

LKQ CORP  
Form 10-K  
February 27, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Commission File No. 000-50404

**LKQ CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**36-4215970**  
(I.R.S. Employer  
Identification Number)

**120 North LaSalle Street**  
**Suite 3300**

**Chicago, Illinois**  
(Address of principal executive offices)

**60602**  
(Zip Code)

**Registrant's telephone number, including area code: (312) 621-1950**

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of each exchange on which registered
<b>Common Stock, par value \$.01 per share</b>	<b>Nasdaq Global Select Market</b>

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as described in Rule 12b-2 of the Exchange Act). Yes  No

**As of June 30, 2008, there were 127,180,454 shares of common stock outstanding held by stockholders who were not affiliates (as defined by regulations of the Securities and Exchange Commission) of the registrant, and the aggregate market value of such shares was approximately \$2.3 billion (based on the closing sale price on the Nasdaq Global Select Market on June 30, 2008). The number of outstanding shares of the registrant's common stock as of February 20, 2009 was 139,932,910.**

**Documents Incorporated by Reference**

**Those sections or portions of the registrant's proxy statement for the Annual Meeting of Stockholders to be held on May 4, 2009, described in Part III hereof, are incorporated by reference in this report.**



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**PART I**

**SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K includes forward-looking statements. Words such as may, will, plan, should, expect, anticipate, believe, estimate, intend, project and similar words or expressions are used to identify these forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. However, these forward-looking statements are subject to risks, uncertainties, assumptions and other factors that may cause our actual results, performance or achievements to be materially different. These factors include, among other things:

uncertainty as to changes in U.S. general economic activity and the impact of these changes on the demand for our products and our ability to obtain financing for operations;

fluctuations in the pricing of new OEM replacement parts;

the availability and cost of our inventory;

variations in vehicle accident rates;

changes in state or federal laws or regulations affecting our business;

changes in the types of replacement parts that insurance carriers will accept in the repair process;

changes in the demand for our products and the supply of our inventory due to severity of weather and seasonality of weather patterns;

the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our business, operations and infrastructure;

increasing competition in the automotive parts industry;

our ability to increase or maintain revenue and profitability at our facilities;

uncertainty as to our future profitability on a consolidated basis;

uncertainty as to the impact on our industry of any terrorist attacks or responses to terrorist attacks;

our ability to operate within the limitations imposed by financing arrangements;

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our ability to obtain financing on acceptable terms to finance our growth;

declines in the values of our assets;

fluctuations in fuel and other commodity prices;

fluctuations in the prices of scrap metal and other metals;

our ability to develop and implement the operational and financial systems needed to manage our operations;

our ability to integrate and successfully operate acquired companies and any companies acquired in the future and the risks associated with these companies;

the risk that Keystone's business will not be integrated successfully or that we will incur unanticipated costs of integration;

claims by original equipment manufacturers that attempt to restrict or eliminate the sale of aftermarket products; and

decreases in the supply of end of life and crush only vehicles that we process and sell for scrap.

Other matters set forth in this Annual Report may also cause our actual future results to differ materially from these forward-looking statements. We cannot assure you that our expectations will prove to be correct. In

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addition, all subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements mentioned above. You should not place undue reliance on these forward-looking statements. All of these forward-looking statements are based on our expectations as of the date of this Annual Report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Copies of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through our website ([www.lkqcorp.com](http://www.lkqcorp.com)) as soon as reasonably practicable after we electronically file the material with, or furnish it to, the SEC.

**ITEM 1. BUSINESS**

**Overview**

We provide replacement systems, components, and parts needed to repair vehicles (cars and trucks). Buyers of vehicle replacement products have the option to purchase from primarily four sources: new products produced by original equipment manufacturers ( OEMs ), which are commonly known as OEM products; new products produced by companies other than the OEMs, which are sometimes referred to as aftermarket products; recycled products originally produced by OEMs, which we refer to as recycled OEM products; and used products that have been refurbished. We participate in the market for recycled OEM products as well as the market for collision repair aftermarket products. We obtain aftermarket products and salvage vehicles from a variety of sources, and we dismantle the salvage vehicles to obtain a comprehensive range of vehicle products that we distribute into the vehicle repair market. We also refurbish bumpers, wheels, head lamps and tail lamps.

In addition, we operate self-service facilities that sell retail recycled automotive products. Retail customers are given access to salvage vehicles and allowed to remove the parts they desire to purchase. In 2008, we acquired a company with multiple self-service facilities in the state of California and three companies in the heavy-duty truck recycled parts business. The heavy-duty truck acquisitions represent an expansion of our business into an area that we believe is complementary to our existing business.

We believe that our business is environmentally responsible. Our recycled automotive products provide an alternative to the manufacture of new products, which would require the expenditure of significantly more resources and energy and would generate a substantial amount of additional pollution. Also, we recycle materials, such as fuel, motor oil, and Freon, from the salvage vehicles that we procure. In addition, we save landfill space because the parts that we recycle would otherwise be discarded.

We are the largest nationwide provider of recycled OEM products and related services, with sales, processing, and distribution facilities that reach most major markets in the U.S. In October 2007, we acquired Keystone Automotive Industries, Inc., the nation's leading distributor of aftermarket collision replacement products. As a result, we are the largest nationwide provider of aftermarket collision replacement products and refurbished bumper covers and wheels.

We procure salvage vehicles, primarily at auctions, using our locally based professionals, proprietary processes, and a disciplined procurement system. In addition, as an alternative source of salvage vehicles, we obtain some inventory directly from insurance companies, vehicle manufacturers, and other suppliers. Once we have received proper title, which serves as a safeguard that the vehicles have not been stolen, we dismantle such vehicles for recycled OEM products. We purchase aftermarket products from manufacturers, primarily in Taiwan, using proprietary order management systems.

Our customers include collision and mechanical repair shops and, indirectly, insurance companies, including extended warranty companies. The majority of our products and services are sold to collision repair

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shops, also known as body shops, and mechanical repair shops. We indirectly rely on insurance companies, which ultimately pay the collision repair shops for the repair of insured vehicles, as a source of business. These insurance companies exert significant influence in the vehicle repair decision, and we provide a nationwide source for consistency, quality, and availability of replacement products. Because of their importance to the process, we have formed business relationships with certain insurance companies and with certain extended warranty providers, in order to be their preferred vehicle alternative parts supplier. For example, with some insurance companies we have vehicle repair order estimate review programs in place and provide their claims adjusters a part quote and locator service. In addition, we provide them an outlet to dispose of certain total loss vehicles directly to us. We provide extended warranty companies a single national call desk to service their nationwide needs for mechanical products.

We believe we provide customers a value proposition that includes high quality products, extensive product availability due to our regional inventory trading zones, product costs lower than new OEM products, and quick delivery. We provide benefits to repair shops and insurance companies because the lower costs for our products enable many vehicles to be repaired rather than declared a total loss. By expanding our product offerings to include recycled OEM products, aftermarket products, and refurbished bumpers, wheels and head and tail lamps, we now offer customers an extensive range of vehicle replacement products. We believe this unique combination of recycled, aftermarket and refurbished products allows us to serve as a one-stop solution for our customers looking for the most cost advantageous way to repair vehicles.

