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# EDITED TRANSCRIPT

KAR - Q1 2012 KAR AUCTION SERVICES INC Earnings Conference Call

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**John Lovallo** *Merrill Lynch - Analyst*

**Rick Nelson** *Stephens Inc. - Analyst*

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

**Bill Armstrong** *C.L. King & Associates - Analyst*

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**Patrick Palfrey** *RBC Capital Markets - Analyst*

## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the KAR Auction Services, Inc. first-quarter 2012 earnings conference call. Today's call is being recorded. Today's host will be Jim Hallett, Chief Executive Officer of KAR Auction Services Inc., and Eric Loughmiller, Executive Vice President and Chief Financial Officer of KAR Auction Services, Inc.

I would now like to turn the call over to Eric Loughmiller. Please go ahead, sir.

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

Thank you for joining us today for the KAR Auction Services first-quarter earnings conference call. Today, we will discuss the financial performance of KAR Auction Services for the quarter ended March 31, 2012. After concluding our commentary, we will take questions from participants. We will make every effort to accommodate all of the questions within the hour we have scheduled today.

Before Jim kicks off our discussion, I would like to remind you that this conference call contains forward-looking statements within the meaning of the Safe Harbor Provision of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that such forward-looking statements involve risks and uncertainties that may affect KAR's business, prospects and results of operations, and such risks are fully detailed in our SEC filings. In providing forward-looking statements, the Company expressly disclaims any obligation to update these statements.

Also, let me mention that throughout this conference call, we will be referencing both GAAP and non-GAAP financial measures. Reconciliations of the non-GAAP financial measures to the applicable GAAP financial measure can be found in the press release that was issued yesterday which is also available in the investor relations section of our website. Now I'll turn the call over to Jim.

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### Jim Hallett - *KAR Auction Services, Inc. - CEO*

Great thank you, Eric, and good morning, ladies and gentlemen, and thank you for joining us today. Really, three topics that I would like to cover. First, I'd like to give you an overview of our first-quarter performance, outlook on the wholesale used vehicle market, and then following Eric's comments, I would like to come back to you and give you an update on the OPENLANE integration process and how that's going.



First, taking a look at KAR's first-quarter performance, KAR was able to achieve 5% revenue growth and all of our segments were up over last year. We continued to maintain very strong gross margins, and Eric will provide more detail on that in his commentary. And I believe, that the Company is well positioned for growth. We've done a good job of controlling our direct costs and holding our SG&A. line steady, other than the SG&A costs that are associated with the integration of OPENLANE. But more importantly, and what Management continues to focus on, is this Company continues to be a very strong generator of free cash flow. In fact, Eric will be telling you that we've repaid our revolver and that has been done ahead of schedule.

So as we look at the business units, starting with ADESA, overall volumes at ADESA increased 9%, and that did include the OPENLANE volumes. Without the OPENLANE volumes, volume at ADESA was down 6%. And just a couple words of caution, I think we need to be careful when we're analyzing the ADESA volumes, we're now selling vehicles at OPENLANE that were previously sold at ADESA. And as we say, the lines between ADESA and OPENLANE are starting to blur. And the most important thing is that we continue to sell as many vehicles as we can. And I've always maintained, it's not up to us to dictate where the car gets sold, whether it'd be on the Internet or at a physical auction, let's just get the most cars sold.

So another thing that I would caution you on is when you look at the quarterly industry data, the quarterly industry data does not provide a complete picture of the industry performance. This quarterly data includes certain projections and excludes certain volumes, particularly online closed sale volumes such as those from OPENLANE, ADESA and other competitors. We're somewhat restricted by confidentiality agreements and the nature of the reporting, were as I'm much more confidence in the year end and AAA industry survey which is a survey of all in AAA auctions which is purely based on the volumes that are being reported, rather than the detailed information that the customers don't want us to report. So hopefully, that all makes sense.

With that said, I do feel ADESA's first quarter volume trends are consistent with the industry's, if not even a little bit better. I'm particularly pleased with the dealer consignment segment. Dealer consignment is up 16% versus the prior year, and dealer consignment continues to help offset the softness that we're seeing in commercial volumes. I think the work and the resources and the effort that we put in place in reference to dealer consignment over the course of the last three years is paying dividends today.

From an industry perspective, we now know that a SAR is expected to be above 14 million vehicles. You may have seen a recent article in the New York Times that quoted that they expect leasing to grow by about 50% through 2017. Also in the first quarter, it was reported very strong fleet sales. In fact some of the import manufactures sold as much as 20% to 30% of their volumes to rentals in the first quarter. And these leasing trends and what we're seeing in fleet sales, not only were a benefit to us in the first quarter, but will continue to be a benefit to us throughout the balance of the year and for the years going forward.

