LKQ CORP | LKQ

INVESTMENT RESEARCH REPORT

"Cashless Clunker"

RECOMMENDATION:

Strong Sell

PRESCIENCE POINT
RESEARCH GROUP

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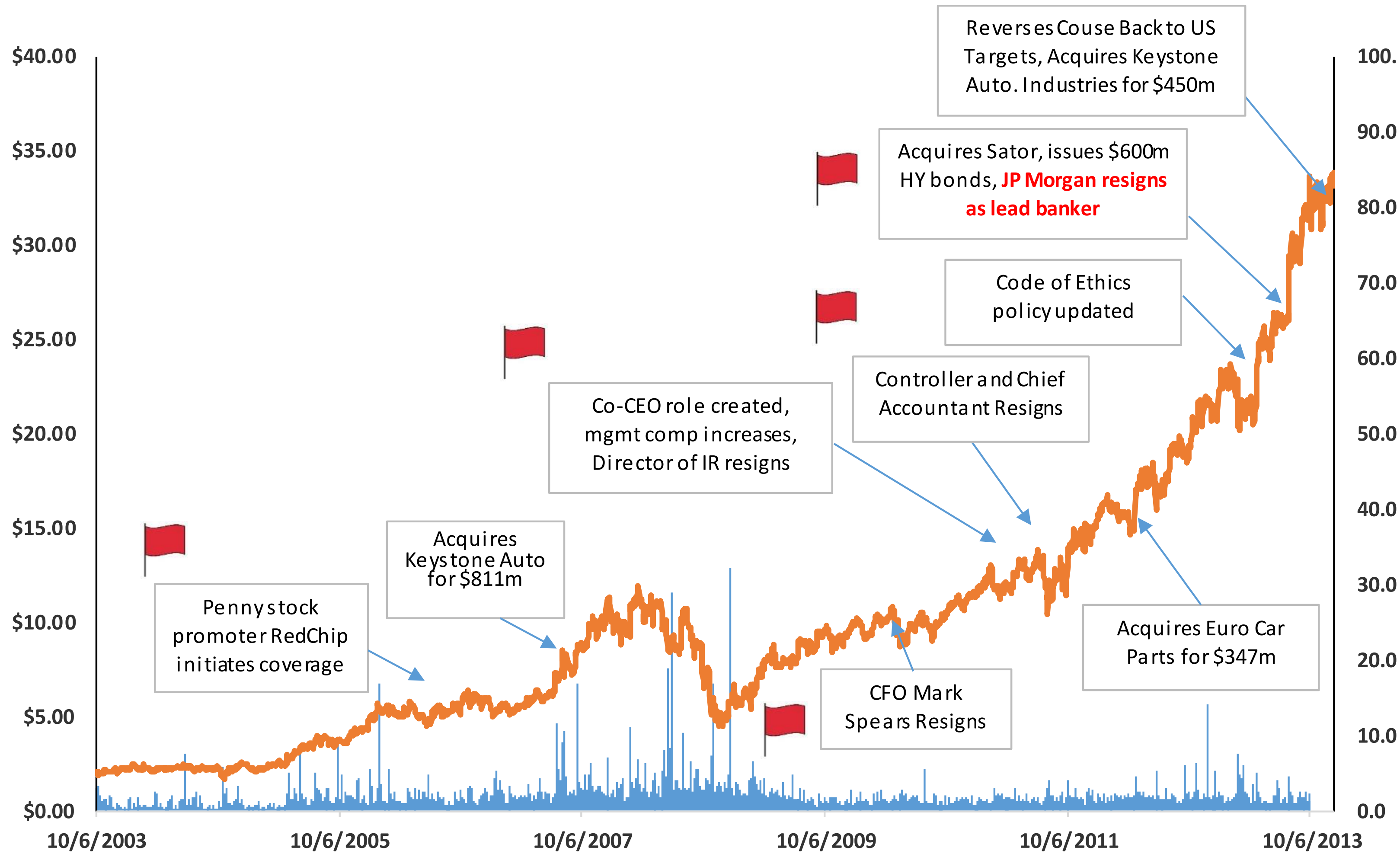
Report Highlights

From Penny Stock Promoter to $10bn+ Wall Street Darling: The Story of LKQ



PRESCIENCE POINT

Prescience Point Believes,

1 **<u>LKQ Is An Ineffective Roll-up</u>** The Company Has Generated No Cumulative Free Cash Flow Adjusted for Acquisitions and Becoming Increasingly Dependent on External Capital to Perpetuate the Illusion of GAAP Profits. LKQ Will Need Larger and Larger Targets to Keep the Growth Game Alive

2 **<u>Caught in a Massive Margin Squeeze</u>** Gross Margins Are In Persistent Decline, and Inventory Accounting Methods Are Likely Blunting the True Problems. North American Organic Growth Very Likely To Be Overstated and Not Reconcilable to Our Research

3 **<u>Problems With the New Growth Story</u>** To Divert Attention from its North American Problems, LKQ Bolted to Europe in Hopes of Spinning a New Growth Story; Our Research Suggests LKQ is Already Facing Problems and Quickly Scrambling to Cover

4 **<u>Dramatic Overvaluation</u>** to Aftermarket Auto, Recycling and Industrial Distributors, and Supported by Sell-Side Analysts' Failing to Question Assumptions, and Not Considering the Fundamental Problems Facing the Company

5 **<u>Previous Accounting Fraud and Failures</u>** at Waste Mgmt/Discovery Zone Associated With Numerous Members of the Management Team Have Cost Shareholders Billions of Lost $'s in Aggressive Roll-up Strategies

Price Target: $10 - $15 per share **>>>** 50% – 70% Downside

Report Highlights (cont'd)

High-Level Indications of Fabricated GAAP Profits, Unsustainable Business Model: LKQ is a classic roll-up, fueling growth through acquisitions. Roll-up business models provide management with a significant amount of discretion in presenting financial results. Roll-ups tend to exhibit strong earnings, CFO, and earnings quality metrics due to the inherent financial statement mechanics of paying for growth through acquisition outflows, which do not affect earnings or CFO. Because of this, *free cash flow after acquisitions* is an important metric for analyzing roll-ups; it presents a better picture of the business's economics. LKQ's free cash flow after acquisitions has been negative in 8 of the last 9 years.

Furthermore, our analysis indicates LKQ is an ineffective rollup **–** wealth creation from years of acquisitions has been nil. Since 2007, LKQ has reported cumulative Earnings and EBIT of $1.22B and $2.15B, respectively. Meanwhile, it has burned cumulative free cash flow after acquisitions of -$1.62B, and raised cumulative net capital of $1.63B, suggesting it has never earned a cash-on-cash return on invested capital. Put another way, the immense wealth generation represented by LKQ's historical GAAP profits is not observable in the company's cash flows – it appears to be 'paper' wealth generated by accounting gimmickry.

In light of this and a broad array of other red flags discussed in this report, we are forced to look through management's representations. We believe the credibility of LKQ's financial statements is questionable and that LKQ bears a heightened risk of a crippling inventory and/or goodwill write-down or financial restatement.

Reported Organic Growth for LKQ's North America Business Appears Overstated: LKQ's aggressive roll-up strategy also gives it a high level of flexibility to inflate revenue growth. LKQ reported organic revenue growth averaging ~6.5% from 2008 – 2012 and ~6% for its North America (NA) Parts & Services (P&S) business (~75% of P&S revenue), with far less variability vs comps, and not a single quarter of negative growth. LKQ does not provide clarity around the calculation or the impact on earnings, making it difficult for investors to confirm its validity. However, based on our research, LKQ's reported organic growth rate does not appear reconcilable with trends in the primary fundamental factors that drive it. We believe it is overstated. We believe LKQ's NA growth rate, normalized for a 2013 spike in collision frequency, more likely measures in the range of 0-2%.

From 2008 to 2012, annual insurance claims paid for repairable accident claims have been flat according to industry consultant The Romans Group, LLC. Additionally, from 2010 to 2012, growth in Alternative Parts Usage ("APU") (i.e., market share of alternative auto parts, which LKQ sells, relative to OEM parts), which had risen steadily for 3 decades and was a primary driver of LKQ's historical organic growth, has flat-lined; going forward, CCC Information Services – provider of the industry's dominant estimate writing platform and LKQ's source for APU data – expects it to taper or reverse. Based on industry data sources and our conversations with industry sources, this is resulting from a recent expansion in OEM price-matching programs; they have become more aggressive in pursuit of retaking lost market share by undercutting alternative parts prices, thereby negating LKQ's value proposition. Internal dealer documents we have obtained indicate the OEMs are increasingly subsidizing dealers to sell parts at levels 33% below aftermarket list prices (i.e., LKQ's price), making them whole on the loss, and paying them an additional 14% profit on the cost for the part. (Refer to dealer source document on page 12.) As a result, for the first time – according to Mitchell International – **parts prices in general deflated in 2012**. LKQ management tells investors APU rose 100bp in 2012; however, their own data source and LKQ's SEC filings refute their claim.

Report Highlights (cont'd)

Short-Term Thinking Pervades Decision-Making, Signals Desperation to Keep Financials Inflated & Meet Targets: With NA growth waning, LKQ looked to Europe for acquisition candidates. In Q4'2011, it made its 2nd largest acquisition ever, acquiring UK-based Euro Car Parts (ECP), a distributor of mechanical aftermarket parts operating out of 89 branch/store locations. As LKQ pitched investors on the open-ended growth opportunity provided by buying ECP, to our knowledge, it never publicly disclosed that the UK aftermarket parts industry was in significant contraction (2011E -5.8%, according to Datamonitor), or that it is projected to continue contracting; but, LKQ touted ECP's 30%+ 'organic' revenue growth rate from 2009-2011.

Now 2 years separated from the date of acquisition, and with its industry still weak, LKQ continues to report 30% organic growth rates for ECP, which would seem to defy logic. It shouldn't; LKQ does not define ECP's 'organic growth' in the way investors might expect for a business characterized by storefronts (i.e., as same store sales growth); it defines it to include both SSS *and* revenue generated by newly opened ECP stores. As such, LKQ's reported organic growth rate is fueled by opening new ECP branches; the more new ECP stores LKQ opens in a given period, the more it can inflate its consolidated organic growth rate.

Rapidly expanding the number of ECP branches was not an LKQ priority when it announced the acquisition, evident in guidance issued on LKQ's ECP M&A call (held on 10/4/11): "*we have a plan to grow 10 to 12 branches per year for the next few years… to complete out the major U.K. markets*." Within just a few months – apparently a direct response to NA growth weakening and the threat of a guidance miss – LKQ abandoned its plan; throughout 2012, it repeatedly raised its guidance for the number of stores to be opened in 2012, from 20, to 30, and finally to 42. By Q4'2012, based on our estimates, ECP accounted for a full 75% of consolidated P&S organic growth, up from ~4% only one year prior! In 2012, ECP also started running periodic, steep online sales promotions (30-45% discounts) of parts across the board – with many promotions implemented right at the end of the quarter, just ahead of reporting to investors, indicating an obsessive desire to meet financial estimates. The combination of a ramp-up in branch openings and steep discounting juiced LKQ's organic growth rate just enough for it to hit the low end of guidance for 2012 P&S organic growth.

LKQ has also repeatedly raised guidance for the maximum number of full-sized ECP branches the UK market can absorb, from 120 to 150 to 175 to 200, giving it further room to continue ramping the number of branch locations. At YE'2012, LKQ operated 130 branches, in only one year surpassing the store count it initially guided would result in saturation of the UK market, 120. On the Q1'2012 earnings call, LKQ CEO Wagman raised his projection for the market-saturating branch count to 150, stating that at that number, "*branches in major metropolitan areas can be* ***5 miles or so apart***" and that "*there's not necessarily cannibalization*" should they be! LKQ has since raised the ceiling on the **maximum branch count to 200**, hinting of desperation.

LKQ appears to operate ECP with the primary intent of unsustainably inflating its financials and meeting guidance targets, at the long term shareholder expense of entrenchment in a contracting market. Inevitably, as ECP reaches its market saturating location capacity, we expect – and we believe management has anticipated – its reported organic growth rate to plummet and converge to the industry average.

Report Highlights (cont'd)

Increasing Dependency on Acquisitions to Inflate Financials, Conceal Cumulative Manipulations: LKQ's gross margins have been in persistent decline, contracting from 47.1% to 41% from FY 2005 to the LTM period ended 9/30/2013. We believe the decline is in part the result of the reversal of cumulative past accounting manipulations while, at the same time, competitive and pricing pressures are intensifying; it appears that over time, LKQ's is growing increasingly dependent on ever larger acquisitions to prevent an unraveling of its financials. As previously mentioned, due to the inherent mechanics of acquisition accounting, acquisitions have a flattering, but unsustainable effect on earnings and CFO that has nothing to do with the performance of the business. When the benefit expires, a hole is left to be filled in its place just to maintain the status quo.

LKQ has been rapidly accelerating its deal making, both in quantity of deals and in dollar value. Within the past 2 years, LKQ has made 3 of 4 of its largest acquisitions ever. LKQ acquired 30 companies in 2012 alone, against the backdrop of having acquired a total of 71 companies in the 3 years from 2010-2012 and over 170 since its 1998 inception. Notably, LKQ reported a record 17 acquisitions in just Q4'12.

Yet, despite this, LKQ missed dramatically on 2012 CFO guidance, which came in 19% below revised guidance issued on 10/25/2012, only 2 months before year end. Making the most acquisitions it has ever made, in a quarter a gaping hole in CFO exposed itself indicates LKQ may be making acquisitions, as we believe, in order to inflate its financials and paper over past accounting manipulations. Management justified the miss as primarily attributable to an investment in inventory that wasn't exactly anticipated. An alternative explanation is that the cumulative deal size was insufficient to bail the company out.

We believe LKQ entered Europe in search of a fresh pool of large-scale acquisition targets. After purchasing ECP – its 2nd largest purchase ever at the time – in Q4'2011, LKQ began unsustainably juicing its organic revenue growth rate via the rabid opening of ECP stores, something completely outside of its plans for the company when it acquired the company. Because of these openings, ECP currently accounts for ~50% of LKQ's organic revenue growth. We believe as ECP branch openings slow and new stores mature, its reported organic growth rate will plummet from current levels, converging to the negative industry rate of growth and resulting in a new hole LKQ will predictably seek to plug with more acquisitions. Operating ECP as it has, with seemingly little regard for building long term value, may be an indication of desperation to keep its financials together as it searched for a larger target.

LKQ moved quickly, buying mainland European company Sator in April 2013, amounting to its 3rd largest purchase ever, at the time. As a result, its European reporting segment now includes both ECP and Sator. This new reporting will obscure future financial deterioration at ECP.

In December 2013 it acquired Keystone Automotive Operations, a company distributing a fundamentally different type of automotive product from that of its core business. The acquisition was LKQ's 2nd largest ever.

We believe management's short-term focus on managing the business to hit financial guidance is unsustainable. LKQ's increased pace of deal making, as gross margins deteriorate, are supportive of questioning the company's motives.

PRESCIENCE POINT

Report Highlights (cont'd)

Gross Margins (GMs) Appear Inflated, as Inventory Turnover is Stable: Caught in a massive margin squeeze with used auto parts prices deflating, and salvage vehicles rising, LKQ's GMs have been in persistent decline since 2005, down 590bps, while consolidated inventory turns have been relatively stable. We believe there is more deterioration in LKQ's GMs than observable on the Income Statement. We believe LKQ may pull 2 primary accounting levers to manipulate GMs and inventory turns:

1. *Aggressive Inventory Policy Enables Overstatement of Inventory* – LKQ uses an aggressive policy for accounting for its Salvage and Remanufactured Inventory that allows for a high level of discretion which management can use to inflate gross margin by leaving costs on the balance sheet in the form of overstated inventory. The recent surge in LKQ's salvage inventory coupled with gross margin deterioration is consistent with this trend and the overall concern of costs being left on the balance sheet. In isolation, this policy results in inflated gross margins and CFO, and exerts downward pressure on the rate of inventory turnover. The generally high level of Salvage & Remanufactured inventory – to which the aggressive policy applies – is a high level sign the company may be manipulating its margins. We believe LKQ is likely inflating its gross margin and earnings by failing to record a necessary expense for excess and obsolete inventory. Omissions of expensing obsolete inventories result in future margin compression.

But the surge in Salvage & Remanufactured inventory, the account subject to the aggressive inventory accounting policy, serves as a higher level sign that margins and CFO may be manipulated. How would LKQ be able to keep consolidated inventory turns from declining in the face of GM manipulation?

2. *Acquisition Accounting Enables Understatement of Acquired Inventories* – The acquisition fair market value process enables LKQ to understate the values of acquired company inventories, and to allocate the plug figure to goodwill. The result is that inventory costs, which should be future period expenses, can be instead permanently deferred. Based on conversations with a recycled auto consultant who consults recycled parts distributors that are selling to LKQ, we estimate acquired inventory values make up 33%-67% of the acquisition purchase price (adjusted for real estate). From 2003-2012, LKQ has allocated only 22.7% of the cumulative acquisition purchase price (ex PP&E) to inventory, which would be consistent with utilizing this policy. In isolation, this would result in inflated gross margins and CFO, and exert upward pressure on the rate of inventory turnover, thereby counterbalancing the downward pressure caused by increases in Salvage and Remanufactured inventory and stabilizing consolidated inventory turnover.

We believe LKQ's GMs will continue to decline through 2014 against the backdrop of intensifying pricing pressures, and as past accounting overstatements have to be reversed; we believe LKQ is at elevated risk of a crippling goodwill write-down. As of 9/30/13 LKQ carries $2.1bn of goodwill + intangibles on its balance sheet (47% of Assets / 92% of Book Equity) for a collection of industrial assets that would ordinarily sell for little premium to book value. We note that LKQ attempts to explain GMs declining as a function of rising costs to acquire salvage vehicles. However, the Manheim Index peaked in 2011 and has already started to decline. When asked for guidance on a sustainable gross margin target, LKQ still cannot give investors any clear guidance on the matter and now cites the move into Europe as a complicating factor for the decline.

Report Highlights (cont'd)

<u>LKQ's Business Strategy and Trajectory, Right out of the Waste Management Playbook</u>: LKQ was founded in 1998 by Donald Flynn, with the financial backing of Dean Buntrock and AutoNation Inc., led by Wayne Huizenga. Flynn, Buntrock, and Huizenga were all previously <u>executives of Waste Management</u>, Inc. (WM), a company notorious for having perpetrated a <u>massive, multi-year financial fraud</u>, resulting in the largest restatement in corporate history at the time.

Following a board-led probe of the company's accounting practices in 1997, WM was forced to restate its financial statements for the period 1992 – Q3'1997, acknowledging that it had misstated its pre-tax earnings by approximately $1.7 billion and took a $3.5 billion charge. The SEC charged certain executives with financial fraud. According to the SEC complaint, "*defendants fraudulently manipulated the company's financial results to meet predetermined earnings targets. The company's revenues were not growing fast enough to meet these targets, so defendants instead resorted to improperly eliminating and deferring current period expenses to inflate earnings*."

- Donald Flynn (<u>LKQ's founder</u>) was a Waste Management <u>Audit Committee member from 1994 until 1997</u> – a period at the heart of the perpetuation of the fraud –and also served as <u>Audit Committee Chairman</u> during a period coinciding with the fraud. He was previously WM's CFO from 1972 – 1989.
- Dean Buntrock (an <u>LKQ founding backer & former director</u>) co-founded WM with Wayne Huizenga (LKQ founding backer). Buntrock was WM's CEO during the period of the fraud and, according to the SEC complaint, "<u>the driving force behind the fraud</u>."

Waste Management's <u>aggressive rollup strategy</u> gave its management a high level of flexibility to inflate revenue growth and margins, and to conceal doing so for years. Many individuals previously associated with Waste Management would go on to build businesses using the WM playbook. Specifically, a closely-knit group of WM alumni and associates (including LKQ's founders) have repeatedly co-invested in and built several companies, <u>with each company replicating</u> WM's aggressive roll-up or an acquire-and-build strategy, either setting out to consolidating a fragmented industry or flooding an industry with store openings in an effort to build a dominant market position as quickly as possible. Some of these companies include Blockbuster Video, Discovery Zone, Boston Chicken, AutoNation, Swisher Hygiene, and LKQ.

Many of these companies have either failed to deliver on their sales pitches to investors, failed outright, or were tarred by allegations of fraud, manipulative accounting, and/or unjust management enrichment. Based on our analysis, in the majority of cases these WM alums and associates built businesses with the intent to create the <u>illusion of growth</u>, as opposed to focusing on creating value through operational excellence, resulting in little to no lasting value.

In light of our belief that LKQ is inflating its financials, it is worth noting that Discovery Zone, another company previously founded by LKQ founder Donald Flynn – and in which Dean Buntrock, Wayne Huizenga, and several other WM alums were associated -- similarly utilized an acquire-and-build strategy. It ended up in bankruptcy and was alleged to have engaged in accounting manipulations. <u>Many current and former officers – notably accounting officers – from both WM and Discovery Zone are current and former accounting officers with LKQ</u> (refer to page 13). We also note that, in light of our opinion that LKQ may be engaging in inventory accounting shenanigans, LKQ's Director of Accounting and Inventory was previously employed by both WM and Discovery Zone.

Report Highlights (cont'd)

Flawed Corporate Governance Rewards Bad Practice: We believe that management's incentive structure is at the foundation of its failed capital allocation record. Management is rewarded by the roll-up strategy with annual bonuses and incentives, incentivizing empire-building at any cost. Annual bonuses are tied to revenue growth and long-term incentives are tied to Revenue, EPS, and ROE with the following weightings revenue (47.5%), earnings (47.5%) and ROE (5%). There are no stipulations that revenue has to be organic, and therefore, the management team is perfectly incentivized to acquire and overpay for revenue and game the accounting to inflate profits.

The CEO's total comp has increased 374% in the past 4 years while free cash flow is up only 9% in the same period. Approximately 50% of the comp increase has come in stock, but as a whole the management team has been net sellers of stock. Insiders have sold shares aggressively since the IPO, when former owners of acquired companies, affiliates and management owned 22%. Since 2009, insider selling pressure has intensified, with insiders currently owning less than 2%. Insiders even sold stock recently in Dec 2013, just days after touting the merits of the Keystone deal. There is now an almost complete break in the linkage between shareholder interests and executive wealth.

In another cautionary sign, in an 8-K filing during April, LKQ revealed that J.P. Morgan was no longer a secured lender under its credit agreement. J.P. Morgan had supported both Keystone and LKQ for a number of years. While we do not know the why the relationship was severed, when a bulge bracket investment bank turns away from a fee generating client of LKQ's size, there is risk of smoke before fire.

Valuation as a "Premium Midcap Growth Story" is Unwarranted: We believe The Street's view of LKQ as a proven acquirer with an "open-ended" growth opportunity does not stand the test of logic. Trading at 2x, 15x, and 25x 2014E sales, EBITDA, and EPS, respectively, LKQ's stock is priced at an unjustified premium to Aftermarket Auto, Metal Recyclers and Industrial Distribution peers, and fails to reflect few, if any, of the serious issues our research highlights. Specifically, our analysis indicates LKQ appears to be engaging in aggressive deal-making and accounting to manufacture GAAP profits, and appears to make bad economic business decisions in order to meet predetermined financial targets. We believe that management has taken to masking the company's weakening growth prospects by gaming the accounting to inflate organic growth, and that it is dependent on ever-larger acquisitions to keep the growth story alive, while insiders cash out. As a result of our concerns over the integrity of its financial reporting, we believe LKQ is at high risk of having to restate its historical financial results. We believe the growth story management has spun to investors is a bill of goods. Given concerns about the reliability of its financial statements, we believe the company has an intrinsic value of $10 – $15 per share, close to its book value, representing 50-70% downside from the current price.

LKQ's Only Competitive Advantage is Price…
GM's Price Matching Program Is Designed Specifically to Thwart LKQ

PRESCIENCE POINT

We have sourced an internal GM dealer document detailing GM's price-matching program, "Bump the Competition." We are told it specifically targets LKQ-Keystone. GM subsidizes dealers to sell parts (in this case a fender and a door) at levels <u>33% below aftermarket list prices</u>, makes them whole on the loss, and pays the dealer an additional, <u>guaranteed 14% profit</u> on the cost for the part.

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Your IMR Status - IN - 1%

Division LMA Status LMA Rate

GMC

Welcome Back, Donna Weber

Bump The Competition Calculator

Print StartOver

Invoice Number: [redacted] **Employee Number:** [redacted] **Employee Name:** JASON ***Invoice Date:** 4/20/2012 (mm/dd/yyyy)

Step 1: Enter your part number(s).

Part Number	20919882	20915589				**Total**
Part Name	FENDER	DOOR				
Dealer Cost	$ 121.59	$ 556.13				$677.72
Dealer List Price	$ 206.09	$ 942.59				$1,148.68
After Market List	$ 176.04	$ 680.63				$856.67
Lowest Selling Price	$ 117.95	$ 456.02				$573.97

Step 2: Enter your selling price(s). Recalculate

Bottom line price you can sell for (Aftermarket average - 33%)	117.95	456.02			BELOW COST	$573.97
Claim to make whole	$3.64	$100.11				$103.75
14% Profit	$17.02	$77.86				$94.88
Max Claim Amount	$20.66	$177.97				$198.63
Code 1	$100.93	$378.16				$479.09

*Denotes a required field.

Keystone List Price

OEM price-match, 33% discount from Keystone Price (Keystone list has generally been 20-25% less than OEM; OEM is now undercutting Keystone's price by 33%)

GM reimburses dealer for loss on part cost

GM pays dealer 14% return on part cost

Source: Felder's Collision Parts, Inc. v. General Motors Company et al, Complaint Exhibit 4, filed 10/12/2012

PRESCIENCE POINT

Same Players, Same Strategy, Results Marred by Accounting Irregularities & Failures

WM Waste Management	Blockbuster	Discovery Zone	Boston Chicken	AutoNation	Swisher Hygiene	LKQ
Wayne Huizenga Co-founder	Wayne Huizenga CEO/Chairman	Wayne Huizenga Investor (via Blockbuster), Director	Wayne Huizenga Investor	Wayne Huizenga Founder, Co-CEO	Wayne Huizenga Chairman	Wayne Huizenga Founding backer (via AutoNation)
Dean Buntrock Co-founder, CEO	Dean Buntrock Investor, Franchisee	Dean Buntrock Franchisee	Dean Buntrock Investor, Director			Dean Buntrock Founding Backer, Director
Donald Flynn CFO, Director -Audit Committee	Donald Flynn Founding Backer, Director	Donald Flynn CEO/Chairman	Donald Flynn Investor			Donald Flynn Founder
John Melk President WM International	John Melk Founding Backer, Director	John Melk Investor, Director	John Melk Investor	John Melk Founding backer, Director		
Lawrence Beck Co-founder	Lawrence Beck Investor, Franchisee		Lawrence Beck Investor, Franchisee			
Peer Pedersen Director	Peer Pedersen Investor, Franchisee	Peer Pedersen Director	Peer Pedersen Investor			
	Scott Beck Investor, COO, Vice Chairman	Scott Beck Investor	Scott Beck CEO/Chair			
	Steven Berrard CFO, then CEO	Steven Berrard CEO post-Viacom		Steven Berrard Co-founder, Co-CEO	Steven Berrard CEO, Director	
		Victor Cassini Gen Counsel,Secretary				Victor Cassini Gen Counsel, Secretary
Charged with accounting fraud, one of the largest in history; Aggressive rollup strategy	**Bought out** by Viacom for $8.4B; Aggressive acquire-&-build strategy	**Goes bankrupt;** Allegations of fraud; Aggressive acquire-&-build strategy	**Goes bankrupt;** Accounting gimmicks to obscure financials; Aggressive acquire-&-build strategy	***$$* Billions Lost;** Pooling of Interests acquisition accounting; Aggressive rollup & acquire-&-build strategy	**Accounting irregularities;** Financials restatement, **Acquisition Accntng Issues** **Ongoing SEC inquiry**; Aggressive rollup strategy	?? An array of accounting red flags & misrepresentations; Aggressive rollup & acquire-&-build strategy

WM and DZ – Previous Employers of Many LKQ Executives & Accounting Personnel

Discovery Zone	Waste Management	LKQ
Fraud Allegations, Improper Capitalization of Expense; Files for Bankruptcy, March 1996	Charged w/ $1.7 billion Accounting Fraud, March 2002	LKQ

Flynn Enterprises Common Shareholder

Discovery Zone		Waste Management		LKQ	
		Joe Holsten COO, CEO WM Int'l	John Quinn Various Positions	Joe Holsten Fmr. CEO, Chairman	John Quinn SVP and CFO
Kevin Flynn VP, Midwest		Mark Spears Controller, Head Acct		Mark Spears Former SVP, CFO	Kevin Flynn Former Director
Victor Casini/ Gen. Counsel & Secretary	Frank Erlain VP & Controller			Victor Casini Gen. Counsel & Secretary	Frank Erlain Fmr. VP Finance Controller, Accountant
Walter Hanley Asso. Gen. Counsel	Stephen Eckel Assistant Corporate Controller			Walter Hanley SVP, Development	Stephen Eckel Dir Oracle Fin Apps. Fmr. Acct'g/Ass. Cont'ller
	Ken Frese Acct'g Mgr	Sinon Galvin Various Positions WM Int'l	Ken Frese Accountant	Sinon Galvin SVP, Revenue Optimization	Ken Frese Dir. Accounting & Inventory
		Vaughn Hooks Chief Tax Officer	Dan Shoener VP	Vaughn Hooks VP Taxes	Dan Shoener VP of Finance

Source: SEC filings; LinkedIn®

Current Capital Structure

LKQ Corp Capital Structure

$ in mm except per share amounts

Stock Price	$33.00
Shares outstanding	300.6
Net Options @ $7.04 avg strike	5.6
RSUs outstanding	2.6
Fully Diluted Shares	308.8
Market Capitalization	**$10,190.9**

Metrics	LTM 9/30/13	2013E	2014E	2015E
EV/Sales	2.5x	2.3x	2.0x	1.8x
EV/EBITDA	19.3x	18.9x	15.0x	12.4x
Price/EPS	33.3x	30.6x	24.3x	19.2x
Debt/EBITDA	2.9x	2.8x	2.2x	1.8x

Debt	Outstanding	Rate	Maturity	Unused	Covenants
Receivables Securitzation	$10.0	1.01%	2015		
Term Loan A	$444.4	3.08%	2018		max lev: 3.5x min EBITDA cov: 3.0x
Revolver (1)	$649.8	3.08%	2018	$700.0	max lev: 3.5x min EBITDA cov: 3.0x
Senior Unsecured Notes	$600.0	4.75%	2023		
Notes Payable	$38.9	1.80%	2018		
Other Debt	$18.9	3.50%	N/A		
Total Debt	$1,762.1	**3.61%**			
Less: Cash	$107.3				
Total Enterprise Value	**$11,845.6**				

1) Assumes $450m Keystone acquisition is fully funded on the revolver as per company press release

Background and Business

Background – LKQ Corp

- LKQ Corporation (LKQ), a wholesale replacement auto parts distributor, was founded in 1998 by Donald Flynn, and with the financial backing of Dean Buntrock and AutoNation Inc., the automobile retailer founded and led at the time by Wayne Huizenga; Flynn would recruit Joseph Holsten to serve as LKQ's CEO.[1] Flynn, Buntrock, Huizenga, and Holsten are all former executives of Waste Management, Inc. (WM)
- LKQ has set out to consolidate the fragmented wholesale alternative auto parts industry by implementing an aggressive roll-up strategy, fueling growth through acquisitions. Since 1998, LKQ has grown through over 171 acquisitions, primarily in the US and Canada, becoming the largest provider of aftermarket & recycled collision auto parts in North America
- In May 2006, the company acquired Keystone Automotive Industries, Inc. (Nasdaq: KEYS), a provider of aftermarket vehicle collision replacement parts, for $48.00 per share in cash or $811m in total enterprise value. The deal was the largest in the company's history
- In October 2011, LKQ expanded into foreign markets with the acquisition of UK-based Euro Car Parts Limited; this was followed by the April 2013 acquisition of Netherlands-based Sator Holding. Using an acquire-and-build strategy to grow in Europe, LKQ has become one of the largest European suppliers of mechanical aftermarket auto parts. LKQ generated $4.1B of revenue in 2012, split 72%/32% between North America and Europe
- LKQ's business strategy – and as later discussed, the strategies of numerous other companies founded by the aforementioned and other former Waste Management executives – appears taken right out of WM's old playbook. The following slide provides a brief elaboration of Waste Management's strategy and significant events in relation to LKQ's founders

(1) *International Directory of Company Histories*, Vol. 71. St. James Press, 2005

PRESCIENCE POINT

Background – Waste Management Inc, 1968-1998

- In 1968, Dean Buntrock and Wayne Huizenga (both LKQ founding backers), along with Lawrence Beck, founded Waste Management (WM). In 1972, Donald Flynn (LKQ's founder) joined WM as CFO. WM set out to consolidate the highly fragmented garbage hauling industry via an aggressive roll-up strategy. By the time WM went public in 1971, it had acquired 133 garbage haulers and was generating >$10m in revenue. In the first 9 months of 1972 it had acquired another 133 firms and generated FY 1972 revenue of $72m. From 1971 to 1980, WM's revenue grew at a rate of 48% per year, reaching $656m in revenue in 1980. By 1986, WM had become the largest waste disposal firm in the world.
- Donald Flynn was given credit as the "financial genius" behind Waste Management's extraordinary growth from the 1970s to the early 1990s in a 1993 corporate history commissioned by the company
- By the late 1980's and early 1990's, WM had undertaken a botched international expansion in a push to become the world's first global 'environmental services' company. *"That ambition led Waste Management to acquire a range of profit-draining businesses. The eventual result was angry shareholders, turmoil in the board room and a disruptive series of management purges and sudden resignations, followed by revelations (in late 1997) of accounting irregularities."*
- Buntrock remained as CEO until 1996, and Flynn as CFO & director until 1989 & 1997, respectively.

