

LKQ CORP  
Form 10-K  
February 27, 2017

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-K

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(Mark One)

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

For the fiscal year ended December 31, 2016

OR

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

Commission File Number: 000-50404

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LKQ CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware	36-4215970
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
500 West Madison Street, Suite 2800, Chicago, IL	60661
(Address of principal executive offices)	(Zip Code)

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

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

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

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

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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

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

As of June 30, 2016, the aggregate market value of common stock outstanding held by stockholders who were not affiliates (as defined by regulations of the Securities and Exchange Commission) of the registrant was approximately \$9.6 billion (based on the closing sale price on the NASDAQ Global Select Market on such date). The number of outstanding shares of the registrant's common stock as of February 17, 2017 was 308,000,350.

Documents Incorporated by Reference

Those sections or portions of the registrant's proxy statement for the Annual Meeting of Stockholders to be held on May 8, 2017, described in Part III hereof, are incorporated by reference in this report.

## PART I

### SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

Statements and information in this Annual Report on Form 10-K that are not historical are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and are made pursuant to the “safe harbor” provisions of such Act.

Forward-looking statements include, but are not limited to, statements regarding our outlook, guidance, expectations, beliefs, hopes, intentions and strategies. Words such as “may,” “will,” “plan,” “should,” “expect,” “anticipate,” “believe,” “if,” “estimate,” “intend,” “project” and similar words or expressions are used to identify these forward-looking statements. These statements are subject to a number of risks, uncertainties, assumptions and other factors including those identified below. All forward-looking statements are based on information available to us at the time the statements are made. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

You should not place undue reliance on our forward-looking statements. Actual events or results may differ materially from those expressed or implied in the forward-looking statements. The risks and uncertainties that could cause actual results to differ from the results predicted or implied by our forward-looking statements include the following (not necessarily in the order of importance):

- changes in economic and political activity in the U.S. and other countries in which we are located or do business, including the U.K. withdrawal from the European Union, and the impact of these changes on our businesses, the demand for our products and our ability to obtain financing for operations;
- increasing competition in the automotive parts industry;
- fluctuations in the pricing of new original equipment manufacturer (“OEM”) replacement products;
- changes in the level of acceptance and promotion of alternative automotive parts by insurance companies and auto repairers;
- changes to our business relationships with insurance companies or changes by insurance companies to their business practices relating to the use of our products;
- our ability to identify sufficient acquisition candidates at reasonable prices to maintain our growth objectives;
- our ability to integrate, realize expected synergies, and successfully operate acquired companies and any companies acquired in the future, and the risks associated with these companies;
- the implementation of a border tax or tariff on imports and the negative impact on our business due to the amount of inventory we import;
- restrictions or prohibitions on selling certain aftermarket products to the extent OEMs seek and obtain more design patents than they have in the past and are successful in asserting infringement of these patents and defending their validity;
- variations in the number of vehicles manufactured and sold, vehicle accident rates, miles driven, and the age profile of vehicles in accidents;
- fluctuations in the prices of fuel, scrap metal and other commodities;
- changes in laws or regulations affecting our business;
- higher costs and the resulting potential inability to service our customers to the extent that our suppliers decide to discontinue business relationships with us;
- price increases, interruptions or disruptions to the supply of vehicles or vehicle parts from aftermarket suppliers and from salvage auctions;
- changes in the demand for our products and the supply of our inventory due to severity of weather and seasonality of weather patterns;
- the risks associated with operating in foreign jurisdictions, including foreign laws and economic and political instabilities;
- declines in the values of our assets;
- additional unionization efforts, new collective bargaining agreements, and work stoppages;

our ability to develop and implement the operational and financial systems needed to manage our operations;  
interruptions, outages or breaches of our operational systems, security systems, or infrastructure as a result of attacks  
on, or malfunctions of, our systems;  
product liability claims by the end users of our products or claims by other parties who we have promised to  
indemnify for product liability matters;  
costs associated with recalls of the products we sell;  
inaccuracies in the data relating to our industry published by independent sources upon which we rely;  
currency fluctuations in the U.S. dollar, pound sterling and euro versus other currencies;  
our ability to obtain financing on acceptable terms to finance our growth; and  
our ability to satisfy our debt obligations and to operate within the limitations imposed by financing arrangements.

Other matters set forth in this Annual Report may also cause our actual results to differ materially from our  
forward-looking statements, including the risk factors disclosed in Item 1A of this Annual Report.

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

## ITEM 1. BUSINESS OVERVIEW

LKQ Corporation ("LKQ" or the "Company") is a leading provider of alternative and specialty parts to repair and accessorize automobiles and other vehicles. LKQ has operations in North America, Europe and Taiwan. LKQ offers its customers a broad range of replacement systems, components, equipment and parts to repair and accessorize automobiles, trucks, and recreational and performance vehicles.

Buyers of vehicle replacement products have the option to purchase from primarily five sources: new products produced by original equipment manufacturers ("OEMs"); new products produced by companies other than the OEMs, which are sometimes referred to as aftermarket products; recycled products obtained from salvage vehicles; used products that have been refurbished; and used products that have been remanufactured. Collectively, we refer to the four sources that are not new OEM products as alternative parts.

Specialty automotive and RV aftermarket accessories and equipment are purchased by consumers to improve the performance, functionality and appearance of their vehicles.

We are organized into five operating segments: Wholesale - North America; Europe; Specialty; Glass and Self Service. We aggregate our Wholesale - North America, Glass and Self Service operating segments into one reportable segment, North America, resulting in three reportable segments: North America, Europe, and Specialty. See Note 14, "Segment and Geographic Information" to the consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K for financial information by reportable segment and by geographic region.

### HISTORY

LKQ was initially formed in 1998 through the combination of a number of wholesale recycled products businesses located in Florida, Michigan, Ohio and Wisconsin. We subsequently expanded through internal development and over 235 acquisitions of aftermarket, recycled, refurbished, and remanufactured product suppliers and manufacturers; self service retail businesses; specialty vehicle aftermarket equipment and accessories suppliers; and a distributor of automotive glass products. Our most significant acquisitions include:

2007 acquisition of Keystone Automotive Industries, Inc., which, at the time of acquisition, was the leading domestic distributor of aftermarket products, including collision replacement products, paint products, refurbished steel bumpers, bumper covers and alloy wheels.

2011 acquisition of Euro Car Parts Holdings Limited ("ECP"), a vehicle mechanical aftermarket parts distribution company operating in the United Kingdom. This acquisition allowed us to expand our operations into the European automotive aftermarket business.

2013 acquisition of Sator Beheer B.V. ("Sator"), a vehicle mechanical aftermarket parts distribution company based in the Netherlands, with operations in the Netherlands, Belgium and Northern France. This acquisition allowed us to further expand our geographic presence into continental Europe.

2014 acquisition of Keystone Automotive Holdings, Inc. ("Keystone Specialty"), which expanded our product offering and increased our addressable market to include specialty vehicle aftermarket equipment and accessories.

2016 acquisition of Rhiag-Inter Auto Parts Italia S.p.A. ("Rhiag"), a distributor of aftermarket spare parts for passenger cars and commercial vehicles in Italy, Czech Republic, Slovakia, Switzerland, Hungary, Romania, Ukraine, Bulgaria, Poland and Spain. This acquisition expanded LKQ's geographic presence in continental Europe.

2016 acquisition of Pittsburgh Glass Works LLC ("PGW"), which performs wholesale and retail distribution services and automotive glass manufacturing. The acquisition expanded our addressable market in North America and globally. In December 2016, we reached an agreement to sell the glass manufacturing business of PGW; the transaction is expected to be completed in the first quarter of 2017. The continuing portion of PGW's business related to wholesale and retail distribution services is included in our North America reportable segment as of December 31, 2016.

Further information regarding our recent acquisitions is included in Note 2, "Business Combinations" and information related to our discontinued operations is included in Note 3, "Discontinued Operations" to the consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K.

### STRATEGY

Our strategy is to build economic value for our stockholders by enhancing our position as a leading source for alternative collision and mechanical repair products, and by expanding into other product lines and businesses that

may benefit from our operating strengths. We strive to offer our customers the most comprehensive, available and cost effective selection of

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part solutions while building strong partnerships with our employees and the communities in which we operate. We believe a supply network with a broad inventory of quality alternative collision and mechanical repair products and specialty vehicle aftermarket products, high fulfillment rates, and superior customer service provides us with a competitive advantage. To execute our strategy, we are focused on the following key areas:

**Extensive in-place network.** We have invested significant capital to develop a network of alternative and specialty vehicle parts facilities across our operating segments. Additionally, our ability to move inventory throughout our distribution networks increases the availability of our products and also helps us to fill a higher percentage of our customers' requests. In order to expand our distribution network, we will continue to seek to grow into new markets and to improve penetration through acquisitions. We will continue to seek opportunities to leverage the distribution network by delivering more parts through our existing network in our North America and Specialty operations. In our Europe segment, we are attempting to implement the same strategy as our North America operations to build a Pan-European distribution network.

**Acquisitions.** We have focused on growth through acquisitions both domestically and abroad. The primary objective of our acquisitions is to expand our presence to new or adjacent markets, to expand into other product lines and business that may benefit from our operating strengths, and to increase the size of our addressable market. When we identify potential acquisitions, we attempt to target companies with a leading market presence, an experienced management team and workforce that provide a fit with our existing operations, and strong cash flows. After completing an acquisition, we focus on integrating the company with our existing business to provide additional value to the combined entity through cost savings and synergies, such as logistics cost synergies resulting from integration with our existing distribution network, administrative cost savings, shared procurement, and cross-selling opportunities.

**Strong business relationships.** We have developed business relationships with key constituents, including automobile insurance companies, suppliers and other industry participants in North America and Europe.

**Broad product offering.** The breadth and depth of our inventory across all of our operating segments reinforces LKQ's ability to provide a "one-stop" solution for our customers' alternative vehicle replacement, maintenance, and specialty vehicle product needs.

**High fulfillment rates.** We manage local inventory levels to improve delivery and maximize customer service.

Improving local order fulfillment rates reduces transfer costs and delivery times, and improves customer satisfaction.

**Technology driven business processes.** We focus on technology development as a way to support our competitive advantage. We believe that we can more cost effectively leverage our data to make better business decisions than our smaller competitors.

## NORTH AMERICA SEGMENT

Our North America segment is composed of wholesale operations, which consists of aftermarket and salvage operations, and self service retail operations. We are a leading provider of alternative vehicle collision replacement products and a leading provider of alternative vehicle mechanical replacement products, with our sales, processing, and distribution facilities reaching most major markets in the U.S. and Canada.

### Wholesale Operations

#### Inventory

Our wholesale automobile product operations in North America sell all five product types (aftermarket, recycled, remanufactured, refurbished and OEM parts) to professional collision and mechanical automobile repair businesses. Our principal aftermarket product types consist of those most frequently damaged in collisions, including bumper covers, automotive body panels, lights and automotive glass products such as windshields. Platinum Plus is our exclusive product line offered under the Keystone brand of aftermarket products. Certain of our products are certified by independent organizations such as the Certified Automotive Parts Association ("CAPA") and NSF International ("NSF"). CAPA and NSF are associations that evaluate the quality of aftermarket collision replacement products compared to OEM collision replacement products. We also developed a product line called "Value Line" for more value conscious, often self-pay, consumers. Our salvage products include both mechanical and collision parts, including engines; transmissions; door assemblies; sheet metal products such as trunk lids, fenders and hoods; lights; and bumper assemblies.

The aftermarket products we distribute are purchased from independent manufacturers and distributors located primarily in the U.S., Taiwan, and China. In 2016, approximately 39% of our aftermarket purchases were made from our top four vendors, with our largest vendor providing approximately 16% of our annual inventory purchases. We believe we are one of the largest customers of each of these suppliers. Outside of this group, no other supplier provided more than 5% of our supply of aftermarket products in 2016. We purchased approximately 48% of our aftermarket products in 2016 directly from



manufacturers in Taiwan and other Asian countries. Approximately 50% of our aftermarket products were purchased from vendors located in the U.S. and Canada; however, we believe the majority of these products were manufactured in Taiwan, Mexico or other foreign countries.

We procure recycled products for our wholesale operations by acquiring total loss vehicles, typically sold at regional salvage auctions, and then dismantling and inventorying the parts. The availability and pricing of the salvage vehicles we procure for our wholesale recycled products operations may be impacted by a variety of factors, including the production level of new vehicles and the portion of damaged vehicles declared total losses. Our bidding specialists are equipped with a proprietary software application that allows our bidding specialist to compare the vehicles at the salvage auctions against our current inventory levels, historical demand, and recent average selling prices to arrive at an estimated maximum bid.

Within our wholesale operations, we focus our procurement on products that are in the most demand, based on a number of factors such as historical sales records of vehicles by model and year, customer requests, projections of future supply and demand trends. Because lead times may take 40 days or more on imported aftermarket products, sales volume and in-stock inventory are important factors in the procurement process.

In our aftermarket operations, we use a third party enterprise management system and other third party software packages to leverage the centralized data and information that a single system provides, such as a data warehouse to conduct enhanced analytics and reporting, an integrated budgeting system, an electronic data interchange tool, and E-commerce tools to enhance our online business-to-business initiatives - OrderKeystone.com and Keyless.

Our wholesale recycled product locations in North America operate an internally-developed, proprietary enterprise management system called LKQX. We believe that the use of a single system across all of our wholesale recycled product operations helps facilitate the sales process, allows for continued implementation of standard operating procedures, and yields improved training efficiency, employee transferability, access to our national inventory database, management reporting and data storage. The system also supports an electronic exchange process for identifying and locating parts at other select recyclers and facilitates brokered sales to fill customer orders for items not in stock.

