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KAR - Q4 2011 KAR AUCTION SERVICES INC Earnings Conference Call

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PRESENTATION

Operator

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

Today's host will be Jim Hallett, Chief Executive Officer for KAR Auction Services Inc.; Eric Loughmiller, Executive Vice President and Chief Financial Officer of KAR Auction Services Inc.; and Jonathan Peisner, Vice President and Treasurer of KAR Auction Services Inc.

I'd now like to turn the call over to Mr. Peisner. Please go ahead, sir.

Jonathan Peisner - *KAR Auction Services Inc - VP and Treasurer*

Thanks, Nancy, and thanks for joining us today for the KAR Auction Services fourth-quarter and year-end earnings conference call.

Today we will discuss the financial performance of KAR Auction Services for the fourth quarter and year ended December 31, 2011. After concluding our commentary, we will take questions from participants. We will make every effort to accommodate all the questions within the hour we have scheduled today.

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 the 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, and 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 & Director*

Thank you, John, and good morning, ladies and gentlemen. Thank you for joining us today.

I'd like to start out with talking about our 2011 results. We ended the year with adjusted EBITDA of $487.2 million, and in terms of our business units, Insurance Auto Actions had an outstanding year. They were able to grow their revenue by 15%, and their adjusted EBITDA grew by 14%. AFC also had another great year. Revenue increased at AFC by 24%, and their adjusted EBITDA grew by 28%; and I would point out that we did this all while maintaining a portfolio that was 99% current for the entire 2011 year.

The performance at ADESA in 2011 was below 2010; and let me try and help you understand what took place there. We knew the volumes were going to be impacted, but the volumes of physical auctions were actually impacted a little bit more than we anticipated. The results came in at 7.7 million units sold by physical auctions, and OPENLANE sold another 300,000 vehicles, approximately. OPENLANE will now report their volumes with the ADESA volumes, as we report to the National Auto Auction Association going forward. Another thing that I would point out is, our volumes in Canada hurt the ADESA volumes as well. You may or may not recall that automotive leasing came to a complete standstill in Canada in 2008 and 2009, and with the very large market share that ADESA and OPENLANE has in Canada, the Canadian market was hit harder than the US market.

So, as much as we were disappointed with the volumes, we were very pleased with our dealer consignment initiatives. ADESA's dealer consignment grew by 13% in 2011 compared to an industry that grew at 10%. And if we look back only a couple years ago, ADESA's volume and dealer consignment was less than 30%; and at the end of 2011 ADESA's dealer consignment was 42%. And the thing that I feel good about is, I feel that we still have much runway here to continue to grow our dealer consignment as the industry averages approximately 53% on dealer consignment. So, overall, I would say that I'm satisfied with our performance in what I would term as a very difficult or tough environment. And I think that the Management team has done a good job of doing the best they could in a difficult situation. But more so, I think, we are well positioned for 2012 and beyond, and I'm going to talk about that a little bit later in my comments.

But now I would like to turn our attention to the OPENLANE integration, and I can't think of anything that is more critical on my radar right now than the integration of OPENLANE. I'm very pleased with the progress that our teams are making. I think they have done a great job of bringing these two companies together. A couple of events that have taken place is, we now have a single sign-on where you can sign-on and get access to the ADESA DealerBlock inventory as well as to the OPENLANE inventory. ADESA DealerBlock will be migrating to the OPENLANE platform, and as we have said to you before, the OPENLANE platform will replace DealerBlock and eventually DealerBlock will go away.

We are also in the process of moving ADESA closed sales to the OPENLANE platform, and we just completed fully integrating the sales teams at both ADESA and OPENLANE, which has actually surpassed my expectation in terms of the timeframe in getting this done. The feedback from our customers has been very positive. I've been able to witness very strong relationships develop between the ADESA and OPENLANE staff. And we now have a fully integrated dealer consignment team, and a fully integrated commercial sales team; and most importantly we are now approaching our customers as one company with one voice.

