LKQ CORP
Form 10-Q
November 07, 2008

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, 2008

OR

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

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 o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

At October 30, 2008, the registrant had issued and outstanding an aggregate of 139,790,781 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, 2008	December 31, 2007
Assets		
Current Assets:		
Cash and equivalents	$ 97,689	$ 74,241
Receivables, net	136,553	125,572
Inventory	331,028	320,238
Deferred income taxes	18,022	18,809
Prepaid income taxes	4,630	6,344
Prepaid expenses	8,472	8,088
Total Current Assets	596,394	553,292
Property and Equipment, net	241,093	217,059
Intangibles:		
Goodwill	910,200	825,881
Other intangibles, net	72,194	74,951
Other Assets	28,290	21,472
Total Assets	$ 1,848,171	$ 1,692,655
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 60,488	$ 68,871
Accrued expenses:		
Accrued payroll-related liabilities	34,788	27,542
Other accrued expenses	44,009	45,630
Deferred revenue	5,203	4,844
Current portion of long-term obligations	19,425	16,936
Total Current Liabilities	163,913	163,823
Long-Term Obligations, Excluding Current Portion	623,028	641,526
Deferred Income Tax Liability	35,992	25,607
Other Noncurrent Liabilities	11,184	11,922
Commitments and Contingencies		
Stockholders Equity:		

Common stock, $0.01 par value, 500,000,000 shares authorized, 138,659,781 and 134,149,066 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively		1,387		1,341
Additional paid-in capital		779,545		705,778
Retained earnings		228,974		142,039
Accumulated other comprehensive income		4,148		619
Total Stockholders Equity		1,014,054		849,777
Total Liabilities and Stockholders Equity	$	1,848,171	$	1,692,655

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, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenue	$ 490,701	$ 243,495	$ 1,467,001	$ 712,091
Cost of goods sold	274,786	135,038	808,064	391,455
Gross margin	215,915	108,457	658,937	320,636
Facility and warehouse expenses	48,479	26,188	136,783	76,432
Distribution expenses	46,636	23,803	136,731	68,191
Selling, general and administrative expenses	60,929	29,107	186,791	85,969
Restructuring expenses	2,400		6,723	
Depreciation and amortization	7,513	3,768	22,029	10,549
Operating income	49,958	25,591	169,880	79,495
Other expense (income):				
Interest expense, net	8,192	2,241	26,904	6,067
Other expense (income), net	1	(468)	(719)	(1,143)
Total other expense	8,193	1,773	26,185	4,924
Income before provision for income taxes	41,765	23,818	143,695	74,571
Provision for income taxes	16,697	9,259	56,760	30,202
Net income	$ 25,068	$ 14,559	$ 86,935	$ 44,369
Net income per share:				
Basic	$ 0.18	$ 0.13	$ 0.64	$ 0.41
Diluted	$ 0.18	$ 0.13	$ 0.62	$ 0.39
Weighted average common shares outstanding:				
Basic	136,585	109,326	135,481	107,678
Diluted	141,190	115,111	140,458	113,237

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, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 86,935	$ 44,369
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,998	10,933
Stock-based compensation expense	4,133	2,386
Deferred income taxes	9,375	4,576
Excess tax benefit from exercise of stock options	(8,192)	(12,150)
Other adjustments	2,221	(94)
Changes in operating assets and liabilities, net of effects from purchase transactions:		
Receivables	(5,738)	(8,464)
Inventory	(5,675)	(21,853)
Prepaid income taxes/income taxes payable	9,733	5,299
Accounts payable	(9,798)	907
Other operating assets and liabilities	(1,678)	5,598
Net cash provided by operating activities	105,314	31,507
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(42,212)	(26,095)
Proceeds from disposal of assets	1,993	417
Purchases of investment securities		(5,885)
Cash used in acquisitions, net of cash acquired	(40,258)	(55,705)
Net cash used in investing activities	(80,477)	(87,268)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	4,722	8,341
Proceeds from the sale of common stock		349,529
Repurchase and retirement of redeemable common stock		(1,125)
Excess tax benefit from exercise of stock options	8,192	12,150
Debt issuance costs	(219)	(206)
Repayments of long-term debt	(13,659)	(3,524)
Net repayments under line of credit		(88,169)
Net cash (used in) provided by financing activities	(964)	276,996
Effect of exchange rate changes on cash and equivalents	(425)	74
Net increase in cash and equivalents	23,448	221,309
Cash and equivalents, beginning of period	74,241	4,031
Cash and equivalents, end of period	$ 97,689	$ 225,340
Supplemental disclosure of cash flow information:		
Notes issued in connection with business acquisitions	$ 25	$ 1,449
Stock issued in connection with business acquisitions	60,041	
Cash paid for income taxes, net of refunds	37,508	20,111
Cash paid for interest	27,619	7,148

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		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders Equity
	Shares Issued	Amount				
BALANCE, December 31, 2007	134,149	$ 1,341	$ 705,778	$ 142,039	$ 619	$ 849,777
Net income				86,935		86,935
Unrealized loss on pension plan, net of tax of $195					(305)	(305)
Unrealized gain on change in fair value of interest rate swap agreements, net of tax of $3,031					4,740	4,740
Foreign currency translation					(906)	(906)
Total comprehensive income						90,464
Stock issued in business acquisition	2,919	29	60,012			60,041
Share price guarantee payment			(3,275)			(3,275)
Stock issued as director compensation	5	1	90			91
Stock-based compensation expense			3,519			3,519
Activity related to restricted stock awards	190	2	521			523
Exercise of stock options, including related tax benefits of $8,192	1,397	14	12,900			12,914
BALANCE, September 30, 2008	138,660	$ 1,387	$ 779,545	$ 228,974	$ 4,148	$ 1,014,054

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, 2007 filed with the SEC.

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 $10.0 million and $7.5 million at September 30, 2008 and December 31, 2007, respectively.

Receivables

We have recorded a reserve for uncollectible accounts of approximately $5.5 million and $4.3 million at September 30, 2008 and December 31, 2007, respectively.

Inventory

Inventory consists of the following (in thousands):

	September 30, 2008	December 31, 2007
Salvage products	$ 136,689	$ 111,775
Aftermarket and refurbished products	187,628	201,408
Core facilities inventory	6,711	7,055
	$ 331,028	$ 320,238

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 such as the tradename acquired in connection with our acquisition of Keystone Automotive Industries, Inc. (Keystone) in the fourth quarter of 2007, covenants not to compete and trademarks.

The change in the carrying amount of goodwill during the nine months ended September 30, 2008 is as follows (in thousands):

Balance as of December 31, 2007	$	825,881
Adjustment of previously recorded goodwill		10,309
Exchange rate effects		(1,659)
Business acquisitions		75,669
Balance as of September 30, 2008	$	910,200

We adjusted previously recorded goodwill by $10.3 million. These adjustments included $4.6 million of inventory valuation adjustments, $2.6 million of fixed asset valuation adjustments and $2.0 million of adjustments to the allowance for estimated returns, discounts and allowances, all of which related to the Keystone acquisition. We made additional purchase price adjustments totaling $1.1 million relating to Keystone and other businesses acquired in the prior year.

Other intangible assets totaled approximately $72.2 million and $75.0 million, net of accumulated amortization of $4.1 million and $1.0 million, at September 30, 2008 and December 31, 2007, respectively. Amortization expense was approximately $3.1 million during the nine months ended September 30, 2008. The expense for the corresponding 2007 period was immaterial. Estimated annual amortization expense is approximately $4.0 million for each of the years 2008 through 2012.

Depreciation Expense

Included in Cost of Goods Sold is depreciation expense associated with refurbishing and smelting operations.

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 2008 was as follows (in thousands):

Balance as of January 1, 2008	$	580
Warranty expense		2,818
Warranty claims		(2,858)
Balance as of September 30, 2008	$	540

We also sell separately priced extended warranty contracts for certain mechanical products. The expense related to extended warranty claims is recognized when the claim is made.

Stock-Based Compensation

We account for stock-based compensation in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123R).

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 stock option grants:

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Expected life (in years)	6.4	6.4
Risk-free interest rate	3.27%	4.40%
Volatility	39.3%	40.0%
Dividend yield	0%	0%
Weighted average fair value of options granted	$ 8.54	$ 4.77

Estimated forfeitures When estimating forfeitures, we consider voluntary and involuntary termination behavior as well as analysis of historical forfeitures. For options granted in 2008, a forfeiture rate of 8.0% has been used for valuing employee option grants, while a forfeiture rate of 0% has been used for valuing executive officer option grants.

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

	Three Months ended September 30, 2008	Three Months ended September 30, 2007	Nine Months ended September 30, 2008	Nine Months ended September 30, 2007
Stock options	$ 1,205	$ 595	$ 3,519	$ 2,307
Restricted stock	183		523	
Stock issued in lieu of quarterly cash compensation for non-employee directors	30	31	91	79
Total stock-based compensation expense	$ 1,418	$ 626	$ 4,133	$ 2,386

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, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Cost of goods sold	$ 3	$ 4	$ 10	$ 10

Facility and warehouse expenses	514	245	1,501	713
Selling, general and administrative expenses	901	377	2,622	1,663
	1,418	626	4,133	2,386
Income tax benefit	(567)	(244)	(1,633)	(930)
Total stock based compensation expense, net of tax	$ 851	$ 382	$ 2,500	$ 1,456

We have not capitalized any stock-based compensation cost during the nine months ended September 30, 2008 and 2007. As of September 30, 2008, 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 2008	$ 1,148	$ 183	$ 1,331
2009	4,570	727	5,297
2010	4,209	727	4,936
2011	3,369	727	4,096
2012	2,447	727	3,174
2013	85	22	107
Total unrecognized compensation expense	$ 15,828	$ 3,113	$ 18,941

Segments

During the third quarter of 2008, we commenced a reorganization of our vehicle replacement products operations into ten operating segments, combining our wholesale recycled original equipment manufacturer (OEM) products and aftermarket products on a geographic basis, with a separate operating segment for our self-service retail OEM products and one for our refurbishing operations. 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 (in thousands):

	Three Months ended September 30,		Nine Months ended September 30,	
	2008	2007	2008	2007
Recycled and related products and services	$ 174,679	$ 139,673	$ 488,966	$ 397,898
Aftermarket, other new and refurbished products	230,328	57,750	746,618	179,816
Other	85,694	46,072	231,417	134,377
	$ 490,701	$ 243,495	$ 1,467,001	$ 712,091

Recent Accounting Pronouncements

Effective January 1, 2008, we adopted SFAS No. 157, Fair Value Measurements (SFAS 157) as it pertains to financial assets and liabilities. In accordance with the provisions of FASB Staff Position 157-2, we elected to defer the adoption of SFAS 157 relating to the fair value of non-financial assets and liabilities. We are currently evaluating the impact, if any, of applying SFAS 157 to our non-financial assets and liabilities. SFAS 157 established a framework for reporting fair value and expands disclosures required for fair value measurements. Although the adoption of SFAS 157 did not have a significant 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 10.

