FINAL TRANSCRIPT

Thomson StreetEvents℠

KAR - Q2 2011 KAR Auction Services Inc Earnings Conference Call

Event Date/Time: Aug. 10. 2011 / 3:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Jonathan Peisner
KAR Auction Services Inc - Treasurer, IR

Jim Hallett
KAR Auction Services Inc - CEO, Director

Eric Loughmiller
KAR Auction Services Inc - EVP, CFO

CONFERENCE CALL PARTICIPANTS

Gary Prestopino
Barrington Research Associates, Inc. - Analyst

Anthony Cristello
BB&T Capital Markets - Analyst

John Murphy
BofA Merill Lynch - Analyst

Rick Nelson
Stephens Inc. - Analyst

William Armstrong
CL King & Associates - Analyst

Scot Ciccarelli
RBC Capital Markets - Analyst

Craig Kennison
Robert W. Baird & Company, Inc. - Analyst

Matthew Fassler
Goldman Sachs - Analyst

Tom Shandell
GoldenTree Asset Management - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen, andwelcome to the KAR Auction Services, Inc. second quarter earnings conference call. Today's call is being recorded.

Today's hosts will be Jim Hallett, Chief Executive Officer of KAR Auction Services, Inc.;Eric Loughmiller, Executive Vice President and Chief Financial Officer of KAR Auction Services, Inc.;and Jonathan Peisner, Vice President and Treasurer of KAR Auction Services Inc. I would now like to turn the call over to Mr. Peisner. Please go ahead, sir.

Jonathan Peisner - *KAR Auction Services Inc - Treasurer, IR*

Thanks, Rachelle, and thankyou for joining us this morning for KAR Auction Services' second quarter earnings call. Today we will discuss the financial performance of KAR Auction Services for the quarter ended June 30, 2011. After concluding our commentary, we will take questions from participants. We will make every effort to accommodate all the questions within the hour we have scheduled today.

Before Jim kicks off our discussion, I would like to remind you that this conference call contains forward-looking statements within the meaning of the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that such forward-looking statements are subject to certain risks, trends, and uncertainties that could cause actual results to differ materially from those projected, expressed or implied by such forward-looking statements,and such risks are fully detailed in our SEC filings.

I would now like to turn this call over to KAR Auction Services' Chief Executive Officer, Jim Hallett. Jim?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Great. Thank you, John, and goodmorning, ladies and gentlemen. And welcome.

I will start with the performance of the consolidated entity, and despite flat car revenue, I would say that I am very pleased with the performance for the quarter. Adjusted EBITDA margin topped 28%, adjusted EPS -- excuse me -- was up 19%, and this is consistent with the 15% to 20% long-term target that we have stated. And again these businesses continue to be very strong generators of free cash flow. Again, we have talked to you much many the past about the complimentary nature of our businesses, and I think as you look at our performance for the quarter and year-to-date even for that matter, it shows how these businesses are really able to offset the ebbs and flows of the different business units.

A couple of financing highlights that we completed in the quarter that Eric is going to talk about in more detail. We were able to complete -- we did complete the refinancing of almost all of our debt, which allowed us to push our maturities out to 2017 and remain covenant light. And we were successful in amending our US and Canadian securitization, taking the facility up to $750 million and extending those maturities out to 2014. And we were able to attract very attractive pricing on this securitization, and I think this is a reflection of AFC's strong track record of performance over the past couple of years.

In terms of the business units, Insurance Auto Auctions continues to perform. Revenues were up 10%. Adjusted EBITDA was up 11%, and they experienced a 5% increase in volume. As well, we were able to achieve higher revenue per unit. This revenue increase was primarily driven by buyer's fee, which is primarily driven by the higher cost of used vehicles. IAA has continued to focus on their synergetics project. As you know, this is the efficiency cost takeout standardization of processes and things of that nature.

Continue to have success with the vehicle remarketing division, or as we refer to it as the VRD. VRD focuses on selling those low end cars that don't typically make it to a whole car auction. I often refer to these as the push/pull/drag sleds that are sitting in the back row of a dealer's lot. We have now rolled this VRD program out to approximately 50% of our sites at IAA, and we will continue to roll out more sites as we go forward, but we're having good success with that program.

Another area that we have experienced some recent success with in IAA is the rental car companies. I think IAA has been able to leverage a [dusses] relationship with many of these whole car providers and sell these rental cars. As you know, these rental car companies are for the most part self-insured, and there is a number of vehicles that are damaged -- as we would say less than perfect -- and these vehicles in the past have been sold out a whole car auction. And we have now piloted a program with the rental car companies to sell these rental cars at Insurance Auto Auctions, and the results have been -- we've had very good success.

We have been able to I believe get them in front of a better buyer base that would buy these damaged vehicles. We have been able to increase the proceeds for the rental car companies, and as a result we're getting more and more of these rental cars coming to Insurance Auto Auctions. And in particular, there is one large rental company that we're working with that is really setting the pace for this business at Insurance Auto Auctions.

At AFC they have just continued to exceed expectations. Revenue was up over 20%. Adjusted EBITDA was up nearly 30%. And this growth has primarily been driven by the number of loan transactions and the revenue per loan transaction. We have also seen a growth in our customer base and number of units floored, and we feel like that we're definitely increasing our market share in this space.

