

FINAL TRANSCRIPT

Thomson StreetEventsSM

KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

Event Date/Time: May. 04. 2011 / 3:00PM GMT



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

CORPORATE PARTICIPANTS

Jonathan Peisner

KAR Auction Services, Inc. - VP and Treasurer

Jim Hallett

KAR Auction Services, Inc. - CEO and Director

Eric Loughmiller

KAR Auction Services, Inc. - EVP and CFO

CONFERENCE CALL PARTICIPANTS

Tony Cristello

BB&T Capital Markets - Analyst

Chris Ceraso

Credit Suisse - Analyst

John Lovallo

BofA Merrill Lynch - Analyst

Rick Nelson

Stephens Inc. - Analyst

Gary Prestopino

Barrington Research - Analyst

Avi Fisher

BMO Capital Markets - Analyst

Ryan Rinkson

Goldman Sachs - Analyst

Craig Kennison

Robert W. Baird & Company, Inc. - Analyst

Patrick Palfore

RBC Capital Markets - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the KAR Auction Services, Inc. first-quarter 2011 earnings conference call. Today's call is being recorded.

Today's host will be Jim Hallett, Chief Executive Officer of KAR Auction Services, Inc.; Eric Loughmiller, 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. - VP and Treasurer*

Thanks, Anna. Good morning, and thank you for joining us today for the KAR Auction Services' first-quarter earnings call. Today, we will discuss the financial performance of KAR Auction Services for the quarter ended March 31, 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.

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

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. Such risks are fully detailed in our SEC filings.

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

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

Great. Thank you, Jon, and good morning, ladies and gentlemen. Let me add my welcome. We have much to discuss, so let me get started with saying that things remain much the same as we've discussed over previous quarters. The supply remains tight. The Company continues to focus on our leverage and paying down our debt, and adjusted EBITDA and earnings are up.

KAR revenue for the quarter was up 5%; our adjusted EBITDA was up 6%; and I think this speaks to the complementary nature of our business model. There's no question that we continue to talk about the tight supply on the whole car side of the business. I believe that we'll continue to see this tightness for the next 12 to 18 months.

But with that said, I'm also very pleased at how KAR continues to perform on a consolidated basis. I also am pleased to recognize that our businesses continue to be strong generators of cash. With that, a couple of trends that we're seeing in the industry is the SAR continues to rise in 2011. I think that most of the economists have us somewhere between 12.5 million and 13 million units. There is some talk that the recent events in Japan will maybe tick that number back closer to the 12.5 million. We don't necessarily see that. This is really a supply issue, not a demand issue.

And if you think about all the parts that are being used by collision shops, about two-thirds of those parts are new, so I think that this is a potential benefit for insurance auto auctions.

Maybe other news and better news is that leasing appears to be back. J.D. Powers, ALG and R.L. Polk have all reported increases in leasing. In fact, Polk has reported that lease penetration rates are at their highest levels since 2007, further confirmed by CNW, who announced that leasing is now at 27.5% of overall new-car originations. And yesterday, Allied Bank reported that their leasing is now at 16%. And when you consider that it wasn't that long ago they were at zero, that's a significant increase. So I'm very much looking forward to the homecoming party.

With that said, as we look at our business units, ADESA volumes are down, down less than 6%. We believe that this compares very favorably with the industry. Our dealer consignment initiative continues to do very well. Volume on dealer consignment was up 18% in the first quarter over 2010 Q1. And our dealer consignment volume or our mix is now at 38% of our total volume, the highest it's been since 2007.

Insurance auto auctions continues to perform at a very high level. We see double-digit growth in both revenue and adjusted EBITDA. We certainly benefit from the margins, from the average selling price, as well I would say, that we benefit from the [Synergetics] project that we've installed at Insurance Auto Auctions. As you know, that Synergetics project is really an efficiency standardization program. We started that project a little over a year ago. Although it's been rolled out, we continue to turn rocks over on a weekly basis.

Auction volumes at Insurance Auto Auctions were up 4%. This is due to a couple of reasons. I would note that we've increased our sale of non-insurance vehicles. As well, we've increased our business with our major insurance suppliers as well. I think it's important to note that this business is still primarily focused on serving the insurance industry, and over 85% of our customers continue to be insurance customers.



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

AFC continues to be a bright light for us. Our revenues at AFC were up 50%; adjusted EBITDA was up over 40%. This has been driven by the growth in the number of loan transactions and the revenue per transaction. I think it's important to note that we continue to have very disciplined growth at AFC. The portfolio remains over 99% current.

KAR has been in the news recently. Over the last week, we made two major announcements, which I'll speak to. First, we announced that we intend to refinance a significant portion of our debt. The goal would be to extend their maturities and improve our ability to pay down debt in the future. And we'll keep you updated as we have more news.