Effective January 1, 2008, we adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). The adoption of SFAS 159 did not have a significant impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the SEC issued Staff Accounting Bulletin (SAB) 110 to amend the SEC s views discussed in SAB 107 regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS No. 123R. We will continue to use the simplified method until we have the historical data necessary to provide a reasonable estimate of expected life in accordance with SAB 107, as amended by SAB 110.

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141R). Under SFAS 141R, companies will be 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. SFAS 141R also requires that acquisition-related expenses be expensed as incurred, restructuring costs be expensed in periods subsequent to the acquisition date, and changes in accounting for deferred income tax asset valuation allowances and acquired income tax uncertainties after the measurement period be included in income tax expense. SFAS 141R will be effective on January 1, 2009 and will change our accounting for business combinations upon adoption. We are currently assessing the impact that the adoption of SFAS

141R will have on our consolidated financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133 (SFAS 161). SFAS 161 requires enhanced disclosures about derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. As SFAS 161 specifically relates to disclosures regarding derivative and hedging activities, it will not impact our consolidated financial position, results of operations or cash flows.

Note 3. Capital Structure

On September 25, 2007, we completed the sale of 23,600,000 shares of our common stock pursuant to a registration statement filed with the SEC. Pursuant to the same registration statement, the selling stockholders named in the registration statement sold 4,000,000 shares of our common stock. We received $349.5 million, net of the underwriting discount and net of offering related expenses of approximately $0.7 million, for the common stock we issued and sold. We did not receive any proceeds from the sale of shares by the selling stockholders. We also received approximately $2.8 million in proceeds from the exercise of 1,000,000 stock options by certain members of management in connection with the offering.

On November 5, 2007, our Board of Directors approved a two-for-one split of our common stock payable as a stock dividend. Each stockholder of record at the close of business on November 16, 2007 received an additional share of common stock for every outstanding share held. The payment date was December 3, 2007, and the common stock began trading on a split-adjusted basis on December 4, 2007. All share and per share amounts for all periods presented have been adjusted to reflect the stock split.

On March 4, 2008, in connection with the acquisition of Texas Best Diesel, L.P., we issued 838,073 shares of our common stock.

On August 25, 2008, in connection with the acquisition of Pick-Your-Part Auto Wrecking (PYP), we issued 2,080,561 shares of our common stock.

Note 4. Stock-Based Compensation Plans

We have two stock-based compensation plans, the LKQ Corporation 1998 Equity Incentive Plan (the Equity Incentive Plan) and the Stock Option and Compensation Plan for Non-Employee Directors (the Director Plan). Under the Equity Incentive Plan, both qualified and nonqualified stock options, stock appreciation rights, restricted stock, performance shares and performance units may be granted.

Stock options expire 10 years from the date they are granted. Most of the options granted under the Equity Incentive Plan vest over a period of five years. Options granted under the Director Plan vest six months after the date of grant. We expect to issue new shares of common stock to cover future stock option exercises.

On January 11, 2008, we issued 190,000 shares of restricted stock to key employees. The grant-date fair value of the awards was approximately $3.6 million, or $19.14 per share. Vesting of the awards is subject to a continued service condition, with 20% of the awards vesting each year on the anniversary of the grant date. The fair value of each share of restricted stock awarded was equal to the market value of a share of our common stock on the grant date.

A summary of transactions in our stock-based compensation plans for the nine months ended September 30, 2008 is as follows:

	Restricted Shares and Options Available For Grant	Restricted Shares Outstanding	Stock Options Number Outstanding	Stock Options Weighted Average Exercise Price
Balance, December 31, 2007	6,852,680		11,032,102	$ 5.06
Granted	(1,617,250)	190,000	1,427,250	19.19
Exercised			(1,397,266)	3.38
Cancelled	98,690		(98,690)	16.61
Balance, September 30, 2008	5,334,120	190,000	10,963,396	$ 7.01

The following table summarizes information about outstanding and exercisable stock options at September 30, 2008:

Range of Exercise Prices	Shares	Outstanding Weighted Average Remaining Contractual Life (Yrs)	Weighted Average Exercise Price	Shares	Exercisable Weighted Average Remaining Contractual Life (Yrs)	Weighted Average Exercise Price
$0.75	158,000	2.3	$ 0.75	158,000	2.3	$ 0.75
2.00 - 2.19	1,108,170	3.9	2.09	1,108,170	3.9	2.09
3.13 - 3.99	1,819,900	3.3	3.47	1,724,300	3.2	3.47
4.16 - 4.72	4,223,286	5.9	4.44	3,966,901	5.9	4.44
7.56 - 7.60	246,000	7.0	7.59	243,600	7.0	7.59
9.33 - 12.42	1,954,840	7.8	10.04	870,860	7.8	10.14
18.87 - 22.58	1,453,200	9.3	19.17	141,970	9.3	19.12
	10,963,396	6.1	$ 7.01	8,213,801	5.3	$ 4.80

At September 30, 2008, a total of 10,915,758 options with an average exercise price of $6.98 and a weighted average remaining contractual life of 6.0 years were exercisable or expected to vest. The total grant-date fair value of options that vested during the nine months ended September 30, 2008 was approximately $3.4 million.

The aggregate intrinsic value (market value of stock less option exercise price) of outstanding, expected to vest and exercisable stock options at September 30, 2008 is $109.2 million, $109.1 million and $100.0 million, respectively. The aggregate intrinsic value represents the total pre-tax intrinsic value, based on the Company s closing stock price of $16.97 on September 30, 2008, which would have been received by the option holders had all option holders exercised their options as of that date. This amount changes based upon the fair market value of our common stock. The total intrinsic value of stock options exercised was $22.4 million during the nine months ended September 30, 2008. There were 2,788,310 stock options exercised during the nine months ended September 30, 2007 with an intrinsic value of $33.0 million.

Note 5. Long-Term Obligations

Long-Term Obligations consist of the following (in thousands):

	September 30, 2008	December 31, 2007
Senior secured debt financing facility:		
Term loans payable	$ 640,121	$ 650,252
Revolving credit facility		
Notes payable to individuals in monthly installments through November 2010, interest at 3.5% to 10.0%	2,332	8,210
	642,453	658,462
Less current maturities	(19,425)	(16,936)
	$ 623,028	$ 641,526

We obtained a senior secured debt financing facility (Credit Agreement) from Lehman Brothers Inc. (Lehman) and Deutsche Bank Securities, Inc. (Deutsche Bank) on October 12, 2007, which was amended on October 26, 2007. The Credit Agreement has a six year term and includes a $610 million term loan, a $40 million Canadian currency term loan, a $100 million U.S. dollar revolving credit facility, and a $15 million dual currency facility for drawings of either U.S. dollars or Canadian dollars. The Credit Agreement also provides for (i) the issuance of letters of credit of up to $35 million in U.S. dollars and up to $10 million in either U.S. or Canadian dollars, (ii) for a swing line credit facility of $25 million under the $100 million revolving credit facility, and (iii) the opportunity for us to add additional term loan facilities and/or increase the $100 million revolving credit facility s commitments, provided that such additions or increases do not exceed $150 million in the aggregate and provided further that no existing lender is required to make its pro rata share of any such additions or increases without its consent. Amounts under each term loan facility are due and payable in quarterly installments of increasing amounts that began in the first quarter of 2008, with the balance payable in full on October 12, 2013. Amounts due under each revolving credit facility will be due and payable October 12, 2013. We are also required to prepay the term loan facilities upon the sale of certain assets, upon the incurrence of certain debt, upon receipt of certain insurance and condemnation proceeds, and with up to 50% of our excess cash flow, with the amount of such excess cash flow determined based upon our total leverage ratio.

As of September 30, 2008, we had no borrowings on our $115 million revolving credit facility. Availability on the revolving credit facility is reduced by outstanding letters of credit totaling approximately $22 million. Lehman Commercial Paper Inc. (LCP) filed for protection under Chapter 11 of the Federal Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York on October 5, 2008. LCP accounts for $15 million of revolver funding commitment and serves as our swing line lender. Accordingly, we no longer believe this $15 million revolver commitment is available, so in effect our availability on the line has been reduced to $78 million. Our ability to access the swing line credit facility is also uncertain as a result of the bankruptcy filing. We believe that the LCP bankruptcy will not have a material adverse effect on our liquidity.

The Credit Agreement contains customary representations and warranties, and contains customary covenants that restrict our ability to, among other things (i) incur liens, (ii) incur any indebtedness (including guarantees or other contingent obligations), and (iii) engage in mergers and consolidations. The Credit Agreement also requires us to meet certain financial covenants, including compliance with the required senior secured debt ratio. We were in compliance with all restrictive covenants as of September 30, 2008.

Borrowings under the Credit Agreement accrue interest at variable rates, which depend on the type (U.S. dollar or Canadian dollar) and duration of the borrowing, plus an applicable margin rate. The weighted-average interest rates on borrowings outstanding against the Company s senior secured credit facility at September 30, 2008 and December 31, 2007 were 4.91% and 7.53%, respectively. Borrowings against the senior secured credit facility totaled $640.1 million and $650.3 million at September 30, 2008 and December 31, 2007, respectively, of which $17.4 million and $10.0 million are classified as current maturities, respectively.