In 1997, a new CEO ordered a review of WM's accounting practices. The probe turned up a massive financial fraud that went undetected from 1992–1997. The fraud involved inflated asset values and profitability, resulting in a $3.5B charge in 1998 and the largest financials restatement in history at that time. SEC charges ensued.

- From 1994 until 1997, a period at the heart of the perpetration of the fraud, **Donald Flynn was a Waste Management Audit Committee member**, the panel responsible for overseeing accounting policies and procedures, and also **served as Audit Committee Chairman** during a period coinciding with the fraud.
- According to the SEC, former WM CEO Dean Buntrock, was "*the driving force behind the fraud,"* and that, "*He was the primary beneficiary of the fraud and reaped more than $16.9 million in ill-gotten gains from, among other things, performance-based bonuses, retirement benefits, charitable giving, and selling company stock while the fraud was ongoing"*

Additional source: http://www.sec.gov/news/headlines/wastemgmt6.htm

Background – LKQ Corporate Evolution

- LKQ began in 1998 to roll-up wholesale recycled auto parts distributors (i.e. salvage yards), establishing a network of such businesses and serving the collision repair industry. By 2003, it had become the largest provider in the fragmented recycled products market in the U.S.
- LKQ soon began diversifying through acquisitions of aftermarket, recycled, refurbished and remanufactured product suppliers and manufacturers, and self service retail businesses.

Acquisition of Keystone Automotive Results in Dominant Competitive Position as a US Aftermarket Parts Distributor:

- In October, 2007, LKQ made a transformative acquisition in buying Keystone Automotive Industries, Inc., becoming the industry's dominant distributor of both recycled and aftermarket products in the U.S. Keystone is LKQ's largest acquisition to date, costing $811m; Keystone generated ~$730m in revenue in 2007. As a result of the acquisition, LKQ's Parts and Services revenue split shifted from 71%/29% to 39%/61% recycled products vs. aftermarket products.
- In 2008 LKQ entered the heavy-duty truck parts recycling industry through various acquisitions. The heavy-duty truck parts recycling industry has operating and sales functions that are similar to the auto recycled parts business.

Recent International Expansion with 2 Large-Scale Acquisitions European Aftermarket Parts Distributors:

- In October 2011, LKQ made its third largest purchase in its history, expanding to the United Kingdom with the acquisition of Euro Car Parts Holdings Limited (ECP). ECP's product offerings are primarily focused on wholesale automotive aftermarket mechanical products. LKQ purchased ECP for a total consideration (including earnouts) of $432m; ECP generated $509.6m in revenue in 2011 and had grown revenue at a CAGR of 33% from 2009-2011. As of October 2013, ECP operated out of 138 branches, supported by a national distribution center.
- In May 2013, LKQ made its second, significant acquisition in Europe, buying Sator Holding, an automotive aftermarket parts distribution company based in the Netherlands, with operations in the Netherlands, Belgium, Luxembourg and Northern France. LKQ bought Sator for $272m (EUR 210m); Sator generated $374m in revenue in 2012. The acquisition expanded LKQ's geographic presence in the European automotive aftermarket products market into continental Europe.

Sources: LKQ 10-K for 2012; 10-Q for Q2'2013; 2007 Investor Presentation; http://www.lkqcorp.com/us/en/about-us.aspx

PRESCIENCE POINT

Background – LKQ Business Overview

- LKQ provides alternative auto parts used for vehicle repairs. Alternative auto parts can be used in vehicle repairs in place of new, branded auto parts made by vehicle manufacturers, or "OEMs"

For example, if you get into an accident and need to replace the vehicle bumper, you have 3 options:

1. Replace it with a new, branded bumper manufactured by General Motors (i.e., a new OEM part)
2. Get a new, generic bumper that was made in Taiwan (i.e. an "aftermarket part")
3. Get a bumper from the junkyard (i.e., a "recycled part")

Options 2 and 3 are examples of alternative parts. There are others, discussed below

- To be clear, buyers of replacement auto parts have 5 options to choose when repairing their vehicles:
  1. **New OEM parts** – branded auto parts produced by vehicle manufacturers (i.e., "OEM")

or any of the below alternative auto parts, all of which LKQ provides:

2. **Aftermarket parts** – new, generic parts that were not produced by the OEMs. LKQ sources the majority of the aftermarket parts it sells in North America from Taiwan and other Asian countries
3. **Recycled products** – used parts that were originally produced by OEMs; LKQ sources its recycled inventories by buying salvaged vehicles at auction, then disassembling them at its salvage/junk yards
4. **Refurbished parts** – used products that have been refurbished; LKQ processes these from cores obtained from salvage vehicles
5. **Remanufactured parts** – used products that have been remanufactured; LKQ processes them from cores obtained from its salvage operations

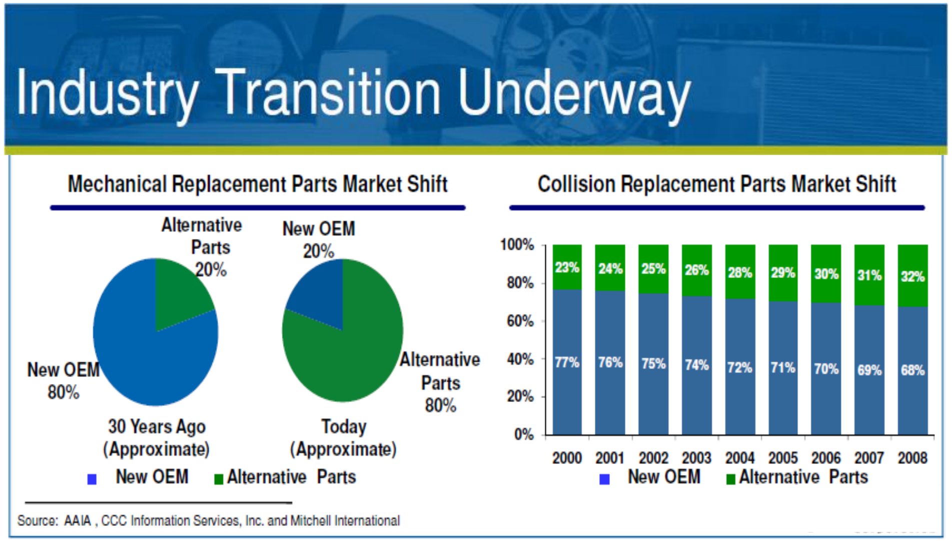
- The value in using alternative parts in place of new OEM parts is that they have traditionally been less expensive.

According to its filings: "We compete with the OEMs primarily on price and to a lesser extent on service and quality." In essence, LKQ sells nothing more than commodity products, which we will show has a diminishing competitive price value proposition. Furthermore, numerous customer complaints and an "F" Rating from the Better Business Bureau (see Appendix), severely calls into question its service and quality performance

Source: LKQ 10-K for 2009 and 2012

Background – LKQ Revenue Growth Driven by APU

- LKQ sells its products and services primarily to collision repair shops (i.e., 'body shops'), but insurance companies are its 'indirect,' de facto customer. Pressure exerted by insurance companies on body shops to hold claims costs down by using alternative auto parts resulted in a 30 year-long rising trend in the market share for usage of alternative parts vs. OEM parts in collision repairs. This trend has been a core pillar of the LKQ growth story since it went public in 2003.
- This trend is measured by the "Alternative Parts Usage" (APU), or the percentage of total replacement part dollars spent on alternative parts vs. OEM parts. The APU has risen from 23% in 2000 to 37% in 2012, according to CCC Information Systems, provider of the industry's dominant estimate writing platform
- LKQ has displayed a chart encapsulating this trend as a centerpiece of its growth story in all of its investor presentations spanning at least the past 5 years, until recently; **the company has excluded it from all of its 2013 presentations**. As explained later in this report, we believe this share shift has stalled and may reverse



"Recently, CCC published their annual crash course publication. The industry's average use of alternative parts for collision repairs increased by almost 300 basis points to 35% for 2009 from 32% in 2008, sharply accelerating from the decade-long trend we have seen of 100 basis points per year increases… Reflecting the increase in APU, demand for LKQ's wholesale parts remain strong during the quarter. Our first quarter organic revenue from the sale of parts and services increased 5.6% even with reductions in miles driven of 1.6% in January and 2.9% in February."

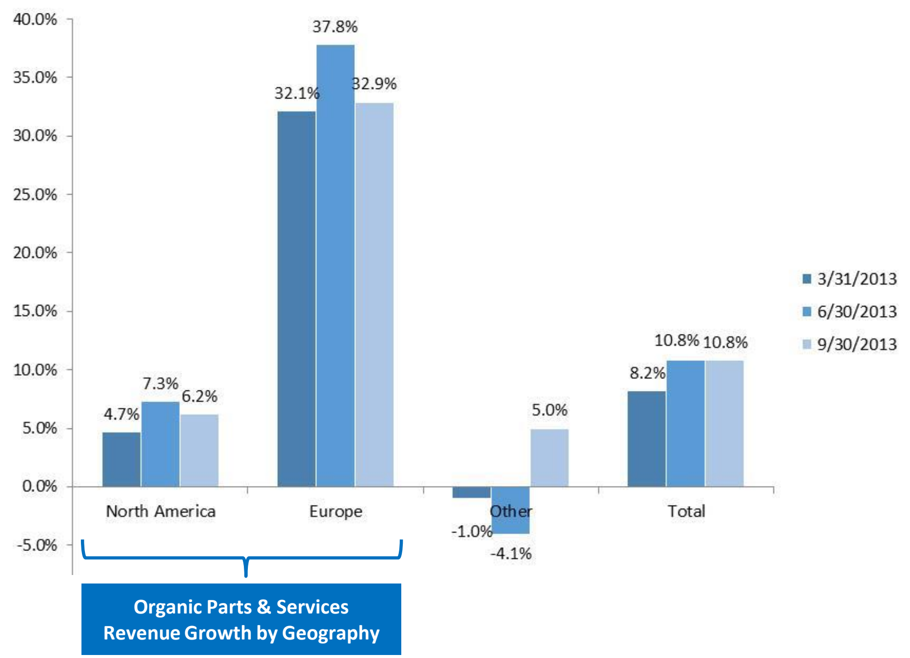
– Joseph Holsten, LKQ Chairman, Q1'2010 Earnings Call (4/29/2010)

Source: LKQ 10-K for 2012, LKQ conference calls, LKQ 2009 investor presentation

European Business Growing as a Percent of Consolidated Revenue

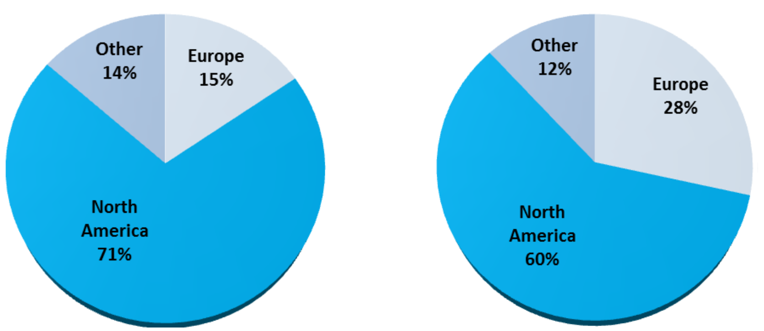
- For the past 3 quarters, LKQ's European Parts and Services business has demonstrated an organic growth rate >5x that of its North America counterpart; over this period, Europe grew at an average rate of ~34% vs. ~6% in North America
- Fueled by organic and acquisition growth (including the relatively large purchase of Sator), as of 9/31/2013, European Parts and Services Revenue had grown to 28% of consolidated revenue, from 15% one year prior

LKQ Organic Revenue Growth by Category



Europe Growing in Terms of Revenue Contribution[1,2,3]

As of Q3'2012	As of Q3'2013



(1) 'North America' & 'Europe' categories represent geographic sources of Parts and Services Revenue
(2) 'Other' Revenue is comprised of sales of scrap metal and aluminum ingots and sows
(3) Revenue shares were computed by annualizing Q3'2012 & Q3'2013 reportable category revenues

High-Level Indications of Fabricated GAAP Profits, Unsustainable Business Model

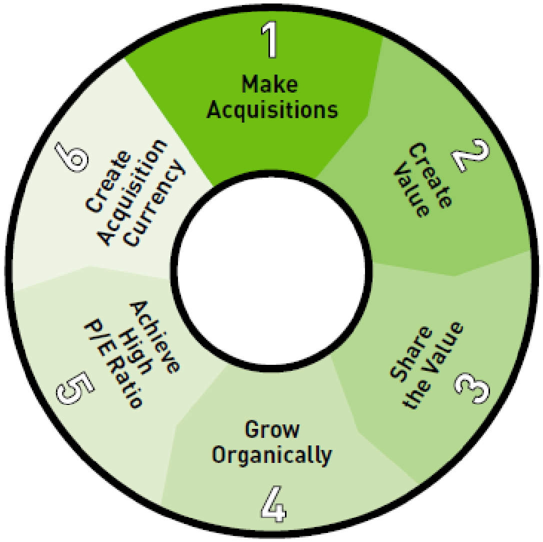
LKQ is a Roll-up; Dynamics of Roll-up Strategies

- LKQ is a classic roll-up, fueling growth through acquisitions. In the following slides, we elaborate on our view that LKQ is an ineffective roll-up; undeserving of its rich valuation. By contrast, an effective roll-up can create enormous value, which warrants a rich P/E:

> ***"The bet underlying a rollup is that it can reduce costs and drive growth to create enormous value. In fact, kindling organic growth – driven by a superior value proposition – is particularly important as the pace of acquisitions begins its inevitable decline. When all goes well, we find a cycle of value creation that takes on a life of its own (refer to the figure at lower right)… <u>The market rewards this kind of growth with a higher P/E ratio</u>, which creates the currency for more acquisitions. "[1]***

- But, Wall Street is littered with companies that have failed to properly effectuate it, and that have over time destroyed vast amounts of shareholder wealth. Among such companies are Waste Management (WM) and AutoNation (AN). In this report, we elaborate on our view that LKQ, with common backers, very much resembles both companies.
- For example, like LKQ, AN set out to build a **<u>one-stop-shop</u>**, establishing presence in all aspects of its markets – new and used auto sales, auto rental, and auto servicing. It tried to consolidate a **<u>highly competitive</u>**, **<u>low margin</u>**, **<u>mature/low growth industry</u>**; as such, AN's **<u>success was dependent on stealing market share</u>** from existing competitors. Like LKQ, it also had no ability to drive down its most basic cost – that of buying used cars; it had to **<u>compete at auctions</u>** with other dealers to build its relatively huge inventory, which **<u>depreciated in value at a very fast rate</u>**.[1] Using public capital, it acquired hundreds of businesses. It used a concerning **<u>acquisition accounting</u>** methodology, pooling of interests (which is no longer allowed by GAAP), that likely **<u>inflated its reported earnings</u>**. In its early stages it was a Wall Street darling – touted as a strong buy by sell-side analysts – and valued for perfection; but, reality caught up with its over- expansion and -extension into money-losing endeavors. Over a 3.5 year period, its market value of >$12B fell by >80% from peak to trough, with **<u>shareholder losses exceeding $10B</u>**.

Dynamics of an Effective Rollup

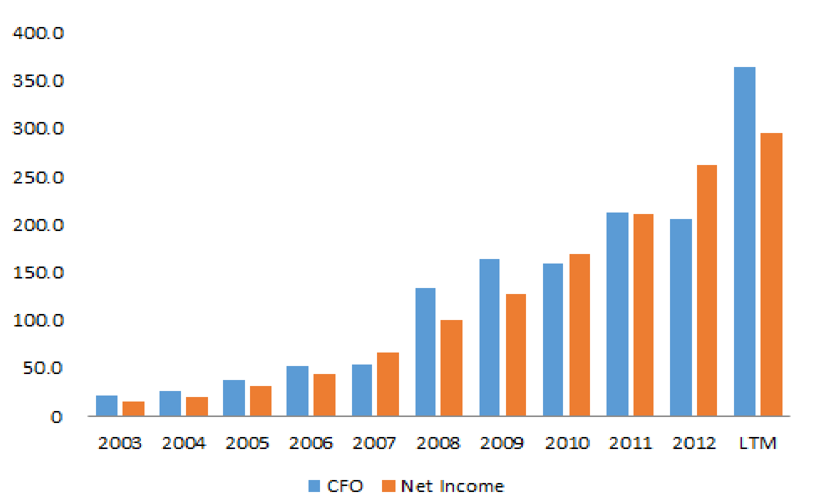


(1) Paul F Kocourek, Steven Y Chung, and Matthew G McKenna, "Strategic Rollups: Overhauling the Multi-Merger Machine," *Strategy & Business,* second quarter 2000.

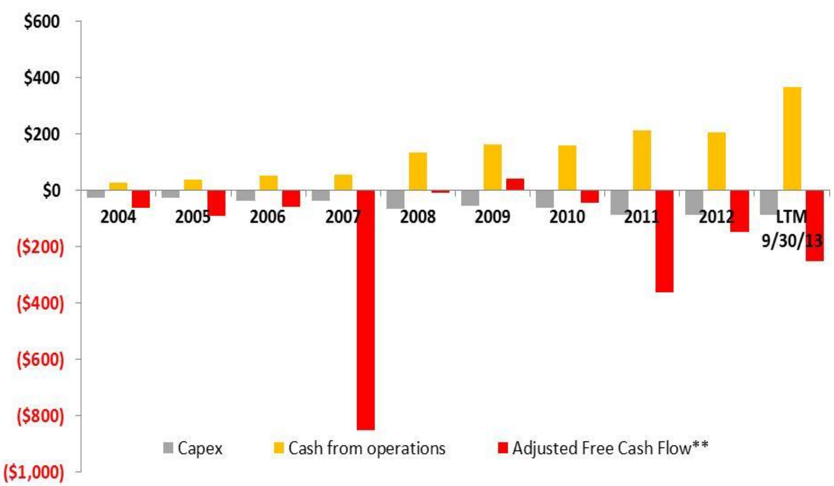
LKQ Appears to be an Ineffective, Consistently Cash-Degenerative Roll-up

- The roll-up strategy inherently flatters earnings and CFO metrics. Roll-ups usually show both strong earnings and strong CFO (i.e., high earnings quality) due to the inherent financial statement mechanics of paying for growth through acquisition outflows (which do not affect earnings or CFO). Cash spent to acquire businesses runs through the Investing section of the Statement of Cash Flows, so the acquirer is able to inherit a new CFO stream without any CFO outlay (i.e. working capital investment). Moreover, as the acquirer liquidates the working capital of the acquired company in the normal course of business – collecting on receivables or selling inventory – it can realize an unsustainable CFO boost that has virtually nothing to do with the performance of its business.
- As such, *free cash flow after acquisitions* is a key metric for analyzing roll-ups, presenting a better picture of the business's economics. In LKQ's case, it demonstrates that LKQ is an ineffective, consistently cash-degenerative roll-up. **LKQ's free cash flow after acquisitions has been <u>negative in 8 of 9 years</u> from 2004-2012, and is negative in the last twelve month period through September 30, 2013, a cautionary sign that its strong, positive CFO is not what it appears**

LKQ's Earnings Quality 'Appears' High



LKQ's Free Cash Flow Adjusted for Acquisitions

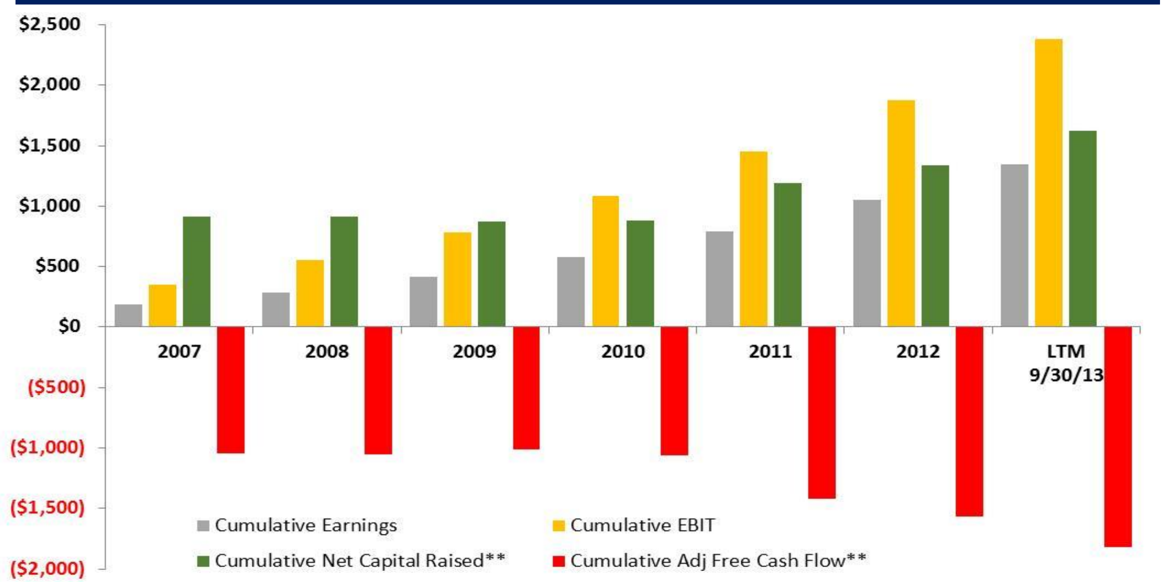


**Adjusted Free Cash Flow is free cash flow after acquisitions (i.e. CFO – capex – acquisition outflows)

High-Level Indications of Fabricated GAAP Profits, Unsustainable Business Model

- Furthermore, our analysis indicates LKQ may be engaging in aggressive accounting to engineer GAAP profits.
  - Since 2007, LKQ has reported cumulative Earnings and EBIT of $1,222m and $2,153m, respectively.
  - Meanwhile, it has burned cumulative free cash flow after acquisitions of -$1,623m, and raised cumulative net capital of $1,625m, suggesting it has never earned a cash-on-cash return on invested capital.
  - Put another way, the immense wealth generation represented by LKQ's historical GAAP profits is not observable in the company's cash flows – it appears to be 'paper' wealth generated from accounting gimmickry and enabled by an aggressive roll-up strategy and accounting practices.

LKQ Appears Increasingly Dependent on External Capital to Generate Any EBIT and Net Income



** Capital Raised = equity + net debt + option proceeds
** Adj FCF = CFO – capex – business acquisitions

Reported North America Parts & Services Organic Revenue Growth Appears Overstated; Pricing Pressures Intensifying

North America (NA) Organic Growth Appears Overstated

- LKQ reported organic revenue growth averaging ~6.5% from 2008 – 2012 and ~6% in the 9 months ended 9/30/2013 for its North America Parts and Services (P&S) business, which accounts for ~75% of consolidated P&S revenue. These growth rates do not appear reconcilable with trends in its primary driving fundamental factors or representative of LKQ's sustainable North America organic growth rate, which we believe likely falls in the range of 0-2%.
  - Data for insurance claims paid for repairable accidents indicates no growth
  - Growth in market share of alternative auto parts relative to OEM parts (i.e., APU), which has risen for 3 decades and served as a primary driver of LKQ's organic growth, flat-lined from 2010 – 2012 and may taper or reverse
  - For the first time, replacement auto parts prices <u>deflated</u> in 2012, as competitive pressures intensified
  - Market share gains from alternative parts competitors are limited by LKQ's market dominance; already owning 25-30% of the market, market share is LKQ's to lose
- LKQ's North American P&S organic growth rate also appears unhinged from growth rates reported by dominant companies in its primary end market. For example, the Boyd Group (TSX: BYD.UN), a large publicly traded multi-service operator in the North American collision repair industry has reported average same store sale growth of just 2% over the same period LKQ has reported organic growth of 6.5%. <u>**While Boyd's results have shown significant cyclicality, LKQ's results have been highly consistent and steadily positive – such patterns in an otherwise cyclical business are often a hallmark of companies over-concerned with meeting Wall Street estimates and financial transgressions**</u>

NA Organic Growth – Insurance Collision Claim Payouts Are Not Growing

- According to LKQ, ~85% of all repairs are paid for by insurance companies; in effect, they are the ultimate payee for replacement auto parts
- The total value of Insurance Collision Claims paid for Repairable Accident Claims (which excludes Total Loss data) has been stable at ~$28 billion over the past 5 years time. This is the result of steadily increasing severity despite a downward trend in accidents and cars repaired
- **Per the table below, the 5yr CAGR for total insurance claims paid for repairable accident claims is 0%!**

	Insurance-Paid Collision Repairs				Consumer-Paid Collision Repairs		Total Spend for Collision Repairs	
Year	Total Paid ($bn)	Annual Growth	$ Avg per unit	Claims (millions)	Total Paid ($bn)	Annual Growth	Total Paid ($bn)	Annual Growth
2012	$27.7	3.4%	$2,550	10.9	$3.0	11.1%	$30.7	4.1%
2011	$26.8	-5.3%	$2,550	10.5	$2.7	0.0%	$29.5	-4.8%
2010	$28.3	2.2%	$2,438	11.6	$2.7	3.8%	$31.0	2.3%
2009	$27.7	-0.4%	$2,350	11.8	$2.6	4.0%	$30.3	0.0%
2008	$27.8	--	$2,320	12.0	$2.5	–	$30.3	--
5 Year CAGR	-0.1%		2.4%	-2.5%	4.7%		0.3%	

Source: The Romans Group LLC

OEM Price-Matching Programs Also Forcing Aftermarket Auto Part Price Deflation

- LKQ has historically benchmarked its prices against OEM parts prices, which historically have risen 1.0% – 2.0% p.a.
  - ***"… maybe another way to look at that is that we typically price our parts based on new OE parts…"*** [1]
  - ***"We track OE prices relative to what they're doing. They are still averaging consistently 1.5% to 2% increases, though we tend to follow right on their heels. When they raise, we're right behind them."*** [2]
- Recently, OEM's have expanded their price-matching programs, wherein they are matching alternative parts prices. They've set their sites on regaining market share previously lost to alternative parts suppliers by empowering their dealers' parts departments to match aftermarket parts prices, and are succeeding.

> ***We believe that substantially in excess of 50% of collision parts by dollar amount are supplied by OEMs, with the balance being supplied by distributors like us. The OEMs are therefore in a position to exert pricing pressure in the marketplace. We compete with the OEMs primarily on price and to a lesser extent on service and quality. From time to time, OEMs have experimented with reducing prices on specific products to match the lower prices of alternative products. If such price reductions were to become widespread, it could have a material adverse impact on our business.***
>
> – LKQ 10-K for 2012 (Risk Factors)

- **We believe these programs have become widespread and much more pervasive than LKQ has led investors to believe**

(1) Joseph Holsten, former CEO on Q4'2008 earnings call

(2) Robert Wagman, CEO on Q3'2011 earnings call

NA Organic Growth – OEM Price Matching: Interview With Aftermarket Distributor

Prescience Point ("PP"): ***Can you describe what's been happening in the industry?***

Aftermarket Parts Distributor ("APD")[1]: The OE's dealerships are selling below their cost. This is happening nationwide. It started around 2008.

PP: ***How is it impacting aftermarket parts distributors?***

APD: It's put 4 out of business within 200 miles of here, and it put me out of business too. So that's 5 out of 5. The only one left standing is LKQ.

It's a really strange deal; I called the 4 companies and asked them why they went out of business, and they said it was because of the OE's matching their prices.

They are being dis-intermediated by the OEM's. They're not selling parts either. By way of example, The gentleman who runs (the local) LKQ-Keystone and I have been competitors ever since I've been in business. He started out w/ a company that LKQ bought out, then he went to another company and LKQ bought them out, and now he works for LKQ. For this entire time we've been competitors. Anytime I've ever asked him about how's he's doing, he's said, 'We're doing great; we're just selling shit left and right…' for about 18 years that's been his answer. 3 weeks ago I called him, and he says, "Talk to any one of my salespeople and they will tell you how badly we've been hurting. If you want to know how bad it is, talk to anyone of my salesmen; <u>we aren't selling shit</u>".. It was the first time he's ever in his life made a negative comment about his business…

PP: ***Do you think this will continue to impact LKQ's ability to generate business in North America?***

APD: If it continues **<u>it will put them out of business as far as aftermarket and salvage parts go</u>**

(1) "Aftermarket Parts Distributor" is an owner of an aftermarket collision parts distributor

OEM Price Matching: Interview With Aftermarket Distributor (Cont'd)

Prescience Point ("PP"): ***What would motivate the OE dealerships to sell products at a loss? How can the dealerships take these losses?***

Aftermarket Parts Distributor ("APD") [1]: Because the OE's are paying them (the dealers) back on their money, making them whole, and then giving them a 14% profit (on top of that).

I have a document that shows how this is happening... This specific document relates to a door… GM is telling its dealer to, "Forget the dealer list price; sell it 33% below Keystone's list price. We'll give you all your money back plus a 14% profit." LKQ cannot then step in and offer the part at the same price ($456); it wouldn't be able to sell the part because the body shop prefers the OE part. Body shops are happy because they are getting OE parts for aftermarket prices.

PP: ***LKQ's investor presentation contains a slide demonstrating its 'Clear Value Proposition'. They give specific examples. For example a new OEM front door might cost $1300, vs a recycled OEM front door that would cost $800, for a savings of 40%. So is that not the case for a new vs recycled products?***

APD: If an insurance company writes the recycled part for $800, the OEM will sell its $1300 (dealer list price) part for $800 and give the dealership a 14% profit.

PP: ***The presentation also gives another example for an aftermarket product. It says a new OEM fender might cost $200, but an aftermarket fender sells for $160, for a 22% savings. Same thing there? The OEM will match that price?***

APD: Same deal, the dealer will sell it for $160. GM reimburse them for their $40 loss, and give them a 14% return on top of that.