#### Scrap and Other Materials

Our salvage operations generate scrap metal and other materials that we sell to metals recyclers. Vehicles that have been dismantled for recycled products and "crush only" end-of-life vehicles acquired from other companies are typically crushed using equipment on site. In other cases, we will hire mobile crushing equipment to crush the vehicles before they are transported to shredders and scrap metal processors. Damaged and unusable wheel cores are melted in our aluminum furnace and sold to consumers of aluminum ingot and sow for the production of various automotive products, including wheels. We also extract and sell the precious metals contained in certain of our recycled parts such as catalytic converters.

#### Customers

We sell our products to wholesale customers that include collision and mechanical repair shops and new and used car dealerships, as well as to retail customers. The majority of these customers tend to be individually-owned small businesses, although the number of independent and dealer-operated collision repair facilities has declined over the last decade, as regional or national multiple location operators have increased their geographic presence through acquisitions. Automobile insurance companies affect the demand for our collision products; while insurance companies do not pay for our products directly, they ultimately pay for the repair costs of insured vehicles in excess of any deductible amount. As a result, insurance companies often influence the types of products used in a repair. The use of our products provides a direct benefit to insurance companies by lowering the cost of repairs, decreasing the time required to return the repaired vehicle to the customer, and providing a replacement product that is of high quality and comparable performance to the part replaced.

Our sales personnel are encouraged to promote LKQ to customers as a "one-stop shop" by offering comparable options from our other product lines if the desired part isn't in stock. To support these efforts, we have provided our sales staff with access to both recycled and aftermarket sales systems, and we have developed sales incentive programs that encourage cross selling throughout our wholesale operations.

To better serve our customers, a consolidated approach has been taken for the electronic sale of wholesale products in our North American Segment. A full suite of E-commerce services is available to approved partners that helps us

improve order accuracy, reduce return rate and better fit our customer workflow. Using these services in coordination with our partners, products can be searched, priced and ordered without leaving the customers' own operating systems.

#### Distribution

We have a distribution network of warehouses and cross dock facilities, which allows us to develop and maintain our service levels with local repair shops while providing fulfillment rates that are made possible by our nationwide presence. Our delivery fleet utilizes a third party software provider to optimize delivery routes, and to track the progress of delivery vehicles throughout their runs. Our local presence allows us to provide daily deliveries as required by our customers, using drivers who

routinely deliver to the same customers. Our sales force and local delivery drivers develop and maintain critical personal relationships with the local repair shops that benefit from access to our wide selection of products, which we are able to offer as a result of our regional inventory network. We operate a delivery fleet of medium-sized trucks and smaller trucks and vans, which deliver multiple product types on the same delivery routes to help minimize distribution costs and improve customer service.

#### Competition

We consider all suppliers of vehicle collision and mechanical products to be competitors, including aftermarket suppliers, recycling businesses, refurbishing operations, parts remanufacturers, OEMs and internet-based suppliers. We compete with alternative parts distributors on the basis of our nationwide distribution system, our product lines and inventory availability, customer service, our relationships with insurance companies, and to a lesser extent, price; we compete with OEMs primarily on the basis of price and, to a lesser extent, on service and product quality. We do not consider retail chains that focus on the do-it-yourself market to be our direct competitors since many of our wholesale product sales are paid for by insurance companies rather than the end user.

#### Self Service Operations

Our self service retail operations, most of which operate under the name "LKQ Pick Your Part," sell parts from end-of-life vehicles directly to consumers. In addition to revenue from the sale of parts, core, and scrap, we charge a nominal admission fee to access the property.

#### Inventory

We acquire inventory for our self service retail product operations from a variety of sources, including but not limited to towing companies, auctions, the general public, municipality sales, insurance carriers, and charitable organizations. We typically procure salvage vehicles that are more than seven model years old for our self service retail product operations; these vehicles are generally older and of lower quality than the salvage vehicles we purchase for our wholesale recycled product operations. Vehicles are delivered to our locations by the seller, or we arrange for transportation. Once on our property, minimal labor is required to process the vehicle other than removing the battery, fluids, refrigerants, catalytic converters and hazardous materials. The extracted fluids are stored in bulk and subsequently sold to recyclers; in the case of gasoline, the fuel retrieved is primarily used to power our delivery vehicles. Vehicles are then placed in the yard for customers to remove parts. In our self service business, availability of a specific part will depend on which vehicles are currently at the site and to what extent parts may have been previously sold. We usually keep a vehicle at our facility for 30 to 120 days, depending on the capacity of the yard and size of the market, before it is crushed and sold to scrap metal processors.

#### Scrap and Other Materials

Our self service operations generate scrap metal, alloys and other materials that we sell to recyclers. Vehicles that we no longer make available to the public and "crush only" vehicles acquired from other companies, including OEMs, are typically crushed using equipment on site.

#### Customers

The customers of our self service yards are frequently do-it-yourself mechanics, small independent repair shops servicing older vehicles, auto rebuilders, and resellers. The scrap from the vehicle hulks, when not processed by us, is sold to metals recyclers, with whom we may also compete when procuring salvage vehicles for our operations.

#### Competition

There are competitors operating self service businesses in all of the markets in which we operate. In some markets, there are numerous competitors, often operating in close proximity to our operations. We try to differentiate our business by the quality of the inventory and the size and cleanliness of the property.

#### EUROPE SEGMENT

As noted in the History section, the Europe segment was built on three key acquisitions: ECP (2011), Sator (2013) and Rhiag (2016). Our Rhiag acquisition provides a potential platform to capitalize on the large and fragmented aftermarket mechanical replacement parts market in Europe, and also complements our existing operations in the U.K. and the Benelux region given the significant overlap in suppliers and product mix, which allows for potential cost savings from the leveraging of our combined purchasing power. In 2014, we expanded our European segment to include wholesale recycling operations through our acquisition of a business with salvage and vehicle repair facilities in Sweden and Norway. In addition to expanding our geographic presence in Europe, we believe these acquisitions

provide us with the opportunity to leverage our experience in operating salvage facilities in a new market and to expand our aftermarket operations to include these countries. In December 2016, we acquired an equity investment in Mekonomen AB ("Mekonomen"), the leading independent car parts and service

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chain in the Nordic region of Europe. Mekonomen will remain independent of our existing European operations, but we plan to explore areas where the companies can work together in a mutually beneficial manner. We have acquired many smaller businesses within these regions and over time, we anticipate further integration of our European operations as we optimize purchasing, warehousing, cataloging, logistics and back-office functions.

#### Inventory

Our inventory is primarily composed of mechanical aftermarket parts for the repair of vehicles 3 to 15 years old. Our top selling products include brake pads; discs and sensors; clutches; electrical products such as spark plugs and batteries; steering and suspension products; filters; and oil and automotive fluids. In addition to mechanical aftermarket parts, we also sell collision parts in our Europe operations. We believe the historically low alternative collision parts usage percentage in Europe provides an opportunity for us in this segment, particularly as insurance companies look to lower their costs.

In 2016, our top five suppliers represented 22% of our aftermarket inventory purchases, with each of our top two suppliers representing approximately 6% of our purchases. No other suppliers comprised a significant portion of our purchases during 2016. The aftermarket products we distribute are purchased from vendors located primarily in the U.K. and continental Europe. In 2016, we purchased 92% of our products from companies in Europe. The remaining 8% of our 2016 purchases were sourced from vendors located primarily in China or Taiwan, some of which also supply collision parts for our Wholesale - North America operations. In 2016, 57%, 29%, and 8% of our total inventory purchases were made in Euros, Pounds Sterling, and U.S Dollars, respectively.

Our aftermarket operations in the U.K. use a single integrated IT platform for our purchasing, branch stock, and finance activities, which are further supported by a national distribution center system to manage inventory movement. The IT system allows customers to identify the correct part for repairs, thereby improving customer satisfaction and reducing return rates. Our aftermarket operations in continental Europe use several IT systems, which are linked to transfer data between systems, to manage customer orders and inventory movement, and for financial reporting purposes. Certain of our IT systems can interface with our repair shop customers' respective IT systems, which enables them to identify the part required for the repair.

In our Scandinavia operations, we purchase severely damaged or totaled vehicles from insurance companies, which are transferred to our dismantling facilities or sold to other third party dismantlers.

#### Customers

We operate under both two-step (i.e. direct sales to customers) and three-step (i.e. sales to distributors who in turn sell to customers) distribution models in Europe. In our two-step operations, such as the UK and Czech Republic, we sell the majority of our products to commercial customers primarily consisting of professional repairers, including both independent mechanical repair shops and collision repair shops. In our three-step operations, such as Italy, Belgium and Switzerland, we sell products to wholesale distributors or jobbers. Historically, our distribution network in the Benelux Region operated under a three-step distribution model where the immediate customers were warehouse distributors. Since the second quarter of 2014, we have acquired a number of aftermarket parts distributors in the Netherlands, which has enabled us to transform the original distribution model in this region to a two-step distribution model. In addition to our sales to repair shops and wholesale distributors, we generate a portion of our revenue through sales to retail customers from ECP's e-commerce platform and from counter sales at the branch locations.

#### Distribution

Our European operations employ a distribution model in which inventory is stored at regional distribution centers or hubs, with fast moving product stored at branch locations or at local warehouse distributors (for some of our Netherlands, Italy and Check Republic operations) for timely delivery to the repair shop customers. Product is moved through the distribution network on our vans or via common carrier. In our U.K. operations, we also sometimes employ a third party motorcycle fleet to deliver parts from our branch locations to nearby repair shop customers. In the U.K., we have undertaken a major project to expand our distribution capabilities by building a new national distribution center in Tamworth, which is expected to be completed in 2018. Between now and completion, we will incur some duplicate operating and other start-up costs, which may be material, as a result of having multiple warehouses during the build out phase.

#### Competition

We view all suppliers of replacement repair products as our competitors, including other alternative parts suppliers and OEMs and their dealer networks. While we compete with all alternative parts suppliers, there are few with national distribution networks like ours that can reach the majority of repair shop customers within the required delivery time in their respective markets. We believe we have been able to distinguish ourselves from other alternative parts suppliers primarily through our distribution network, efficient stock management systems and proprietary technology which allows us to deliver our products

quickly, as well as through our product lines and inventory availability, pricing, and service. We compete with OEMs primarily on the basis of price, service and availability.

#### SPECIALTY SEGMENT

Our Specialty operating segment was formed in 2014 with our acquisition of Keystone Specialty, a leading distributor and marketer of specialty vehicle aftermarket products and accessories in North America. Our Specialty operations reach most major markets in the U.S. and Canada and serve the following six product segments: truck and off-road; speed and performance; RV; towing; wheels, tires and performance handling; and miscellaneous accessories.

#### Inventory

The specialty vehicle aftermarket equipment and accessories we distribute are purchased from suppliers located primarily in the U.S., Canada, and China. Our top selling products are RV appliances & air conditioners, towing hitches, truck bed covers, vehicle protection products, cargo management products, and wheels, tires & suspension products. Specialty aftermarket suppliers are typically small to medium-sized, independent businesses that focus on a narrow product or market niche. Due to the highly fragmented supplier base for specialty vehicle aftermarket products, we have limited supplier concentration. In 2016, approximately 24% of our specialty vehicle aftermarket purchases were made from our top five suppliers, with our largest vendor providing approximately 8% of our annual inventory purchases.

Our Specialty operations utilize an internally developed inventory management and order entry system that interfaces with third party software systems for accounting, transaction processing, data analytics, and reporting.

#### Customers

Overall, the specialty vehicle aftermarket parts and accessories market contains a fragmented customer base composed of RV and specialty automotive dealers, installers, jobbers, builders, parts chains, and mail-order businesses. Our customers are principally small, independent businesses. These customers depend on us to provide a broad range of products, rapid delivery, marketing support and technical assistance. In addition to traditional customers, in recent years we have increased sales to several large parts and accessory online retailers. Our Specialty segment also operates retail stores in northeast Pennsylvania.

We promote our products to customers through marketing programs, which include: catalogs, advertising, sponsorships and promotional activities; product level marketing and merchandising support; and online initiatives. Our national footprint allows us to stage trade shows across the U.S., which provide an opportunity to improve sales through the showcasing of new and innovative products from our vendors to our customers.

Online sales of our Specialty products take place through our [ekeystone.com](http://ekeystone.com) and [viantp.com](http://viantp.com) sites. These sites provide customers (i) the ability to match products with the make and model of car thus allowing the customer to order the right part, (ii) the product information (e.g. pictures, attributes) available for review and (iii) the convenience of searching inventory availability and ordering the product on the site. Additionally, the site can provide sales opportunities by suggesting other parts to purchase based on an inquiry submitted by the customer.

#### Distribution

Our Specialty segment operations employ a hub-and-spoke distribution model which enables us to transport products from our primary distribution centers to our non-inventory stocking cross docks, a majority of which are co-located with our North America wholesale operations and provide distribution points to key regional markets and synergies with our existing infrastructure. We believe this provides added value to our customers through a broader product offering and more efficient distribution process. We use our delivery routes to provide multi-day per week delivery and returns of our products directly to and from our customers in all 48 continental U.S. states and 9 Canadian provinces, and we ship globally to customers in other countries. Our delivery fleet utilizes a third party software provider to optimize delivery routes, and to track the progress of delivery vehicles throughout their runs.

#### Competition

Industry participants have a variety of supply choices. Vendors can deliver products to market via warehouse distributors and mail order catalog businesses, or directly to retailers and/or consumers. We view all suppliers of specialty vehicle aftermarket equipment and accessories as our competitors. While we compete with all specialty vehicle aftermarket parts suppliers, there are few with national distribution networks like LKQ's that can reach the majority of customers within the optimum delivery time. We believe we have been able to distinguish ourselves from other specialty vehicle aftermarket parts and equipment suppliers primarily through our broad product selection,

which encompasses both popular and hard-to-find products, our distribution network, and efficient inventory management systems, as well as through our service. We compete on the basis of product breadth and depth, rapid and dependable delivery, marketing initiatives, support services, and price.