The weighted average interest rate at September 30, 2008 includes the effect of the following interest rate swap agreements, which we entered into in March 2008 and September 2008 in order to hedge a portion of the variable interest rate risk on our variable rate term loans:

Notional Amount		**Effective Date**	**Maturity Date**	**Fixed Interest Rate**
$	200,000,000	April 14, 2008	April 14, 2011	2.74%
$	50,000,000	April 14, 2008	April 14, 2010	2.43%
$	250,000,000	September 15, 2008	October 14, 2010	2.63%

Beginning on the effective dates of the interest rate swap agreements, we will, on a monthly basis through the maturity date, pay the fixed interest rate and receive a variable rate of interest based on the London InterBank Offered Rate (LIBOR) on the notional amount. The interest rate swap agreements qualify as cash flow hedges, as defined by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS 133). As of September 30, 2008, the fair market value of these market contracts was approximately $7.8 million. The fair market value of the interest rate swaps is subject to changes in value due to changes in interest rates. Hedge ineffectiveness for the nine months ended September 30, 2008 was immaterial.

Note 6. Commitments and Contingencies

We are obligated under noncancelable operating leases for corporate office space, warehouse and distribution facilities, trucks and certain equipment. The future minimum lease commitments under these leases at September 30, 2008 are as follows (in thousands):

Three months ended December 31, 2008	$	12,805
Years ended December 31:		
2009		45,282
2010		37,560
2011		29,869
2012		23,784
2013		18,761
Thereafter		54,094
	$	222,155

Litigation and Related Contingencies

On December 2, 2005, Ford Global Technologies, LLC (Ford) filed a complaint under Section 337 of the Tariff Act of 1930 with the United States International Trade Commission (USITC) against Keystone and five other named Respondents, including four Taiwan-based manufacturers (collectively, the F-150 Respondents). On December 12, 2005, Ford filed an Amended Complaint. Both the Complaint and the Amended Complaint contended that the F-150 Respondents infringed 14 design patents covering eight parts on the 2004-2005 Ford F-150 truck (the Ford Design Patents). Ford asked the USITC to issue a permanent general exclusion order excluding from entry into the United States all automotive parts that infringe the Ford Design Patents and that are imported into the United States, sold for importation in the United States, or sold within the United States after importation. Ford also sought a permanent order directing the F-150 Respondents to cease and desist from, among other things, selling, marketing, advertising, distributing and offering for sale imported automotive parts that infringe the Ford Design Patents. On December 28, 2005, the USITC issued a Notice of Investigation based on Ford s Amended Complaint. The USITC s Notice of Investigation was published in the Federal Register on January 4, 2006.

On January 23, 2006, the F-150 Respondents filed their Response to the Complaint and Notice of Investigation. In the Response, the F-150 Respondents denied, among other things, that any of the Ford Design Patents is valid and/or enforceable and, accordingly, denied each and every allegation of infringement. The F-150 Respondents further asserted several affirmative defenses. In interlocutory rulings, the Administrative Law Judge (ALJ) struck the F-150 Respondents affirmative defenses of patent exhaustion, permissible repair, license and patent misuse and the affirmative defense that each of the patents is invalid for failure to comply with the ornamentality requirement of 35 U.S.C.§171. Additionally, the ALJ granted Ford s request to drop four patents from the investigation. A hearing before the ALJ took place the last week of August 2006.

On December 4, 2006, the ALJ issued an Initial Determination upholding seven of Ford s design patents and declaring the remaining three design patents to be invalid. Both Ford and the F-150 Respondents petitioned the USITC to review and set aside portions of the ALJ s Initial Determination. The F-150 Respondents petition also sought review of the ALJ s interlocutory rulings concerning certain of their affirmative defenses. On March 20, 2007, the USITC decided not to review the ALJ s Initial Determination.

On June 6, 2007, the USITC issued its Notice of Final Determination. The Notice of Final Determination denied the F-150 Respondents petition for reconsideration and their motion for leave to supplement their petition. In addition, the USITC issued a general exclusion order prohibiting the importation of certain automotive parts found to infringe the seven Ford design patents found valid. The USITC s decision became final on August 6, 2007 upon the expiration without action of the 60-day Presidential review period. On May 18, 2007, Ford filed a Notice of Appeal with the United States Federal Circuit Court of Appeals. On August 23, 2007, the F-150 Respondents filed a Notice of Appeal with the United States Federal Court of Appeals. The appeals were consolidated, and the parties have submitted their respective briefs to the appellate court.

On May 2, 2008, Ford filed with the USITC another complaint under section 337 of the Tariff Act of 1930. The complaint alleges that LKQ Corporation, Keystone Automotive Industries, Inc., and six other entities (collectively, the Mustang Respondents) import and sell certain automotive parts relating to the 2005 Ford Mustang that infringe eight Ford design patents. On May 29, 2008, the USITC issued a Notice of Investigation based on Ford s complaint. The USITC s Notice of Investigation was published in the Federal Register on June 5, 2008. On June 23, 2008, the Mustang Respondents filed their Response to the Complaint and Notice of Investigation. In the Response, the Mustang Respondents denied, among other things, that any of the Ford design patents is valid and/or enforceable and, accordingly, denied each and every allegation of infringement. The Mustang Respondents further asserted several affirmative defenses. The parties are conducting discovery. The USITC has set September 7, 2009 as the target date for completion of the investigation.

We will continue to vigorously defend the December 2005 action and the May 2008 action. At the time the exclusion order was issued in the December 2005 action, the parts that were subject to the order comprised only a minimal amount of our sales. Similarly, the parts that relate to the May 2008 action comprise only a minimal amount of our sales. However, as such parts become incorporated into more vehicles over time, it is likely that the amount of our sales of such parts will increase or would have increased substantially. If the design patents in question are ultimately upheld as valid and infringed, it is not anticipated that the loss of sales of these parts over time will be materially adverse to our financial position, results of operations or cash flows. However, depending upon the nature and extent of any adverse ruling, auto manufacturers may attempt to assert similar allegations based upon design patents on a significant number of parts for several of their models, which over time could have a material adverse impact on the entire aftermarket parts industry.

We also have certain other contingent liabilities resulting from litigation, claims and other commitments and are subject to a variety of environmental and pollution control laws and regulations incident to the ordinary course of business. We believe that the probable resolution of such contingencies will not materially affect our financial position, results of operations or cash flows.

Note 7. Earnings Per Share

The following chart sets forth the computation of earnings per share (in thousands, except per share amounts):

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Net income	$ 25,068	$ 14,559	$ 86,935	$ 44,369
Denominator for basic earnings per share-Weighted-average shares outstanding	136,585	109,326	135,481	107,678
Effect of dilutive securities:				
Stock options	4,587	5,785	4,868	5,559
Restricted stock	18		109	
Denominator for diluted earnings per share-Adjusted weighted-average shares outstanding	141,190	115,111	140,458	113,237
Earnings per share, basic	$ 0.18	$ 0.13	$ 0.64	$ 0.41
Earnings per share, diluted	$ 0.18	$ 0.13	$ 0.62	$ 0.39

The following chart sets forth the number of employee stock options outstanding but not included in the computation of diluted earnings per share because their effect would have been antidilutive (in thousands):

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Antidilutive securities:				
Stock options	1,460	31	1,460	894

Note 8. Business Combinations

During the nine month period ended September 30, 2008, we acquired a 100% interest in each of four businesses (three in the recycled OEM parts business and one wheel polishing business) including on August 25, 2008, PYP, an auto recycler with nine recycling locations in California, and on March 4, 2008, Texas Best Diesel, L.P., a recycled OEM heavy truck parts business. The acquisitions enabled us to expand our presence in an existing market and also become a provider of recycled OEM heavy truck parts. The aggregate consideration for these businesses totaled approximately $41.6 million in cash, net of cash acquired, and $60.0 million in stock issued. The cash consideration for PYP included a $3.3 million contingent payment to the former owners based on a share price guarantee for shares sold in the market during the month following the acquisition date. The guarantee period was closed as of September 30, 2008, and we do not anticipate any further payments to the former owners of PYP. As the payment was based on a contingency involving share prices, the $3.3 million has not been included in the cost of the acquired entity for purchase accounting but instead reduced additional paid-in capital. We expect to receive a refund of a portion of the purchase price during the fourth quarter resulting from a working capital adjustment.

During the nine month period ended September 30, 2007, we acquired a 100% interest in each of eight businesses (five in the recycled OEM products business, two in the aftermarket products business and one that refurbishes and distributes head lamps and tail lamps) for an aggregate of $52.2 million in cash and $1.4 million in notes issued. The acquisitions enabled us to expand our presence in existing markets, serve new market areas and become a provider of refurbished head lamps and tail lamps.

On October 12, 2007, we completed our acquisition of 100% of the outstanding common stock of Keystone. The acquisition of Keystone enabled us to become the largest nationwide provider of aftermarket collision replacement products and refurbished bumper covers and wheels. During the nine months ended September 30, 2007, we incurred $1.5 million in direct costs associated with the acquisition. In September 2008, we received a refund of approximately $1.3 million of the purchase price for an overpayment on Keystone shares at the acquisition date.

The acquisitions are being accounted for under the purchase method of accounting and are included in our financial statements from the dates of acquisition. The purchase prices were allocated to the net assets acquired based upon estimated fair market values at the dates of acquisition. In connection with acquisitions made subsequent to September 30, 2007, the purchase price allocations are preliminary as we are in the process of determining the following: 1) whether any operations acquired will be closed or combined with existing operations; 2) valuation amounts for certain of the inventories and fixed assets acquired and the fair value of liabilities assumed; and 3) the final estimation of the tax basis of the entities acquired. During the nine months ended September 30, 2008, we made adjustments to the preliminary purchase price allocations to finalize the inventory and fixed asset valuations, reserve balances and the estimated tax basis for certain of the businesses acquired in 2007. These adjustments increased goodwill related to these 2007 acquisitions by approximately $10.3 million.

The purchase price allocations for acquisitions completed and adjustments made to preliminary purchase price allocations during the nine months ended September 30, 2008 and 2007 are as follows (in thousands):

	2008	2007
Receivables, net	$ 5,645	$ 3,062
Inventory	5,912	9,546
Prepaid expenses and other assets	493	314
Property and equipment	6,797	8,927
Goodwill	85,978	34,922
Current liabilities assumed	(7,548)	(2,776)
Deferred taxes	1,195	

Purchase price payable in subsequent period				(190)
Notes issued		(25)		(1,449)
Stock issued (See Note 3)		(60,041)		
Long-term obligations assumed		(1,423)		(118)
Payment of prior year purchase price payable				1,956
Cash used in acquisitions, net of cash acquired	$	36,983	$	54,194

We recorded goodwill of $86.0 million during the nine month period ended September 30, 2008, of which $75.7 million is expected to be deductible for income tax purposes. Of the $34.9 million of goodwill recorded during the nine month period ended September 30, 2007, $12.9 million is expected to be deductible for income tax purposes.

