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KAR - Q1 2010 KAR AUCTION SERVICES INC Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the KAR Auction Services quarter-one earnings call. Today's call is being recorded. Today's host will be Jim Hallett, Chief Executive Officer of KAR Auction Services, and Eric Loughmiller, Chief Financial Officer of KAR Auction Services. I would now like to turn the call over to Mr. Loughmiller. Please go ahead, sir.

Eric Loughmiller - *KAR Auction Services - CFO*

Welcome to the KAR Auction Services first-quarter earnings call. Today we will discuss the results of operations of KAR Auction Services Inc. After concluding our commentary, we will take questions from participants. We will try to accommodate all of your questions, but our call will end promptly at noon today.

Before we begin today's discussion, I would like to remind you that this conference call may contain forward-looking statements. Such 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.

Now, I will turn the call over to Jim Hallett.

Jim Hallett - ***KAR Auction Services - CEO***

Great. Thank you, Eric, and good morning, ladies and gentlemen. And let me add my welcome as well. I'm very excited and very pleased to report that all of our businesses had a very good first quarter.

And I think -- really, as I go through my comments today, I think one of the things I want to highlight is, I want to highlight our diverse business model. And I'll speak to that somewhere later in my comments as well.

But in terms of performance, high level, we were very successful in growing our revenues, able to grow our margins, our adjusted EBITDA, and we continue to be a very strong generator of free cash flow. And as I turned to our ADESA business unit, first I will acknowledge that there is no question that revenue and EBITDA is down for the quarter. But overall, I would say I'm very, very satisfied with the results at ADESA, especially as I walk you through the quarter and some of the things that we dealt with throughout the quarter.

First and foremost, I would draw your attention to the tough comp that we had compared to 2009. If I can take you back a little bit in time, as we ended up 2008, we had a tremendous buildup of inventory with manufacturer bankruptcies going on, the credit crunch taking place. There were a lot of vehicles backed up, and sellers just weren't willing to sell those cars at depressed prices.

And we carried those vehicles into 2009. And when I look at the first quarter of 2009, compared to January 2010, we had in excess of 50,000 more vehicles on the ground in January '09 than we did in January of 2010.

So with that said, the other factor that we had is, these sellers were very much anxious to push these vehicles through the pipe in the first quarter of 2009. And we've seen conversion rates that were the highest that we'd ever seen in the history of the Company. So I think that kind of explains the tough comparison that we're up against in the quarter.

The other things I would point to is that there is no question that weather played a role in the quarter. Normally, we get concerned about weather in Canada and the northeastern parts of the United States. In this past quarter, weather really played a role in the US. And I think it's been well documented or publicized that we had snow or ice in 49 of the 50 states.

And we feel that on an overall basis, we lost what would be the equivalent of six sales at ADESA. And when you lose a sale and dealers aren't able to get their vehicles through the sale or get the sale to purchase, you do get the opportunity to sell the commercial vehicles at a subsequent sale. But you never really get the opportunities to regain those dealer sales. So that was certainly a loss for us.

And then the other factor I would draw your attention to is I spoke about the Toyota recall on our last call. And there's no question that Toyota was a disruption for Toyota. And we talked about that. But the thing that I would add to that, it was also a disruption for the rental car business. And many of our -- or not many; all of those Toyota vehicles had to be pulled from the fleets, and had to comply with the recall. And there is no question that this was a disruption of the selling cycle for those vehicles as well.

Now I have spoken with Toyota as recently as this week. And they have shared with me that of all the vehicles that were grounded and that were scheduled to be sold in the first quarter of 2010, that the majority of those vehicles did get sold. However, there will be a carryover of those vehicles into the second quarter and beyond for the remainder of the year.

So what do we see ADESA looking like going forward? There's no question that we're still very pleased with the conversion rates. The conversion rates were very strong in the first quarter. But certainly not like they were last year. No question that inventory is tight, and inventory is going to remain tight for the balance of the year. And as I take a look at our business, there is no question that the first half of the year is a better half in terms of performance for the whole car business. And the comps get much easier -- or I will say easier in the second half of the year.

And also, I would say to you that I've been very encouraged by the recent news that's been released on new car sales for the month of April. It was reported that the new car sales year over year were up 20% in April and that that's got to be a good thing, especially for our dealer business. There's no question as we sell more new cars that generates more trades; more trades generate more transactions at the auctions. And I would say now that a number of economists are pointing to an 11.5 million to 12.5 million [SAR], which again will only be good for many of the things that we have going on with our dealer initiative, which I will come back to in a few moments.

If I can take you to Insurance Auto Auctions -- in a nutshell, I would say Insurance Auto Auctions hit an absolute home run. They had the best quarter that they've ever had in the history of the Company. And proceeds were at a record all-time high. And this was driven primarily by the strong used-car prices. As well, steel prices have continued to increase.

And as much as weather has been a detriment in the first quarter for ADESA, it has really played in Insurance Auto Auction's favor. And we have the opportunity at Insurance Auto Auctions to really see our inventories 60 to 75 days in advance. And I can tell you that we expect to see a strong continued performance through the second quarter at Insurance Auto.

I want to touch briefly on the Allstate situation and tell you that that transition is in the initial stages. We think that the transition of the Allstate business will be completed sometime late in the fourth quarter and perhaps even into 2011.

But with that said, I want to reassure you that we feel with the business wins that we've had at Insurance Auto, that the loss of the Allstate business should not have a material effect on Insurance Auto's performance.

What I would focus on, I guess, if I was concerned -- I would be more focused or more concerned about how long we can continue these record proceeds. Obviously, it would be great if we could continue them right through the year. But we are remaining cautiously optimistic that these proceeds will remain high.

