LKQ CORP
Form 10-Q
July 30, 2010

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 June 30, 2010

OR

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

For the Transition Period from to

Commission File Number: 000-50404

LKQ CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

At July 23, 2010, the registrant had issued and outstanding an aggregate of 143,155,166 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)

	June 30, 2010	December 31, 2009
Assets		
Current Assets:		
Cash and equivalents	$ 190,477	$ 108,906
Receivables, net	155,339	152,443
Inventory	412,507	385,686
Deferred income taxes	30,027	31,847
Prepaid income taxes		4,663
Prepaid expenses	12,183	9,603
Assets of discontinued operations		9,720
Total Current Assets	800,533	702,868
Property and Equipment, net	293,493	289,902
Intangible Assets:		
Goodwill	950,621	938,783
Other intangibles, net	65,168	67,239
Other Assets	20,927	21,329
Total Assets	$ 2,130,742	$ 2,020,121
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 52,405	$ 51,300
Accrued expenses:		
Accrued payroll-related liabilities	35,959	37,314
Self-insurance reserves	33,770	30,368
Other accrued expenses	25,004	26,345
Income taxes payable	8,816	
Deferred revenue	9,555	9,259
Current portion of long-term obligations	27,080	10,063
Liabilities of discontinued operations	3,061	3,832
Total Current Liabilities	195,650	168,481
Long-Term Obligations, Excluding Current Portion	567,324	592,982
Deferred Income Tax Liabilities	52,830	52,209
Other Noncurrent Liabilities	25,040	27,015
Commitments and Contingencies		
Stockholders Equity:		
Common stock, $0.01 par value, 500,000,000 shares authorized, 143,128,064 and 142,004,797 shares issued and outstanding at June 30, 2010 and December 31, 2009, respectively	1,431	1,420
Additional paid-in capital	832,142	815,952
Retained earnings	461,301	369,459

Accumulated other comprehensive loss	(4,976)	(7,397)
Total Stockholders Equity	1,289,898	1,179,434
Total Liabilities and Stockholders Equity	$ 2,130,742	$ 2,020,121

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 June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Revenue	$ 584,681	$ 486,355	$ 1,188,197	$ 997,225
Cost of goods sold	323,415	266,107	643,641	547,406
Gross margin	261,266	220,248	544,556	449,819
Facility and warehouse expenses	55,358	47,835	113,134	96,764
Distribution expenses	51,168	42,732	102,357	87,004
Selling, general and administrative expenses	75,679	66,423	150,766	132,795
Restructuring expenses	290	255	370	1,058
Depreciation and amortization	9,162	8,246	18,391	16,520
Operating income	69,609	54,757	159,538	115,678
Other expense (income):				
Interest expense, net	7,155	7,724	14,431	15,302
Other income, net	(138)	(106)	(299)	(147)
Total other expense, net	7,017	7,618	14,132	15,155
Income from continuing operations before provision for income taxes	62,592	47,139	145,406	100,523
Provision for income taxes	24,686	18,684	55,517	40,050
Income from continuing operations	37,906	28,455	89,889	60,473
Discontinued operations:				
Income from discontinued operations, net of taxes		402	224	688
Gain on sale of discontinued operations, net of taxes			1,729	
Income from discontinued operations		402	1,953	688
Net income	$ 37,906	$ 28,857	$ 91,842	$ 61,161
Basic earnings per share [(a)]				
Income from continuing operations	$ 0.27	$ 0.20	$ 0.63	$ 0.43
Income from discontinued operations		0.00	0.01	0.00
Total	$ 0.27	$ 0.21	$ 0.64	$ 0.44
Diluted earnings per share [(a)]				
Income from continuing operations	$ 0.26	$ 0.20	$ 0.62	$ 0.42
Income from discontinued operations		0.00	0.01	0.00
Total	$ 0.26	$ 0.20	$ 0.63	$ 0.43
Weighted average common shares outstanding:				
Basic	142,842	140,223	142,520	140,009
Diluted	145,496	143,500	145,307	143,317

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

See notes to unaudited consolidated condensed financial statements.

LKQ CORPORATION AND SUBSIDIARIES

Unaudited Consolidated Condensed Statements of Cash Flows

(In thousands)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 91,842	$ 61,161
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,011	18,589
Stock-based compensation expense	5,112	3,578
Deferred income taxes	(1,097)	1,483
Excess tax benefit from share-based payments	(5,953)	(2,696)
Gain on sale of discontinued operations	(2,744)	
Other	1,376	1,393
Changes in operating assets and liabilities, net of effects from acquisitions and divestitures:		
Receivables	(1,484)	10,585
Inventory	(24,672)	(16,709)
Prepaid income taxes/income taxes payable	18,223	19,397
Accounts payable	(393)	(7,110)
Other operating assets and liabilities	970	(2,632)
Net cash provided by operating activities	101,191	87,039
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(20,847)	(18,584)
Proceeds from sales of property and equipment	236	839
Proceeds from sale of businesses, net of cash sold	11,992	
Cash used in acquisitions, net of cash acquired	(13,742)	(15,952)
Net cash used in investing activities	(22,361)	(33,697)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	5,136	2,744
Excess tax benefit from share-based payments	5,953	2,696
Repayments of long-term debt	(8,581)	(11,160)
Borrowings under line of credit		2,310
Net cash provided by (used in) financing activities	2,508	(3,410)
Effect of exchange rate changes on cash and equivalents	233	469
Net increase in cash and equivalents	81,571	50,401
Cash and equivalents, beginning of period	108,906	79,067
Cash and equivalents, end of period	$ 190,477	$ 129,468
Supplemental disclosure of cash flow information:		
Notes issued in connection with business acquisitions	$ 381	$ 729
Cash paid for income taxes, net of refunds	39,697	19,438
Cash paid for interest	14,071	14,898
Property and equipment purchases not yet paid	139	868