Like Insurance Auto Auctions, the tight supply at ADESA is really a positive for AFC as well. AFC continues to have very disciplined growth. The portfolio remains over 99% current, and with the new securitization in place and the additional capacity, it does provide us with more opportunity, and AFC is now expanded into motorcycles, RVs, boats, things of that nature.

At ADESA, at the risk of sounding like a broken record, it is more of the same. Volumes may become even more challenging as we go forward. The tight supply is going to continue to be a challenge. It has been a challenge through 2011, and as I stated before and will restate again today, it is going to continue to be a challenge in 2012. The National Auto Auction Association came out with their second quarter industry volume numbers, and in a word, they were disappointing. They were down 11%.

At ADESA revenue was down 8%, and we had a 14% decline in volume, but if there was a bright light, it would be the gross profit. We were able to maintain gross profit of 44.2% of revenue, and I believe that this is a reflection of a couple of things. Number one, our continued focus on dealer consignment that we really started 18 to 24 months ago. Year-to-date our dealer consignment is up over 15%, and we're confident that this fares better than the industry. And we don't feel we're done on the dealer consignment initiative. We still feel there is room to continue to grow that segment of our business, and we continue to focus on that.

And then the other factor that I would say contributed is the ongoing PRIDE focus, and again the pride focus is the efficiency process standardization that you are familiar with at ADESA. We have been able to consolidate some auctions where we have been able to co-locate Insurance Auto Auctions and ADESA on the same property. We're currently in the process of co-locating both those entities in Montreal right now as we speak. In some cases we have been able to expand the General Manager's scope of responsibility. We have one General Manager now overseeing both the Insurance Auto Auctions business and the ADESA business at the same site. We piloted that in Edmonton last year, and that is something that we think we can continue to leverage over the North American footprint in some cases as we go forward.

As we look at our year-to-date, we feel that our volume decline is generally tracking with the industry. In terms of the outlook, I believe that long-term the trends remain positive. New vehicle leasing remains very strong. As you know, that's a huge driver for our business, and there has been a number of entities report on the penetration levels of leasing, and I think you have probably read those as much as we have. Toyota appears -- their production is nearly back to the pre-earthquake levels that took place earlier this year. Used car sales are reported to be the highest they have been since 2007. And as I have said previously, and I will say again, the world doesn't end in 2011, and it doesn't end in 2012, but there is no question that our primary challenge will be navigating the next 18 months as we go forward.

On our last call I shared with you my vision and my commitment to technology. I just want to touch on technology here a little bit and tell you that hasn't changed. We continue to focus on enhancing our technology at all of our business units. We have a number of different enhancements in the works, and just to touch on a couple that we have rolled out, ADESA has continued to deploy the auction track technology, which is the GPS system that allows you to identify a car. This has been a benefit to ADESA. It allowed us to reduce our lot labor. As well it has been very well received by our customers. It is a huge benefit to our customers in terms of their people finding and locating cars in a timely manner.

Insurance Auto Auctions has rolled out their mobile version of the website, and they have also enhanced their vehicle search capabilities through their iPhone applications. AFC is in the process of upgrading their technology platform as we speak. I would say we have a lot going on in technology, and we have a number of enhancements that we plan on bringing to market, and we will keep you posted as those things become live.

In terms of our guidance, we are not changing our expectations for adjusted EBITDA of approximately $500 million for 2011. However, with that said, I will remind you that we're focused on very tight supply that is causing tremendous pressure at ADESA, and that will continue to be our number one challenge. And to date the strong performances at Insurance Auto Auctions and AFC, as well as a number of actions that we have taken within the business units, have really caused us to offset the weakness that we have seen at the whole car level.

So I am going to wrap up for the moment and allow Eric to do his financial review, and then after Eric completes his comments, and just before we go to Q&A, I would like to come back with some more commentary on our guidance and outlook for the remainder of the year. Eric?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Thank you, Jim. I just have a couple of things to cover today. First, I would like to provide some more detail on the effects of our refinancing of debt.

As Jim mentioned, we completed the refinancing of our debt in May and redeemed our 8.75% senior notes and 10% subordinated notes in June. Our goal in this transaction was to increase our flexibility to repay debt and extend the maturity of our senior debt. I am pleased to report that this was accomplished.

Further more, we will have a modest reduction in our aggregate interest expense this year. We issued $1.7 billion of senior term loan B and have available $250 million of undrawn revolver. This debt has interest at LIBOR plus 375 basis points, with a 1.25% LIBOR floor. The term loan B is covenant light, and the revolver carries a senior leverage covenant that applies at any quarter end thereis an amount outstanding on the revolver.

As a result of the refinancing transaction, we recognized $53.5 million in costs related to the extinguishment of our existing debt. This cost related to redemption premiums paid on the repayment of the notes and the write-off of unamortized debt issuance costs. In addition, we terminated the existing interest rate swap arrangement and expensed a cash payment of $14.5 million that is recorded as interest expense in the quarter. The interest rate swap had a remaining term of 13 months at time of termination. The after-tax impact of these debt issuance costs ago aggregated $42.2 million or $0.31 per share.

I will remind you that we still have $150 million of floating rate notes outstanding that are due in 2014. The floating rate notes bear interest at LIBOR plus 400 basis points, with no LIBOR floor.