I want to take a minute and reinforce our belief and commitment to the hybrid methodology that we use at Insurance Auto Auctions. As most of you are aware, our competitor chooses to sell 100% of their vehicles on the Internet.

At Insurance Auto Auctions, we offer every vehicle physically. As well, we offer 100% of those vehicles electronically. We feel that this absolutely brings more eyeballs to the vehicles. More eyeballs bring more bids to each vehicle sold. And more bids should equate to higher values for our insurance customers.

And I think there is a story in the number. Because when you think that we offer 100% of these vehicles electronically, we only receive a bid on 75% of these vehicles, and we end up selling somewhere in the order of 45% to 50% of these vehicles on the Internet. And so, again, I'm just going to repeat, we think that not only does it drive value, but we think as time goes on, that the hybrid methodology will enhance our opportunity to grow our market share as well.

And I often get asked -- why do we continue to use the hybrid methodology? And I would say simply because it drives value. And we think it will grow marketshare. And if we thought for a minute it didn't give us that result, we would scrap it in a heartbeat.

And finally, on Insurance Auto Auctions, I just want to speak to our [Synergetics] project. Much like the PRIDE project that we had at ADESA, the Synergetics project is an efficiency, standardization of processes, consolidation of back-office functions -- that initiative has been deployed at Insurance Auto Auctions, and will continue to be rolled out throughout the remainder of the year.

We don't expect any significant savings through 2010. But we feel the real impact of the Synergetics project for IAA will come in 2011.

If I can move to Automotive Finance, AFC, for just a moment, I would say to you that AFC exceeded our expectations for the quarter. Not only were we able to increase our transaction and grow the portfolio, but the thing that has been very, very pleasing has been the quality of the dealer that we are able to attract. We are attracting a much higher quality of dealer, and we feel that we have really been able to eliminate the lower end or the more risky dealer. And I think it proves out in the numbers. We are 99% current with the portfolio. And this is not just for the last three months, but this has been for the last seven, eight, nine months running -- our portfolio has been in that 98% to 99% current rate. And that is certainly the highest that we've ever witnessed in the history of the Company.

You know, we've always looked at AFC as being a complementary service to our whole car business, to ADESA. But recently over the course of the last four or five months, we have been able to take AFC and roll it out to many of our salvage buyers. And although the salvage buyers remain a very small portion of our portfolio, we are really pleased with the traction that we're seeing on the salvage side as well.

So with that said, let me just move back to whole car for a few minutes, and talk about a couple of major initiatives that we've spoken to you about before. We told you that we were going to be focused on e-business and our dealer consignment initiative, and let me take those in order.

E-business -- we recently reported in a press release in April that 19.5% of our total sales were sold over the Internet. And we think this is an area of the business that may continue to expand. And we are continuing to prepare for that, and continuing to make the investments in our technology. And in fact, we are planning on rolling out a new, enhanced version of our platform before the end of the year.

On the dealer consignment initiative, there's no question that the initiative is working. Dealer sales for the first quarter are up significantly. I think that's being driven by a number of factors. There is no question there's very strong demand for used cars in the marketplace.

But also the independent dealers that have survived are really healthy and they are back in the game. And I think that's witnessed through our AFC unit and what we're seeing at AFC.

And then I would turn to the training that we've done, not only internally with our sales folks at all of our auction sites, but then, taking those best practices, rolling them out internally, and now being able to take those and train franchise dealers across the nation. We have rolled those out. We've done a lot of training with our franchise dealers. Certainly, we have a long way to go. But it certainly shows that it's having some effect.

I'll share a couple of numbers with you. In the first quarter of 2009, we sold -- 25% of our sales were dealer consignment sales. In the first quarter of 2010, over 30% of our sales were dealer consignment sales. And I think it's important to note not only did we increase the percentage, but the raw number of vehicles increased as well.

We are seeing that continuing to trend up in April and we think this is a very good sign. We are very pleased with the initial results. And we look for this area to continue to grow.

And I think the thing that I would focus on with this dealer consignment initiative is this is not market share that we are having to take from anybody else. This is a whole new business that we have created. These are people that haven't been coming to auction, haven't been attending auction, and this is creating more business.

And I know when we get to Q&A, you're going to have concerns about the volumes at ADESA. We really think -- as well as taking some market share, we really believe that this dealer initiative and growing this new dealer business will largely offset the drop in volume at ADESA.

And then if I can just wind up before I get to Eric here, let me maybe take you back to where I started. And I want to talk about our diverse business model.

And I think that in itself is a very significant part of the value proposition at KAR, especially when you consider that we are number one or number two market position with all three of our business segments. We're not dependent on any one product or any one service. And I think that when you see this diversity that we have within KAR, I think that adds tremendous value to our investors.

And with that, I will speak to the guidance that we provided for you. On the last call, we said we would be somewhere in that $458 million to $465 million range of adjusted EBITDA. I am now very comfortable guiding you to the top end of that range.

And with that, I'm going to turn it over to Eric, and Eric is going to walk us through the financials. And I will look forward to answering some of your questions here in just a few moments.

Eric Loughmiller - ***KAR Auction Services - CFO***

Thank you, Jim. Yesterday, we reported our financial results for the quarter ended March 31, 2010. I will reiterate Jim's comment that we are very pleased with our performance in the first quarter.

Net revenues for the quarter of $458.4 million increased 4% from $442.5 million in the first quarter of 2009. Our growth in consolidated revenue was especially noteworthy, given the extremely strong revenue generated in the first quarter of '09 at ADESA.

Adjusted EBITDA for the quarter ended March 31, 2010 and was $120.1 million compared to $97.1 million for the first quarter of '09, an increase of 23.7%. Equally important to our strong EBITDA performance was the cash generation during the quarter. We closed the corner with $161.1 million of available cash. I will speak more about our cash generation and liquidity in a few minutes.