So I've been quoted in the past as saying that the world will not end in 2012. And I'm very confident as I look forward that this industry should see 8.4 million units in 2013 and approach 9 million units by the year 2015. The last comment that I would make on ADESA, is that ADESA sold 32 % of its vehicles to online buyers in the first quarter.

As I turn to Insurance Auto Auctions, Insurance Auto Auctions had growth in revenue and adjusted EBITDA in the first quarter. This was driven by continued strength in prices paid at auction leading to record-setting returns for our customers in the first quarter. We also had a 6% increase in volumes. This was growth in both insurance and non insurance volumes. And while the mild winter was a benefit to ADESA in the first quarter, it will have a negative impact on Insurance Auto Auctions in the second quarter.

At Insurance Auto Auctions we continue to be very proactive in our international buyer activity. We've been marketing across the globe, as I was saying, this includes training sessions and seminars that we're holding in foreign markets. We're now providing support in 10 different languages throughout our buyer services department. And Insurance Auto Auctions website and online selling platforms are also available in multiple languages. Insurance Auto Auctions has implemented industry leading mobile technology for our buyers and sellers, and we've just completed the rollout of our live chat function, which makes it easier for all of our buyers to participate in our online auctions. And finally, at Insurance Auto Auctions, we continue to diversify our customer mix by attracting more non insurance vehicles to the auctions.



Looking at AFC, AFC continues to have very impressive growth. During the first quarter, AFC posted double-digit revenue and adjusted EBITDA. The AFC leadership team is very focused on using technology to more efficiently deliver customers-- to deliver service to our customers. And the growth in loan transactions continues to outpace the growth in wholesale used vehicle transactions. The portfolio was down slightly in the first quarter from year end, this is a normal seasonal trend. But perhaps more importantly, the portfolio remains 99% current and we continue to see high credit quality throughout the portfolio.

So as we look ahead, we continue to be comfortable with achieving approximately \$515 million of adjusted EBITDA for 2012. On our last earnings call, I gave you a wholesale vehicle volume expectations for 2012 and beyond, and I don't see any reason why we would change those expectations. I believe that 2012 will look a lot like 2011. And we should expect the second quarter to be softer than the first quarter for the entire industry. And with that said, our commercial consigners continue to tell us to expect volumes to pick up in the latter half of the year. So with that, I'm now going to turn it over to Eric and I'll come back before Q&A and update you on the OPENLANE integration. Eric?

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

Thank you, Jim. I'd like to start with what I think is a real highlight, and that's the KAR gross profit. We hit 46.9% gross profit for the first quarter compared to 45.4 % from the prior year. A big contributor to this growth is ADESA's gross profit was up to 45.3% from 42.2% last year. IAA's gross profit continued to be strong, above 41%. And AFC's gross profit is also very strong for us. And as Jim mentioned, for the first time in a while, all three business segments increased revenue year over year with the consolidated revenue increase of about 5%.

In terms of spending, our SG&A now includes OPENLANE which has added about \$10 million of recurring expenses. Also, this quarter, we experienced increased profit interest expense. It was \$5.2 million for the quarter, up from \$3.3 million in the first quarter of last year. In terms of the OPENLANE integration expenses, or the nonrecurring component, we had \$2.7 million of such expenses that are in SG&A in the first quarter. These integration expenses are added back in computing our adjusted EBITDA. All of these integration expenses are cash, nonrecurring costs. And they include such things as the legal costs of the transaction, severance arrangements and some third-party consulting that was part of our integration plan.

Another important item for me to talk about is our effective tax rate. It came in at 41% for the quarter. That's up from 2% for the same period last year. As I discussed in our last earnings call, we expected an effective tax rate of 30% to 35% for the year. I also indicated, that if profit interest expense were greater than the amount assumed in our estimated tax rate, we would see an effective tax rate above our expected range. Well this was the case in Q1.

Increases in our stock price following the quarter end, will result in more nondeductible profit interest expense in Q2. The closing price for our stock at the end of Q1 was \$16.21. For every \$1 increase in the value of our stock, from \$16.21, we will record just under \$2 million in nondeductible profit interest expense. Not only will increased profit interest expense result in increased SG&A costs, but it will also cause our effective tax rate to increase. I am revising my expectations for our effective tax rate for the year to 40%. This does not impact our cash taxes, which we continue to estimate at about \$70 million for 2012.

Now let me turn to cash flows, and I think they were especially strong in Q1. We were able to repay the revolver, as Jim mentioned, ahead of schedule. More importantly, we are building cash in the second quarter. We have not had any temporary borrowings on the revolver since the first week of April, and even then, it was only a small balance outstanding for one day, following a particularly strong ADESA sale day. We continue to focus on reducing our net leverage. Our goal continues to be achieving net leverage of three times.