Secondly, we announced that AFC has amended its US securitization. We have increased the size of the portfolio to \$650 million. The maturity has been extended through June of 2014. I believe this puts us in a position to take advantage of additional market opportunities.

Since we last talked, a couple of things I had the opportunity to be involved with. I had the opportunity to attend Insurance Auto Auctions' charity processor meeting. Many of the charities and many of the charity processors were represented. And I believe, to the best of my knowledge, this is the first time that a conference of this nature has been held where the charity processors and charities have come together in one room, facilitated by Insurance Auto Auctions, and the opportunity to discuss best practices and how they can best utilize the salvage auctions to improve upon their proceeds for their donated vehicles.

And later this month, I will have the opportunity to attend the ADESA Client Advisory Meeting. This is an annual meeting where ADESA invites in all of their remarketing customers -- an opportunity for ADESA to kind of give the state of the nation and tell our customers some of the things that we've got in the works; some of the new products and enhancements that we're planning on rolling out, as well as it gives the customers a voice to voice their concerns about their needs and their requirements, and how their remarketing needs are being serviced.

Very pleased to announce that our Internet sales in the first quarter were at 24%. We announced to you at the end of 2010 that we finished the year, 2010, at 22%. And as you can see, that number continues to increase. And I believe it continues to demonstrate the significance of technology within our industry, and I will come back and talk more about that just before Q&A.

Also pleased to announce that ADESA is going to open our newest location -- ADESA Las Vegas will open in the second week of June. We're extremely excited with Las Vegas. It's been a hole in our footprint in a market that we've wanted to be in for some period of time. But I think even more than our excitement is the excitement of our customers. There has been no competitive alternative in Las Vegas, and customers have lined up and I believe they're ready to support us and support the ADESA Las Vegas in becoming a success right out of the gate.

So, with that overview, I'm going to turn it over to Eric Loughmiller, who is going to walk you through our financial performance. And just before Q&A, I will come back with a little bit more commentary. So with that, Eric.

Eric Loughmiller - KAR Auction Services, Inc. - EVP and CFO

Thank you, Jim. I would like to start with just a few additional comments on our performance in the first quarter. First, I would like to speak to our 5% consolidated revenue growth.

It is obvious that Insurance Auto Auctions is enjoying a strong market for salvage vehicles, generating 11% growth in revenue this quarter. As people keep cars longer and the average age of a vehicle on the road increases, it is reasonable to expect strong demand for aftermarket recycled parts.

We are experiencing this strong demand for aftermarket parts right now and IAA benefits, as the average selling price of vehicles improve. But even more encouraging is our 4% increase in volume this quarter.



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

ADESA, on the other hand, is facing some real secular pressure with the shortage of supply of used cars. Obviously, this creates a very strong pricing environment for used cars, and we continue to see strong retail used car sales which would support this pricing. This is why we have believed all along that there will be more dealer cars coming to auction.

Our 18% increase in dealer volume this year compared to last was a strong performance, given that Q1 2010 also had strong growth over 2009. This is further evidence that more dealer cars may be at the auction, as the institutional volumes remain low.

I would also like to highlight the growth in AFC revenue. AFC revenue grew 48%. But more importantly, interest and fee income grew 36%, representing the majority of this revenue growth. I am not sure anyone outside of the Company focuses on the fact that AFC is another revenue source from our auction customers.

The fact that we have a comprehensive service offering that includes providing floor plan lending is truly a differentiator for us in our markets. I know this is a different way to look at things, but offsetting the 2% decline in ADESA revenue was an increase in AFC revenue. As most of you know, when we talk about our businesses in presentations, we talk about ADESA inclusive of AFC, as ADESA and AFC have the same general customer base. And floor planning is often described as one of our services we offer post-auction.

Our combined revenue for ADESA and AFC who was \$306.8 million for the first quarter of 2011 compared to \$299.6 million for 2010, an increase of 2.4%.

I would also like to highlight our gross profit. We achieved 45.5% gross profit in the first quarter, up from 44.2% in the prior year. We spoke to you last year about our Synergetics initiative at Insurance Auto Auctions, and this is contributing to improved gross profit. Clearly, increased ASPs are driving our gross profit above 40% at IAA; but the focus on cost, even in a robust salvage industry environment, is the reason we were able to experience 42.9% gross profit in Q1 compared to 41.1% last year at IAA.

You may recall that a year ago, I mentioned that gross profit above 40% at IAA was not likely sustainable for the long-term. Well, our team at IAA has proven that even in the strongest selling environment, there is still room for operational improvement and improving gross profit.

