LKQ CORP
Form 10-Q
November 02, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period from to

Commission File Number: 000-50404

LKQ CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**36-4215970**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
120 NORTH LASALLE STREET, SUITE 3300, CHICAGO, IL	**60602**
(Address of principal executive offices)	**(Zip Code)**

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

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

At October 23, 2009, the registrant had issued and outstanding an aggregate of 141,402,254 shares of Common Stock.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

LKQ CORPORATION AND SUBSIDIARIES

Unaudited Consolidated Condensed Balance Sheets

(In thousands, except share and per share data)

	September 30, 2009	December 31, 2008
Assets		
Current Assets:		
Cash and equivalents	$ 166,005	$ 79,067
Receivables, net	127,434	147,886
Inventory	361,095	330,511
Deferred income taxes	19,732	19,644
Prepaid income taxes	6,839	21,164
Prepaid expenses	9,194	7,716
Assets of discontinued operations	24,597	24,129
Total Current Assets	714,896	630,117
Property and Equipment, net	259,453	254,346
Intangibles:		
Goodwill	930,552	907,218
Other intangibles, net	68,095	71,150
Other Assets	20,987	18,973
Total Assets	$ 1,993,983	$ 1,881,804
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 54,195	$ 65,363
Accrued expenses:		
Accrued payroll-related liabilities	35,680	32,869
Other accrued expenses	48,461	41,960
Deferred revenue	6,152	4,733
Current portion of long-term obligations	29,515	21,934
Liabilities of discontinued operations	2,723	354
Total Current Liabilities	176,726	167,213
Long-Term Obligations, Excluding Current Portion	606,048	620,940
Deferred Income Tax Liability	47,254	43,518
Other Noncurrent Liabilities	32,519	29,627
Commitments and Contingencies		
Stockholders Equity:		
Common stock, $0.01 par value, 500,000,000 shares authorized, 141,175,304 and 139,921,410 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	1,412	1,399
Additional paid-in capital	806,988	790,933

Retained earnings	332,254	241,938
Accumulated other comprehensive loss	(9,218)	(13,764)
Total Stockholders Equity	1,131,436	1,020,506
Total Liabilities and Stockholders Equity	$ 1,993,983	$ 1,881,804

See notes to unaudited consolidated condensed financial statements.

LKQ CORPORATION AND SUBSIDIARIES

Unaudited Consolidated Condensed Statements of Income

(In thousands, except per share data)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenue	$ 494,812	$ 481,614	$ 1,492,037	$ 1,443,766
Cost of goods sold	269,708	269,805	817,114	796,758
Gross margin	225,104	211,809	674,923	647,008
Facility and warehouse expenses	48,337	46,956	145,101	133,203
Distribution expenses	45,604	46,476	132,608	136,553
Selling, general and administrative expenses	65,893	60,423	198,688	185,512
Restructuring expenses	852	2,400	1,910	6,723
Depreciation and amortization	8,373	7,387	24,893	21,719
Operating income	56,045	48,167	171,723	163,298
Other expense (income):				
Interest expense, net	7,780	8,190	23,082	26,891
Other (income) expense, net	(23)	22	(170)	(688)
Total other expense, net	7,757	8,212	22,912	26,203
Income from continuing operations before provision for income taxes	48,288	39,955	148,811	137,095
Provision for income taxes	18,147	16,027	58,197	54,318
Income from continuing operations	30,141	23,928	90,614	82,777
(Loss) income from discontinued operations, net of taxes	(986)	1,140	(298)	4,158
Net income	$ 29,155	$ 25,068	$ 90,316	$ 86,935
Basic earnings per share [(a)]				
Income from continuing operations	$ 0.21	$ 0.18	$ 0.65	$ 0.61
(Loss) income from discontinued operations	(0.01)	0.01	0.00	0.03
Total	$ 0.21	$ 0.18	$ 0.64	$ 0.64
Diluted earnings per share [(a)]				
Income from continuing operations	$ 0.21	$ 0.17	$ 0.63	$ 0.59
(Loss) income from discontinued operations	(0.01)	0.01	0.00	0.03

Total	$ 0.20	$ 0.18	$ 0.63	$ 0.62
Weighted average common shares outstanding:				
Basic	140,746	136,585	140,257	135,481
Diluted	144,047	141,190	143,669	140,458

(a) The sum of the individual earnings per share amounts may not equal the total due to rounding.