See notes to unaudited consolidated condensed financial statements.

LKQ CORPORATION AND SUBSIDIARIES

Unaudited Consolidated Condensed Statements of Stockholders Equity and Other Comprehensive Income

(In thousands)

	Common Stock Shares Issued	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
BALANCE, December 31, 2009	142,005	$ 1,420	$ 815,952	$ 369,459	$ (7,397)	$ 1,179,434
Net income				91,842		91,842
Net reduction of unrealized loss on fair value of interest rate swap agreements, net of tax of $1,661					2,953	2,953
Foreign currency translation					(532)	(532)
Total comprehensive income						94,263
Stock issued as director compensation	7		145			145
Stock-based compensation expense			4,967			4,967
Exercise of stock options	1,116	11	5,125			5,136
Excess tax benefit from share-based payments			5,953			5,953
BALANCE, June 30, 2010	143,128	$ 1,431	$ 832,142	$ 461,301	$ (4,976)	$ 1,289,898

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.

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 Annual Report on Form 10-K for the year ended December 31, 2009 filed with the SEC on February 26, 2010.

As described in Note 3, Discontinued Operations, during the fourth quarter of 2009, we sold, agreed to sell or closed certain of our self service facilities. These facilities qualified for treatment as discontinued operations. The financial results and assets and liabilities of these facilities are segregated from our continuing operations and presented as discontinued operations in the unaudited consolidated condensed balance sheets and unaudited consolidated condensed statements of income for all periods presented.

Note 2. Financial Statement Information

Revenue Recognition

The majority of our revenue is derived from the sale of recycled and aftermarket products. Revenue is recognized when the products are shipped or picked up by customers 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 $15.0 million and $15.8 million at June 30, 2010 and December 31, 2009, respectively. We present taxes assessed by governmental authorities collected from customers on a net basis. Therefore, the taxes are excluded from revenue and are shown as a liability on our unaudited consolidated condensed balance sheets until remitted. Revenue from the sale of separately-priced extended warranty contracts is reported as deferred revenue and recognized ratably over the term of the contracts or three years in the case of lifetime warranties.

Receivables

We have recorded a reserve for uncollectible accounts of approximately $6.4 million and $6.5 million at June 30, 2010 and December 31, 2009, respectively.

Inventory

Inventory consists of the following (in thousands):

	June 30, 2010	December 31, 2009
Salvage products	$ 181,983	$ 152,438
Aftermarket and refurbished products	224,584	226,299
Core facilities inventory	5,940	6,949
	$ 412,507	$ 385,686

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

Intangibles

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

The change in the carrying amount of goodwill during the six months ended June 30, 2010 is as follows (in thousands):

Balance as of December 31, 2009	$ 938,783
Business acquisitions	12,568
Exchange rate effects	(730)
Balance as of June 30, 2010	$ 950,621

Other intangible assets totaled approximately $65.2 million and $67.2 million, net of accumulated amortization of $11.3 million and $9.2 million, at June 30, 2010 and December 31, 2009, respectively. Amortization expense was approximately $2.1 million during each of the six months ended June 30, 2010 and 2009. Estimated annual amortization expense is approximately $4.0 million for each of the years 2010 through 2014.

Depreciation Expense

Included in cost of goods sold on the unaudited consolidated condensed statements of income 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. The changes in the warranty reserve during the six months ended June 30, 2010 were as follows (in thousands):

Balance as of January 1, 2010	$ 604
Warranty expense	3,515
Warranty claims	(3,374)
Balance as of June 30, 2010	$ 745

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

Stock-Based Compensation

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

	Six Months Ended June 30,	
	2010	2009
Expected life (in years)	6.4	6.3
Risk-free interest rate	3.18%	1.83%
Volatility	43.9%	44.6%
Dividend yield	0%	0%
Weighted average fair value of options granted	$ 9.54	$ 5.47

Estimated forfeitures When estimating forfeitures, we consider voluntary and involuntary termination behavior as well as analysis of historical forfeitures. For options granted in 2010, a forfeiture rate of 8.0% has been used in calculating the stock-based compensation expense for employee option grants, while a forfeiture rate of 0% has been used in calculating the stock-based compensation expense for executive officer option grants.