Now, let me speak to the performance of our business segments. I will start with ADESA.

ADESA's revenue for the first quarter of 2010 was $273.6 million compared to $288.3 million for the same period of '09. This decrease in revenue reflects a decrease in volume sold of just less than 10% for the first quarter of 2010 compared to the prior year.

Preliminary data released by the National Automobile Auction Association indicates industry volumes were off by 10% in the first quarter as compared to the prior year. Although volumes were below the prior year, we did see revenue per vehicle increase to about $560 per vehicle for the first quarter as compared to slightly less than $540 in the prior year. This strong revenue per vehicle was driven by increased auction fee revenue per vehicle, reflecting the selective price increases that were implemented late in 2009 and during the first quarter of 2010.

We also benefited from a weak US dollar in relation to the Canadian dollar, which contributed to increased revenue.

Although total ancillary services revenue for the first quarter declined from the prior-year by about $3 million, this was all volume related, as our ancillary services revenue per vehicle remained consistent with the prior year.

Gross profit of 43% for the first quarter of 2010 increased from 41% for the prior year. The improvement in gross profit reflects the strong conversion rate for the quarter of 68.7%, although it was down slightly from the prior-year conversion rate of 71.5%.

The lower conversion rate is directly related to an increase in dealer consignment vehicles sold in 2010 as compared to the prior year. Although dealer consignment vehicles convert at a lower rate than institutional vehicles, the slightly lower conversion rate was offset by the higher gross profit on these transactions.

Next, let me speak to the Insurance Auto Auctions strong first-quarter performance. IAAI had a 15% increase in revenue to $158.8 million for the first quarter of 2010 compared to $138 million for the prior year. Same-store volumes were flat year-over-year for the first quarter. We have seen very strong average selling prices for the vehicles sold, and this has provided higher returns to our sellers. This has also directly contributed to increased revenue per vehicle sold.

We were very pleased with consistent volumes at AIIA, as they had a very strong volume growth in the first quarter of 2009, and we were able to sustain this high level of performance in the first quarter of 2010.

Gross profit at IAAI for the first quarter was 41.1% compared to 33.5% in the prior year. The high level of gross profit reflects our operating model at IAAI. We were able to service our customers and generate higher revenues with only modest increases in the cost of services.

We did report higher SG&A costs for IAAI. However, these increased costs related to the increased incentive compensation associated with the strong performance in this first quarter at IAAI, and also increased non-cash stock-based compensation.

Now, I hope you'll bear with me. I've got to give you a few details about an accounting change which is a little bit boring, but important to understanding our financial statements.

We adopted FAS 167 at AFC. And consistent with other companies with securitized loan portfolios, we have a change in our accounting for the loans originated in the first quarter as compared to prior years.

This new accounting for securitized loans applies prospectively, and does not impact our previous reporting. There have been no changes to the structure of our securitization facility or the use of our bankruptcy remote wholly-owned subsidiary.

You will notice that we have included as a current liability obligations collateralized by finance receivables totaling $433.9 million at March 31, 2010. This represents the amount funded by our securitization facilities, and is offset by a corresponding amount included as a component of the finance receivable securitized on the asset side of the balance sheet.

Prior to January 1, 2010, obligations for the securitized receivables and the related finance receivable balance were excluded from the Company's balance sheet. We all know that as off-balance-sheet accounting.

The impact of this new accounting on our income statement is to include interest expense on our securitization in interest expense for the first quarter, as opposed to in prior years, we included this interest expense as a reduction in revenue. We have also eliminated the gain on sale accounting for loans sold into the bankruptcy remote subsidiary of AFC. This is consistent with everybody else in the industry with these types of facilities.

Last, we are now reflecting the entire provision for credit losses as a discrete reduction in revenue. Although our income statement presents $3.5 million in provision for credit losses in the first quarter of 2010, and compares to $0.6 million in the prior year, the actual credit losses recorded in the first quarter of '09 were $10 million, with a majority of this reflected net in the securitization income that we reported last year.

Notwithstanding this change in accounting, AFC had a very strong first-quarter result. The net impact of all these changes in the revenue line is a decrease in net revenue of $1.4 million for the first quarter of 2010. The 60% increase in net revenue in the first quarter we reported would have actually been a little higher had we not had the change in accounting.

Most importantly, the strong revenue performance resulted in an increased operating income for AFC. We have seen improved revenue for loan transaction and increases in the number of loan transactions for the first quarter of 2010 as compared to the prior year.

For purposes of computing adjusted EBITDA, we have reduced the interest expense addback by the amount of securitization interest expense in the first quarter of 2010. This results in comparable presentation of adjusted EBITDA for all periods presented in accordance with our debt agreement.

The impact of this change in accounting has been reflected in the first quarter due to the short-term nature of our loan portfolio. Accordingly, we have included an adjustment of $2.8 million for the change in accounting for securitization revenue in the first quarter. This is the full impact of the change, and we will not see a similar impact in future periods.

The holding company's SG&A costs in the first quarter of $18.8 million increased from $15.4 million for the prior year. This increase relates to the increased non-cash stock-based compensation expense and increased first-quarter healthcare costs.

As I mentioned previously, we had a very good quarter in generating available cash. We closed the quarter with $161.1 million in available cash, despite the fact that our first quarter is usually a quarter with more modest cash generation.

We also paid about $244 million for the early extinguishment of the 10% senior notes as we completed our tender offer in early January. We recorded a loss on this extinguishment of debt aggregating $25.3 million in the first quarter.

We also repaid $28.3 million of term loan B in the first quarter. This represents half the net proceeds of our securitization of Canadian finance receivables that was completed in February.