See notes to unaudited consolidated condensed financial statements.

LKQ CORPORATION AND SUBSIDIARIES

Unaudited Consolidated Condensed Statements of Cash Flows

(In thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 90,316	$ 86,935
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	27,931	23,998
Stock-based compensation expense	5,457	4,133
Deferred income taxes	2,663	9,375
Excess tax benefit from share-based payments	(5,744)	(8,192)
Other adjustments	3,873	2,221
Changes in operating assets and liabilities, net of effects from purchase transactions:		
Receivables	18,671	(5,738)
Inventory	(24,302)	(5,675)
Prepaid income taxes/income taxes payable	19,887	9,733
Accounts payable	(12,722)	(9,798)
Other operating assets and liabilities	9,434	(1,678)
Net cash provided by operating activities	135,464	105,314
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(28,993)	(42,212)
Proceeds from disposal of assets	952	1,993
Cash used in acquisitions, net of cash acquired	(18,580)	(40,258)
Net cash used in investing activities	(46,621)	(80,477)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	4,986	4,722
Excess tax benefit from share-based payments	5,744	8,192
Debt issuance costs		(219)
Repayments of long-term debt	(16,212)	(13,659)
Borrowings under line of credit	2,310	
Net cash used in financing activities	(3,172)	(964)
Effect of exchange rate changes on cash and equivalents	1,267	(425)
Net increase in cash and equivalents	86,938	23,448
Cash and equivalents, beginning of period	79,067	74,241
Cash and equivalents, end of period	$ 166,005	$ 97,689
Supplemental disclosure of cash flow information:		
Notes issued in connection with business acquisitions	$ 1,129	$ 25
Stock issued in connection with business acquisitions		60,041
Cash paid for income taxes, net of refunds	34,450	37,508

Cash paid for interest	22,235	27,619
Property and equipment purchases not yet paid	598	642

See notes to unaudited consolidated condensed financial statements.

LKQ CORPORATION AND SUBSIDIARIES

Unaudited Consolidated Condensed Statements of Stockholders Equity and Other Comprehensive Income

(In thousands)

	Common Stock					
	Shares Issued	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
BALANCE, December 31, 2008	139,921	$ 1,399	$ 790,933	$ 241,938	$ (13,764)	$ 1,020,506
Net income				90,316		90,316
Change in interest rate swap agreements, net of tax of $1,275 (see Note 6)					1,058	1,058
Foreign currency translation					3,488	3,488
Total comprehensive income						94,862
Stock issued as director compensation	14		217			217
Stock-based compensation expense			5,240			5,240
Exercise of stock options and issuance of restricted stock, including related tax benefits of $5,625	1,240	13	10,598			10,611
BALANCE, September 30, 2009	141,175	$ 1,412	$ 806,988	$ 332,254	$ (9,218)	$ 1,131,436

See notes to unaudited consolidated condensed financial statements.

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements

Note 1. Interim Financial Statements

The unaudited financial statements presented in this report represent the consolidation of LKQ Corporation, a Delaware corporation, and its subsidiaries. LKQ Corporation is a holding company and all operations are conducted by subsidiaries. When the terms the Company, we, us, or our are used in this document, those terms refer to LKQ Corporation and its consolidated subsidiaries. All intercompany transactions and accounts have been eliminated.

We have prepared the accompanying Unaudited Consolidated Condensed Financial Statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) applicable to interim financial statements. Accordingly, certain information related to our significant accounting policies and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These Unaudited Consolidated Condensed Financial Statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to fairly state, in all material respects, our financial position, results of operations and cash flows for the periods presented.

Operating results for interim periods are not necessarily indicative of the results that can be expected for any subsequent interim period or for a full year. These interim financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto included in our most recent report on Form 10-K for the year ended December 31, 2008 filed with the SEC.