(1) "Aftermarket Parts Distributor" is an owner of an aftermarket collision parts distributor

LKQ's Only Competitive Advantage is Price… GM's Price Matching Designed to Thwart LKQ

PRESCIENCE POINT

We have sourced an internal GM dealer document detailing its price-matching program, "Bump the Competition." We are told it specifically targets LKQ-Keystone. GM subsidizes dealers to sell parts (in this case a fender and a door) at levels <u>33% below aftermarket list prices</u>, makes them whole on the loss, and pays the dealer an additional, <u>guaranteed 14% profit</u> on the cost for the part.

gmLAM.com

Page 1 of 2

HOME | IMR | CCA | TRAINING | FAVORITES | ADMIN

ADD TO FAVORITES | CONTACT US | LOGOUT

Your IMR Status - IN - 1%

Division LMA Status LMA Rate

Welcome Back, Donna Weber

Bump The Competition Calculator

Print StartOver

Invoice Number:	Employee Number:	Employee Name:	*Invoice Date:
[redacted]	[redacted]	JASON	4/20/2012 (mm/dd/yyyy)

Step 1: Enter your part number(s).

Part Number	20919882	20915589	Estimate	Estimate		Total
Part Name	FENDER	DOOR				
Dealer Cost	$ 121.59	$ 556.13				$677.72
Dealer List Price	$ 206.09	$ 942.59				$1,148.68
After Market List	$ 176.04	$ 680.63				$856.67
Lowest Selling Price	$ 117.95	$ 456.02				$573.97

Step 2: Enter your selling price(s). Recalculate

Bottom line price you can sell for (Aftermarket average - 33%)	117.95	456.02			BELOW COST	$573.97
Claim to make whole	$3.64	$100.11				$103.75
14% Profit	$17.02	$77.86				$94.88
Max Claim Amount	$20.66	$177.97				$198.63
Code 1	$100.93	$378.16				$479.09

*Denotes a required field.

Keystone List Price

OEM price-match, 33% discount from Keystone Price (Keystone list has generally been 20-25% less than OEM; OEM is now undercutting Keystone's price by 33%)

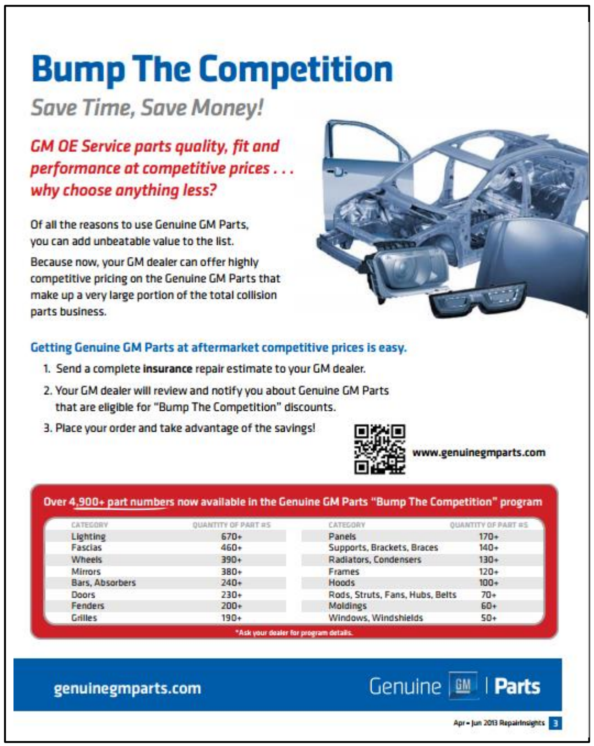
GM reimburses dealer for loss on part cost

GM pays dealer 14% return on part cost

Source: Felder's Collision Parts, Inc. v. General Motors Company et al, Complaint Exhibit 4, filed 10/12/2012

GM's "Bump The Competition" Directed at Outcompeting LKQ, Retaking Lost Share

- Launched in 2009, the "Bump the Competition" program from General Motors was designed to capture share of the aftermarket by lowering the price of its OEM replacement parts relative to the competition. The initial rebates took the form of fast cash Visa® Award Cards….



Bump The Competition

Save Time, Save Money!

GM OE Service parts quality, fit and performance at competitive prices . . . why choose anything less?

Of all the reasons to use Genuine GM Parts, you can add unbeatable value to the list.

Because now, your GM dealer can offer highly competitive pricing on the Genuine GM Parts that make up a very large portion of the total collision parts business.

Getting Genuine GM Parts at aftermarket competitive prices is easy.

1. Send a complete **insurance** repair estimate to your GM dealer.
2. Your GM dealer will review and notify you about Genuine GM Parts that are eligible for "Bump The Competition" discounts.
3. Place your order and take advantage of the savings!

www.genuinegmparts.com

Over 4,900+ part numbers now available in the Genuine GM Parts "Bump The Competition" program

CATEGORY	QUANTITY OF PART #S	CATEGORY	QUANTITY OF PART #S
Lighting	670+	Panels	170+
Fascias	460+	Supports, Brackets, Braces	140+
Wheels	390+	Radiators, Condensers	130+
Mirrors	380+	Frames	120+
Bars, Absorbers	240+	Hoods	100+
Doors	230+	Rods, Struts, Fans, Hubs, Belts	70+
Fenders	200+	Moldings	60+
Grilles	190+	Windows, Windshields	50+

*Ask your dealer for program details.

genuinegmparts.com Genuine GM Parts

Apr–Jun 2013 RepairInsights 3

http://gmbtc.ca/login.php

http://www.gmrepairinsights.com/wp-content/uploads/2013/04/Repair-Insights-Q2-2013.pdf

www.genuinegmparts.com

OEM Price Matching Programs Date to 2009; GM Expanded its Programs in 2013 to Be Even More Price Competitive, Applied to More Parts

PRESCIENCE POINT

GM COLLISION CONQUEST CALCULATOR

Ver.1a
1/01/09

Enter GM Part #
9592871

Enter the part number here to see if it is on the program.

Part Name	WHL16X6.5
Dealer Cost	$135.01
Dealer List Price	$228.83
After Market List	$179.00

This assumes that you sell the part at the lowest price.

Bottom line price you can sell for: $119.93

Bottom line price = (Aftermarket average minus 33%)

Claim to make whole	$15.08
14% Profit	$18.90
MAX Claim Amount	$33.98

If boxes read #N/A then part number is not part of Conquest Collision Program.

Invoice # | Date

Employee Name | Employee Number

Certain dealers asked for these fields. There is no requirement to use this form or to enter any information in these boxes.

EXHIBIT
tabbies
2

GM's push to Bump the Competition Dates back to 2009, & Recent Evidence it has become **"More Price Competitive"**

Certified Service

Date: 12/20/2012 Ref. number: Parts / Program and Promotion / G_0000154401
Subject: **2013 overPOWER and Bump the Competition Programs**

To: Chevrolet, Buick, GMC, and Cadillac Dealers and Medium Duty Service Centers

DESCRIPTION:
General Motors Customer Care and Aftersales announces the 2013 Conquest Programs "overPOWER (oP) and Bump the Competition (BTC)". These programs provide the opportunity to be more price competitive with non-OEM parts in the market. Dealers can gain incremental sales by selling Genuine GM Parts when other parts are specified on an insurance estimate (BTC) or quote (oP).

Program Changes for 2013
overPOWER the Competition
Engine and Transmission Assemblies and select Powertrain Components will now be included on Genuine GM Rewards, the dealer incentive and Independent Aftermarket (IAM) loyalty program which rewards selling dealers and participating IAM customers. See message #G_0000154750 for the new 2013 Genuine GM Rewards Program.

With the enhancements to Genuine GM Rewards we are making the following changes.
- Powertrain Components have been removed from the overPOWER program.
- Dealers now earn 1% of net invoice purchases of engine (product line 39) and transmissions (product line 40) assemblies.
- overPOWER the Competition claim amounts have been reduced

Bump the Competition
- Due to the expansion of "Make them an Offer" program parts on Bump the Competition, aftermarket list price will no longer be available.
- The extended warranty pilot program will not be extended due to business results.

Announcing Fast Start funding promotion for January
- Bump the Competition Fast Start Bonus is 10% of dealer's 2012 Calendar Year conquest amount reimbursed through the Bump the Competition program.
- overPOWER Fast Start Bonus is $500 for any dealer that purchased engines and/or transmissions assemblies directly from GM Customer Care and Aftersales in 2012.

Complete 2013 Program Parts Lists and Tools will be available shortly on GMLAM.com.

Note: GM reserves the right to modify or cancel this program at any time, without notice.

EFFECTIVE DATE:
January 1, 2013

Contact name: Carol Balgenorth E-Mail: carol.balgenorth@gm.com
Department: Parts - Customer Care & Aftersales WHQ Phone: 810-606-4520
Intended roles: All-NON-010-Roles, Body Shop Manager, Dealer, Dealer Principal, Parts Manager, Sales Management, Service Manager
Archives: 01/20/2013 Expires: 12/20/2018

Source: Felder Collision Parts Inc. vs. General Motors Company et all, 10/12/12
http://www.mcmlsp.com/sandbox/podmock/2431Collision/tools/BTC_Calculator_010109v1a.xls

Source: http://www.gmlam.com/guidelines/parts/conquest_bulletin.pdf

Mazda's "Collision Parts Advantage™" Program Also Directed at Displacing LKQ

- Launched in 2011, the "Collision Parts Advantage™ " program was launched by Mazda, to warn its customers that aftermarket **L**ike **K**ind and **Q**uality are generally of lower quality than certified OEM parts. The program offers its customers and chosen repair shops the choice to use its OEM parts with a price matching guarantee

If you're replacing parts,
think original
and genuine.

When it comes to their advanced designs, meticulous craftsmanship, and quality factory parts. all new Mazdas are created equal. But once a vehicle requires repair, whether as a result of an accident, or normal wear and tear on parts like brakes, things can get quite different. This is because there are two types of parts you can use to fix a Mazda: Aftermarket (or imitation parts) and Genuine Mazda Body Parts.

GENUINE MAZDA BODY PARTS VS. AFTERMARKET PARTS

When you use Genuine Mazda Body Parts to fix your vehicle, you're literally making that piece of it brand-new again. That's because Genuine Mazda Body Parts have been made from the same blueprints as the original. Every single part is guaranteed to perform and wear the same as the day you first drove your new Mazda. Equally important, only Genuine Mazda Body Parts are specifically covered by the Mazda warranty.

But aftermarket parts are quite different. They're generally made to a lower standard in order to cut costs. And without access to original manufacturing specifications, their fit and finish can be dramatically different – panels may not match up perfectly, brakes don't stop or wear as well, and lower-quality steel may corrode quickly. Worse yet, the original warranty could become invalid if aftermarket parts contribute to the damage of original parts. Even lease-end charges can be affected if the replacement parts fit poorly.

ACCIDENTS HAPPEN BUT REPAIRS CAN BE PLANNED

Always be sure to specifically ask your repair shop to use Genuine Mazda Body Parts before anyone creates a repair order or estimate. In addition, be sure to watch out when insurance companies try to use aftermarket replacement parts, which they misleadingly refer to as "like kind and quality." Depending upon the state you live in, you may actually have the legal right to demand Genuine Mazda Body Parts. If your insurance company refuses, simply contact your agent, or the office of the State Insurance Commissioner to find out what rights and recourse you may have.

NOTHING COMPARES TO AN ORIGINAL

Genuine Mazda Body Parts are manufactured of the same high quality steel and a dual layer galvanized zinc process as the sheet metal installed at the factory.

AFTERMARKET BODY PANEL | GENUINE MAZDA BODY PANEL

Single Layer Galvanization | Steel of Unknown Quality | Dual Layer Galvanization Zinc Process | High Quality Steel

The result is sheet metal components of superior strength and corrosion resistance. Some aftermarket panels aren't even single-layer galvanized.

We've Got Your Genuine Mazda Collision Parts.

And Now We Offer Price Matching through our Newly Announced Collision Parts Advantage™ Program!

Mazda Collision Parts Advantage™ (CPA) is a program which allows participating Mazda dealers to **price match** select Genuine Mazda Parts to aftermarket parts.

Because you want to use OE parts, your Mazda dealer can offer Genuine Mazda Collision Parts at aftermarket prices. You now have the choice to use OE parts and avoid the hassle of aftermarket "Like Kind and Quality."

The Mazda Collision Parts Advantage™ means you get great prices plus:

- Perfect Fit & Performance
- Factory Specifications
- Faster Repair Times
- Getting Your Customers Back on the Road Quicker

Components that Cover Your Most Frequent Repairs

Hoods	Fog Lamps
Bumpers	Side Markers
Fenders	A/C Condensers
Headlamps	Radiators
Tail Lamps	Radiator Core Supports

Applications for Most Popular Models

CX-7	MAZDA6	Tribute
CX-9	MPV	Truck
MAZDA3	MX-5	626
MAZDA5	Protegé	

Contact your Mazda dealer for program details. Take advantage of the best availability and now the most competitive prices to save you time and money.

COLLISION PARTS ADVANTAGE

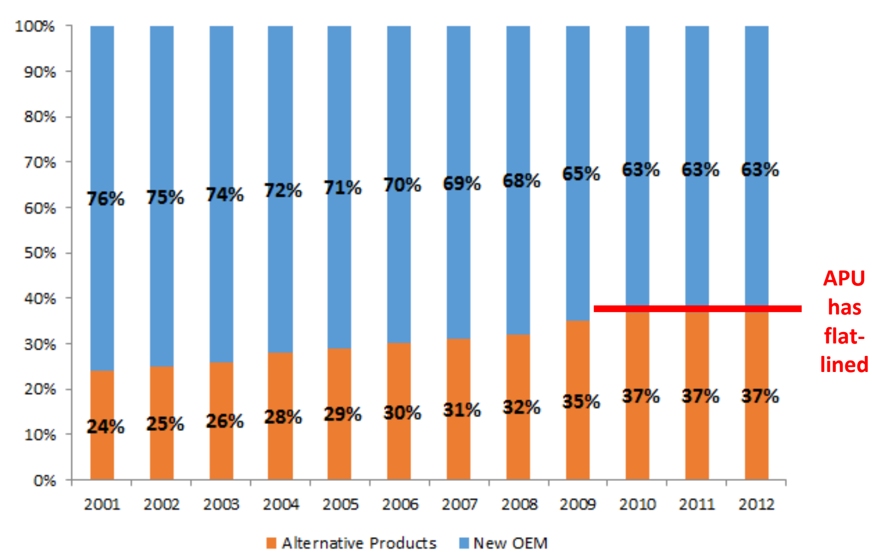
http://www.mazdaserviceinfo.com/PDFs/Collision%20Parts%20Advantage.pdf

OEM Price-Matching:
APU Has Flat-Lined, Likely to Taper/Decline

- The OEMs are aggressively reclaiming market share by competing away LKQ's price advantage – the prime basis of its value proposition. Their efforts have successfully halted the three decade-long trend of steadily increasing APU. CCC Information Services, provider of the dominant estimate-writing platform, indicates APU has leveled off over the past 3 years and the share shift may reverse. CCC's assessment is that **a decline or tapering in APU is likely to materialize**.
  - **A rising APU *was* a primary driver of LKQ's organic growth**. We note that every single LKQ investor presentation we have studied dating back to 2007 has given prominence to a slide displaying the decade long trend in APU. **For the first time ever LKQ has chosen to exclude this slide from its 2013 presentations.** We believe this change is a tacit admission that this metric no longer figures into the company's '*growth story*'

> *The Autumn Update to Crash Course 2011 included a discussion on the impact of the aging fleet on parts utilization, and showed that the increase in industry-wide non-OE part utilization was driven in large part by the growing share of older model year vehicles, where non-OE parts availability is higher. As consumers begin to purchase more new vehicles, and as more manufacturers provide price-matching programs for their dealers, non-OE share of parts dollars (i.e. APU) will likely taper or decline.*
>
> *– CCC Crash Course 2012*, published on 3/7/2012

Collision Replacement Products Market Shift



Sources: LKQ Third Quarter 2012 Investor Presentations, *CCC Crash Course 2012*

LKQ Appears To Be Deceiving Investors About the Current APU Problems

- According to CEO Robert Wagman on the Q3'2011 earnings call, LKQ claims APU rose from 37% to 38% in 2012

> *"As mentioned on previous calls, we were confident that the historical trend of 100 basis point improvement in alternative part usage would continue in 2012… According to CCC Information Services, APU now stands at 38%.…As we enter the last quarter of 2012 and prepare for 2013, our outlook continues to be positive. I'm encouraged by… the continued growth in APU …"*

- Its own data source refutes that claim. As its source for APU data communicated in conference calls and investor presentations, LKQ cites the annual results released by CCC Information Services: Per Robert Wagman on the Q3'2011 earnings conference call,

> *"… we only get the **annual results** from the estimating company as to what's happening to the APU trend…"*

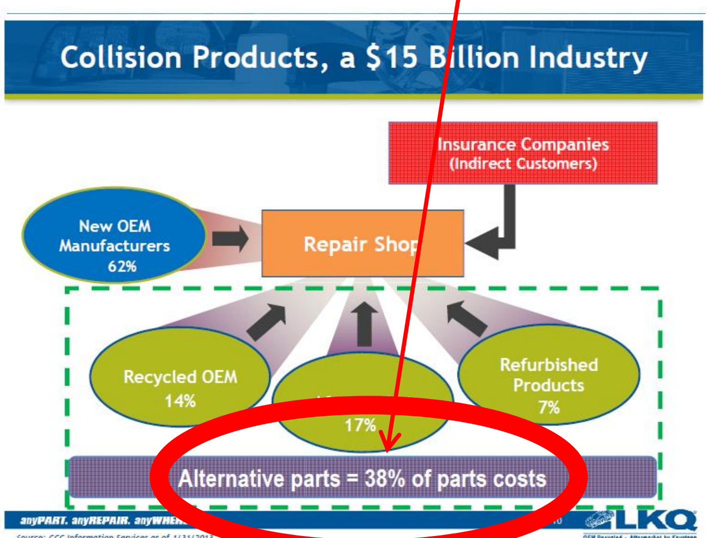
Discussion	What LKQ Tells Investors	What LKQ's Data Source Says
Alternative Parts Usage (APU) rate	**Source: Q3'12 conference call on 10/25/2012 --** *As mentioned on previous calls, **we were confident that the historical trend of 100 basis point improvement in alternative part usage would continue in 2012**. And today, I am pleased to announce that, that goal* (for a 100 basis point improvement in APU in 2012) *was achieved through the end of the third quarter. **According to CCC Information Services, APU now stands at 38%.***	**Source: CCC Crash 2012 Fall Update, published 10/17/2012 --** ***The percent of the total dollars spent on replacement parts that were OEM was essentially flat year-over-year: 63.2 percent at mid-year 2012 versus 63.1 percent at mid-year 2011.*** (i.e. From mid-year 2011 to 2012, APU fell from 36.9% to 36.8%) **CCC Crash Course 2013 report, published 3/28/2013 --** *At the close of 2012, the industry's share of replacement part dollars was split at **63 percent OEM versus 37 percent non-OEM**.*
Assessment of Trend in APU	**Source: Q3'12 conference call on 10/25/2012 --** *As we enter the last quarter of 2012 and prepare for 2013, our outlook continues to be positive. I'm encouraged by the trends in miles driven, **the continued growth in APU**, the recent reduction in vehicle pricing at auctions, the strength of Euro Car Parts and the robust pipeline of acquisition opportunities we are witnessing.*	**CCC Crash 2012 Crash Course, published on 3/7/2012 --** *The Autumn Update to Crash Course 2011 included a discussion on the impact of the aging fleet on parts utilization, and showed that the increase in industry-wide non-OE part utilization was driven in large part by the growing share of older model year vehicles, where non-OE parts availability is higher. **As consumers begin to purchase more new vehicles, and as more manufacturers provide price-matching programs for their dealers, non-OE share of parts dollars** (i.e. APU) **will likely taper or decline.***

NA Organic Growth – APU
LKQ Appears to have Deceived Investors

Even as it tells investors APU rose 100 basis points in 2012, LKQ contradicts itself in its own filings with the Securities and Exchange Commission, which report that **APU did indeed *not* rise**

What LKQ Tells Investors

In its March 2013 Investor Presentation, LKQ claims that **APU had reached 38%**, in accordance with previous guidance



What LKQ Says in its SEC Filings

*We believe, however, that as the insurance and repair industries continue to recognize the advantages of aftermarket, recycled, refurbished and remanufactured products, the alternatives to new OEM replacement products will account for a larger percentage of total vehicle replacement product sales. Since 2008, **alternative parts usage has increased from approximately 32% to 37%** of the collision replacement product market. We compete with OEMs on the basis of price, service and product quality*

Sources: LKQ 10-K for 2012, March 2013 Investor Presentation (Raymond James 34th Annual Institutional Investors Conference)

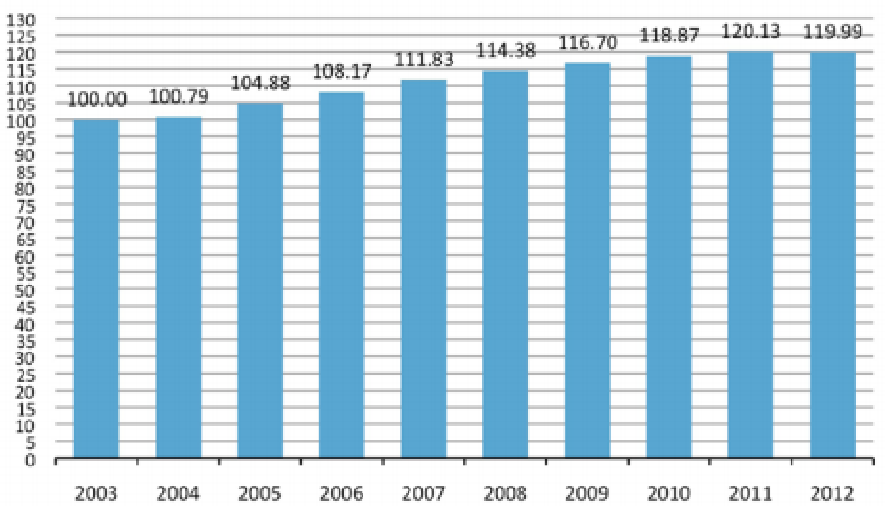
OEM Price-Matching: Parts Price Deflation Began in 2H'2012

- The expansion of OEM price-matching programs have become so expansive that they drove **deflation in parts prices in 2012**. Industry data source Mitchell International reported a decrease in the indexed price of vehicle parts for its market basket for the first time in the 10 years Mitchell International has been collecting data.
- Prices began deflating in the second half of the year; it is clear that the OEMs are expanding their price matching programs to cover more parts and that the programs are being implemented by more and more dealers.

"For the first time, we saw a decrease in the indexed price for the market basket. Loyal readers of the Industry Trends Report will see that the 2012 decrease was not evident when we ran the index report early in 2012, so the decrease was in the latter half of 2012… The domestic vehicle parts market basket experienced such a decrease that it offset the moderate increases in the Asian and European market basket… So what we are seeing is the impact of the expansion of the competition parts price matching programs from the domestic OEs driving the decrease in the overall index…"

– Mitchell Industry Trends Report, Q2 2013

Figure 1–Top 20 Parts Index for all Vehicles



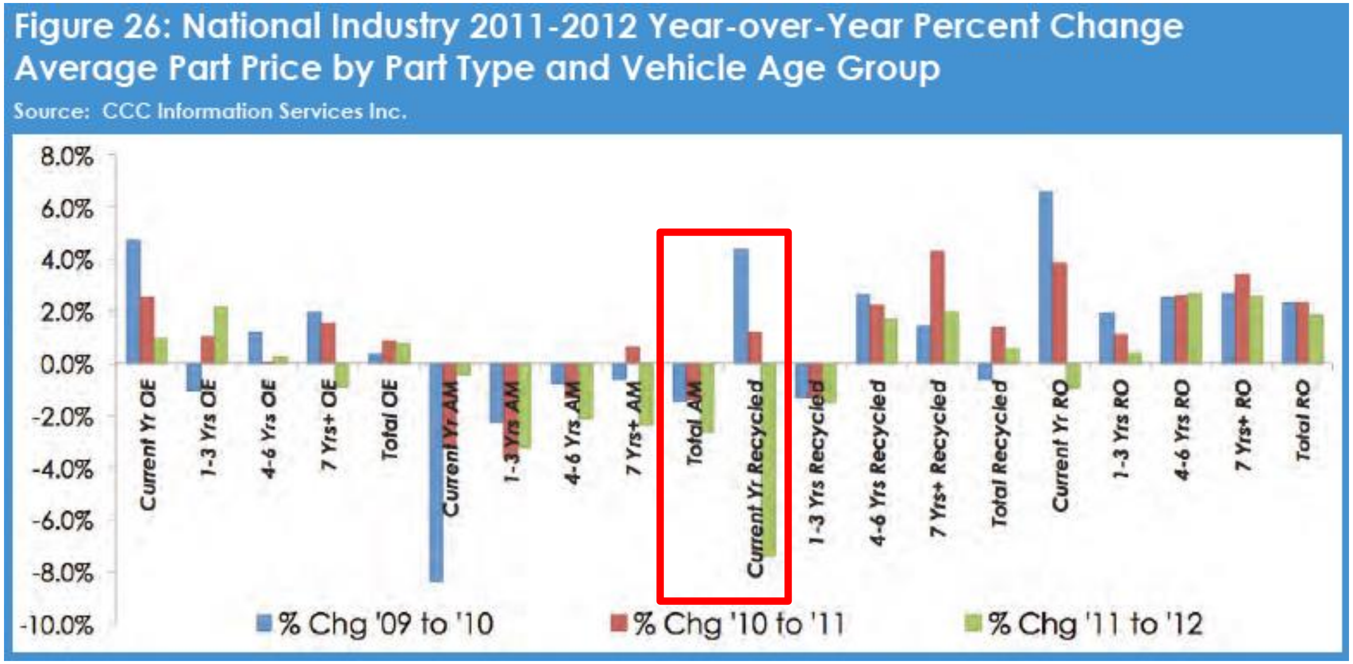
Source: *Mitchell Industry Trends Report*, Q2 2013

OEM Price-Matching (Cont'd): Parts Price Deflation Began in 2H'2012

- >50% of LKQ's consolidated revenues are generated from the sale of aftermarket parts
- According to CCC Information Systems, aftermarket parts deflated by 2.4% in 2012.

"Between 2011 and 2012 … the average price paid per replacement part fell by 0.3 percent. Average price paid per replacement part varied by part type, with reconditioned parts increasing 2.0 percent, aftermarket parts decreasing by 2.4 percent, and recycled parts increasing 0.8 percent."

– CCC Crash Course 2013 report, published 3/28/2013



Source: CCC Crash Course 2013

PRESCIENCE POINT

State Farm Insurance's New PartsTrader Platform to Drive Even More Pricing Pressure

- Insurance companies exert significant influence in the vehicle repair decision since they ultimately pay for the majority of collision repairs of insured vehicles. **Therefore, they are incentivized to drive auto parts prices as low as possible to maximize their profits**
- In May 2013, State Farm Insurance, the largest US auto insurer, confirmed the end of the pilot phase, and a national rollout of PartsTrader, an electronic ordering system to its Select Service direct repair facilities. The national roll-out is expected to be completed by 2014*
- PartsTrader is a web-based collision replacement parts market connecting OEM, aftermarket, remanufactured, specialized and recycled automotive parts suppliers with collision repairers looking for replacement parts
- As an online competitive marketplace designed to allow collision shops to make better procurement decisions with information on part quality, delivery time, supplier reputation, and prices, **PartsTrader is expected to drive more competition amongst alternative parts distributors, lowering auto parts prices and serving as another blow to industry organic revenue growth**

www.partstrader.us.com

* http://www.fenderbender.com/FenderBender/May-2013/State-Farm-Initiates-PartsTrader-Expansion/

NA Organic Growth – Not Reconcilable w/ End Market Growth

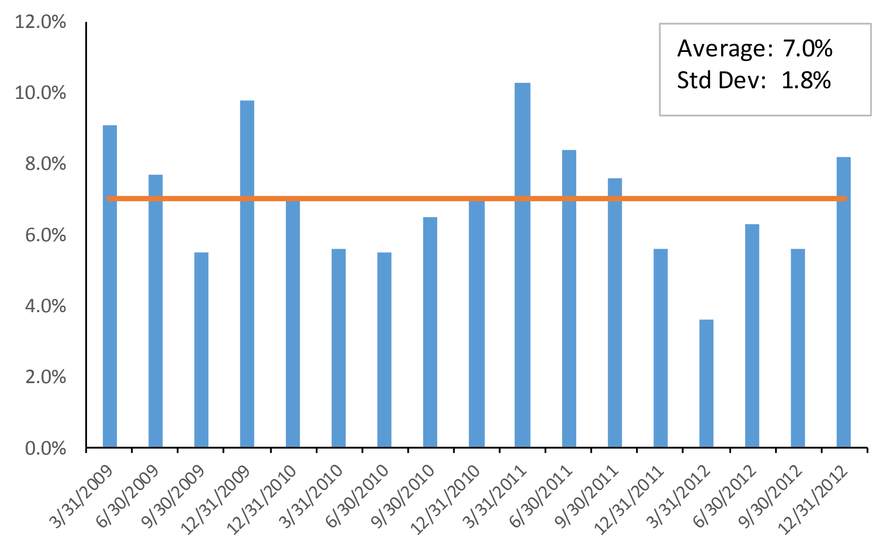
- LKQ's reported NA Parts and Services organic growth rate also appears unhinged from the growth rates reported by companies in its primary North American end market, collision repair shops
- For example, Boyd Group (TSX: BYD.UN) is a Canada-based company that is consolidating the US/Canada collision repair industry as a multi-service operator (MSO). Boyd has 228 locations in five Canadian provinces and 14 U.S. states.
- According to the Romans Group LLC, Boyd is a player in the fastest growing segment of the collision repair industry and is outperforming its peers in that segment.[1] Specifically,
  - Boyd is a part of *"the $20+ million U.S. collision repair segment (which) continues to grow market share and brand relatively faster than other segments of the collision repair industry",* and
  - Boyd has significantly grown its market share relative to the other top $20mm+ operators since 2006

(1) *A Profile of the Evolving Collision Repair Marketplace*, Parts 1 & 2. The Romans Group, 2012.

LKQ's NA Organic Growth is Too Predictably Positive and Smooth in a Cyclical Industry

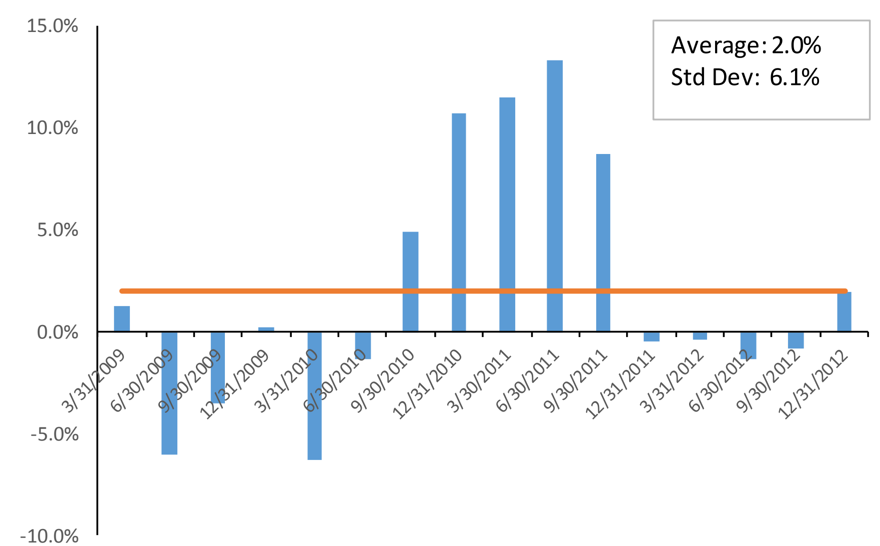
- The significance in disparity between LKQ and Boyd's organic growth rates defies logic: Boyd Group – again, an outperformer amongst collision repairers – has reported organic growth of <u>2% on average since Q1'2009</u>, with significant variability in its growth rate (<u>6.1% standard deviation</u>), and has reported negative growth in several quarters; on the other hand, LKQ has reported organic growth in Parts and Services of <u>7.0% on average</u> over the same time period, with relatively little variability in its growth rate (<u>standard deviation of just 1.8%</u>), and has <u>never reported a period of negative organic growth</u>

LKQ Quarterly Parts and Services Reported Organic Growth Rate



Source LKQ Press Release

SSS Growth - Boyd Group - Multi-Service Operator of Collision Repair Shops



Source: Boyd Group Press Releases

Note that LKQ changed its reporting of organic growth categories on 3/3/13. As a result, this analysis runs through 12/31/12 for the purpose of presenting a fair, apples-to-apples comparison.