## **Our History**

We believe we were the first recycler of light vehicle products to achieve a national network and presence. Since our formation in 1998, we have grown through both internal development and acquisitions. Our acquisition strategy has been to target companies with strategic locations and significant market presence, strong management teams, a record of environmental compliance, solid growth prospects, and a reputation for quality and customer service.

In February 2004, we expanded our product offerings by acquiring a supplier of aftermarket products and a provider of self-service retail recycled vehicle products. In January 2006, we acquired an aluminum alloy wheel refurbishing business. In January 2007, we acquired a head and tail lamp refurbishing company. In October 2007, we significantly increased our size by acquiring Keystone Automotive Industries, Inc. At the time of the acquisition, Keystone was the leading distributor of aftermarket collision replacement parts. Keystone also refurbished alloy wheels, which added to our existing wheel business. The Keystone acquisition also expanded our product offerings with refurbished bumpers and paint and other materials used in the repair of damaged vehicles. In March 2008, we acquired our first heavy-duty truck recycled parts business.

## **Our Strengths**

### ***We Provide a National Solution to Insurance Companies and Extended Warranty Providers.***

We believe that our nationwide presence gives us a unique ability to service the major automobile insurance companies and extended warranty providers. Insurance companies and extended warranty providers operate generally at a national or regional level and play a critical role in the repair process. We believe we provide a direct benefit to these companies by lowering the cost of repairs, decreasing the time required to return the repaired vehicle to the customer, and providing a replacement product that is of comparable quality to the part replaced. Specifically, we assist insurance companies by purchasing insured total loss vehicles and by providing cost effective products through sales to collision repair shops, especially to repair shops that are part of an insurance company network. We also provide a review of vehicle repair order estimates to insurance companies so they may assess the opportunity to increase usage of recycled OEM, aftermarket, and refurbished products. For extended warranty providers, we provide a single national call desk to service their nationwide need for mechanical products.

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### ***We Believe We Have the Only National Network for Alternative Automotive Replacement Products and it Would be Difficult to Replicate.***

We have invested significant capital developing a national network of recycled OEM, aftermarket and refurbished product facilities that serves most major metropolitan areas in the U.S. We have differentiated ourselves from our local competitors and made replication of our network difficult by developing our network through purchasing anchor companies that were among the largest companies in the industry. The difficulty and time required to obtain proper zoning, as well as dismantling and other environmental permits necessary to operate newly-sited recycled OEM facilities, would make establishing such new facilities challenging. In addition, there are difficulties associated with recruiting and hiring an experienced management team that has strong industry knowledge and local relationships with customers. Finally, our national network allows us to enter new adjacent markets quickly by establishing redistribution facilities, which avoids the need for local dismantling capabilities and inventory.

### ***We Benefit From a Local Presence.***

Our network of facilities allows us to develop and maintain our relationships with local repair shops, while providing a level of service to insurance companies and national customers that is made possible by our nationwide presence. Our local presence allows us to provide daily deliveries that our customers require, using drivers who routinely deliver to the same customers. Our sales force and local delivery drivers develop and maintain critical personal relationships with the local repair shops that benefit from access to our wide selection of products, which we are able to offer as a result of our regional inventory network.

### ***We Have a Proven and Effective Procurement Process.***

We use information systems and methodologies designed to enable us to procure salvage vehicles and aftermarket products cost-effectively. As our largest single expenditure, efficient procurement of salvage vehicles and aftermarket products is critical to the growth, operating results and cash flow of our business. Our processes and know-how allow us to identify and value the parts that can be recycled on a damaged vehicle at auction and to determine rapidly the maximum price we will pay for the vehicle in order to achieve our target margins on resale of the recycled OEM products. We carefully analyze the market and obtain aftermarket products and salvage vehicles of the type whose parts are in demand at prices that we believe will allow us to sell products profitably. We have also taken advantage of our relationships with insurance companies and vehicle manufacturers to obtain salvage vehicles outside the auction process.

### ***We Have a Broad and Deep Inventory of Products.***

We believe that our customers place a high value on availability of a broad range of vehicle replacement products. We also believe that our inventory of recycled OEM, aftermarket and refurbished products allows us to fill a higher percentage of our customers' orders than our competitors. In addition, our ability to share inventory on a regional basis increases the availability of replacement products and also helps us to fill a higher percentage of our customers' orders. We have developed regional trading zones within which we make our inventory available to our local facilities, mostly via overnight product transfers. We manage our inventory and purchasing on a regional basis to enhance the availability of the products that we believe will be in the highest demand within each region. Our broad and deep inventory furthers our ability to serve as a one-stop solution for our customers' recycled OEM, aftermarket and refurbished product needs.

### ***We Have Implemented Management Disciplines.***

Our management and operations team is highly experienced, with many managers having spent their entire careers in the vehicle replacement parts industry. We have developed and built procurement, operating, and



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financial systems that have allowed us to grow and develop our national network and implement professional management techniques and disciplines. As our business has grown, we have acquired additional management talent that has furthered the sharing of best practices throughout the company. In addition, our senior management team has extensive acquisition experience and will continue to use our disciplined approach in targeting growth opportunities.

### **Our Strategies**

#### ***Strengthen our North American Network Through Internal Growth and Acquisitions.***

We intend to continue to expand our market coverage through a combination of internal development and acquisitions and to look for opportunities to expand into new regions and into adjacent markets. We plan to establish a presence in additional metropolitan markets and a number of smaller markets in North America. We have applied an analytical and disciplined approach to our acquisition process and have targeted companies with strong management teams, a record of environmental compliance, solid growth prospects, and a reputation for quality and customer service. We have also expanded our product offerings and will continue to consider additional opportunities to expand our product offerings.

#### ***Further Develop Business Relationships.***

We intend to continue to develop business relationships with automobile insurance companies, extended warranty providers, and other industry participants. We believe that insurance companies and extended warranty providers, as payors for many repairs, will take a more active role in the selection of replacement products in the repair process in order to use lower cost alternatives to new OEM products. On behalf of certain insurance company customers, we provide a review of vehicle repair order estimates so they may assess the opportunity to increase usage of recycled OEM, aftermarket and refurbished products in the repair process, thereby reducing their costs. Our employees also provide quotes for our products to assist several insurance companies with their estimate and settlement processes. We also work with insurance companies and vehicle manufacturers to procure salvage vehicles directly from them on a selected basis, which provides us an additional source of supply and provides them improved economics on salvage vehicle sales. We believe we are positioned to take advantage of the increasing importance of these industry participants and will continue to look for ways to enhance our relationships.

#### ***Continue to Improve our Operating Results.***

We are working to improve our operating results by applying our business disciplines to our most recently acquired facilities, continuing to build our network, further centralizing certain functions, improving our use of technology, and increasing revenue at our lower volume facilities. Our higher volume facilities generally operate at a higher profitability level as a percentage of revenue. We believe we can improve the profitability level at our lower volume facilities by achieving the higher volumes and improved economies of scale that we realize at our higher volume facilities. We intend to continue to refine our procurement system, which uses methodologies that analyze demand levels for our products, existing inventory levels, and projected margins.