From a free cash flow perspective, we had a strong first quarter. We generated over \$80 million in cash from operating activities. Our businesses continued to be strong generators of cash, and expect to continue to having strong cash flows throughout the remainder of this year. Our capital expenditures in the first quarter totaled \$16.1 million.

Now I would like to speak to a couple of other items. First, as Jim mentioned, we completed the new US securitization facility last week that gives us additional capacity. Our US facility now runs to June 2014, and we expect our Canadian facility to be extended through that same date. With our new US facility, we will see a very modest increase in interest costs for the amounts borrowed of about 0.5%. We are very pleased with this new agreement.

We also launched the effort to refinance our debt. We have proposed a \$1.5 billion senior term loan B facility with a \$250 million undrawn revolving credit facility. The proceeds of this new credit facility, if we're successful, would be used to retire our existing senior term loan B due 2013; all remaining 10% Senior Subordinated Notes; and a portion of the 8.75% senior notes. As part of the transaction, we anticipate utilizing \$20 million to \$25 million of our available cash to cover a portion of the fees, expenses and redemption premiums incurred in the refinancing transactions.

Last, I would like to explain something in our accounting for stock-based compensation. In my visits with investors either at conferences or in one-on-one meetings, over the past two months, I have identified what I believe is a misunderstanding of our stock compensation plans. Most investors I speak to do not realize that we have two types of options.

First, we have a few hundred key managers and officers that have incentive stock options that permit them to purchase shares of common stock at a strike price determined at the date of grant. A portion of these options are vested due to years of service,



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

but most vest upon attainment of a specified stock value, with the first vesting occurring when our stock trades at that value for 90 consecutive trading days.

The compensation expenses for these options is fixed, and will be recognized in 2011, '12, and '13 in addition to what we recognized in the past. In fact, the amount of expense in 2012 and '13 will decline from the current levels.

Most investors I speak to understand these options and their potential dilution. They are very comparable to what we see at other public companies. However, the second type of option is our profit interests in KAR Holdings to LLC and Axle Holdings II LLC.

The profit interests are held by a limited number of executives and are considered liability awards. Because these are liability awards, the changes in our stock price directly result in compensation expense; or, if our stock price were to decline from one quarter to the next, it would be a decrease in previously recognized compensation expense. However, while this is hitting our income statement similar to our other options, the profit interests are unique in both how value is realized and their vesting.

The profit interests cannot result in the issuance of common stock and are not exercisable into common stock. Further, no cash will be paid from the Company's balance sheet to satisfy an obligation under these awards. Holders of the profit interests are only entitled to a portion of the return earned on the original equity investments by our private equity partners and management. There is no dilution to our public shareholders as the value of the profit interests that will be received by the executives is a portion of the gain realized by the original LBO investments.

The realization of value for the profit interests will not occur until substantially all of the ownership of the private equity and management group is monetized through a transaction or a series of transactions. The documents necessary for you to evaluate what I've just told you are all publicly available in our various filings.

Now let me comment on our annual guidance, which remains unchanged from our last call. We expect 2011 adjusted EBITDA of about \$500 million, which translates into earnings per share of \$0.75 to \$0.80, and adjusted earnings per share of \$1.20 to \$1.25. Although a number of discreet tax items were recognized in the first quarter, resulting in an effective tax rate of 2.5%, these items were contemplated in our annual guidance for the effective tax rate of 30%. Accordingly, I want to be clear there is no change in our expectations for the effective tax rate in 2011.

So now let me turn it back to Jim and he'll give you a few concluding remarks.

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

Great. Thank you, Eric. And just before we go to Q&A, I want to take a few minutes and elaborate on my technology vision for our companies.

Oftentimes when I'm on the road or I'm with investors, I get asked, what keeps me awake at night? And quite frankly, in the past, I've kind of struggled trying to answer that question.

But I can tell since I became the CEO of KAR in September 2009, there's no question that technology is on my mind on a very regular basis. As I say to the group here, I go to sleep thinking about technology and I wake up thinking about technology. And I want to assure you, I do not fear technology -- quite the opposite. In fact, I embrace technology. And I think I believe I have a vision and an understanding of how technology will differentiate our businesses going forward.

I have been spending a significant amount of time studying technology -- technology that's used in our industry; technology that's used by our competitors. And I've even had an opportunity to study other technologies in other businesses as well,

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

unrelated to the re-marketing business. I'm very focused on driving innovation and making technology -- making KAR a technology leader in all of our businesses.

One very recent example I'd like to share with you is we have just completed the roll-out of a new Internet selling platform with one of ADESA's largest customers. And this was really a true sense of partnership. We worked very closely with the customer. They spent a considerable amount of time in our building here in Carmel, Indiana. We spent a considerable amount of time in their headquarters.