Now let me speak further to our guidance. As Jim mentioned, adjusted EBITDA is expected at about \$515 million. GAAP net income per share is expected to be \$0.75 to \$0.80. Our revised guidance reflects additional profit interest expense and an effective tax rate of 40%. Adjusted net income per share is expected to be \$1.10 to \$1.15. The reduction in adjusted net income per share is due to the increase in our effective tax rate. I will also remind you that our expected rate of 40% for 2012 compares to an actual effective tax rate of about 20% for 2011. There are no changes to our guidance for capital expenditures, cash interest or cash income taxes. So that concludes what I wanted to talk about. Let me turn it back to Jim to comment on the OPENLANE integration.



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

Great, thanks, Eric. And I guess I would start by saying we have a lot of significant issues-- or a lot of significant initiatives going on within KAR and I would say to you that there's probably nothing more important on my radar right now than this OPENLANE integration and not only getting it right but getting it done in the timely manner that we set out. During the quarter, I'm pleased to say that we significantly have enhanced the customer experience. We have integrated two ADESA private label closed sales onto the OPENLANE platform. We have now had ADESA dealer block transfer or migrate onto the OPENLANE platform and we are migrating the other functionality on [adesa.com](http://adesa.com) for our US customers to OPENLANE throughout the balance of 2012, and this will include the Market Guide, LiveBlock, Auction Run List and Notify Me. As we complete the US in 2012, that will immediately be followed by going through the same integration processes in Canada as we begin 2013.

Also, I would remind you that the CarsArrive project continues to go well. I believe I mentioned on our last call, that CarsArrive is a real-time transportation solution that gives you guaranteed quotes on price and gives you guaranteed delivery times. We piloted seven auctions and now we're up to 12 sites that have been fully deployed and we are on track to rollout CarsArrive and integrate it with all of our physical auctions by the end of 2012. And this is a real opportunity for both our buyers and sellers. It really is a value add, it's a win-win, it provides us the opportunity to move any vehicle anywhere in the country basically at any time.

So I think it also provides us an opportunity to further improve our operating efficiency of our transportation departments at the physical auctions. Transportation at the physical auctions has always been a struggle for us, doing inbound and outbound and managing it on, what I would refer to as a manual basis. Now by integrating CarsArrive and that technology, I certainly would hope that we would become much more efficient in this area at the physical auctions.

So while we're leveraging our capabilities of OPENLANE through ADESA, we're making these changes carefully and well thought out with a very detailed plan. But most importantly, I would say we're preserving the OPENLANE's culture of innovation and we're expanding that culture of innovation within the culture of ADESA physical auctions as well.

So in summary on the OPENLANE integration, I would say that we continue to get great customer feedback about this transaction, and I guess that's the most important measurement of all, is what your customers have to say. Our customers are very excited about the transaction. They're very interested in learning and understanding, as we achieve our milestones. And they're holding us accountable to do what we say we're going to do. We are on target for delivering the synergies that we previously discussed, and I'm pleased with what we've been able to accomplish to date and I look forward to keeping you updated on our progress as we go forward.

The bottom line for this acquisition was always to create value for our customers by providing them to what we've been referring to as an end-to-end vehicle remarketing solution for all their remarketing needs. And I believe we're well on our way to delivering on this commitment. So with that, I am going to turn it back to our Operator, Melissa, and we'll go to Q&A. Thank you.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Matthew Fassler with Goldman Sachs.

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

A couple questions on OPENLANE and ADESA. If you could just remind us as you talked about things like ADESA gross margin, the impact of OPENLANE on the various line items and as part of that, Jim, it sounds like you don't really want to try to unscramble the egg at this point. But if there's some sense you could give us as to the evolution, or rather the contribution of legacy OPENLANE business to the ADESA top line, it sounds like your indication is that negative [6%] probably is not quite as bad as it sounds because you are shifting some business, any sense to what the underlying run rate really would be?



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

You know what, Matt, we aren't breaking it out, again it's consistent. That was a \$100 million business with about 300,000 cars. And it-- the volumes are down, like the rest of the industry. But it's still-- it's roughly in the run rate we expected, but we're not giving granularity greater than that.

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

And the impact on margin rate?

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

It was up. It contributes a little bit, but it's very similar to dealer consignment where it's a lower average revenue per vehicle but a higher gross margin percent. And I will tell you, what contributed to the ADESA gross margin being up so much was actually, the US and Canadian physical auction component of it. It wasn't really driven by online, although online does add a few bips, it was really driven by the physical auction. And that was great news for us. And that was--

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

Sorry, Jim, go ahead.