#### ***Further Develop our Technology and Business Processes.***

We continue to emphasize the use of technology in our processes to improve efficiency and to increase the standardization of our business. We continue to develop our technology to allow us to better manage and analyze our inventory, to assist our salespeople with up-to-date pricing and availability of our products, and to further enhance our procurement process. For example, many of our representatives responsible for procuring vehicles, whom we refer to as scouts, are equipped with handheld computing devices to assist them in appraising the vehicles prior to submitting a bid to purchase the vehicle.

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### ***Raise Industry Standards by Being the Industry Leader.***

Since our inception, we have employed a professional approach to the vehicle recycling business and have applied the same approach to our aftermarket and refurbishing businesses. Our leadership position in the collision repair aftermarket industry was further enhanced with our acquisition of Keystone, which was the largest provider of collision repair aftermarket products. We continue to seek new ways to improve our methodologies and to communicate our standards to our customers. We believe that, by elevating industry standards in areas such as customer service, integrity, product quality and availability, delivery time, warranty support, environmental compliance, and appearance of facilities, we can help promote the acceptability of the use of recycled OEM, aftermarket and refurbished products.

### **Our Process**

Our operations generally involve the procurement of inventory, vehicle processing (in the case of recycled OEM products), sales, and distribution. We also perform refurbishing of OEM wheels, bumpers, head lamps and tail lamps. Such refurbishing work is primarily cosmetic.

### ***Procurement of Inventory***

We start the process of procuring recycled OEM products for our wholesale operations by acquiring severely damaged or totaled vehicles. We acquired approximately 144,500 salvage vehicles for our wholesale operations in 2008. We purchase the majority of our vehicles for our wholesale operations from salvage auctions. Wrecked vehicles are sold at salvage auctions held each weekday throughout the country. Salvage auctions provide an outlet for salvage vehicles to be processed and sold primarily to automotive recyclers and rebuilders. We pay third parties fees to tow the vehicles from the auction to our facilities. Salvage auctions charge fees both to the supplier of vehicles (primarily insurance companies) and to the purchaser (including us).

For the vast majority of our salvage auction purchases, we send a scout in advance of each auction to investigate the vehicles we would be interested in buying. The scout obtains key information such as the model, mileage, and damage assessment and determines which parts on the targeted vehicles are recyclable. This information is electronically forwarded to our bid specialists via handheld computing devices or facsimile transmissions. The bid specialists analyze the data in light of current demand for the parts in question, the levels of our inventory with respect to such parts, and the projected margins expected for each vehicle. The specialists then set a maximum bid price that our bidders use to purchase the vehicle at auction. We believe that this system provides a disciplined approach to procurement.

We also obtain salvage vehicles and parts from insurance companies, vehicle manufacturers, abandoned vehicle programs, and other salvage sources. Some of these arrangements allow us to acquire salvage vehicles directly from the insurance company or vehicle manufacturer at a cost calculated as a percentage of revenue, which is remitted as products are sold from these vehicles. These arrangements eliminate the fees we and the insurance company would otherwise pay to the salvage auction and provide us inventory with a lower initial expenditure of capital.

We acquire inventory for our self-service recycled OEM products operations from a variety of sources, including but not limited to auctions, towing companies, municipalities, insurance carriers, charitable organizations and the general public. In 2008, we purchased approximately 297,000 lower cost self-service and crush only vehicles.

We purchase aftermarket products from independent manufacturers primarily in Taiwan and the United States. We purchased and imported approximately 38% of our aftermarket products directly from manufacturers in Taiwan and other Asian countries. Approximately 62% of our aftermarket products have been purchased from locations in the United States. However, we believe that the majority of these products are manufactured in

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Taiwan and other Asian countries. No single supplier currently provides more than 21% of our aftermarket products. We use proprietary order management systems to procure our aftermarket inventory. The systems initiate inventory purchases based on stocking levels and historical sales data. We believe that the systems help us to procure our aftermarket inventory efficiently and to maintain one of the highest fulfillment rates in the aftermarket products industry.

### ***Vehicle Processing***

Vehicle processing for our wholesale operations involves dismantling a salvage vehicle into recycled OEM products ready for delivery. When a salvage vehicle arrives at one of our facilities, an inventory specialist identifies, catalogs, and schedules the vehicle for dismantling. We do not dismantle the vehicle until we have received proper title documentation, which serves as a safeguard that the vehicle was not stolen.

The dismantler removes components that will become products for sale. Products that are placed directly on inventory shelves generally include such items as the engine, transmission, hood, trunk lid, head and tail lamp assemblies, rear bumper, and doors. We remove all recyclable items including fluids, Freon, batteries, tires, and catalytic converters. These items are sold to recyclers and reprocessors. Dismantlers also perform any required cutting of the vehicle frame or body.

Each inventory item is entered into our inventory tracking system, inspected for quality, tagged for identification, and prepared for storage and delivery to our customers. Mechanical products not in a condition to be sold as recycled products or that are in surplus supply are separated and sold in bulk to parts remanufacturers, while the wheel, bumper and lighting items are sent to our refurbishing facilities. The remaining vehicle hulks and components, such as fabrics, rubber, plastics, and glass, are sold to scrap processors.

The processing of vehicles for our self-service recycled OEM products operations involves removal of all recyclable items including the fluids, Freon, batteries, and catalytic converters. The vehicles are then moved to a site on our retail lots and made available for customers to remove parts.

### ***Refurbishing Process***

We refurbish both chrome plated bumpers and plastic bumper covers. The refurbishing process for chrome plated bumpers generally includes some or all of the following steps: straightening or reforming to original dimensions; welding breaks or cracks; surface grinding to remove rust or corrosion; chemical stripping to remove the original electroplated finishes; metal polishing and buffing; electroplating layers of copper, or nickel and chromium; and inspecting and packaging.

The refurbishing process for plastic bumper covers generally includes some or all of the following steps: straightening or reforming to original dimensions with heat; sanding or sandblasting the surface; using plastic welding techniques when necessary; finishing the surface with various epoxies and similar materials; painting; texturing and color coating as needed; and inspecting and packaging.

We refurbish steel and alloy wheels. The refurbishing process for wheels generally includes some or all of the following steps: straightening; welding minor dents or chips; hand-detailing; painting; machining; applying a clear powder coat; and inspecting and packaging.

We refurbish head and tail lamps. The refurbishing process for lamps includes: a proprietary method of repairing the housing; sanding and buffing to remove imperfections; cleaning the lamp; re-coating the lens with a UV protectant coat; reassembling; and inspecting and packaging.

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Our refurbished products are processed from cores obtained from our recycled OEM locations, from customers and from brokers. The higher quality cores are then refurbished. For popular wheels, we also purchase aftermarket wheels from outside vendors to fill demand.