The European “Growth Fantasy” – Short-Term Decision-Making Signals Desperation to Keep Financials Inflated & Meet Guidance Targets

Euro Car Parts – LKQ's Largest Contributor to Organic Growth

- In Q4'2011 LKQ began expanding into Europe. Its acquisition of UK-based Euro Car Parts (ECP), a distributor of <u>mechanical</u> aftermarket parts, was made – and this was never disclosed by LKQ – as the UK aftermarket industry was significantly contracting (which is projected to continue), amounting to a high risk gamble using shareholder capital. At the time of purchase, ECP operated out of 89 branch/store locations, and opened an average of 10 new branches per year in the period 2007-2011.

- LKQ pitched the purchase primarily as an <u>open-ended opportunity</u> to replicate its North American success in Europe, by driving APU – currently at 5% in the UK vs. 37% in the US – for <u>collision</u> repairs.

- **We believe LKQ is operating ECP to inflate its financials and meet guidance targets, at the long term shareholder expense of entrenchment in a <u>contracting market</u>, which will result in a new financial hole LKQ will predictably seek to plug with more acquisitions (which it has already begun making)**

Euro Car Parts – LKQ's Largest Contributor to Organic Growth

- **History of Acquisition:** In October, 2011, LKQ acquired Euro Car Parts (ECP), a leading distributor of mechanical aftermarket parts in the U.K., for a total of ~$432m (including the paid in full performance-based contingent component). ECP was founded by Sukhpal Singh Ahluwalia, who today serves as Chairman of LKQ Europe.
  - LKQ reported that ECP had grown revenue at a CAGR of 30%+ from 2009-2011; it generated 2011 revenue of $523m, equating to ~15% of LKQ sales.
  - At the time of purchase, ECP operated 89 branch locations, and opened an average of 10 new branches per year in the period 2007-2011
  - LKQ pitched the acquisition as,
    a) an opportunity to continue expanding ECP's branch network, and
    b) an open-ended opportunity to drive alternative part usage (APU) for collision repairs in the UK – where APU is ~5% (vs. 37% in the US) – by educating insurers about the value proposition of alternative parts. Per Chairman Joseph Holsten on the October, 4 2011 ECP acquisition call,

> *"… the opportunity is that whereas APU in the United States has moved from really even a sub-20% level when we first formed LKQ to 37% last year, the U.K. market today stands at 3-7% APU utilization rate."*

- ECP is LKQ's single largest driver of reported organic growth. LKQ reported ECP's organic growth rate to be 30%+ beginning in Q4'2012 and in each quarter since

ECP – 30%+ Organic Growth in a Contracting Industry?

- In its investor presentations, LKQ cites ECP's growth rate and the potential to increase collision-repair APU to imply the acquisition presents a new doorway for growth. It cites Datamonitor Group as its source for sizing the expansive UK aftermarket parts industry, an '$18bn market'
- LKQ never mentioned that according to the same source (Datamonitor Group / MarketLine), the UK aftermarket parts industry was in significant contraction at the time LKQ acquired ECP. According to Datamonitor's February 2012 publication, the UK industry was expected to contract in 2011 by -5.8%, and is projected to continue contracting:

> *"The United Kingdom automotive aftermarket sector shrank by 5.8% in 2011 to reach a value of $17,259.5 million… In 2016, the United Kingdom automotive aftermarket sector is forecast to have a value of $16,877.1 million, a decrease of 2.2% since 2011."*
>
> *"*The UK automotive aftermarket sector entered a period of decline from 2008 through to 2011. The sector is expected to continue to recover with marginal growth in 2012 before falling into decline once again from 2013 through to the end of the forecast period in 2016"… It contracted at a *"compound annual rate of change **(CARC) of -3.5% between 2007 and 2011**.*"
>
> *"The performance of the sector is forecast to decline further, with an anticipated CARC of -0.4% for the five-year period 2011-2016, which is expected to take the sector to a value of $16,877.1 million by the end of 2016."*
>
> – Datamonitor / MarketLine, *Automotive Aftermarket in the United Kingdom*, February 2012

Table 1: United Kingdom automotive aftermarket sector value: $ million, 2007–11(e)

Year	$ million	£ million	€ million	% Growth
007	19,939.1	12,911.3	15,032.2	
2008	19,510.0	12,633.5	14 08.7	-2.2
2009	18,329.0	11,868.7	13,818.4	-6.1
2010	18,318.0	11,861.7	13,810.1	-0.1
2011(e)	17,259.5	11,176.2	13,012.1	-5.8
CAGR: 2007–11				(3.5%)

SOURCE: MARKETLINE

MARKETLINE

- **How can a U.K.-based distributor of aftermarket auto parts regularly report 'organic growth' exceeding 30% as the industry around it is contracting?**

ECP –
'Organic Growth' That Isn't Really 'Organic'

- LKQ doesn't define ECP's 'organic growth' in the way investors might expect for a business characterized by sales originating at storefronts, for which 'organic growth' would be represented by a same store sales growth:
  - **LKQ treats ECP revenue from stores existing for >1 year *and* revenue from stores opened during the year as organic revenue**[1]
- As such, its reported organic growth rate is fueled by opening new ECP branches, and the more new branches it opens in a given period, the more it can inflate the reported organic growth rate
- Because ECP is in the midst of a rapid branch expansion, it is able to report 'organic' growth of 30%+ even as the broader UK aftermarket parts industry contracts
- While ECP's reported growth rate sheds light on the company's size, in comparing data that are fundamentally incomparable, it provides little information on the performance and health of its existing branch network. Further, it obscures LKQ's consolidated organic growth metric; LKQ uses a different standard for reporting its North America organic growth, which according to management only includes salvage yards open and within the system for a year. In essence, the company is mixing two different measurement approaches and potentially misleading investors

	Revenue Change Attributable to:			
	Acquisition	Organic	Foreign Exchange	% Change
North America	4.7%	6.2%	(0.3%)	10.7%
Europe	72.9%	32.9%	(1.9%)	103.9%
Parts and services	18.7%	11.7%	(0.6%)	29.8%
Other	8.9%	5.0%	(0.1%)	13.7%
Total	17.4%	10.8%	(0.5%)	27.7%

Different measurement approaches Yet each described as 'Organic'

(1) LKQ Earnings conference call for Q2'2012
(2) Q3'13 earnings release

Short-Term Decision-Making Signals Desperation to Keep Financials Inflated & Hit Guidance

- Throughout 2012, LKQ repeatedly raised guidance for the number of 2012 branch openings, from 20 to 30 to 42. ECP has also repeatedly raised guidance for the maximum number of full-sized ECP branches the UK market can absorb, from 100 to 120 to 150 to 175 to 200, giving itself more and more room to continue ramping the number of branch locations. As demonstrated in the pages to follow, these revisions were made with the purpose of meeting P&S revenue growth guidance
- The table below summarizes LKQ's repeated revisions of guidance for the number of branches to be opened per period and for the maximum number branches the UK market could absorb. The slides to follow detail these revisions

Source:	Guidance for New ECP Branch Openings	Guidance for Maximum # ECP Branches UK market could absorb
Article in The Telegraph (4/21/2009)		90 to 100 total ECP branches to give presence across the UK
ECP Acq. call (10/4/2011)	10-12 per year	
Q4'2011 earnings call (2/23/2012)	Guidance for 2012: 20 openings Change vs prior guidance: +10 openings Total store count if guidance met: 110 branches	120 full sized branches + 15 satellites
Q1'2012 earnings call (4/26/2012)	Revised guidance for 2012: 30 openings Change vs prior guidance: +10 openings Cumulative change vs initial guidance: +20 opens Total store count if guidance met: 120 branches 2013E guidance: 20-25 openings	150 full sized branches + 25 satellites (175 total) Change vs prior guidance: +40
Q3'2012 earnings call (10/25/2012)	Revised guidance for 2012: 42 openings Change vs prior guidance: +12 openings Cumulative change vs initial guidance: +32 opens Total store count if guidance met: 132	150 full sized branches + 25 satellites (175 total)
Q4'12 earnings call (2/28/2013)	Guidance for 2013: 10 openings Change vs prior 2013 guidance: -10 openings Total store count if guidance met: 142	150-175 full sized branches + 25 satellites (175-200 total) Change vs prior guidance: +25 Cumulative change vs initial guidance: +65
Q1'2013 earnings call (4/25/2013)	Revised guidance for 2013: 15 openings Change vs prior 2013 guidance: +5 openings Total store count if guidance met: 147	
Q2'2013 earnings call (8/1/2013)		175-200 full sized branches + 25 satellites (225 total) Change vs prior guidance: +25 Cumulative change vs initial guidance: +90

Short-Term Decision-Making Signals Desperation to Keep Financials Inflated & Hit Guidance

- In an article published by The Telegraph on 4/21/2009, ECP founder (currently Chairman of LKQ Europe) Sukhpal Singh Ahluwalia stated that he thought ECP could have a total of 90-100 branches, "giving it a presence across the UK"
- On the October, 2011 conference call detailing the ECP acquisition, LKQ told investors **it had a plan to open 10-12 branches per year for the next few years**. At that time LKQ appeared more focused on the opportunity to grow collision repair APU in the UK
- On the Q4'2011 earnings call, LKQ raised the number of branches it had planned to open to 20 in 2012. LKQ stated that the UK could support a total of **120 full-sized stores and 15 smaller, 'satellite' stores, so "*when we're all said and done, we could be in the 135 range*"**

Source:	Plans for New ECP Branches	Guidance for Maximum # ECP Branches UK market could absorb
Article in The Telegraph (4/21/2009)		**Sukhpal Singh** (from The Telegraph article, *Sukhpal Singh's Next Goals for Euro Car Parts)* I think we could increase to 90 to 100 branches. We need to have a presence across the UK
ECP Acquisition Call (10/4/2011)	**Robert L. Wagman** Yes, we -- right now, Craig, we have a plan to grow 10 to 12 branches per year for the next few years -- for the upcoming years to complete out the major U.K. markets, major markets that they're in.	
Q4'11 Earnings Call (2/23/2012)	Given the market opportunities in the U.K. and the attractive unit economics at ECP's locations, we anticipate ramping up our total branch openings for 2012 to roughly 20.	**Craig R. Kennison** RE ECP… what do you think that market, the U.K. market can support, long-term, in terms of the number of stores that you operate. **Robert L. Wagman** We think the right number is going to be somewhere around 120, Craig, to fully develop the network. So we think we'll be at 20 by the end of this year. **As far as the what the market -- the overall market, 120 seems to be the number, what we'll also do is open some satellite stores. They won't be full branch stores to support some of the remote areas of the U.K. So I think when we're all said and done, we could be in the 135 range.**

Short-Term Decision-Making, Cont'd

- On the Q1'2012, LKQ announced an increase in anticipated store openings to 30 in 2012, **which would result in a total of 120 stores (the previously stated market saturating count)**. Furthermore, it announced plans to open another 20-25 stores in 2013, which would take the **total number of stores to 140-145, well beyond previous guidance for UK market saturation**. It followed by raising the ceiling on the number of stores the market could absorb to **150 full-sized stores and 25 satellite branches (175 in total), which would seem to indicate branches in major metropolitan areas being "5 miles or so apart"(akin to a Starbucks model)!** LKQ would continue to raise, from this level, the maximum number of stores the UK could absorb
- On the Q3'2012 earnings call, for the 3rd time LKQ revised higher guidance for the number of branch openings planned to **32 for 2012 (**from initial guidance for 10-12), which would make for **132 branches in total**. LKQ also stated, "*We've said we believe the total store count is going to be somewhere around 150 to 175*"

Source:	Plans for New ECP Branches	Guidance for Maximum # ECP Branches UK market could absorb
Q1'12 Earnings Call (4/26/2012)	And due to favorable market conditions and ECP's management's proven ability to effectively and efficiently open branches, we anticipate accelerating new branch openings to 30 in 2012, which is 10 more than the 20 we were anticipating on our last call.. **Robert L. Wagman** **So we believe we'll get to roughly 120 locations by the end of this year, if all goes to plan. We want to add probably another 20 or 25 next year, which adds to about 150.**	**Unknown Analyst** Would you tell us just a little bit there about ECP and talk about the footprint? I mean, with the growth expansion-- if you look at how far these are apart, **any chance of cannibalizing in those markets?** **Robert L. Wagman** ...**We think that surely branches in major metropolitan areas can be 5 miles or so apart.** So there's not necessarily cannibalization, it's just better service for the customers.... And then on the last call, we talked about these ancillary locations, not full sized branches. Our average branch over there is a 10,000-square foot branch. These would be smaller offshoots in more rural areas. **That may be another 20 to 25 locations. So when this is all said and done, we'll be at about roughly 175 locations in the U.K.** **Cannibalization, there is a slight -- when you put one 5 miles apart from each other, we do move some of the revenue from one branch to the other.** But again, because of the better service levels we can provide, we do see an uptick in the revenue pretty quickly.
Q3'12 Earnings Call (10/25/2012)	During the quarter, we opened 10 new branches in the U.K., **bringing our total branch count to 120. Since the acquisition of ECP in early October 2011, we have opened 31 branches, surpassing the target number of 30,** I mentioned on the last call. Given that market conditions in the U.K., combined with the continued success of ECP, we have approved an additional 12 new branch openings for the fourth quarter bringing our total target to 132 branches by year-end.	**John R. Lawrence** Rob, would you take a -- if you look at ECP overall out for the next 12 to 18 months -- how do you look at allocating CapEx dollars? Obviously, you're doing that with some more stores, but longer term, that marketplace -- the viability to spend more capital over there? **Robert L. Wagman** **We've said we believe the total store count is going to be somewhere around 150 to 175.** We believe that number is still to be true. And in fact, we may actually be able to go a little bit above 175, with those satellite stores to feed the more remote areas.

Short-Term Decision-Making, Cont’d

- On the Q4’12 call, LKQ indicated that the 12 stores opened through January 2013 were pulled forward from the 25 it had projected to open in 2013, and that it would take a break from opening new stores until Q2’2013, at which point it could have evaluated the progress of the newly opened stores. **There was a deceptive change in language in guidance for possible total store count, calling for 150-175 full sized branches and an additional 25 satellites (200 in total)!** (Recall that on the Q1’12 call, then reaffirmed on the Q3’12 call, they guided that the market could absorb to **150 full-sized stores and 25 satellite branches (175 in total)**
- On the Q1’2013 earnings call, LKQ announced plans to open another 15 in Q3 and Q4, 2013, which would make for a total of 147 ECP branches (against initial guidance that the UK could absorb 120)
- On the Q2’2013 call in August 2013, LKQ again raised the limit on its estimate for the total number of stores the UK could absorb, to **175-200 full sized branches (from 150-175 before that, 150 before that, and 120 before that)!**
- Then on November 12, 2013, in a press release announcing ECP’s founder had been promoted to serve as chairman of LKQ Europe, he stated, “The UK alone will have **200 Euro Car Parts branches within three years**”!

Source:	Plans for New ECP Branches	Guidance for Maximum # ECP Branches UK market could absorb
Q4’12 Earnings Call (2/28/2013)	**Robert L. Wagman** During the fourth quarter, we opened 10 new branches, and we opened 2 additional branches in January, bringing our total branch count to 132… …With the 12 we did in Q4 originally scheduled for 2013 so we pushed them in 2012. So as John said, we're going to reevaluate this in Q2, but I would expect if we feel comfortable, **we'll add another 10 in 2013 to fill up, to get to 142**, with still some growth for 2014 and '15 as well.	**Robert L. Wagman** …We're still standing by our projections of 150 to 175 what we call, Tier 1 ECP locations and an additional 25 or so, Tier 2, the smaller or remote markets.
Q1’13 Earnings Call (4/25/2013)	Now turning to Euro Car Parts. We continue to be impressed with the performance of Euro Car Parts and its ability to capture market share. **In Q1, ECP achieved strong organic revenue growth of 32.1%. With the continued performance in ECP's financial results and the strength of ECP's management team, I am pleased to announce that we have approved an additional 15 new branches for 2013 that are scheduled to open in the third and fourth quarter of this year.**	
Q2’13 Earnings Call (8/1/2013)	**John S. Quinn** …. We've targeted 15 for the balance of this year. That will take us up to circa 147.	**John S. Quinn** … **We think the right number is probably somewhere in 175 to 200 for what we consider a full branch, and then there will be some satellite opportunities in addition to that**. Over time, as we grow that, we're going to have to look at the infrastructure associated with that regional hubs and the 2 main central hubs.
LKQ PR announcing leadership change		Sukhpal Singh Ahluwalia ‘I have never been more hungry, excited or determined to maximise our potential for the next decade and beyond. The UK alone will have 200 Euro Car Parts branches within three years and we have ambitious targets for paint, collision parts and e-commerce.’

Short-Term Decision-Making: Steep Discounting to Hit Numbers in 2012?

- In 2012, ECP started heavy price discounting of parts across the board. Most discounts touted up to 30% off, often on all products sold. By the end of the year, the savings discounts reached up to 45% off
- **Many of these sales appeared right at the end of the quarter, in what appears to be an attempt to juice results ahead of reporting to investors**

9/27/2012: **Right before Q3'12 Ended**
ECP ran a promotion "*The Boss is Away! 31% off Promo Code Inside…Ends Sunday*!" Our biggest ever discount offered on almost ALL car parts…cash in before the boss is back!

http://www.golfgtiforum.co.uk/index.php?topic=236138.0

8/16/2012: *"Mid Month Madness 30% off Car Parts Selected Car Parts"* Owning to popular demand (everybody likes a big juicy discount!) – we've decided to bring the big daddy back – yes that's 30% off Car Parts as well as ALL Engine oils

http://www.golfgtiforum.co.uk/index.php?topic=238645.0

12/28/2012: **Right before 2012 Yr. End**
"*Our Biggest Sale Ever! Up to 45%*" We have a Sale on at the moment where you can save up to 45% off on Car Parts..but it doesn't last long - must end midnight 1st Jan... so hurry!

http://www.golfgtiforum.co.uk/index.php?topic=246135.0

With Even Bigger Promotions in 2013!

- In 2013, discounts increased noticeably from 30% to upwards of 50% off. Each promotion is touted as its “biggest sale ever.” ECP has continued its practice of running promotions right towards the end of the quarter
- **Not one time has LKQ attributed such discounts as a driver of its persistently declining gross margin**

3/28/2013: **Before the end of Q1’13**

“*Our Biggest Ever Sale – Up to 50% off Everything!*”

http://www.golfgtiforum.co.uk/index.php?PHPSESSID=rffknoatjiinf0n2nuhh828uv6&topic=251262.0

5/24/2013 –”The Online Bank Holiday Sale, Up to 50% Off Everything!”

“It’s BACK again! – Up to 50% OFF EVERYTHING! No promo code required! Must End Midnight Monday, 27th May…”

http://www.golfgtiforum.co.uk/index.php?PHPSESSID=rffknoatjiinf0n2nuhh828uv6&topic=254275.0

9/27/2013: **Before the end of Q3’13**

“*End of Summer Clearance, up to 50% off Everything Online!*”..and you don’t need a promo code as current prices reflect the discount by default.”

http://www.golfgtiforum.co.uk/index.php?PHPSESSID=rffknoatjiinf0n2nuhh828uv6&topic=259869.0

PRESCIENCE POINT

How Did This Play Out In Pacifying Wall St. Estimates?

	High		Low
2012 Guidance -2/23/12			
Organic Revenue (parts/services)	5.50%	--	7.50%
ECP branch openings included in guidance	20	--	20
Income from continuing ops	$258.0	--	$278.0
Diluted EPS (1)	$0.860	--	$0.93
CFO	$250.0	--	$280.0
CAPEX	$100.0	--	$115.0
2012 Guidance -4/26/12			
Organic Revenue	5.00%	--	7.00%
ECP branch openings included in guidance	30	--	30
Income from continuing ops	$262.0	--	$282.0
Diluted EPS	$0.88	--	$0.94
CFO	$250.0	--	$280.0
CAPEX	$100.0	--	$115.0
2012 Guidance -7/26/12			
Organic Revenue	5.50%	--	7.00%
ECP branch openings included in guidance	30	--	30
Income from continuing ops	$265.0	--	$282.0
Diluted EPS (1)	$0.89	--	$0.94
CFO	$250.0	--	$280.0
CAPEX	$100.0	--	$115.0
2012 Guidance -10/25/12			
Organic Revenue	6.00%	--	7.00%
ECP branch openings included in guidance	42	--	42
Income from continuing ops	$265.0	--	$272.0
Diluted EPS (1)	$0.88	--	$0.91
CFO	$240.0	--	$270.0
CAPEX	$90.0	--	$100.0

On the Q4'2011 call (2/23/12), LKQ guided for 20 stores to be opened in 2012 and guided for 2012 Parts and Services organic revenue growth 5.5-7.0%. (Guidance for P&S organic growth includes the impact from anticipated ECP store openings)

On the Q1'2012 earnings call (4/26/12), guidance was revised lower to 5.0-7.0%, even as LKQ raised the number of anticipated 2012 store openings by +10 to 30, **indicating the intent to make up for unanticipated weakness in North America with new branch openings**. LKQ stated that in order to meet 2012 guidance, certain anticipated tailwinds would have to materialize, specifically stating APU would likely rise from 37% to 38%:

> *"We included in the internal growth and the earnings guidance the new ECP locations opened to date and planned for the balance of the year. Rob mentioned that we plan to increase the number of branch openings… **To reach our guidance, we're obviously assuming that the rest of the year gets better and we do think there are some tailwinds to help us in that regard**… In 2011, we saw alternative part usage rate in the industry of 37%. Based on what we're seeing in the market today, we believe that **in 2012 we'll see that rate increase to at least 38%…***

On the Q3'2012 earnings call (10/25/12), LKQ raised the number of anticipated 2012 store openings by +12 to 42 and raised the lower end of the range for organic growth by 50bp to 6.0-7.0%. In Q3, the opening of new ECP branches alone accounted for 40% of Parts and Services organic growth.

The increase in the number of stores openings during Q4'12 resulted in ECP growing to account for 75% of LKQ's Q4'2012 P&S organic growth, by our estimates, enabling it to report 6% organic revenue growth and meet the low end of the guidance range

In sum, LKQ stated a reliance on APU rising to 38% to meet the initially released 2012 guidance levels; although LKQ appears deceptive with investors in claiming this APU target was met, the data released by its information source refutes its claims, reporting that at the end of 2012 APU was 37%, unchanged from 2011. This left LKQ reliant on other sources of organic growth to meet guidance.

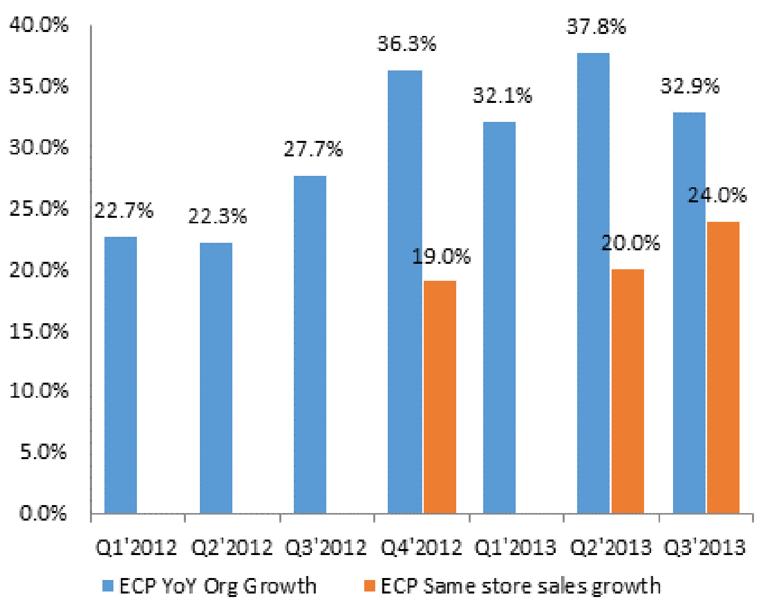
In 2012 LKQ juiced its organic growth rate by opening double the number of ECP branches initially guided for, indicating LKQ made strategic decisions related to ECP openings at the expense of long-term value creation to inflate its financials and hit guidance 2012 guidance for organic revenue growth

ECP – 'Organic' Growth Contribution to LKQ Parts and Services Org Growth is Now >50%

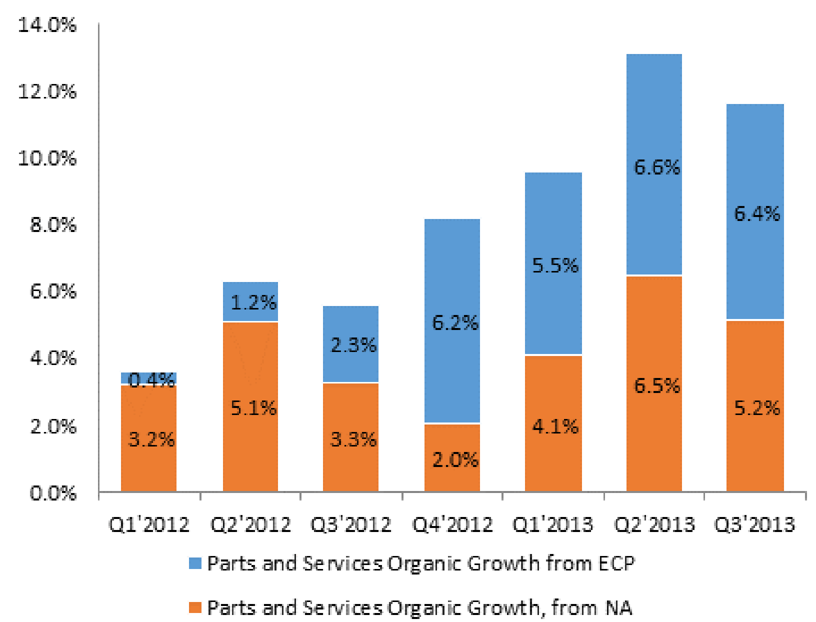
PRESCIENCE POINT

- ECP's reported organic growth rate has grown to account for >50% of LKQ's consolidated Parts and Services organic growth rate
- ECP's organic growth rate is a **short-term phenomenon**
- As ECP's reported organic growth rate begins to fall and converge with the industry rate of growth, **it will result in yet another large financial hole LKQ will predictably seek to plug**

ECP Reported Organic Sales Growth[1]



ECP Contribution to Parts and Services Organic Growth[2]

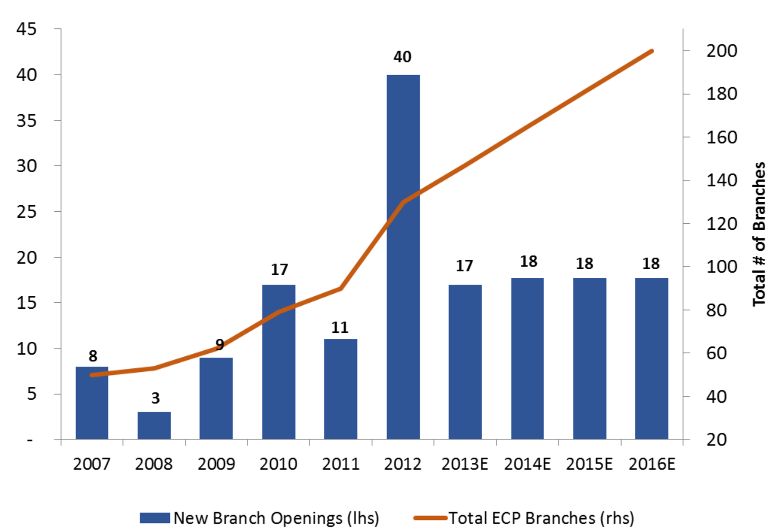


(1) Q2'2013 ECP SSS # adjusted for 2 extra selling days; SSS provides little insight, as it is inflated by the revenue ramp of newly opened branches, which take 3 years to mature
(2) NA organic growth contribution is a PP estimate, imputed by backing out organic growth from ECP from reported Parts and Services organic growth

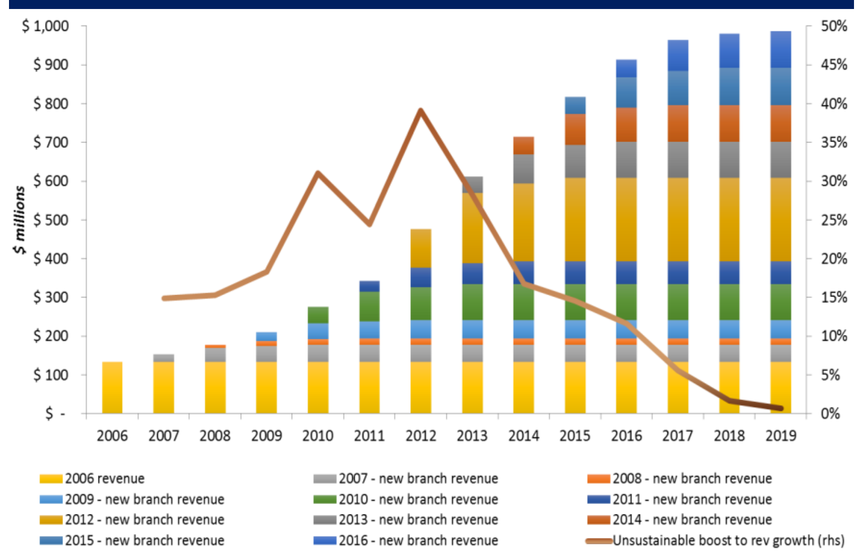
ECP – 'Organic' Growth Rate Unsustainable, Driven by Accelerated Store Expansion

- ECP had a total of 89 branches when LKQ bought it in October, 2011 and had opened an average of 10 new branches per year from 2007-2011. In 2012 alone, LKQ opened 40 new branches. In just 2 years, at 9/31/2013, LKQ had 138 total branches and intends to have 200 by the end of 2016
- The chart to the right below contains a simulation approximating the revenue build and growth rate for ECP that would result solely from opening new ECP branches. The levels of organic growth projected by the estimated growth rate trend are reflective of the levels reported by ECP (after taking into account that our simulation understates ECP's reported growth rates in its earlier periods due to assuming no new stores were opened in 2006 and prior). As such, we believe ECP's growth is almost entirely explained by branch openings, as opposed to same store sales growth for matured (i.e., >3 years old) branches, a result we would expect given the industry may be contracting
- This means that as ECP approaches its market saturating goal of 200 total branches, **its reported organic growth rate will plummet, converging to the industry rate of growth – which is negative**

ECP Current and Projected Store Base**



Simulated ECP Growth Solely from New Branch Openings**



**Historical Data from ECP 2009 Annual Report & the ECP Heritage webpage.
2014-2016E from "200 Euro Car Parts branches within three years "

**PP model: Uses 2006 as anchor year and is based on the number of per year ECP branch openings since 2006 and our projection of store builds through 2016, which reflects LKQ's Europe Chairman's expectation of 200 stores within 3 years. Assumes that at maturation, each store generates $5.4m, ECP's average reported revenue/store in the period 2010-2012. ECP generally experiences the most significant growth benefit from a new branch in the year of first generating sales, and benefits continue to accrue through a 3 year store maturation period (LKQ earnings conference call for Q3'2012)

LKQ's Short-Termism Results in Increasing Dependency on Acquisitions to Stay Afloat

- **LKQ appears to operate ECP with the primary intent of unsustainably inflating its financials and meeting guidance targets, at the long term shareholder expense of entrenchment in a <u>contracting market</u>. We believe the result is predictable: A <u>new financial hole</u> will be left in the wake of a slowdown of in ECP branch openings that LKQ will seek to plug with <u>more acquisitions</u> (which have already begun taking place):**
  - Growing ECP branches was not an LKQ priority when it justified the acquisition, and this is evident by its initial plan to open only 10-12 stores per year. On the ECP Acquisition call (11/4/2012), LKQ stated that it had a strategic "plan to grow 10 to 12 branches per year for the next few years". It broke from that 'plan' just one quarter later and following repeated revisions branch store openings, opened 40 branches in 2012. Coincidentally, growth in North America was weakening. Based on our estimates, by Q4'2012 ECP accounted for a full <u>75% of consolidated P&S organic growth and enabling LKQ to hit guidance</u>
  - LKQ has repeatedly raised the ceiling for the maximum number of ECP branches the UK market can absorb. On the Q1'2012 earnings call, LKQ stated, in another revision, that the UK could absorb a maximum of 150 full-sized ECP branches, and indicated that at that level "<u>branches in major metropolitan areas can be 5 miles or so apart</u>", which would clearly result in cannibalization. LKQ has since raised the ceiling on the maximum branch count to 200!
  - As of 9/30/2013, LKQ had a total of 138 stores (and growing), and plans to have 147 by YE2013, exceeding by 27 branches its initial guidance for the maximum number of stores the UK market could absorb (120 full-sized stores), which was likely the most credible number it has espoused given that it preceded the repeated store ramp-up and apparent quest to meet guidance. It may have already saturated the UK market, yet LKQ continues to invest shareholder capital into building new branches
  - LKQ appears to be juicing ECP sales with heavy discounting of parts, with many such promotions offered right at the end of LKQ's fiscal quarters
- Inevitably, as ECP reaches its market saturating location capacity, we expect – and **<u>we believe management has anticipated</u>** – its reported organic growth rate to plummet and converge to the industry average. **<u>LKQ moved quickly to buy Sator in April 2013, amounting to its 3nd largest purchase ever, at the time</u>**. As a result, its European reporting segment now includes both ECP and Sator. This new reporting will **<u>obscure future financial deterioration at ECP</u>**

Other Red Flags: ECP's Receivables Growing 2x Faster Than Revenues

The recent acquisition of Sator appears designed to hide the problems occurring at Euro Car Parts. By removing Sator's Q2 2013 revenue and accounts receivable contribution, **we find that ECP's receivables grew at 2x faster than reported revenues**. This is a major red flag for investors to consider.