I would also like to give some more detail on guidance for 2011. As Jim mentioned, we expect adjusted EBITDA of approximately $500 million. This will result in earnings per share of $0.45 to $0.50 per share. Previously we had provided guidance on earnings per share of $0.75 to $0.80 per share. The difference relates to the loss on the extinguishment of debt and the termination of the interest rate swap arrangement.

We also provide guidance on add adjusted earnings per share basis. We anticipate adjusted earnings per share of $1.20 to $1.25. This did not change from our previous guidance. Adjusted earnings per share excludes noncash stock compensation, stepped up depreciation and amortization from the 2007 LBO transaction, and two new items. We have adjusted for nonrecurring loss on the extinguishment of debt and another income item which was recognized as previously recorded contingent consideration from an acquisition. These adjustments are detailed in our earnings announcement and our filing on Form 10-Q.

A couple of items for which I have provided previous guidance have changed as well. Our effective income tax rate is now expected to be approximately 25% instead of 30% as previously discussed. This reflects the impact of the tax deductible costs associated with the extinguishment of debt. I would also like to give clear guidance on our expected cash taxes. We expect our cash taxes for 2011 to aggregate $40 million to $50 million.

Previously I have indicated capital expenditures will be $80 million in 2011. We are now expecting 2011 CapEx to be $85 million. This increase reflects increased investment in technology at AFC as mentioned by Jim, and an increase in capital expenditures at Insurance Auto Auctions as a result of additional growth experienced in this business unit.

As June 30, 2011, our net leverage ratio is 3.5 times. We are pleased with our progress in reducing our leverage.

As you know, we issued our 10-Q last night in addition to the release of our earnings announcement. This gives a comprehensive explanation of our financial performance, so I won't go through any of the detail today.

I will now turn it back to Jim for a few final remarks. Jim?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Good. Thank you, Eric.

Ladies and gentlemen, just before we go to Q&A, I want to come back and speak to the guidance that both Eric and I have been talking about here over the last few minutes. And want to start out by assuring you we have a plan in place to achieve our goals for 2011.

I want to speak to the visibility that we have within these businesses looking out to the next six months. At IAA and AFC we believe our visibility is pretty good, and we have pretty good understanding of where these businesses are going to be and how they're going to perform. At ADESA I would term it as being extremely cloudy. More so, as cloudy as what I have ever seen. As you know, in the first half of 2011, we mentioned that the shortfall at ADESA was covered by Insurance Auto Auctions and AFC. I am hopeful that is also going to be the case for the second half of 2011. I would remind you that the tight supply challenges that we see at ADESA are truly a benefit to IAA and AFC's performances.

I think it has become clear the industry will be under 8 million units this year. Tight supplies are going to continue for the remainder of this year on the whole car side of the business, and I think it would be prudent of me to caution you that there is no assurance that the strong performance that Insurance Auto Auctions and at AFC will continue at the same levels for the remainder of the year and offset the impact of these lower volumes at ADESA.

So are we faced with some challenging conditions, absolutely yes. But I believe that our consolidated performance of our businesses remains our strength. We have natural hedges that we spoke about between our businesses. We have spoken about the strong cash flow generation. The repayment of our debt will reduce our interest expense, and as a result I believe that this Company will have the ability to perform in these challenging conditions.

So with that I will turn it over to Rachelle, and we will go to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question we'll hear from Gary Prestopino with Barrington Research.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Good morning, everyone.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Good morning, Gary.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Jim, did the Las Vegas site that you opened up, did that come on stream in -- early in the quarter or later in the quarter? Was that in the mix this quarter?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Gary, that came on in June. We had hoped to get it open a little bit earlier, but as a result of issues that we had there, it actually didn't get opened up until June.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

But you did have the units from the Premier Auction Group in the mix this quarter, then?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Yes, that's correct, Gary.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

And could you give us an idea what percentage were dealer cars this quarter versus last year at this time?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Yes. Dealer cars, I would say without pointing exact number, are in excess of 40% of our total business.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Okay. Okay. And then, Eric, could you give us an idea what amount of capacity is left at AFC?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Yes, Gary. With the expansion of the securitizations, we feel we have a lot of capacity. We're borrowed out now in the neighborhood of $550 million with a couple hundred million of capacity. And, again, the advance rates didn't change, so there is plenty of room to grow that portfolio through the term of the arrangement.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Okay. Lastly, and I will jump off. You said the interest expense was going to be coming down because of the re-fi. Can you give us an idea of what we can expect now? Or how much it would come down vis-a-vis the first half of the year?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Well, giving guidance isn't my specialty, Gary, but I think you can look at it. It is going to come down about 65 to 70 bips is the effective change in the rate. Because of the LIBOR floor at 1.25, thatputs that term loan B at 5%. That will put us I think, again, at about 65, 70 bips of savings.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Thank you.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Good. Thank you, Gary.

Operator

Next we'll move to Tony Cristello with BB&T Capital Markets.

Anthony Cristello - *BB&T Capital Markets - Analyst*

Thank you. Good morning.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Good morning.

