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KAR - Q2 2012 KAR AUCTION SERVICES INC Earnings Conference Call

EVENT DATE/TIME: AUGUST 07, 2012 / 3:00PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the KAR Auction Services, Incorporated second-quarter 2012 earnings conference call. Today's call is being recorded. Today's hosts will be Jim Hallett, Chief Executive Officer of KAR Auction Services, Incorporated Eric Loughmiller, Executive Vice President and Chief Financial Officer of KAR Auction Services Incorporated, and Jonathan Peisner, Vice President and Treasurer of KAR Auction Services, Incorporated. I would like to turn the call over to John Peisner. Go ahead, sir.

John Peisner - *KAR Auction Services, Inc. - VP and Treasurer*

Thanks, Deena. Good morning, and thank you for joining us today for the KAR Auction Services second-quarter earning conference call. Today we will discuss the financial performance of KAR Auction Services for the quarter ended June 30, 2012. After concluding our commentary, we will take questions from participants. 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.

Lastly, 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 measures can be found in the press release that we issued yesterday, which is also available in the Investor Relations section of our website. Now I'd like to turn this call over to KAR Auction Services' CEO, Jim Hallett. Jim?

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

Great, and thank you, John, and good morning ladies and gentlemen. Welcome to our call. I'd like to start where we left off on our last conference call. We left off telling you that we felt the second quarter would be a challenging quarter. There's no question that it did prove to be challenging. I'd like to walk you through the results by the various businesses. In the whole KAR business at ADESA, we have seen commercial volumes in the industry continue to be soft. ADESA volumes were off 6% year-over-year, but with the OPENLANE addition, we were actually up 11%. I would ask you to keep in mind that it's difficult for us to breakout our online volumes between ADESA and OPENLANE due to the integration of the businesses. Remember a year ago, the dealer blocked cars that were part of ADESA are now being reported as part of the OPENLANE sales.

So let me give you some good news in terms of looking forward. We are looking forward to an improved supply situation at the end of 2012 and into 2013. We'll talk more about that in a moment. We expect that 2012 volumes will be similar to what we've seen in 2011. We're also expecting that the industry will sell approximately 8.4 million vehicles in 2013, and that number should rise to nearly 9 million unit sold in 2015. As I look forward, I'm really excited about the supply and how well positioned ADESA is to take advantage of what's coming at us here. As you know or may not know, ADESA is nationally weighted on the institutional side of the business, and we have very good long-term visibility with our leading commercial consignors. In fact, we know what their volumes look like two and three years out and what those returns are going to be. And I think ADESA, as these returns come, is in a very strong position to take advantage of these volumes, and I wouldn't want to lose sight of the tremendous work that we've done on dealer consignment over the course of the last couple of years. I think we've done a great job at training our dealers, creating good behavior both by our dealers and also some good training with our employees, and we've done a fabulous job of growing our dealer consignment business. And as we stay focused on dealer consignment and then get the onslaught of commercial volumes coming back, I think this is going to put ADESA in a very, very good position.

In terms of the integration activities between ADESA and OPENLANE, continues to go very well. We are now selling our online vehicles on a single platform that is powered by the OPENLANE technology. We continue to migrate ADESA's private-label customers to OPENLANE. And we continue to eliminate redundant corporate costs. Many of the OPENLANE corporate functions are now being performed by KAR. As I look back on this acquisition, when we originally bought OPENLANE, we really viewed it as possibly the fourth leg on the stool. But as we've continued to go through the integration process and we've had feedback from a number of our employees who have worked on this integration, but more importantly from our customers, we've actually seen OPENLANE as really an additional service offering within ADESA powered by the OPENLANE technology and it's really all one Company. For example, at one point in time, we seen it as needing two separate sales teams. We've now integrated those sales teams under one VP of sales because the customers told us they wanted one point of contact, things of that nature.