## INTELLECTUAL PROPERTY

We own various trade names and trademarks as a result of past acquisitions. In addition to acquired trade names and trademarks, we also have technology-based intellectual property that has been both internally developed and obtained through license agreements. We do not believe that our business is materially dependent on any single or group of related trademarks, licenses or registrations, nor would the expiration of any particular intellectual property right or termination of any particular intellectual property license agreement materially affect our business.

## EMPLOYEES

As of December 31, 2016, we employed approximately 42,500 persons, which includes approximately 3,000 persons employed by PGW's glass manufacturing business that we expect to sell in the first quarter of 2017. Of the approximately 39,500 employees of our continuing operations, approximately 20,500 were employed in North America and approximately 19,000 were employed outside of North America. Of our employees in North America associated with continuing operations, approximately 1,370 were represented by unions. Outside of North America, we have government-mandated collective bargaining agreements and union contracts in certain countries, particularly in Europe where many of our employees are represented by unions and/or works councils. We consider our employee relations to be good.

## FACILITIES

Our continuing operations include 1,339 facilities, including 548 facilities in the U.S. and 791 facilities located in 20 other countries, most of which are leased. Many of our locations stock multiple product types or serve more than one function.

Our corporate headquarters are located at 500 West Madison Street, Chicago, Illinois 60661. We operate a field support center in Nashville, Tennessee that performs certain centralized functions for our North American operations, including accounting, procurement, and information systems support; in 2017, we announced our plans to expand the size of our field support center via construction of a new 100,000 square foot facility in Nashville. Our Specialty operations maintain primary procurement, accounting and finance functions in Exeter, Pennsylvania. Certain back-office support functions for our segments are performed in Bangalore, India. Our European operations maintain procurement, accounting, and finance functions in Wembley, outside of London, England and Tamworth, England; in Schiedam, the Netherlands; in Milan, Italy; and in Prague, Czech Republic. In addition to these offices, we have a 500,000 square foot national distribution center in Tamworth that houses inventory to supply the hubs and branches of our U.K. operations. We are in the process of constructing a second national distribution center in Tamworth; we expect the 750,000 square foot facility will be fully operational by 2018. Additionally, we operate an aftermarket parts warehouse in Taiwan to aggregate inventory for shipment to our locations in North America.

## REGULATION

Our operations and properties are subject to laws and regulations relating to the protection of the environment in the U.S. and the other countries in which we operate. See the risk factor "We are subject to environmental regulations and incur costs relating to environmental matters" in Part I, Item 1A of this Annual Report on Form 10-K for further information regarding the effects of environmental laws and regulations on us.

## SEASONALITY

Our operating results are subject to quarterly variations based on a variety of factors, influenced primarily by seasonal changes in weather patterns. During the winter months, we tend to have higher demand for our vehicle replacement products because there are more weather related repairs. Our specialty vehicle operations typically generate greater revenue and earnings in the first half of the year, when vehicle owners tend to install this equipment. We expect our aftermarket glass operations to generate greater revenue and earnings in the second and third quarters, when the demand for glass replacements increases after the winter weather.

## ITEM 1A. RISK FACTORS

Our operating results and financial condition have been and could continue to be adversely affected by the economic and political conditions in the U.S. and elsewhere.

Changes in economic and political conditions in the U.S. and other countries in which we are located or do business could have a material effect on our company. Changes in such conditions have, in some periods, resulted in fewer miles driven, fewer accident claims, and a reduction of vehicle repairs, all of which could negatively affect our

business. The number of new vehicles produced and sold by manufacturers affects our business. A decrease in the number of vehicles on the road results in a decrease in accidents requiring repairs. Moreover, we supply vehicle glass directly to vehicle manufacturers, and a decrease in the number of vehicles produced would result in a decrease in the demand for our glass products.

Our sales are also impacted by changes to the economic health of vehicle owners. The economic health of vehicle owners is affected by many factors, including, among others, general business conditions, interest rates, inflation, consumer debt levels, the availability of consumer credit, taxation, fuel prices, unemployment trends and other matters that influence consumer confidence and spending. Many of these factors are outside of our control. If any of these conditions worsen, our business, results of operations, financial condition and cash flows could be adversely affected. In addition, economic conditions, including decreased access to credit, may result in financial difficulties leading to restructurings, bankruptcies, liquidations and other unfavorable events for our customers, suppliers, logistics and other service providers and financial institutions that are counterparties to our credit facilities and hedge transactions. These unfavorable events affecting our business partners could have an adverse effect on our business, results of operations, financial condition and cash flows.

We have a substantial business presence in Europe, including a significant presence in the United Kingdom. In June 2016, voters in the United Kingdom decided by referendum to withdraw from the European Union. The precise timing and impacts of this action on our businesses in the United Kingdom and other parts of Europe are unknown at this time. Since the vote, we have seen fluctuations in exchange rates leading to pricing pressures and unfavorable translation effects on our sterling denominated earnings. As the details of the United Kingdom's withdrawal from the European Union are negotiated and implemented, our European businesses could be adversely affected as a result of further fluctuations in exchange rates, disruptions to access to markets by United Kingdom companies, interruptions of the movement of goods and services between countries, a decrease of economic activity in Europe, and political or social unrest.

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

The vehicle replacement products industry is highly competitive and is served by numerous suppliers of OEM, recycled, aftermarket, refurbished and remanufactured products. Within each of these categories of suppliers, there are local owner-operated companies, larger regional suppliers, national and international providers, and internet-based suppliers. Providers of vehicle replacement products that have traditionally sold only certain categories of such products may decide to expand their product offerings into other categories of vehicle replacement products, which may further increase competition. Some of our current and potential competitors may have more operational expertise; greater financial, technical, manufacturing, distribution, and other resources; longer operating histories; lower cost structures; and better relationships in the insurance and vehicle repair industries or with consumers, than we do. In certain regions of the U.S., local vehicle recycling companies have formed cooperative efforts to compete in the wholesale recycled products industry. Similarly in Europe, some local companies are part of cooperative efforts to compete in the aftermarket parts industry. As a result of these factors, our competitors may be able to provide products that we are unable to supply, provide their products at lower costs, or supply products to customers that we are unable to serve.

We believe that a majority of collision parts by dollar amount are supplied by OEMs, with the balance being supplied by distributors of alternative aftermarket, recycled, refurbished and remanufactured collision parts like us. The OEMs are therefore able 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, the OEMs have implemented programs seeking to increase their market share in the collision repair parts industry. For example, they have reduced prices on specific products to match the lower prices of alternative products and introduced other rebate programs that may disrupt our sales. The growth of these programs or the introduction of new ones could have a material adverse impact on our business.

We rely upon our customers and insurance companies to promote the usage of alternative parts.

Our success depends, in part, on the acceptance and promotion of alternative collision parts usage by automotive insurance companies. There can be no assurance that current levels of alternative parts usage will be maintained or will increase in the future. Alternative part usage in the U.S. has been relatively flat over the last three years. In addition, in some places we operate, alternative parts usage is relatively low.

We also rely on business relationships with insurance companies. These insurance companies encourage vehicle repair facilities to use products we provide. The business relationships include in some cases participation in aftermarket quality and service assurance programs that may result in a higher usage of our aftermarket products than would be

the case without the programs. Our arrangements with these companies may be terminated by them at any time, including in connection with their own business concerns relating to the offering, availability, standards or operations of the aftermarket quality and service assurance programs. We rely on these relationships for sales to some collision repair shops, and a termination of these relationships may result in a loss of sales, which could adversely affect our results of operations.

In an Illinois lawsuit involving State Farm Mutual Automobile Insurance Company ("Avery v. State Farm"), a jury decided in October 1999 that State Farm breached certain insurance contracts with its policyholders by using non-OEM replacement products to repair damaged vehicles when use of such products did not restore the vehicle to its "pre-loss

condition." The jury found that State Farm misled its customers by not disclosing the use of non-OEM replacement products and the alleged inferiority of those products. The jury assessed damages against State Farm of \$456 million, and the judge assessed an additional \$730 million of disgorgement and punitive damages for violations of the Illinois Consumer Fraud Act. In April 2001, the Illinois Appellate Court upheld the verdict but reduced the damage award by \$130 million because of duplicative damage awards. On August 18, 2005, the Illinois Supreme Court reversed the awards made by the circuit court and found, among other things, that the plaintiffs had failed to establish any breach of contract by State Farm. The U.S. Supreme Court declined to hear an appeal of this case. As a result of this case, some insurance companies reduced or eliminated their use of aftermarket products. Our financial results could be adversely affected if insurance companies modified or terminated the arrangements pursuant to which repair shops buy aftermarket or recycled products from us due to a fear of similar claims.

In addition, to the extent that the collision repair industry continues to consolidate, the buying power of collision repair shop customers may further increase, putting additional pressure on our financial returns.

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

We may not be able to successfully complete potential strategic acquisitions if we cannot reach agreement on acceptable terms, if we do not obtain antitrust or other regulatory approvals on applicable terms, or for other reasons. Moreover, we may not be able to identify a sufficient number of acquisition candidates at reasonable prices to maintain our growth objectives. Also, over time, we will likely seek to make acquisitions that are relatively larger as we grow. Larger acquisition candidates may attract additional competitive buyers, which could increase our cost or could cause us to lose such acquisitions.

If we buy a company or a division of a company, we may experience difficulty integrating that company's or division's personnel and operations, which could negatively affect our operating results. In addition:

- the key personnel of the acquired company may decide not to work for us;
- customers of the acquired company may decide not to purchase products from us;
- suppliers of the acquired company may decide not to sell products to us;
- we may experience business disruptions as a result of information technology systems conversions;
- we may experience additional financial and accounting challenges and complexities in areas such as tax planning, treasury management, and financial reporting;
- we may be held liable for environmental, tax or other risks and liabilities as a result of our acquisitions, some of which we may not have discovered during our due diligence;
- we may intentionally assume the liabilities of the companies we acquire, which could result in material adverse effects on our business;
- our existing business may be disrupted or receive insufficient management attention;
- we may not be able to realize the cost savings or other financial benefits we anticipated, either in the amount or in the time frame that we expect; and
- we may incur debt or issue equity securities to pay for any future acquisition, the issuance of which could involve the imposition of restrictive covenants or be dilutive to our existing stockholders.

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

OEMs and other manufacturers have attempted to use claims of intellectual property infringement against manufacturers and distributors of aftermarket products to restrict or eliminate the sale of aftermarket products that are the subject of the claims. The OEMs have brought such claims in federal court and with the U.S. International Trade Commission.

To the extent OEMs and other manufacturers are seeking and obtaining more design patents than they have in the past and are successful in asserting infringement of these patents and defending their validity, we could be restricted or prohibited from selling certain aftermarket products, which could have an adverse effect on our business. We will likely incur significant expenses investigating and defending intellectual property infringement claims. In addition, aftermarket products certifying organizations may revoke the certification of parts that are the subject of the claims. Lack of certification may negatively impact us because many major insurance companies recommend or require the use of aftermarket products only if they have been certified by an independent certifying organization.

In December 2005 and May 2008, Ford Global Technologies, LLC filed complaints with the International Trade Commission against us and others alleging that certain aftermarket products imported into the U.S. infringed on Ford design patents. The parties settled these matters in April 2009 pursuant to a patent license arrangement that is currently scheduled to expire in March 2020. In January 2014, Chrysler Group, LLC filed a complaint against us in the U.S. District Court in the

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Eastern District of Michigan contending that certain aftermarket parts we sell infringe Chrysler design patents. The parties settled this matter in June 2014 pursuant to a patent license arrangement that expires in June 2019. In the event that these license arrangements, or other similar license arrangements with OEMs, are terminated or we are unable to agree upon renewal terms, we may be subject to costs and uncertainties of litigation as well as restrictions on our ability to sell aftermarket parts that replicate parts covered by design patents.

If the number of vehicles involved in accidents declines or the number of cars being repaired declines, our business could suffer.

Our business depends on vehicle accidents and mechanical failures for both the demand for repairs using our products and the supply of recycled, remanufactured and refurbished parts. To the extent that a relatively higher percentage of damaged vehicles are declared total losses, there will be less demand for our products to repair such vehicles. In addition, our business is impacted by factors which influence the number and/or severity of accidents and mechanical failures including, but not limited to, the number of vehicles on the road, the number of miles driven, the ages of drivers, the occurrence and severity of certain weather conditions, the congestion of traffic, drivers distracted by electronic equipment, the use of alcohol and drugs by drivers, the effectiveness of accident avoidance systems in new vehicles, the reliability of new OEM parts, and the condition of roadways. For example, an increase of the acceptance of the ride-sharing business model would reduce the number of vehicles on the road. Additionally, an increase in fuel prices may cause the number of vehicles on the road, the number of miles driven, and the need for mechanical repairs and maintenance to decline, as motorists seek alternative transportation options. Mild weather conditions, particularly during winter months, tend to result in a decrease in vehicle accidents. Moreover, a number of states and municipalities have adopted, or are considering adopting, legislation banning the use of handheld cellular telephones or other electronic devices while driving, and such restrictions could lead to a decline in accidents.

Systems designed to help drivers avoid accidents are becoming more prevalent and more technologically sophisticated. To the extent OEMs install or are mandated by law to install accident avoidance systems in their vehicles, the number and severity of accidents could decrease, which could have a material adverse effect on our business.

The average number of new vehicles sold annually has fluctuated from year-to-year. Periods of decreased sales could result in a reduction in the number of vehicles on the road and consequently fewer vehicles involved in accidents or in need of mechanical repair or maintenance. Substantial further declines in automotive sales in the future could have a material adverse effect on our business, results of operations and/or financial condition. In addition, if vehicle population trends result in a disproportionately high number of older vehicles on the road, insurance companies may find it uneconomical to repair such vehicles or there could be less costly repairs. If vehicle population trends result in a disproportionately high number of newer vehicles on the road, the demand generally for mechanical repairs and maintenance would likely decline due to the newer, longer-lasting parts in the vehicle population and mechanical failures being covered by OEM warranties for the first years of a vehicle's life. Moreover, alternative collision and mechanical parts are less likely to be used on newer vehicles. Electric vehicles do not have traditional engines, our biggest selling product. Thus, an increase in electric vehicles as a percentage of vehicles sold will have a negative impact on our engine sales.