In October 2009, we sold to Schnitzer Steel Industries, Inc. (SSI) four retail oriented self-service recycling facilities in Oregon and Washington. We also sold certain business assets to SSI related to two self-service facilities in Northern California and a self-service facility in Portland, Oregon. In the fourth quarter of 2009, we will close what remains of the two self-service facilities in Northern California and convert the self-service operation in Portland to a wholesale recycling business. We have also agreed, subject to customary closing conditions, to sell to SSI two self-service recycling facilities in Dallas, Texas, with an anticipated closing date in mid-January 2010. Certain of these facilities qualified for treatment as discontinued operations as of September 30, 2009. The financial results and assets and liabilities of these facilities are segregated from our continuing operations and presented as discontinued operations in the consolidated condensed balance sheets and statements of income for all periods presented.

We have evaluated subsequent events through the time of filing this Form 10-Q with the SEC on November 2, 2009. No material subsequent events have occurred since September 30, 2009 that required recognition or disclosure in these financial statements, except for those described in the previous paragraph and Note 3, Greenleaf Transaction and the amendment to the senior secured debt financing facility described in Note 5, Long-Term Obligations.

Note 2. Financial Statement Information

Revenue Recognition

Revenue is recognized when products are shipped and title has transferred, subject to an allowance for estimated returns, discounts and allowances that we estimate based upon historical information. We have recorded a reserve for estimated returns, discounts and allowances of approximately $12.3 million and $11.2 million at September 30, 2009 and December 31, 2008, respectively.

Receivables

We have recorded a reserve for uncollectible accounts of approximately $6.2 million and $5.8 million at September 30, 2009 and December 31, 2008, respectively.

Inventory

Inventory consists of the following (in thousands):

	September 30, 2009	December 31, 2008

Salvage products	$	136,771	$	137,973
Aftermarket and refurbished products		217,039		184,435
Core facilities inventory		7,285		8,103
	$	361,095	$	330,511

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

Intangibles

Intangible assets consist primarily of goodwill (the cost of purchased businesses in excess of the fair value of the net assets acquired), and other specifically identifiable intangible assets, including the Keystone trade name, covenants not to compete and trademarks.

The change in the carrying amount of goodwill during the nine months ended September 30, 2009 is as follows (in thousands):

Balance as of December 31, 2008	$ 907,218
Adjustment of previously recorded goodwill	2,723
Exchange rate effects	4,861
Business acquisitions	15,750
Balance as of September 30, 2009	$ 930,552

Other intangible assets totaled approximately $68.1 million and $71.1 million, net of accumulated amortization of $8.2 million and $5.1 million, at September 30, 2009 and December 31, 2008, respectively. Amortization expense was approximately $3.1 million during each of the nine months ended September 30, 2009 and 2008. Estimated annual amortization expense is approximately $4.0 million for each of the years 2009 through 2013.

Depreciation Expense

Depreciation expense associated with our refurbishing and smelting operations is included in Cost of Goods Sold rather than Depreciation and Amortization on the Unaudited Consolidated Condensed Statements of Income.

Warranty Reserve

Some of our mechanical products are sold with a standard six-month warranty against defects. We record the estimated warranty costs at the time of sale using historical warranty claim information to project future warranty claims activity and related expenses. Our warranty activity during the first nine months of 2009 was as follows (in thousands):

Balance as of January 1, 2009	$ 540
Warranty expense	3,417
Warranty claims	(3,354)
Balance as of September 30, 2009	$ 603

For an additional fee, we also sell extended warranty contracts for certain mechanical products. The expense related to extended warranty claims is recognized when the claim is made.

Stock-Based Compensation

The fair value of stock options has been estimated using the Black-Scholes option-pricing model. The following table summarizes the assumptions used to compute the weighted average fair value of options granted during the respective periods:

	Nine Months Ended September 30,	
	2009	2008
Expected life (in years)	6.3	6.4
Risk-free interest rate	1.84%	3.27%
Volatility	44.6%	39.3%
Dividend yield	0%	0%
Weighted average fair value of options granted	$ 5.50	$ 8.54

Estimated forfeitures When estimating forfeitures, we consider voluntary and involuntary termination behavior as well as analysis of historical forfeitures. For options granted in 2009, a forfeiture rate of 9.0% has been used in calculating the stock-based compensation expense for employee option grants, while a forfeiture rate of 0% has been used in calculating the stock-based compensation expense for non-employee director and executive officer option grants.