Anthony Cristello - *BB&T Capital Markets - Analyst*

First question I have is maybe a bit more clarity on the guidance and the outlook. I guess I sense a bit of optimism, but in the same breadth is a bit of a cautionary tone. You talk about ADESA, and maybe the volumes -- obviously, it sound like sub 8 million from an industry standpoint, maybe a little worse than you might have expected them to be at the beginning of the year. You have had also the benefit of IAA and AFC. The worst that ADESA gets, is it a direct then opposite in terms of IAA and AFC should get that much better? Or I guess in your text you actually said you're not sure that those trends can continue, so I am trying to understand the confidence that you have in the various segments to help each other offset. Or is the guidance you're giving just based on where we are today, and if things worsen, you may not have that same comfort level? I am sorry, that's a long-winded question.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

And hopefully I have caught most of that. Let me start by saying that most importantly we look at this business on a consolidated basis, and we have a plan in place to reach our goals for 2011, which I stated. And I think that's most significant. The cloudiness that I spoke about at ADESA, there is no question there is a lot of things going on that's causing unusual behavior, as I would term it.

I think dealers are -- change their profile of the used cars that they sell. The dealer who typically hasn't sold a five- to seven-year-old car with 120,000 miles on it is now holding onto that car and selling it. Dealers are going to greater lengths to acquire cars, whether they be from wholesalers or swapping between dealers or going to auctions that are completely across the country. I think there is just a lot of unsurity.

And you factor in what's going to happen to the SAR. If that increases, what impact that will have on trade-ins and vehicle prices and the number of vehicles that will eventually make it to a physical auction. I think with all of the things that are going on, there is just uncertainty with respect to the ADESA level, where as I mentioned, we have much better visibility and a much better grip on how we think the other business units are going to perform, which again gets us to a comfort level of the approximately $500 million on a consolidated basis, and that's really what we're focused on.

Anthony Cristello - *BB&T Capital Markets - Analyst*

Maybe one other question, if I can. When you talked about the changes you're seeing in the dealer side of the business and holding onto these longer cars -- cars longer that are 120,000 miles or such. If you look at your dealer consignment mix at 42%, with the initiatives you have in place, is there a number that you want to get to? Do you want to be at 50%? And how does that ultimately help your business if the trends in the industry seem to be shifting a little bit? Maybe they're not a permanent shift, but certainly near term a shift nonetheless.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Yes, I think -- to answer your question, I think that our goal is to be at the market in terms of mix. If I have got my numbers right, I think the mix was 55% dealer business and 45% commercial business. And if that's where the market is, that's where we would like to line up.

Anthony Cristello - *BB&T Capital Markets - Analyst*

And I assume all of the initiatives in infrastructure you have in place to get there is working, it is there, and now it is just a matter of time to finish achieving to -- that path to get to the 50?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

I think you said it well. We're very pleased, number one, with how we rolled out the initiative. Very pleased with the focus that we've had and the success we've had. And the nice thing about it is we feel there is more runway. There is more opportunity on the dealer side of the business, and we feel that with the team that we have in place at ADESA, we feel that will continue to get better as we go forward.

Anthony Cristello - *BB&T Capital Markets - Analyst*

Okay. Thank you for the time.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

You're very welcome.

Operator

Next we'll move on to John Murphy with Bank of America Merrill Lynch.

THOMSON REUTERS

John Murphy - *BofA Merill Lynch - Analyst*

Good morning, guys.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Good morning, John.

John Murphy - *BofA Merill Lynch - Analyst*

I have a couple questions here. Good morning. First question is just on the conversion rate at 60.8% at ADESA. Obviously that was a pretty significant drop from where it has been running for the past really five quarters. And I know you highlight an increase in the dealer business that converts at a lower rate as part of the reason. I am just trying to understand, with everything going on in the used car market and dealers pushing that business harder and used car prices up, is there anything else going on there? Is it really just mix? Because it seems like the conversion rate should be higher given the market dynamics right now.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

John, I think you answered it with the first statement. It is really dealer consignment cars convert at a lower rate, so we have to get a lot more of these vehicles. And convert them at a lower rate, and when you measure in the drop of commercial vehicles, that's the way the numbers work themselves out. And there is nothing else that I could point to that is causing that change in conversion other than the impact of dealer cars converting lower.

John Murphy - *BofA Merill Lynch - Analyst*

And if that conversion rate -- somehow the mix shifted back and you are converting it 400 to 500 basis points higher -- so 64%, 65% range -- your margins in ADESA would just be significantly higher. Is that a fair assumption, or would there be any cost creep if that conversion shifted?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

No, I think it is a direct drip to the bottom line. Obviously, I will let Eric do the math, but in terms of conversion rates, it is a huge driver of our margins and a huge driver of our profitability. So as that conversion jumps another 1%, 2%, 3%, 4%, that's going to have a significant difference on our margins and our profitability.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

John, the only caution I would add to that is when you start putting those commercial cars back in, there is a higher use of ancillary services, which can blend it down slightly. But again, the levels we're at now we sustain those levels when we had high commercial sales, and we're holding them in there with the dealer consignment, so I don't know that it would be a big move. But that would be my only caution, is if you saw them using more transportation or something, that could have a minor impact on it.