### ***Sales***

As of December 31, 2008, we employed 620 full-time sales staff in our wholesale recycled OEM products operations. Of these, 571 were located at sales desks at our facilities and generally are responsible for accepting incoming calls from, and selling our inventory to, our customers. We put all of our sales personnel through a thorough training program. Most of our sales personnel are paid primarily on a commission basis. In addition, as of December 31, 2008, we had approximately 49 traveling sales staff who visit our customers and focus on business development in various markets.

In our aftermarket products operations, sales orders are accepted either by our aftermarket and refurbished products sales personnel at our sales call centers or by our route sales persons. As of December 31, 2008, we had approximately 589 employees selling aftermarket and refurbished products at such call centers and approximately 1,366 route sales persons selling aftermarket and refurbished products to the customers they visit.

As part of the integration of Keystone into our preexisting operations, we initiated a program to encourage cross selling of aftermarket and recycled OEM products to our customers. In late 2008, we provided access to Keystone's point of sales system to our recycled OEM products sales staff. We have also created better links for Keystone's sales staff to refer customers to our recycled OEM products sales staff. Frequently, when recycled OEM parts are unavailable or out of stock, we are able to fill the order with aftermarket parts from Keystone's inventory.

We are continually reviewing and revising the pricing of our recycled OEM products. Our pricing specialists take into consideration factors such as location, recent demand, inventory quantity, inventory turnover, new OEM product prices, recycled OEM product prices, aftermarket and refurbished product prices, and remanufactured part prices, with the goal of optimizing revenue. We update the pricing of our aftermarket and refurbished products at least annually when we update our product catalogs or when standard pricing guides are provided to estimating systems. We may adjust prices during the year in response to material price changes of OEM products.

The inventory base of each of our facilities, supplemented by the inventory sharing system within our regional trading zones, gives us what we believe to be a competitive advantage through our ability to meet our customers' requirements more frequently than smaller competitors.

### ***Distribution***

Each sale results in the generation of a work order. A dispatcher is then responsible for ensuring product accuracy, printing the final invoice, and including the products on the appropriate truck route for delivery to the customer. We operate a delivery fleet of medium-sized trucks and smaller trucks and vans. These trucks deliver products to our customers within a specified territory, typically on a daily basis. In markets where we offer recycled OEM, aftermarket and refurbished products, we often deliver more than one product type on the same delivery routes to help minimize distribution costs.

Additionally, we have developed an internal distribution network to allow our sales representatives to sell recycled OEM, aftermarket and refurbished products from the inventory of nearby facilities within our regional trading zones, thus improving our ability to fulfill customer requests and accelerating inventory turnover. Each weekday we operate approximately 245 transfer runs between our facilities generally within our trading zones that carry recycled OEM, aftermarket and refurbished products. In addition, we have approximately 2,400 local delivery routes serving our customers each weekday.

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### **Our Products**

When we procure salvage vehicles for our wholesale operations, we focus on vehicles for which the insured repair market has the most recycled OEM product demand. These tend to be popular types of vehicles such as sport utility vehicles and pickup trucks, and automobile models with high sales volume. These vehicles generally are a few model years old, as insurers tend to use new OEM products on repairs of vehicles that are one to two years old. Similarly, insurers are less likely to authorize the repair of vehicles more than ten model years old. The degree of damage is not a significant factor in our process as we assign value only to the undamaged products when we prepare our bids.

Our most popular recycled OEM products include engines, transmissions, vehicle front end assemblies, doors, trunk lids, bumper assemblies, wheels, head and tail lamp assemblies, mirrors, fenders, and axles.

We typically procure salvage vehicles that are more than seven model years old for our self-service retail recycled products operations. These vehicles are placed in our self-service yards where retail customers pay a fee for entry. The customers remove parts from the vehicles and pay us for the parts they desire to purchase.

When we obtain a mechanical product, wheels, bumpers or certain lighting products from a dismantled vehicle and determine that we have an excess supply of such product or it is defective, the mechanical item is then sold in bulk to mechanical remanufacturers, while the wheel, bumper and lighting items are sent to our refurbishing locations. We refer to these items as core products. The majority of the mechanical products are transferred to our core facility in Houston, Texas where we sort them by product and model type. Examples of such products are engine blocks and heads, transmissions, starters, alternators, and air conditioner compressors.

When we procure aftermarket products and decide which wheels, bumpers and lights to refurbish, we focus on products that are in the most demand by the insured repair market. Our most popular aftermarket products are head lamps, tail lamps, grilles, hoods, mirrors, bumpers, bumper covers, and fenders. We offer paint and related repair materials (like tape, sandpaper, paint guns and frame racks) so that our customers can purchase these products and the alternative automotive repair parts from a single source.

In 1987, the Certified Automotive Parts Association ( CAPA ) was founded to provide insurance companies, distributors, collision repair shops and consumers with an objective method of evaluating the functional equivalence of aftermarket collision replacement products and OEM collision replacement products. CAPA, a non-profit association of insurance companies, manufacturers, importers, distributors, collision repair shops and consumer groups, establishes the specifications for, tests, and certifies the quality of, aftermarket collision replacement products. Through independent testing laboratories, CAPA develops engineering specifications for aftermarket collision replacement products based upon an examination of OEM parts; certifies the factories, manufacturing processes and quality control procedures used by independent manufacturers; and certifies the materials, fit and finish of specific aftermarket collision replacement products. Many major insurance companies have adopted policies recommending or requiring the use of parts certified by CAPA, when available. We distribute parts certified by CAPA when available and actively participate with CAPA, insurance companies and consumer groups in encouraging independent manufacturers of collision replacement products to seek CAPA certification.

Our wholesale and self-service operations generate scrap metal and other metals that we sell. After we dismantle a salvage vehicle for wholesale parts and after vehicles have been used in our self-service business, the remaining vehicle hulks are sold to scrap processors and other metals are sold to processors and brokers of metal. In addition, we receive crush only vehicles from other companies, including OEMs, which we dismantle and that generate scrap and other metals.

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### **Our Customers**

#### ***Insurance Companies***

We consider automobile insurance companies our customers, as they are a key demand driver for our products. Our products are delivered directly to the repair shop or installer, because insurance companies and extended warranty providers generally do not take receipt of repair parts. While insurance companies do not pay for our products directly, the insurance company does ultimately pay for the repair costs of the insured vehicle in excess of any deductible amount. As a result, the insurance company often exerts significant influence in the decision-making process as to how a damaged vehicle is repaired, and the cost level of the product used in the repair process. Insurance companies are also concerned with customer satisfaction with the repair process and the total time to return the repaired vehicle to its owner.

#### ***Repair Shops and Others***

We sell the majority of our products wholesale to collision repair shops and mechanical repair shops. The majority of these customers tend to be individually-owned small businesses, although there has been a trend toward consolidation resulting in the formation of several national and regional repair companies. We also sell our products to automobile dealerships and fleet management groups. In addition, we sell our products to individual retail customers at our self-service retail locations and at certain of our wholesale recycled OEM, aftermarket and refurbished product locations.