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

The components of pre-tax stock-based compensation expense are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Stock options	$ 1,624	$ 1,205	$ 4,696	$ 3,519
Restricted stock	183	183	544	523
Stock issued to non-employee directors	72	30	217	91
Total stock-based compensation expense	$ 1,879	$ 1,418	$ 5,457	$ 4,133

The following table sets forth the total stock-based compensation expense included in the accompanying Unaudited Consolidated Condensed Statements of Income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Cost of goods sold	$ 13	$ 3	$ 36	$ 10
Facility and warehouse expenses	688	514	1,992	1,501
Selling, general and administrative expenses	1,178	901	3,429	2,622
	1,879	1,418	5,457	4,133
Income tax benefit	(738)	(567)	(2,145)	(1,633)
Total stock-based compensation expense, net of tax	$ 1,141	$ 851	$ 3,312	$ 2,500

We have not capitalized any stock-based compensation costs during either the nine months ended September 30, 2009 or 2008. As of September 30, 2009, unrecognized compensation expense related to unvested stock options and restricted stock is expected to be recognized as follows (in thousands):

	Stock Options	Restricted Stock	Total
Remainder of 2009	$ 1,623	$ 183	$ 1,806
2010	6,127	727	6,854
2011	5,291	727	6,018
2012	3,967	727	4,694
2013	1,683	22	1,705
2014	55		55
Total unrecognized compensation expense	$ 18,746	$ 2,386	$ 21,132

Fair Value of Financial Instruments

We are required to disclose the fair value for any financial instruments not currently reflected at fair value on the balance sheet for all interim periods.

Our debt is reflected on the balance sheet at cost. Based on current market conditions, our interest rate margins are below the rate available in the market, which causes the fair value of our debt to fall below the carrying value. The fair value of our term loans (see Note 5, Long-Term Obligations) is approximately $580 million at September 30, 2009, as compared to the carrying value of $622.5 million. We estimated the fair value of our term loans by calculating the upfront cash payment a market participant would require to assume our obligations. The upfront cash payment, excluding any issuance costs, is the amount that a market participant would be able to lend at September 30, 2009 to an entity with a credit rating similar to ours and achieve sufficient cash inflows to cover the scheduled cash outflows under our term loans. The carrying amounts of our cash and equivalents, net trade receivables and accounts payable approximate fair value.

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

We apply the market approach to value our financial assets and liabilities, which include the cash surrender value of life insurance, deferred compensation liabilities and interest rate swaps. The market approach utilizes available market information to estimate fair value. Required fair value disclosures are included in Note 7, Fair Value Measurements. The carrying amounts of financial instruments approximate fair value.

Segments

During the third quarter of 2009, we modified our management structure to add a Vice President Operations Wholesale Parts, who is responsible for managing our wholesale recycled original equipment manufacturer (OEM) and aftermarket products operations for the nine geographic regions. With this change, our vehicle replacement products operations are organized into three operating segments, comprised of wholesale recycled OEM and aftermarket products, self-service retail products, and recycled heavy duty truck products. These segments are aggregated into one reportable segment because they possess similar economic characteristics and have common products and services, customers and methods of distribution.

The following table sets forth our revenue by product category within our reportable segment (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Recycled and related products and services	$ 180,482	$ 172,322	$ 548,040	$ 482,652
Aftermarket, other new and refurbished products	257,670	230,292	799,953	746,512
Other	56,660	79,000	144,044	214,602
	$ 494,812	$ 481,614	$ 1,492,037	$ 1,443,766

Revenue from other sources includes scrap sales, bulk sales to mechanical remanufacturers, and sales of aluminum ingots and sows.

Recent Accounting Pronouncements

Effective January 1, 2008, we adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820-10 (ASC 820-10), Fair Value Measurements and Disclosures (formerly Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements) pertaining to financial assets and liabilities. ASC 820-10 established a framework for reporting fair value and expands disclosures required for fair value measurements. Although the adoption of ASC 820-10 did not have an impact on our consolidated financial position, results of operations or cash flows, we are now required to provide additional disclosures as part of our financial statements. These additional disclosures are provided in Note 7, Fair Value Measurements. We adopted ASC 820-10 for our non-financial assets and liabilities on January 1, 2009, which did not have an effect on our consolidated financial position, results of operations or cash flows.