European Segment Quarterly Operating Results

$ in millions

	Euro Car Parts Results Only						Sator/ECP		Pro Forma
	3m Ended Dec 2011	3m Ended March 2012	3m Ended June 2012	3m Ended Sept 2012	3m Ended Dec 2012	3m Ended March 2013	3m Ended June 2013	Sator Contribution(1)	ECP Only June 2013
Revenue	**$138.5**	**$160.7**	**$165.2**	**$181.3**	**$188.8**	**$212.6**	**$297.8**	**$68.8**	**$229.0**
QoQ growth	--	*16.0%*	*2.8%*	*9.7%*	*4.1%*	*12.6%*	*40.1%*	--	*7.7%*
YoY growth	--	--	--	--	*36.3%*	*32.3%*	*80.3%*	--	*38.6%*
Acct's Receivables, Net	**$50.9**	**$59.0**	**$60.0**	**$68.9**	**$70.2**	**$78.7**	**$143.7**	**$53.1**	**$90.6**
QoQ growth	--	*16.0%*	*1.7%*	*14.8%*	*1.8%*	*12.1%*	*82.7%*	--	*15.2%*
YoY growth	--	--	--	--	*37.9%*	*33.3%*	*139.3%*	--	*50.9%*

(1) LKQ Quarterly filing, Note 9

Source: Company financial filings

PRESCIENCE POINT

The Real ECP: A Lemon with Terrible Customer Feedback

Euro Car Parts - www.eurocarparts.com Reviews

euro CAR PARTS
Any Part For Any Car

Visit eurocarparts.com

WRITE A REVIEW

2 / 5

From 255 reviews

25.1% of users recommend this

Click here if this is your business

Customer Service	
Quality of website	
Value For Money	

7 Like | 0 +1 | 5 Tweet

"Very poor and dishonest sales staff"

Written on: 24/09/2013 by sciamo (2 reviews written)

WRITE A REVIEW

I ordered an important part (MAF Sensor) for my car yesterday. I could have gone with another company, for cheaper, but my brain left me temporarily and I unfortunately went with Euro Car Parts. Think I would have learned last time when they lied and said something was in stock when it wasn't and was therefore delayed. I phoned immediately after placing the order to see if it was indeed in stock like the website said. They told me it was, and that I would have it today. I phoned this... (read more)

Visit eurocarparts.com

Comment on this review

Report this review

"SHUT THEM DOWN"

Written on: 17/09/2013 by fuzzydrums (2 reviews written)

WRITE A REVIEW

BUYERS BEWARE! This may have been a legit company at one time, I don't know because I just placed my first order with them 6 weeks ago, but I do know that it appears they are out of business or scamming money. Both toll Free numbers on their website are no good and and no one responds to my emails. I am only out $60.00 but that's enough to get me mad. Try their toll Free numbers before ordering anything- that should be all you need to see this is not a real business and spend your money... (read more)

Visit eurocarparts.com

Comment on this review

Report this review

"Poor Sales & Poorer Service"

Written on: 24/09/2013

WRITE A REVIEW

I ordered a part over 2 weeks ago from Euro Car Parts and informed them that I live outside mainland Spain. They told me that they use DHL and as I use DHL myself to receive parcels form the UK and US I didn't think this would be an issue. How wrong I was... What hacks me off most is that they knew where I lived at the time of placing the order and instead of confirming they could deliver simply dispatched the parcel and still took two weeks to tell me they could not deliver. Now I... (read more)

Visit eurocarparts.com

Comment on this review

Report this review

"Absolutely useless zoo"

Written on: 28/09/2013

WRITE A REVIEW

Can't even send the right window wiper blades despite having my car reg. To exchange them I have to drive an 80 mile round trip, remind me why I paid for next day delivery. To top that I'm still waiting on other everyday parts that were all ordered together. Never use euro car parts. (read more)

Visit eurocarparts.com

Comment on this review

Report this review

http://www.reviewcentre.com/Online-Car-Part-Suppliers/Euro-Car-Parts-www-eurocarparts-com-review_2041339

Increasing Dependency on Acquisitions to Inflate Financials, Conceal Cumulative Manipulations

Apparent Dependency on Acquisitions to Inflate Profits and Conceal Cumulative Manipulations

- LKQ's move to expand internationally, beginning with its acquisition of ECP, was reminiscent of another chapter from the Waste Management Story – **the final chapter that ended with fraud and failure**
- On the October 4, 2011 ECP Acquisition conference call, LKQ Chairman (and former President of Waste Management International) Joseph Holsten, unprompted, assured shareholders that LKQ would not repeat Waste Management's international expansion mistakes

> *Now a few of us in LKQ have kind of been down a similar road before in the waste business, when we founded **Waste Management International** in the early 90s. And we ran down the road kind of fast and probably got into markets that were not good markets to be in. And as I go out -- you will see it from this management team. It's a team that learns from that lesson and **will be more cautious in its market entries in Europe**. We have a very strong commitment to our board that job one is to **make sure that the deal in the U.K. is functioning and functioning extremely well before we move into further markets**.*

- **The ensuing realities, however, have reflected little in the form of caution**

Dependency on Acquisitions to Inflate Profits and Conceal Possible Cumulative Manipulations

PRESCIENCE POINT

- **We believe LKQ entered Europe in search of a fresh pool of large-scale acquisition targets, and that it is dependent on acquisitions to continue inflating its organic growth rate and GAAP profits, while papering over cumulative past misstatements.**
- LKQ entered the UK market with the express, primary purpose of driving APU for collision repairs, and has made very little progress in doing so to date.
- Despite Chairman Holsten's pledge of caution, LKQ has invested shareholder capital to aggressively ramp the ECP branch count, while the industry around it contracts
- Furthermore, just a year and a half following the ECP acquisition – again, not having yet proven "the deal in the UK is functioning extremely well" when measured against its stated, core purpose – LKQ acquired Netherlands-based Sator Holding, a distributor of spare parts to the automotive aftermarket industry in Belgium, the Netherlands and Luxembourg, for a total of \$273m. Sator was LKQ's 3rd largest acquisition ever at the time. LKQ pitched the acquisition as an opportunity to "*achieve significant synergies, and ultimately, in the coming years, use Sator in our highly successful Euro car parts operations as platforms for further expansion into collision parts or other revenue and profit streams in Europe*." In the same way that it did ECP – as an <u>open-ended opportunity</u> of driving APU for collision repairs, currently at 7% in Western Europe vs. 37% in the US.
- In commenting about the acquisition, founder and President of ECP Sukhpal Singh Ahluwalia, appears to have had its sites set more on acquisitions than on expanding collision-repair APU

> *"… Our goal is also to use this transaction as a springboard for further acquisitions in Europe."*

- In a November 12, 2013 LKQ press release announcing that Sukhpal Singh Ahluwalia would be promoted to serve as Chairman of LKQ Europe, Singh stated,

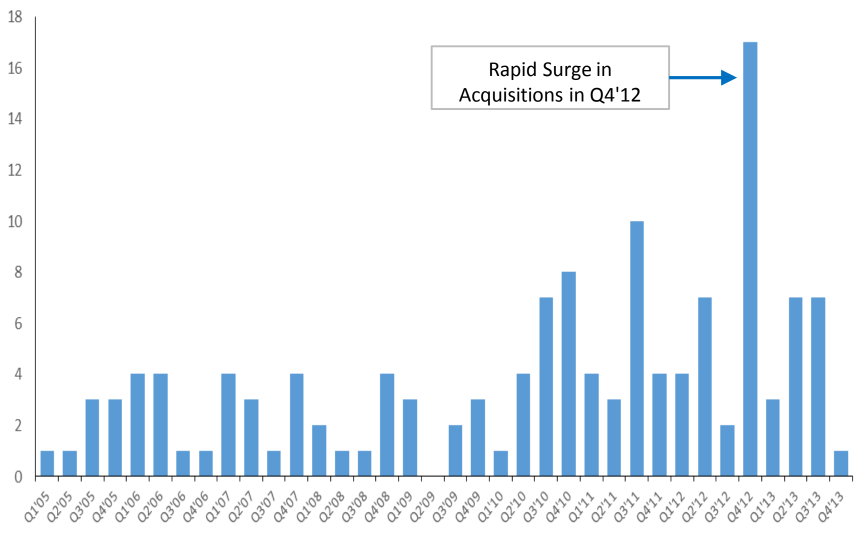
> *"… Under my Chairmanship, we will continue to hunt for <u>new acquisitions</u>, maintain relationships with our key suppliers and push forward to access new markets. My vision is to **<u>develop a group of European aftermarket companies exceeding \$5bn in annualised revenue within five years</u>**. The UK alone will have <u>200 Euro Car Parts branches</u> within three years and we have <u>ambitious targets</u> for paint, collision parts and e-commerce.'."*

- With time, Holsten's assurances of caution and LKQ's pitches for open-ended opportunities to drive collision European collision APU have been exposed to be diversions

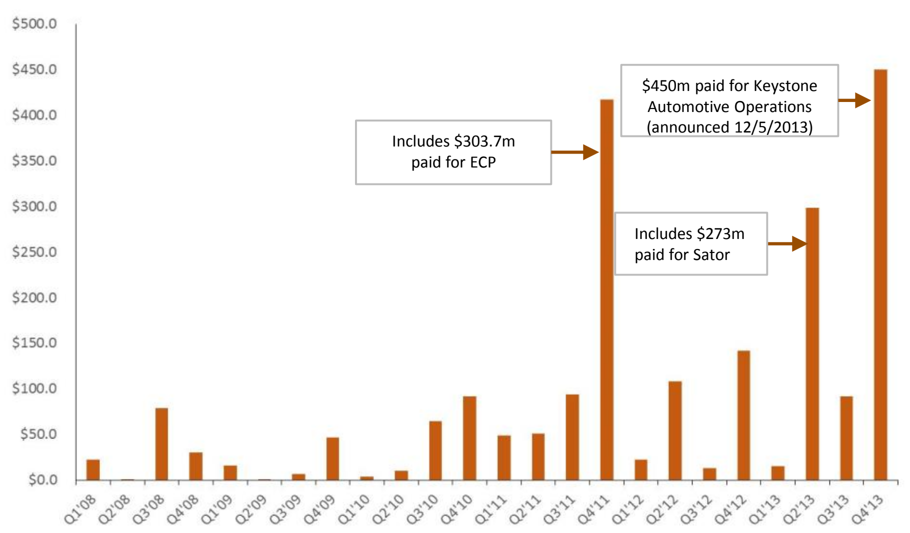
Dependency on Larger and Larger Acquisitions to Inc. Profits and Conceal Cumulative Problems

- LKQ is rapidly accelerating its deal making, both in number and in dollar value:
  - LKQ acquired 30 companies in 2012 alone, against the backdrop of having acquired a total of 71 companies in the 3 years from 2010-2012 and 171 since its 1998 inception. Notably, LKQ reported a record 17 acquisitions in just Q4'12.
  - Within the past 2 years, LKQ announced 3 of 4 of its largest acquisitions ever:
    - Its acquisition of Keystone Automotive Operations on December 5, 2013 is its 2nd largest ever. Its acquisition of ECP in Q4, 2011 is its 3rd largest ever. Its acquisition of Sator in Q2'2013 is its 4th largest ever

# of Quarterly Deals Completed



Acquisition Fair Value



Dependency on Acquisitions to Inflate Profits and Conceal Cumulative Manipulations

	High		Low
2012 Guidance -2/23/12			
Organic Revenue (parts/services)	5.50%	--	7.50%
ECP branch openings included in guidance	20	--	20
Income from continuing ops	$258.0	--	$278.0
Diluted EPS (1)	$0.860	--	$0.93
CFO	$250.0	--	$280.0
CAPEX	$100.0	--	$115.0
2012 Guidance -4/26/12			
Organic Revenue	5.00%	--	7.00%
ECP branch openings included in guidance	30	--	30
Income from continuing ops	$262.0	--	$282.0
Diluted EPS	$0.88	--	$0.94
CFO	$250.0	--	$280.0
CAPEX	$100.0	--	$115.0
2012 Guidance -7/26/12			
Organic Revenue	5.50%	--	7.00%
ECP branch openings included in guidance	30	--	30
Income from continuing ops	$265.0	--	$282.0
Diluted EPS (1)	$0.89	--	$0.94
CFO	$250.0	--	$280.0
CAPEX	$100.0	--	$115.0
2012 Guidance -10/25/12			
Organic Revenue	6.00%	--	7.00%
ECP branch openings included in guidance	42	--	42
Income from continuing ops	$265.0	--	$272.0
Diluted EPS (1)	$0.88	--	$0.91
CFO	$240.0	--	$270.0
CAPEX	$90.0	--	$100.0

(1) Adjusted for 2:1 stock split on 8/17/12. In April, guidance was adjusted to include $0.03c legal settlement

	2012	% change from midpoint	
Actual Results - 2/28/13	**Actual**	**Initial Guidance**	**Final Guidance**
Organic Revenue (parts/services)	6.00%	0.50%	0.50%
Income from continuing ops	$261.2	-2.5%	-2.7%
Diluted EPS	$0.87	-2.5%	-2.8%
CFO	$206.2	-22.2%	-19.1%
CAPEX	$88.2	-18.0%	-7.2%

Note: Yellow shading indicates changes in guidance

While LKQ met 2012 revenue and barely missed on EPS guidance, it missed dramatically on CFO guidance. 2012 CFO came in -19% below revised guidance issued only 2 months before year end on 10/25/2012, even as consolidated inventory turnover rose to 2.7x in 2012 (vs. 2.5x in 2011).

As previously discussed, acquisition accounting inherently and unsustainably boosts CFO. LKQ made a record number of acquisitions in Q4, just as a gaping financial hole in CFO exposed itself. We believe LKQ may be making acquisitions with the intent of inflating its financials and papering over past accounting manipulations.

The cumulative deal size was insufficient to bail the company out, but we note that in 2013 LKQ proceeded to raise the stakes, making its 2nd and 4th largest acquisitions since its inception.

..As LKQ's Deal Making Gets Progressively Worse and More Desperate

PRESCIENCE POINT

- The recent acquisitions of Euro Car Parts, Sator and Keystone Automotive Operations exhibit **progressively lower gross margins**, and have been acquired at multiples that are substantially lower than LKQ's own current valuation. We believe these acquisitions are partially used as a cover to explain away possible overstatement and deterioration of margins in its core business

	Keystone Auto Industries	Euro Car Parts	Sator Holding	Keystone Auto Operations
$ in mm	**2007**	**2011**	**2013**	**2013**
Revenues % growth[a]	$726.9 13.6%	$509.6 25%	$374.0 ~4-6%	$700.0 --
Gross Margin	44.8%	43.8%	33.1%	Low 30%
EBIT % margin	$49.1 6.8%	$33.4 6.6%	$26.0 *7.0%*	-- --
EBITDA % margin	$64.9 8.9%	$38.9 7.6%	$31.0 *8.3%*	$70.0 10.0%
EPS Accretion[b]	--	0.15 - $0.18c	$0.01c	--
Purchase Price[c]	$811	$347	$272	$450
EV/LTM EBITDA	12.5x	8.9x	8.8x	6.4x
EV/LTM Revenues	1.1x	0.68x	0.73x	0.64x

Source: Company financials, converted from local currencies
(a) Sator growth described as low single digits on investor conference call
(b) As stated to investors in the deal announcement
(c) ECP deal excludes $76m of earnout payments to be made in 2013 and 2014

Even Tuck-in Acquisition Quality Smells of Desperation

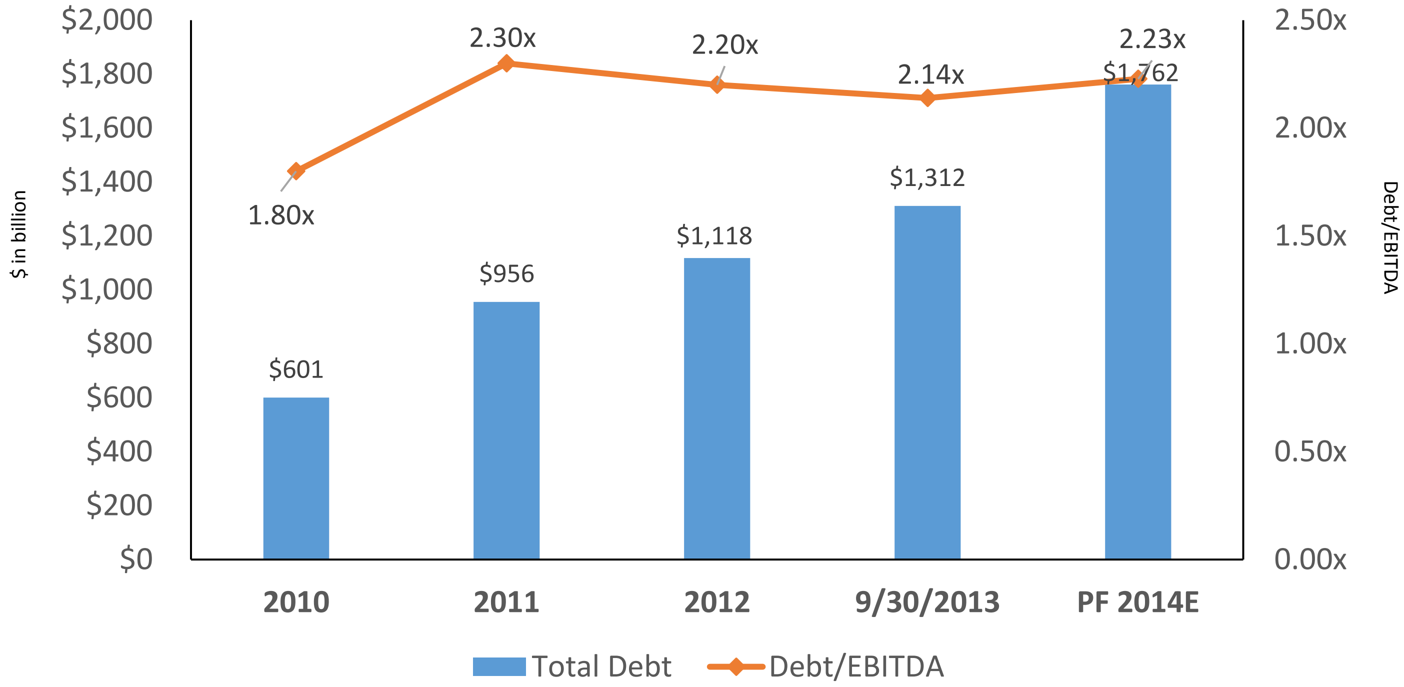
- Aside from large announced deals, LKQ has continued to acquire various businesses in an opaque and unannounced fashion. Below, we analyze information found in the footnotes of its SEC filings for trends in its recent deal-making.
- We find further evidence that its deals are getting increasingly desperate with smaller sized and lower EBIT contribution

$ in mm	2012	YTD 2013 (a)	Observation
Number of Deals	30	9	At 25-30% market share, it must be harder to find smaller deals
Total Deal Value / Goodwill Recorded	$284.6 / $197.6	$41.1 / $26.1	Goodwill amounting to ~65% of recent deals
Avg. Deal Size	$9.5	$4.5	Avg. Deal Size Down 50%
Revenue Contribution	$116.3	$12.4	
EBIT Contribution	$11.0	$0.5	
Implied Avg. EBIT Margin Contribution	9.4%	4.0%	Avg EBIT Contribution Margin down 540bps indicates lower quality businesses being added

Source: Company financials (Note 9)
(a) As the 6 months ended June 30, 2013 and excludes the Sator acquisition

..As Leverage Rises at the Same Time

- With margins under persistent pressure, growth in the U.S. stagnating, and the need to produce increasing revenue and EPS targets, LKQ has brazenly pushed into Europe with two recent acquisitions
- Recently in an unexpected manner, LKQ announced the acquisition of Keystone Automotive Industries for $450m, a deal that is currently being financed by short-term borrowing. Pro forma for the incremental $70m of acquired EBITDA, we estimate the company's leverage to be 2.2x Debt/EBITDA



Note: Pro forma for debt financed Keystone deal

Inventory Accounting:

Is Creative Accounting Inflating Gross Margins?

The Art of Inventory Accounting

Inventory Chicanery Tempts More Firms, Fools More Auditors, Wall St Journal, Dec 14, 1992

"When companies are desperate to stay afloat, inventory fraud is the easiest way to produce instant profits and dress up the balance sheet," says Felix Pomerantz, director of Florida International University's Center for Accounting, Auditing and Tax Studies in Miami." Even auditors at the top accounting firms are often fooled because they usually still count inventory the old-fashioned way, that is, by taking a very small sample of the goods and raw materials in stock and comparing the count with management's tallies. In addition, Mr. Pomerantz says, outside auditors can fail to catch inventory scams because they "either trust management too much or fear they will lose clients by being tougher."

No One Knows What LKQ's Sustainable Gross Margin Rate is, Potentially Even Management

LKQ Does Not Guide on Gross Margins, But When Recently Asked About LKQ's Sustainable Margin Rate, the CFO Seemed to *Theorize* Gross Margins to be Driven by 5 Different Factors and Evaded the Question Wholly!

Q2 2013 Earnings Call, Aug 01, 2013

Craig Kennison, Robert W. Baird & Co. Incorporated, Research Division

And lastly on gross margin, John, it fell a little bit year-over-year. I'm guessing that's largely mix and a little bit of the scrap issue. **But what do you think the sustainable margin rate would be at the gross level**?

John Quinn, LKQ Chief Financial Officer and Executive Vice President

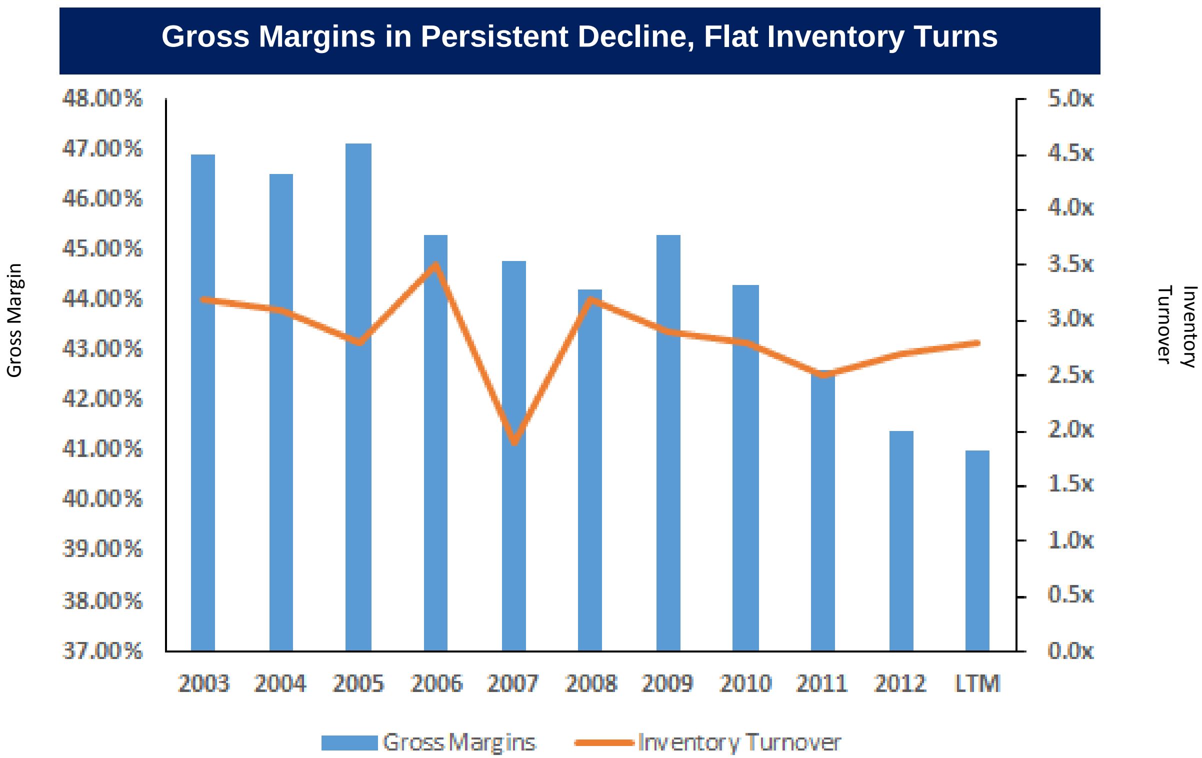
1 2 3 4 5

Craig, I think we've talked in the past that our view is excluding the **seasonality** that unless something changes, things tend to stay the way they are in the short term. And we probably did get a little bit negative impact in Q2 because of **falling scrap prices**. We did see a **little bit of benefit coming through in the car costs** on the domestic side. As I had mentioned, the demand obviously went down. Rob mentioned we're buying a little bit better year-over-year, so we are trying to see that theory, if you will, evidence of it coming through in the financials. Then **we do have a downtick coming with Sator in the short run** because they'll be fully consolidated next quarter, fourth quarter, and so on. And we only had them for 2 months. So I would expect it to see a little sequential decline as a result of having them onboard to the full quarter. **(ECP) will, as I mentioned earlier, just anniversaried now**, so I don't anticipate any impact from that. And you get a little bit sequential impact at having the absence of a decline in the scrap prices. It'll help us a little bit in the next quarter.

http://seekingalpha.com/article/1595912-lkq-management-discusses-q2-2013-results-earnings-call-transcript?page=6&p=qanda&l=last

The Facts: Gross Margins in Persistent Decline

- LKQ’s margins have been in <u>persistent decline</u> since 2005, while consolidated inventory turns have been <u>relatively stable</u>
- We believe there is <u>more deterioration</u> in LKQ’s gross margin than observable on the Income Statement



Sources: LKQ financials; CapitalIQ

Three Accounting Levers Would Enable Gross Margin Inflation

- If LKQ's consolidated gross margin is being inflated, how would it be able to maintain a stable consolidated inventory turnover?
  - For reference, from FY 2005 to the LTM period ended 9/30/2013, consolidated inventory turns have been relatively stable, measuring 2.8x. Over the same time period, consolidated gross margin contracted disproportionately from 47.1% to 41%

LKQ Appears to be Pulling 3 Accounting Levers in Unison:

1. **Aggressive Inventory Policy Enables Overstatement of Inventory** – LKQ's Salvage & Remanufactured products inventory accounting policy allows for complete discretion to leave costs on the balance sheet in the form of overstated inventory. The recent surge in salvage inventory coupled with gross margin deterioration is consistent with this trend. In isolation, this policy results in inflated gross margins and CFO, and exerts downward pressure on the rate of inventory turnover. The generally high level of Salvage & Remanufactured inventory – to which the aggressive policy applies – is a high level sign the company may be manipulating its margins
2. **Acquisition Accounting Enables Understatement of Acquired Inventories** – The acquisition fair market value process enables LKQ to understate the values of acquired company inventories, and to allocate the plug figure to goodwill. The result is that inventory costs, which should be future period expenses, are instead permanently deferred. In isolation, this would result in inflated gross margins and CFO, and exert upward pressure on the rate of inventory turnover, thereby counterbalancing the downward pressure caused by increases in Salvage and Remanufactured inventory and stabilizing consolidated inventory turnover.
3. **Mis-categorization of One-Time Gains to Directly Inflate Gross Margins** – Management has shown the willingness to use its discretion to very blatantly inflate gross margins

- Furthermore, we observe that **LKQ has never disclosed or broken out in its financials amounts for inventory writedowns**. We find this odd for a company that holds inventory such as auto parts that have a finite useful life
- We believe LKQ's gross margins will **continue to decline through 2014** against the backdrop of intensifying competitive pricing pressures, and as past accounting overstatements have to be reversed; we believe LKQ is at elevated risk of a crippling goodwill write-down.