And I think I'll go back to what I said early on is I don't believe it's our position to dictate how and where a vehicle sells. It's always been my opinion that we need to provide the best physical footprint that we can. And then we need to complement that with the best internet site that we can. And I think that we're able to do that. And I also think that we did it at a time when we knew that volumes were going to be at their lowest point. Not only were volumes at their lowest point when we started this integration, but I think it also put us at the lowest risk period to be able to pull this integration off. And although we're not at the finish line on the integration yet, we are well down the road and, touch wood, we've had no significant blips, and the customer reaction has been very, very, very positive. So when you think about ADESA, think about the combination of the OPENLANE technology in combination with ADESA's broad footprint and all the service offering that they provide. I think that we can confidently say that we feel ADESA has the leading end-to-end remarketing solution in the entire industry.

As we look at Insurance Auto Auctions, Insurance Auto Auctions continues to perform at a high level. Their units sold increased 3% in the quarter year- over-year. Insurance volumes were light, and I don't think that was any surprise given the mild winter that we experienced throughout North America. Although I will also tell you that the non-insurance volumes have been quite strong; proceeds have leveled off somewhat. This is the result of some softening that we've seen in used car prices as well as scrap prices. And although we've always maintained that we won't discuss individual customer wins and losses, I can tell you that Insurance Auto Auctions is consistently winning new business through the RFP process. I believe that Insurance Auto Auctions continues to be recognized as the industry leader. We are getting consistent feedback from our customers that they love the hybrid auction method, and they believe that it does provide exceptional returns. And again, I believe that is the differentiator between us and the competition.

As we look at AFC, AFC continues to perform at a very high level as well. Our loan transactions were up 16% in the quarter, and at the end of the quarter, the portfolio was over $900 million. But again, more importantly, it was in excess of 99% current. So I think about AFC, and sometimes we ask ourselves how are we achieving such strong results at AFC in what we've considered to be a soft market. And I want it touch on a couple of those things. I think number one, I think it's due to our continued investment in technology, both in our core operating systems and in some of the enhancements we've made, especially in the area of mobile applications. And then we've often asked ourselves about the 104 loan production offices that we have across North America, and whether we need all those offices or whether we should be centralizing them, and I think we've gotten our answer. We feel that the loan production offices really differentiates us from our competition. We think it puts us closer to our customers.

It enables us to provide a higher level of service to our customers as we high touch business, we have 450 sets of boots on the ground in these markets. We see our customers on a weekly basis. And maybe more importantly and most importantly, I think it mitigates risk. And if there are concerns with any of our customers, usually we're first to hear about it because we're closest to the customer. And again, a big differentiator for us.

So as I think about KAR's performance overall, and Eric's going to cover this in much more detail in just a minute or two here, I'm pleased with the consolidated performance of KAR. We increased revenue 3%. We had a gross profit of over 46%. And we've generated $170 million of cash through the first six months of the year. In terms of guidance, we expect that we'll be at approximately $515 million of adjusted EBITDA for 2012, and I can assure you that the management team is very focused on delivering these results. As you know, we have a number of levers that we can pull to enhance our performance and to hit our goals. And although I don't want to get into the specifics of some of the things we're doing, just to give you an example of things that we continue to focus on and monitor on a regular basis, we look at selective price increases across all of our business units, growing our revenues and our ancillary services, continue to focus on gaining market share and winning new customers. There is absolutely no finish line on our focus on cost reductions. And we continue to look at ways that we can improve our business through the use of technology.

So with that, I want to tell you that we're focused on executing and on delivering the results. And at this point in time, I'd now like to turn it over to Eric Loughmiller, who will provide more commentary on our financial performance. Eric?

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

Thank you, Jim. Let me start with an overview of our financial performance. And as Jim mentioned, the revenues were up 3% to $488 million for the second quarter. This includes $21.7 million of revenue from OPENLANE. Our consolidated gross profit was 46% in the second quarter; this is consistent with the prior year. Selling, general, and administrative expense increased 4% in the second quarter to $103.5 million. This includes $9 million of SG&A for OPENLANE in 2012. Excluding the impact of OPENLANE, SG&A decreased 5% compared to the prior year. Adjusted EBITDA of $128 million in the second quarter was down from $132 million in the prior year. Adjusted net income per share for the second quarter of $0.26 was down from $0.32 in 2011. A key driver this decline was our effective income tax rate.