John Murphy - *BofA Merill Lynch - Analyst*

Okay. And then just a second question on volumes. And, Jim, you mentioned that used car sales as they're being reported by the industry are the highest that they have been since 2007, yet auction volume from the NAAA are actually own 11% in the second quarter. And I am just trying to understand if there is some shift going on away from auctions in the near term, or is this a trend we're seeing and the dealers are bypassing the auctions and retailing more vehicles? I am trying to understand what happened in the quarter, if I am just misunderstanding that, or something is changing here.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

John, I believe it is a temporary response to supply. It's just this so difficult for dealers to get enough inventory to fulfill their inventory requirements that they're just hanging onto more cars, and they're going more places to get cars, and perhaps in some cases they're getting to these cars before they make their way to a physical auction.

John Murphy - *BofA Merill Lynch - Analyst*

Okay. And then just lastly, if we look at Insurance Auto Auctions, it has been outperforming, as you mentioned, offsetting somewhat the pressure on ADESA, and you mentioned VRD and your focus on doing more business with rental car companies. Is there any cannibalization that's going on here, where some of the business is moving from the ADESA line item to the Insurance Auto Auctions segment? I know you mentioned there were a couple of site where is you're starting to combine the General Manager role. And I am trying to think if we should be looking at these business maybe as a whole of Insurance Auto Auctions and ADESA together as opposed to separately, because it seems like there is some fungibility in volumes beginning to develop.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

John, I think that's a good point. There is no question that there has been business -- I wouldn't use the word cannibalization, but I would say there has been business that has shifted as a result of the relationships with ADESA. ADESA has been able to introduce Insurance Auto Auctions to a myriad of customers who previously did not do business with salvage auctions, and this comes back to what we talk about in terms of channel optimization or best venue. And now we're really able to provide our customers with the opportunity to look at both venues.

And recently , as you have already said but at the risk of repeating, we now have these rental car companies trying pilot projects with us, and quite frankly some of these pilot projects are working out. In some cases we didn't necessarily get all of those cars at ADESA, butit did take some cars away from ADESA. There is no question. Overall I would say there is a smidge of cannibalization here, but on the other hand I think there is a growth in the segment for KAR overall.

John Murphy - *BofA Merill Lynch - Analyst*

Okay, great. Thank you very much, guys.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

You're very welcome.

Operator

Next we'll move to Rick Nelson with Stephens.

Rick Nelson - *Stephens Inc. - Analyst*

Good morning.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Good morning, Rick. Hi, Rick.

Rick Nelson - *Stephens Inc. - Analyst*

You mentioned that ADESA volumes were down 14%, the industry down 11%. Can you talk to what you think is happening to market share, both on the dealer consignment side as well as the institutional business?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Yes, Rick. If you take a look at our business, first of all, we have told you in the past that our business is historically 70/30, 70% commercial and 30% dealer. And so obviously the biggest segment of business that's down is the commercial business, so that's going to have more of an impact on the ADESA commercial numbers. But on the other side, the flip side of that coin is the dealer consignment business. We have been able to grow that business above the market, so I think that speaks to the volume declines. We've lost it on the commercial side, but we have actually done quite well on the dealer side.

Rick Nelson - *Stephens Inc. - Analyst*

And when do the off-lease vehicles being able to grow again? That's later 2012 that would positively impact the institutional business?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Yes, I am sorry, Rick, I just didn't catch the first part of your question. I'm sorry, wouldyou mind repeating that?

Rick Nelson - *Stephens Inc. - Analyst*

When do off lease vehicles begin to turn up again that would have a positive impact on the institution?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Right, yes. I would say for sure we're going to see those lease vehicles in 2013, but towards the end of 2012 we could see some of the early terminations coming back. So we expect -- especially as some of these leases were written in 2010, we could see some of those cars start to return late 2012, but I think the real impact will come in 2013.

Rick Nelson - *Stephens Inc. - Analyst*

And do the comparisons get more difficult as we move through the remainder of this year and into next year from an institutional side of the business?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Rick, we have been under pressure in this business. It really began the latter part of last year, and I was say was heavily focused beginning in the fall and definitely in the fourth quarter. But to characterize the comparisons getting easier in today's environment is really difficult for us, because it is just things have changed in terms of the supply of vehicles. But yes, volumes were down in the last part of last year more so than they were earlier in the year, so I do think, again, the comps are a little easier if you want to call it that.

Rick Nelson - *Stephens Inc. - Analyst*

Got you. And as new vehicle inventories begin to improve, there is some thought that we're going to see some pickup in incentives from the [JT] and the other OEMs. How do you see that affecting used car values and IAA's business, as well as a pickup perhaps affecting the ADESA volume side?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Well, there is no question that as the new car sales increase, that should increase trades and that should increase volumes at the auctions and transactions, and you might see a decline on the proceeds side at Insurance Auto Auctions. But I think, given a choice, we would be pleased to see the SAR rise and the number of trade-ins increase, which would have a much greater impact than what we would see being eroded at -- on proceeds at IAA.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

And, Rick, I will add to that. There just doesn't appear to be any relief on aftermarket parts, pricing right now. That's a driver of this. If people are repairing the cars, it probably is not as direct a relationship to a point in time measurement of new and used car pricing. There is high demand at the salvage auctions, and it is really to drive the aftermarket parts business, which is collision repair oriented.

Rick Nelson - *Stephens Inc. - Analyst*

Got you. Thanks for that color. Also, Eric, like to ask you about the SG&A expense ratio this quarter. With all the adjustments itis a little difficult for us to look at that, but it appears as if it widened on this quarter?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Yes. In fact, if you take out the stock-based compensation, which is a direct reflection of movements in our stock price, if you take that element out of it, we were actually down as a percent of revenue about 70 basis points.