Capital expenditures in the first quarter were only $8.6 million. We continue to expect $75 million in capital expenditures for the year. Most of our capital expenditure projects this year and in past years are focused in the second half.

On a trailing 12 month basis, adjusted EBITDA through March 31, 2010 was $448.9 million. Our total debt, less available cash of $1.8579 billion at March 31, 2010 results in a net leverage ratio of [4.14 times].

Net income for the quarter ended March 31, 2010 was $8.1 million or $0.06 per share, compared to a net loss of $3.5 million or a net loss of $0.03 per share for the prior year. We feel an adjusted earnings and earnings per share, which excludes LBO, depreciation and amortization, stock-based compensation, and the loss on extinguishment of debt, all of these net of taxes, is a better reflection of how our performance compares to other companies. Our adjusted earnings per share for the quarter ended March 31, 2010 was $0.29 per share, compared to $0.09 per share for the prior year.

With respect to our outlook for 2010, Jim mentioned that we expect adjusted EBITDA at the top of our previously disclosed range of $458 million to $465 million. We also expect earnings per share to be at the top of the range of $0.40 to $0.45 per share we provided in our last call. And we are updating our expectations for adjusted earnings per share to the top of the range of $0.90 to $0.95 per share for 2010 as well.

I will now return the call to our operator to facilitate the questions. And thank you for your attending the call today.

QUESTION AND ANSWER

Operator

(Operator Instructions). Matthew Fassler, Goldman Sachs.

Matthew Fassler - ***Goldman Sachs - Analyst***

A couple of questions if I could -- one, on the salvage business and then one on the whole car business. If you could just recap for us within the salvage business, in terms of revenue drivers, volumes versus pricing? And as you discuss pricing, help us think about scrap metal and what you've seen there, and how much you think it influenced the strong performance in the quarter.

Eric Loughmiller - ***KAR Auction Services - CFO***

Matt, thanks for calling in. What I would tell you -- proceeds are driven by a combination of factors. And there's no doubt in a subset of the cars we sell, scrap metal is going to be a key driver. But in other parts of the cars, the higher value -- it's really a less significant portion, because there, you are looking at the availability of used cars and demand for repair parts.

So it's hard to weight it. But I would tell you I think the strong used-car values and the lack of supply in used cars was the most significant driver of really the outstanding revenue performance in that business. And on the bottom end we did get a little lift from the scrap metal prices. And that helps on all cars. But it wasn't as significant as really what we were seeing in the used-car retail industry as well as what was happening in the parts businesses that I know many of you follow.

Matthew Fassler - ***Goldman Sachs - Analyst***

Got it. A second question -- obviously, there are prospects for consolidation in the rental car sector. Different customers in that business have different approaches to trying to run their own auctions versus going through you or your competitor. What is your sense of how the evolving dynamic among those companies is going to impact the flow of revenue from that channel.

Jim Hallett - ***KAR Auction Services - CEO***

Matt, and I would say to you that first and foremost, as I mentioned before, rental car companies looking to optimize the various channels -- that's nothing new to us. That's something that's been going on for some period of time.

But in terms of some of these consolidations and possible consolidations that are taking place, we have very good relationships with all the rental companies. We have a very good relationship with Hertz. We have a very good relationship with the Avis, Budget people; the Dollar, Thrifty people who have must recently been in the news. And we don't feel that it will have any impact one way or the other, regardless of how these companies might consolidate. We are doing business with them all, and we're talking to them on a regular basis.

Operator

Chris Ceraso, Credit Suisse.

Chris Ceraso - ***Credit Suisse - Analyst***

A couple of things. You mentioned Toyota in your discussion about the whole car business. You said there would be some carryover effect. First, just to explain what you mean by that. And then if you can, give any kind of quantification about what the impact was in the quarter in terms of both volume and revenue from the disruptions at Toyota.

Jim Hallett - ***KAR Auction Services - CEO***

Chris, I would say that -- best put is that there was no question there were a number of vehicles that were taken out of the marketplace and that did not get sold in the quarter. Putting that in and quantifying that into numbers -- as I spoke with the folks at Toyota, they said certainly the majority of these vehicles got sold. But obviously there were some cars that did get pushed out into the second quarter. And that's probably as best I can quantify for you.

Eric Loughmiller - ***KAR Auction Services - CFO***

And Chris, let me add just a little flavor. Jim spoke to the inventory change. To be honest, if you look at the shortfall in sales this year compared to last, that accounts for the entire difference in our number of vehicles sold. So I really think what this is is, it really impacted how we would have offset some of that difference.

Jim Hallett - ***KAR Auction Services - CEO***

And maybe I can just add to that Chris, as I also talked about the disruption that it caused in the rental car business as well. And I think that probably speaks for itself. But as all these vehicles had to be pulled from the rental car fleets, it meant that the rental car fleets weren't able to continue with their regular cycle, just because they needed to keep these existing cars and service while these Toyotas were being fixed.

Chris Ceraso - ***Credit Suisse - Analyst***

Similar question on the weather. I think you mentioned that you lost six sales because of that. How much of that do you think you made up before the quarter was done? And do you have kind of a net figure on what you might have lost in terms of volume and revenue?

Jim Hallett - ***KAR Auction Services - CEO***

Well, I think I equated it to saying that we lost what we would consider to be the equivalent of six sales. And again, you don't really lose the commercial business. It's really the dealer business that you lose, because you don't get that dealer business -- you don't get a second chance for that dealer business to come back, where really, the commercial vehicles don't leave the property and they are just there.

However, I will say those vehicles have to be re-washed and re-parked and re-cleaned, and there is a labor cost associated with putting those vehicles through the second time. In terms of the dealer business, I don't think we regain that in the quarter. But we do see the dealer business being up again in April, being very, very strong in April, and exceeding the levels that we've seen in the first quarter.