For the second quarter, our effective tax rate was nearly 46% compared to only 32.5% in 2011. This unusually high tax rate was impacted by a couple of discreet items. First, we had changes in enacted tax rates in various states, in Quebec, Canada, that required us to adjust our deferred tax liability balances. This accounts for a 3% increase in the effective tax rate. Second, we recorded additional income tax expense for the settlement of tax audits in Canada that increased the effective tax rate an additional 1%. Another item contributing to our higher tax rate was approximately $2 million in profit interest expense recorded during the quarter. As I have mentioned before, this expense is not deductible for tax purposes, but is expensed as SG&A in our financial statements. The accounting for profit interest expense increased our effective tax rate approximately 2% in the second quarter. Adjusting for the discreet items and the impact of profit interest expense, our normalized income tax rate is about 40%.

Generating cash from operating activities continues to be one of our strengths. We measure free cash flows as adjusted EBITDA, less capital expenditures, cash taxes, and cash interest paid. Through the first six months of 2012, we generated $134.6 million of free cash flow. We continue to have no borrowings on our revolver and had available cash of $83.9 million. Our net leverage is 3.6 times adjusted EBITDA, and we continue to target three times or less. We believe we can achieve this target in 2013.

In terms of our guidance for 2012, let me add to Jim's comments. We are adjusting our range for earnings per share and adjusted earnings per share to reflect the possibility of a higher tax rate. We are now expecting earnings per share of $0.70 to $0.75, and adjusted earnings per share of $1.05 to $1.10. This reflects a tax rate that will range from 40% to 43%. In each case, the low end of the range reflects an effective tax rate of 43%, and the high end of the range reflects an effective tax rate of 40%. Additionally, the Company expects capital expenditures for 2012 of $90 million, cash taxes paid of $70 million, and cash interest paid on corporate debt of $95 million. None of these items changed from our previous guidance. As you can see, our expectations for free cash flow for 2012 of approximately $260 million have not changed from our previous guidance.

I think you can read the supplement that is posted on our website and the earnings release for more details. So we will now try to accommodate as many questions as possible. And I'll turn it back to Deena, our operator. Thanks, Deena.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Thank you. We'll take our first question from Matt Fassler with Goldman Sachs.

Matthew Fassler - *Goldman Sachs - Analyst*

Hi. A couple questions if we could. First of all, I guess the year-on-year gross margin trend in the whole KAR business was a bit different in the second quarter than it was in Q1. And you alluded in your release, I believe, to mix, I guess, tilting a bit towards the dealer side. If you could just comment on what changed on a year-on-year basis from Q1 to Q2, whether OPENLANE was a part of that, although I wouldn't imagine the impact would have been that different between the two quarters. Any other factors that would have contributed to that. And then finally on this point, how that gross margin rate or gross profit line item should play out relative to sales over the course of the year.

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

Sure, Matt. Thanks for the question. First let me talk about the trend. We do have a mix shift. And one thing, again, when we file the Q tonight, which is our expectation, we'll give you conversion rates. But the conversion rate in the second quarter was down from what we saw in the first quarter. And of course, that affects our labor costs and affects our margin. I was very pleased with the margin at ADESA. And the impact of OPENLANE, I just gave you the revenue number for the quarter of $21.7 million. It's just really not that significant where it can really pull up the gross margin. Particularly because it's -- OPENLANE's so heavily focused on off-lease volumes. And that's probably, I would think, the hardest hit sector that we serve. So as that market recovers, I'm hoping it will have a more positive impact on the margin profile of ADESA.

The -- we did have the benefit in the first quarter of the warm winter, and therefore, lower labor costs in clearing snow. And we mentioned that previously. So that helped us quite a bit in the first quarter. Again, seasonally, though, I think we continued the second quarter performance is extremely strong, in particular with the strong dealer consignment mix, Matt. And as I look at the future, again, I think we will benefit. Jim talks about it as the commercial volumes return, that's the strength of ADESA. I think my expectation is we'll benefit. I will caution you the mix of ancillary services is going to have an impact of gross profit percent. Clearly if the revenues and ancillary services increase and it impacts our margin, it actually contributes more EBITDA dollars, and that's a good thing for all of us.