The following pro forma summary presents the effect of the businesses acquired during 2008 and 2007 as though the businesses had been acquired as of January 1, 2007 and is based upon unaudited financial information of the acquired entities (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenue as reported	$ 490,701	$ 243,495	$ 1,467,001	$ 712,091
Revenue of purchased businesses for the period prior to acquisition:				
Keystone, net of eliminations		174,212		553,271
Other acquisitions	25,316	36,026	105,527	121,760
Pro forma revenue	$ 516,017	$ 453,733	$ 1,572,528	$ 1,387,122
Net income as reported	$ 25,068	$ 14,559	$ 86,935	$ 44,369
Net income of purchased businesses for the period prior to acquisition, including adjustments for interest and amortization:				
Keystone		(2,869)	665	(118)
Other acquisitions	2,235	753	9,434	3,370
Pro forma net income	$ 27,303	$ 12,443	$ 97,034	$ 47,621
Earnings per share-basic, as reported	$ 0.18	$ 0.13	$ 0.64	$ 0.41
Effect of purchased businesses for the period prior to acquisition:				
Keystone		(0.03)		
Other acquisitions	0.02	0.01	0.07	0.02
Pro forma earnings per share-basic	$ 0.20	$ 0.11	$ 0.71	$ 0.43
Earnings per share-diluted, as reported	$ 0.18	$ 0.13	$ 0.62	$ 0.39
Effect of purchased businesses for the period prior to acquisition:				
Keystone		(0.03)		
Other acquisitions	0.01	0.01	0.06	0.02
Pro forma earnings per share-diluted	$ 0.19	$ 0.11	$ 0.68	$ 0.41

Unaudited pro forma supplemental information is based upon accounting estimates and judgments that we believe are reasonable. Revenue between LKQ and Keystone has been eliminated. The unaudited pro forma supplemental information also includes purchase accounting adjustments (including a $2.9 million increase in Keystone s reported cost of goods sold during the nine months ended September 30, 2007, resulting from a write-up of Keystone inventory to fair value), adjustments to depreciation on acquired property and equipment, amortization expense associated with the Keystone tradename, adjustments to interest expense, and the related tax effects. These pro forma results are not necessarily indicative either of what would have occurred if the acquisitions had been in effect for the period presented or of future results.

Note 9. Restructuring and Integration Costs

We have undertaken certain restructuring activities in connection with our October 2007 acquisition of Keystone. The restructuring activities primarily include reductions in staffing levels resulting from the elimination of duplicative functions and staffing and the closure of excess facilities resulting from overlap with existing LKQ facilities. To the extent these restructuring activities are associated with Keystone operations, they are being accounted for in accordance with EITF Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination. Restructuring activities associated with our existing operations are being accounted for in accordance with SFAS No. 146, Accounting for Costs Associated With Exit or Disposal Activities.

In connection with the Keystone restructuring activities, as part of the cost of the acquisition, we established reserves as detailed below. Upon finalization of restructuring plans or settlement of obligations for less than the expected amount, any excess reserves will be reversed with a corresponding decrease in goodwill. Any additional reserves required after the close of the purchase accounting period will be recorded through charges to restructuring expense. Accrued acquisition expenses are included in accrued expenses in the accompanying Unaudited Consolidated Condensed Balance Sheets.

The changes in accrued acquisition expenses directly related to the Keystone acquisition during 2007 and the nine months ended September 30, 2008 are as follows (in thousands):

	Severance Related Costs	Excess Facility Costs	Other	Total
Reserves established	$ 11,233	$ 2,823	$ 488	$ 14,544
Payments	(1,727)	(85)	(488)	(2,300)
Balance at December 31, 2007	9,506	2,738		12,244
Reserves adjusted	(800)	(700)		(1,500)
Payments	(7,524)	(462)		(7,986)
Balance at September 30, 2008	$ 1,182	$ 1,576	$	$ 2,758

Severance related costs are expected to be paid through 2009. The excess facility costs are expected to be paid over the remaining terms of the leases through 2013.

Restructuring and integration costs associated with our operations of $2.4 million and $6.7 million are included in Restructuring expenses on the accompanying Unaudited Consolidated Condensed Statements of Income for the three and nine months ended September 30, 2008, respectively. These charges include costs to move inventory between facilities, migrate systems, and standardize processes and procedures totaling $1.8 million and $4.7 million for the three and nine months ended September 30, 2008, respectively. We also recognized costs associated with the closure of existing facilities due to overlap with acquired Keystone locations of $0.6 million and $2.0 million for the three and nine months ended September 30, 2008, respectively.

We have established a reserve for the costs related to the closure of existing facilities. The other restructuring charges are generally expensed and paid in the same reporting period. The changes in accrued restructuring expenses for the nine months ended September 30, 2008 are as follows (in thousands):

	Excess Facility Costs
Balance at December 31, 2007	$
Reserves established	2,047
Payments	(599)
Balance at September 30, 2008	$ 1,448

The excess facility costs are expected to be paid over the remaining terms of the leases through 2016.

Note 10. Fair Value Measurements

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

We use the market approach to value our financial assets and liabilities, and there were no changes in valuation techniques during the nine months ended September 30, 2008. The following table presents information about our financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2008 (in thousands):

	Balance as of September 30, 2008	Fair Value Measurements as of September 30, 2008		
		Level 1	Level 2	Level 3
Assets:				
Cash equivalents	$ 68,492	$ 68,492	$	$
Interest rate swaps	7,771		7,771	
Cash surrender value of life insurance	4,665		4,665	
Total Assets	$ 80,928	$ 68,492	$ 12,436	$
Liabilities:				
Deferred compensation liabilities	$ 4,137	$	$ 4,137	$
Total Liabilities	$ 4,137	$	$ 4,137	$

Note 11. Income Taxes

We calculate our interim income tax provision in accordance with Accounting Principles Board Opinion No. 28, Interim Financial Reporting and FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods. At the end of each interim period, we estimate our annual effective tax rate and apply that rate to our interim earnings. We also record the tax impact of certain unusual or infrequently occurring items, including changes in judgment about valuation allowances and the effects of changes in tax laws or rates, in the interim period in which they occur.

The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in state and foreign jurisdictions, permanent and temporary differences, and the likelihood of recovering deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, additional information is obtained or as the tax environment changes.

Our effective tax rate for the nine months ended September 30, 2008 was 39.5% compared with 40.5% for the comparable prior year period.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

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 OEM products that have been refurbished. We participate in the markets 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 and sell bumpers, wheels, head lamps and tail lamps.

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 United States. In October 2007, we acquired Keystone Automotive Industries, Inc., the nation s leading distributor of aftermarket collision parts. As a result, we are the largest nationwide provider of aftermarket collision replacement products, and refurbished bumper covers and wheels. We believe there are opportunities for growth in both product lines through acquisitions and internal development.

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. Please refer to the risk factors enumerated in Item 1A in our 2007 Annual Report on Form 10-K filed with the SEC on February 29, 2008, and the updates to Item 1A included in Part II of our Quarterly Reports on Form 10-Q filed subsequently. Due to these risk factors, our operating results in future periods can be expected to fluctuate. Accordingly, our historical results of operations may not be indicative of future performance.

Acquisitions

Since our inception in 1998 we have pursued a growth strategy of both organic growth and acquisitions. We have pursued acquisitions that we believe will help drive profitability, cash flow and stockholder value. Our principal focus for acquisitions is companies that will expand our geographic presence and our ability to provide a wider choice of alternative vehicle replacement products and services to our customers.

In the first nine months of 2008, we acquired four businesses (three in the recycled OEM parts business and one wheel polishing business). In October 2008, we acquired two additional recycled OEM heavy truck parts businesses. The 2008 business acquisitions enabled us to expand our presence in an existing market and become a provider of recycled OEM heavy truck parts.

Sources of Revenue

Since 2005, our revenue from the sale of vehicle replacement products and related services, and since February 2008, heavy truck parts, has ranged between 81% and 89% of our total revenue, of which between 5% and 13% of our total revenue has come from our self-service facilities. We sell the majority of our vehicle replacement products to collision repair shops and mechanical repair shops. Our vehicle replacement products include engines, transmissions, front-ends, doors, trunk lids, bumpers, hoods, fenders, grilles, valances, wheels, head lamps, and tail lamps. We sell extended warranty contracts for certain mechanical products. These contracts cover the cost of parts and labor and are sold for periods of six months, one year, or two years. We defer the revenue from such contracts and recognize it ratably over the term of the contracts. We also sell damaged vehicles to vehicle repairers. The demand for our products and services is influenced by several factors, including the number of vehicles in operation, the number of miles being driven, the frequency and severity of vehicle accidents, availability and pricing of new parts, seasonal weather patterns, and local weather conditions. Additionally, automobile insurers exert significant influence over collision repair shops as to how an insured vehicle is repaired and the cost level of the products used in the repair process. Accordingly, we consider automobile insurers to be key demand drivers of our products. While they are not our direct customers, we do provide insurance companies services in an effort to promote the increased usage of alternative replacement products in the repair process. Such services include the review of vehicle repair order estimates, as well as direct quotation services to their adjusters. There is no standard price for recycled OEM products, but rather a pricing structure that varies from day to day based upon such factors as product availability, quality, demand, new OEM replacement product prices, the age of the vehicle being repaired, and competitor pricing. The pricing for aftermarket and refurbished products is determined based on a number of factors, including availability, quality, demand, new OEM replacement product prices, and competitor pricing.

Since 2005, approximately 11% to 19% of our revenue has been obtained from other sources. These include bulk sales to mechanical remanufacturers, scrap sales, and sales of aluminum ingots and sows. We derive scrap metal from several sources, including OEM s and other companies that contract with us to dismantle and scrap certain vehicles (which we refer to as crush only vehicles) and from vehicles that have been used in both our wholesale and self service recycling operations. Our revenue from other sources has increased since 2004 primarily due to our obtaining an aluminum smelter through a business acquisition in 2006, higher scrap sales from our recycle and wheel operations, and higher bulk sales of certain products. Subsequent to September 30, 2008, scrap metal prices have fallen significantly, which will have a negative effect on our revenue (Item 3 of this Quarterly Report on Form 10-Q provides further description of this price risk).