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

The other thing that I'd just add to that, would be the reference that I made to the dealer consignment. Dealer consignment being up 16% year over year. As you know, the margin on that dealer consignment business is greater than it is on the commercial side of the business and even on the OPENLANE side of the business.

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

Got it. And then a second question, you talked about the second quarter outlook being lighter. The only explicit reason that I think you gave to itemize why that would be the case was the impact of the benign spring weather on the salvage business. Any particular reason the auction business, rather the whole car auction business, would see that as well? And when you talk about it being lighter, you're talking about from a revenue perspective or an earnings perspective?

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

When we talk about it being lighter, I'm speaking to volumes. And if you take a look at this business historically, the second quarter has always been softer than the first quarter. You come out of the fourth quarter of the year, pretty strong first quarter where maybe some of the accounts have held vehicles over the holiday season. Then they run those vehicles off in the first quarter. And then the volumes tend to drop down a little bit in the second quarter. So it's primarily related to the volumes, the off lease volumes dropping down and slightly impacted by the weather at Insurance Auto Auctions where, as you know, those vehicles that were accidents in the first quarter really won't come to market until the second quarter and those volumes may be down a little bit just based on the number of accidents that took place.

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

So you're saying that-- because I guess there's been some inconsistency over time. You're saying that the volumes of car sold at ADESA should come down sequentially from Q1?

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

Matt, that 's what it's looking like, yes. And heavily driven by the commercial side. And it's a little harder to predict the SAR and what new car sales will do that creates trades which creates dealer consignment volumes. But it, what Jim is saying is we're seeing the second quarter start a little softer than how we finish the first quarter.

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

Got it, that's helpful. Thank you so much, guys.

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

You're welcome.

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

Thanks, Matt.

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**Operator**

John Lovallo from Merrill Lynch.

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**John Lovallo** - *Merrill Lynch - Analyst*

Hello, guys, thanks for taking the call.

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

Good morning, John Lovallo.

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**John Lovallo** - *Merrill Lynch - Analyst*

Just to follow up on the last question, or one of the last questions. When we think about ADESA going forward, I mean with the integration of OPENLANE, I mean is it fair to assume that your volumes will increase but that revenue per vehicle should come down?

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

Yes, I think that's a fair assumption.

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

And particularly, John, until we annualize over the acquisition in the fourth quarter. So we're just adding the OPENLANE volumes. And the average revenue per vehicle will come down as our mix increases to dealer consignment. But what Jim was mentioning is it's not just OPENLANE, it's actually equal to the mix. I mean what are we at 46% dealer consignment, that also has an average revenue per vehicle lower than a physical sale of a commercial vehicle, which usually uses more ancillary services.

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**John Lovallo** - *Merrill Lynch - Analyst*

Okay, great thanks. If I could sneak one more in here, if we think about the depreciation levels across the businesses, looking at AFC in particular, I mean what actually drives the depreciation at AFC? I mean is it loan curtailments or what is the factors behind that?

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

When you say depreciation, are-- you're talking about the accounting depreciation in--

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**John Lovallo** - *Merrill Lynch - Analyst*

Yes, correct.

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

Yes, I mean that's really the original purchase accounting being amortized. I mean there's no capitalized assets associated with a loan transaction. So it's a lot of the capital. We also have, Jim mentioned that the leadership there is focused on investing in technology. But again, it's not really that significant compared to the other businesses. But that's the only thing that would really be significant capital expenditure is technology.

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**John Lovallo** - *Merrill Lynch - Analyst*

Great, thanks very much, guys.

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

You're welcome.

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**Operator**

Rick Nelson with Stephens.

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**Rick Nelson** - *Stephens Inc. - Analyst*

I wanted to pull up on the commentary about the second quarter. The volume, I think you addressed sequentially. If you could talk some about what you expect year over year, you were plus 9% in the first quarter, minus 6% on an ADESA only basis and what's your--



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

Rick, we've avoided since we went public, of giving quarterly guidance, other than some general impressions. And again the visibility into volumes is difficult. Again, all we're pointing out is the second quarter commercial volumes are going to be lighter. That's a function of what happened with leasing three years ago, right Jim? I mean it's just pointing that out, we don't really want to go out there and put a number on it. And Jim mentioned it and I'll just reiterate it, our customers are telling us though that later in the year we'll probably going to see things reverse a little bit and we'll see a little bit stronger volumes, based again, on what they did three years ago.

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**Rick Nelson** - *Stephens Inc. - Analyst*

Okay. If we could talk some about the conversion 62.6% compared to 66.7%. If drilling down looking at commercial dealer consignment and OPENLANE the trends, at least anecdotally, would be helpful.