Rick Nelson - *Stephens Inc. - Analyst*

Okay. Good. Thank you, and good luck.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Thank you.

Operator

Next we move onto Bill Armstrong with CL King & Associates.

William Armstrong - *CL King & Associates - Analyst*

Good morning, Jim and Eric.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Good morning, Bill.

William Armstrong - *CL King & Associates - Analyst*

Just to follow up on one of those previous questions, so looks like ADESA in second quarter lost market share on the institutional side. Are you seeing Manheim or any other players getting more aggressive in that area?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

I think speaking to your first point, yes, we've lost a little bit of share on the institutional side just because of our high levels of institutional cars. In terms of what's going on with the competition, I think I will stay away from commenting on that.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

And, Bill, I will add to that. We don't like to make excuses about these metrics, but the interim data that NAAA puts out is based upon some estimations, and quarter to quarter there are odd movements I would just highlight for you. That's why we really don't measure market share until we get the annual numbers, which is based on a survey of all of the auctions and is actual data. So when we compare our numbers of units sold, it is the actual number of units sold, and it's the same data we submit. But not all of the data that they're using is as precise as that, and we know that. So that's why we say generally in line. Next quarter -- you may have somebody that reported this quarter that didn't report in the first quarter, and that affected it. And so we look at it more over a period of a year.

William Armstrong - *CL King & Associates - Analyst*

I see. On the SG&A line for ADESA, you had more auctions in operation than a year ago, but your SG&A was actually down slightly in dollars. Where did those declines come from?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Well, again, Project PRIDE is the biggest mover of that. We look at it -- we talked about dealer consignment, where we have invested in the marketing spend there, but in other areas of our business we have had reductions. And we continually look at our headcount, what support staff are needed to want is the current levels of activities. And I have to tell you I am proud of the ADESA team. They have been proactive in trying to keep as much of their costs in line with the current activity levels, so that's the primary driver in my view of what keeps it down. And it is -- Bill, back to 2007, I would argue that a greater percentage of our cost structure, even on the SG&A front was more of a fix for sure, and we kind of made it a little more variable than we had previously, so I think that helped us.

William Armstrong - *CL King & Associates - Analyst*

I see. Finally on interest expense, I know you don't want to give forward-looking guidance on that, but the 40 -- what is it, $49.7 million in the second quarter, if you stripped out any one-time items, what would that number have been? If there were any one-time items.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Well, on interest expense?

William Armstrong - *CL King & Associates - Analyst*

Yes.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

You can take out -- just a second. I will give you the number. $14.5 million pretax was the cash paid on the interest rate swap termination. Take that out. Everything else was interest expense.

William Armstrong - *CL King & Associates - Analyst*

Got it. Okay. Thank you very much.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

And that would include noncash amortization of debt issuance costs, so -- but you can go to our cash flow statement and figure out most of it.

William Armstrong - *CL King & Associates - Analyst*

Right, right. Okay. Thanks.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

You're welcome.

Operator

Next we'll move to Scot Ciccarelli with RBC Capital Markets.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

Quick housekeeping item first. The IAA figures, is that all same-store sales?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Yes. We have not added in the auction at IAA last year.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

That's helpful. And then I guess -- again not to -- I am sure the horse is glue at this point, but about ADESA volumes. You mentioned that 2012 is also going to be challenging, but obviously the comparisons get much more -- much easier following what's going on in 2011. So I guess what I am trying to figure out is 2012 is still just going to be under pressure, so it won't show much of a rebound for 2011? Or do you think year-over-year 2012 will actually be worse than 2011?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Given what we're experiencing, Scot, I think we'll wait until the economists come out and we look at all the activity, but Jim's commentary was very specific. I mean, we don't see any indicators that would say there would be a great change to the market conditions, other than what he spoke to. Some of the behaviors of the dealers, if the SAR were to increase, that might help bring activity, but again pressure on supplies is the key. That's what we're expecting.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

That doesn't make sense mathematically. Your -- 2008 was kind of -- or late 2008 and early 2009 was kind of the peak of the decline, I suppose, in new car sales run rate. If you use that typical three-year timeframe for leases, et cetera, it means end of 2011 or mid-quarter end of 2011 should really be the peak of the supply. Is there something else that is occurring that I am just not appreciating properly?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

If I understand your question right, if you refer back to 2008 and 2009, even though that was kind of at the peak of the recession or the meltdown in what was going on in the marketplace, we still had a lot of volume to run off these portfolios. So we were still running off volume in 2008, 2009, and into 2010, and that's -- and during that time leasing came to a stand still, and the credit markets started to tighten up, and repos kind of dropped off a little bit, and we -- so we really started to refill the pipe in 2010, and so --

---

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

I will add to that, Jim, the SAR was declining throughout 2009. So you are right, there is a number of factors, Scot. You're on that. But lease originations returned on a much lower number of new car sales. And we didn't see the rebound in the SAR really come in until 2010.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

Okay. I will follow up after. Thank you.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

All right, Scott.