When we obtain mechanical products from dismantled vehicles and determine they are damaged, or when we have a surplus of a certain mechanical product type, we sell them in bulk to mechanical remanufacturers. The majority of these products are sorted by product type and model type. Examples of such products are engine blocks and heads, transmissions, starters, alternators, and air conditioner compressors. After we have recovered all the products we intend to resell, the remaining materials are crushed and sold to scrap processors.

Cost of Goods Sold

Our cost of goods sold for recycled OEM products includes the price we pay for the salvage vehicle and, where applicable, auction, storage, and towing fees. We are facing increasing competition in the purchase of salvage vehicles from shredders and scrap recyclers, internet-based buyers, and others. Our cost of goods sold also includes labor and other costs we incur to acquire and dismantle such vehicles. The acquisition and dismantling of salvage vehicles is a manual process and, as a result, energy costs are not material.

Our cost of goods sold for aftermarket products includes the price we pay for the parts, freight, and other inventoried costs such as import fees and duties, where applicable. Our aftermarket products are acquired from a number of vendors. Our cost of goods sold for refurbished wheels, bumpers and lights includes the price we pay for inventory, freight, and costs to refurbish the parts, including direct and indirect labor, rent, depreciation and other overhead costs related to refurbishing operations.

In the event we do not have a recycled OEM product or suitable aftermarket product in our inventory to fill a customer order, we attempt to purchase the part from a competitor. We refer to these parts as brokered products. Since 2005, the revenue from brokered products that we sell to our customers has ranged from 2% to 6% of our total revenue. The gross margin on brokered product sales as a percentage of revenue is generally less than half of what we achieve from sales of our own inventory because we must pay higher prices for these products.

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. We also sell separately priced extended warranty contracts for certain mechanical products. The expense related to extended warranty claims is recognized when the claim is made.

Expenses

Our facility and warehouse expenses primarily include our costs to operate our distribution, self-service, and warehouse facilities. These costs include labor for both plant management and facility and warehouse personnel, stock-based compensation, facility rent, property and liability insurance, utilities, and other occupancy costs.

Our distribution expenses primarily include our costs to deliver our products to our customers. Included in our distribution expense category are labor costs for drivers, local delivery and transfer truck rentals and subcontractor costs, vehicle repairs and maintenance, insurance, and fuel.

Our selling and marketing expenses primarily include our advertising, promotion, and marketing costs; salary and commission expenses for sales personnel; sales training; telephone and other communication expenses; and bad debt expense. Since 2005, personnel costs have accounted for approximately 77% to 80% of our selling and marketing expenses. Most of our recycled OEM product sales personnel are paid on a commission basis. The number and quality of our sales force is critical to our ability to respond to our customers needs and increase our sales volume. Our objective is to continually evaluate our sales force, develop and implement training programs, and utilize appropriate measurements to assess our selling effectiveness.

Our general and administrative expenses include primarily the costs of our corporate and regional offices that provide corporate and field management, treasury, accounting, legal, payroll, business development, human resources, and information systems functions. These costs include wages and benefits for corporate, regional and administrative personnel, stock-based compensation, long term incentive compensation, accounting, legal and other professional fees, office supplies, telephone and other communication costs, insurance and rent.

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 more weather related accidents occur generating a larger supply of total loss vehicles.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP). The preparation of these financial statements requires us to make estimates, assumptions, and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, assumptions, and judgments, including those related to revenue recognition, inventory valuation, allowance for doubtful accounts, goodwill impairments, self-insurance programs, contingencies, stock-based compensation, and accounting for income taxes. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of these estimates form the basis for our judgments about the carrying values of assets and liabilities and our recognition of revenue. Actual results may differ from these estimates.

Revenue Recognition

We recognize and report revenue from the sale of vehicle replacement products when they are shipped and title has transferred, subject to a reserve for returns, discounts, and allowances that management estimates based upon historical information. A replacement product would ordinarily be returned within a few days of shipment. Our customers may earn discounts based upon sales volumes or sales volumes coupled with prompt payment. Allowances are normally given within a few days following product shipment. We analyze historical returns and allowances activity by comparing the items to the original invoice amounts and dates. We use this information to project future returns and allowances on products sold.

We also sell separately priced extended warranty contracts for certain mechanical products. Revenue from these contracts is deferred and recognized ratably over the term of the contracts.

Inventory Accounting

Salvage Inventory. Salvage inventory is recorded at the lower of cost or market. Our salvage inventory cost is established based upon the price we pay for a vehicle, and includes buying; dismantling; and, where applicable, auction, storage, and towing fees. Inventory carrying value is determined using the average cost to sales percentage at each of our facilities and applying that percentage to the facility s inventory at expected selling prices. The average cost to sales percentage is derived from each facility s historical vehicle profitability for salvage vehicles purchased at auction or from contracted rates for salvage vehicles acquired under direct procurement arrangements.

Aftermarket and Refurbished Product Inventory. Aftermarket and refurbished product inventory is recorded at the lower of cost or market. Our aftermarket inventory cost is based on the average price we pay for parts, and includes expenses incurred for freight and buying, where applicable. For items purchased from foreign sources, import fees and duties and transportation insurance are also included. Our refurbished product inventory cost is based on the average price we pay for wheel and bumper cores, and includes expenses incurred for freight, buying, and refurbishing overhead.

For all inventory, our carrying value is reduced regularly to reflect the age and current anticipated demand for our products. If actual demand differs from our estimates, additional reductions to our inventory carrying value would be necessary in the period such determination is made.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. The allowance for doubtful accounts is based on our assessment of the collectibility of specific customer accounts, the aging of the accounts receivable, and our historical experience. Our allowance for doubtful accounts at September 30, 2008 was approximately $5.5 million, which represents 3.9% of gross receivables. If actual defaults are higher than our historical experience, our allowance for doubtful accounts may be insufficient to cover the uncollectible receivables, which would have an adverse impact on our operating results in the period of occurrence. A 10% change in the 2007 annual write-off rate would result in a change in the estimated allowance for doubtful accounts of approximately $0.2 million. For our vehicle replacement parts operations, our exposure to uncollectible accounts receivable is generally limited because the majority of our sales are to a large number of small customers that are geographically dispersed. We also have certain customers in our vehicle replacement parts operations that pay for products at the time of delivery. The aluminum smelter and our mechanical core operation sell in larger quantities to a small number of distributors, foundry customers and remanufacturers. As a result, our exposure to uncollectible accounts receivable is greater in these operations. We control credit risk through credit approvals, credit limits, and monitoring policies.

Goodwill Impairment

We record goodwill as a result of our acquisitions. SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142), requires us to analyze our goodwill for impairment at least annually. The determination of the value of goodwill requires us to make estimates and assumptions that affect our consolidated financial statements. In assessing the recoverability of our goodwill, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets. We perform goodwill impairment tests annually in the fourth quarter and between annual tests whenever events may indicate that an impairment exists. In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of goodwill.

Our goodwill would be considered impaired if the net book value of a reporting unit exceeded its estimated fair value. The fair value estimates are primarily established using a discounted cash flow methodology, supported by comparative market multiples where appropriate. As of September 30, 2008, we had $910.2 million in goodwill subject to future impairment tests. If we were required to recognize goodwill impairments in future periods, we would report those impairment losses as part of our operating results. We determined that no adjustments were necessary when we performed our annual impairment testing in the fourth quarter of 2007. A 10% decrease in the fair value estimates used in the fourth quarter of 2007 impairment test would not have changed this determination.

Self-Insurance Programs

We self-insure a portion of employee medical benefits under the terms of our employee health insurance program. We also self-insure a portion of automobile, general liability, and workers compensation claims. We have purchased both aggregate (in some cases) and specific (in all cases) stop-loss insurance coverage from third party insurers in order to limit our total liability exposure. The cost of the stop-loss insurance is expensed over the contract periods.

We record an accrual for the claims expense related to our employee medical benefits, automobile, general liability, and workers compensation claims based upon the expected amount of all such claims. If actual claims are higher than what we anticipated, our accrual might be insufficient to cover our claims costs, which would have an adverse impact on our operating results in that period.

Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business resulting from litigation, claims and other commitments, and from a variety of environmental and pollution control laws and regulations. We consider the likelihood of loss or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. We accrue an estimated loss contingency when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. We determine the amount of reserves, if any, with the assistance of our outside legal counsel. We regularly evaluate current information available to us to determine whether the accruals should be adjusted. If the amount of an actual loss were greater than the amount we have accrued, the excess loss would have an adverse impact on our operating results in the period that the loss occurred. If the loss contingency is subsequently determined to no longer be probable, the amount of loss contingency previously accrued would be included in our operating results in the period such determination was made.

Accounting for Income Taxes

All income tax amounts reflect the use of the liability method. Under this method, deferred tax assets and liabilities are determined based upon the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial and income tax reporting purposes. We operate in multiple tax jurisdictions with different tax rates, and we determine the allocation of income to each of these jurisdictions based upon various estimates and assumptions.

We record a provision for taxes based upon our effective income tax rate. We record a valuation allowance to reduce our deferred tax assets to the amount that we expect is more likely than not to be realized. We consider historical taxable income, expectations, and risks associated with our estimates of future taxable income and ongoing tax planning strategies in assessing the need for a valuation allowance. We had a valuation allowance of $1.2 million and $0.7 million at September 30, 2008 and December 31, 2007, respectively, against our deferred tax assets. Should we determine that it is more likely than not that we would be able to realize all of our deferred tax assets in the future, an adjustment to the net deferred tax asset would increase income in the period such determination was made. Conversely, should we determine that it is more likely than not that we would not be able to realize all of our deferred tax assets in the future, an adjustment to the net deferred tax assets would decrease income in the period such determination was made.

We account for uncertain tax positions in accordance with FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 establishes a threshold for the financial statement recognition and measurement of tax positions taken or expected to be taken in tax returns. Only those positions that meet the more-likely-than-not recognition threshold may be recognized in the financial statements. We recognize interest accrued relating to unrecognized tax benefits in our income tax expense. In the normal course of business we will undergo tax audits by various tax jurisdictions. Such audits often require an extended period of time to complete and may result in income tax adjustments if changes to the allocation are required between jurisdictions with different tax rates. Under existing GAAP, changes in accruals for uncertainties arising from the resolution of pre-acquisition contingencies of acquired businesses are charged or credited to goodwill. Adjustments to other tax accruals we make are generally recognized in the period they are determined. Under Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS 141R), changes in accruals for uncertainties arising from the resolution of pre-acquisition contingencies and income taxes of acquired businesses will be recorded in earnings in the period the changes are determined after the effective date of SFAS 141R. See Recent Accounting Pronouncements for further discussion of SFAS 141R.