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

I think, that's a reflection of the increase in dealer consignment sales. As you know, the commercial vehicles convert at a much higher rate than the dealer vehicles. And with dealer consignment being up 16%, still the overall selling percentage is brought down by that conversion rate.

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

And, Rick, you've brought up a good point that I don't know that I've clarified for everyone. We are not including OPENLANE listings and sales in the conversion rate calculation. And the reason being, it's a different business model, a lot of cars get listed. But what I will tell you, again anecdotally, is we are seeing a very strong conversion relative to history in terms of the number of listings that are resulting in sales of commercial vehicles. As we see, more dealer consignment cars go to that OPENLANE platform, it'll be the same thing. You'll probably see a lower conversion of those. But at this point, I will tell you with the tight supplies of commercial vehicles, the OPENLANE platform is very attractive and they're seeing a very strong sell through rate of the number of listings.

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**Rick Nelson** - *Stephens Inc. - Analyst*

I would like to also follow up on SG&A, it did widen. It looks like ex some one-time items and a lot of that has to do with the growth in expenses due to OPENLANE. If we look at SG&A as a percent of revs ex OPENLANE, did we see a narrowing in the expense ratio? It's difficult to calculate without the revenue from OPENLANE.

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

What I do know, Rick, is the absolute number went down. But I didn't calculate the percent ex OPENLANE revenues because we look at a ADESA segment in total. But the absolute dollars spent on SG&A ex OPENLANE were actually down, even with the increased profit interest expense.

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**Rick Nelson** - *Stephens Inc. - Analyst*

Got you. Okay, great. Thanks a lot and good luck.

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

Thank you.

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**Operator**

Gary Prestopino from Barrington Research.

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

You mentioned what the ADESA division is doing in online sales, can you talk-- give us a percentage of what Insurance Auto is doing and how is that trending year over year?

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

Yes, I-- Gary, we've reported that they're getting bids on approximately close to 80% of the vehicles, maybe a little bit better than 80% of their vehicles and selling a little bit more than 50 % of the vehicles online. That's been pretty consistent I think over the course of the last few years. It may be up a smidge, but pretty consistent over the course of the last few years.

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

And then what's the mix there between insurance, non-insurance, have you made that public?

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

Yes. I think we've said that the insurance business is primarily responsible for 80% of the volume, approximately 80% or little bit better than that. And the balance of that is obviously these non-insurance and charity vehicles.

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

Okay. And then I didn't see it in the press release, but in terms of, what's the size of the overall AFC portfolio and how much more capacity do you have to build that?

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

We have plenty of capacity and the size is I just want to-- like \$866 million, Gary. But give me one second and I'll look up and give you the number. It'll be in the Q that we filed tonight.

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

Okay. I can look at that. So--

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

Anyway it's just under-- I think it's just under \$900 million, Gary.

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

Okay and then in terms of capacity, when you say have plenty, can you put a number out there?

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

Yes, we have \$750 million of securitization availability and we had drawn \$610 million on it at quarter end.

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

So \$610 drawn. Okay and then lastly in terms of OPENLANE, although its early in your ownership, but in terms of your efforts with the institutional market, garnering new share, can you talk about, maybe, what some of your people in the field have experienced? Obviously, this is going to help you, I would tend to think but anything you could share there with us?

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

Well I-- first thing I would share is the reception by the customers of basically merging the sales teams together. We now have one person dedicated to all of the-- to each major account, calling on each major account. So as we say, we're speaking with one product and one voice when we're really going there as KAR. We've always said, that we don't talk specifically about individual customer wins and losses and things of that nature, but I can tell you that our sales folks have had a little bit of success in picking up some new business along the way.

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

Okay. And is this-- you had mentioned at one time or another that this OPENLANE platform was applicable to the dealer trade market. Are you doing anything there, or is that contemplated?

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

We are, Gary, as a matter of fact, that's part of this whole dealer consignment initiative and we've certainly invested in a lot of people and a lot of resources to go out and train the dealers. It's a little bit slower, coming, quite frankly. It's a little bit more work to get the dealers trained and to get them to take pictures and post cars and to get into the adoption. But we have a very dedicated team under the direction of Tim Zierden who has been leading this initiative for the last three years. Not only leading the initiative at a [depth] of physical sales but leading the initiative with the OPENLANE sales team, as well. And now that we've transitioned dealer block on to OPENLANE, hopefully I think Tim is feeling that we have that single product and we have more focus and we'll be able to kind of bring them to the trough, here, a little bit more as we go forward.

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

Okay, thank you, guys.

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

You're welcome.