Our two groups worked together to develop the content and the specs, the timelines and the rollout. And it was very, very successful. And I think this is just one indication of how we are now cooperating or operating with our customers on a one-on-one basis to develop customized solutions for their remarketing needs.

And I'll share with you where I get my inspiration and my motivation for technology. And I get that from Insurance Auto Auctions. You know, I've had the opportunity to be involved in Insurance Auto Auctions since 2007. But even prior to that, I've watched how technology has really led the way on the salvage side of the business. I believe there's no question that the salvage side of the business is ahead of the whole car business when it comes to technology and innovation, and what they've been able to do.

I also believe that Insurance Auto Auctions is clearly become a leader in terms of the technology that they provide, not only to their employees, but to their customers around the globe. And my goal is that all of our businesses would be recognized as technology leaders. I can tell you as CEO of KAR, I can promise you that I'm very focused on how we continue to advance our technology. And I believe that you will see, as we go forward, we will continue to roll out new technologies, new enhancements that make it easier and more efficient for customers to do more business with us.

So, wanted to share that with you. And with that, I'm going to turn it to our Operator, and we'll go to Q&A. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Tony Cristello, BB&T.

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

Based upon the quarter and, certainly, the balance models show through, but it appears when you look at the [NAAA] numbers, you outperform the industry on the [core] car side. And it definitely is apparent that the dealer consignment initiatives are gaining traction. Do you think that the dealer consignment initiatives are ahead of plan and perhaps the overall contribution may end up being better than you initially expected?

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

Well, Tony, I would say that we are pleased with where we are. I'm not sure if we have a finish line in mind. There is no finish line, as we say.

We're very pleased with the results and we would agree with your statement that we feel we have outperformed the market. And we just continue to focus on this area of our business; continue to add more resources as we go along. And I would say that we would think that we're not done yet. We think there's more opportunity on the dealer consignment side of the business, and -- especially during these next 12 to 18 months.



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

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

Is driving the growth of the dealer consignment business -- once you get that infrastructure in place, is the incremental benefit easier to obtain? Well, you talked about the next 12 to 18 months, but I'm just trying to think about your ability to continue to extract growth on that channel.

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

There's no question that, as you implement these best practices and you put these processes in place, you put the resources in place, and you do these during the difficult times, then there's no question that you look for the benefit of those to carry on as the good times, as we would say, as the good times return.

So there is continued benefit going forward. And even as the lease cars return and that market comes back, we will never take our focus off dealer consignment. Because we recognize that, in the past, we probably neglected dealer consignment to some point. And we realized what a significant opportunity this was. And you said it as well as anyone, where it's showing up in the numbers.

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

And Tony, I'll add to -- let me add to that. There's still execution every day. The car we sold last week won't be sold next week. We've got to get that next car. So the dealer consignment, what Jim talked about in best practice, is how we can have a more consistent execution with that customer base. And I think we're demonstrating that we can accomplish that.

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

And then just as a follow-up, when you look at the success you've had here on dealer consignment, is that in part related to some of the success you've then seen in the non-insurance vehicle growth? I mean, volume up 4% in what has been sort of a flattish industries is very solid as well.

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

You know, Tony, when I spoke about the 4% volume increase [that] Insurance Auto Auctions, that is due to some non-related insurance business that I spoke about, both on the [VRD] side and the charity side. But I would also want to acknowledge that we've had growth with our insurance customer base as well. So, to your point, it's a little bit of both.

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

Thank you.

Operator

Chris Ceraso, Credit Suisse.

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

Chris Ceraso - *Credit Suisse - Analyst*

A couple of questions about the supply. You talked about the fact that it was tight. We've been hearing from some of the OEMs, particularly the Japanese car companies that, given constraints in new vehicle inventory, they've been trying to hang on to more used vehicles and sell them in their certified pre-owned channel. Are you seeing some of that in recent weeks in terms of even tighter supply in the used market? And what's your expectation of that impact over the next couple of quarters?

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

Yes. I can't say that we can specifically say that we're seeing that, but I can say that we somewhat expect that. We expect that with a couple of manufacturers -- and you can probably name who they are -- with a couple of manufacturers that we would think that supply is going to get a little bit tighter. And I think that all dealers are holding onto as many used vehicle trade-ins as they possibly can. I would expect that as we go forward, that those manufacturers will try, as we say, squeeze more vehicles and put them into their retail marketplace.

But on the other hand, I think it really creates an opportunity for us. Number one, it's going to drive the sale prices of those used vehicles. And it's going to make them increasingly difficult for these dealers to buy, which is going to drive prices. And obviously, when we drive price, that's a good thing for our customers and for us as well.