Stock-Based Compensation

We measure compensation cost for all share-based payments (including employee stock options) at fair value and recognize compensation expense for all awards on a straight-line basis over the requisite service period of the award in accordance with SFAS No. 123R, Share-Based Payment (SFAS 123R).

Several key factors and assumptions affect the valuation models currently utilized for valuing our stock option awards under SFAS 123R. We have been in existence since early 1998 and have been a public company since October 2003. As a result, we do not have the historical data necessary to consider using a lattice valuation model at this time. We have therefore elected to use the Black-Scholes valuation model. In December 2007, the SEC issued Staff Accounting Bulletin No. 110 (SAB 110) to amend the SEC s views discussed in SAB 107 regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS No. 123R. We will continue to use the simplified method until we have the historical data necessary to provide a reasonable estimate of expected life in accordance with SAB 107, as amended by SAB 110. Key assumptions used in determining the fair value of stock options granted in 2008 were: expected term of 6.4 years; risk-free interest rate of 3.27%; dividend yield of 0%; forfeiture rate of 6.7%; and volatility of 39.3%.

Recent Accounting Pronouncements

In December 2007, the SEC issued SAB 110 to amend the SEC s views discussed in SAB 107 regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS No. 123R. We will continue to use the simplified method until we have the historical data necessary to provide a reasonable estimate of expected life in accordance with SAB 107, as amended by SAB 110.

In December 2007, the FASB issued SFAS No. 141R, which requires companies to, among other things, recognize the assets acquired, liabilities assumed, including contractual contingencies, and contingent consideration at fair value on the date of acquisition. SFAS 141R also requires that acquisition-related expenses be expensed as incurred, restructuring costs be expensed in periods subsequent to the acquisition date, and changes in accounting for deferred income tax asset valuation allowances and acquired income tax uncertainties after the measurement period be included in income tax expense. SFAS 141R will be effective on January 1, 2009 and will change our accounting for business combinations upon adoption. We are currently assessing the impact that the adoption of SFAS 141R will have on our consolidated financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133 (SFAS 161). SFAS 161 requires enhanced disclosures about derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. As SFAS 161 specifically relates to disclosures regarding derivative and hedging activities, it will not impact our consolidated financial position, results of operations or cash flows.

Segment Reporting

Over 95% of our operations are conducted in the U.S. During 2004, we acquired a recycled OEM products business with locations in Guatemala and Costa Rica. In May and July 2007, we acquired two recycled OEM products businesses located in Canada. Keystone has bumper refurbishing operations in Mexico and two aftermarket products businesses in Canada. Revenue generated and properties located outside of the U.S. are not material. We manage our operations geographically. During the third quarter of 2008, we commenced a reorganization of our vehicle replacement products operations into ten operating segments, combining our wholesale recycled OEM products and aftermarket products on a geographic basis, with a separate operating segment for our self-service retail OEM products and one for our refurbishing operations. 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. Our vehicle replacement products operations account for over 94% of our revenue, earnings, and assets.

Results of Operations

The following table sets forth statement of operations data as a percentage of total revenue for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Statement of Operations Data:				
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	56.0%	55.5%	55.1%	55.0%
Gross margin	44.0%	44.5%	44.9%	45.0%
Facility and warehouse expenses	9.9%	10.8%	9.3%	10.7%
Distribution expenses	9.5%	9.8%	9.3%	9.6%
Selling, general and administrative expenses	12.4%	12.0%	12.7%	12.1%
Restructuring expenses	0.5%		0.5%	
Depreciation and amortization	1.5%	1.5%	1.5%	1.5%
Operating income	10.2%	10.5%	11.6%	11.2%
Other expense, net	1.7%	0.7%	1.8%	0.7%
Income before provision for income taxes	8.5%	9.8%	9.8%	10.5%
Net income	5.1%	6.0%	5.9%	6.2%

Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007

Revenue. Our revenue increased 101.5% to $490.7 million for the three month period ended September 30, 2008, from $243.5 million for the comparable period of 2007. The increase in revenue was primarily due to business acquisitions, in particular Keystone. In addition, our operations other than Keystone had a higher volume of product sales in the third quarter of 2008 compared to the same period in the prior year. Also, we processed a higher volume of vehicles in the period, which resulted in higher revenue from processing fees and from the sale of scrap and other commodities derived from the dismantling process. Since the October 2007 acquisition of Keystone, we have been integrating the sale and distribution of our pre-existing aftermarket, wheel and reconditioned light product offerings with Keystone and with our recycled parts in more locations in order to provide a wider selection of products to our customers. Organic revenue growth was approximately 12.4% in the three month period ended September 30, 2008, and was calculated assuming we had owned Keystone in the three month period ended September 30, 2007. The integration of our pre-existing aftermarket and wheel operations with Keystone prevents us from measuring revenue growth between Keystone and our pre-existing businesses since the acquisition.

Cost of Goods Sold. Our cost of goods sold increased 103.5% to $274.8 million in the three month period ended September 30, 2008, from $135.0 million in the comparable period of 2007. The increase in cost of goods sold was primarily due to increased volume of products sold. Our acquisition of Keystone accounted for a majority of the increase. As a percentage of revenue, cost of goods sold increased from 55.5% to 56.0%. This increase as a percentage of revenue was primarily due to higher sales volumes of aftermarket products that traditionally have seasonally weaker margins during the summer.

Gross Margin. Our gross margin increased 99.1% to $215.9 million in the three month period ended September 30, 2008, from $108.5 million in the comparable period of 2007. Our gross margin increased primarily due to increased volume. As a percentage of revenue, gross margin decreased from 44.5% to 44.0%. Our gross margin as a percentage of revenue decreased due primarily to the factors noted above in *Cost of Goods Sold*.

Facility and Warehouse Expenses. Facility and warehouse expenses increased 85.1% to $48.5 million in the three month period ended September 30, 2008, from $26.2 million in the comparable period of 2007. Our facility and warehouse expenses increased primarily due to $10.7 million in higher wages and fringe benefits resulting from increased headcount and stock option expenses for field personnel and $9.5 million related to higher facility and equipment rent, property taxes, repairs and maintenance, utilities and supplies. Our acquisition of Keystone accounted for a majority of the increase, while our acquisition of Pick Your Part Auto Wrecking in August 2008 contributed $3.7 million to the increase. As a percentage of revenue, facility and warehouse expenses decreased from 10.8% to 9.9%, as we achieved greater leverage from combining Keystone with our existing LKQ operations.

Distribution Expenses. Distribution expenses increased 95.9% to $46.6 million in the three month period ended September 30, 2008, from $23.8 million in the comparable period of 2007. Our distribution expenses increased primarily due to $10.6 million of higher wage and benefit costs from an increase in the number of employees, higher fuel costs of $5.7 million, higher truck rentals and repairs of $2.7 million, and higher third party freight of $2.4 million. Our acquisition of Keystone accounted for the majority of the increases. As a percentage of revenue, our distribution expenses decreased from 9.8% to 9.5%. This reduction is primarily attributable to lower employee costs as a percentage of revenue resulting from combining Keystone with our existing LKQ operations, partially offset by higher fuel costs.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses increased 109.3% to $60.9 million in the three month period ended September 30, 2008, from $29.1 million in the comparable period of 2007. The majority of the expense increase was a result of an increase in labor and labor-related expenses of $21.8 million due primarily to higher sales commission expenses and increased headcount. Our selling expenses tend to rise as revenue increases due to our commissioned sales forces. Our remaining selling, general and administrative expenses increased due primarily to higher professional fees of $2.1 million, higher telephone expense of $1.6 million, higher bad debt expense of $1.0 million, and higher advertising and promotion of $1.6 million. Our acquisition of Keystone accounted for a majority of the increases. As a percentage of revenue our selling, general, and administrative expenses increased from 12.0% to 12.4%. This increase as a percentage of revenue is primarily attributable to the mix of product sales. Aftermarket products, which became a larger portion of our business with the Keystone acquisition, have higher selling costs as a percentage of revenue than our recycled products.

Restructuring Expenses. Restructuring expenses totaled $2.4 million in the three month period ended September 30, 2008. We had no restructuring expenses in the comparable period of 2007. The restructuring expenses are the result of our integration of Keystone and pre-existing LKQ operations, and include LKQ facility closure costs and moving expenses of $1.4 million, professional fees of $0.6 million and $0.4 million of severance, relocation and other costs for LKQ employees.

Depreciation and Amortization. Depreciation and amortization (including that reported in cost of goods sold above) increased 111.4% to $8.2 million in the three month period ended September 30, 2008, from $3.9 million in the comparable period of 2007. Our acquisition of Keystone accounted for the majority of the increase in depreciation and amortization expense, including $0.9 million of amortization of the Keystone trade name.

Operating Income. Operating income increased 95.2% to $50.0 million in the three month period ended September 30, 2008 from $25.6 million in the comparable period of 2007. As a percentage of revenue, operating income decreased from 10.5% to 10.2%. Operating income for the three month period ended September 30, 2008 included a 0.5% reduction from restructuring expenses.

Other (Income) Expense. Total other expense, net increased 362.1% to $8.2 million for the three month period ended September 30, 2008, from $1.8 million for the comparable period of 2007. Net interest expense increased 265.6% to $8.2 million for the three month period ended September 30, 2008, from $2.2 million for the comparable period of 2007. Our average bank borrowings were approximately $500.0 million higher at September 30, 2008 as compared to September 30, 2007, due primarily to the Keystone acquisition. Other income decreased $0.5 million to $0.0 million in the three month period ended September 30, 2008. Included in other income in the three month period ended September 30, 2007 is approximately $0.4 million of proceeds recognized from a corporate-owned life insurance policy. We use corporate-owned life insurance policies to fund our obligations under our nonqualified deferred compensation plan. As a percentage of revenue, net other expense increased from 0.7% to 1.7%.