Fluctuations in the prices of metals and other commodities could adversely affect our financial results.

Our recycling operations generate scrap metal and other metals that we sell. After we dismantle a salvage vehicle for wholesale parts and after vehicles have been processed in our self service retail business, the remaining vehicle hulks are sold to scrap processors and other remaining metals are sold to processors and brokers of metals. In addition, we receive "crush only" vehicles from other companies, including OEMs, which we dismantle and which generate scrap metal and other metals. The prices of scrap and other metals have historically fluctuated, sometimes significantly, due to market factors. In addition, buyers may stop purchasing metals entirely due to excess supply. To the extent that the prices of metals decrease materially or buyers stop purchasing metals, our revenue from such sales will suffer and a write-down of our inventory value could be required. The cost of our wholesale recycled and our self service retail inventory purchases will change as a result of fluctuating scrap metal and other metals prices. In a period of falling metal prices, there can be no assurance that our inventory purchasing cost will decrease the same amount or at the same rate as the scrap metal and other metals prices decline, and there may be a delay between the scrap metal and other metals price reductions and any inventory cost reductions. The prices of steel, aluminum, and plastics are

components of the cost to manufacture products for our aftermarket business. If the prices of commodities rise and result in higher costs to us for products we sell, we may not be able to pass these higher costs on to our customers. Existing or new laws and regulations may prohibit, restrict or burden the sale of aftermarket, recycled, refurbished or remanufactured products.

Most states have passed laws that prohibit or limit the use of aftermarket products in collision repair work. These laws include requirements relating to consumer disclosure, vehicle owner's consent regarding the use of aftermarket products in the repair process, and the requirement to have aftermarket products certified by an independent testing organization. Additional legislation of this kind may be introduced in the future. If additional laws prohibiting or restricting the use of aftermarket products are passed, it could have an adverse impact on our aftermarket products business.



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

Some jurisdictions have enacted laws prohibiting or severely restricting the sale of certain recycled products that we provide, such as airbags. These and other jurisdictions could enact similar laws or could prohibit or severely restrict the sale of additional recycled products. The passage of legislation with prohibitions or restrictions that are more severe than current laws could have a material adverse impact on our business. Additionally, Congress could enact federal legislation restricting the use of aftermarket or recycled automotive products used in the course of vehicle repairs.

The Federal Trade Commission (FTC) has issued guides which regulate the use of certain terms such as “rebuilt” or “remanufactured” in connection with the sale of automotive parts. Restrictions on the products we are able to sell and on the marketing of such products could decrease our revenue and have an adverse effect on our business and operations. In 1992, Congress enacted the Anti-Car Theft Act to deter trafficking in stolen vehicles. The purpose of the law is to implement an electronic system to track and monitor vehicle identification numbers and major automotive parts. In January 2009, the U.S. Department of Justice implemented the portion of the system to track and monitor vehicle identification numbers. The portion of the system that would track and monitor major automotive parts would require various entities, including automotive parts recyclers like us, to inspect salvage vehicles for the purpose of collecting the part number for any "covered major part." The Department of Justice has not promulgated rules on this portion of the system, and therefore there has been no progress on the implementation of the system to track and monitor major automotive parts. However, if this system is fully implemented, the requirement to collect the information would place substantial burdens on vehicle recyclers, including us, that otherwise would not normally exist. It would place similar burdens on repair shops, which may discourage the use by such shops of recycled products. There is no pending initiative to implement the parts registration from a law enforcement point of view. However, there is a risk that a heightened legislative concern over safety of parts might precipitate an effort to push for the implementation of such rules.

An adverse change in our relationships with our suppliers or auction companies or a disruption to our supply of inventory could increase our expenses and impede our ability to serve our customers.

Our business is dependent on a relatively small number of suppliers of aftermarket products, a large portion of which are sourced from Taiwan. We incur substantial freight costs to import parts from our suppliers, many of which are located in Asia. If the cost of freight rose, we might not be able to pass the cost increases on to our customers.

Furthermore, although alternative suppliers exist for substantially all aftermarket products distributed by us, the loss of any one supplier could have a material adverse effect on us until alternative suppliers are located and have commenced providing products. In addition, we are subject to disruptions from work stoppages and other labor disputes at port facilities through which we import our inventory. Moreover, our operations are subject to the customary risks of doing business abroad, including, among other things, natural disasters, transportation costs and delays, political instability, currency fluctuations and the imposition of tariffs, import and export controls and other non-tariff barriers (including changes in the allocation of quotas), as well as the uncertainty regarding future relations between China, Japan and Taiwan. The current U.S. administration has discussed the implementation of a tariff on imports into the U.S., the imposition of which would likely have a negative impact on our business due to the amount of inventory we import.

Because a substantial volume of our sales involves products manufactured from sheet metal, we can be adversely impacted if sheet metal becomes unavailable or is only available at higher prices, which we may not be able to pass on to our customers. Additionally, as OEMs convert to raw materials other than steel, it may be more difficult or expensive to source aftermarket parts made with such materials and it may be more difficult for repair shops to work with such materials in the repair process.

Most of our salvage and a portion of our self service inventory is obtained from vehicles offered at salvage auctions operated by several companies that own auction facilities in numerous locations across the U.S. We do not typically have contracts with the auction companies. According to industry analysts, a small number of companies control a

large percentage of the salvage auction market in the U.S. If an auction company prohibited us from participating in its auctions, began competing with us, or significantly raised its fees, our business could be adversely affected through higher costs or the resulting potential inability to service our customers. Moreover, we face competition in the purchase of vehicles from direct competitors, rebuilders, exporters and other bidders. To the extent that the number of bidders increases, it may have the effect of increasing our cost of goods sold for wholesale recycled products. Some states regulate bidders to help ensure that salvage vehicles are purchased for legal purposes by qualified buyers. Auction companies have been actively seeking to reduce, circumvent or eliminate these regulations, which would further increase the number of bidders.

In addition, there is a limited supply of salvage vehicles in the U.S. As we grow and our demand for salvage vehicles increases, the costs of these incremental vehicles could be higher. In some states, when a vehicle is deemed a total loss, a

salvage title is issued. Whether states issue salvage titles is important to the supply of inventory for the vehicle recycling industry because an increase in vehicles that qualify as salvage vehicles provides greater availability and typically lowers the price of such vehicles. Currently, these titling issues are a matter of state law. In 1992, the U.S. Congress commissioned an advisory committee to study problems relating to vehicle titling, registration, and salvage. Since then, legislation has been introduced seeking to establish national uniform requirements in this area, including a uniform definition of a salvage vehicle. The vehicle recycling industry will generally favor a uniform definition, since it will avoid inconsistencies across state lines, and will generally favor a definition that expands the number of damaged vehicles that qualify as salvage. However, certain interest groups, including repair shops and some insurance associations, may oppose this type of legislation. National legislation has not yet been enacted in this area, and there can be no assurance that such legislation will be enacted in the future.

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

Our annual and quarterly performance may fluctuate.

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

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

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

We operate in foreign jurisdictions, which exposes us to foreign exchange and other risks.

We have operations in North America, Europe, Taiwan and China, and we may expand our operations in the countries in which we do business and into other countries. Our foreign operations expose us to additional risks associated with international business, which could have an adverse effect on our business, results of operations and/or financial condition, including import and export requirements and compliance with anti-corruption laws, such as the U.K. Bribery Act 2010 and the Foreign Corrupt Practices Act. We also incur costs in currencies other than our functional currencies in some of the countries in which we operate. We are thus subject to foreign exchange exposure to the extent that we operate in different currencies, as well as exposure to foreign tax and other foreign and domestic laws. In addition, certain countries in which we operate have a higher level of political instability and criminal activity relative to the U.S. that could affect our operations and the ability to maintain our supply of products.

If we determine that our goodwill or other intangible assets have become impaired, we may incur significant charges to our pre-tax income.

Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations. In the future, goodwill and intangible assets may increase as a result of acquisitions. Goodwill is reviewed at least annually for impairment. Impairment may result from, among other things, deterioration in the performance of acquired businesses, increases in our cost of capital, adverse market conditions, and adverse changes in applicable laws or regulations, including modifications that restrict the activities of the acquired business. As of December 31, 2016, our total goodwill subject to future impairment testing was \$3.1 billion. For further discussion of our annual impairment test, see "Goodwill Impairment" in the Critical Accounting Policies and Estimates section of Item 7 in this Annual Report on Form 10-K.

We amortize other intangible assets over the assigned useful lives, each of which is based upon the expected period to be benefited. We review other intangible assets for possible impairment whenever events or circumstances indicate that the carrying value may not be recoverable. In the event conditions change that affect our ability to realize the underlying cash flows associated with our intangible assets, we may record an impairment charge. As of December 31, 2016, the value of our other intangible assets, net of accumulated amortization, was \$584 million.

Our business may be adversely affected by union activities and labor and employment laws.

Certain of our employees are represented by labor unions and work under collective bargaining or similar agreements, which are subject to periodic renegotiation. From time to time, there have been efforts to organize additional portions of our workforce and those efforts can be expected to continue. In addition, the U.S. Department of Labor or applicable foreign government agencies could adopt new regulations or interpret existing regulations that could make it significantly easier for unionization efforts to be successful. Also, we may in the future be subject to strikes or work stoppages, union and works council campaigns, and other labor disruptions and disputes. Additional unionization efforts, new collective bargaining agreements, and work stoppages could materially increase our costs and reduce revenue and could limit our flexibility in terms of work schedules, reductions in force and other operational matters. We also are subject to federal and state laws and regulations, such as the Fair Labor Standards Act, that govern such matters as minimum wage, overtime and other working conditions. Some of these laws are technical in nature and could be subject to interpretation by government agencies different than our interpretations. Efforts to comply with existing laws, changes to such laws and newly-enacted laws may increase our labor costs. If we were found not to be in compliance with such laws, we could be subject to fines, penalties and liabilities to our employees or government agencies.

We rely on information technology and communication systems in critical areas of our operations and a disruption relating to such technology could harm our business.

Some of the information technology systems and communication systems we use for management of our facilities and our financial functions are leased from or operated by other companies, while others are owned by us. In the event that the providers of these systems terminate their relationships with us or if we suffer prolonged outages of these or our own systems for whatever reason, we could suffer disruptions to our operations.

In the event that we decide to switch providers or to implement upgrades or replacements to our own systems, we may also suffer disruptions to our business. We may be unsuccessful in the development of our own systems, and we may underestimate the costs and expenses of developing and implementing our own systems. Also, our revenue may be hampered during the period of implementing an alternative system, which period could extend longer than we anticipated.

We believe we have taken reasonable and appropriate steps to protect our information systems and personal information about our customers and employees; however, if we experience a significant data security breach, we could be exposed to damage to our reputation, additional costs, lost sales or possible regulatory action. The regulatory environment related to information security and privacy is constantly changing, and compliance with those requirements could result in additional costs. There is no guarantee that the procedures that we have implemented to protect against unauthorized access to our systems and personal data are adequate to safeguard against all security breaches, and such a breach could potentially have a negative impact on our results of operations and financial condition.

Business interruptions in our distribution centers or other facilities may affect our operations, the function of our computer systems, and/or the availability and distribution of merchandise, which may affect our business.

Weather, terrorist activities, war or other disasters, or the threat of any of them, may result in the closure of our distribution centers ("DC"s) or other facilities or may adversely affect our ability to deliver inventory through our system on a timely basis. This may affect our ability to serve our customers, resulting in lost sales or a potential loss of customer loyalty. Some of our merchandise is imported from other countries and these goods could become difficult or impossible to bring into the U.S. or into the other countries in which we operate, and we may not be able to obtain such merchandise from other sources at similar prices. Such a disruption in revenue could potentially have a negative impact on our results of operations and financial condition.

We are subject to environmental regulations and incur costs relating to environmental matters.

We are subject to various federal, state, and local environmental protection and health and safety laws and regulations governing, among other things: the emission and discharge of hazardous materials into the ground, air, or water; exposure to hazardous materials; and the generation, handling, storage, use, treatment, identification, transportation, and disposal of industrial by-products, waste water, storm water, and mercury and other hazardous materials. We are also required to obtain environmental permits from governmental authorities for certain of our operations. If we violate or fail to obtain or comply with these laws, regulations, or permits, we could be fined or otherwise sanctioned

by regulators. We could also become liable if employees or other parties are improperly exposed to hazardous materials. We have an environmental management process designed to facilitate and support our compliance with these requirements. We cannot assure you, however, that we will at all times be in complete compliance with such requirements.

We have made and will continue to make capital and other expenditures relating to environmental matters. Although we presently do not expect to incur any capital or other expenditures relating to environmental controls or other environmental matters in amounts that would be material to us, we may be required to make such expenditures in the future.

Under certain environmental laws, we could be held responsible for all of the costs relating to any contamination at, or migration to or from, our or our predecessors' past or present facilities and at independent waste disposal sites. These laws often impose liability even if the owner or operator did not know of, or was not responsible for, the release of such hazardous substances. Many of our facilities are located on or near properties with a history of industrial use that may have involved hazardous materials. As a result, some of our properties may be contaminated. Some environmental laws hold current or previous owners or operators of real property liable for the costs of cleaning up contamination. These environmental laws also impose liability on any person who disposes of, treats, or arranges for the disposal or treatment of hazardous substances, regardless of whether the affected site is owned or operated by such person, and at times can impose liability on companies deemed under law to be a successor to such person. Third parties may also make claims against owners or operators of properties, or successors to such owners or operators, for personal injuries and property damage associated with releases of hazardous or toxic substances.

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

When we identify a potential material environmental issue during our acquisition due diligence process, we analyze the risks, and, when appropriate, perform further environmental assessment to verify and quantify the extent of the potential contamination. Furthermore, where appropriate, we have established financial reserves for certain environmental matters. In the event we discover new information or if laws change, we may incur significant liabilities, which may exceed our reserves.