Chris Ceraso - *Credit Suisse - Analyst*

Okay. And then, Eric, you mentioned the 40% gross profit figure for the salvage business. You thought maybe that wasn't sustainable but the team has proven that they can get there. Have you changed your view on that? Do you think they can keep it up at that level?

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

Well, what I will say with the average selling prices being so strong, Chris, yes, it looks like they're -- I mean, we did it all of last year and this year started the same. What I'm really counting on is not that 40% is the standard, but we can improve -- previously, I told you that that business can run on a high 30s margin; well, we're improving upon that. I'm not really quantifying it to a specific number.

Chris Ceraso - *Credit Suisse - Analyst*

So in the near-term, as long as prices stay this tight, maybe they can do that longer-term, high 30s-plus is more likely?

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

I think it's a distinct possibility. I would hate to talk likelihood with you, Chris, because I think we would all argue that the likelihood that the ASP stayed as high as they are as long as they have, might have been less probable than what it's turned out to be.

But I mean, it's a tough thing to predict. And we continue to improve on our businesses. You know what? We're not satisfied -- what I'm really proud of the IAA team for is they're not satisfied with just doing what the goal was. They're outperforming that goal and doing it over a sustained period of time. And so I think they'll continue to be top performers in their industry.

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

Chris Ceraso - *Credit Suisse - Analyst*

Okay. And then just one kind of model question. You mentioned the low tax in the first quarter was contemplated in your full-year guidance. Does that mean in the subsequent quarters we'll see a rate that's higher than your full-year guidance?

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

Well, we don't give quarterly guidance, Chris, yes. That's a fair assumption for you to make.

Chris Ceraso - *Credit Suisse - Analyst*

Okay. Thank you very much.

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

Because the 30% is the annual number we expect.

Chris Ceraso - *Credit Suisse - Analyst*

Okay. Appreciate that. Thanks.

Operator

John Murphy, Bank of America Merrill Lynch.

John Lovallo - *BofA Merrill Lynch - Analyst*

This is actually John Lovallo on for John Murphy. Thanks for taking the call. (multiple speakers)

On the IAA side, you mentioned some of the initiatives that you guys have in place to help improve volume. I was just wondering, in the quarter, how much of the benefit, if it's quantifiable, was due to the tough winter that we had?

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

Well, here's the good news for you. We know that from the time of an accident, and the car ends up on our lot to the time we sell it, averages something, call it, 75 to 90 days. So, a lot of what you're talking about in the winter weather is still in process.

At the same time, we don't give any guidance beyond the volume. What Jim mentioned and I mentioned, though, our insurance business remained a very strong component, over 85% of our volume. And that does reflect weather patterns, driving habits and all of that, John. So, you know what? I also think we're past some of the issues in the insurance industry, that would tell you were people under-insured or uninsured. I mean, again, that seems to be an issue that's behind us as well. So again, strong volume in the industry; strong volume at IAA.

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

John Lovallo - BofA Merrill Lynch - Analyst

Great. That's helpful. And one last one here, more of a high level question. How do you guys think about the trade-off between higher used vehicle prices driving potentially higher selling prices, at the same time resulting -- and probably resulting in fewer cars being scrapped?

Jim Hallett - KAR Auction Services, Inc. - CEO and Director

Yes, I think, given the situation, obviously, we'd like to see a return to higher volumes. I think higher volumes in more transactions is probably more of an opportunity for us than strictly high sale prices.

John Lovallo - BofA Merrill Lynch - Analyst

Great. Thanks very much, guys.

Operator

Rick Nelson, Stephens.

Rick Nelson - Stephens Inc. - Analyst

I wanted to discuss conversions fell again this quarter. Can you talk about the trends in conversion on the dealer consignment area as well as the institutional side? And are you seeing any changes in that conversion on the institutional side or dealer consignment, given -- (multiple speakers)?

Jim Hallett - KAR Auction Services, Inc. - CEO and Director

Yes, I think, overall, Rick, I think that dealer consignment business tends to convert at a lower percentage than the commercial business. And that's always been the case.

And dealer consignment is converting at a higher rate than what we've been used to in past years. But certainly, it's not converting at a rate anywhere near the level that the commercial vehicles convert at. And we've always said that the commercial vehicles, depending on whether it's fleet, lease; whether it's rental, repo, or a factory car -- those vehicles convert somewhere in the neighborhood of 70% to 90%. And they're still converting at those rates.

The dealer consignment vehicles we've typically talked in past years of being in that 40% to 45%. I would say that those conversion rates are up significantly, and in some cases, we're seeing conversion rates on dealer consignment over 60%.