Matthew Fassler - *Goldman Sachs - Analyst*

Understood. Just a second question but we have clarification. The new adjusted EPS guidance that reflects the new 40% to 43% tax rate. Does that include the impact of some of those discreet items like the [Canadian] tax audit and the adjustment to the tax liability, which would seem like I guess you're not calling them one-time items, but they would seem like they might not have a recurring impact. As we think about the true underlying recurring net income, your tax rate normalizes at 40%. I get it. But are you getting penalized incrementally even within that adjusted number for a couple of those discreet line items?

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

No, Matt. That's a good question. When I say discreet, it means one time. And we have trued up the balance. Now the only thing that could happen -- we know the pressure on the states to raise money for satisfying their needs. Other states could increase rates. But when that occurs, we revalue all of the liabilities to the current rate, and so it does not have an ongoing impact on the deferred tax liability.

Matthew Fassler - *Goldman Sachs - Analyst*

So not to belabor the point but just to get clarity, you talked about three discreet items -- the 3% increase in the tax rate for changes in states, Quebec et cetera; the tax audit in Canada; and then the profit interest expense. Which of those three would be included in that guidance and which would be excluded?

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

I described two as discreet, and that was the raising the rate and the tax audit. The profit interest is an ongoing impact that we would have depending on the movements in our stock price.

Matthew Fassler - *Goldman Sachs - Analyst*

So as we reconcile the quarter to the annual guidance, that 4 percentage point increase, the 1% plus the 3% to the tax rate in Q2, we should back out.

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

Back out, and as we have more earnings, to be honest, it dilutes the impact because I had to pick that up against second quarter earnings. As a catch-up adjustment.

Matthew Fassler - *Goldman Sachs - Analyst*

Got it. Thank you very much.

Operator

We'll take our next question from John Lovallo with Merrill Lynch.

John Lovallo - *BofA Merrill Lynch - Analyst*

A couple questions for you here. If we look at the past couple of years, it seems like conversion rates at ADESA have been a little bit softer in the back half of the year. Can we expect that in this year, as well?

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

I think that because we're seeing an increase in dealer consignment, dealer cars tend to convert at a lower percentage than the commercial cars do. So yes, I think you will see the overall conversion rate soften somewhat as to what has been previous.

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

And John, what Jim's talking about is we've been growing our dealer consignment business, I think, at an excellent pace. So it's had that impact. What I really look forward to is what Jim commented on. When the commercial cars start coming back to the marketplace, either late this year or into 2013, you'll start to probably see that impact positively the conversion rate because those cars obviously will have a higher conversion rate than the dealer car. Right, Jim?

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

Absolutely.

John Lovallo - *BofA Merrill Lynch - Analyst*

That's helpful. Thank you. Second question, if we look at ADESA volumes, up 11% and then AFC loan transactions up about 16%, does that indicate that you're further penetrating IAA?

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

IAA, we have further penetrated it, considering in 2007 when we put this deal together, AFC wasn't doing any business with Insurance Auto Auctions. But it's a very small number. So I wouldn't want to put a lot of importance on that number.

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

In fact, if would be insignificant, John, the IAA business. It's still that small.

John Lovallo - *BofA Merrill Lynch - Analyst*

Okay. Fair enough. And last question -- sorry.

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

It's more a differentiator for IAA having that available than the outcome that we see at AFC.

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

I think AFC has just done a tremendous job in the marketplace in being able to grow their business and grow their market share.

John Lovallo - *BofA Merrill Lynch - Analyst*

Okay. Very helpful. And last question, I believe on the last call you had indicated that there were 12 Cars Arrive sites fully deployed. Is there any update on that?

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

Yes. I can tell you that we continue to install the Cars Arrive technology at all of our US auctions. All of our US auctions will be completely installed by December 31. I believe we're currently at 17. And then in the first quarter of '13, we'll complete the Canadian auctions.

John Lovallo - *BofA Merrill Lynch - Analyst*

Great. Thank you very much, guys.

Operator

We'll take our next question from Rick Nelson with Stephens.

Rick Nelson - *Stephens Inc. - Analyst*

I want to ask you about the conversion rates. I know what you had to decline at ADESA. How that might look to the commercial type, specifically dealer consignment and then OPENLANE, the trends in each of those.