Operator

Next we'll move to Craig Kennison with Robert W. Baird.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Good morning. Thanks for taking my question as well. First question --

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Good morning, Craig.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Good morning. Eric, the 25% tax rate, is that on a GAAP basis or adjusted pretax profit? Just want to confirm.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

That's our effective tax rate on a GAAP basis.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

And is there any nuance I am not appreciating about the impact on pretax profit on an adjusted basis for that tax rate?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Well, the nuance, Craig, is the fact that most of those adjustments result in tax deductions. I mean, that -- so what I am doing is giving you the nuance of the rate goes down because a lot of those adjustments are tax deductible, but I am not taking them out on my pretax GAAP income.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Okay. That's helpful. Thank you --

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

That's why -- Craig, just to be clear, that's why I gave you the guidance of $40 million to $50 million on cash taxes, because there I don't think you can get to the number. That is where the nuance occurs that you're referring to, isyour pretax on an adjusted basis is up, so I am giving you the cash tax number we expect rather than a percent.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Understood. That's helpful. Thanks, Eric. And, Jim, I think one of our online competitors recently announced they would be offering a buyback guarantee. Is that a disruptive new service, and is that something you would consider?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Yes, that's something that we have actually -- that the industry has done. It has been a practice of the industry over the years from time to time. I think it might be something new for that particular entity, but there are insurance programs in place where insurers -- you can buy insurance that will protect you to buy the vehicle back over the course of 60 or 90 days and refund 95% of our vehicle purchase or something of that nature. But it is a program, quite frankly, that we used over the years as well for specific customers and specific promotions.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

And just to confirm, is that a service you currently offer either directly or through an insurance partner?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Yes, it is a service that we could provide through an insurance affiliate.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

And different markets offer it based upon market conditions there, but again we aren't retaining that risk generally. I am not aware of any right now where we're retaining the risk. We insure it all through a third party, and actually the customer pays for the insurance, not us.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Got it. Thank you.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

You're welcome.

Operator

And Matthew Fassler with Goldman Sachs will have our next question.

Matthew Fassler - *Goldman Sachs - Analyst*

Thanks a lot. Good morning. It is Matt Fassler sitting in for [Ryan Brinkman] today.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Good morning.

Matthew Fassler - *Goldman Sachs - Analyst*

Good morning. So two questions. First of all, thanks for your candor what's going on at ADESA, and you spoke to some of the cyclical drags and the turning points we might see. Is there anything of a structural nature that you see having gained -- or lost momentum in terms of impediments to the whole KAR Auction business model this quarter, whether it is what the rental companies are doing or online-only auctions in the whole car space? Anything like that?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

No, Matt,I would say things are non -- nothing out of the ordinary. Things are pretty consistent, and it is much of what we stated already.

Matthew Fassler - *Goldman Sachs - Analyst*

Fair enough. Then -- I am sorry, go ahead, Eric.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Matt, I was going to add, Jim did comment maybe the only thing you're seeing, grounding dealers are buying more off lease vehicles because of residual values set three years ago. Compared to the used car values of today, it is very attractive for them to do that. That's not structural. I think that's temporary.

Matthew Fassler - *Goldman Sachs - Analyst*

Understood.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

But that is an impact we are monitoring.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. And then you spoke about IAI and AFC holding their ground and essentially acting as hedges. Not to take the direction that -- the discussion in this direction, but if there were an item to watch for in IAI and the salvage business in particular that would be potentially concerning, what would it be? What should the watch fronts on the horizon be here?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

I am sorry, Matt, would you mind just repeating that for me?

Matthew Fassler - *Goldman Sachs - Analyst*

Sure. Of course. Just real briefly, sounds like IAI and AFC are doing well. You said I guess almost the pro forma statement, there no guarantees that continues. Is there anything that could possibly -- what would we look for that might not move in the right direction in the salvage business that wouldn't be offset by an offset in the whole car business?

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

I think the thing I would point to I guess would be if there was a drop in proceeds. The salvage business is -- obviously there are a number of factors that affect prices, including used car values, including currencies, including miles driven and scrap prices. If there was a significant change in those areas, it could possibly bring down the proceed prices at IAA, which would not allow them to perform at the same level.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. Fair enough. Thank you so much.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

You're welcome.

Operator

Our next question we'll hear from Tom Shandell with GoldenTree Asset Management.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Hi, thank you. Good morning.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Good morning, Tom.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Some of my questions were already answered. Question -- sort of a housekeeping question on the supplement. If I look at page three, which has the quarterly breakdown of all of your EBITDA calculations, you show nonrecurring charges in this quarter of 16.2, and noncash charges of 46.2. And I was hoping you could help me understand which of those -- your EBITDA calculation is from net income going up, and I usually look at the other direction, so I am just trying to understand what I should and shouldn't include in my add-backs. So I was wondering if you can help me understand which of these items are below the operating income line and which are above. I mean, I presume the noncash charges has a lot of the loss on debt retirement in there because of the size.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Yes, but it does not include the $14.5 million from termination of the swap, because that was an interest expense, which is up above.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Sure.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

But everything else is above -- if you look at it, the differentiation, it is above the operating income line. It is an add-back. If it is below that line -- and then the exceptions would be depreciation and amortization, which is an operating cost we show separately.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Okay. But the adjustment to the contingent acquisition costs (inaudible -- multiple speakers) other income.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

That [ran to -- actually it ran] through SG&A.