Chris Ceraso - ***Credit Suisse - Analyst***

Okay. I know you probably don't have all the data yet, but do you have an estimate of what you think your market share was in dealer for the quarter?

Jim Hallett - ***KAR Auction Services - CEO***

Well, on market share, I think what we go back to is we go back to what we've reported most recently. And at the end of 2009, we reported that our market share was 22% at ADESA. And all I would say to that point is we feel confident that we are continuing to take share and gain share, but we don't have any specifics that we can share at this point in time.

Operator

John Murphy, Bank of America.

John Murphy - ***Bank of America - Analyst***

Just wanted to touch on sort of the channels of vehicle flow in the first quarter. And backing into the numbers, it looks like the dealer units were up about 8%, and the institutional vehicles were down about 16%. Is that 16% decline a function of what you talked about about the inventory being low?

And then second, on this dealer increase of about 8%, it sounds like April is going well. But do you think you can continue that trajectory through the course of the year?

Jim Hallett *- KAR Auction Services - CEO*

Yes, if I got your question, I'll take it in two parts. Number one, on the commercial side -- it's directly a reflection of inventory being low. Not having the inventory that we had coming into 2009. And also, I think it's pretty well established that as we go forward, those lease terminations, those lease vehicles are going to continue to decline, especially as we get closer to 2011.

On the dealer side of the business, we are very excited by those results and feel it's very sustainable. And I would say to you for the most part, we are really just getting started. As you know, we put together a team of people in the fourth quarter of 2009. We hired a vice president of dealer consignment reporting directly to our CEO at ADESA. And in turn, he hired three regional managers that were going to roll this business out to the various regions. And so there was a lot of training that took place. And all these best practices took place.

And we really didn't get the initiative -- really going to the dealer body until probably very close to the end of the year and I would say, really, in January of this year. And just from what we've seen from January to the end of the first quarter, with -- we feel not only is it sustainable, but we feel that this a huge opportunity to grow the business and offset some of the declines in other areas of the business.

John Murphy *- Bank of America - Analyst*

Great. And then the second question is, you mentioned on the e-business on the whole car side in ADESA, that 19 vehicles -- 90% of your vehicles were sold over the Internet. But how much of your vehicles passing through the lanes are receiving or being simulcast and actually receive Internet bids?

Jim Hallett *- KAR Auction Services - CEO*

Good question -- thank you. We offer 100% of our vehicles online. Every vehicle that you see running physically in the lane, that vehicle is also being broadcast simultaneously on our live block.

Eric Loughmiller *- KAR Auction Services - CFO*

And John, we have some very, very specific at IAA. And Jim spoke to how many cars receive a bid. I would tell you we are less refined in our comfort with the reporting on the whole car side. But when you're in the lane, you see an Internet bid pop up on a lot of cars. But it's not as meaningful, because again, we don't capture quite the same way yet.

So I think your question is, how many cars are receiving bids. It's a very large number but, I'm not ready to tell you a percentage, mainly because of the measurement of it.

John Murphy *- Bank of America - Analyst*

But they are all simulcast?

Eric Loughmiller *- KAR Auction Services - CFO*

But they are all simulcast.

John Murphy *- Bank of America - Analyst*

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Got it. And then just lastly, Insurance Auto Auctions is having a good performance on the cost side and the operating site. And you mentioned that Synergetics is just being beginning to be implemented this year. You won't expect any cost saves to really kick into the bottom line or the operating line until next year. What specifically is going on there? What additional actions are you taking in the Insurance Auto Auctions with that?

Eric Loughmiller *- KAR Auction Services - CFO*

I think that obviously we're looking at just overall at the structure -- the number of regions, the number of personnel that's required, how we can consolidate some of the back-office functions even here at the corporate office; how we can standardize some of these processes to become more efficient in the way that we do handle the business. I think it's just taking a look at the overall business and turning over every rock that we can and finding ways that we're able to save money through becoming more efficient, whether that's through technology or people or resources, and much like we experienced with the PRIDE project at ADESA that I spoke about.

John Murphy *- Bank of America - Analyst*

Just one follow-up, and I'll get off. Is there the ability to leverage your IT backbone, and potentially back-office functions at ADESA to combine them with Insurance Auto Auctions? Is there any opportunity to do that? Or is this just blocking and tackling with -- inside Insurance Auto Auctions?

Jim Hallett *- KAR Auction Services - CEO*

No, I think that there is the opportunity to consolidate those functions into KAR. And I'm going to let Eric speak to that, because he's been more involved with that initiative.

Eric Loughmiller *- KAR Auction Services - CFO*

Yes, John -- the answer is, this is really focused on Insurance Auto Auctions. However, while we haven't spoken about it specifically, we have already -- as part of the PRIDE initiative, as well as the integration of the ADESA impact -- businesses into IAA done a number of things to look at back-office IT operations and share skill sets, look at certain functions where we get efficiency out of serving the whole organization versus individual business segments.

So we've actually accomplished some of that already, and will continue to look at it. And there's probably opportunities in the future for, again, further efficiency.

Operator

Himanshu Patel, JPMorgan.

Himanshu Patel *- JPMorgan - Analyst*

A couple of questions. The $560 average revenue per unit at ADESA -- I think that compares to, I think, $530 to $544 or so in the prior four quarters. What drove the increase, and what's kind of your view on the sustainability of that?

Jim Hallett *- KAR Auction Services - CEO*

I think Eric mentioned in his comments that we implemented price increases at ADESA during the fourth quarter of 2009. And then maybe additionally, we did some selective price increases as we came into the new year. And I think they take full effect immediately, and I think we see that in the results.