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

Sure, Rick. I think the most important thing is the mix shift to dealer consignment is the impact. It's not a market shift that tells me there's changes within the types of vehicles. Again, dealer consignment cars historically would convert 50% or less of the time. And commercial cars will convert at a significantly higher rate. And Jim, factory at the highest rate -- there's different changes. And that is the impact that we are seeing. Again, given the fact that we have such a strong representation of dealer consignment cars more as a result of the declining commercial vehicles is what I think I would attribute this to, Rick, not to a shift in the buying patterns of the dealers at auction.

Rick Nelson - *Stephens Inc. - Analyst*

Got you. And I'd like to ask you also about the unit growth reported plus 11%. I realize OPENLANE is a driver of that, and it's complicated to try to pull it out. But is there a way to look at unit volumes I guess ex acquisitions including OPENLANE, how that might compare to the industry?

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

Yes, Rick. Let me make sure I got the question. You had stated that ADESA was up 11% on volumes including OPENLANE. What's the outlook ex acquisitions, is that correct?

Rick Nelson - *Stephens Inc. - Analyst*

Yes. Ex OPENLANE, how that volume would have looked or ex -- under the same store --

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

Yes. On a same-store basis -- I got it, Rick. On a same-store basis, ADESA was down 6%. And then to your point, when you add OPENLANE back, we were up 11%.

Rick Nelson - *Stephens Inc. - Analyst*

And how do you --

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

Rick, let me -- I want to clarify one thing. We count on sold in the OPENLANE platform -- Jim mentioned this in his remarks -- with the integration of dealer block into OPENLANE, those become OPENLANE cars in our count. I just want you to know cars a year ago sold by ADESA are now included as OPENLANE vehicles because we've merged the platforms.

Rick Nelson - *Stephens Inc. - Analyst*

Okay. And how do you think that might affix compares to the industry in the same period?

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

The industry data is always difficult on the quarterly basis. But I would tell you -- I think the industry would be down slightly whether it's minus 6% or not, with the addition of OPENLANE, I think we've outperformed the industry. But it -- we don't really get into measuring the specific market share because the interim reads on this are as much projection as they are fact.

But I would think -- I'll be fair. I would think that with our weighting toward commercial historically, that impact us more. So that part of our business would be down more than the industry just because of our weighting. But we've outperformed on the dealer consignment basis, Jim. So it just may not be enough to offset that. I don't think the ADESA stand-alone would be significantly different than the industry. And I think the industry would probably be down year-to-date.

Rick Nelson - *Stephens Inc. - Analyst*

Got you.

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

Yes. I guess the point is on the commercial side because of our weighting. And repeating what Eric said, we had more to lose on the commercial side, but coming up here, we have a heck of a lot more to gain.

Rick Nelson - *Stephens Inc. - Analyst*

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

Operator

We'll hear next from Gary Prestopino with Barrington Research.

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

Did you break out what the percentage of dealer cars were this quarter?

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

Yes. I think it was 43% total dealer cars sold. Let's confirm that.

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

And then that is versus what last year? Do you have that handy, too, or we have to confirm that, as well?

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

Yes. Actually, it was a point less. It was 42% last year.

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

Okay. Then with what you're saying with these statistics on what you think units coming into the auction volume will be, which I assume those are industry estimates, or are those your estimates, Jim?

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

No, what we've done, Gary, is we've basically met with all of our commercial consigners one at a time, Peter Kelly, Tom Caruso, and myself, as well as our national relationship sales teams. But we have gotten their projections into the number of leases that they've written and the number of returns that they'll be getting over the course of the next three years right through 2015. The only thing -- we know what our market share is with each of these customers. I guess the only thing we couldn't tell you, we couldn't tell you whether the car's going to sell in an upstream venue or at a physical auction. We know what our volumes are going to look like, and it's a very positive story.

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

So with what you've done with this work, what you've done, is it safe to assume that obviously the institutional cars as we start going into these out years will start becoming a bigger percentage of the pie?

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

Yes, absolutely.

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

Cars, that you're going to be auctioning off.

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

Yes. If you think back, wasn't that long ago that we were weighted 70/30. Today we're 60/40. With these commercial volumes coming back, I see that commercial number obviously going back up.

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

Okay. All right. And then --

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

Gary, I want to be clear because I'm not sure -- we have too many numbers. For everybody on the call, our dealer consignment volumes were 43% of used vehicles sold at ADESA this year compared to 42% last year. Jim gave both those numbers, but we had others. I just wanted that to be clear. 43% of our volume this year. 42% last year.