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**Operator**

Bill Armstrong with C.L. King & Associates.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Good morning, Jim and Eric. I just want to clarify on the SG&A with OPENLANE. Eric, I think you said that SG&A included about \$10 million in recurring SG&A from OPENLANE and in the breakout that you published there's a dollar figure of \$12.3 million. I just wanted to reconcile those.

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

Yes. I'm rounding numbers, Bill, you've it right. The \$12.3 million is the actual OPENLANE SG&A which was just under \$10 million, it rounds to \$10 million. And add to that the \$2.7 million that I gave you in my comments and you'll get to that number.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Okay. The \$2.7 million was the acquisition in nonrecurring costs?

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

The cash nonrecurring integration related costs, yes, for OPENLANE only.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Got it, okay. Interest expense, I think in your last call you were looking at GAAP interest expense of \$100 million to \$105 million. Sounds like it's going to be a little higher now, is that correct or no?

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

Well, I'm looking for cash interest expense that I believe is \$95 million, and GAAP interest expense I don't know that I would change my expectations on that other than we have paid off the revolver a little bit ahead of time, we mentioned that. So there could be a little bit of savings there. But again it's just a little bit ahead of schedule.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Okay. Was there anything nonrecurring in the corporate SG&A line?

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

Yes, there are some add backs. If you just analyze the add backs, which you'll see tonight in our 10-Q that we file, there are some other non-cash activities such as stock-based compensation that go into there, I gave you the profit interest. But there's also an option component to that. And there are some other nonrecurring costs that aren't that significant this quarter related to other activities within the corporation that meet the definition of nonrecurring.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Okay. Moving to Insurance Auto Auctions, it looks like you had a nice quarter there. I guess, two questions, how much of that increase came from your higher number of owned vehicles, Company-owned vehicles, that you sold? And it looks like you're taking some market share even though I know you had an account loss last quarter. It looks like you might still be taking market share, do you see it that way?



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

First, our number of vehicles purchased and then sold was 5% this quarter, which was consistent with where we finished last year, Bill. So on a relative basis it may be up on absolute numbers because of the 9% year-over-year growth, but it's really pretty-- we're hovering right around 5% is the purchased vehicle component. And relative to market share, again it's a little bit harder with Insurance Auto Auctions to give you an absolute number because there's no industry data. We know what we sell, we hear a little bit about some of our competition that discloses some information. But we feel good how the business is performing and we think we have a strong platform. Jim, anything to add I mean relative-- I mean our-- we really like the fact that our hybrid methodology seems to have traction with the customers and the record levels of returns they realized at our auctions in the first quarter.

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

Again, I'd just take it right back to the customer and the customer's voice when the customers are telling us that the proceeds are at record levels and they're instant and much of the marketing that we're doing and the ability to attract more buyers from around the world and put more eyeballs on these cars, that's all driving the retentions. And so to me, that's always a measurement.

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

And Bill, one last thing, just I want everyone to understand this. When we talk a customer situation, it does take a while to transition those cars away. So I don't believe that situation impact of the first quarter at all. In other words, I don't think we wouldn't say we had lost really any of their business, other than the impact of their business where their volumes up or down, which I'm not going to get into.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Right, and it sounds like the mild winter weather, the negative impact from that, is probably going to hit more in the second quarter than in the first?

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

Yes. We say that approximately the turn rate from accident to divestiture is usually 70 to 90 days. So in those quarters those cars are going to get sold in the second quarter and again it's not going to be huge, but there is going to be some impact there on volumes.

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

And Bill, this is a chance for me to again clarify something. A softer quarter is because we've had a series of very strong year over year quarters in a row. It doesn't mean that we see this business going backwards in any way. It just may not be as strong as what we've been experiencing really the last probably five, six, seven quarters.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

No, I understand and you have that unusual weather situation, too. Last question, on ADESA, obviously we have-- the SAR has improved, your dealer consignment business has improved, do you think that's-- is there any way to parse out how much is market share gain and how much are we just seeing a rising tide from greater used trade-in volumes from dealerships? And then related to that, we're hearing that car rental companies had sold off a larger number of vehicles this quarter versus a year ago, any comments or color you can provide on that, also, would be helpful.

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

I think I would term it as probably all of the above. I think that obviously, new car sales increasing creates more used vehicles and more transactions that can take place at auctions. I think the initiatives that we've done and going out and working with the dealers and training dealers and the work we've done in this technology area of bringing them to technology. I think as you-- as we see leasing increasing and rentals increasing and turning over more often, I think it all adds up to a better situation for ADESA. And I think we've seen that through the first quarter. Even with volumes being soft, we feel it picking up.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Okay, got it. Thanks very much.