Environmental laws are complex, change frequently, and have tended to become more stringent over time. Our costs of complying with current and future environmental and health and safety laws, and our liabilities arising from past or future releases of, or exposure to, hazardous substances, may adversely affect our business, results of operations, or financial condition.

We could be subject to product liability claims and involved in product recalls.

If customers of repair shops that purchase our products are injured or suffer property damage, we could be subject to product liability claims by such customers. The successful assertion of this type of claim could have an adverse effect on our business, results of operations or financial condition. In addition, we may become involved in the recall of a product that is determined to be defective. The expenses of a recall and the damage to our reputation could have an adverse effect on our business, results of operations or financial condition.

We have agreed to defend and indemnify in certain circumstances insurance companies and customers against claims and damages relating to product liability and product recalls. The existence of claims or damages for which we must defend and indemnify these parties could also negatively impact our business, results of operations or financial condition.

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

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

New regulations related to conflict-free minerals may force us to incur additional expenses and otherwise adversely impact our business.

In August 2012, as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC adopted final rules regarding disclosure of the use of certain minerals, known as conflict minerals, originating from the Democratic Republic of Congo (DRC) or adjoining countries. These new requirements impose significant burdens on U.S. public companies. Compliance with the rules requires substantial due diligence in an effort to determine whether products contain the conflict minerals. The results of such due diligence efforts must be disclosed on an annual basis

in a filing with the SEC.

Our supply chain is complex and we may incur significant costs to determine the source of any such minerals used in our products. We may also incur costs with respect to potential changes to products, processes or sources of supply as a consequence of our diligence activities. Further, the implementation of these rules and their effect on customer, supplier and/or consumer behavior could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers offering products free of conflict minerals in some circumstances, we cannot be sure that we will be able to obtain necessary products from such suppliers in sufficient quantities or at competitive prices. We may face

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reputational challenges if we determine that certain of our products contain minerals not determined to be conflict-free or if we are unable to sufficiently verify the origins for all conflict minerals used in our products through the procedures we implement. Accordingly, these rules could have a material adverse effect on our business, results of operations and/or financial condition.

If we experience problems with our fleet of trucks, our business could be harmed.

We use a fleet of trucks to deliver the majority of the products we sell. We are subject to the risks associated with providing trucking services, including inclement weather, disruptions in the transportation infrastructure, governmental regulation, availability and price of fuel, liabilities arising from accidents to the extent we are not covered by insurance, and insurance premium increases. In addition, our failure to deliver products in a timely and accurate manner could harm our reputation and brand, which could have a material adverse effect on our business.

#### Risks Relating to Our Common Stock and Financial Structure

The market price of our common stock may be volatile and could expose us to securities class action litigation.

The stock market and the price of our common stock may be subject to wide fluctuations based upon general economic and market conditions. The market price for our common stock may also be affected by our ability to meet analysts' expectations. Failure to meet such expectations, even slightly, could have an adverse effect on the market price of our common stock. In addition, stock market volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated to the operating performance of these companies. Downturns in the stock market may cause the price of our common stock to decline. Additionally, the market price for our common stock has been in the past, and in the future may be, adversely affected by allegations made or reports issued by short sellers, analysts, activists or others regarding our business model, our management or our financial accounting.

Following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such companies. If similar litigation were instituted against us, it could result in substantial costs and a diversion of our management's attention and resources, which could have an adverse effect on our business. Delaware law, our charter documents and our loan documents may impede or discourage a takeover, which could affect the price of our stock.

The anti-takeover provisions of our certificate of incorporation and bylaws, our loan documents and Delaware law could, together or separately, impose various impediments to the ability of a third party to acquire control of us, even if a change in control would be beneficial to our existing stockholders. Our certificate of incorporation and bylaws have provisions that could discourage potential takeover attempts and make attempts by stockholders to change management more difficult. Our credit agreement provides that a change of control is an event of default. Our incorporation under Delaware law and these provisions could also impede an acquisition, takeover, or other business combination involving us or discourage a potential acquirer from making a tender offer for our common stock, which, under certain circumstances, could reduce the price of our common stock.

Future sales of our common stock or other securities may depress our stock price.

We and our stockholders may sell shares of common stock or other equity, debt or instruments which constitute an element of our debt and equity (collectively, "securities") in the future. We may also issue shares of common stock under our equity incentive plan or in connection with future acquisitions. We cannot predict the size of future issuances of securities or the effect, if any, that future issuances and sales of shares of our common stock or other securities will have on the price of our common stock. Sales of substantial amounts of common stock (including shares issued in connection with an acquisition), the issuance of additional debt securities, or the perception that such sales or issuances could occur, may cause the price of our common stock to fall.

We have a substantial amount of indebtedness, which could have a material adverse effect on our financial condition and our ability to obtain financing in the future and to react to changes in our business.

As of December 31, 2016, we had approximately \$2.2 billion aggregate principal amount of secured debt outstanding and approximately \$1.1 billion of availability under the Senior Secured Credit Facilities (without giving effect to approximately \$72.7 million of letters of credit outstanding). In addition, we had approximately \$1.1 billion aggregate principal amount of unsecured debt outstanding comprising \$600 million aggregate principal amount of the 4.75% senior notes due 2023 (the "U.S. Notes") and €500 million (\$526 million) aggregate principal amount of the senior notes due April 1, 2024 (the "Euro Notes," and together with the U.S. Notes, the "senior notes").

Our significant amount of debt and our debt service obligations could limit our ability to satisfy our obligations, limit our ability to operate our business and impair our competitive position.

For example, our debt and our debt service obligations could:

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- increase our vulnerability to adverse economic and general industry conditions, including interest rate fluctuations, because a portion of our borrowings are and will continue to be at variable rates of interest;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, which would reduce the availability of our cash flow from operations to fund working capital, capital expenditures or other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and industry;
- place us at a disadvantage compared to competitors that may have proportionately less debt;
- limit our ability to obtain additional debt or equity financing due to applicable financial and restrictive covenants in our debt agreements; and
- increase our cost of borrowing.

In addition, if we or our subsidiaries incur additional debt, the risks associated with our substantial leverage and the ability to service such debt would increase.

Our senior notes do not impose any limitations on our ability to incur additional debt or protect against certain other types of transactions.

Although we are subject to our senior secured credit facilities for so long as they remain in effect, the indenture governing the U.S. Notes and the indenture governing the Euro Notes do not restrict the future incurrence of unsecured indebtedness, guarantees or other obligations. The indentures contain certain limitations on our ability to incur liens on assets and engage in sale and leaseback transactions. However, these limitations are subject to important exceptions. In addition, the indentures do not contain many other restrictions, including certain restrictions contained in our senior secured credit facilities, including, without limitation, investments or prepaying subordinated indebtedness or engaging in transactions with our affiliates.

Our senior secured credit facilities will permit, subject to specified conditions and limitations, the incurrence of a significant amount of additional indebtedness. As of December 31, 2016, we would have been able to incur an additional \$1.1 billion of indebtedness under our revolving credit facility (without giving effect to approximately \$72.7 million of outstanding letters of credit). If we or our subsidiaries incur additional debt, the risks associated with our substantial leverage and the ability to service such debt would increase.

Our senior secured credit facilities impose significant operating and financial restrictions on us and our subsidiaries, which may prevent us from capitalizing on business opportunities.

Our senior secured credit facilities impose significant operating and financial restrictions on us. These restrictions limit our ability, among other things, to:

- incur, assume or permit to exist additional indebtedness (including guarantees thereof);
- pay dividends or certain other distributions on our capital stock or repurchase our capital stock or prepay subordinated indebtedness;
- incur liens on assets;
- make certain investments or other restricted payments;
- engage in transactions with affiliates;
- sell certain assets or merge or consolidate with or into other companies;
- guarantee indebtedness; and
- alter the business we conduct.

As a result of these covenants and restrictions, we will be limited in how we conduct our business and we may be unable to raise additional debt or equity financing to compete effectively or to take advantage of new business opportunities. The terms of any future indebtedness we may incur could include more restrictive covenants. We cannot assure you that we will be able to maintain compliance with these covenants in the future and, if we fail to do so, that we will be able to obtain waivers from the lenders and/or amend the covenants. The failure to comply with any of these covenants would cause a default under the credit agreement. A default, if not waived, could result in acceleration of our debt, in which case the debt would become immediately due and payable. If this occurs, we may not be able to repay our debt or borrow sufficient funds to refinance it. Even if new financing were available, it may be on terms that are less attractive to us than our existing credit facilities or it may be on terms that are not acceptable to us.



We may not be able to generate sufficient cash to service all of our indebtedness, and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot assure you that we will maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness. If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations. If our operating results and available cash are insufficient to meet our debt service obligations, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. We may not be able to consummate those dispositions or to obtain the proceeds that we could realize from them, and these proceeds may not be adequate to meet any debt service obligations then due. Any future refinancing of our indebtedness could be at higher interest rates and may require us to comply with more onerous covenants which could further restrict our business operations. Additionally, the senior secured credit facilities and the indentures that govern our senior notes limit the use of the proceeds from certain dispositions of our assets; as a result, our senior secured credit facilities and our senior notes may prevent us from using the proceeds from such dispositions to satisfy all of our debt service obligations.

In addition, we are a holding company and repayment of our indebtedness is dependent upon cash flow generated by our subsidiaries and their ability to make such cash available to us, by dividend, debt repayment or otherwise. Unless they are borrowers or guarantors of the indebtedness, our subsidiaries do not have any obligation to pay amounts due on the indebtedness or to make funds available for that purpose. Our subsidiaries may not be able to, or be permitted to, make distributions to enable us to make payments in respect of our indebtedness. Each of our subsidiaries is a distinct legal entity and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from our subsidiaries and, under certain circumstances, distributions from our subsidiaries may be subject to significant taxes that reduce the amount of such distributions available to us. In the event that we do not receive sufficient distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness.

Our future capital needs may require that we seek to refinance our debt or obtain additional debt or equity financing, events that could have a negative effect on our business.

We may need to raise additional funds in the future to, among other things, refinance existing debt, fund our existing operations, improve or expand our operations, respond to competitive pressures, or make acquisitions. From time to time, we may raise additional funds through public or private financing, strategic alliances, or other arrangements. Funds may not be available or available on terms acceptable to us as a result of different factors, including but not limited to turmoil in the credit markets that results in the tightening of credit conditions and current or future regulations applicable to the financial institutions from whom we seek financing. If adequate funds are not available on acceptable terms, we may be unable to meet our business or strategic objectives or compete effectively. If we raise additional funds by issuing equity securities, stockholders may experience dilution of their ownership interests, and the newly issued securities may have rights superior to those of the common stock. If we raise additional funds by issuing debt, we may be subject to higher borrowing costs and further limitations on our operations. If we refinance or restructure our debt, we may incur charges to write off the unamortized portion of deferred debt issuance costs from a previous financing, or we may incur charges related to hedge ineffectiveness from our interest rate swap obligations. In addition, there are restrictions in the indenture that governs the U.S. Notes on our ability to refinance such notes prior to 2018. There are also restrictions in the indenture that governs the Euro Notes on our ability to refinance such notes prior to 2024. If we fail to raise capital when needed, our business may be negatively affected.

Our variable rate indebtedness subjects us to interest rate risk, which could cause our indebtedness service obligations to increase significantly and could affect the value of our senior notes.

Certain borrowings under our senior secured credit facilities and the borrowing under our accounts receivable securitization facility are at variable rates of interest and expose us to interest rate risk. If interest rates increase, our debt service obligations on the variable rate indebtedness would increase even though the amount borrowed remained

the same, and our net income and cash flows, including cash available for servicing our indebtedness, would correspondingly decrease. Moreover, changes in market interest rates could affect the trading value of the notes. Assuming all revolving loans were fully drawn and no interest rate swaps were in place, each one percentage point change in interest rates would result in a \$32.8 million change in annual cash interest expense under our senior secured credit facilities and our accounts receivable securitization facility.

Repayment of our indebtedness, including our senior notes, is dependent on cash flow generated by our subsidiaries. We are a holding company and repayment of our senior notes will be dependent upon cash flow generated by our subsidiaries and their ability to make such cash available to us, by dividend, debt repayment or otherwise. Unless they are guarantors of the notes, our subsidiaries do not have any obligation to pay amounts due on the notes or to make funds available

for that purpose. Our subsidiaries may not be able to, or be permitted to, make distributions to enable us to make payments in respect of our indebtedness, including the notes. Each of our subsidiaries is a distinct legal entity and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from our subsidiaries. While the indentures governing the notes limit the ability of our subsidiaries to restrict the payment of dividends or make other intercompany payments to us, these limitations are subject to certain qualifications and exceptions. In the event that we do not receive distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness, including the notes.

A downgrade in our credit rating would impact our cost of capital and could impact the market value of our senior notes.

Credit ratings have an important effect on our cost of capital. Credit rating agencies rate our debt securities on factors that include, among other items, our results of operations, business decisions that we make, their view of the general outlook for our industry, and their view of the general outlook for the economy. Actions taken by the rating agencies can include maintaining, upgrading, or downgrading the current rating or placing us on a watch list for possible future downgrading. We believe our current credit ratings enhance our ability to borrow funds at favorable rates. A downgrade in our current credit rating from a rating agency could adversely affect our cost of capital by causing us to pay a higher interest rate on borrowed funds under our credit facilities. A downgrade could also adversely affect the market price and/or liquidity of our senior notes, preventing a holder from selling the notes at a favorable price, as well as adversely affect our ability to issue new notes in the future or incur other indebtedness upon favorable terms.

The right to receive payments on the senior notes is effectively junior to those lenders who have a security interest in our assets.