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

You know, and just one other point of color I could add, Gary. I would remind you that dealer consignment percentage would have been closer to 50% excluding OPENLANE.

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

Right, right. Then in terms of allocation -- not asset allocation, cash and all that, Eric, do you plan to use a lot this free cash flow to pay down debt in the back half of the year?

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

Again, what I'll tell you, Gary, is our priority is to delever, as we said to get down to 3 times. And that's just the priority. I can't speak to -- there are no other priorities that we have right now. And I would think the building up of cash, we've repaid the revolver in the first quarter. And now we're building up a little cash as we're in the summer season. And again, I would tell you our priority is to delever and repay debt over the next, well, over the long term.

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

And how much did you repay on that revolver? Can you refresh my memory?

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

Yes, when we did the OPENLANE deal, the net borrowings after the first couple of days was about $110 million. That was all paid back within the first six month of owning it. So that was outstanding that we were able to get that repaid. And we've used about $100 million of available cash or a little more than that at the close of the deal. So again, excellent cash flow performance allowed us to get that paid off very quickly.

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

And then one last question. Was the impact of the OPENLANE acquisition about an 8% hit to adjusted EPS from amortization for this year?

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

Gary, I don't have that number in front of me.

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

We can circle back.

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

I can circle back to you. Just a second -- I'm looking.

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

That's fine, Eric. That's all I have. I'll circle back to you --

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

$4 million for the quarter was depreciation and amortization from OPENLANE.

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

Okay.

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

So that would be less than $0.08.

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

Okay.

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

That's for the quarter, and it would be about the same quarter to quarter. It's about the same.

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

Okay, thanks.

Operator

We'll take our next question from Chris Ceraso with Credit Suisse.

Unidentified Participant - *- Analyst*

This is actually [Shrase], I'm on for Chris. I just a couple of quick questions. You mentioned that your volumes in IAA were light, particularly tied to the weak used vehicle pricing environment and some warm winter weather. Obviously we have the winter weather behind us, but used vehicle prices are still turning south. So I'm wondering how we should think about that business going forward for the rest of the year.

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

Yes. Let me clarify one thing. We were up 3% in volume, and the insurance component was where you saw a little softer activity than recent years. And it was just the mild winter. Separately, though, we're seeing the average sale price of a vehicle soften a little bit as used car prices drop. That's an independent point. Again, Jim, we don't see the significance --

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

No, when we talk about used car prices softening, it's not a significant event. So again, we don't expect it to have a strong impact on proceeds at this point.

Unidentified Participant - - *Analyst*

Okay. And then I guess you guys mentioned -- you talked about dealer consignment earlier. Is there a target you guys are looking to hit as you bring back the institutional volumes in 2013, 2014?

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

Could you repeat that -- you said is there a target, what target?

Unidentified Participant - - *Analyst*

For dealer consignment levels. You mentioned your level for this quarter. I'm wondering is there a target level that you're trying to hit, especially as you bring back institutional volumes in 2013 and 2014?

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

I don't think so much of a target. I think more it's more a case of just trying to maintain our focus on dealer consignment. Our dealer consignment has come a long way. If you go back to the trough of our dealer consignment business a few years ago, we're at about 25%. And we just reported to you that sold close to 50% in this past quarter if you exclude OPENLANE. So, I think it's -- we want to do the best job in both venues. We want to continue to focus on dealer consignment and continue to drive that business and take advantage of these volumes. I think the combination of both is a pretty good recipe for success.

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

And I would add to that, keep in mind when commercial volumes recover because of our historical weighting and the focus on that business, we would expect that it's possible that our dealer consignment weighting would decline somewhat, like it's increased at a greater rate than the industry over the past two years.

Unidentified Participant - - *Analyst*

Okay. And then I guess also on OPENLANE, you talked about what the amortization costs were, but can you talk about what cost savings you're seeing, either now or you expect to see maybe over the next few years?

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

You know what, we don't give the -- our guidance or the results at that level. What we've said, though, is if you go back to the earnings -- or to the announcement of the deal, about 50% of their performance was expected to come from synergies, and we're on target to hit our expectations there. Again, I'm not updating that number. I'm just telling you what it said then, and Jim reported that we're doing the things that we set out to do.