1) Inflated Profitability, Focus on Inventory – Interview w/ Recycled Parts Distributor

Prescience Point ("PP"): ***LKQ reports a 10-11% profit margin. Is that the standard for a recycled parts distributor in general?***

Recycled Parts Distributor ("RPD") [1]: I can't hit those numbers; I'm not even sure they're making any money on the recycled business. I'm in the business, it's hard to make a profit… It is *very* competitive

Prescience Point ("PP"): ***Do you have some skepticism as to whether LKQ is as profitable as it indicates?***

RPD: Well, the first thing I would look at is their (recycled parts) inventories. Because they're easy to manipulate. There is no way to take an accurate inventory on recycled parts. There is no way to get the right value... You can do some estimating. How they value their inventory is crucial; as inventory gets older its almost worthless

(1) "Recycled Parts Distributor" is an owner of large, independent auto parts recyclers

1) Aggressive Inventory Accounting Policy – Enables Overstatement of Inventory & GM

PRESCIENCE POINT

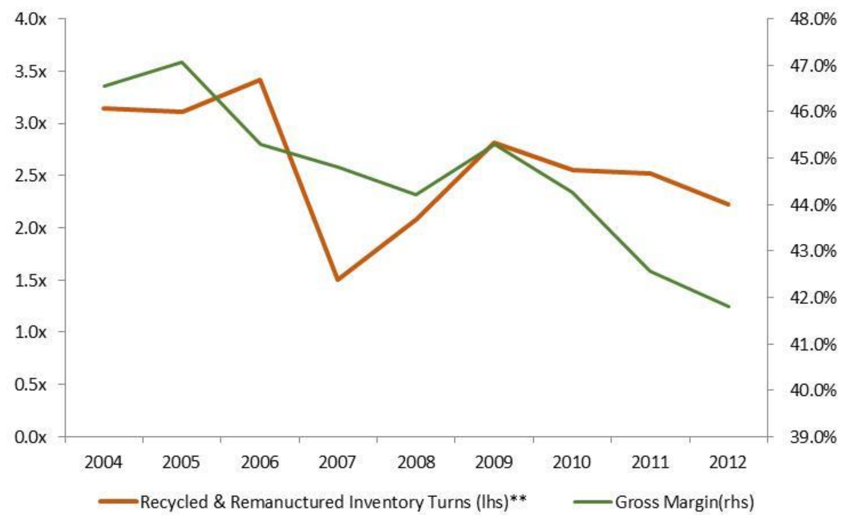
- LKQ uses an aggressive policy for accounting for its Salvage and Remanufactured Inventory (refer to next slide) that allows for a high level of discretion to leave costs on the balance sheet in the form of overstated inventory. LKQ is likely inflating its gross margin and earnings by failing to record a necessary expense for excess and obsolete inventory. Omissions of expensing obsolete inventories result in future margin compression, as past overstatements must be reversed; earnings will be pressured at the time when the inventory is sold (at a deep discount) or disposed of. In isolation, a policy of overstating inventory exerts downward pressure on LKQ's rate of inventory turnover
- LKQ calculates the carrying value of inventory through a formula that applies 1) the historical average of gross margin and 2) expected selling prices.[1] Using historical margins and future pricing estimates as inputs may paint an unrealistic picture of inventory value. As a result, the impact of any rapid margin change may be smoothed over time; we believe LKQ's gross margin is deteriorating faster than presented in its Income Statement
- The recent surge in salvage inventory coupled with gross margin deterioration is consistent with this smoothing trend and the overall concern of costs being left on the balance sheet

Salvage & Remanufactured Inventory Has Recently Surged, While Gross Margins are Declining

	2007	2008	2009	2010	2011	2012	LTM 9/30/13
Revenue	1,112.4	1,908.5	2,047.9	2,469.9	3,269.9	4,122.9	4,813.8
COGS	(614.0)	(1,064.7)	(1,120.1)	(1,376.4)	(1,877.9)	(2,399.0)	(2,839.6)
Gross Profit	498.4	843.8	927.8	1,093.5	1,392.0	1,723.9	1,974.2
Gross Margin	*44.8%*	*44.2%*	*45.3%*	*44.3%*	*42.6%*	*41.8%*	*41.0%*
Inventory by Product Type							
Salvage and Remanufactured Products	201	185	152	210	291	377	368
Aftermarket and Refurbished Products	112	140	226	275	446	524	650
Core Facilities Inventory	7	8	7	8	-	-	-
Total	**320**	**333**	**385**	**493**	**737**	**901**	**1,018**
Cons Inventory turns	**1.9x**	**3.2x**	**2.9x**	**2.8x**	**2.5x**	**2.7x**	**2.8x**
Total DSI	190	114	126	131	143	137	131

(1) Note for there are no standard prices for many of LKQs products, which would give management wide discretion for marking inventory values

Salvage & Remanufactured Inventory Turns and Consolidated Gross Margin Are Declining



- **Prescience Point estimate: assumes aftermarket and recycled product categories have equivalent margins. Keystone and LKQ margins were ~inline prior to the Keystone acquisition. Excludes our estimate for 'Other' inventory turns, which was imputed assuming a 45 DSI.

1) Aggressive Inventory Accounting Policy – Enables Overstatement of Inventory Balance

LKQ's Salvage and Remanufactured Inventory Accounting Policy

Aftermarket and Refurbished Product Inventory. Our aftermarket inventory cost is established based on the average price we pay for parts, and includes expenses incurred for freight and overhead costs. For items purchased from foreign companies, import fees and duties and transportation insurance are also included. Refurbished inventory cost is based on the average price we pay for cores, and also includes expenses incurred for freight, labor and other overhead.

Salvage and Remanufactured Inventory. Our salvage inventory cost is established based upon the price we pay for a vehicle, including auction, storage and towing fees, as well as expenditures for buying and dismantling. 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 certain direct procurement arrangements. Remanufactured inventory cost is based upon the price paid for cores, and also includes expenses incurred for freight, direct manufacturing costs and overhead.

- The company's policy sounds like the Gross Margin, or Gross Profit (GP), method used by many retailers for estimating inventories for interim financial statements. The GP method is not an acceptable method for determining the year-end inventory balance, since it only estimates what the ending inventory balance *may be*. GAAP requires companies that use the GM method to conduct an annual physical inventory count to determine the actual value of inventory at year end, as inventory values and physical quantities can decrease over time even if they are not sold. Failing to identify and reflect such shrinkage would undermine the reliability and accuracy of a company's financial statements.
- Although LKQ does not call its policy the GP method, its description indicates the two policies are close to, if not, identical. LKQ may be violating GAAP at every year-end as GAAP mandates taking an annual physical inventory count. If we are correct, that LKQ could have gotten away with calculating inventory based on these estimates is surprising. Like any retailer, LKQ is not immune to shrinkage (refer to *Thieves Steal Dozens of Car Parts from Local Shop*), which undermines the credibility of financial statements in which inventory is based on estimates.

Source: http://wnep.com/2013/06/04/thieves-steal-dozens-of-car-parts-from-local-shop/

2) Acquisition Accounting – Enables Understatement of Acquired Inventories

- Because LKQ is a serial acquirer that does not disclose specifics of the vast majority of its acquisitions, such as deal terms or consistencies of target company balance sheets, analyzing its accounting irregularities with precision and across periods is difficult. But the surge in Salvage & Remanufactured inventory, the account subject to the aggressive inventory accounting policy, serves as a higher level sign that margins and CFO may be manipulated

How would LKQ be able to keep consolidated inventory turns from declining in the face of GM manipulation?

- LKQ's acquisition policy gives it a lot of discretion when it comes to accounting manipulations. We believe LKQ may be using acquisition accounting to understate values of acquired inventories, further inflating its gross margin. In isolation, this policy would exert upward pressure on LKQ's rate of inventory turnover
- At the time of any acquisition, the acquirer is required by GAAP to present the fair value – or present a current value – of all the assets and liabilities on the balance sheet. When LKQ acquires a company, it is required to mark at fair value the inventory acquired; undervaluing the inventory would enable the company to counterbalance the rises in Salvage and Remanufactured inventory (previously discussed), keeping consolidated inventory turns flat, and inflate gross margins and CFO
    - As Tyco demonstrated when its frauds were exposed there is plenty of room for manipulation in the fair value process. (Refer to paragraph 4 in the SEC settlement announcement).
- The strategy would entail marking the value of tangible assets – that would otherwise result in future expenses down (e.g. inventory and PP&E) – as low as possible in the name of conservatism, and to allocate the balance to goodwill. In effect, the policy moves future period expenses to the balance sheet as goodwill, where they are permanently deferred
- To demonstrate, *at the extreme*, if the Company books the entire value of acquired inventory as goodwill (implying that it has marked acquired inventory down to a $0 value), then sells that inventory, the revenue will flow right down to its bottom line: Because there is no cost associated with that inventory, the Company's gross margin on the sale is inflated, in this case equating to 100%

2) Acquisition Accounting – Interview with Salvage Auto Consultant

Prescience Point ("PP"): ***When people sell to LKQ, what prices is LKQ paying? What metrics are they using and what are they buying a yard at?***

Salvage Auto Consultant ("SAC") [1]: I do some consulting for people that are selling to LKQ… If the business meets their (LKQ's) criteria, it would be rare for them to pay more than 0.6x sales. These days that's the most I have seen them pay, 60% of annual sales, so they are probably paying less than that, and only that amount if profitability is above 10% net, capex has been maintained, and it fits their customer mix – they will not buy a yard unless it sells late model collision…

PP: ***So if a yard sells at 0.6x sales, what is the typical value of inventory being bought?***

SAC: Lets back up and triangulate this. Lets take a yard that does $5m and that sells to LKQ for 60% of sales, or $3m… Understand that this revenue multiple does not include real estate; it applies only to the business... Let's assume that 80% of the yard's sales are used parts, which is typical for the industry; so it has $5m in annual sales, 80% from used parts, implying that $4m of their sales come from used part sales, which is $350k per month. The inventory values that are sustainable on the balance sheet for an IRS audit are between 2-3 months sales… At 3 months sales, which I think is more sustainable (than 2 months' sales), but probably more than that is needed actually… but I don't think the IRS would give a yard trouble with 3 months' sales in inventory – they'd kinda look at it and go on because it implies 4 turns to COGS. So 3 x $350k = $1.0m of inventory. That would imply that of the $3m purchase price LKQ paid, the inventory purchase component of that is *at least* $1m

PP: ***OK, so they buy a yard for $3m, and that yard would typically have $1m in inventory?***

SAC: I'd say $1m to $1.5m is what they're bringing it in at. I think they're being thoughtful about that number by the way. I don't think they're just applying some percentage method to it. I think they're looking at the reports, the turns, the gross margins, and making some assumptions on how valuable that inventory truly is, and how much obsolescence there truly is. **And they're bringing it in at a value to avoid taking writedowns later. And it may mean they may do some cookie jar accounting on the front end and amortize or replace some of it with goodwill because they'd bake off over a long time**

- We believe it is exactly this **'cookie jar accounting'** the consultant refers to that LKQ is using to inflate GM and CFO and to manage stability in its inventory turns, which inherently lends to the appearance of a high quality earnings stream

(1) Salvage Yard / Recycled Auto Consultant – consults for salvage yards; consults for some through the process of being acquired by LKQ

2) Acquisition Accounting – Enables Understatement of Acquired Inventories

- According to the 'Salvage Auto Consultant' interview on the previous slide, LKQ buys recycled auto distributors at a maximum of 60% of annual sales, a valuation that applies solely to the operation and excludes the value of real estate. Based on his experience, LKQ targets companies generating 10% profit margins. If we assume the purchase price ranges from 40-60% of sales, this would imply:
  - LKQ is paying 4x–6x net earnings for recycled auto parts distributors
  - Acquired inventory values make up 33% – 67% of the purchase price
- From 2003 to 2012 (excluding the impacts of the distressed purchase of Greenleaf), LKQ spent $2.3 billion on acquisitions. If we assume for conservatism that the purchase price allocations to PP&E were all related to real estate buys and back the cumulative PP&E allocation out from the cumulative purchase price, we are left with $2.1 billion spent to acquire the businesses. Over the same period $482m of the cumulative purchase price was allocated to inventory, or only 22.7% of the cumulative purchase price, ex PP&E.
- We believe LKQ's purchase price allocations are consistent with a policy of having used acquisition accounting to systematically understate acquisition inventory values, thereby, inflating its financials and successfully stabilizing its inventory turnover

2) Acquisition Accounting – LKQ at Elevated Risk of Goodwill Writedown

- **We believe LKQ is at an elevated risk of a significant goodwill write down**
- From 2003 to 2012 (excluding the impacts of the distressed purchase of Greenleaf), LKQ allocated ~70% of its aggregate acquisition costs to balance sheet goodwill. To date, it has amassed an $1.92 billion of goodwill (and a further $154m to intangibles) relative to a book equity totaling $2.25 billion; goodwill makes up 85% of LKQ's book value.
  - By way of comparison, Keystone – prior to LKQ's buyout of the company – from April 1 1998 to March 30, 2006 allocated only 44.9% of its aggregate acquisition costs to goodwill; in FY 2007, Keystone's goodwill amounted to 15.2% of book value
- A goodwill write down for LKQ is not without precedent. Jan 1, 2002, LKQ wrote off ~57% of its balance sheet goodwill. Prior to the write down, goodwill had amounted to 72% of book value

Previous LKQ Write-Off of ~57% of Goodwill Balance

Balance as of January 1, 2001	$ 118,333,214
Amortization	(3,110,770)
Goodwill written off	(178,000)
Balance as of December 31, 2001	115,044,444
Adjustment of previously recorded goodwill	238,499
Impairment losses	(66,019,500)
Balance as of December 31, 2002	49,263,443
Business acquisitions (unaudited)	1,501,402
Balance as of June 30, 2003 (unaudited)	$ 50,764,845

LKQ Explanation: Lower Valuations of Comps

Valuations for some of the Company's acquisitions have declined significantly since the Company completed its acquisitions during 1998 and 1999 due to a number of factors, including lower earnings multiples applied in the valuations of comparable companies. As a result, the Company determined that the carrying value of certain reporting units exceeded the fair value of those reporting units at January 1, 2002, and recorded an impairment of goodwill in the amount of $49,898,800, net of tax of $16,120,700.

- That LKQ took a valuation impairment during the post-tech recession in 2002, citing contracting multiples, but did nothing of the such during or after the 2008-2009 financial crisis, which was the deepest recession the US has endured since the Great Depression, does not pass logic. In 2009, LKQ's closest comparable Greenleaf, the 2nd largest wholesale auto parts recycling business in the US, was in distress and sold it itself to LKQ for 'less than the fair market value of its assets'; enterprise valuations were down across the board as liquidity evaporated.
- Today, the stakes are much higher for LKQ than they were in 2002. The current size of its goodwill account is multiples of its 2002 enterprise value. Because we believe that LKQ may be using this account to manipulate margins and CFO, we also believe the account appears inflated and impaired as it stands

Sources: 10-k's for Keystone Automotive; Form S-1 for LKQ filed July 28, 2003

3) One-Time Gains to Inflate Gross Margins

- We believe LKQ was manipulative in how it booked gains in 2012 from legal settlements awarded in a class action suit against several aftermarket suppliers. The awards were booked as two legal settlement gains of $8.3m and $8.4m in Q1'12 and Q2'12, respectively
- The gain classification artificially inflated gross margins: The gains were booked as <u>reductions of COGS</u>, significantly propping up and blunting a multi-year decline in gross margins. In 2012, these gains <u>elevated gross margins from 40.95% to 41.38%, which helped to mask the significant drop from 42.57% in 2011</u>
- The settlement gains had nothing to do with ongoing COGS. While the original source of the lawsuit may have originated from issues related to LKQ’s inventory account, receiving a one-time settlement gain is irrelevant to current period operations and should be treated as one-time, non-operating gains in nature. **In our judgment LKQ’s classification is exceedingly aggressive**
- In light of our belief that games are likely being played in LKQ’s accounting for inventories, the nature of management’s choice in this case underscores the potential severity of other manipulations, exposed or not
- Management also inflated its earnings prospects by including the legal settlement gains <u>in its EPS guidance</u>. The Company chose to factor these one-time legal settlement benefits into guidance, even while explicitly excluding other one-time gains/losses from guidance

Cont'd:
3) One-Time Gains to Inflate Gross Margins

PRESCIENCE POINT

- In Q1'12, management raised 2012 EPS guidance due to inclusion of the first legal settlement gain in its revision. The entire value of the positive differential over prior guidance was attributable to the one time legal gain.
- Based on its Q1 10-Q (excerpted below), <u>management knew</u> that an additional settlement gain of near-equivalent value would be recognized sometime in 2012. Even though it also expected to recognize this second gain, management <u>chose not</u> to also include it in the 2012 guidance revision that included the first gain…

> *"We are a plaintiff in a class action lawsuit against several aftermarket product suppliers. Our recovery is expected to be approximately $16 million in the aggregate. In January 2012, we reached a settlement agreement with certain of the defendants, under which we recognized a gain of $8.3 million, which was recorded in Cost of Goods Sold during the three month period ended March 31, 2012….*
>
> *<u>We expect to recognize an additional $8 million gain related to settlements with certain other defendants in this lawsuit in the last nine months of 2012</u>."*
>
> – LKQ Q1'2012 10-Q

- Instead, in Q2'2012, management booked the remaining, previously expected settlement gain in the amount of $8.4m, equating to +$.04 EPS. When they reported Q2'2012 results (issued 7/26/2012), management <u>**AGAIN**</u> raised its 2012 guidance to $265–$282m and $1.77 – $1.88. And <u>again</u>, the positive differential from the prior guidance resulted from including the 2nd, previously anticipated gain, offset by a fall in scrap prices, in the revised numbers. In other words, guidance would likely have been <u>lowered</u> had LKQ included the 2nd gain in the original guidance revision. This seems to indicate they kept it in their back pocket to ensure the next revision to guidance would be a raise

Cont'd:
3) One-Time Gains to Inflate Gross Margins

- On the Q2'2012 earnings conference call, CFO John Quinn was asked by an alert analyst whether he'd expected the 2nd settlement gain when guidance had been issued in Q1; he completely dodged the question:

> **Craig R. Kennison (Robert W. Baird & Co. Incorporated, Research Division):**
>
> *"Just to finalize on the guidance. In the second quarter, you had a $0.04 legal benefit, which is being included in your guidance. <u>Did you expect that when you initially gave guidance</u> after last quarter?"*
>
> **John S. Quinn:**
>
> *"It was <u>not included</u> in the guidance last quarter."*
>
> – LKQ Q2'2012 Earnings Conference call, Q&A, 7/28/2012

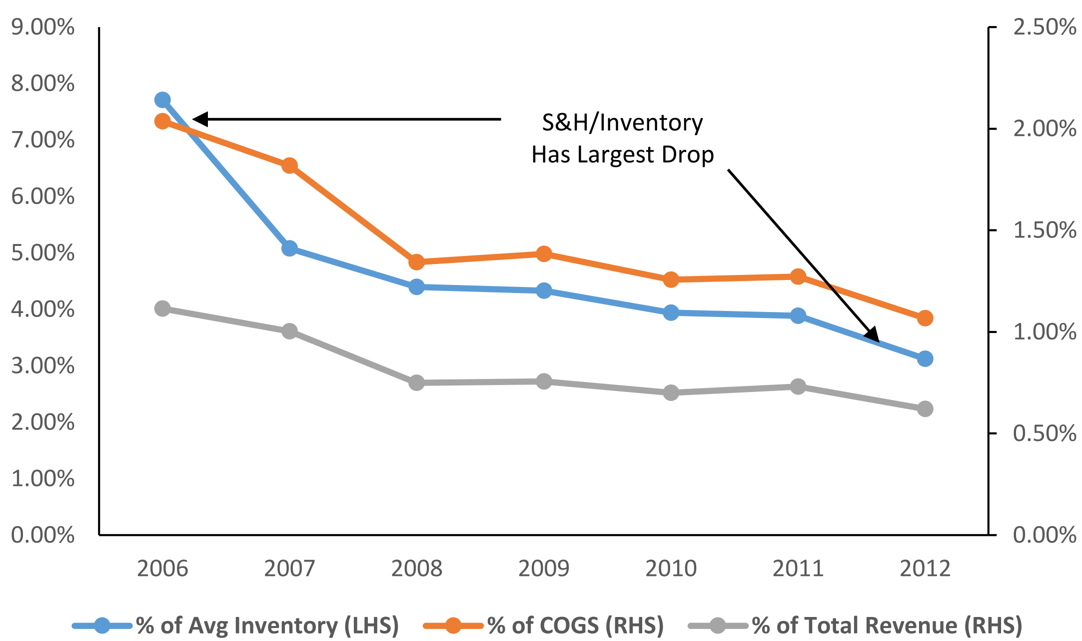
- But per the previous slide, it's written in black and white in the Q1'2012 10-Q. <u>Of course he expected it</u>!

Another Red Flag: Shipping/Handling Revenue is Diverging from Other Metrics

- LKQ collects revenues related to shipping and handling (S&H), and regularly reports these figures in its 10-K
- If LKQ were a healthy, growing firm, we would expect to see S&H revenue at least stay constant over time with reported revenues, COGS, and average inventory

However, we observe declining trends in LKQ's S&H revenue among all relevant financial metrics. In particular, we observe that S&H revenue to average inventory has declined at the fastest rate in the past six years. We interpret this as strong indicator of potential inventory shenanigans

Shipping and Handling Revenue vs. Other Financial Metrics



Source: Company filings

WM and DZ – Previous Employers of Many LKQ Execs & Accounting Personnel

PRESCIENCE POINT

ZONE DISCOVERY: Fraud Allegations, Improper Capitalization of Expense; Files for Bankruptcy, March 1996		WASTE MANAGEMENT: Charged w/ $1.7 billion Accounting Fraud, March 2002		LKQ	
Flynn Enterprises Common Shareholder					
		Joe Holsten COO, CEO WM Int'l	John Quinn Various Positions	Joe Holsten Fmr. CEO, Chairman	John Quinn SVP and CFO
Kevin Flynn VP, Midwest		Mark Spears Controller, Head Acct		Mark Spears Former SVP, CFO	Kevin Flynn Former Director
Victor Casini/ Gen. Counsel & Secretary	Frank Erlain VP & Controller			Victor Casini Gen. Counsel & Secretary	Frank Erlain Fmr. VP Finance Controller, Accountant
Walter Hanley Asso. Gen. Counsel	Stephen Eckel Assistant Corporate Controller			Walter Hanley SVP, Development	Stephen Eckel Dir Oracle Fin Apps. Fmr. Acct'g/Ass. Cont'ller
	Ken Frese Acct'g Mgr	Sinon Galvin Various Positions WM Int'l	Ken Frese Accountant	Sinon Galvin SVP, Revenue Optimization	Ken Frese Dir. Accounting & Inventory
		Vaughn Hooks Chief Tax Officer	Dan Shoener VP	Vaughn Hooks VP Taxes	Dan Shoener VP of Finance

Source: SEC filings; LinkedIn®

PRESCIENCE POINT

LKQ's Director of Inventory Accounting

- In light of our belief that LKQ may be inflating its financials, and most likely via inventory accounting shenanigans, it is worth noting that LKQ's Director of Accounting and Inventory is connected with two companies previously alleged to have engaged in accounting manipulations to inflate their stock prices

Ken Frese

Director of Corporate Accounting & Inventory at LKQ Corporation

Greater Chicago Area | Automotive

Previous Waste Management, Discovery Zone, Chemical Waste Management

Experience

Director of Corporate Accounting & Inventory
LKQ Corporation

Accountant
Waste Management
September 1995 – October 1998 (3 years 2 months)

Project Accounting Manager
Discovery Zone
1993 – 1995 (2 years) | Greater Chicago Area

$1.7bn Accounting Fraud

Fraud Allegations, Filed for Ch. 11 Bankruptcy

Source http://www.linkedin.com/profile/view?id=30515327&locale=en_US&trk=tyah2&trkInfo=tas%3Aken%20frese

The Waste Management Playbook for Paper ‘Profitability,’ Used Over and Over Again

Waste Management – Aggressive Roll-up Strategy Replicated by LKQ & Many Others

- In 1968, Dean Buntrock, Wayne Huizenga (both LKQ founding backers), and Lawrence Beck founded Waste Management (WM). In 1972, Donald Flynn (LKQ's founder) joined WM as CFO. WM set out to consolidate the highly fragmented garbage hauling industry via an aggressive roll-up strategy. Its growth would benefit from the tailwinds of recently issued EPA regulations that posed challenges for mom and pop operators
- By the time WM went public in 1971, it had acquired 133 garbage haulers and was generating >$10m in revenue. In the first 9 months of 1972 it had acquired another 133 firms and by the end of the year had generated $72m in revenue. From 1971 to 1980, WM's revenue grew at a rate of 48% per year, and in 1980 it generated $656m in revenue. By 1986, WM had become the largest waste disposal firm in the world.
  - **Donald Flynn was given credit as the "financial genius" behind Waste Management's extraordinary growth from the 1970s to the early 1990s in a 1993 corporate history commissioned by the company**
- In 1976, the SEC alleged that WM founder Huizenga was involved in disguising unlawful political contributions, that Waste Management was skimming dump fees and using the proceeds to create an illegal "slush fund" to be used for political contributions. Huizenga signed a consent decree barring him and WM from using corporate money for "unlawful political contributions" and from filing "materially false and misleading" financial statements. There was no admission of wrongdoing
- In 1984, WM co-founder Huizenga and John Melk, President of WM International, sold their stakes in the company and would go on to invest in Blockbuster Entertainment; Buntrock remained as CEO until 1996, and Flynn as CFO & director until 1989 & 1997, respectively
- By the late 1980's and early 1990's, WM had undertaken a botched international expansion in a push to become the world's first global 'environmental services' company. *"That ambition led Waste Management to acquire a range of profit-draining businesses. The eventual result was angry shareholders, turmoil in the board room and a disruptive series of management purges and sudden resignations, followed by revelations (in late 1997) of accounting irregularities."*

In 1997, a WM board-led probe turned up a massive financial fraud that went undetected from 1992–1997, involving the inflation of asset values and pre-tax earnings, resulting in a $3.5B charge in 1998 and the largest financial restatement in history at that time. The SEC charged WM with perpetrating a massive financial fraud

- In 1998, the troubled company merged with USA Waste Services Inc.

SEC vs Waste Management

- In mid-July 1997, a new CEO ordered a review of WM’s accounting practices. That review ultimately led to the restatement of the Company's financial statements for 1992 through the third quarter of 1997. When the Company filed its restated financial statements in February 1998, it acknowledged that it had misstated its pre-tax earnings by approximately $1.7 billion and took a $3.5 billion charge. At the time, the restatement was the largest in corporate history.
  - **From 1994 until 1997, a period at the heart of the perpetuation of the fraud, Donald Flynn (LKQ’s founder) was a Waste Management Audit Committee member and also served as Audit Committee Chairman during a period coinciding with the fraud.**
  - **According to the SEC, former WM CEO Dean Buntrock, who would later be LKQ’s founding backer & director, was “*the driving force behind the fraud,*”** and that, “*He was the primary beneficiary of the fraud and reaped more than $16.9 million in ill-gotten gains from, among other things, performance-based bonuses, retirement benefits, charitable giving, and selling company stock while the fraud was ongoing*”

Waste Management Founder, Five Others Sued for Massive Fraud
http://www.sec.gov/news/headlines/wastemgmt6.htm

SEC vs Waste Management – RE: Multi-Year, "Massive Earnings Management Fraud"

Defendants Inflated Profits by $1.7 Billion To Meet Earnings Targets;
Defendants Reap Millions in Ill-Gotten Gains While Defrauded Investors Lose More Than $6 Billion

"The Securities and Exchange Commission filed suit today against the founder and five other former top officers of Waste Management Inc., charging them with perpetrating a massive financial fraud lasting more than five years."

…

"The complaint alleges that defendants fraudulently manipulated the company's financial results to meet predetermined earnings targets. ***The company's revenues were not growing fast enough to meet these targets, so defendants instead resorted to improperly eliminating and deferring current period expenses to inflate earnings****. They employed a multitude of improper accounting practices to achieve this objective."*

– SEC Press Release, 3/26/2002

- On August 29, 2005, the SEC announced its fraud action against the accused Waste Management officers would be settled for a total of $30.8m.
- Buntrock and the others accused neither admitted nor denied wrongdoing.