Our obligations under our senior notes and our guarantors' obligations under their guarantees of the notes are unsecured, but our and each co-borrower's obligations under our senior secured credit facilities and each guarantor's obligations under their respective guarantees of the senior secured credit facilities are secured by a security interest in substantially all of our domestic tangible and intangible assets, including the stock of most of our wholly-owned United States subsidiaries and the stock of certain of our non-United States subsidiaries. If we are declared bankrupt or insolvent, or if we default under our senior secured credit facilities, the lenders could declare all of the funds borrowed thereunder, together with accrued interest, immediately due and payable. If we were unable to repay such indebtedness, the lenders could foreclose on the pledged assets to the exclusion of holders of our notes, even if an event of default exists under the applicable indenture governing the notes. Furthermore, if the lenders foreclose and sell the pledged equity interests in any subsidiary guarantor under our notes, then that guarantor will be released from its guarantee of the notes automatically and immediately upon such sale. In any such event, because the notes are not secured by any of our assets or the equity interests in subsidiary guarantors, it is possible that there would be no assets remaining from which claims by holders of the notes could be satisfied or, if any assets remained, they might be insufficient to satisfy claims fully. As of December 31, 2016, we had approximately \$2.2 billion aggregate principal amount of secured debt outstanding and approximately \$1.1 billion of availability under the senior secured credit facilities (without giving effect to approximately \$72.7 million of letters of credit outstanding).

United States federal and state statutes allow courts, under specific circumstances, to void the senior notes and the guarantees, subordinate claims in respect of the senior notes and the guarantees, and require holders of the senior notes to return payments received from us or the guarantors.

Our direct and indirect domestic subsidiaries that are obligors under the senior secured credit facilities guarantee the obligations under our senior notes. In addition, certain subsidiaries of the issuer of the Euro Notes guarantee the obligations under the Euro Notes. The issuance of our senior notes and the issuance of the guarantees by the guarantors may be subject to review under state and federal laws if a bankruptcy, liquidation or reorganization case or a lawsuit, including in circumstances in which bankruptcy is not involved, were commenced at some future date by, or on behalf of, our unpaid creditors or the unpaid creditors of a guarantor. Under the federal bankruptcy laws of the United States and comparable provisions of state fraudulent transfer laws, a court may avoid or otherwise decline to enforce the notes, or a guarantor's guarantee, or may subordinate the notes, or such guarantee, to our or the applicable guarantor's existing and future indebtedness. While the relevant laws may vary from jurisdiction to jurisdiction, a court might do so if it found that when indebtedness under the notes was issued, or when the applicable guarantor entered into its guarantee, or, in some jurisdictions, when payments became due under the notes, or such guarantee, the issuer

or the applicable guarantor received less than reasonably equivalent value or fair consideration and:

• was insolvent or rendered insolvent by reason of such incurrence;

• was engaged in a business or transaction for which its remaining assets constituted unreasonably small capital; or

• intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature.

A court would likely find that we or a guarantor did not receive reasonably equivalent value or fair consideration for the notes or such guarantee if we or such guarantor did not substantially benefit directly or indirectly from the issuance of the



notes. Thus, if the guarantees were legally challenged, any guarantee could be subject to the claim that, since the guarantee was incurred for our benefit, and only indirectly for the benefit of the guarantor, the obligations of the applicable guarantor were incurred for less than reasonably equivalent value or fair consideration. If a court were to void the issuance of the notes or any guarantee, a holder of the notes would no longer have any claim against us or the applicable guarantor. In the event of a finding that a fraudulent transfer or conveyance occurred, a holder of the notes may not receive any repayment on the notes. Further, the avoidance of the notes could result in an event of default with respect to our and our subsidiaries' other debt, which could result in acceleration of that debt. The measures of insolvency for purposes of these fraudulent transfer laws vary depending upon the law applied in any proceeding to determine whether a fraudulent transfer has occurred. Generally, however, an issuer or a guarantor, as applicable, would be considered insolvent if:

- the sum of its debts, including contingent liabilities, was greater than the fair value of its assets;
- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they become absolute and mature; or
- it could not pay its debts as they become due.

A court might also void the notes, or a guarantee, without regard to the above factors, if the court found that the notes were incurred or issued or the applicable guarantor entered into its guarantee with actual intent to hinder, delay or defraud its creditors. We cannot give any assurance as to what standard a court would apply in determining whether we or the guarantors were solvent at the relevant time or that a court would agree with our conclusions in this regard, or, regardless of the standard that a court uses, that it would not determine that we or a guarantor were indeed insolvent on that date; that any payments to the holders of the notes (including under the guarantees) did not constitute preferences, fraudulent transfers or conveyances on other grounds; or that the issuance of the notes and the guarantees would not be subordinated to our or any guarantor's other debt. In addition, any payment by us or a guarantor pursuant to the notes, or its guarantee, could be avoided and required to be returned to us or such guarantor or to a fund for the benefit of our or such guarantor's creditors, and accordingly the court might direct holders of the notes to repay any amounts already received from us or such guarantor. Among other things, under U.S. bankruptcy law, any payment by us pursuant to the notes or by a guarantor under a guarantee made at a time we or such guarantor were found to be insolvent could be voided and required to be returned to us or such guarantor or to a fund for the benefit of our or such guarantor's creditors if such payment is made to an insider within a one-year period prior to a bankruptcy filing or within 90 days for any outside party and such payment would give such insider or outsider party more than such party would have received in a distribution under the Bankruptcy Code in a hypothetical Chapter 7 case. Although each guarantee contains a "savings clause" intended to limit the subsidiary guarantor's liability to the maximum amount that it could incur without causing the incurrence of obligations under its subsidiary guarantee to be a fraudulent transfer, this provision may not be effective as a legal matter to protect any subsidiary guarantees from being avoided under fraudulent transfer law. In that regard, in *Official Committee of Unsecured Creditors of TOUSA, Inc. v Citicorp North America, Inc.*, the United States Bankruptcy Court in the Southern District of Florida held that a savings clause similar to the savings clause included in our indentures was unenforceable. As a result, the subsidiary guarantees were found to be fraudulent conveyances. The United States Court of Appeals for the Eleventh Circuit subsequently affirmed the liability findings of the Bankruptcy Court without ruling directly on the enforceability of savings clauses generally. If the decision of the bankruptcy court in TOUSA were followed by other courts, the risk that the guarantees would be deemed fraudulent conveyances would be significantly increased.

To the extent a court avoids the notes or any of the guarantees as fraudulent transfers or holds the notes or any of the guarantees unenforceable for any other reason, the holders of the notes would cease to have any direct claim against us or the applicable guarantor. If a court were to take this action, our or the applicable guarantor's assets would be applied first to satisfy our or the applicable guarantor's other liabilities, if any, and might not be applied to the payment of the notes. Sufficient funds to repay the notes may not be available from other sources, including the remaining guarantors, if any. In addition, the Euro Notes and the guarantees may be subject to avoidance under the laws of other foreign jurisdictions, including Italy and the Czech Republic, to the extent that we or any of the guarantors (as applicable) were to be the subject of an insolvency or related proceeding in such jurisdiction(s).

Not all of our subsidiaries have guaranteed our senior secured credit facilities or our senior notes, and the assets of our non-guarantor subsidiaries may not be available to make payments on such obligations.

Not all of our subsidiaries have guaranteed the senior secured credit facilities, our U.S. Notes or our Euro Notes. In the event that any non-guarantor subsidiary becomes insolvent, liquidates, reorganizes, dissolves or otherwise winds up, holders of its indebtedness and its trade creditors generally will be entitled to payment on their claims from the assets of that subsidiary before any of those assets are made available to the lenders under the senior secured credit facilities or the holders of the senior notes. Consequently, claims in respect of the senior secured credit facilities and the senior notes are structurally subordinated to all of the liabilities of our subsidiaries that are not guarantors of such instruments, including trade payables, and any claims of third party holders of preferred equity interests, if any, in our non-guarantor subsidiaries. For the year ended December 31,

2016, our subsidiaries that are not borrowers under or do not guarantee the senior secured credit facilities and our subsidiaries that do not guarantee the U.S. Notes represented approximately 38% and 27% of our total revenue and operating income, respectively. In addition, these non-guarantor subsidiaries represented approximately 46% and 34% of our total assets and total liabilities, respectively, as of December 31, 2016 (excluding, in each case, intercompany amounts). As of the same date, our subsidiaries that do not guarantee the senior secured credit facilities or the U.S. Notes had approximately \$923.0 million of outstanding indebtedness (which includes \$267.8 million of borrowings under our revolving credit facilities by foreign subsidiaries that are borrowers under the revolving credit facilities but that do not guarantee the U.S. Notes). The group of subsidiaries that does not guarantee the Euro Notes is similar to the group that does not guarantee the U.S. Notes, except that there are four additional subsidiaries that guarantee the Euro Notes.

We may not be able to repurchase the senior notes upon a change of control or pursuant to an asset sale offer. Upon a change of control, as defined in the indentures governing the senior notes, the holders of the notes will have the right to require us to offer to purchase all of the notes then outstanding at a price equal to 101% of their principal amount plus accrued and unpaid interest. Such a change of control would also be an event of default under our senior secured credit facilities. In order to obtain sufficient funds to pay amounts due under the senior secured credit facilities and the purchase price of the outstanding senior notes, we expect that we would have to refinance our indebtedness. We cannot assure you that we would be able to refinance our indebtedness on reasonable terms, if at all. Our failure to offer to purchase all outstanding senior notes or to purchase all validly tendered senior notes would be an event of default under the indenture. Such an event of default may cause the acceleration of our other debt. Our other debt also may contain restrictions on repayment requirements with respect to specified events or transactions that constitute a change of control under the indenture.

The definition of change of control in the indentures governing the senior notes includes a phrase relating to the sale of “all or substantially all” of our assets. There is no precise established definition of the phrase “substantially all” under applicable law. Accordingly, the ability of a holder of senior notes to require us to repurchase its notes as a result of a sale of less than all our assets to another person may be uncertain.

In addition, in certain circumstances as specified in the indentures governing the senior notes, we will be required to commence an asset sale offer, as defined in the indenture, pursuant to which we will be obligated to purchase certain senior notes at a price equal to 100% of their principal amount plus accrued and unpaid interest with the proceeds we receive from certain asset sales. Our other debt may contain restrictions that would limit or prohibit us from completing any such asset sale offer. In particular, our senior secured credit facilities contain provisions that require us, upon the sale of certain assets, to apply all of the proceeds from such asset sale to the prepayment of amounts due under the senior secured credit facilities. The mandatory prepayment obligations under the senior secured credit facilities will be effectively senior to our obligations to make an asset sale offer with respect to the senior notes under the terms of the indentures. Our failure to purchase any such senior notes when required under the indenture would be an event of default under the indentures.

Key terms of the senior notes will be suspended if the notes achieve investment grade ratings and no default or event of default has occurred and is continuing.

Many of the covenants in the indentures governing the senior notes will be suspended if the notes are rated investment grade by Standard & Poor’s and Moody’s provided at such time no default or event of default has occurred and is continuing, including those covenants that restrict, among other things, our ability to pay dividends, incur liens and to enter into certain other transactions. There can be no assurance that the senior notes will ever be rated investment grade. However, suspension of these covenants would allow us to engage in certain transactions that would not be permitted while these covenants were in force (although provisions under our other debt, like the senior secured credit facilities, may continue to restrict us from engaging in these transactions), and the effects of any such transactions will be permitted to remain in place even if the senior notes are subsequently downgraded below investment grade.

The liquidity and market value of the senior notes may change due to a variety of factors.

The liquidity of any trading market in the senior notes, and the market price quoted for the senior notes, may be adversely affected by changes in the overall market for these types of securities, changes in interest rates, changes in our ratings, and changes in our financial performance or prospects or in the prospects for companies in our industries generally.

We rely on an accounts receivable securitization program for a portion of our liquidity.

We have an arrangement whereby we sell an interest in a portion of our accounts receivable to a special purpose vehicle and receive funding through the commercial paper market. This arrangement expires in November 2019. In the event that the market for commercial paper were to close or otherwise become constrained, our cost of credit relative to this program could rise, or credit could be unavailable altogether.

Our credit ratings may not reflect all risks associated with an investment in our senior notes. Credit rating agencies rate our debt securities on factors that include our results of operations, actions that we take, their view of the general outlook for our industry and their view of the general outlook for the economy. The rating agencies can upgrade or downgrade our current rating or place us on a watch list for possible future downgrading. Downgrading the credit rating of our debt securities or placing us on a watch list for possible future downgrading would likely increase our cost of financing, limit our access to the capital markets and have an adverse effect on the market price of our securities, including our senior notes.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our properties are described in Item 1 of this Annual Report on Form 10-K, and such description is incorporated by reference into this Item 2. Our properties are sufficient to meet our present needs, and we do not anticipate any difficulty in securing additional space to conduct operations or additional office space, as needed, on terms acceptable to us.

**ITEM 3. LEGAL PROCEEDINGS**

The Office of the District Attorney of Harris County, Texas has been investigating a possible violation of the Texas Clean Water Act in connection with alleged discharges of petroleum products at two of our facilities in Texas. The resolution of this matter may involve a monetary payment to Harris County for the alleged violations at each location. The amount of each payment individually and the amount of the payments in the aggregate (if any) are expected to have a de minimis effect on our financial position, results of operations and cash flows.

In addition, we are from time to time subject to various claims and lawsuits incidental to our business. In the opinion of management, currently outstanding claims and suits will not, individually or in the aggregate, have a material adverse effect on our financial position, results of operations or cash flows.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NASDAQ Global Select Market ("NASDAQ") under the symbol "LKQ." At December 31, 2016, there were 20 record holders of our common stock. The following table sets forth, for the periods indicated, the range of the high and low sales prices of shares of our common stock on NASDAQ.