#### ***Remanufacturers***

A mechanical part that is not suitable for sale as a replacement part, or that is a product for which we have an excess supply, is sold to mechanical remanufacturers in bulk shipments. Examples of mechanical parts we sell in this manner are engine blocks and heads, transmissions, starters, alternators, and air conditioner compressors. Remanufacturers usually are significantly larger companies than repair shops. Our sales to them tend to be large orders and are dependent on their needs for a certain product line.

### **Our Employees**

As of December 31, 2008, we had approximately 9,600 employees. In July 2006, approximately 60 of our employees at our Totowa, New Jersey facility voted to be represented by a union. We signed a collective bargaining agreement with the union in July 2007. Approximately 200 of our employees at our bumper refurbishing plant in Mexico and approximately 130 of our employees at our recycled OEM parts facility in Quebec City, Canada are also represented by unions. Other than these locations, none of our employees is a member of a union or participates in other collective bargaining arrangements.

### **Our Facilities**

Our corporate headquarters are located at 120 North LaSalle Street, Suite 3300, Chicago, Illinois 60602. The lease for our corporate headquarters expires in July 2011. We also have regional offices throughout the United States, all of which perform corporate functions. The primary functions performed at our corporate offices are financial, accounting, treasury, marketing, business development, human resources, information systems support, and legal. In addition to our corporate offices, we have numerous operating facilities that handle recycled OEM, aftermarket, refurbished, and self-service retail products. We operate out of a total of approximately 280 physical locations. A majority of these locations are leased. Some of our locations stock multiple product types. Thus, some of our facilities may be described under more than one category below.

#### ***Recycled OEM Parts***

Our wholesale recycled OEM parts facilities are located among nine geographic regions. A typical facility has processing, sales and distribution operations, including a large warehouse with multiple bays to dismantle

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vehicles, indoor and outdoor storage areas, and administrative and sales offices. Equipment typically used at each facility includes hydraulic lifts, forklifts and loaders, and hand tools to dismantle vehicles. We also have facilities that operate primarily as redistribution centers. As of December 31, 2008, we conducted our wholesale recycled OEM parts operations from 73 facilities, 57 of which include a combination of processing, sales and redistribution operations, and 16 of which are primarily redistribution facilities. We also have five recycled OEM parts facilities in Central America. Further, we have three heavy-duty truck operations, one core processing facility and one aluminum smelter.

### ***Aftermarket Parts***

We conduct our aftermarket parts business from facilities that serve as sales, warehousing or distribution centers for these parts. As of December 31, 2008, we conducted our aftermarket parts operations from 152 facilities in the United States and Canada.

### ***Refurbished Parts***

We refurbish bumpers and wheels at 54 locations in the United States and Canada and one location in northeast Mexico. We refurbish head lamps and tail lamps primarily at a facility in Grand Rapids, Michigan.

### ***Self-Service Retail Parts***

Our self-service retail parts facilities typically consist of several acres of vehicles stored outdoors and a retail building through which customers access the vehicles. As of December 31, 2008, we conducted our self-service retail parts operations from 38 facilities in North America.

## **Competition**

We operate in a highly competitive industry. We consider all suppliers of vehicle products to be competitors, including other recycled OEM businesses, OEMs, parts remanufacturers, suppliers of aftermarket and refurbished products, and internet-based suppliers. We believe the principal areas of competition in our industry include availability of inventory, pricing, product quality, and service.

We compete with more than 6,000 domestic vehicle product recyclers, most of which are single-unit operators. We believe most of the vehicle parts recyclers in the U.S. have less than \$3.0 million in annual revenue. In some markets, smaller competitors have organized affiliations to share marketing and distribution resources. Greenleaf LLC, which is owned by Schnitzer Steel Industries Inc., is our largest competitor in the light vehicle OEM product recycling business. Schnitzer has operations in the steel manufacturing, metals recycling, and vehicle product recycling businesses and also is a significant operator in the self-service retail recycling business.

We also compete with distributors of aftermarket and refurbished collision light vehicle products. The distribution of aftermarket collision parts is highly fragmented and our competitors, other than OEMs, generally are independently owned distributors having from one to three distribution centers.

Manufacturers of new original equipment parts sell the majority of light vehicle replacement products. We believe, however, that as the insurance and repair industries come to appreciate the advantages of recycled OEM, aftermarket and refurbished products, those products can account for a larger percentage of total vehicle replacement product sales.

## **Information Technology**

We use a single third party facility management system in most of our wholesale recycled OEM operations. We believe that a single system helps us with the continued implementation of standard operating procedures,

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training efficiency, employee transferability, access to a national inventory database, management reporting, and data storage. It also eliminates the need to create multiple versions of proprietary applications and systems support processes.

The major features of our facility management systems include inventory control, customer selling and billing, sales analysis, vehicle tracking, and profitability reporting. The systems also support an electronic exchange system for identifying and locating parts at other selected recyclers and facilitates brokered sales to fill customer orders for items not in stock.

We have separate third party providers for our financial systems such as financial and budget reporting, general ledger accounting, accounts payable, payroll, and fixed assets. We intend to implement a common financial reporting system throughout our organization.

We currently protect our local customer, inventory, and corporate consolidated data, such as financial information, e-mail files, and other user files, with daily backups. These backups are stored off site with a third party data protection vendor.

We have consolidated our facility management systems onto regional system platforms. The hardware for all such platforms is located at a single data center. The center is in a secure environment with around-the-clock monitoring; redundant power backup; and multiple, diverse data and telecommunication routing. Facility management system data is mirrored (replicated) off site in real time to a disaster recovery facility located in a different part of the country. This disaster recovery facility is also housed in a secure environment with around-the-clock monitoring; redundant power backup; and multiple, diverse data and telecommunications routing.

We use a single third party facility management system in most of our aftermarket operations. We expect to convert the remaining few locations that use a separate system in 2009. Additional third party software packages have been implemented to leverage the centralized data and information that a single system provides, such as a data warehouse to conduct enhanced analytics and reporting, an integrated budgeting system, an electronic data interchange tool, and eCommerce tools to enhance our online business-to-business initiatives, OrderKeystone.com and Keyless.

Our critical aftermarket management systems are housed at a third-party, off site data center that is fully redundant across its infrastructure to ensure that operations are continuously maintained. The data center is secure and monitored 24 hours a day throughout the year by skilled technical staff. Systems are backed up daily and stored off site with a third party storage and archiving company.

We use a single facility management system in most of our refurbishing operations. We are evaluating the options to standardize the facility management systems relating to our heavy-duty truck and self-service operations.

We continually evaluate our systems with the goal of ensuring that all critical systems remain scalable and operational as we continue to grow.

## **Regulation**

### ***Environmental Compliance***

Our operations and properties, including the maintenance of our delivery vehicles, are subject to extensive federal, state, and local environmental protection and health and safety laws and regulations. These environmental laws govern, among other things, the emission and discharge of hazardous materials into the ground, air, or water; exposure to hazardous materials; and the generation, handling, storage, use, treatment,



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identification, transportation, and disposal of industrial by-products, waste water, storm water, and mercury and other hazardous materials.