Eric Loughmiller *- KAR Auction Services - CFO*

And Himanshu, also, when you look at all auction revenue per vehicle, it will be higher on a dealer car in total -- the sum of the buyer and the seller -- than it is on a commercial car. And so you're actually getting the benefit of that.

So that's not a price increase. That's the actually the mix of the higher seller fee that we get on the dealer car has really enhanced that number, which is why I pointed out to you -- the ancillary services revenue per vehicle was flat year over year. So you're seeing that increase which is -- again, you gave the numbers -- from just below $540 to up to $560 was all driven at the auction services level. And that's actually very good for our business.

Himanshu Patel *- JPMorgan - Analyst*

So if it's pricing and sort of -- customer mix that's really driving that, it sounds like that should be pretty sustainable through the balance of the year. Is there kind of anything funky in terms of seasonality, in terms of customer mix, that we should be thinking about that could change that around?

Eric Loughmiller *- KAR Auction Services - CFO*

The only thing that I've seen in the business -- I do think the customer mix might shift a little bit -- pretty consistent with what you see in the retail car sales. The dealer business is tied to trade-ins, isn't it, Jim?

Jim Hallett *- KAR Auction Services - CEO*

Absolutely.

Eric Loughmiller *- KAR Auction Services - CFO*

And so, there's probably periods during the year when there's less trade-in activity -- probably right before new model year introductions and things like that that occur, I think, late summer, fall. And then there may be incentives that offset that. We don't know, is the answer, Himanshu. I just don't want to predict it will be flat. But it will really tie to the mix.

Himanshu Patel *- JPMorgan - Analyst*

You mentioned tough comp at ADESA on -- I think you said conversion rates and volumes. I understand why that was happening a year ago. How would you characterize the Q2 '09 period -- or I guess the comp for the current quarter in terms of volumes and conversion rates at ADESA?

Jim Hallett *- KAR Auction Services - CEO*

You know, I would say that we expect the comps to be more favorable -- I think I mentioned earlier in Q2 through three and four. There's no question that different segments of the business are going to move around.

And obviously, we were down 10%, or just a few ticks under 10% in the first quarter. We certainly don't expect to remain down 10% for the entire year. And I will go back to the -- I will just point to the NAAA, National Auto Auction Association release, that their economist is predicting a total market of 9.3 million vehicles for the year.

Himanshu Patel *- JPMorgan - Analyst*

And Himanshu, last year's Q2 started very similar to Q1 and then really leveled off as that inventory had worked through. So if I were to describe the comps, I would tell you the toughest comp is Q1. And again, the relative comp gets easier as the quarters progress, with the fourth quarter having been really a fairly weak quarter as we reported in the conference call in February.

Operator

Rick Nelson, Stephens.

Rick Nelson - ***Stephens - Analyst***

You put up some nice increases in dealer consignment. Wondering if you can give us an idea of the differential in revenues per vehicle -- I think you just mentioned that they were higher, but also the margins and the conversion rates?

Eric Loughmiller - ***KAR Auction Services - CFO***

Well, what I would like to speak to is maybe the revenue. And then I will have Jim speak to the conversion rate, because as an operator in his past, he is the one that's on the ground knowing that.

On the revenue side, if you think about it, we've told you in the past and told our investors that it's -- typically it's 60% of the revenues from buyer fees and 40% is from seller fees. And that's across the whole of the cars we sell. When you go to a dealer consignment car, it is 50/50. It's essentially the same fee to the buyer and the seller.

And so, that blended rate -- I mean, I hope that gives you a flavor that it's 50/50. And so on the institutional side, it's actually greater than 60 and less than 40 on that individual transaction.

In terms of margins, again, auction revenue margins are very high -- and we've disclosed in the past, well over 50%. And that dealer consignment car, as you can tell, would be one of the strongest contributors to profitability when you are getting that. But Jim, speak to the conversion, because there's a little bit of offset because we handle more cars.

Jim Hallett - ***KAR Auction Services - CEO***

Right. I think the thing I would add to Eric's comment is with the dealer consignment car also, you don't touch that car nearly as often. The dealer consignment car usually shows up the day before or the morning of the sale, and you're really just handling that car on sale day, and a lot less touches and a lot less labor associated with processing that dealer car.

From a conversion standpoint, dealer cars convert at a lower level than what the commercial cars do. And just giving you some generalities, historically, I would say that dealer cars have always converted in that 40%, 45% range. And in this current market that we are in, where there is such strong demand, we're seeing extremely high conversion rates. And in some cases, we are seeing conversion rates almost touching that equivalent to what's going on with some of the fleet lease cars.

Rick Nelson - ***Stephens - Analyst***

Thank you for that color. Also, wondering if you could talk about the institutional business and how you are seeing the off-lease business -- how that may have impacted, and when do you see the biggest headwind coming in the off-lease vehicles as the year unfolds?

Jim Hallett - ***KAR Auction Services - CEO***

Well, there is no question that the institutional vehicles are down, and the off-lease vehicles are starting to decline. And I think that we're going to feel the biggest impact of that as we go into 2011. And I think that we are probably in for -- I think that's going to remain for probably somewhere in the area of 12 to 18 to 24 months, where that lease volume is going to be down.

There's no question that the manufacturers are getting back into the leasing business. We are originating more leases as we speak today that will be coming out of the pipe in two or three or four years down the road. But that segment is going to be down for a while and I think we're really going to start to feel that in '11 as I said.

But again, on the other hand, I think it's like we always talk about the different segments. There is ebb and flow to this business, where a certain segment will be up and it seems the other one offsets it. In the case of the lease business, we really feel that the things that we prepared for on the dealer consignment side of the business will significantly offset this drop in leasing.

Rick Nelson *- Stephens - Analyst*

Eric, if I could ask you just one more, on the SG&A if you could give us some visibility into that, ex adjustments? Obviously, depreciation does affect the SG&A. But should we assume that the other adjustments are in the SG&A account?

