still active on that, so more to come
- And obviously it's been a challenging market for our employees, so I just want to say thank you to all the employees that helped us deliver and continue to deliver every day

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