Effective January 1, 2009, we adopted ASC 805, Business Combinations (formerly SFAS No. 141 (revised 2007), Business Combinations). Under ASC 805, we are required to, among other things, recognize the assets acquired, liabilities assumed, including contractual contingencies, and contingent consideration at fair value on the date of acquisition. We are also required to expense acquisition-related expenses as incurred, restructuring costs in periods subsequent to the acquisition date, and changes in deferred income tax asset valuation allowances and acquired income tax uncertainties after the measurement period in income tax expense. We applied the provisions of ASC 805 to the acquisitions made in 2009 and the income tax provisions of ASC 805 to all acquisitions. See Note 10, Business Combinations, for related disclosures.

Effective January 1, 2009, we adopted the enhanced disclosures about derivative and hedging activities incorporated into ASC 815, Derivatives and Hedging (as formerly issued in SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133). ASC 815 specifically relates to disclosures regarding derivative and hedging activities and did not have an effect on our consolidated financial position, results of operations or cash flows. The additional disclosures are provided in Note 6, Derivative Instruments and Hedging Activities.

Effective June 30, 2009, we adopted ASC 855, Subsequent Events (formerly SFAS No. 165, Subsequent Events), which established general standards of accounting and disclosure for events that occur after the balance sheet date but before the financial statements are issued. Although the standard is based on the same principles as those that currently exist in the auditing standards, it includes a new required disclosure of the date through which an entity has evaluated subsequent events (see disclosure in Note 1, Interim Financial Statements). The adoption of the standard did not have an effect on our consolidated financial position, results of operations or cash flows.

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

Note 3. Greenleaf Transaction

On October 1, 2009, we acquired Greenleaf Auto Recyclers, LLC (Greenleaf) from SSI for $39.5 million, net of cash acquired, subject to a post closing cash adjustment. Greenleaf is the entity through which SSI operated its late model automotive parts recycling business. We are in the process of completing the purchase accounting for Greenleaf, and as a result, we are unable to disclose the amounts recognized for each major class of assets acquired and liabilities assumed.

In addition, we sold to SSI four retail oriented self-service recycling facilities in Oregon and Washington and certain business assets related to two self-service facilities in Northern California and a self-service facility in Portland, Oregon for $18.0 million, net of cash sold, subject to a post closing cash adjustment. We currently expect to recognize a gain on the sale of approximately $4 million in our fourth quarter results. In the fourth quarter of 2009, we will close what remains of the two self-service facilities in Northern California and convert the self-service operation in Portland to a wholesale recycling business.

We have also agreed, subject to customary closing conditions, to sell to SSI two self-service recycling facilities in Dallas, Texas for $12.0 million, with an anticipated closing date in mid-January 2010.

The self-service facilities that we sold, agreed to sell or will close in the fourth quarter are reported as discontinued operations for all periods presented. A summary of the assets and liabilities applicable to discontinued operations included in the unaudited consolidated condensed balance sheets as of September 30, 2009 and December 31, 2008 is as follows (in thousands):

	September 30, 2009	December 31, 2008
Inventory	$ 2,620	$ 2,245
Other current assets	951	685
Property and equipment, net	4,437	4,610
Goodwill	16,589	16,589
Total assets	$ 24,597	24,129
Accounts payable and accrued liabilities	$ 2,723	$ 354
Total liabilities	$ 2,723	$ 354

Results of operations for the discontinued operations for the three and nine months ended September 30, 2009 and 2008 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenue	$ 7,335	$ 9,087	$ 20,853	$ 23,235
(Loss) income before income tax (benefit) provision	$ (1,565)	$ 1,810	$ (473)	$ 6,600
Income tax (benefit) provision	(579)	670	(175)	2,442
(Loss) income from discontinued operations, net of taxes	$ (986)	$ 1,140	$ (298)	$ 4,158