Tom Shandell - *GoldenTree Asset Management - Analyst*

That ran through SG&A?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Yes.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Interesting. Okay. Appreciate that.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Yes, it's how we're -- I mean, it is an operating cost. It is the new -- actually , Tom, I will just give you -- it is the new accounting for business acquisitions. It is not how we used to do it.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Okay. Good. That's helpful. Switching to IAAI, could you help understand what percentage of the business this quarter was your traditional business, and what percentage was from rental and charity and things of that sort?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

We still continue to be about 85% insurance. It did fall just slightly below that this quarter, but for the year we're still running right around 85%, and there is not a big change there. And I don't think that is surprising, because we're in the summer months where there is fewer insurance claims, soI think it is probably more seasonal than anything that it probably dropped a little bit.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Yes. And do some of these natural disasters that we seem to be experiencing, weather-related, does that have a meaningful change in the volume of business?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

It is one of the more meaningful things that occurs throughout the year is weather-related claims. And ithas been a very interesting cycle, as you probably know , with the numbers of tornadoes, floods. I mean, the heat. All the things that go with heat have really created some situations, whether they be the tornadoes or the flooding or the severe storms.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

And let's not leave out snow and ice.

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

And the snow and ice earlier in the year. But I'm talking that's probably been something that's been a trend in our favor that is abnormal for the summer months.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Okay. But in the quarter where the tornado activity, et cetera, was that a meaningful benefit to your volume?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

It's not meaningful so far, because a lot of that has occurred and taken average term of 75 days from the time that a car is assigned to us to the same we sell it, but again meaningful over the course of a year. Weather-related is an impact, and again that's what's keeping insurance volumes probably at the normal levels. But remember, there are natural disasters every year. They're just -- each year they're some place else. It's -- whether it is a hurricane, a tornado, it's kind of a recurring thing that these weather events occur.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Okay. So the quarter had some pretty good cash flow, and I know money is fungible, but the way I line up the numbers, it would appear that your good cash flow was invested in these receivables held for investment, which apparently have good returns. Can we think about when we model the Company that will be a reasonable use of free cash flow going forward?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

There will be an impact of us growing -- as we grow the AFC portfolio, you will see us utilize some of our cash, because we retain $0.225 on the dollar and securitize the remainder. In periods where we were running that portfolio off, it was a significant generator of cash. So, Tom, yes, that's part of our model, although I don't think you will see the moves as drastic as they occurred in 2008, 2009, and the growth is more steady now.

Tom Shandell - *GoldenTree Asset Management - Analyst*

All right. But we could probably think about this quarter being more normal?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Yes, thisquarter is fairly normal. Yes. I mean, again, there is a bit of seasonality in that business. You build up, and then it kind of lags into -- their portfolio will lag a little bit into the fall, where it will start to see some more activity generally as they get near year end, and people start buying inventory and flooring it as they prepare for the next season.

Tom Shandell - *GoldenTree Asset Management - Analyst*

I see. Finally, the whole car business, as you mentioned is supply constrained, but yet in AFC you're picking up share. So I guess the question is are you making whole car floor plan loans, or are you expanding the type of loans to include just general floor plan loans to used car dealers who may not be buying cars at auctions?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

Tom, right now it is being driven by used cars that are being floored. With our recent improvement we have been able to expand, but that's still -- there are limitations on the ability to go into these other baskets. There is a limit to the securitization. But right now the number of units floored, which is actually vehicles -- cars -- has increased substantially. So we have a number of things going in our favor, but it is primarily cars. We are moving in a little bit more into the specialty area that Jim mentioned. We have that capacity, but again it can't grow substantially because there are limits as to how much of the securitization can be used in those areas.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Right. But are you flooring cars that are from auction, or are you replacing incumbent lenders and just capturing more customers?

Eric Loughmiller - *KAR Auction Services Inc - EVP, CFO*

We're flooring cars purchased at auction. There is a little bit with the activity of the retailers buying cars from consumers. We will floor those vehicles up to black book prices, and things like that, but we still are predominantly flooring cars acquired at auction. That's our focus and that's where they're getting their growth.

Tom Shandell - *GoldenTree Asset Management - Analyst*

Thanks, Jim and Eric.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Rachelle, we have time for one more question.

Operator

We'll move to Gary Prestopino with Barrington Research.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

Hey, Gary.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Yes, I am fine, thanks.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

All right, I think we may have one more person. We can take their question.

Operator

Okay. Mr. Prestopino, your line is open.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

I'm done.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

He is done.

Operator

Okay. There are no further questions.

Jim Hallett - *KAR Auction Services Inc - CEO, Director*

All right. Rachelle, maybe just are before we close out here, I would just close in saying thank you for being on, and thank you for your interest.

We're definitely going through some challenging times here. This certainly isn't the first challenge that we have dealt with as you think of what we have been through over the course -- actually what we have been through over the first half of this year, and then as we take a look at what we have been through over the last three or four years as a management team. And I would just remind you that this is a very, very talented management team, very passionate about this business, and we're a scrappy bunch, and we find a way to get things done. I can tell you that we will fight to the bitter end to deliver on our goals and our expectations. And with that hopefully we'll continue to see things moving in a positive direction here.

So I will wind up with that, and thank you very much for your time and interest today.

Operator

That will conclude today's call. We thank you for your participation.

THOMSON REUTERS