Unidentified Participant - - *Analyst*

Okay, thank you.

Operator

We'll take our next question from David Melka with New York Life.

David Melka - *New York Life - Analyst*

I just wanted to ask, the public dealers keep talking a lot about their success in selling cars themselves, that at one time they would send to auction. I know you guys have been working hard, and have been successful in expanding your dealer consignment business. But can you talk about what the headwind has been and what you anticipate it being as those dealers continue that process? What do you think the headwind has been this year, and what do you bake into your '13 and '15 forecasts for auction units in the industry?

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

As we look at it from an industry standpoint, that's always been there. There's always been dealers that have elected to try and wholesale their own cars, and rental companies have attempted to wholesale their own cars. And when you think about it, from an industry standpoint, it's really immaterial. We don't really see it having a major impact on the industry, and we certainly don't see it having a major impact on our results.

Our value proposition has always been that we're going to put thousands of eyes on these vehicles, both from a physical and a virtual standpoint. And that's what we've been able to do for the consumer, and we think we drive much higher proceeds. And although there's been recent noise about that, I would just say it's nothing that we would term material.

David Melka - *New York Life - Analyst*

And are you -- do you have confidence that's going to be the case as you look out with your '13 and '15 forecasts? Or do you have any concern that it may actually start to become a material number at some point?

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

To that point for the handful -- not even for the handful, for the few clients that have announced that they have this desire to sell their own vehicle -- wholesale their own vehicles, we've gained multiple customers in that segment. And have continued to grow that area of the business with many of those like customers. So again, I don't think it's something that I'm concerned about.

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

David, I'll add to that. The issue is coming to our auction environment gives you greater liquidity meaning more people in the lanes. If the goal is to optimize what you can get for the car or to get access to the most number of vehicles to ensure you're buying the right cars, either way, it's hard to replicate the dynamics of our auction environment.

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

I'm sorry -- I was going to say when you think about the number of bidders that we have both in the lane and on our internet platform on Live Block that are able to bid on these cars. I just don't think a small group trying to attract those eyeballs is able to compete with the size of our network and the size of our dealer base. We're talking about if I want to expose this thing, we're talking about a buyer base of 150,000 buyers that we have registered within the car organization. So again, I don't want to discard that we wouldn't like to have those cars. We would love to have those cars. We do have relationships with those cars, and we still get cars from those people that are saying that they're selling cars direct. We still sell for those companies. So but -- I don't want to discard it, but I want to assure you that we've looked at it, and it's not a big concern.

David Melka - *New York Life - Analyst*

Okay. Thank you very much.

Operator

(Operator Instructions)

We'll hear next from Bill Armstrong with CL King and Associates.

Bill Armstrong - *CL King & Associates - Analyst*

Good morning, Jim and Eric. On the salvage vehicle side, you had a 3% increase in unit volume despite the warm winter and despite the loss of a national account. How are you driving these increases, and do you think you're taking market share?

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

I would say that your first -- your last portion of the question, we do believe that we continue [win] -- as I reported -- we continue win a number of RFPs. An area that continues to grow for us is what we call our VRD division, vehicle remarketing division. That is many of these lower-end vehicles that are actually coming from the whole car side of the business that are being sold in the IAA venue. We continue to do a very good job of attracting charity business, and selling those vehicles, as well. So I think the non-insurance vehicles have really supplemented the insurance vehicles. I think our -- I think we're still over 80% on the insurance side, but we've grown these other areas of the business.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. And you mentioned that the ASPs are softening a bit. Any way to quantify that at all?

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

Bill, what I'll point to is our revenue at IAA was up 2% for the quarter year-over-year, and volume was up 3%. So it wasn't a big move. But as you know, the selling price of the vehicle has a high correlation to the revenue per vehicle for us. And that would tell you that the pricing was a little bit softer. That the combination of those two factors.

Bill Armstrong - *CL King & Associates - Analyst*

Got it. And then moving on to the ADESA side, you mentioned you have some pretty good visibility on the institutional or commercial volume outlook, it's going to start to improve end this year through 2013. Is that being driven just by off-lease, or are there other segments that you also see maybe increasing volumes?