	High	Low
2016		
Fourth Quarter	\$35.58	\$29.57
Third Quarter	\$36.35	\$31.18
Second Quarter	\$34.26	\$29.37
First Quarter	\$32.12	\$23.95
2015		
Fourth Quarter	\$30.50	\$27.08
Third Quarter	\$32.25	\$26.67
Second Quarter	\$30.82	\$24.92
First Quarter	\$28.23	\$22.90

We have not paid any cash dividends on our common stock. We intend to continue to retain our earnings to finance our growth and for general corporate purposes. We do not anticipate paying any cash dividends on our common stock in the foreseeable future. In addition, our senior secured credit agreement and our senior notes indentures contain, and future financing agreements may contain, limitations on payment of cash dividends or other distributions of assets. Based on limitations in effect under our senior secured credit agreement and senior notes indentures, the maximum amount of dividends we could pay as of December 31, 2016 was approximately \$1.0 billion. The limit on the payment of dividends is calculated using historical financial information and will change from period to period.

The following graph compares the percentage change in the cumulative total returns on our common stock, the Standard & Poor's 500 Stock Index ("S&P 500 Index") and the following group of peer companies (the "Peer Group"): Copart, Inc.; O'Reilly Automotive, Inc.; Genuine Parts Company; and Fastenal Co., for the period beginning on December 31, 2011 and ending on December 31, 2016 (which was the last day of our 2016 fiscal year). In May 2016, S&P Dow Jones added us to the S&P 500 Index. Accordingly, pursuant to Securities and Exchange Commission rules, we were required to change the broad equity market index in our graph from the NASDAQ Stock Market (U.S.) Index, which we used last year, to the S&P 500 Index. The stock price performance in the graph is not necessarily indicative of future stock price performance. The graph assumes that the value of an investment in each of the Company's common stock, the S&P 500 Index and the Peer Group was \$100 on December 31, 2011 and that all dividends, where applicable, were reinvested.

## Comparison of Cumulative Return

Among LKQ Corporation, the NASDAQ Stock Market (U.S.) Index and the Peer Group

	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
LKQ Corporation	\$ 100	\$ 140	\$ 219	\$ 187	\$ 197	\$ 204
S&P 500 Index	\$ 100	\$ 113	\$ 147	\$ 164	\$ 163	\$ 178
Peer Group	\$ 100	\$ 111	\$ 140	\$ 177	\$ 188	\$ 217

This stock performance information is "furnished" and shall not be deemed to be "soliciting material" or subject to Rule 14A, shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, and shall not be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date of this report and irrespective of any general incorporation by reference language in any such filing, except to the extent that it specifically incorporates the information by reference.

Information about our common stock that may be issued under our equity compensation plans as of December 31, 2016 included in Part III, Item 12 of this Annual Report on Form 10-K is incorporated herein by reference.

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Annual Report on Form 10-K and our consolidated financial statements and related notes included in Item 8 of this Annual Report on Form 10-K.

(in thousands, except per share data)	Year Ended December 31,				
	2016 (1)	2015 (2)	2014 (3)	2013 (4)	2012 (5)
<b>Statements of Income Data:</b>					
Revenue	\$8,584,031	\$7,192,633	\$6,740,064	\$5,062,528	\$4,122,930
Cost of goods sold	5,232,328	4,359,104	4,088,151	2,987,126	2,398,790
Gross margin	3,351,703	2,833,529	2,651,913	2,075,402	1,724,140
Operating income	763,398	704,627	649,868	530,180	437,953
<b>Other expense (income):</b>					
Interest expense	88,263	57,860	64,542	51,184	31,429
Other (income) expense, net	(2,146)	) (2,263)	) (2,562)	) 3,169	(2,643)
Income from continuing operations before provision for income taxes	677,281	649,030	587,888	475,827	409,167
Provision for income taxes	220,566	219,703	204,264	164,204	147,942
Equity in earnings (loss) of unconsolidated subsidiaries	(592)	) (6,104)	) (2,105)	) —	—
Income from continuing operations	456,123	423,223	381,519	311,623	261,225
Income from discontinued operations, net of tax	7,852	—	—	—	—
Net income	\$463,975	\$423,223	\$381,519	\$311,623	\$261,225
<b>Basic earnings per share: <sup>(6)</sup></b>					
Income from continuing operations	\$1.49	\$1.39	\$1.26	\$1.04	\$0.88
Income from discontinued operations	0.03	—	—	—	—
Net income	\$1.51	\$1.39	\$1.26	\$1.04	\$0.88
<b>Diluted earnings per share: <sup>(6)</sup></b>					
Income from continuing operations	\$1.47	\$1.38	\$1.25	\$1.02	\$0.87
Income from discontinued operations	0.03	—	—	—	—
Net income	\$1.50	\$1.38	\$1.25	\$1.02	\$0.87
Weighted average shares outstanding-basic	306,897	304,722	302,343	299,574	295,810
Weighted average shares outstanding-diluted	309,784	307,496	306,045	304,131	300,693



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(in thousands)	Year Ended December 31,				
	2016 (1)	2015 (2)	2014 (3)	2013 (4)	2012 (5)
<b>Other Financial Data:</b>					
Net cash provided by operating activities <sup>(7)</sup>	\$635,014	\$544,282	\$388,711	\$446,404	\$221,927
Net cash used in investing activities	(1,709,928 )	(329,993 )	(920,994 )	(505,606 )	(352,534 )
Net cash (used in) provided by financing activities <sup>(7)</sup>	1,225,737	(238,537 )	501,189	147,593	141,335
Capital expenditures	207,074	170,490	140,950	90,186	88,255
Cash paid for acquisitions, net of cash acquired	1,349,339	160,517	775,921	408,384	265,336
Depreciation and amortization	206,086	128,192	125,437	86,463	70,165

**Balance Sheet Data:**

Total assets	\$8,303,199	\$5,647,837	\$5,475,739	\$4,438,058	\$3,664,503
Working capital <sup>(8)</sup>	2,045,273	1,588,742	1,491,169	1,062,926	843,689
Long-term obligations, including current portion	3,341,771	1,584,702	1,846,148	1,287,242	1,111,058
Stockholders' equity	3,442,949	3,114,682	2,720,657	2,350,745	1,964,094

(1) Includes the results of operations of: (i) Rhiag, from its acquisition effective March 18, 2016; (ii) PGW, from its acquisition effective April 21, 2016; and (iii) 13 other businesses from their respective acquisition dates in 2016.

(2) Includes the results of operations of 18 businesses from their respective acquisition dates in 2015.

(3) Includes the results of operations of Keystone Specialty from its acquisition effective January 3, 2014 and 22 other businesses from their respective acquisition dates in 2014.

(4) Includes the results of operations of Sator from its acquisition effective May 1, 2013 and 19 other businesses from their respective acquisition dates in 2013.

(5) Includes the results of operations of 30 businesses from their respective acquisition dates in 2012. Our 2012 results include gains totaling \$17.9 million, which are included in Cost of goods sold, resulting from lawsuit settlements with certain of our aftermarket product suppliers.

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

(7) Prior year balances have been updated to reflect the adjustments resulting from the retrospective adoption of ASU 2016-09 during 2016 as described in Recent Accounting Pronouncements within Note 4, "Summary of Significant Accounting Policies" in Part II, Item 8 of this Annual Report on Form 10-K. The adjustments to prior year amounts are reflected in the table below:

	Year Ended December 31,			
	2015	2014	2013	2012
Net cash provided by operating activities				
Prior to adoption of ASU 2016-09	\$529,837	\$370,897	\$428,056	\$206,190
Adjustment - adoption of ASU 2016-09	14,445	17,814	18,348	15,737
As adjusted	\$544,282	\$388,711	\$446,404	\$221,927
Net cash (used in) provided by financing activities				
Prior to adoption of ASU 2016-09	\$(224,092)	\$519,003	\$165,941	\$157,072
Adjustment - adoption of ASU 2016-09	(14,445 )	(17,814 )	(18,348 )	(15,737 )
As adjusted	\$(238,537)	\$501,189	\$147,593	\$141,335

(8) Working capital amounts exclude assets and liabilities of discontinued operations.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a global distributor of vehicle products, including replacement parts, components and systems used in the repair and maintenance of vehicles, specialty vehicle products and accessories, and automotive glass products. Buyers of vehicle replacement products have the option to purchase from primarily five sources: new products produced by original equipment manufacturers ("OEMs"); new products produced by companies other than the OEMs, which are sometimes referred to as aftermarket products; recycled products obtained from salvage vehicles; used products that have been refurbished; and used products that have been remanufactured. We distribute a variety of products to collision and mechanical repair shops, including aftermarket collision and mechanical products, recycled collision and mechanical products, refurbished collision products such as wheels, bumper covers and lights, and remanufactured engines. Collectively, we refer to these products as alternative parts because they are not new OEM products.

We are the nation's largest provider of alternative vehicle collision replacement products and a leading provider of alternative vehicle mechanical replacement products, with our sales, processing, and distribution facilities reaching most major markets in the United States and Canada. We are also a leading provider of alternative vehicle replacement and maintenance products in the United Kingdom, the Benelux region (Belgium, Netherlands, and Luxembourg), Italy, Czech Republic and Switzerland. In addition to our wholesale operations, we operate self service retail facilities across the U.S. that sell recycled automotive products from end-of-life-vehicles. We are also a leading distributor of specialty vehicle aftermarket equipment and accessories reaching most major markets in the U.S and Canada.

On April 21, 2016, we expanded our product offerings to include aftermarket automotive glass products through our acquisition of PGW. With our acquisition of PGW, we are a leading global distributor of automotive glass products reaching most major markets in North America.

We are organized into five operating segments: Wholesale – North America; Europe; Specialty; Glass and Self Service. We aggregate our Wholesale –North America, Glass and Self Service operating segments into one reportable segment, North America, resulting in three reportable segments: North America, Europe and Specialty.

Our revenue, cost of goods sold, and operating results have fluctuated on a quarterly and annual basis in the past and can be expected to continue to fluctuate in the future as a result of a number of factors, some of which are beyond our control. Factors that may affect our operating results include, but are not limited to, those listed in the Special Note on Forward-Looking Statements in Part I, Item 1 and Risk Factors in Part I, Item 1A of this Annual Report on Form 10-K. Due to these factors and others, which may be unknown to us at this time, our operating results in future periods can be expected to fluctuate. Accordingly, our historical results of operations may not be indicative of future performance.

Acquisitions and Investments

Since our inception in 1998, we have pursued a growth strategy through both organic growth and acquisitions. We have pursued acquisitions that we believe will help drive profitability, cash flow and stockholder value. We target companies that are market leaders, will expand our geographic presence and enhance our ability to provide a wide array of automotive products to our customers through our distribution network.

On March 18, 2016, LKQ acquired Rhiag, a distributor of aftermarket spare parts for passenger cars and commercial vehicles in Italy, Czech Republic, Switzerland, Hungary, Romania, Ukraine, Bulgaria, Slovakia, Poland and Spain. This acquisition expanded LKQ's geographic presence in continental Europe, and we believe the acquisition will generate potential purchasing synergies.

On April 21, 2016, LKQ acquired PGW, a leading global distributor and manufacturer of automotive glass products. PGW's business comprises wholesale and retail distribution services, automotive glass manufacturing, and retailer alliance partnerships. We have signed an agreement to divest the automotive glass manufacturing component of PGW, which we expect to close in the first quarter of 2017. Unless otherwise noted, the discussion related to PGW throughout Part II, Item 7 of this annual report on Form 10-K refers to the aftermarket glass distribution operations of PGW, which are included within continuing operations. See Note 3, "Discontinued Operations" in Item 8 of this

annual report on Form 10-K for further information related to our discontinued operations. The acquisition of PGW's aftermarket glass distribution business expanded our addressable market in North America. Additionally, we believe the acquisition will create potential distribution synergies with our existing network.

In addition to our acquisitions of Rhiag and PGW, we acquired eight wholesale businesses in Europe, and five wholesale businesses in North America during the year ended December 31, 2016.

On December 1, 2016, we acquired a 26.5% equity interest in Mekonomen AB ("Mekonomen"), the leading independent car parts and service chain in the Nordic region of Europe, offering a wide range of quality products including spare parts and accessories for cars, and workshop services for consumers and businesses. We are accounting for our interest in Mekonomen using the equity method of accounting, as our investment gives us the ability to exercise significant influence, but not control, over the investee.

During the year ended December 31, 2015, we completed 18 acquisitions, including 4 wholesale businesses in North America and 12 wholesale businesses in Europe, a self service retail operation, and a specialty vehicle aftermarket business. Our wholesale business acquisitions in North America included PartsChannel, Inc. ("Parts Channel"), an aftermarket collision parts distributor. The specialty aftermarket business acquired was The Coast Distribution System, Inc. ("Coast"), a supplier of replacement parts, supplies and accessories for the recreational vehicle ("RV") and outdoor recreation markets. Our European acquisitions included 11 aftermarket parts distribution businesses in the Netherlands, 9 of which were former customers of and distributors for our Netherlands subsidiary, Sator, and were acquired with the objective of expanding our distribution network in the Netherlands. Our other acquisitions completed in 2015 enabled us to expand our geographic presence.

On January 3, 2014, we completed our acquisition of Keystone Specialty. Keystone Specialty is a leading distributor and marketer of specialty vehicle aftermarket equipment and accessories in North America serving the following six product segments: truck and off-road; speed and performance; recreational vehicle; towing; wheels, tires and performance handling; and miscellaneous accessories. Our acquisition of Keystone Specialty allowed us to enter into new product lines and increase the size of our addressable market. In addition, the acquisition created logistics and administrative cost synergies and cross-selling opportunities.

In addition to our acquisition of Keystone Specialty, we made 22 acquisitions during 2014, including 9 wholesale businesses in North America, 9 wholesale businesses in Europe, 2 self service retail operations, and 2 specialty vehicle aftermarket businesses. Our European acquisitions included 7 aftermarket parts distribution businesses in the Netherlands, 5 of which were customers of and distributors for our Netherlands subsidiary, Sator. Our acquisitions in the Netherlands enabled us to transform the existing distribution model to better align with that of our U.K. operations. This realignment has allowed us to sell directly to the end repair shop customer instead of through a local wholesale distributor, and to improve margins, customer service, and fulfillment rates, and positioned us well to introduce additional product categories in the long term. Our other acquisitions completed during the year ended December 31, 2014 enabled us to expand into new product lines and enter new markets.