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Stock options	$ 2,288	$ 1,612	$ 4,514	$ 3,072
Restricted stock	228	182	453	361
Stock issued to non-employee directors	72	73	145	145
Total stock-based compensation expense	$ 2,588	$ 1,867	$ 5,112	$ 3,578

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 June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Cost of goods sold	$ 73	$ 12	$ 143	$ 23
Facility and warehouse expenses	540	684	1,067	1,304
Selling, general and administrative expenses	1,975	1,171	3,902	2,251
	2,588	1,867	5,112	3,578
Income tax benefit	(1,017)	(736)	(2,009)	(1,410)
Total stock-based compensation expense, net of tax	$ 1,571	$ 1,131	$ 3,103	$ 2,168

We have not capitalized any stock-based compensation costs during either the six months ended June 30, 2010 or 2009. As of June 30, 2010, 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 2010	$ 4,596	$ 460	$ 5,056
2011	8,366	913	9,279
2012	7,038	913	7,951
2013	4,780	208	4,988
2014	3,136	139	3,275
2015	73		73
Total unrecognized compensation expense	$ 27,989	$ 2,633	$ 30,622

Fair Value of Financial Instruments

We are required to disclose the fair value for any financial instruments carried at cost on the balance sheet.

Our debt is reflected on the balance sheet at cost. Based on current market conditions, our interest rate margins are below the rate available in the market, which causes the fair value of our debt to fall below the carrying value. The fair value of our term loans (see Note 5, Long-Term Obligations) is approximately $570 million at June 30, 2010, as compared to the carrying value of $587.8 million. We estimated the fair value of our term loans by calculating the upfront cash payment a market participant would require to assume our obligations. The upfront cash payment, excluding any issuance costs, is the amount that a market participant would be able to lend at June 30, 2010 to an entity with a credit rating similar to ours and achieve sufficient cash inflows to cover the scheduled cash outflows under our term loans. The carrying amounts of our cash and equivalents, net trade receivables and accounts payable approximate fair value.

We apply the market and income approaches to value our financial assets and liabilities, which include the cash surrender value of life insurance, deferred compensation liabilities and interest rate swaps. Required fair value disclosures are included in Note 7, Fair Value Measurements.

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

Segments

Our vehicle replacement products operations are organized into three operating segments, composed of wholesale recycled and aftermarket products, self service recycled products, and recycled heavy-duty truck products. These segments are aggregated into one reportable segment because they possess similar economic characteristics and have common products and services, customers and methods of distribution.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Recycled and related products and services	$ 214,159	$ 183,033	$ 429,382	$ 367,558
Aftermarket, other new and refurbished products	290,271	260,632	602,644	542,283
Other	80,251	42,690	156,171	87,384
	$ 584,681	$ 486,355	$ 1,188,197	$ 997,225

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

Note 3. Discontinued Operations

On October 1, 2009, we sold to Schnitzer Steel Industries, Inc. (SSI) four self service retail facilities in Oregon and Washington and certain business assets related to two self service facilities in Northern California and a self service facility in Portland, Oregon for $17.5 million, net of cash sold. We recognized a gain on the sale of approximately $2.5 million, net of tax, in our fourth quarter 2009 results. Goodwill totaling $9.9 million was included in the cost basis of net assets disposed when determining the gain on sale. In the fourth quarter of 2009, we closed the two self service facilities in Northern California and converted the self service operation in Portland to a wholesale recycling business.

On January 15, 2010, we also sold to SSI two self service retail facilities in Dallas, Texas for $12.0 million. We recognized a gain on the sale of approximately $1.7 million, net of tax, in our first quarter 2010 results. Goodwill totaling $6.7 million was included in the cost basis of net assets disposed when determining the gain on sale.

The self service facilities that we sold or closed are reported as discontinued operations for all periods presented. We reported these facilities in discontinued operations because the cash flows derived from the facilities were eliminated as a result of the sales or closures and we will not have continuing involvement in these facilities. A summary of the assets and liabilities applicable to discontinued operations included in the unaudited consolidated condensed balance sheets as of June 30, 2010 and December 31, 2009 is as follows (in thousands):

	June 30, 2010	**December 31, 2009**
Inventory	$	$ 1,152
Other current assets		307
Property and equipment, net		1,553
Goodwill		6,708
Total assets	$	$ 9,720
Accounts payable and accrued liabilities	$ 3,061	$ 3,832

Total liabilities	$ 3,061	$ 3,832

As of June 30, 2010, approximately $3.1 million of accrued restructuring expenses remained in liabilities of discontinued operations on our unaudited consolidated condensed balance sheets for the excess lease payments (net of estimated sublease income), and facility closure costs related to the two closed self service facilities in Northern California. The excess facility costs are expected to be paid over the remaining term of the leases through 2018.

LKQ CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

Results of operations for the discontinued operations for the three and six months ended June 30, 2010 and 2009 are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Revenue	$	$ 6,399	$ 686	$ 13,518
Income before income tax provision		638	355	1,092
Income tax provision		236	131	404
Income from discontinued operations, net of taxes, before gain on sale of discontinued operations		402	224	688
Gain on sale of discontinued operations, net of taxes of $1,015			1,729	