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

Yes. Good question. And let's not get totally focused on off-lease vehicles here, because another big driver of our business is repossessions. And the credit markets have loosened up, as you know, in the past few years here and a lot more consumer credit available. And we've -- repossessions has been a very big part of our business. And that will continue to be a channel that will provide cars for us.

The rental car business is a growing segment for us. In fact, as you know, many of these rental car companies are taking more and more cars at risk. They're -- we think they're probably looking to turn these cars a little bit more often than they have in the past. I think people are getting tired of showing up at the airport and getting a car two years old with 50,000 miles on it. So the rental car business was always one of -- it was our lowest performing segment. That has been a growing segment for us. And we continue to sell more rental cars. So all in all, coupled with the good job we've done on dealer consignment, all of our segments are growing.

Bill Armstrong - *CL King & Associates - Analyst*

So better credit availability you think will drive more repos. Are you seeing that happen already or is that a logical follow through of the loosening credit environment?

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

I think it's more than what we see, it's more in talking to our customers, more as to what their expectations are, and more of what they see their volumes being. Obviously the more paper you write, the more loans you take, the more opportunity there is for one of those cars to be repo'd.

Bill Armstrong - *CL King & Associates - Analyst*

Got it. Got it. Okay. Great. Thanks.

Operator

Operator. We'll take our next question from Eli Halliwell with D.E. Shaw.

Eli Halliwell - *D.E. Shaw - Analyst*

Wanted to just ask a couple of questions. Looking at the OPENLANE volumes in Q2, wanted to see if you could give us the actual number so we could reconcile everything. And also, wanted to ask on that, is pricing still in the range that you told us a couple quarters ago? I think it was like $326 in terms of the magnitude of difference between OPENLANE and the regular ADESA cars, start there.

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

Eli, first and foremost, we don't discuss specific numbers on volumes. We give you the percentages so you can understand the trends. Primarily because you know, we think that's enough information to understand how we're performing without giving competitive information out in this forum. Relative to pricing, though, I will tell you that OPENLANE's revenue per vehicle continues to be in the same ballpark, low $300s, like we've told you before. Just so you can understand how it goes.

Eli Halliwell - *D.E. Shaw - Analyst*

Got it. That's helpful then. What I was trying to get at, it looked like you really didn't have, if you reverse engineer those numbers, you didn't really have much of a hit in your revenue per unit at the core ADESA business. Am I doing that math right? Is that still holding in pretty strong?

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

I think I'll avoid commenting on your math in particular. But Eli, you heard what Jim said at the conclusion of his initial remarks. We have a number of levers, and we're looking at them all the time. I don't think you should be surprised if we've been able to stay strong on revenue per vehicle at the ADESA auctions.

Eli Halliwell - *D.E. Shaw - Analyst*

Awesome. That's great. And then on the last little bit, you gave us great clarity that you have visibility to when the volumes are coming back from the off-lease business. Can you help us a little bit in terms of -- you said it could come back at the end this year, it could come back in 2013. If we're looking through the phasing here, when you look at your $515 million of EBITDA guidance for the year, are you assuming that we're hitting the bottom in terms of volumes? Do you assume continued declines in H-II? Are you assuming a bit of an uptick?

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

Yes. We've hit the bottom. We've parted the trough and the greatest declines are now behind us. I'm sorry, I --

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

In terms of us saying the end of '12, into '13, it's really the least originations aren't as precise as to what day the cars come back. We're really looking back three years saying, here's when we saw the upturn. Right, Jim?

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

Yes. To put it in perspective you should think about the impact being in '13. There could be a small pick up in -- near the end of '12, but you really need to think about '13 being significant, and '14 and '15 being to take it up extremely strong in term of where it is today.

Eli Halliwell - *D.E. Shaw - Analyst*

Great. That's really helpful. Thank you.

Operator

At this time, back over to Mr. Jim Hallett for any closing or final remarks.

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

Okay. Well, thank you. We appreciate you being on. And appreciate your continued interest in our business. And we will thank you, and we will look forward to catching up with you next quarter. With that, you all have a good day.

Operator

This does conclude today's conference. We thank you for your participation. You may now disconnect.