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

And before we move on to another question, I'd like to clarify something someone's just slipped me a note which was a good one. I misspoke, our dealer consignment volumes in Q1 were 41%, I had mentioned 46%, which may have been last year's number. But last year in the first quarter, we were at 38%. So I wanted to clarify that. And another analyst, Gary, had asked us, our March 31 total managed receivables was \$867.6 million. So I wanted to clarify that number just to be accurate. So now we can go the next question.

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**Operator**

(Operator Instructions) Chris Ceraso from Credit Suisse.

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

So just to clarify what you just said, Eric, because I had this on my list here, the dealer consignment you said was 41% in first quarter '12, was 38% in first quarter '11?

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

That is correct.

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

Okay. The-- a question about CarsArrive, can you give us some numbers or any kind of metrics about how much incremental business that's adding, I know it's early, still? And is there going to be some kind of metric that we can track to see how additive this is to your business over time?

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

Well I can-- Chris, I can tell you that through the pilot of the initial seven auctions, it's thousands of vehicles that we moved through that pile and now we're up to 12 auctions. I would say we're moving in excess of 10,000 vehicles.

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

And you-- what's-- can you quantify the incremental revenue that's coming from this?



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

Chris, it's a pilot. We're actually, right now, focused on transitioning ADESA transportation to OPENLANE's CarsArrive platform. So incrementally, I don't see it as a contributor. It's really, can we change the profit profile when we get to the CarsArrive platform and have a lower cost to deliver those services. So at this stage, I'm not seeing it incrementally adding revenue to the combined enterprise.

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

I think Eric's saying that we're trying to get it integrated and get it working and then we'll focus on the efficiency and the profitability.

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

Right.

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

So it's not about extra units or extra revenue, it's about lower cost?

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

In terms of the pilot. Overtime, we think it'll be so attractive it might draw more transportation business to us. But at this point, we're really transitioning ADESA transportation over to the OPEN-- or the CarsArrive platform.

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

Okay. And I want to clarify another thing that you said, Eric, recently here on the call that second quarter is going to be softer than the first. Are you talking about in absolute terms, the EBITDA, for example? Or are you saying that it's going to be a lower year-over-year growth rate than what you're printed in Q1?

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

Well what I'm focused on is year over year in terms of volumes. Again, Chris, we don't get granular to the quarters relative to our guidance in total. We just felt it was important to give you an idea of what we're seeing early in the second quarter on the volumes. And again, we would attribute that to both IAA and ADESA volumes.

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

So year-over-year growth in volumes, smaller in the second quarter than the first quarter?

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

Yes, definitely growth when you describe IAA. And again, trends are different at ADESA as you know because year over year we've been--

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

Right, okay. And then the-- you mentioned on the call at one point that dealer business was up 16%. How much was commercial down?

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

I didn't calculate that, unfortunately. But overall, ADESA was down 6% excluding OPENLANE. At was 41% -- I'll have to-- we'll have to do the math, Chris. I didn't bring that number with me.

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

Okay.

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

But I think it was down by a noticeable amount.

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

And then just lastly, what was the-- do you have any industry data, what was industry auction volume in the quarter?

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

Jim-- that's the Jim's comment, I mean I haven't seen anything published. I am aware of at least one in AAA economist presentation he did where he had it down slightly. I will tell you, again, the data we get, we're just being careful with that. We outperformed in dealer consignment the data we received and we were pretty consistent on the commercial side. So we think we did a little better.

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

Okay. Thank you.

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**Operator**

Craig Kennison from Robert W. Baird.

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

Thanks for taking my questions, many have been asked already. But wanted to ask on the OPENLANE integration and just try to understand that the pitch to the customer. Would you expect existing ADESA customers to transfer incremental volume from those ADESA platforms to OPENLANE platforms? And then could you just explain how the economics look when they make that switch from a customer perspective and then from a car perspective?

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

Yes, no question that we would expect customers to go on to the OPENLANE platform. And customers have been very cooperative in transitioning to the OPENLANE platform. And relative to the revenue profile, it again, Craig, it's a little bit lower revenue per vehicle with a higher margin, so we think overall the contribution can be at the same level on a per car basis. And we're hoping to protect price in order to achieve that.

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

And then just a longer term question then as that transition happens, at what point would you need to reevaluate your real estate footprint to optimize for that new structure?

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

I think, obviously, we expect that this Internet component will continue to grow. We're not sure where the sweet spot is. But we know where the 32% in the first quarter. I think we're continuously focusing on our footprint. Continuously focusing on brick and mortar and real estate and how much of that we need and how that fits in there. I've said before, there's always going to need to-- be a need for brick and mortar because we do need a place to park these cars and image these cars and marshall these cars and do the things that we do in terms of reconditioning and other things. But it's something that our Board and our Management team continues to focus on, is to how do we right-size this physical business with this Internet business.