Eric Loughmiller *- KAR Auction Services - CFO*

Yes, again, the biggest adjustment, as you know, to EBITDA is the loss on extinguishment of debt, which is not. But the stock-based comp, and virtually all the others are heavily -- well probably over 90% related to SG&A, with a very small portion -- there's a small severance component that does hit cost of services, but that would be about it.

Rick Nelson *- Stephens - Analyst*

Thanks a lot. Good luck.

Operator

[Tony Costello], BB&T Capital Markets.

Tony Costello *- BB&T Capital Markets - Analyst*

First question -- just maybe a point of clarification. You talk about comparisons on the wholesale side for volume getting easier as the year progresses. Does it get easier to the point where that volume differential turns positive, or at least enough to where this strong revenue per unit is enough to offset the decline in unit volumes such that EBITDA is not negative year-over-year?

Jim Hallett *- KAR Auction Services - CEO*

Yes, I think it pretty much is level through two and three, and I think it will get stronger in the fourth quarter based on what we've seen in the fourth quarter of 2009.

Tony Costello *- BB&T Capital Markets - Analyst*

Okay. And then on looking at that then, if you look at your -- the guidance and sort of the affirmation of where you think things will be in the higher end of the range, is the mix of contribution to that EBITDA number today any different than you would've thought it would've been start of the year three months ago? Or do you still think each respective segment is going to contribute just as much as you thought?

Eric Loughmiller *- KAR Auction Services - CFO*

Tony, let me first speak to that. I would tell you that the strength of the performance at IAA probably exceeded our expectations going into the year in the first quarter. And if proceeds stay up, it will continue to exceed our expectations. If proceeds more normalize -- and by the way, normalize would be above the proceeds levels we had at the beginning of '09 which were really depressed -- it would change that mix.

But on the ADESA site, again, without talking about the individual EBITDA and what our expectations are -- again, we knew the supply was tight. We would expect again that it will perform especially as the rest of the year goes on, and probably contribute, again, as we get late in the year -- as much due to easier comps than anything.

That business -- Jim might remind them of the NAAA numbers. I mean, we're off 10% in the first quarter, as is the industry. NAAA is still not coming off of us being in the low end of that $9 million $10 million we've been experiencing in total industry volumes for over 10 years. So, that -- if that would happen for us, Tony, that would be a very positive event.

Tony Costello *- BB&T Capital Markets - Analyst*

Okay. And when you -- specifically to IAA, it definitely seems like the demand side is very robust right now and, there's -- even if you talk to some of the customers that are attending the auctions, it sounds like the number of incremental buyers is going up, and that's not only a function of supply on the salvage side, but also supply somewhat on the wholesale side, trying to find some vehicles that perhaps they can remarket in a different channel. Is that enough from a visibility standpoint for you to feel confident that the pricing dynamics are going to remain pretty favorable at least for the foreseeable future?

Jim Hallett *- KAR Auction Services - CEO*

I'm trying to understand it.

Tony Costello *- BB&T Capital Markets - Analyst*

I'm just saying, are you seeing an increase in new customers that are buying at your auction, or is the demand at auction coming from sort of an existing customer base? And then two, is the supply and demand such that the -- you are seeing more demand that is causing an elevated run rate on price that should be sustainable?

Jim Hallett *- KAR Auction Services - CEO*

Okay. Got it, and thank you for the clarification. I would say to you that -- it's the same base of dealers primarily. We continue to add dealers. But I think the most significant add is the number of franchised dealers that we are seeing in the lanes. Because of this tremendous drop in new car sales over the last couple of years, we are seeing more and more franchised dealers getting into the used car business. And quite frankly, the new car dealers haven't always been the best merchandisers of used cars, generally speaking. And I think in recent years they've had to get into the game.

And as you get those franchises -- as we say, as we get those suits in the lanes, they can really drive up the value of these cars because they feel very confident in their ability to take these cars back to the dealership and get them resold.

Eric Loughmiller *- KAR Auction Services - CFO*

And Tony, were you also talking about salvage?

Tony Costello *- BB&T Capital Markets - Analyst*

Yes I was.

Eric Loughmiller *- KAR Auction Services - CFO*

All right, on the salvage side, our live buyer attendance is up, and we measure that. Our number of registered buyers is up. And I don't actually have any breakdowns of the components of that. We continue to have great representation internationally, and we just continue to see a lot of people. But I think that's a function of the ability of people to make money with salvage vehicles.

And then, last, the Internet continues to be a way for people to participate in multiple auctions, and it's an efficient process, which is why we offer again the hybrid methodology. We offer them 100% on the Internet and physically.

But I mean, we're seeing increases across the board. But I would reiterate, buyer registration and buyer attendance is up in our salvage business.

Tony Costello - ***BB&T Capital Markets - Analyst***

I appreciate it; thank you.

Eric Loughmiller - ***KAR Auction Services - CFO***

We are short on time and I know there's a number of you in the queue. So perhaps we could ask one question at a time so we could try to get to everybody, because we really can't go more than a minute or two late. I know we were late starting; we might be able to give you a couple of extra minutes.

Operator

Scott Ciccarelli, RBC Capital Markets.

Scott Ciccarelli - ***RBC Capital Markets - Analyst***

I guess my question is kind of regarding the gross margin. I think because your proceeds per vehicle or per unit were higher, I think a lot of that winds up flowing through to higher gross margins. Now if we start to see prices normalize, is it fair to assume we'll see gross margins contract? Or is there something else possibly going on under the cover there?