We have made and will continue to make capital and other expenditures relating to environmental matters. We have an environmental management process designed to facilitate and support our compliance with these requirements. We cannot assure you, however, that we will at all times be in complete compliance with such requirements.

Although we presently do not expect to incur any capital or other expenditures relating to environmental controls or other environmental matters in amounts that would be material to us, we may be required to make such expenditures in the future. Environmental laws are complex, change frequently and have tended to become more stringent over time. Accordingly, we cannot assure you that environmental laws will not change or become more stringent in the future in a manner that could have a material adverse effect on our business.

Contamination resulting from vehicle recycling processes can include soil and ground water contamination from the release, storage, transportation, or disposal of gasoline, motor oil, antifreeze, transmission fluid, CFCs from air conditioners, other hazardous materials, or metals such as aluminum, cadmium, chromium, lead, and mercury. Contamination from the refurbishment of chrome plated bumpers can occur from the release of the plating material. Contamination can migrate on-site or off-site which can increase the risk, and the amount, of any potential liability.

In addition, many of our facilities are located on or near properties with a history of industrial use that may have involved hazardous materials. As a result, some of our properties may be contaminated. Some environmental laws hold current or previous owners or operators of real property liable for the costs of cleaning up contamination, even if these owners or operators did not know of and were not responsible for such contamination. These environmental laws also impose liability on any person who disposes of, treats, or arranges for the disposal or treatment of hazardous substances, regardless of whether the affected site is owned or operated by such person, and at times can impose liability on companies deemed under law to be a successor to such person. Third parties may also make claims against owners or operators of properties, or successors to such owners or operators, for personal injuries and property damage associated with releases of hazardous or toxic substances.

When we identify a potential material environmental issue during our acquisition due diligence process, we analyze the risks, and, when appropriate, perform further environmental assessment to verify and quantify the extent of the potential contamination. Furthermore, where appropriate, we have established financial reserves for certain environmental matters. In addition, at times we, or sellers from whom we purchased a business, have undertaken remediation projects. We do not anticipate, based on currently available information and current laws, that we will incur liabilities in excess of reserves to address environmental matters. However, in the event we discover new information or if laws change, we may incur significant liabilities, which may exceed our reserves.

### ***Title Laws***

In some states, when a vehicle is deemed a total loss, a salvage title is issued. Whether states issue salvage titles is important to the supply of inventory for the vehicle recycling industry because an increase in vehicles that qualify as salvage vehicles provides greater availability and typically lowers the price of such vehicles. Currently, these titling issues are a matter of state law. In 1992, the U.S. Congress commissioned an advisory committee to study problems relating to vehicle titling, registration, and salvage. Since then, legislation has been introduced seeking to establish national uniform requirements in this area, including a uniform definition of a salvage vehicle. The vehicle recycling industry will generally favor a uniform definition, since it will avoid inconsistencies across state lines, and will generally favor a definition that expands the number of damaged vehicles that qualify as salvage. However, certain interest groups, including repair shops and some insurance

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associations, may oppose this type of legislation. National legislation has not yet been enacted in this area, and there can be no assurance that such legislation will be enacted in the future.

### ***Anti-Car Theft Act***

In 1992, Congress enacted the Anti-Car Theft Act to deter trafficking in stolen vehicles. The purpose of the law is to implement an electronic system to track and monitor vehicle identification numbers and major automotive parts. In January 2009, the U.S. Department of Justice implemented the portion of the system to track and monitor vehicle identification numbers. The portion of the system that would track and monitor major automotive parts would require various entities, including automotive parts recyclers like us, to inspect salvage vehicles for the purpose of collecting the part number for any covered major part. The Department of Justice has not promulgated rules on this portion of the system, and therefore there has been no progress on the implementation of the system to track and monitor major automotive parts. However, if this system is fully implemented, the requirement to collect the information would place substantial burdens on vehicle recyclers, including us, that otherwise would not normally exist. It would place similar burdens on repair shops, which may further discourage the use by such shops of recycled products.

### ***Legislation Affecting Automotive Repair Parts***

Most states have laws that restrict the use of aftermarket parts in collision repair work. These restrictions range from the requirement to disclose to the vehicle owner the use of aftermarket parts in the repair process to the requirement to have aftermarket parts certified by an independent testing organization. Some jurisdictions have laws that prohibit or restrict the sale of certain recycled OEM products that we provide, such as airbags. Additional laws of this kind may be introduced in the future. An increase in the number of states passing such legislation or the passing of legislation with prohibitions or restrictions that are more severe than current laws could have a material adverse impact on our business. Additionally, Congress could enact federal legislation restricting the use of aftermarket and recycled automotive parts in the repair process.

### **Seasonality**

Our operating results are subject to quarterly variations based on a variety of factors, influenced primarily by seasonal changes in weather patterns. During the winter months we tend to have higher demand for our products because there are more weather related accidents. In addition, the cost of salvage vehicles tends to be lower as weather related accidents generate a larger supply of total loss vehicles.

## **ITEM 1A. RISK FACTORS**

### **Risks Relating to Our Business**

***Our operating results and financial condition have been and could continue to be adversely affected by the economic conditions in the United States.***

The recent declining economic conditions in the U.S. have adversely impacted our business. Such conditions have resulted in fewer miles driven, fewer accident claims and a reduction of vehicle repairs. In the event that the U.S. economic conditions do not improve or continue to decline, we expect that our business will continue to be negatively affected.

***We face intense competition from local, national, and internet-based vehicle products providers, and this competition could negatively affect our business.***

The vehicle replacement products industry is highly competitive and is served by numerous suppliers of OEM products, recycled OEM products, aftermarket products, and refurbished products. Within each of these categories of suppliers, there are local owner-operated companies, larger regional suppliers, national providers,

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and internet-based suppliers. Providers of vehicle replacement products that have traditionally sold only certain categories of such products may decide to expand their product offerings into other categories of vehicle replacement products, which may further increase competition. Some of our current and potential competitors may have more operational expertise; greater financial, technical, manufacturing, distribution, and other resources; longer operating histories; lower cost structures; and better relationships in the insurance and vehicle repair industries, than we do. In certain regions of the U.S., local vehicle recycling companies have formed cooperative efforts to compete in the recycled OEM products industry. As a result of these factors, our competitors may be able to provide products that we are unable to supply, provide their products at lower costs, or supply products to customers that we are unable to serve.

We believe that substantially in excess of 50% of collision parts by dollar amount are supplied by OEMs, with the balance being supplied by distributors like us. The OEMs are therefore in a position to exert pricing pressure in the marketplace. We compete with the OEMs primarily on price and to a lesser extent on perceived quality. From time to time, OEMs have experimented with reducing prices on specific products to meet the lower-priced alternative products. If such price reductions were to become widespread, it could have a material adverse impact on our business.

***Claims by OEMs relating to aftermarket products could adversely affect our business.***

OEMs have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEMs have brought such claims in federal court and with the United States International Trade Commission. Since our acquisition of Keystone Automotive Industries, Inc. in October 2007, the distribution of aftermarket products constitutes a significantly larger percentage of our business.