Provision for Income Taxes. The provision for income taxes increased 80.3% to $16.7 million in the three month period ended September 30, 2008, from $9.3 million in the comparable period of 2007, due primarily to improved operating results. Our effective tax rate was 40.0% in 2008 and 38.9% in 2007. The increase in our effective income tax rate in 2008 was due primarily to a valuation allowance adjustment of $0.4 million for a state net operating loss that is not expected to be realizable. Additionally, our 2007 effective rate was favorably impacted by the receipt of $0.4 million of nontaxable life insurance proceeds.

Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007

Revenue. Our revenue increased 106.0% to $1,467.0 million for the nine month period ended September 30, 2008, from $712.1 million for the comparable period of 2007. The increase in revenue was primarily due to business acquisitions, in particular Keystone. In addition, our operations other than Keystone had a higher volume of product sales in the nine month period ended September 30, 2008 compared to the same period in the prior year. Also, we processed a higher volume of vehicles in the period, which resulted in higher revenue from processing fees and from the sale of scrap and other commodities derived from the dismantling process. Organic revenue growth was approximately 11.6% in the nine month period ended September 30, 2008, and was calculated assuming we had owned Keystone since January 1, 2007. The integration of our pre-existing aftermarket and wheel operations with Keystone prevents us from measuring revenue growth between Keystone and our pre-existing businesses since the acquisition.

Cost of Goods Sold. Our cost of goods sold increased 106.4% to $808.1 million in the nine month period ended September 30, 2008, from $391.5 million in the comparable period of 2007. The increase in cost of goods sold was primarily due to increased volume of products sold. Our acquisition of Keystone accounted for a majority of the increase. As a percentage of revenue, cost of goods sold increased from 55.0% to 55.1%.

Gross Margin. Our gross margin increased 105.5% to $658.9 million in the nine month period ended September 30, 2008, from $320.6 million in the comparable period of 2007. Our gross margin increased primarily due to increased volume. As a percentage of revenue, gross margin decreased from 45.0% to 44.9%.

Facility and Warehouse Expenses. Facility and warehouse expenses increased 79.0% to $136.8 million in the nine month period ended September 30, 2008, from $76.4 million in the comparable period of 2007. Our facility and warehouse expenses increased primarily due to $29.7 million in higher wages and fringe benefits resulting from increased headcount and stock-based compensation expenses for field personnel, along with $26.0 million related to higher facility and equipment rent, property taxes, repairs and maintenance, utilities and supplies. Our acquisition of Keystone accounted for a majority of the increase. As a percentage of revenue, facility and warehouse expenses decreased from 10.7% to 9.3%, as we achieved greater leverage from combining Keystone with our existing LKQ operations.

Distribution Expenses. Distribution expenses increased 100.5% to $136.7 million in the nine month period ended

September 30, 2008, from $68.2 million in the comparable period of 2007. Our distribution expenses increased due to higher wages and fringe benefits of $32.1 million primarily from an increase in the number of employees, and higher fuel costs of $16.6 million, higher truck rentals and repairs of $8.7 million, and higher third party freight of $7.2 million. Our acquisition of Keystone accounted for a majority of the increases. As a percentage of revenue, our distribution expenses decreased from 9.6% to 9.3%. This reduction is primarily attributable to lower employee costs as a percentage of revenue resulting from combining Keystone with our existing LKQ operations, partially offset by higher fuel costs.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses increased 117.3% to $186.8 million in the nine month period ended September 30, 2008, from $86.0 million in the comparable period of 2007. The majority of the expense increase was a result of an increase in labor and labor-related expenses of $71.0 million due primarily to higher sales commission expenses and increased headcount. Our selling expenses tend to rise as revenue increases due to our commissioned sales forces. Our remaining selling, general and administrative expenses increased due primarily to higher professional fees of $6.7 million, higher telephone expense of $4.7 million, higher travel and related expenses of $3.6 million, higher bad debt expense of $3.1 million, and higher advertising and promotion of $4.0 million. Our acquisition of Keystone accounted for a majority of the increases. As a percentage of revenue our selling, general, and administrative expenses increased from 12.1% to 12.7%. This increase as a percentage of revenue is primarily attributable to the mix of product sales. Aftermarket products, which became a larger portion of our business with the Keystone acquisition, have higher selling costs as a percentage of revenue than our recycled products.

Restructuring Expenses. Restructuring expenses totaled $6.7 million in the nine month period ended September 30, 2008. We had no restructuring expenses in the comparable period of 2007. The restructuring expenses are the result of our integration of Keystone and pre-existing LKQ operations, and include facility closure costs and moving expenses of $4.9 million, professional fees of $0.9 million and $0.9 million of severance, relocation and other costs for LKQ employees.

Depreciation and Amortization. Depreciation and amortization (including that reported in cost of goods sold above) increased 119.5% to $24.0 million in the nine month period ended September 30, 2008, from $10.9 million in the comparable period of 2007. Our acquisition of Keystone accounted for the majority of the increase in depreciation and amortization expense, including $2.8 million of amortization of the Keystone trade name.

Operating Income. Operating income increased 113.7% to $169.9 million in the nine month period ended September 30, 2008 from $79.5 million in the comparable period of 2007. As a percentage of revenue, operating income increased from 11.2% to 11.6%. Operating income for the nine month period ended September 30, 2008 included a 0.5% reduction from restructuring expenses.

Other (Income) Expense. Total other expense, net increased 431.8% to $26.2 million for the nine month period ended September 30, 2008, from $4.9 million for the comparable period of 2007. The net interest expense component of other expense, net increased 343.4% to $26.9 million for the nine month period ended September 30, 2008, from $6.1

million for the comparable period of 2007. Our average bank borrowings were approximately $527.0 million higher for the nine month period ended September 30, 2008 as compared to the comparable period of 2007, due primarily to acquisitions. Other income was $0.7 million and $1.1 million in the nine month periods ended September 30, 2008 and 2007, respectively. Included in other income in the nine month period ended September 30, 2007 is approximately $0.9 million of proceeds recognized from corporate owned life insurance policies. We use corporate owned life insurance policies to fund our obligations under our nonqualified deferred compensation plan.

Provision for Income Taxes. The provision for income taxes increased 87.9% to $56.8 million in the nine month period ended September 30, 2008, from $30.2 million in the comparable period of 2007, due primarily to improved operating results. Our effective tax rate was 39.5% in 2008 and 40.5% in 2007. The decrease in our effective income tax rate in 2008 was due primarily to lower taxes on our Canadian operations as well as from the benefit of a state net operating loss that is now expected to be realizable. These effects were partially offset by a valuation allowance adjustment recorded in the third quarter of 2008 for a state net operating loss that is not expected to be realizable and the settlement of a state tax audit. Our 2007 effective rate was impacted negatively by the enactment of a new income tax law in a state in which we operate. We reduced certain deferred tax assets and increased our income tax provision by approximately $0.6 million in 2007 as a result of this new law.

Liquidity and Capital Resources

Our primary sources of ongoing liquidity are cash flow from our operations and our credit facility. At September 30, 2008, we had $97.7 million in cash and cash equivalents and approximately $78.0 million available under our bank credit agreement ($115 million commitment less outstanding letters of credit of $22 million and excluding a $15 million commitment from Lehman Brothers Commercial Paper Inc. that is unlikely to be honored, as described below). On September 25, 2007, we completed a public offering of 27.6 million shares of our common stock, with 23.6 million shares sold by us and 4.0 million shares sold by selling stockholders. We received approximately $349.5 million in net proceeds from the offering, after deducting the underwriting discount and expenses of the offering. We paid all amounts outstanding under our revolving credit facility at that time and temporarily invested the remaining proceeds in cash equivalents pending the acquisition of Keystone on October 12, 2007.

We obtained a senior secured debt financing facility (Credit Agreement) from Lehman Brothers Inc. (Lehman) and Deutsche Bank Securities, Inc. (Deutsche Bank) on October 12, 2007, which was amended on October 26, 2007. The Credit Agreement has a six year term and includes a $610 million term loan, a $40 million Canadian currency term loan, a $100 million U.S.

dollar revolving credit facility, and a $15 million dual currency facility for drawings of either U.S. dollars or Canadian dollars. The Credit Agreement also provides for (i) the issuance of letters of credit of up to $35 million in U.S. dollars and up to $10 million in either U.S. or Canadian dollars, (ii) for a swing line credit facility of $25 million under the $100 million revolving credit facility, and (iii) the opportunity for us to add additional term loan facilities and/or increase the $100 million revolving credit facility s commitments, provided that such additions or increases do not exceed $150 million in the aggregate and provided further that no existing lender is required to make its pro rata share of any such additions or increases without its consent. Amounts under each term loan facility are due and payable in quarterly installments of increasing amounts that began in the first quarter of 2008, with the balance payable in full on October 12, 2013. Amounts due under each revolving credit facility will be due and payable on October 12, 2013. We are also required to prepay the term loan facilities upon the sale of certain assets, upon the incurrence of certain debt, upon receipt of certain insurance and condemnation proceeds, and with up to 50% of our excess cash flow, with the amount of such excess cash flow determined based upon our total leverage ratio.

Lehman Brothers Holdings Inc. and Lehman Commercial Paper Inc. (LCP) filed for protection under Chapter 11 of the Federal Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York on September 15, 2008 and October 5, 2008, respectively. LCP is the administrative agent under our Credit Agreement and had committed to provide $15 million under the revolving credit facility that is a part of our Credit Agreement. Our ability to draw on that $15 million is uncertain as a result of the bankruptcy filing. LCP is also our swing line lender and in such capacity had committed to provide same day borrowing of swing line loans as part of our revolving credit facility. We have not borrowed any amounts under any swing line loans. Our ability to access this short term borrowing is uncertain as a result of the bankruptcy filing. However, we do not believe that any 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.

The Credit Agreement contains customary representations and warranties, and contains customary covenants that restrict our ability to, among other things (i) incur liens, (ii) incur any indebtedness (including guarantees or other contingent obligations), and (iii) engage in mergers and consolidations. The Credit Agreement also requires us to meet certain financial covenants, including compliance with the required senior secured debt ratio. We were in compliance with all restrictive covenants as of September 30, 2008.

Borrowings under the Credit Agreement accrue interest at variable rates, which depend on the type (U.S. dollar or Canadian dollar) and duration of the borrowing, plus an applicable margin rate. The weighted-average interest rates on borrowings outstanding against the Company s senior secured credit facility at September 30, 2008 (after giving effect to the interest rate swap contracts in force, described in Item 3 of this Quarterly Report on Form 10-Q) and December 31, 2007 were 4.91% and 7.53%, respectively, before debt issuance cost amortization. Borrowings against the senior secured credit facility totaled $640.1 million and $650.3 million at September 30, 2008 and December 31, 2007, respectively, of which $17.4 million and $10.0 million are classified as current maturities, respectively.