Eric Loughmiller - ***KAR Auction Services - CFO***

Well, for now, Scott, I think, again, your observation that we are above -- we're in the 43% range, that's abnormally high. If proceeds were to drop, you would probably see revenue drop and our cost structure remain fairly -- there would be a small cost savings, perhaps. But you would see those margins -- and we've told you in the past, those margins are more like 40% margins on an ongoing basis than 43. But the proceeds are what would drive this a little above that. Or as we experienced in '09, below that when the proceeds were so low.

Scott Ciccarelli - ***RBC Capital Markets - Analyst***

Okay. I'll pass it on. I'll follow up after.

Operator

Gary Bisbee, Barclays Capital.

Gary Bisbee - ***Barclays Capital - Analyst***

Just want to ask a little question. You talked about building this sales effort or team of folks to go after the dealer business. Can you just give us a sense of exactly how -- what they are doing, what their responsibility is? Is it just sort of visiting the dealers and explaining service offering, is it trying to go win business from others who have already visited these dealers?

And then how quickly do these folks ramp? So are they sort of there doing the job now, or could we expect over the next few quarters they're going to get better at what they are doing as they season with the Company there?

Jim Hallett - ***KAR Auction Services - CEO***

Your last point is -- I hope that we always continue to get better. I think it's continuous improvement.

But let me start with saying, these people are going to the dealers, and they are really taking them a basket of goods or a basket of services.

And they are helping the dealer not only understand the value of being able to buy and sell at the auction, but also the value of our ancillary services, how to better prepare the car, how to present the car for sale to get the best proceeds. They are teaching them how to use our technology, how to post cars on our Dealer Block technology which is our static bulletin board site; how to how to post cars, how to buy cars on that site, how to buy cars on our Live Block simulcast; teaching them how to get better pictures taken, but get better condition reports uploaded.

It's just -- you know this business has changed dramatically over the last four or five years, especially with the growth that we've seen on the Internet. And I think a lot of dealers are still, I guess, reluctant to really dive in and really understand a lot of the services that we provide.

And I think it's just going out there and saying to the dealer almost -- you don't have to be afraid of this stuff. And it's really quite simple. And let me help you understand not only the auction and how it functions, but the services and technology, and just getting him very, very comfortable with wanting to do business with us -- and then, really developing a relationship at the local level, where there is a relationship; he has a direct access to the general manager or a direct access to a dealer consignment manager, somebody that he can call and he can get a quick answer from or, just get some direction from. So it's just generally training.

Gary Bisbee - ***Barclays Capital - Analyst***

Okay. And are they paid on a commission based on volumes from the dealers they work with?

Jim Hallett - ***KAR Auction Services - CEO***

They are paid for every single car they bring to the -- that gets sold at the auction. So it's on a commission basis. And every additional car they are paid a commission. And there is no limit to the amount of money that we will pay them.

Operator

Craig Kennison, Robert W. Baird.

Craig Kennison - ***Robert W. Baird - Analyst***

I will keep it brief here. Eric, could you comment on what you see conversion trends headed? I know you said elevated, but might they decline a little bit? And also, comment on where you see debt going in your leverage? Thanks.

Eric Loughmiller - ***KAR Auction Services - CFO***

All right, Craig. In terms of conversion rates, it's hard to predict because there's so many factors. We continue, though, to see them being really high relative to historical levels, where it hovered around 60%, right, Jim?

Jim Hallett - ***KAR Auction Services - CEO***

Right.

Eric Loughmiller - ***KAR Auction Services - CFO***

And again, there's a lot of things that contribute to that. But strong demand and the tight supply should keep conversion rates up. Dealer consignment becoming a higher part of the mix puts a little pressure. But that took it again from low 70s to high 60s. It wasn't a big move in this quarter, and we wouldn't expect it to be a big move in future quarters.

Relative to debt, again, we are building cash. We told you that our focus is to delever the Company. But our current term loan B is at a very low -- that part that has not been fixed through a swap is very low interest rate. So again, we'll study that later in the year. But again, we remain focused on delevering. And we will be sure to let you know when we are going to make a debt payment. But at this point, I don't have anything planned, and we will just continue to study it as to when we make any payments on our debt.

Operator

Gary Prestopino, Barrington Research.

Gary Prestopino - ***Barrington Research - Analyst***

I will be brief. Were there any was there any acquisitions in the mix there on for Insurance Auto? Is that all straight comparison without acquisitions?

Jim Hallett - ***KAR Auction Services - CEO***

No, Gary, that's all straight comparison.

Gary Prestopino - ***Barrington Research - Analyst***

Did you guys get a fee increase like on the wholesale side at IAAI, or is that just all related to pricing of cars?

Jim Hallett - ***KAR Auction Services - CEO***

At IAAI, we have taken what I would refer to as a standard annual increase in price on the buy side.

Eric Loughmiller - ***KAR Auction Services - CFO***

Yes, and it was on the buy side. And our last -- I mean, again, we don't give a lot of details on this, Gary. But our last increase was in the latter part of the first quarter of last year. So it was actually in March.

Gary Prestopino - ***Barrington Research - Analyst***

Okay and then just real quickly one last question. The direct expense on the ADESA side -- ancillary services are in that direct expense number. So as you do more dealer cars, you would expect that to trend down relative to the top line?

Jim Hallett - ***KAR Auction Services - CEO***

Yes, they are higher-margin. I am coming at it backwards, Gary. You are correct. As you do more dealer cars, the cost of services is lower.

Operator

We have no further questions.

Jim Hallett - ***KAR Auction Services - CEO***

Okay, great. I just want to take a moment and thank everybody for being on this morning. Again, we are very pleased with the quarter. We remain very encouraged with what we see in terms of going forward for the balance of the year. And we look forward to updating you next time around. So with that, thank you, and have a good day.

Operator

This concludes your teleconference. Thank you for your participation and you may now disconnect.