WM Alumni Borrowing from the Old WM Playbook Over and Over Again

- Waste Management's aggressive rollup strategy gave its management a high level of flexibility to inflate revenue growth and margins, and to conceal doing so.
- A closely-knit group of WM alumni and associates (including LKQ's founders) have repeatedly co-invested in and built several companies, with each company replicating WM's aggressive roll-up or an acquire-and-build strategy, in either case either consolidating or flooding an industry with store openings in an effort to claim the dominant position as fast as possible. Some of these companies include Blockbuster Video, Discovery Zone, Boston Chicken, AutoNation, Swisher Hygiene, and LKQ. Many of these companies have either failed to deliver on their sales pitches to investors, failed outright, or were tarred by allegations of fraud, manipulative accounting, and/or unjust management enrichment.
- Based on our analysis, in the majority of cases these WM alums and associates build businesses with the intent to create the illusion of growth, as opposed to focusing on creating value through operational excellence. This has prompted some critics to claim that they build companies that have little lasting value.
- Many involved seem to have learned to begin cashing out just before and soon after building a roll-up large enough to sell to the public at inflated valuations, and have gotten very rich in the process.
- Billionaire Wayne Huizenga (LKQ founding backer and WM co-founder) has been involved in all of the above mentioned companies, either as a backer or as an executive, or both. As he is quoted as saying (regarding some of the roll-ups that went on to fail after he cashed out),
  - ***"We left these companies in great shape, and to be blamed for their problems years after I left is ridiculous."***

Same Players, Same Strategy, Results Marred by Accounting Irregularities & Failures

PRESCIENCE POINT

WM Waste Management	Blockbuster	Discovery Zone	Boston Chicken	AutoNation	Swisher Hygiene	LKQ
Wayne Huizenga Co-founder	Wayne Huizenga CEO/Chairman	Wayne Huizenga Investor (via Blockbuster), Director	Wayne Huizenga Investor	Wayne Huizenga Founder, Co-CEO	Wayne Huizenga Chairman	Wayne Huizenga Founding backer (via AutoNation)
Dean Buntrock Co-founder, CEO	Dean Buntrock Investor, Franchisee	Dean Buntrock Franchisee	Dean Buntrock Investor, Director			Dean Buntrock Founding Backer, Director
Donald Flynn CFO, Director -Audit Committee	Donald Flynn Founding Backer, Director	Donald Flynn CEO/Chairman	Donald Flynn Investor			Donald Flynn Founder
John Melk President WM International	John Melk Founding Backer, Director	John Melk Investor, Director	John Melk Investor	John Melk Founding backer, Director		
Lawrence Beck Co-founder	Lawrence Beck Investor, Franchisee		Lawrence Beck Investor, Franchisee			
Peer Pedersen Director	Peer Pedersen Investor, Franchisee	Peer Pedersen Director	Peer Pedersen Investor			
	Scott Beck Investor, COO, Vice Chairman	Scott Beck Investor	Scott Beck CEO/Chair			
	Steven Berrard CFO, then CEO	Steven Berrard CEO post-Viacom		Steven Berrard Co-founder, Co-CEO	Steven Berrard CEO, Director	
		Victor Cassini Gen Counsel,Secretary				Victor Cassini Gen Counsel, Secretary
Charged with accounting fraud, one of the largest in history; Aggressive rollup strategy	**Bought out** by Viacom for $8.4B; Aggressive acquire-&-build strategy	**Goes bankrupt;** Allegations of fraud; Aggressive acquire-&-build strategy	**Goes bankrupt;** Accounting gimmicks to obscure financials; Aggressive acquire-&-build strategy	***$$* Billions Lost;** Pooling of Interests acquisition accounting; Aggressive rollup & acquire-&-build strategy	**Accounting irregularities;** Financials restatement, **Acquisition Accntng Issues** **Ongoing SEC inquiry**; Aggressive rollup strategy	?? An array of accounting red flags & misrepresentations; Aggressive rollup & acquire-&-build strategy

Blockbuster Entertainment

Blockbuster Entertainment proved to be Huizenga and his associates' most lucrative endeavor; and its success would become a core aspect of their pitch to sell investors on subsequent endeavors employing the same strategy (with little success). We believe Blockbuster worked primarily because it operated in a relatively nascent, quickly growing space – it had the wind at its back, allowing for a comfortable margin for error. Additionally by executing an extremely **aggressive acquire-and-build strategy**, the company's key financial metrics were inherently blessed. Lastly, it was bought out by Viacom, prior to falling apart as the result of fundamental forces. The associates' subsequent endeavors, however, evidence that absent high luck, rapid expansion strategies that depend on external capital are customarily near-impossible to manage and that managers are seduced by flexibility in accounting policies

- In 1987, Donald Flynn, Wayne Huizenga, and John Melk (former President, WM International) bought a controlling interest in Blockbuster Entertainment Company. Blockbuster set out to consolidate the highly fragmented video rental field, which was already growing in the double-digit range when Blockbuster came into the picture – via the implementation of a rabid buy-and-build strategy
- Huizenga, who assumed the role of CEO and Chairman, built the company in accordance with his modus operandi – at a furious pace and with a buy-and-build strategy, purchasing smaller chains and constructing new outlets. When Huizenga and his associates invested in 1987, Blockbuster owned 15 stores and franchised 20 others. From that point on, Huizenga opened a Blockbuster store every 17 hours on average for seven years; by the time of its 1994 takeout by Viacom, Blockbuster had expanded the store count to 3,700!
- Worries that the video rental industry was reaching a saturation point cast doubts on Blockbuster's ability to keep opening stores indefinitely. One response to this concern was to look to markets outside the United States for growth.
- In April 1993, Blockbuster supported Donald Flynn by injecting equity capital into his new venture: Discovery Zone (DZ), buying a 20% stake (with the option to buy 49.9%). Huizenga and other Blockbuster executives joined the DZ board.
- In September 1994, Viacom Inc. acquired Blockbuster for $8.4 billion

PRESCIENCE POINT

Discovery Zone - Reckless Buy-and-Build, Fraud Allegations, Bankruptcy

"This is a question of a company that grew too quickly, without the infrastructure to do orderly and profitable growth"

– Robert Mead, Discovery Zone spokesman commenting just after the company files for Ch 11 (March 26, 1996)

- In July 1992, Donald Flynn (LKQ's founder) bought a controlling interest in and assumed the role of CEO/Chairman of the Discovery Zone, an owner/franchiser of indoor kids' playgrounds, using proceeds from his success with Blockbuster. DZ set out to build a leading market position in its space via a **reckless acquire-&-build strategy**. Unfortunately, in its rush to accelerate revenue growth, it incurred substantial debts and lost control of its costs, **landing it in bankruptcy**. Viacom later sued Flynn in 1997, claiming he was responsible for inflating DZ's earnings and misrepresented its financials to secure the sale of his stock to Viacom in 1995, shortly before DZ declared bankruptcy. The suit was settled for an undisclosed cash sum
- In April 1993, Blockbuster Entertainment injected equity capital into DZ to finance Flynn's expansion plans, buying a 20% stake (with the option to buy 49.9%). In June 1993, DZ IPOed
- DZ used public capital to expand rapidly. Between 1991 and 1995, DZ expanded from 28 locations to 336 locations. In September, 1994, DZ bought 60 franchised DZ units operated by Blockbuster; Blockbuster simultaneously increased its equity ownership in DZ to 49.9% by exercising its option to purchase additional equity directly from the Flynn family (through DKB Investments, L.P.); on September 29, 1994, Viacom acquired Blockbuster
- November 1994-March 1995 – 3 lawsuits, which were later consolidated, were filed against DZ as it reported substantial operating losses in Q3'04 and subsequent periods. The claims allege DZ and certain directors & officers, including Flynn, engaged in fraud intended to inflate DZ's stock price, such as improperly capitalized preopening expenses, failing to timely make public the change in the method of accounting for preopening expenses, etc. The consolidated complaint was dismissed as a result of DZ's Ch11 filing
- On February 1, 1996, DZ warned shareholders that it may seek bankruptcy protection after January sales fell below expectations; the stock collapsed by >60%; on Feb 27, 1996, Flynn resigned as DZ's Chairman. On March 25, 1996, DZ filed for Ch11 protection
- In 1997, Viacom sued Donald Flynn and his sons, claiming they inflated earnings through improper accounting adjustments and misrepresented the company's financial statements to secure a $25m sale of their personal stock to Viacom and to meet Wall Street Expectations for profitability. According to Kevin Forde, Donald Flynn's attorney, following settlement of the matter in 2004, "*There was a payment of a certain sum for dismissal of all claims and our clients were very satisfied with the settlement*"

Boston Chicken – Reckless Buy-and-Build, Accounting Gimmickry, Bankruptcy

PRESCIENCE POINT

- In 1992 Scott Beck and a partner bought a controlling interest in Boston Chicken (BC), a rotisserie-style chicken restaurant, with the $120m he made from selling his stake in Blockbuster Video franchise stores back to Blockbuster Entertainment. The foundation of BC's business strategy was based on **reckless acquire-&-build strategy**. This reckless expansion program, however, would prove to be the root cause of BC's financial demise, **pushing the company into bankruptcy**. BC would likely have ended up in bankruptcy much sooner given its cash-degenerative store unit economics had gimmicky accounting not concealed signs of its deteriorating business
- 6 months after taking over Boston Chicken, Beck was overseeing a chain of 53 restaurants in ten states. By the end of 1992, Boston Chicken had 83 stores. In 1993, Boston Chicken went public, accumulating external capital for even more growth. In 1993 BC went public; the chain nearly tripled in size to 217 stores. By the end of 1994, it had 534 stores. Management announced its intent to grow the chain at a rate of more than 325 stores annually at least through the end of the decade;

"*They have the most aggressive expansion program ever undertaken in the restaurant industry*"
– Restaurant Analyst Mike Mueller in *Restaurant Business (4/10/1994)*

- Problems surfaced during the summer of 1997. Poor employee training, high operating expenses, and its lending policy to developer-franchisees had started to take their toll on company finances. In 1998, Beck resigned. Stores sales continued to falter, and by July losses had reached $437.1 million.
- On October 5, 1998, BC filed for bankruptcy… A noted short-seller commented, "*The Chicken has been plucked due to deteriorating store-level economics, management turmoil, and an outsized amount of debt due to an aggressive expansion plan that had once impressed Wall Street but perhaps never made financial sense*."

Deceptive Accounting at Boston Chicken Discussed in *Financial Shenanigans,* By Howard Schilit (Excerpts Below)[1]

Watch for Companies That Include Investment Income as Revenue. Investors should be particularly alert when companies include non-operating gains or investment income in revenue. Boston Chicken, the franchisor of the Boston Market restaurant chain, camouflaged its deteriorating business by including in revenue its interest income and various fees charged to the franchisees. While treating interest income as revenue clearly would be appropriate for banks and other financial institutions, it certainly sounds a bit unusual for a restaurant.

Boston Chicken's inclusion of investment income as part of revenue cleverly hid its dire financial situation. As a result, many investors failed to notice that Boston Chicken had been losing money in its core restaurant operations. Indeed, all of the company's profits came from noncore activities, such as interest income on loans or various service fees charged to these same franchisees. One huge (but apparently ignored) warning in the 1996 annual report was that franchisee-owned restaurants were losing a ton of money. The losses grew to $156.5 million in 1996 from $148.3 million during the prior year.

WARNING SIGNS AND LESSONS FROM BOSTON CHICKEN

Boston Chicken cleverly hid signs that its business was deteriorating by including noncore sources of income in revenue. The company reported that 1996 pretax income doubled to $109.9 million, yet CFRA calculated that it had *actually lost $14.7 million* on its core operations. (We define income from core operations to include revenues from company-operated stores and from royalties and initial franchise and area development fees, but *not* from activities such as interest, real estate, and software fees. Expenses deducted include cost of products sold, salaries and benefits expenses, and general and administrative expenses.)

(1) Howard Schilit, *Financial Shenanigans: How to Detect Accounting Gimmicks & Frauds in Financial Reports (*New York: Mcgraw-Hill,2010), 103-104

Swisher Hygiene – Reckless Roll-Up, Financials Restatement, SEC Inquiry

- In 2004, Wayne Huizenga and Steven Berrard bought and took private public company Swisher International, an industrial cleaning business. In August 2010, they took Swisher public through a reverse merger, renaming the successor entity Swisher Hygiene. Swisher was set on consolidating its industry via an **aggressive and reckless roll-up strategy**. Eventually the company announced that **previously-issued financials could not be relied upon** and that its **profitability had been overstated**. Swisher's Audit Committee is currently **probing the company's acquisition accounting policies**, as the company contends with ongoing SEC and US Attorney inquiries
- Based on an August 2010 Bloomberg News article, Huizenga planned "to build Swisher much the same way as he grew Waste Management, Blockbuster, and AutoNation;" and, according to Huizenga,

> *This is another opportunity to build a company that will grow… Now we'll have public capital to do acquisitions.*
>
> ……………
>
> *You go to a guy and you say, 'Do you want to sell?' If they think they can be a part of something that's going to grow -- you give them some cash and some stock -- they'll say 'yes… They want the stock because they'll think, 'Oh boy, you guys are going to grow this business, and I'm going to watch my stock grow!'*

- Swisher began raising capital, and in approximately one year, had bought 55 companies, an average of more than one per week. The Wall Street Journal named Swisher the "most acquisitive" business in North America in 2011 after its buying spree.
- By March 2012, Swisher's Audit Committee announced its 2011 interim financials could not be relied upon and that it would delay the filing of its annual report due to an ongoing internal investigation "primarily relating to possible adjustments to (1) **the accounting for business acquisitions** and (2) the calculation of the allowance of doubtful accounts receivable." It concluded that previously issued interim financial statements could not be relied upon and that **earnings were inflated for the affected periods**. According to its most recent 10-Q, the SEC and the US Attorney's Office have requested more information from the company, and the company faces federal shareholder lawsuits that allege the company artificially inflated its stock price (which collapsed as a result of the announcement).
- Further disclosure in a corresponding 8-k shows that Swisher is focusing on its accounting for acquisitions , which we believe LKQ may be using to manipulate its accounting, as a source of its accounting irregularities:

> *During the course of its independent review, and due in part to the significant number of acquisitions made by the Company, the Audit Committee determined it would be in the best interest of the Company and its stockholders to review* ***the accounting entries relating to each of the 63 acquisitions made by the Company during the year ended December 31, 2011****.*

- Huizenga resigned from Swisher's board in May 2013. Berrard resigned as CEO in August, 2012.

AutoNation – Reckless Buy-and-Build, Billions Lost; Most Comparable to LKQ

- The case study of AutonNation Inc. and its predecessor entity Republic Industries (collectively, "AN"), we believe, bears many parallels to how LKQ's will develop. AN tried to consolidate a **highly competitive**, **low margin**, **mature/low growth industry** but lacked a fundamentally superior way of making money. Using public capital, it over- expanded and -extended itself, losing focus and eventually resulting in billions **of dollars of shareholder losses**.
- AN was led by Wayne Huizenga and Steve Berrard as co-CEO's from 1996 – 1999. Using an **aggressive acquire-&-build strategy** fueled by company shares, they set out to consolidate the automotive business by building a **one-stop-shop** involved in every stage of selling, renting and servicing new and used cars. They built an empire of new car dealerships, car rental agencies and used car megastores, selling investors the vision that each one would feed the other to enable the company to generate profits on a vehicle throughout its lifetime.
- In 1996 & 1997, it acquired hundreds of businesses, mostly relying on the **controversial pooling of interests acquisition accounting practice**, with its **earnings likely inflated** as a result. In less than 2 years' time, AN was the largest auto retailer in the US with a market cap of >$12B.
- They continuously reminded investors of the successes they achieved with Waste Management Inc. (Huizenga sold out of WM in 1984) and Blockbuster Inc. Per AN's 1995 annual report, "We want to build a brand just like we did at Blockbuster." Wall Street bought into the vision that Huizenga could replicate those successes in consolidating the autos market.
- The association would prove misleading; the growth of WM and Blockbuster were supported by strong secular tailwinds. WM's growth was supported by regulatory changes that made it almost impossible for mom and pops to compete. Blockbuster's growth benefited from a video-rental industry that was growing in the double digit range. **Like LKQ's, AN's end markets on the other hand were already mature**, growing at a very low single digit growth rates – AN's **success was dependent on stealing market share** from existing competitors. Similar to LKQ, it also lacked the ability to drive down its most basic costs.

"…it found it had no way to drive down the basic cost of the business — buying cars. Unlike new-car dealers that accept many used vehicles as trade-ins, often on favorable terms, AutoNation had to compete at auctions with other dealers to build its inventory. With relatively high fixed costs, a huge inventory that depreciated in value with every passing week, and no sign of improvement, AutoNation bailed out and exited the used-car business in late 1999. "[1]

- With high fixed costs and inventory values that depreciated with each passing moment, AN's used car business lost significant sums of money and led to investor disappointment; its share price fell by >80% from peak to trough, representing a cumulative value of >$10B.
- In 1999, Huizenga and Berrard stepped down. New CEO Michael Jackson would dismantle the empire via asset sales and spin-offs in an effort to focus the enterprise and improve margins. He spun off the rental car business and closed the money-losing used car business, resulting in a pre-tax charge of >$400m. He announced AN would suspend further purchases of new-car dealerships and concentrate instead on reducing costs at existing dealerships, and announced an increased its stock buyback program by $500m.

(1) Paul F Kocourek, Steven Y Chung, and Matthew G McKenna, "Strategic Rollups: Overhauling the Multi-Merger Machine," *Strategy & Business,* second quarter 2000.

AutoNation – Reckless Buy-and-Build; the Build-Out of an Empire Destined to Fail

- In May 1995, Huizenga and a relative invested $31m in **Republic Industries**, a public waste disposal company that would allow him to raise public capital for his next venture; Huizenga was appointed CEO and Chairman of the company

> ***"We were looking for a shell [company], and this happened to come up," he says. "It could have been in anything…"[1]***

- The next year Steven Berrard joined him as co-CEO and director. Under their leadership, the company announced plans to aggressively grow into a completely unrelated industry, setting out to build a one-stop-shop for consumers' automotive needs via consolidating the fragmented automotive retail and rental markets. According to a New York Times article, Huizenga said that Republic would cater to anybody who wants to rent, lease or buy a car that is brand new or used:

> ***'When they think of transportation,'' he said, ''we want them to think about us.''***

- Republic expanded aggressively, purchasing hundreds of franchised & used car dealerships and car rental companies, with the vision of assembling an empire that would reap economies of scale by involving itself in every stage of selling, renting and servicing new and used cars. It grew from only one franchised vehicle dealership at the end of 1996 to more than 270 franchised dealerships owned or under contract by the end of 1997, becoming America's largest automotive retailer in 1 years time.
- Amongst Republic's major acquisitions was **AutoNation USA ("AN USA")**, a **developmental-stage private company owned by Huizenga and Berrard**. The two co-founded the company in September 1995, intending to grow it into a nationwide chain of used car megastores, each of which would offer up to 1,000 reconditioned, late model, low mileage vehicles. When Republic's intent to acquire AN was announced, AN **had not yet opened a single megastore**; and, from inception to September 29, 1996, AN USA had **lost $21.4m on revenues of $9.2m**, with shareholder's equity of $30.7m. Republic paid 17.5m shares of stock for AN USA, **equating to $250m** at its intent to acquire was announced on March 29, 1996; but according to a class action complaint filed in January 1997, due to a rise in Republic's share price prior to its close, the **deal was consummated for $643m**
- In 1996 and 1997 Republic also bought several vehicle rental companies, including Alamo Rent-A-Car and National Car Rental System, becoming one of the leading vehicle rental companies in the world.
- In 1998 , Republic generated revenue of $16bn, up from $5.6bn in 1996. **But when the dust began to settle from a slowdown in its acquisition binge, the economics of its business model did not pan out as promised**. Republic struggled as a car dealership with high overhead, low profits and a strategy based on synergies that didn't materialize. The AutoNation USA business was a money-losing business operation.
- Furthermore, Republic may have been relying on the **acquisition accounting practice known as pooling of interests to inflate its earnings**. Republic applied this approach for more than half of its deals in 1996 & 1997; without having used it, its thin margins may have been in the red
- Republic stock had risen from a split-adjusted $2 when Huizenga bought in to a peak of ~$44 in January 1997; by June 1997 shares had declined ~50% and would continue their descent each year until hitting a low of $5 in December 2000. It's **market cap fell from a peak exceeding $12bn by >80%, representing ~$10bn in lost shareholder value**.

(1) Machan, Dyan. "Crime, Garbage and Billboards." Forbes, November 20, 1995, vol. 156, issue

PRESCIENCE POINT

AutoNation – Reckless Buy-and-Build, New Profit-Focused CEO Dismantles Empire

- At Republic's May 1998 shareholder meeting, Huizenga expressed his disappointment about the company's stagnant share price; according to an Sun Sentinel article describing the event, he told investors about "how the matrix of car dealerships and rental car agencies was going to simultaneously grow sales 'to perhaps as much as **$60 billion in three to five years**'," and that costs would be cut to boost profits.
- Notwithstanding the mounting pressures to remain focused, in July 1998 AutoNation invested in Huizenga's close associate Donald Flynn's new endeavor, LKQ Corp. (It would cash out of this investment in 2003.)
- In 1999, under pressure from shareholders and a falling share price, Republic began to unwind what it had built over the preceding 4 years, streamlining its operations and undergoing management changes.
- In April 1999, Republic **spun off its waste disposal segment**, and subsequently changed its name to Autonation Inc. ("AN")
- On September 24, 1999, **Huizenga and Berrard stepped down** from their co-CEO positions; Michael Jackson, former CEO of Mercedes Benz USA, was named new CEO.
- On September 30, 6 days after Jackson was hired, Autonation announced the **spin-off of the car rental business** to focus exclusively on the automotive retail business.
- On December 13, 1999, 3 months after taking the helm, Jackson **killed the concept of used-car megastores**, announcing the immediate closure of the money-losing chain and the expectation of a pre-tax loss of between $430 – $490m. Of its 29 megastores, 23 would be closed and 6 integrated with new vehicle franchises.
- According to a December 14, 1999 New York Times article,

"Mr. Jackson… said that the used car superstores (i.e. AN USA) were high-cost operations with no chance of ever generating profits proportionate to their risk. Even if AutoNation had been willing to invest heavily, devote a lot of management time and wait for years, he said, ''the cost structure in those stores would still have been very high, leading to marginal operations.''

- AN also announced it would **suspend further acquisitions of new car dealerships**, instead **concentrating on reducing costs** at existing dealerships, and announced an **increased its stock buyback program by $500m**. In the press release, Jackson emphasized his focus on improving profitability and the sustainability of the AN business model

"Our focus now is on improving our operating margins and on creating a unique and branded customer experience in our new vehicle franchises, which are now AutoNation's sole business focus. By closing the megastores and implementing SG&A reductions, we have taken the necessary steps to ensure the long-term success of AutoNation."

- Jackson's initiatives tremendously benefited the company's efficiency tremendously. A 2001 study for USA Today showed that AutoNation increased revenue per employee 82 percent from 1998 to 2002, a greater increase in efficiency than any other large public company in the country.

LKQ Governance Concerns

Key Management Changes Start in 2009-2010: Just As Business is Improving??

- We believe LKQ's core business began slowing in the 2009-2010, which coincided with the APU rate stalling, and a stagnation in insurance paid collision repairs. Beginning in this period, we also observe various changes to key management positions
- LKQ's CFO, Mark Spears, also the former Principal Accountant at Waste Management, mysteriously resigned in May 2009, despite a record year for the Company. Spears' departure came ~1 year after the SEC issued a comment letter questioning numerous aspects of their business, and further comment letters would follow
- Subsequent changes have included a new CEO, and the departure of the Head of IR and Chief Acct'g Officer

Date	Executive	Role	Note
5/21/09	Mark Spears	CFO Resigns	Press Release
12/6/10	Rob Wagman	Promotion from SVP Ops, to Co-CEO	Press Release
12/6/10	Joe Holsten	Resign CEO, joins the Board	Press Release
Dec 2010	Sarah Lewensohn	Director of Investor Relations	No longer listed as IR contact in PR
2/28/11	Frank Erlain	Long time VP, Finance, Chief Acct'g Officer Retires	8K filing
3/5/12	Victor Casini	SVP General Counsel resigns from the Board	8K filing

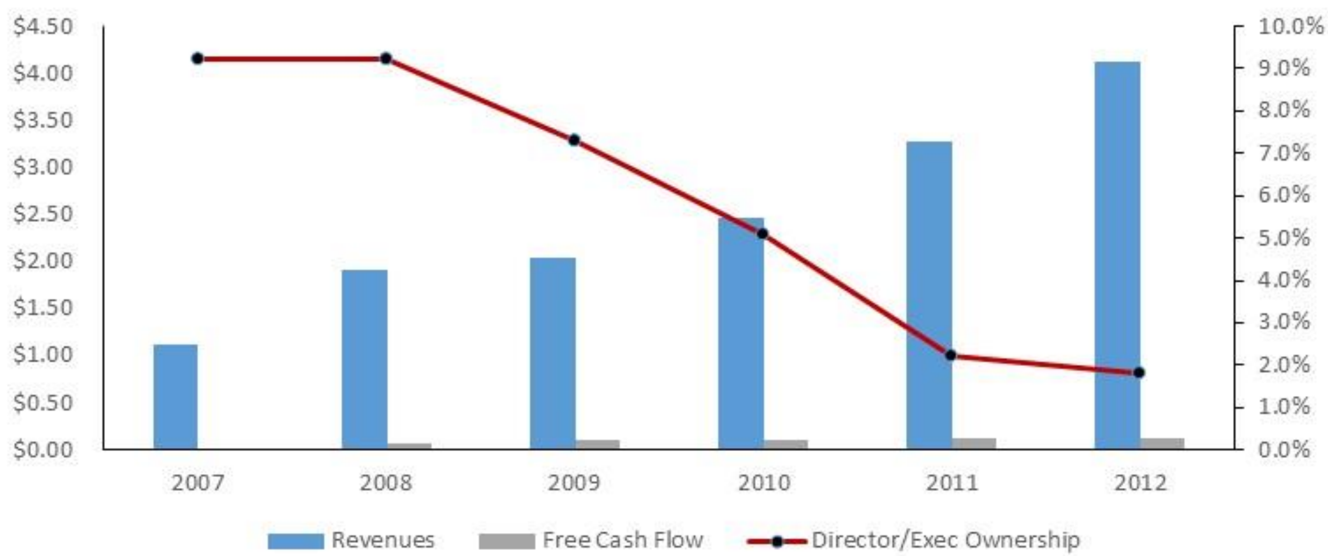
Comment Letters:
http://www.sec.gov/Archives/edgar/data/1065696/000000000008014694/filename1.pdf
http://www.sec.gov/Archives/edgar/data/1065696/000000000010023419/filename1.pdf

Delinkage of Incentives: Insiders Dumping, Rewarded to Acquire at Any Cost

- Insiders have been selling shares aggressively since the IPO when former owners of acquired companies, affiliates and management owned 22%. Since 2009, insider selling pressure has intensified and **<u>now insiders own less than 2%</u>**
- Management's annual bonuses are tied to revenue growth, and long-term incentives are also tied to Revenue, EPS and ROE, with the following weightings revenue (47.5%), earnings ($47.5%) and ROE at just 5%. These metrics incentive management to recklessly acquire revenue, and boost EPS

% Beneficial Ownership of Insiders vs. Revenue and Free Cash Flow Growth

$ in bn



And Sell Stock Shortly After Trumpeting the Merits and Growth Opportunities at Keystone

- SEC Form 4 filings show that key members of the management team made timely open market sales shortly after announcing the acquisition of Keystone Automotive Operations, Inc. on December 5, 2013
- These sales directly call into question why management would announce one of the largest deals in company history that "significantly expands its addressable market," and then abruptly unload stock. Our take is that there's an increasing disconnect between shareholders' best interest and managerial incentives

Executive	Role	Date	Shares	Wtd Avg Price	Type
Wagman	President/CEO	12/10/2013	25,000	$33.71	Open Market
Quinn	CFO	12/9/2013	15,000	$33.62	Open Market
		12/10/2013	5,000	$34.31	Open Market
Holsten	Chairman of the Board	12/11/2013	6,025	$33.50	Open Market
		12/13/2013	25,975	$33.55	Open Market
Greenspan	SVP, Operations	12/13/2013	20,000	$33.88	Open Market

Source: SEC Form 4 filings

Board Lacking Relevant Experience and Necessary Focus for Adequate Oversight

- LKQ’s Board is comprised of accomplished business executives; but, only one non-executive member, Mr. Foster, appears to have relevant experience in the auto parts business.
- Furthermore, no other Board members appear to have experience in the scrap metal or related industrial sectors that would be of value to shareholders.
- Mr. Meister and Mr. O’Brien both serve on the compensation committee and serve on a combined 24 other Boards, which makes us question there focus and commitment to LKQ.

				Committee Service				Current
Director	**Age**	**Role**	**Main Background**	**Comp.**	**Audit**	**Govern**	**Gov't Affairs**	**Other Boards**
A. Clinton Allen	69	Lead Independent	Lab Testing		x	x		3
Kevin Flynn (1)	45		Seed Investor/Discovery Zone		x		Chair	1
Ronald Foster	71		Fmr Chairman of Keystone	x			x	1
Joe Holsten	60	Chairman	Waste Management					1
Blyth McGarvie	56		Consumer Products		Chair	x		2
Paul Meister	60		Healthcare/Life Sciences	Chair	x			8
John O'Brien	69		Insurance	x		Chair		16
Guhan Subramanian	42		Academic/No Board Exp.		x	x		0
Robert Wagman	48	President and CEO	Auto Products					0
William Webster	55		Payday Lending	x			x	2

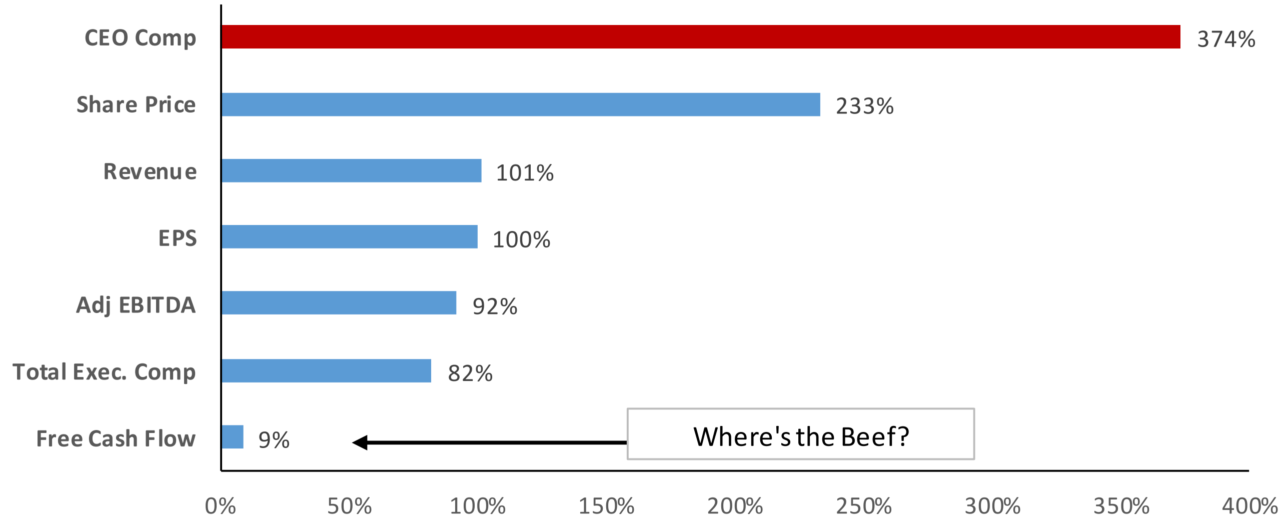
(1) Recently deceased in August 2013, and yet to be replaced

Source: Company and public information; CapitalIQ

Governance Concerns: Executive Pay

- Also concerning is that the compensation committee constituents appear overcommitted. The Chairman, Mr. Meister serves on 8 other boards, while Mr. O'Brien is listed as serving on 16 other boards. We suspect shareholders interests may not be adequately supervised on the matter of compensation with the big time commitments of its committee members
- Management annual bonuses are tied to revenue growth, and long-term incentives are also tied to Revenue, EPS and ROE, with the following weightings revenue (47.5%), earnings ($47.5%) and ROE at just 5%. This mix of metrics incentivizes management to **recklessly acquire revenue**, and **do whatever possible to boost EPS**.
- The CEO's total comp has increased 374% in the past 4 years, while free cash flow is up only 9%; over a multi-year horizon, cumulative free cash flow after acquisitions is nil. Approximately 50% of the comp increase has come in stock, but as a whole the management team has been net sellers. The 6 member management team reaped $12.9m in compensation for 2012 (up 83% from 2009 comp of $7.1m)[1]

Cumulative Growth 2009 - 2012



(1) Includes consulting comp and incentive comp related to Mr. Holsten

The Misguided Analyst Community

LKQ Enlists Firm Associated with Stock Pumps for Research Coverage Initiation

RedChip, a firm commonly associated with having promoted speculative and, in many previous instances, fraudulent companies, was among the first to provide research coverage on LKQ

"Occasionally, we find a critic of RedChip who in a fury of madness mistakenly throws us into the "pump and dump" category of investor relations firms" –Dave Gentry, Founder of Redchip[1]

LKQ
OEM Recycled • Aftermarket by Keystone

SEARCH INVENTORY | FIND A LOCATION | CAREERS | INVESTOR RELATIONS | CONTACT

Home | About | Solutions | Auto & Light Truck Parts | Self Service Auto Parts | Heavy Truck & Equipment

Close

RedChip Independent Issues Quarterly Research Update on LKQ Corporation

ORLANDO, Fla., Nov 20, 2006 (PrimeZone Media Network via COMTEX News Network) -- RedChip Independent, a division of RedChip Companies, announced today that they have updated research on LKQ Corporation (Nasdaq:LKQX).

Lisa Springer, CFA, RedChip Research Analyst, wrote in the report:

"We are increasing our estimate of FY 2006 EPS to $0.80 per share and raising our target price to $28.00. At a current price of $23, LKQ shares are trading at 29 times our estimate of FY 2006 EPS but at a comparatively low forward P/E of 23 times (based on 2007 consensus analyst estimates) and at a modest PEG (P/E to earnings growth) ratio of 1.2. We believe these shares remain well positioned for continued double-digit earnings growth in the years ahead."

To receive a complimentary copy of the RedChip Independent quarterly update for LKQX, please visit:

http://www.redchip.com/independent/subscriber.asp?page=requestLKQX_Q3_2006s

Photo Source: http://www.redchip.com/about/aboutmain.asp?page=management

http://phx.corporate-ir.net/phoenix.zhtml?c=147311&p=irol-newsArticle&ID=933038&highlight=

(1) http://www.redchip.com/blog/index.php/redchippresident/pump-and-dump-is-a-pejorative-term-and-rightly-so/#.UZ05RrW1E0w

RedChip Denounced by the Investing Public for Promotion of Frauds

Prescience Point was on the forefront of identifying Chinese investment scams and has been wary of paid-for research conducted by RedChip

CNBC Faceoff: Heat Over Chinese Reverse Mergers

Jan 11, 2011

Chinese reverse mergers are continuing to make headlines, causing investors to take notice and, as a result, these special types of mergers have come under increased scrutiny.

Tuesday on "The Strategy Session," David Gentry, president and CEO of RedChip Companies, a business that promotes small-cap companies, including Chinese reverse mergers, fired back.

CNBC's David Faber and partner continue their discussion about Chinese reverse mergers with Dave Gentry, president of RedChip, a company that promotes these products.

Source: http://www.cnbc.com/id/41024808

RedChip Announces Exit From China Small-Cap Sector

Jan 3, 2013

RedChip Companies, Inc. ("RedChip"), an international small-cap research, investor relations, and media company, today announced that it has exited the China small-cap sector and terminated its contracts with its three Chinese clients. "We made a decision to close our Beijing office months ago and wind down our China operations," stated Dave Gentry, President and CEO of RedChip. "Wall Street has, for the most part, lost confidence in the financial reporting of U.S.-listed Chinese companies. We are concerned that Big Four accounting firms were unable to detect financial fraud in companies like Sino-Forest and Longtop Financial." Mr. Gentry continued, "When multi-billion dollar funds like Paulson & Co. and The Carlyle Group, with their unlimited resources, are unable to detect fraud in their Chinese-based portfolio companies; when top-tier investment banks like Goldman Sachs are unable to detect fraud in their Chinese-client companies; then I think reasonable investors must take a step back and seriously consider whether the potential rewards outweigh the downside risks of investing in U.S.-listed Chinese companies. We simply are not willing to take the risk."