In December 2005, Ford Global Technologies, LLC initiated a complaint with the International Trade Commission against six companies, including Keystone, alleging that certain aftermarket parts imported into the United States infringed on 14 design patents held by Ford Global. In December 2006, an administrative law judge of the International Trade Commission preliminarily ruled that seven of the Ford Global design patents were valid and that the importation of automotive parts covered by these seven patents violated Section 337 of the Tariff Act of 1930. The International Trade Commission affirmed the ruling of the administrative law judge and issued an order prohibiting further importation of automotive parts covered by the patents. The parties to the action have appealed the decision to the United States Circuit Court of Appeals for the Federal Circuit.

In May 2008, Ford Global filed another complaint with the International Trade Commission. The complaint alleges that LKQ Corporation, Keystone Automotive Industries, Inc, and six other entities import and sell certain automotive parts relating to the 2005 Ford Mustang that infringe eight Ford design patents. On May 29, 2008, the International Trade Commission issued a Notice of Investigation based on Ford's complaint and has set November 2009 as the target date for completion of the investigation.

United States Patent and Trademark Office records indicate that OEMs are seeking and obtaining more design patents than they have in the past. To the extent that the OEMs are successful with intellectual property infringement claims, we could be restricted or prohibited from selling certain aftermarket products which could have an adverse effect on our business. We will likely incur significant expenses investigating and defending intellectual property infringement claims. In addition, an unexpected result of the intellectual property infringement litigation is that CAPA is decertifying parts that are the subject of the claims. Lack of CAPA certification may negatively impact us because many major insurance companies recommend or require the use of CAPA certified aftermarket parts.

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*An adverse change in our relationships with auction companies or our suppliers could increase our expenses and hurt our ability to serve our customers.*

Most of our salvage inventory is obtained from vehicles offered at salvage auctions by several companies that own auction facilities in numerous locations across the U.S. We do not have contracts with any auction company. According to industry analysts, a small number of companies controls a large percentage of the salvage auction market in the U.S. If an auction company prohibited us from participating in its auctions, or significantly raised its fees, our business could be adversely affected through higher costs or the resulting potential inability to service our customers. Moreover, we are facing increased competition in the purchase of salvage vehicles from shredders and scrap recyclers, internet-based buyers, and others. This increase in the number of bidders may increase our cost of goods sold for recycled OEM products. Most states regulate bidders to help ensure that salvage vehicles are purchased for legal and legitimate purposes. Auction companies have been actively seeking to reduce or eliminate these regulations, which if successful would further increase the number of bidders.

We also acquire inventory directly from insurance companies, OEMs, aftermarket parts manufacturers, and others. To the extent that these suppliers decide to discontinue these arrangements, our business could be adversely affected through higher costs or the resulting potential inability to service our customers.

We are dependent on a relatively small number of suppliers of aftermarket products. Although alternative suppliers exist for substantially all aftermarket products distributed by us, the loss of any one supplier could have a material adverse effect on us until alternative suppliers are located and have commenced providing products. Moreover, our operations are subject to the customary risks of doing business abroad, including, among other things, transportation delays, political instability, currency fluctuations and the imposition of tariffs, import and export controls and other non-tariff barriers (including changes in the allocation of quotas), as well as the uncertainty regarding future relations between China and Taiwan. Because a substantial volume of our sales involves parts manufactured from sheet metal, we can be adversely impacted if sheet metal becomes unavailable or is only available at higher prices, which we may not be able to pass on to our customers.

*If our business relationships with insurance companies end, we may lose important sales opportunities.*

We rely on business relationships with several insurance companies. These insurance companies encourage vehicle repair facilities to use products we provide. Our arrangements with these companies may be terminated at any time. We rely on these relationships for sales to some collision repair shops, and a termination of these relationships may result in a loss of sales, which could adversely affect our results of operations.

In an Illinois lawsuit involving State Farm Mutual Automobile Insurance Company ( *Avery v. State Farm* ), a jury decided in October 1999 that State Farm breached certain insurance contracts with its policyholders by using non-OEM parts to repair damaged vehicles when use of such parts did not restore the vehicle to its pre-loss condition. The jury found that State Farm misled its customers by not disclosing the use of non-OEM parts and the alleged inferiority of those parts. The jury assessed damages against State Farm of \$456 million, and the judge assessed an additional \$730 million of disgorgement and punitive damages for violations of the Illinois Consumer Fraud Act. In April 2001, the Illinois Appellate Court upheld the verdict but reduced the damage award by \$130 million because of duplicative damage awards. On August 18, 2005, the Illinois Supreme Court reversed the awards made by the circuit court and found, among other things, that the plaintiffs had failed to establish any breach of contract on the part of State Farm. The U.S. Supreme Court declined to hear an appeal of this case. As a result of this case, some insurance companies had reduced or eliminated their use of aftermarket products. Our financial results could be affected, perhaps adversely, if insurance companies modified or terminated the arrangements pursuant to which repair shops buy aftermarket or recycled OEM products from us due to a fear of similar claims with respect to such products.

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***We may not be able to sell our products due to existing or new laws and regulations prohibiting or restricting the sale of recycled OEM, aftermarket or refurbished products.***

Some jurisdictions have enacted laws prohibiting or severely restricting the sale of certain recycled OEM products that we provide, such as airbags. These and other jurisdictions could enact similar laws or could prohibit or severely restrict the sale of additional recycled OEM products. Restrictions on the products we are able to sell could decrease our revenue and have an adverse effect on our business and operations.

Most states have passed laws that prohibit or limit the use of aftermarket products in collision repair work and/or require enhanced disclosure or vehicle owner consent before using aftermarket products in such repair work. Additional legislation of this kind may be introduced in the future. If additional laws prohibiting or restricting the use of aftermarket products are passed, it could have an adverse impact on our aftermarket products business.

Certain organizations test the quality and safety of vehicle replacement products. In the event that such organizations decide that a particular vehicle product does not meet applicable quality or safety standards, we may decide to discontinue sales of such product or insurance companies may decide to discontinue authorization of repairs using such product. Such events could adversely affect our business.

***We may not be able to successfully acquire new operations or integrate acquisitions, which could cause our business to suffer.***

We may not be able to successfully complete potential strategic acquisitions if we cannot reach agreement on acceptable terms or for other reasons. If we buy a company or a division of a company, we may experience difficulty integrating that company's or division's personnel and operations, which could negatively affect our operating results. In addition:

the key personnel of the acquired company may decide not to work for us;

we may experience business disruptions as a result of information technology systems conversions;

we may experience additional financial and accounting challenges and complexities in areas such as tax planning, treasury management, and financial reporting;

we may be held liable for environmental risks and liabilities as a result of our acquisitions, some of which we may not have discovered during our due diligence;

our ongoing business may be disrupted or receive insufficient management attention; and

we may not be able to realize the cost savings or other financial benefits we anticipated, either in the amount or in the time frame that we expect.

The acquisition of Keystone in October 2007 was our largest acquisition to date. Because of the magnitude of the Keystone acquisition, significant integration challenges remain, including the realization of the total projected cost savings, synergies and revenue enhancements that we anticipated.