Rick Nelson - Stephens Inc. - Analyst

And do you think the supply shortages -- or the looming supply shortages are going to push that ratio still higher? And then the prices on the used cars continue to rise? Is that kind of having a negative influence on conversion rates?



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

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

I believe that we will continue to see more and more dealer cars selling. There's no question -- these are replacement cars, so to speak, for a lot of commercial cars. So we're getting the natural tailwind of that. So I believe the dealer will increase; I believe the conversions will continue to increase.

And I think you had a second part of the question -- I'm sorry, would you mind just repeating it for me?

Rick Nelson - *Stephens Inc. - Analyst*

The upset, I guess, because the prices on used cars are higher has had a negative impact on the conversion rate.

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

I don't believe so. I think the pricing, at some point in time, as Tom Kontos, our economist, would say, there comes an inflection point at where the consumer makes a decision, do I buy new or do I buy used? You know, I think we reported recently that once a used car gets to be about 60% value of a new car, then the consumer really has to start to take a second look at whether I go new or whether I go used. So, I don't think the conversion will get affected as much as maybe the mix may get affected going forward.

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

And Rick, the other thing I'd add is -- and Jim knows this from his history as an automobile dealer -- you know what? When you're giving those trade-in values, and then you find out, hey, I'm not moving that car as quickly as I'd like, but you can go to a wholesale auction and get a strong price, you don't hold that car as long on the lot probably -- because you can convert it to cash, get your money out of the car, put it into a car that you can sell on the lot.

That's what we're talking about, right, Jim? Moving that inventory around the dealer network, because that car will sell to somebody.

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

Absolutely.

Rick Nelson - *Stephens Inc. - Analyst*

Okay. Thank you for that. Eric, I'd like to ask you about the SG&A. It's difficult for us to analyze, given the adjustments, but it appears as if the ratio widened versus last year. If you could provide some color there.

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

Well, yes. First and foremost, I think if you took the SG&A net of add-backs -- and I know we don't make that the easiest number to come up with -- but a majority of our add-backs do hit SG&A. You don't see a major shift. And in fairness, that's how we run the business.

I mean, a big component of SG&A this quarter is stock-based compensation, which is non-cash. And we will be filing our 10-Q tonight -- or we expect to file it tonight. But in there, we're giving you a breakdown between the profit interests. And one of the things that you'll see when you get that information -- I'm not going to give you the number on the call -- is that the amount

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

of profit and interest expense in the first quarter was higher than the total we had recognized in all of 2010. And that all hit SG&A.

Rick Nelson - *Stephens Inc. - Analyst*

Okay. (multiple speakers) Thank you for that and good luck.

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

Yes. And I think what I'm basically saying is our cash outlay on SG&A has not increased as much as what you're seeing in the accounting line SG&A.

Rick Nelson - *Stephens Inc. - Analyst*

Got you.

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

Thank you, Rick.

Operator

Gary Prestopino, Barrington Research.

Gary Prestopino - *Barrington Research - Analyst*

Most have been answered, but do you have what the percentage of the dealer cars was last year of your volume in the first quarter?

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

Gary, we do not. And the reason we do not is, as we were giving the growth rate, we did not give it out last year. I don't have it in front of me. It was much lower. But for last year, we were in the low 30s. The number was growing. We did give directional guidance a year ago where it had moved just above 30%. I read that in our script. But you know what? What we've learned throughout the year is -- we didn't give you numbers. So to give you the number now wasn't useful, but it's increased substantially.

Gary Prestopino - *Barrington Research - Analyst*

And I assume there was some cars in there from the Premier acquisition?

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

Pardon me?

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

Gary Prestopino - *Barrington Research - Analyst*

The Premier -- the Premier Auto Group acquisition -- there were some cars in there this quarter?

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

Yes, there were cars in there. Again, that was a very insignificant transaction. We don't call it out. It did not have a big impact on our growth number, so we're not focusing on a same-store number like retailers do.

Gary Prestopino - *Barrington Research - Analyst*

Okay. Thanks.

Operator

Avi Fisher, BMO Capital Markets.

Avi Fisher - *BMO Capital Markets - Analyst*

The ADESA, the implied ADESA vehicles entered was down about 3%, which, given the expectations that supply would be a major headwind. How does that compare to what you thought going into the year and what your expectations are for the rest of the year?

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

Well, Avi, first let me comment -- you've done an implied number that I can't affirm. I know the cars entered is down. I know the conversion -- I haven't done the math. It would surprise me if it wasn't down comparable to what we've seen the reduction in cars sold.

Again, I'm not sure where you're getting those numbers. But clearly, cars entered are down, and cars entered are down in a manner that is consistent with our expectation that supply was going to remain tight for the year. To quantify pluses and minuses, we don't do that.