Source: http://globenewswire.com/news-release/2013/01/04/514584/10017068/en/RedChip-Announces-Exit-From-China-Small-Cap-Sector.html

LKQ Has Worked Hard to Garner Broader Analyst Support as a Wall St. Darling

The chorus of analysts are singing buy, buy, buy. The one independent analyst at Wellington/Great Lakes Research recently downgraded the stock to Hold.

Broker	Rating	Price Target
Barrington	Market Perform	$33.00
BB&T	Outperform	$35.00
Bofa/ML	Neutral	$32.00
CL King	Buy	$32.00
Deutsche	Hold	$27.00
Great Lakes	Hold	$33.00
Stifel Nicolaus	Buy	$33.00
Ray James	Outperform	$32.00
Baird	Outperform	$38.00
Sidoti	Buy	$39.00
Stephens	Overweight	$35.00
FBR	Outperform	$40.00
William Blair	Outperform	--
	Average Price	**$34.20**

Date	Conferences Presented
5/22/13	BB&T, Stephens, William Blair
2/12/13	Raymond James, Sidoti, BofA/ML
8/1/12	BB&T
5/23/12	Stephens, William Blair, Deutsche Bank
4/17/12	Baird, Barrington
3/15/12	BofA Merrill Lynch
2/15/12	Raymond James, Sidoti
8/25/11	CL King, ThinkEquity,
7/12/11	Jefferies, Canaccord Genuity, BB&T
4/12/11	Baird, Barrington
3/7/11	Raymond James
2010	Raymond James, CLK King, BofA/ML, Morgan Keegan, Gabelli, Deutsche Bank
2009	BB&T, RBC, CL King, Morgan Keegan, Deutsche, JPM

While JP Morgan Recently Ditched its Credit Exposure to LKQ Earlier this Year

- J.P Morgan was Keystone Automotive's long-time banker, M&A advisor, and lead admin agent for its credit facility. J.P Morgan continued to serve as LKQ's lead banker
- **J.P. Morgan resigned from its lead banking position in 2013 and appears to have completely severed all ties to the company**. The significance of this event must be considered; as a leading underwriter in high yield bonds, J.P. Morgan mysteriously did not participate in LKQ's $600m bond offering, thereby sacrificing underwriting fees. The bank also assigned key swap contracts to other parties as another credit risk reducing measure

On April 30, 2013, JPMorgan Chase Bank, N.A. ("JP Morgan"), the counterparty on certain of the Company's floating to fixed interest rate swaps, assigned its obligations under its swap contracts to Wells Fargo Bank, N.A. and Bank of America, N.A. JP Morgan is no longer a secured lender under the Second Amended and Restated Credit Agreement and therefore assigned its obligation to Wells Fargo Bank, N.A. and Bank of America, N.A. The Company believes Wells Fargo Bank, N.A. and Bank of America, N.A. are creditworthy to perform their obligations as the counterparty to their respective swap contracts. The counterparty, notional amount, maturity date and fixed interest rate of each of the swaps assigned by JP Morgan are listed below.

New Counterparty	Notional Amount	Maturity	Fixed Int. Rate
Wells Fargo	US$250m	10/14/15	1.5638%
Wells Fargo	US$60m	10/31/16	1.1950%
Bank of America	C$25m	3/24/16	1.43%

Source: http://www.sec.gov/Archives/edgar/data/1065696/000106569613000044/lkq8-k.htm

Analysts' Views on the Growth Story are Completely Wrong!

Wall St. Analyst Views of LKQ	Prescience Point View
"Open Ended Growth Story with the Collision Strategy Just Beginning to Unfold. LKQ Can Grow Revenues Organically 5-7% and Earnings 15-20% in the Next Several Years"	Sustainable organic growth is likely overstated and closer to 0 – 2% in North America. European expansion is fraught with problems and a mature and competitive marketplace. Earnings growth appears highly engineered with opaque acquisitions and levers for multiple accounting shenanigans being pulled. Adjusted free cash flow after acquisitions is the appropriate yardstick to evaluate LKQ.
"Secular growth drivers for LKQ include the annual shift to alternative parts versus OEM parts that continues at a rate of 50-100 basis points annually"	Share shift has stalled and may reverse. OEMs with large balance sheets are subsidizing price matching programs and vehicle fleet age has likely peaked
"LKQ brings professional processes and technology to an under-managed industry"	Early mover advantages have eroded; auto recycling is now a global business. Rampant customer service/employee complaints suggest that LKQ is acquiring just to manage earnings and not build a world class operation
"LKQ's is a preferred partner for insurance companies, small auto recyclers seeking a partner/exit strategy, and repair shops	Our research suggests not many want to do business with LKQ, but rather they have to. Insurance companies are introducing new programs such as PartsTrader that will force price compression
"LKQ is a Premium Mid-cap Growth Story"	LKQ is a poorly constructed roll-up and should not trade at a premium to leading after market auto, recycling or industrial distributors

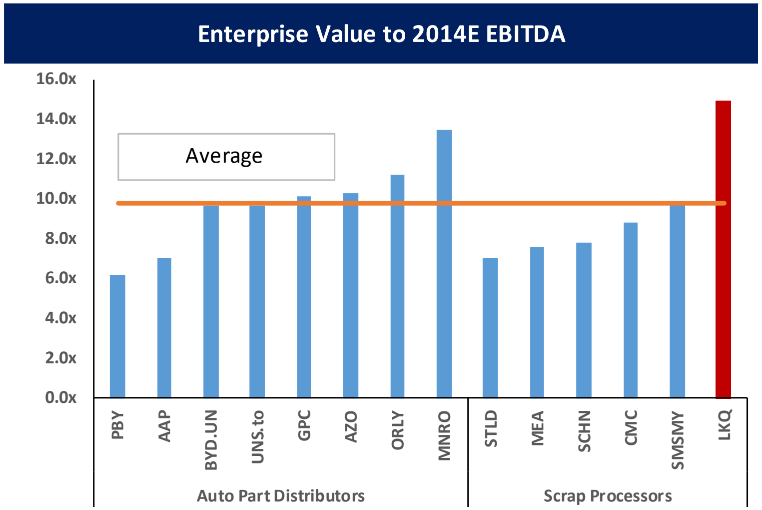
Detailed Aftermarket Auto Part and Metal Recycling Comparables

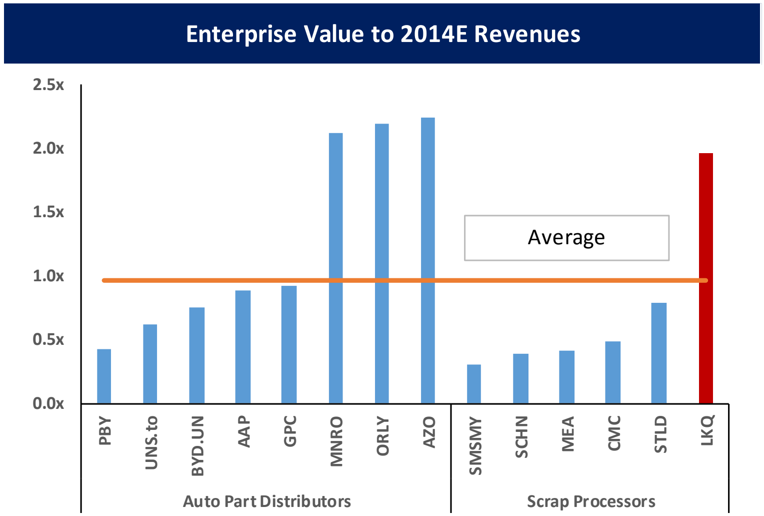
($ in millions, except per share figures)

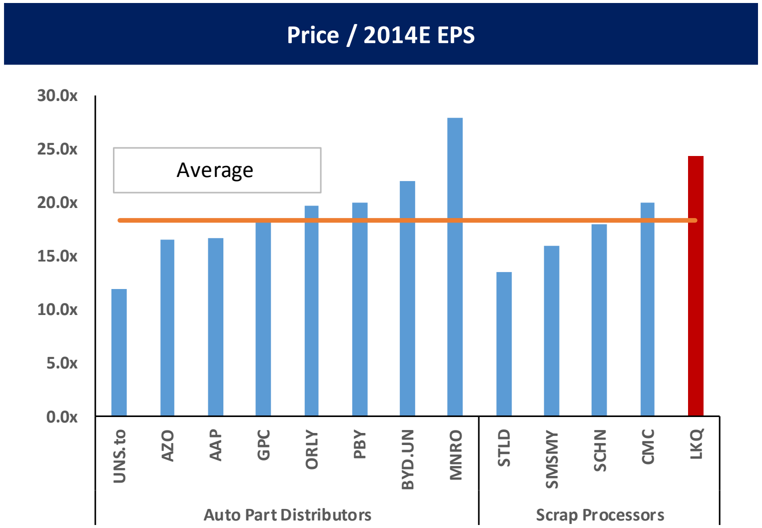
Name	Ticker	Stock Price 1/10/2014	Ent. Value	'13E-'14E Revenue Growth	'13E-'14E EPS Growth	LTM EBITDA Margin	LTM FCF Margin	P/E 2014E	P/E 2015E	Enterprise Value / EBITDA 2014E	Enterprise Value / EBITDA 2015E	Enterprise Value / Sales 2014E	Enterprise Value / Sales 2015E	Net Debt/ EBITDA	Price / Tangible Book
Aftermarket Auto Parts															
AutoZone	AZO	$490.00	$21,241	2.3%	2.7%	21.8%	10.4%	16.5x	14.8x	10.3x	9.9x	2.2x	2.2x	2.0x	NM
O'Reilly Automotive	ORLY	$132.99	$15,473	6.3%	13.1%	19.0%	10.5%	19.7x	17.3x	11.2x	10.4x	2.2x	2.1x	0.8x	2.3x
Genuine Parts	GPC	$83.45	$13,630	5.2%	5.5%	8.8%	6.4%	18.2x	16.7x	10.2x	9.5x	0.9x	0.9x	0.6x	7.1x
Advance Auto Parts	AAP	$115.64	$8,560	49.3%	27.8%	13.6%	5.5%	16.6x	14.3x	7.1x	6.4x	0.9x	0.9x	0.1x	7.6x
Monro Muffler	MNRO	$55.81	$1,917	9.9%	27.1%	13.7%	8.4%	27.9x	22.0x	13.5x	11.9x	2.1x	1.9x	1.6x	15.1x
Uni-Select	UNS.to	$30.00	$1,104	-0.2%	14.0%	4.2%	5.9%	11.9x	11.0x	9.7x	9.3x	0.6x	0.6x	6.1x	4.5x
Pep Boys	PBY	$11.80	$922	4.7%	145.8%	5.7%	0.2%	20.0x	14.8x	6.1x	5.6x	0.4x	0.4x	2.5x	1.3x
Boyd Group	BYD.UN	$33.41	$505	19.3%	67.0%	6.9%	3.8%	22.0x	21.3x	9.7x	9.5x	0.7x	0.7x	-0.1x	1.1x
			Max	49.3%	145.8%	21.8%	10.5%	27.9x	22.0x	13.5x	11.9x	2.2x	2.2x	6.1x	15.1x
			Average	12.1%	37.9%	11.7%	6.4%	19.1x	16.5x	9.7x	9.1x	1.3x	1.2x	1.7x	5.6x
			Min	-0.2%	2.7%	4.2%	0.2%	11.9x	11.0x	6.1x	5.6x	0.4x	0.4x	-0.1x	1.1x
Metal Recycling															
Steel Dynamics	STLD	$19.10	$6,072	4.4%	69.9%	8.1%	2.4%	13.5x	11.2x	7.0x	6.2x	0.8x	0.8x	3.3x	3.1x
Comercial Metals	CMC	$20.56	$3,468	-0.3%	54.2%	4.7%	-0.2%	19.9x	13.3x	8.8x	7.1x	0.5x	0.5x	3.1x	2.1x
Sims Metal	SMSMY	$9.24	$2,028	-10.7%	107.4%	2.7%	2.1%	15.9x	11.5x	9.7x	7.0x	0.3x	0.3x	0.7x	1.2x
Schnitzer Steel	SCHN	$28.94	$1,118	4.6%	125.2%	4.1%	0.7%	18.0x	13.7x	7.8x	6.6x	0.4x	0.4x	3.4x	1.8x
Metalico	MEA	$2.40	$233	4.7%	-145.5%	3.4%	2.4%	48.0x	21.8x	7.6x	6.6x	0.4x	0.4x	6.6x	1.4x
			Max	4.7%	125.2%	8.1%	2.4%	48.0x	21.8x	9.7x	7.1x	0.8x	0.8x	6.6x	3.1x
			Average	0.5%	42.3%	4.6%	1.5%	23.1x	14.3x	8.2x	6.7x	0.5x	0.5x	3.4x	1.9x
			Min	-10.7%	-145.5%	2.7%	-0.2%	13.5x	11.2x	7.0x	6.2x	0.3x	0.3x	0.7x	1.2x
LKQ Corp	**LKQ**	**$33.00**	**$11,846**	**18.8%**	**25.7%**	**13.5%**	**6.1%**	**24.3x**	**19.2x**	**15.0x**	**12.4x**	**2.0x**	**1.8x**	**2.7x**	**57.0x**

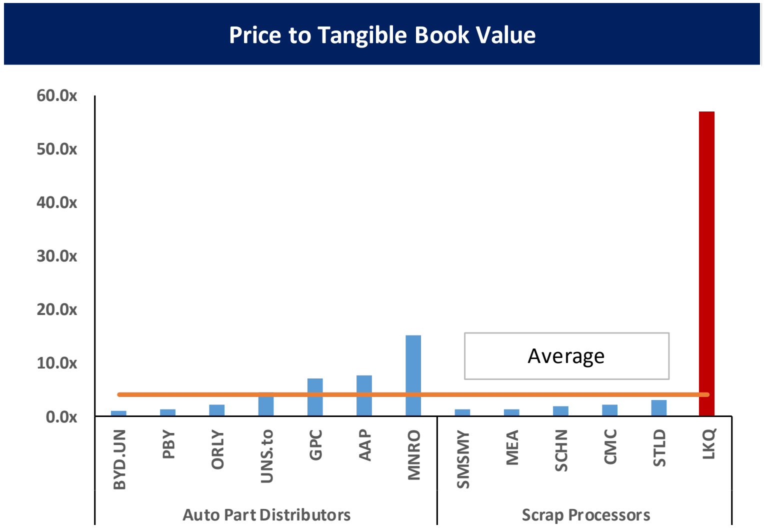
Source: Company financials, CapitalIQ calendarized estimates.

Valuation Premium is Unwarranted Relative to Aftermarket Parts and Recyclers









Source: CapitalIQ; company filings.
Averages exclude LKQ

Detailed Industrial Distribution Comparables

PRESCIENCE POINT

LKQ often refers to itself as a "distribution" company. From this perspective, LKQ's stock is dramatically overvalued relative to some of the best industrial distribution companies in America.

($ in millions, except per share figures)

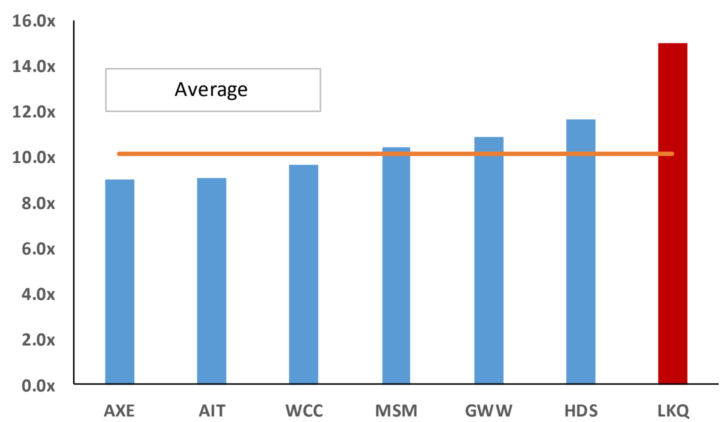
Name	Ticker	Stock Price 1/10/2014	Ent. Value	LTM EBITDA Margin	LTM FCF Margin	P/E 2014E	P/E 2015E	Enterprise Value / EBITDA 2014E	Enterprise Value / EBITDA 2015E	Enterprise Value / Sales 2014E	Enterprise Value / Sales 2015E	Net Debt/ EBITDA	Price Book Value
WW Grainger	GWW	$263.71	$18,396	15.9%	7.9%	37.7x	18.2x	10.8x	9.9x	1.8x	1.7x	0.0x	3.5x
Home Depot Supply	HDS	$24.30	$10,218	8.8%	-11.5%	18.0x	11.6x	11.7x	9.9x	1.1x	1.0x	7.3x	NM
Wesco	WCC	$91.94	$5,545	6.0%	3.5%	15.1x	14.1x	9.7x	8.8x	0.7x	0.7x	3.4x	2.3x
MSC Industrial	MSM	$85.40	$5,214	18.3%	9.6%	20.3x	17.4x	10.4x	9.0x	1.8x	1.7x	-0.4x	3.9x
Anixter	AXE	$93.22	$3,773	5.8%	2.5%	14.2x	13.1x	9.0x	8.4x	0.6x	0.6x	2.1x	2.8x
Applied Industrial Tech	AIT	$48.26	$1,955	8.0%	3.8%	16.5x	13.8x	9.1x	7.8x	0.8x	0.7x	-0.4x	2.6x
			Max	18.3%	9.6%	37.7x	18.2x	11.7x	9.9x	1.8x	1.7x	7.3x	3.9x
			Average	10.5%	2.6%	20.3x	14.7x	10.1x	9.0x	1.1x	1.0x	2.0x	3.0x
			Trim Avg*	9.7%	4.4%	17.5x	14.6x	10.0x	8.9x	1.1x	1.0x	1.3x	3.0x
			Min	5.8%	-11.5%	14.2x	11.6x	9.0x	7.8x	0.6x	0.6x	-0.4x	2.3x
LKQ Corp	**LKQ**	**$33.00**	**$11,846**	**13.5%**	**6.1%**	**24.3x**	**19.2x**	**15.0x**	**12.4x**	**2.0x**	**1.8x**	**2.7x**	**4.5x**

Source: Company financials, CapitalIQ calendarized estimates.

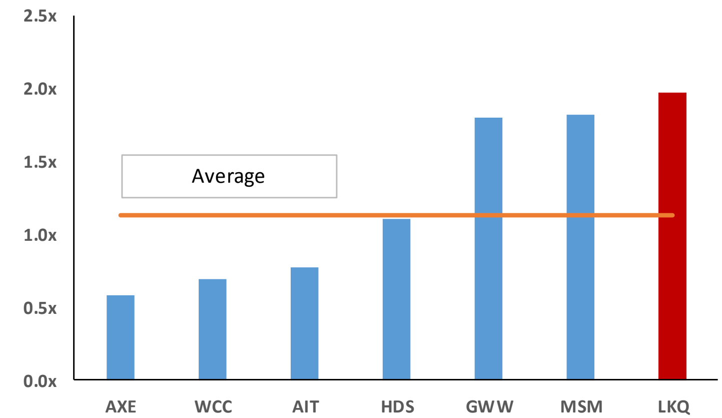
* Trim average exludes maximum and minimum

LKQ's Valuation Premium is Unwarranted Relative to Industrial Distributors

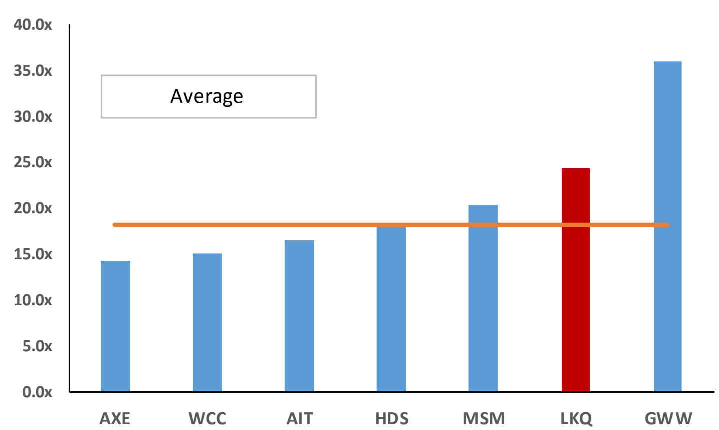
Enterprise Value to 2014E EBITDA



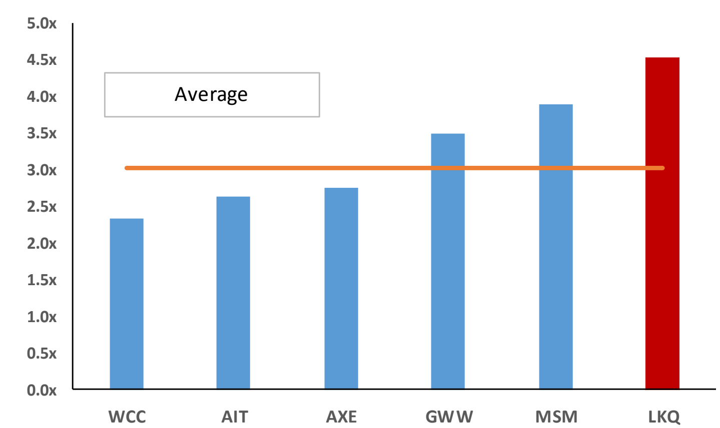
Enterprise Value to 2014E Revenues



Price / 2014E EPS



Price to Book Value



Source: CapitalIQ; company filings. Averages exclude LKQ

LKQ is an Ineffective Roll-up; Valuation Beyond the Sum of its Parts Isn't Justifiable

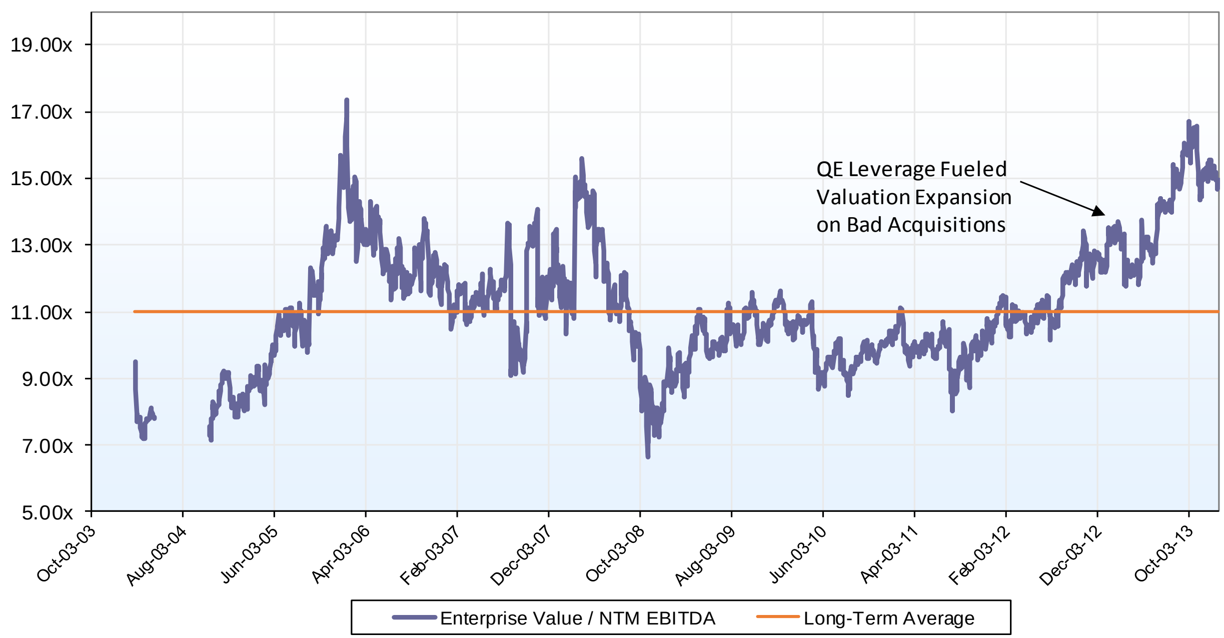
	Over 160 Acquisitions (Salvage, Aftermarket, Reman, Heavy Duty, Etc.)	Euro Car Parts	Sator Holding	Keystone Auto Operations	LKQ Corp
$ in mm	**1998-2013**	**Acq. 2011**	**Acq. May 2013**	**Acq. Dec 2013**	**Approx Total**
Estimated Revenues ~% growth	~$3,700 0-2%	~$1,200 ~20%	~$400.0 ~4-6%	~$700.0 NA	$6,000 Low single digits
Gross Margin Contribution	Low 40%, if accurate	~43.0%	~33.0%	Low 30%	?
Estimated EBITDA % margin	$440.0 12.0%	$91.0 7.6%	$33.0 *8.3%*	$70.0 10.0%	$650 10.8%
Purchase Price	~$2,100	$347 (1)	$272	$450	>$2,700
EV/LTM EBITDA	--	Acquired: 8.9x	Acquired: 8.8x	Acquired: 6.4x	At best 7.0x – 10.0x
EV/LTM Revenues	--	Acquired: 0.68x	Acquired: 0.73x	Acquired: 0.64x	At best 0.60x – 1.0x
Comments	(2) North American Salvage Assets of diminished value and potentially impaired value in Heavy Duty. Core business value in serious question. LKQ has paid big premiums to book value for these industrial assets	Growth is artificially high in the near term due to rapid store expansion. Growth is expected to slow dramatically as it reaches its market saturating location limit. Also, LKQ has yet to demonstrate an ability to drive APU growth in Europe	(3) Acquired from H2 Partners, which also owns the UK's Unipart Auto (a competitor to ECP). H2 did not appear to extract synergies between the two, so we are skeptical of LKQ's ability to drive value between ECP/Sator	(4) Keystone was previously bankrupt and up for sale for at least a year until LKQ bought it. LKQ has yet to demonstrate any ability to extract value here, and its key markets are fundamentally different from LKQ's existing ones	At 7.0x – 10.0x EBITDA, and adjusting for $1.7bn of debt outstanding, $107m of cash and 308.8m shares o/s, our price target is ~$10.00 - $15.00/share (50% – 70%) downside. **LKQ's current valuation at 15x is a substantial premium to the sum of its parts, at the upper end of its historical range, and a significant premium to all its stock trading peers**

Source: Company financials, converted from local currencies
(1) ECP deal excludes $33.9m earnout payment made in March 2013.
(2) Note that in Q4'12 LKQ mysteriously realigned the reporting structure of its heavy-duty salvage yards and removed it as an operating segment to be included within Wholesale North America (p. 7 2012 10K)
(3) H2 Equity Acquires Unipart (UK): http://www.unipart.co.uk/UserFiles/File/UnipartAutomotiveH2pressrelease[1].pdf
(4) Platinum Equity Seeks Buyer for Keystone Automotive: http://www.reuters.com/article/2013/01/29/keystone-platinum-idUSL1N0AXM6U20130129

Cheap Money, Leverage and Bad Deals = Valuation Expansion?

- LKQ's long-term Enterprise Valuation to forward EBITDA multiple has trended in the 10x – 11x range. The recent valuation expansion appears to be a function of expansionary monetary policies favoring stocks, the company's use of more leverage to buy low quality businesses as it expand into Europe, and, we believe, a fundamental misevaluation by market participants of LKQ as an effective roll-up
- We believe investors' are discounting perfect execution and unrealistic growth expectations for a company with significant fundamental challenges, and lacking operational excellence as indicated by:
  - An "F" rating by the Better Business Bureau
  - 2.8 our of 5 ranking on Employee Review site Glassdoor.com
  - Our conversations with industry participants

LKQ's EV/ NTM EBITDA Historical Valuation



Appendix

Does LKQ Have Too Cozy a Relationship with its Auditors?

- According to the SEC, at the onset of the WM fraud, the Company capped Arthur Andersen's audit fees. However, WM advised AA it could earn additional fees for "special work" — e.g., consulting services. Over the succeeding years, AA's corporate audit fees remained flat while the fees for special work multiplied

Despite enormous revenue growth and international geographic expansion, LKQ's audit and total fees paid to auditors have barely increased. Oddly enough, tax planning fees have fallen at the fastest pace despite LKQ having reported progressively growing international earnings and cash flow

$ in millions

	2008	2009	2010	2011	2012	CAGR
Audit Fees	$1.82	$1.60	$1.70	$1.97	$2.04	**2.9%**
Audit-Related	$0.05	$0.09	$0.30	$0.28	$0.12	**21.1%**
Tax Fees	$0.63	$0.75	$0.62	$0.32	$0.35	**-14.0%**
All Other Fees	$0.12	$0.00	$0.00	$0.00	$0.00	**-100.0%**
Total Fees	**$2.63**	**$2.44**	**$2.61**	**$2.57**	**$2.51**	**-1.2%**
Annual Growth						
% revenues	69.4%	7.3%	20.6%	32.4%	26.1%	**21.2%**
% employees	5.5%	4.2%	20.0%	49.2%	13.4%	**16.2%**
Sales by Geography						
% US	100.0%	100.0%	100.0%	100.0%	83.1%	78% (1)
% Europe	0.0%	0.0%	0.0%	0.0%	16.9%	22%(1)

(1) as of LTM 9/31/13. Source: Company filings

PRESCIENCE POINT

LKQ Received the Coveted "F" Grade by The Better Business Bureau

BBB BUSINESS REVIEW

Is this your Business?

Overview | Complaints | Directions

THIS BUSINESS IS NOT BBB ACCREDITED

LKQ Corp

Find a Location

(877) 557-8677

View Additional Phone Numbers

500 W Madison St Ste 2800, Chicago, IL 60661-2506

http://www.lkqcorp.com

View Additional Web Addresses

F

On a scale of A+ to F

Reason for Rating

BBB Ratings System Overview

Customer Complaints Summary

Read complaint details

77 complaints closed with BBB in last 3 years | 28 closed in last 12 months

Complaint Type	Total Closed Complaints
Advertising / Sales Issues	3
Delivery Issues	4
Guarantee / Warranty Issues	25
Problems with Product / Service	45
Billing / Collection Issues	0
Total Closed Complaints	77

Read Complaints | Definitions | BBB Complaint Process | File a Complaint

http://www.bbb.org/chicago/business-reviews/auto-parts-and-supplies-used-and-rebuilt/lkq-in-chicago-il-12010519

PRESCIENCE POINT

Insider Views from Glassdoor

LKQ Reviews

All Employees | Current Employees Only

2.8 ★★★☆☆ 45 reviews

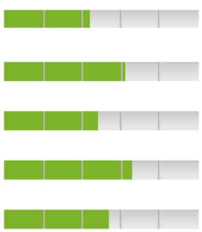
Culture & Values

Work/Life Balance

Senior Management

Comp & Benefits

Career Opportunities



62% Approve of the CEO

Robert L. Wagman
(16 ratings)

38% of employees recommend this company to a friend

"A den of thieves."

Inside Sales (Former Employee)
Hutchins, TX
Oct 2, 2013

"do not think of working here"

Purchasing (Former Employee)
Houston, TX
Dec 19, 2013

"What a joke."

IT Support (Former Employee)
Nashville, TN
Sep 12, 2013

"Site management a joke"

Anonymous Employee (Former Employee)
Albert Lea, MN
May 25, 2013

"Not a company you should associate your self with. No loyalty!"

Anonymous Employee (Former Employee)
Portland, OR
Apr 21, 2013

Source: http://www.glassdoor.com/Reviews/LKQ-Reviews-E20395.htm?sort.sortType=RD&sort.ascending=false