#### Sources of Revenue

We report our revenue in two categories: (i) parts and services and (ii) other. Our parts revenue is generated from the sale of vehicle products and related services including (i) aftermarket, other new and refurbished products and (ii) recycled, remanufactured and related products and services. Our service revenue is generated primarily from the sale of extended warranties, fees for admission to our self service yards, and processing fees related to the secure disposal of vehicles. For the year ended December 31, 2016, parts and services revenue represented approximately 95% of our consolidated revenue.

The majority of our parts and services revenue is generated from the sale of vehicle replacement products to collision and mechanical repair shops. In North America, our vehicle replacement products include sheet metal crash parts such as doors, hoods, and fenders; bumper covers; head and tail lamps; automotive glass products such as windshields; mirrors and grills; wheels; and large mechanical items such as engines and transmissions. In Europe, our products include a wide variety of small mechanical products such as filters, belts and hoses, spark plugs, alternators and water pumps, batteries, suspension and brake parts, clutches, and oil and lubricants. The demand for these products is influenced by several factors, including the number of vehicles in operation, the number of miles being driven, the frequency and severity of vehicle accidents, the age profile of vehicles in accidents, seasonal weather patterns and local weather conditions, and the availability and pricing of new OEM parts. With respect to collision related products, automobile insurers exert significant influence over collision repair shops as to how an insured vehicle is repaired and the cost level of the products used in the repair process. Accordingly, we consider automobile insurers to be key demand drivers of our vehicle replacement products. While they are not our direct customers, we do provide insurance carriers services in an effort to promote the increased usage of alternative replacement products in the repair

process. Such services include the review of vehicle repair order estimates, direct quotation services to insurance company adjusters and an aftermarket parts quality and service assurance program. We neither charge a fee to the insurance carriers for these services nor adjust our pricing of products for our customers when we perform these services for insurance carriers. There is no standard price for many of our vehicle replacement products, but rather a pricing structure that varies from day to day based upon such factors as new OEM product prices, product availability, quality, demand, the age and mileage of the vehicle from which the part was obtained (in the case of recycled products), competitor pricing and our product cost.

Our revenue from aftermarket, other new and refurbished products also includes revenue generated from the sale of specialty aftermarket vehicle equipment and accessories. These products are primarily sold to a large customer base of specialty

vehicle retailers and equipment installers, including mostly independent, single-site operators. Specialty vehicle aftermarket products are typically installed on vehicles within the first year of ownership to enhance functionality, performance or aesthetics. As a result, the demand for these products is influenced by new and used vehicle sales and the overall economic health of vehicle owners, which may be affected by general business conditions, interest rates, inflation, consumer debt levels and other matters that influence consumer confidence and spending. The prices for our specialty vehicle products are based on manufacturers' suggested retail prices, with discounts applied based on prevailing market conditions, customer volumes and promotions that we may offer from time to time.

For the year ended December 31, 2016, revenue from other sources represented approximately 5% of our consolidated sales. These other sources include scrap sales, bulk sales to mechanical manufacturers (including cores) and sales of aluminum ingots and sows from our furnace operations. We derive scrap metal from several sources, including vehicles that have been used in both our wholesale and self service recycling operations and from OEMs and other entities that contract with us for secure disposal of "crush only" vehicles. Other revenue will vary from period to period based on fluctuations in commodity prices and the volume of materials sold.

#### Cost of Goods Sold

Our cost of goods sold for aftermarket products includes the price we pay for the parts, freight, and overhead costs related to the purchasing, warehousing and distribution of our inventory, including labor, facility and equipment costs and depreciation. Our aftermarket products are acquired from a number of vendors. Our cost of goods sold for refurbished products includes the price we pay for cores, freight, and costs to refurbish the parts, including direct and indirect labor, facility and equipment costs, depreciation and other overhead related to our refurbishing operations. Our cost of goods sold for recycled products includes the price we pay for the salvage vehicle and, where applicable, auction, towing and storage fees. Prices for salvage vehicles may be impacted by a variety of factors, including the number of buyers competing to purchase the vehicles, the demand and pricing trends for used vehicles, the number of vehicles designated as "total losses" by insurance companies, the production level of new vehicles (which provides the source from which salvage vehicles ultimately come), the age of vehicles at auction and the status of laws regulating bidders or exporters of salvage vehicles. From time to time, we may also adjust our buying strategy to target vehicles with different attributes (for example, age, level of damage, and revenue potential). Due to changes relating to these factors, we have seen the prices we pay for salvage vehicles fluctuate over time. Our cost of goods sold also includes labor and other costs we incur to acquire and dismantle such vehicles. Our labor and labor-related costs related to acquisition and dismantling generally account for between 9% and 13% of our cost of goods sold for vehicles we dismantle. The acquisition and dismantling of salvage vehicles is a manual process and, as a result, energy costs are not material.

Our cost of goods sold for remanufactured products includes the price we pay for cores; freight; and costs to remanufacture the products, including direct and indirect labor, facility and equipment costs, depreciation and other overhead related to our remanufacturing operations.

Some of our salvage mechanical products are sold with a standard six-month warranty against defects. Additionally, some of our remanufactured engines are sold with a standard three-year warranty against defects. We also provide a limited lifetime warranty for certain of our aftermarket products that is supported by certain of the suppliers of those products. We record the estimated warranty costs at the time of sale using historical warranty claims information to project future warranty claims activity and related expenses.

Other revenue is primarily generated from the hulks and unusable parts of the vehicles we acquire for our wholesale and self service recycled product operations, and therefore, the costs of these sales include the proportionate share of the price we pay for the salvage vehicles as well as the applicable auction, storage and towing fees and internal costs to purchase and dismantle the vehicles. Our cost of goods sold for other revenue will fluctuate based on the prices paid for salvage vehicles, which may be impacted by a variety of factors as discussed above.

#### Expenses

Our facility and warehouse expenses primarily include our costs to operate our aftermarket warehouses, salvage yards and self service retail facilities. These costs include personnel expenses such as wages, incentive compensation and employee benefits for plant management and facility and warehouse personnel, as well as rent for our facilities and related utilities, property taxes, repairs and maintenance. The costs included in facility and warehouse expenses do not

relate to inventory processing or conversion activities and, as such, are classified below the gross margin line on our Consolidated Statements of Income.

Our distribution expenses primarily include our costs to prepare and deliver our products to our customers. Included in our distribution expense category are personnel costs such as wages, employee benefits and incentive compensation for drivers;

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third party freight costs; fuel; and expenses related to our delivery and transfer trucks, including vehicle leases, repairs and maintenance, and insurance.

Our selling and marketing expenses primarily include salary, commission and other incentive compensation expenses for sales personnel; advertising, promotion and marketing costs; credit card fees; telephone and other communication expenses; and bad debt expense. Personnel costs generally account for between 75% and 80% of our selling and marketing expenses. Most of our sales personnel are paid on a commission basis. The number and quality of our sales force is critical to our ability to respond to our customers' needs and increase our sales volume. Our objective is to continually evaluate our sales force, develop and implement training programs, and utilize appropriate measurements to assess our selling effectiveness.

Our general and administrative expenses primarily include the costs of our corporate offices and field support center, which provide management, treasury, accounting, legal, payroll, business development, human resources and information systems functions. General and administrative expenses include wages, benefits, stock-based compensation and other incentive compensation for corporate, regional and administrative personnel; information systems support and maintenance expenses; and accounting, legal and other professional fees.

#### Seasonality

Our operating results are subject to quarterly variations based on a variety of factors, influenced primarily by seasonal changes in weather patterns. During the winter months, we tend to have higher demand for our vehicle replacement products because there are more weather related repairs. Our specialty vehicle operations typically generate greater revenue and earnings in the first half of the year, when vehicle owners tend to install this equipment. We expect our aftermarket glass operations to generate greater revenue and earnings in the second and third quarters, when the demand for glass replacements increases after the winter weather.

#### Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, assumptions, and judgments, including those related to revenue recognition, inventory valuation, business combinations and goodwill impairment. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of these estimates form the basis for our judgments about the carrying values of assets and liabilities and our recognition of revenue. Actual results may differ from these estimates.

#### Revenue Recognition

We recognize and report revenue from the sale of vehicle products when they are shipped to or picked up by the customers and title has transferred, subject to an allowance for estimated returns, discounts and allowances that management estimates based upon historical information. In instances where a product is returned by a customer, the product would ordinarily be returned within a few days of shipment. Our customers may earn discounts based upon sales volumes or sales volumes coupled with prompt payment. Allowances are normally given within a few days following product shipment. We analyze historical returns and allowances activity by comparing the items to the original invoice amounts and dates. We use this information to project future returns and allowances on products sold. If actual returns and allowances are higher than our historical experience, there would be an adverse impact on our operating results in the period of occurrence.

We recognize revenue from the sale of scrap metal, other metals, and cores when title has transferred, which typically occurs upon delivery to the customer.

#### Inventory Accounting

**Salvage and Remanufactured Inventory.** Our salvage inventory cost is established based upon the price we pay for a vehicle, including auction, towing and storage fees, as well as expenditures for buying and dismantling vehicles. 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 assessment of which incorporates the sales probability based on a part's days in stock and historical demand. The average cost to sales percentage is derived from



each facility's historical profitability for salvage vehicles. Remanufactured inventory cost is based upon the price paid for cores, and also includes expenses incurred for freight, direct manufacturing costs and overhead related to our remanufacturing operations.

For all inventory, carrying value is recorded at the lower of cost or market and is reduced to reflect current anticipated demand. If actual demand differs from our estimates, additional reductions to inventory carrying value would be necessary in the period such determination is made.

#### Business Combinations

We record our acquisitions using the acquisition method of accounting, under which the acquisition purchase price is allocated to the assets acquired and liabilities assumed based upon their respective fair values. We utilize management estimates and, in some instances, independent third-party valuation firms to assist in determining the fair values of assets acquired, liabilities assumed and contingent consideration granted. Such estimates and valuations require us to make significant assumptions, including projections of future events and operating performance.

#### Goodwill Impairment

We are required to test our goodwill for impairment at least annually. When testing goodwill for impairment, we are required to evaluate events and circumstances that may affect the performance of the reporting unit and the extent to which the events and circumstances may impact the future cash flows of the reporting unit to determine whether the fair value of the assets exceed the carrying value. If these assumptions or estimates change in the future, we may be required to record impairment charges for these assets. In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of goodwill.

We perform goodwill impairment tests annually in the fourth quarter and between annual tests whenever events indicate that an impairment may exist. During 2016, we did not identify any events or changes in circumstances that would more likely than not reduce the fair value of our reporting units below their carrying amounts. Therefore, we did not perform any impairment tests other than our annual test in the fourth quarter of 2016. As of the date of our annual goodwill impairment test, we were organized into five operating segments: Wholesale - North America; Europe; Specialty; Glass; and Self Service. Our Glass operating segment was composed of two reporting units, the aftermarket business and the glass manufacturing business; however, goodwill was recorded only in the aftermarket reporting unit. The other four operating segments were single reporting units for purposes of goodwill testing in 2016. Our goodwill would be considered impaired if the net book value of a reporting unit exceeded its estimated fair value. The fair value estimates are established using weightings of the results of a discounted cash flow methodology and a comparative market multiples approach. We believe that using two methods to determine fair value limits the chances of an unrepresentative valuation. As of December 31, 2016, we had a total of \$3.1 billion in goodwill subject to future impairment tests. We determined that no adjustments were necessary when we performed our annual impairment testing in the fourth quarter of 2016 on all five reporting units. We noted that the proximity of the PGW acquisition to the goodwill testing date resulted in a fair value estimate for the Glass aftermarket reporting unit which exceeded the carrying value by less than 10%. This result aligns with our expectations as there has not been a significant change in the value of the business since the acquisition date while we continue to execute our integration plans. No other reporting unit had a fair value estimate which exceeded the carrying value by less than 25%. If we were required to recognize goodwill impairments, we would report those impairment losses as part of our operating results.

#### Recently Issued Accounting Pronouncements

See "Recent Accounting Pronouncements" in Note 4, "Summary of Significant Accounting Policies" to the consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K for information related to new accounting standards.

#### Financial Information by Geographic Area

See Note 14, "Segment and Geographic Information" to the consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K for information related to our revenue and long-lived assets by geographic region.

## Results of Operations—Consolidated

In the "Results of Operations - Consolidated" and "Results of Operations - Segment Reporting" sections below, we discuss the impact of PGW on our consolidated and segment results for the year ended December 31, 2016. Unless otherwise noted, the discussion related to PGW refers only to the aftermarket glass distribution operations of PGW, which are included within continuing operations.

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

	Year Ended December 31,		
	2016	2015	2014
Revenue	100.0 %	100.0 %	100.0 %
Cost of goods sold	61.0 %	60.6 %	60.7 %
Gross margin	39.0 %	39.4 %	39.3 %
Facility and warehouse expenses	8.0 %	7.7 %	7.8 %
Distribution expenses	8.0 %	8.4 %	8.6 %
Selling, general and administrative expenses	11.5 %	11.5 %	11.3 %
Restructuring and acquisition related expenses	0.4 %	0.3 %	0.2 %
Depreciation and amortization	2.2 %	1.7 %	1.8 %
Operating income	8.9 %	9.8 %	9.6 %
Other expense, net	1.0 %	0.8 %	0.9 %
Income from continuing operations before provision for income taxes	7.9 %	9.0 %	8.7 %
Provision for income taxes	2.6 %	3.1 %	3.0 %
Equity in earnings (loss) of unconsolidated subsidiaries	(0.0 )%	(0.1 )%	(0.0 )%
Income from continuing operations	5.3 %	5.9 %	5.7 %
Income from discontinued operations	0.1 %	— %	— %
Net income	5.4 %	5.9 %	5.7 %

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Revenue. The following table summarizes the changes in revenue by category (in thousands):