Avi Fisher - *BMO Capital Markets - Analyst*

Okay. And most of the other questions have been answered. I have a very general question and a specific one. Specific one with Vegas -- how many locations do you expect to have that, I mean -- is that already included in your locations of 70?

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

Yes, Vegas would be the 70th location, yes.

Avi Fisher - *BMO Capital Markets - Analyst*

Okay. And generally speaking, how do you view new car versus used car substitutes -- as substitutes? Is that generally viewed as substitutes the way you view it? Or not really? When thinking about the industry in general.

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

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

Avi, the way we look at it is a new car sale is good for our business because it generates as we call the churn. And you know that little -- that slide many of you have seen that has the wheel in it.

With the cars coming into the vehicle park, it creates a car that will change hands at some point in the future, whether it be off-leased, trade-in -- it could be any number of things, right, Jim?

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

Right. Sure.

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

I mean -- so, Avi, that -- we actually consider that one of the key inputs that will create the activity in the future in the wholesale marketplace. So the increasing SAR, although it's a modest increase, over time, Jim mentioned, is a positive trend for our business.

Avi Fisher - *BMO Capital Markets - Analyst*

Thanks for the time.

Operator

[Ryan Rinkson], Goldman Sachs.

Ryan Rinkson - *Goldman Sachs - Analyst*

It looks like the gross profit decline at ADESA was fairly in line with what we would expect, given the revenue falloff, but adjusted EBITDA tracked quite a bit lower, with the decline in EBITDA being even greater than the decline in sales. In the supplemental information, you mentioned FX.

I don't know how much of the stock-based compensation, if any, fell at the ADESA level, but to what extent is this being driven, I'm interested, by the investments that you're making, to drive more dealer consignment volumes? Maybe that's showing up in travel costs. And what do you think the payback looks like on that effort?

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

Well, again, you've summarized it well, although I wouldn't focus just on dealer consignment. We still have a very, very strong institutional presence. So I would look at it as marketing -- what are we doing to get as many cars to the auction as we can? And of course, that is part of what we put in the SG&A.

I will tell you also there's not a significant amount of IT costs in the ADESA segment. A majority of its IT costs is in Holding Company and we clearly disclosed that. And so, when you talk about the investments we're making, I think you're right -- it has to do with what we're doing in the field; the types of things that we're spending at the auctions in SG&A.

We also have -- and this will come out -- we have bonuses accrued in the first quarter at a level that is higher than a year ago, based upon our incentive targets. I will admit, we are not assured they will hit those targets. But those are accrued and the



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

majority of those hit SG&A. So that is a specific item that we have and it was zero a year ago. So those are the types of things and that our view on that may change as the year goes on if their performance doesn't hit the threshold levels.

Ryan Rinkson - *Goldman Sachs - Analyst*

Okay. And then also I'm interested -- were you able to detect a difference in pricing for either -- for used cars, that either your whole car or salvage car auctions in the immediate wake of the March 11 earthquake in Japan? And was there a notable increase in prices following that event? And if so, did the strength continued into April?

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

Yes, you know, I would say that we could not point to a specific price increase in any given situation. There may have been. And it may have happened without us consciously being aware of it. But nothing that we could point to with certainty.

Ryan Rinkson - *Goldman Sachs - Analyst*

Okay. And I guess (multiple speakers) -- yes.

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

(multiple speakers) And you know, to your point -- and I think I understand where you're going -- to your point, you would think that if those manufacturers are having -- tightening the supply on specific units. And they did announced yesterday, there was an announcement by one of the import manufacturers that specific units will get much tighter. You would think that, as it tightens up and as that supply becomes restricted, it would be obvious that maybe that the used cars would follow and prices would go up.

Ryan Rinkson - *Goldman Sachs - Analyst*

Yes (multiple speakers) --

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

And Ryan, I'll ask you to keep in mind, we were already in an environment that had very strong pricing.

Ryan Rinkson - *Goldman Sachs - Analyst*

Yes.

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

I mean --.

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

Ryan Rinkson - Goldman Sachs - Analyst

Yes. Okay. And just last question for Jim. There was an interesting soliloquy on technology that you gave. And I don't know if I'm reading way, way between -- too much between the lines. But you mentioned studying technology, looking at technology competitors. You mentioned wanting your company to be a technology leader.

Are you thinking -- is it wrong to think that you're thinking a little bit more incrementally toward maybe offering online-only auctions for salvage similar to one of your competitors at some point in the future? Is that potentially in the cards?