In connection with future acquisitions, we may assume the liabilities of the companies we acquire. These liabilities, including liabilities for environmental-related costs, could materially and adversely affect our business. We may have to incur debt or issue equity securities to pay for any future acquisition, the issuance of which could involve the imposition of restrictive covenants or be dilutive to our existing stockholders.

***Financing the Keystone acquisition substantially increased our leverage and involves restrictions on our business.***

## Edgar Filing: LKQ CORP - Form 10-K

In connection with the acquisition of Keystone, we entered into a senior secured debt financing facility with a group of lenders. Our total outstanding indebtedness (including bank financing, letters of credit, and notes

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payable in connection with acquisitions) as of December 31, 2008 was \$666.1 million. The increase in our indebtedness may reduce our flexibility to respond to changing business and economic conditions or to fund capital expenditure or working capital needs because we will require additional funds to service our indebtedness.

In addition, the senior secured credit agreement contains operating and financial restrictions and requires that we satisfy certain financial covenants. The failure to comply with any of these covenants would cause a default under the credit agreement. A default, if not waived, could result in acceleration of our debt, in which case the debt would become immediately due and payable. If this occurs, we may not be able to repay our debt or borrow sufficient funds to refinance it. Even if new financing were available, it may be on terms that are less attractive to us than our existing credit facility or it may be on terms that are not acceptable to us.

Lehman Commercial Paper Inc. is the administrative agent and swing line lender under our credit agreement and had committed to provide \$15 million under the revolving credit facility that is part of the credit agreement. Lehman Commercial Paper filed for protection under Chapter 11 of the Federal Bankruptcy Code on October 15, 2008. Accordingly, our access to same day borrowing of swing line loans and the \$15 million of revolving credit is doubtful. We do not believe that an inability to draw on the \$15 million revolving credit facility or to access our swing line facility will have a material adverse impact on us. However, to the extent that other lenders that are part of our credit agreement fail or file for bankruptcy protection, our access to funds under our revolving credit facility may be further adversely affected, which could harm our ability to do business.

***Our future capital needs may require that we seek debt financing or additional equity funding that, if not available, could cause our business to suffer.***

We may need to raise additional funds in the future to, among other things, fund our existing operations, improve or expand our operations, respond to competitive pressures, or make acquisitions. From time to time, we may raise additional funds through public or private financing, strategic alliances, or other arrangements. However, the recent turmoil in the credit markets has resulted in severely tighter credit conditions, which could affect our ability to raise additional funds until the turmoil subsides. If adequate funds are not available on acceptable terms, we may be unable to meet our business or strategic objectives or compete effectively. If we raise additional funds by issuing equity securities, stockholders may experience dilution of their ownership interests, and the newly issued securities may have rights superior to those of the common stock. If we raise additional funds by issuing debt, we may be subject to further limitations on our operations. If we fail to raise capital when needed, our business will be negatively affected.

***Our annual and quarterly performance may fluctuate.***

Our revenue, cost of goods sold, and operating results have fluctuated on a quarterly and annual basis in the past and can be expected to continue to fluctuate in the future as a result of a number of factors, some of which are beyond our control. Future factors that may affect our operating results include, but are not limited to, those listed in the Special Note on Forward-Looking Statements in this Annual Report on Form 10-K. Due to these factors, our operating results in future periods can be expected to fluctuate. Accordingly, our results of operations may not be indicative of future performance. These fluctuations in our operating results may cause our results to fall below the expectations of public market analysts and investors, which could cause our stock price to decline.

***Fluctuations in the prices of scrap metal and other metals could adversely affect our financial results.***

Our wholesale recycled OEM operations and our self-service retail recycled OEM operations generate scrap metal and other metals that we sell. After we dismantle a salvage vehicle for wholesale parts and after vehicles have been used in our self-service business, the remaining vehicle hulks are sold to scrap processors and other remaining metals are sold to processors and brokers of metals. In addition, we receive crush only vehicles from

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other companies, including OEMs, which we dismantle and which generate scrap metal and other metals. The prices of scrap and other metals have historically fluctuated due to market factors, sometimes significantly. In addition, buyers may stop purchasing metals entirely due to excess supply. To the extent the prices of metals decrease materially or buyers stop purchasing metals, our revenue from such sales will suffer and a write-down of inventory value could be required. The cost of our wholesale recycled OEM and our self-service inventory purchases may also decrease as a result of falling scrap metal and other metals prices, but there can be no assurance that our inventory purchasing cost will decrease the same amount or at the same rate as the scrap metal and other metals prices, and there may be a delay between the scrap metal and other metals price reductions and any inventory cost reductions. Our operating results in the fourth quarter of 2008 were adversely affected by the declining scrap metal and other metal prices as described in the Results of Operations section in Item 7 of this Annual Report on Form 10-K.

*If we determine that our goodwill has become impaired, we may incur significant charges to our pre-tax income.*

Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations. In the future, goodwill and intangible assets may increase as a result of future acquisitions. Goodwill and intangible assets are reviewed at least annually for impairment. Impairment may result from, among other things, deterioration in the performance of acquired businesses, adverse market conditions, and adverse changes in applicable laws or regulations, including changes that restrict the activities of the acquired business. As of December 31, 2008, our total goodwill, subject to future impairment testing, was approximately \$923.8 million. For further discussion of our annual impairment test, see **Goodwill Impairment** in the Critical Accounting Estimates section of Item 7 in this Annual Report on Form 10-K.

*If the number of vehicles involved in accidents declines, our business could suffer.*

Because our business depends on vehicle accidents for both the supply of recycled OEM products and the demand for repairs using our products, factors which influence the number and/or severity of accidents, including, but not limited to, the number of vehicles on the road, the number of miles driven, the ages of drivers, the use of cellular telephones and other electronic equipment by drivers, the congestion of traffic, the occurrence and severity of certain weather conditions, the use of alcohol and drugs by drivers, and the condition of roadways, impact our business. In this regard, a number of states and municipalities have adopted, or are considering adopting, legislation banning the use of handheld cellular telephones while driving and such restrictions could lead to a decline in accidents. To the extent vehicle manufacturers develop new accident avoidance systems, the number and severity of accidents could decrease. Moreover, an increase in fuel prices may cause the number of vehicles on the road to decline as motorists seek alternative transportation options and this also could lead to a decline in accidents.

*Governmental agencies may refuse to grant or renew our operating licenses and permits.*

Our operating subsidiaries must obtain licenses and permits from state and local governments to conduct their operations. When we develop or acquire a new facility, we must seek the approval of state and local units of government. Governmental agencies may resist the establishment of a vehicle recycling or refurbishing facility in their communities. There can be no assurance that future approvals or transfers will be granted. In addition, there can be no assurance that we will be able to maintain and renew the licenses and permits our operating subsidiaries currently hold.

*If we lose our key management personnel, we may not be able to successfully manage our business or achieve our objectives.*

Our future success depends in large part upon the leadership and performance of our executive management team and key employees at the operating level. If we lose the services of one or more of our executive officers or key employees, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, we may not be able to successfully manage our business or achieve our business

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