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

And Craig, I'll go back to late 2008 when there wasn't a parking spot for a car, we had so many vehicles. We avoided adding long-term leases and expanding the footprint then and now the market has right-sized or down sized and as short-term leases and we aren't renewing them. So I think we have our footprint where we like it. And Jim has told me this many times, so I'll repeat it for all of you. The online platform gets a few days to sell a car, then the car has to go somewhere. And we need to have the home for that car, is that right Jim?

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

Absolutely.

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

One more follow up, Eric. In terms of 2013, the tax rate this year it's going to go a little higher, any thoughts on where that could be in 2013?

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

Again, without specific guidance, but I've always said, overtime, we were going to migrate up into that 38% to 40% range and I think we're getting there, Craig, to be honest.

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

Great. Thanks so much.



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

And the-- again I'll highlight once again that profit interest is nondeductible. So if the stock price were to increase it does play games with that. But again, I will also point out that, I did this a couple of calls ago, the private interest do not result in dilution to our shareholders. It-- the private interests are held by a small number of our Executives and it comes out of the returns realized by the private equity firms. It doesn't great dilution or new equity in the business, so that's why it has the unique feature.

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

Thank you.

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

Thanks, Craig.

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**Operator**

Scot Ciccarelli from RBC Capital Markets.

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**Patrick Palfrey** - *RBC Capital Markets - Analyst*

Hi, guys this is Patrick Palfrey on for Scot, today. Thanks for taking my question.

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

Hi, Patrick.

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**Patrick Palfrey** - *RBC Capital Markets - Analyst*

Just real quick, within ADESA, could you speak a little bit about the type of vehicles you're currently selling as to say what you were selling about a year ago? And is there a big difference between the units sold at OPENLANE and ADESA?

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

In terms of ADESA, I mean what we were selling a year ago is probably what we're selling today, the mix will shift a little bit from time to time as we've talked about the dealer cars have gone up a little bit, commercial cars have come down. Commercial cars, price points are-- they can vary from time to time. But they may have been slightly higher on the commercial side, the selling prices. And on the OPENLANE platform, we're primarily focused on selling off leased vehicles there. And those off lease vehicles tend to be a three to four-year old car and tend to be what I would term pretty consistent in terms of mileage and condition and things of that nature. But primarily off leased vehicles versus not as many dealer vehicles and vehicles from the other segments of the business.

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

And I'll add to that. The average selling price of a vehicle at OPENLANE is higher than at a ADESA physical auction because it tends to focus on these later model vehicles. And the other thing, Patrick, to keep in mind is, and this has been published, there's a shortage of these late model



vehicles because of the low SAR we've had for the past few years. So that's going to blend the entire marketplace to be a little bit older in average age of vehicles sold at auction.

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**Patrick Palfrey** - RBC Capital Markets - Analyst

Okay, great. Great, thanks. And then one more, if I may. I guess also looking at AFC, your loan transaction units continue to be up, I think this quarter was 17%. I was just curious, what's driving that growth and is it coming from increased financing of units related to the OPENLANE acquisition, or is there something else there?

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

I think it just comes down to performance and the levels of customer service that this AFC team is able to provide. It's a very strong team, it's a very strong Management team we put together under Don Gottwald. These guys are on it, it's continuous improvements, it's continuous levels of service. And I think at the end of the day, that's what the dealer is looking for rather than a few bucks here or there, he's looking for good, fast, efficient quick service.

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

And 103 locations close to these dealers -- I mean there's a lot of things that go into it, Patrick, that I think we're out there with them, watching them operate day to day at the auctions and in their retail marketplace.

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**Patrick Palfrey** - RBC Capital Markets - Analyst

Great, guys, thanks for taking my questions.

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

Thank you.

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**Operator**

And at this time, we have no further questions in the queue so I'll turn the call back over to Jim Hallett for any closing remarks.

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

Okay, thank you, Melissa. And I would just say thank you for being on our call today, we appreciate your interest in our Company. From our standpoint, very pleased with the first quarter, very pleased with really how we've been able to work through the last several years, quite frankly. And as we've dealt with the headwinds on the whole car side. And as we work through the second quarter, we know that as we work through 2012, that things get better. And we expect that things, we know things will significantly improve in 2013 and 2014, especially on the whole car side, where we have insight to what those volumes are going to look like. So we feel good about our business, feel good about where we're heading and we'll look forward to coming back to you next quarter. So with that, thank you for your time and attention.

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**Operator**

And that does conclude our conference for today. Thank you for your participation, you may now disconnect.



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