Jim Hallett - KAR Auction Services, Inc. - CEO and Director

Not something that I'd be thinking at this point in time. I think my major focus on technology is making sure that we put all of our companies in a position, from a technological standpoint, to be able to offer the best solution for our customer.

And quite frankly, I don't have a preference if that car sales electronically or if that car sells physically. I'll tell you one preference I do have -- I have a preference to sell 100% of everything we get, regardless of the channel.

But I think it's being absolutely certain that you have what we would refer to as the leading technology that dealers would tell us that's easy to use; that's friendly; that's convenient; that's efficient -- all those things that allows them to conduct businesses. That's the position that we want to be in. And as I mentioned, I feel we're very much in that position at Insurance Auto Auctions. And I feel that we are working diligently to put our other businesses in a similar position.

Ryan Rinkson - Goldman Sachs - Analyst

Okay. Great. Thanks for all that extra color.

Operator

Craig Kennison, Robert W. Baird.

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

Thanks for taking my question as well. I apologize for any background noise. Jim, I wanted to follow-up on your discussion of technology. And just maybe ask, big picture, how you think about capital deployment and how that may change -- whether you'd go more towards technology spending versus acquiring property and hard equipment such as that. I'm just trying to think big picture, how capital deployment might change. Thank you.

Jim Hallett - KAR Auction Services, Inc. - CEO and Director

Thank you. And Craig, if you look back at -- since 2007, there is no question that this Company had under-invested in technology. And so we had a major spend in 2007, 2008, and that spend has come down in 2009 -- or in 2010 going forward.

And so we're not looking at a huge additional spend. I think Eric can speak to the numbers -- I think he did speak to the numbers on the spend. But I think to your other point, brick and mortar is not going away. You know, you still have to transport these cars; you still have to inspect the cars; take pictures of these vehicles; you have to do certain types of reconditioning or mechanical work or bodywork. There's [marshalling] and storage to take place. So there's very much a need to have a physical presence and we definitely don't see the brick-and-mortar going away.

May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

I did mention to you that we have seen an increase in our online sales, our Internet sales, up to 24% in the quarter. We think that trend may continue to grow. And what we want to make certain -- again, forgive me for repeating -- we want to make certain that we position ourselves to be able to provide that customer with the very best solution, whether it's from a physical standpoint or an electronic standpoint. But the spend overall is very much within our range that Eric spoke about.

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

Yes, Craig, and let me add to that. What you're seeing with that \$80 million that we've told you we'll spend this year on CapEx -- a higher percent is going to technology-related projects than, say, ADESA or IAA might have spent in 2004, '05, and '06 -- less IAA, because they were in a technology upgrade then as well; but on a combined basis, I'm referring to it. So you'll see more. But you don't see us actually increasing our expectations, other than those that relate to our growing business.

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

Got it. Thank you.

Operator

Scot Ciccarelli, RBC Capital Markets.

Patrick Palfore - *RBC Capital Markets - Analyst*

This is [Patrick Palfore] sitting in for Scot. Thanks for taking my call. (multiple speakers)

Quickly, if I may -- what sort of impact are you seeing or would you expect to see from rising gas prices affecting miles driven; potential affecting volumes at IAA or change in consumer purchasing habits affecting sales or sales mix at ADESA? And how does that affect your assumptions at those two segments?

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

Good question. Thank you. I would say that, generally speaking, I think the public is getting fairly comfortable with \$4 per gallon gasoline. Certainly don't see the impact that we'd seen when it first hit in 2008 and 2009, when we saw large SUVs drop 30%, 40% overnight. We're not seeing that kind of reaction.

And I would say to you on the whole car side, that there's no question that the compacts and subcompacts are still going to be the most popular vehicles in the lane. People are still gas-conscious but not to the point where they were when it first hit.

And from the salvage side of the business, miles driven -- could we see miles driven drop a little like we did in 2008, 2009? That's potentially a factor that could take place. We could see the miles driven start to tighten up a little bit.

Patrick Palfore - *RBC Capital Markets - Analyst*

Okay. Well, thank you for taking my question.

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

You're welcome. Thanks, Patrick.



May. 04. 2011 / 3:00PM, KAR - Q1 2011 KAR Auction Services Inc Earnings Conference Call

Operator

Gentlemen, it appears there are no further questions. Do you have any final or closing remarks?

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

Thank you, ladies and gentlemen. I appreciate your being on, and taking interest in our Company and our stock. Again, very pleased with the quarter. Very pleased with the -- as we continue to talk about the complementary nature of our businesses, and how they complement and operate on a consolidated basis. And we look forward to talking with you next quarter. So thank you for being on.

Operator

And once again, that does conclude today's conference and we thank you for your participation.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2011, Thomson Reuters. All Rights Reserved.