Our liquidity needs are primarily to fund working capital requirements and expand our facilities and network. The procurement of inventory is the largest operating use of our funds. We normally pay for salvage vehicles acquired at salvage auctions and under some direct procurement arrangements at the time that we take possession of the vehicles. We normally pay for aftermarket parts purchases at the time of shipment or on standard payment terms, depending on the manufacturer and payment options offered. Wheel cores acquired from third parties are normally paid for on standard payment terms. We acquired approximately 34,900 and 106,600 wholesale salvage vehicles in the three month and nine month periods ended September 30, 2008, respectively, and 28,600 and 93,200 in the comparable periods of 2007, respectively. In addition, we acquired approximately 88,500 and 219,100 lower cost self-service and crush only vehicles in the three month and nine month periods ended September 30, 2008, respectively, and 48,400 and 145,700 in the comparable periods of 2007, respectively. Our purchases of aftermarket parts and wheels totaled approximately $117.3 million and $366.4 million in the three month and nine month periods ended September 30, 2008, respectively, and $25.0 million and $78.6 million in the comparable periods of 2007, respectively, with the increase principally due to our acquisition of Keystone.

We intend to continue to evaluate markets for potential growth through the internal development of redistribution centers, processing facilities, and warehouses, through further integration of aftermarket, refurbished and recycled OEM product facilities, and through selected business acquisitions. Our future liquidity and capital requirements will depend upon numerous factors, including the costs and timing of our internal development efforts and the success of those efforts, the costs and timing of expansion of our sales and marketing activities, and the costs and timing of future business acquisitions.

Net cash provided by operating activities totaled $105.3 million for the nine month period ended September 30, 2008, compared to $31.5 million for the same period of 2007. Net income adjusted for non-cash items generated $126.7 million of cash in 2008, a $64.5 million increase over the same period of 2007. Working capital uses of cash, net of effects of purchase acquisitions, included increases in receivables and inventory, and decreases in accounts payable and other operating assets and liabilities, partially offset by a net cash inflow from income taxes. Receivables increased primarily due to increased revenue. Inventory increased primarily due to increases in salvage inventory as we took advantage of favorable supplies at the salvage auctions, partially offset by a reduction in aftermarket inventory due primarily to seasonal fluctuations and the consolidation of LKQ s former aftermarket operations with Keystone s. Accounts payable decreased primarily due to accelerating some of Keystone s vendor payments in order to take advantage of discounts offered for earlier payment. Other operating assets and liabilities reduced cash primarily due to payments for severance. Income taxes represented a cash inflow in 2008 as the current provision exceeded estimated tax payments due for 2008.

Net cash used in investing activities totaled $80.5 million for the nine month period ended September 30, 2008, compared to $87.3 million for the same period of 2007. We invested $41.6 million of cash in four acquisitions in 2008 compared to $55.7 million for eight acquisitions in the comparable period of 2007. Net property and equipment and other long term asset purchases increased $14.5 million in 2008. Purchases of investment securities totaled $5.9 million in 2007 related to acquisitions of shares of Keystone Automotive Industries, Inc. prior to our acquisition of that company in October 2007.

Net cash used in financing activities totaled $1.0 million for the nine month period ended September 30, 2008, compared to $277.0 million provided by financing activities for the same period of 2007, which resulted primarily from the sale of common stock in September 2007. Exercises of stock options provided $4.7 million and $8.3 million in the nine month periods ended September 30, 2008 and 2007, respectively. The excess tax benefit from share-based payment arrangements reduced income taxes payable by $8.2 million and $12.2 million in the nine month periods ended September 30, 2008 and 2007, respectively. Repayments of long-term debt obligations and line of credit borrowings totaled $13.7 million in 2008 and $91.7 million in 2007. In the first quarter of 2007, we repurchased and retired 100,000 shares of redeemable common stock for $1.1 million pursuant to a call option that was issued in connection with a 2003 business acquisition.

We may in the future borrow additional amounts under our credit facility or enter into new or additional borrowing arrangements. We anticipate that any proceeds from such new or additional borrowing arrangements will be used for general corporate purposes, including to develop and acquire businesses and operating facilities; to further the integration of our aftermarket, refurbishing and recycled OEM product facilities; to expand and improve existing facilities; to purchase property, equipment, and inventory; and for working capital.

We estimate that our capital expenditures for the full year 2008, excluding business acquisitions, will be approximately $65.0 million to $70.0 million. We expect to use these funds for several major facility expansions, purchases of machinery and equipment, improvement of current facilities, real estate acquisitions and systems development projects. We anticipate that net cash provided by operating activities for 2008 will be in excess of $100.0 million.

We believe that our current cash and equivalents, cash provided by operating activities, and funds available under our credit facility will be sufficient to meet our current operating and capital requirements. However, we may, from time to time, raise additional funds through public or private financing, strategic relationships, or other arrangements. There can be no assurance that additional funding, or refinancing of our credit facility, if needed, will be available on terms attractive to us, or at all. Furthermore, any additional equity financing may be dilutive to existing stockholders, and debt financing, if available, may involve restrictive covenants in addition to those to which we are subject under our current credit facility. Our failure to raise capital if and when needed could have a material adverse impact on our business, operating results, and financial condition.

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes forward-looking statements. Words such as may, will, plan, should, expect, anticipate, be 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, those described under Risk Factors in Item 1A of our 2007 Annual Report on Form 10-K, filed with the SEC on February 29, 2008, and the updates to Item 1A included in Part II of our Quarterly Reports on Form 10-Q filed subsequently.

Other matters set forth in this Quarterly 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 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 Quarterly 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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our results of operations are exposed to changes in interest rates primarily with respect to borrowings under our credit facility, where interest rates are tied to either the prime rate or LIBOR. In March 2008, we implemented a policy to manage our exposure to variable interest rates on a portion of our outstanding variable rate debt instruments through the use of interest rate swap contracts. These contracts convert a portion of our variable rate debt to fixed rate, matching effective and maturity dates to specific debt instruments. All of our interest rate swap contracts have been executed with banks that we believe are creditworthy and are denominated in currency that matches the underlying debt instrument. Net interest payments or receipts from interest rate swap contracts will be included as adjustments to interest expense in our consolidated income statement. As of September 30, 2008, three interest rate swap contracts representing a total of $500 million of notional amount were outstanding with maturity dates through April 2011. All of these contracts are designated as cash flow hedges and modify the variable rate nature of that portion of our variable rate debt. The fair market value of our outstanding interest rate swap contracts at September 30, 2008 was approximately $7.8 million, and the value of such contracts is subject to changes in interest rates.

At September 30, 2008, we had unhedged variable rate debt of $140.1 million. Using sensitivity analysis to measure the impact of a 100 basis point movement in the interest rate, interest expense would change by $1.4 million annually.

We are also exposed to market risk related to price fluctuations in scrap metal and other precious metals such as platinum, palladium and rhodium. Market prices of these metals affect the amount that we pay for our inventory as well as the revenue that we generate from sales of these metals. As both our revenue and costs are affected by the price fluctuations, we have a natural hedge against the changes. However, there is typically a lag between the metal price fluctuations, which influence our revenue, and any inventory cost changes. Therefore, we can experience positive or negative margin effects in periods of rising or falling metal prices, particularly when such prices move rapidly. Subsequent to September 30, 2008, scrap and other precious metal prices have fallen significantly which will have a negative effect on our margins in the fourth quarter until inventory costs normalize at the lower price point.

Additionally, we are exposed to currency fluctuations with respect to the purchase of aftermarket parts in Taiwan. While all transactions with manufacturers based in Taiwan are conducted in U.S. dollars, changes in the relationship between the U.S. dollar and the Taiwan dollar might impact the purchase price of aftermarket parts. We might not be able to pass on any price increases to customers. Under our present policies, we do not attempt to hedge this currency exchange rate exposure.

Our investment in our operations in Central America and Canada are not material, and we do not attempt to hedge our foreign currency risk related to such operations.

Item 4. Controls and Procedures

As of September 30, 2008, the end of the period covered by this report on Form 10-Q, an evaluation was carried out under the supervision and with the participation of LKQ Corporation s management, including our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective to ensure that we are able to collect, process and disclose the information we are required to disclose in the reports we file with the Securities and Exchange Commission within the required time periods. There has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties that could adversely affect our business, financial condition and results of operations, and the trading price of our common stock. Please refer to our annual report on Form 10-K for fiscal year 2007 and our quarterly reports on Form 10-Q filed subsequent to the 10-K, for information concerning risks and uncertainties that could negatively impact us. The following items are changes and additions to the risks and uncertainties previously disclosed in such reports.

Fluctuations in the prices of scrap 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 other companies, including OEMs, which we dismantle and which generate scrap 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. 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.

Item 6. Exhibits

Exhibits

Exhibit Number	Description of Exhibit
10.1	LKQ Corporation Employees Retirement Plan, as amended and restated as of September 1, 2008.
10.2	Amendment No. 1 dated October 23, 2008 to LKQ Corporation Employees Retirement Plan, as amended and restated as of September 1, 2008.
10.3	ISDA 2002 Master Agreement between Deutsche Bank AG and LKQ Corporation, and related schedule.
10.4	Stock Purchase Agreement dated as of August 15, 2008, among LKQ Corporation, Glenn C. McElroy, Phillip B. McElroy, Thomas C. Hutton, John L. Neu, Robert T. Neu and Jeffrey P. Neu, and Pick-U-Part Auto Wrecking (incorporated herein by reference to Exhibit 10.1 to the Company s report on Form 8-K filed with the SEC on August 21, 2008).
10.5	LKQ Corporation Amended and Restated Stock Option and Compensation Plan for Non-Employee Directors, as further amended on November 5, 2008.
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 7, 2008.

LKQ CORPORATION

/s/ Mark T. Spears
Mark T. Spears
Executive Vice President and Chief Financial Officer
(As duly authorized officer and Principal Financial Officer)

/s/ Frank P. Erlain
Frank P. Erlain
Vice President Finance and Controller
(As duly authorized officer and Principal Accounting Officer)