If there was a hidden gem or golden nugget in the OPENLANE transaction, it would have to be the CarsArrive. And at a high level, I think we told you before that CarsArrive is the only fully-automated transportation solution in the industry. And the last time we spoke we said that we were rolling the CarsArrive project out -- we are rolling a pilot out at seven of our auction locations.

I'm pleased to report that we've completed that pilot. We were successful in moving thousands of cars through these seven auctions, and now we are continuing to roll CarsArrive out to all of the other ADESA auctions. In fact, many of our general managers are lined up jockeying for position as to who will be the next install. And another interesting fact is, many of our commercial customers have contacted us wanting to inquire about opportunities for CarsArrive outside of the traditional remarketing or auction channels. So, when we initially reported this deal on OPENLANE, we felt that we could increase adjusted EBITDA by approximately $20 million to $25 million in 2012. And I would say to you that I'm extremely pleased with the progress that we have made, and I don't see any changes to my expectations on delivering to this increased level of adjusted EBITDA.

In terms of the outlook for 2012 and beyond, I believe that 2012 is the trough year, and the steepest volume declines are behind us. I think 2012 industry volumes will be comparable to what we've seen in 2011; and just to repeat that, 7.7 million vehicles sold at physical auctions and approximately 300,000 vehicles sold by OPENLANE. There may be a channel shift that occurs, but we don't expect that shift to be seismic or sudden. I think, more importantly, we're well positioned, whether it be virtual or whether it be physical, to be able to sell the car.

So as I look at our expectations for the next few years, we've all been hearing that new car sales will continue to improve. We know that lease originations have improved over the past two years and will continue to improve going forward. And we've had discussions with many, if not all, of our commercial consignors who support our view, and have given us much visibility into what their volume projections are, not only for 2012, but for the next few years going forward. And we would expect that 2013, that the wholesale auction sales would approach 8.4 million vehicles, growing to nearly 9 million vehicles in 2015.

As I mentioned, we may see more vehicles sell online, whether that be through our upstream, our midstream channels, or through our LiveBlock broadcast; but I think the most important thing, and the thing that I really want to point out here is, that we now feel that we are extremely competitive in both spaces. Whether the car is sold virtual or the car is sold in the physical auction, is not really our decision. We feel that we have to provide the best platforms, the best venues that we can, and we believe it is up to the customers and the markets to determine how the vehicle gets sold.

Another thing that we are keeping a close eye on is the values of used vehicles. We would expect values of the used vehicles to remain strong in 2012. Values may moderate as we move into 2013, depending on what happens to the new car business and new car sales; but we don't expect any big changes.

So, what's all this mean for KAR? Obviously, the improving volumes will be of benefit to ADESA, should also benefit AFC as they continue to grow. I believe that Insurance Auto Auctions will continue to grow, but potentially at lower levels than we've experienced in the last two years. And when you think about the things that affect volume growth at Insurance Auto Auctions, a couple things I would point out is, this mild weather that we are experiencing may lead to fewer claims, and although this will be a concern for Insurance Auto Auctions, it has been very positive for ADESA. In fact, at ADESA we have had no cancelled sales to date, and I believe that is the first time I can remember saying that as we approach March 1 in any year. The other benefit is that it lowers our labor cost across the board, as we are not pushing snow around. It makes for a lot happier employees, and it makes it a lot more conducive to customers to want to come and see you on a regular basis.

There has been a lot of talk about rising fuel prices. As fuel prices continue to rise and approach that $4.00 level, we may see fewer miles driven, which could result in lower claims, again. And then I would point out, as you all know, Insurance Auto Auctions wins and loses business from time to time. Recently Insurance Auto Auctions was on the losing end of a national RFP, which was unfortunate, but will not be material to our results; and the impact of this is reflected in our guidance.

So, before I turn things over to Eric, a couple of comments that I would make. First of all, I would say thank you for your support of KAR in 2011. In summary, we expect adjusted EBITDA of approximately $515 million in 2012. Our business will continue to generate strong free cash flow, and Eric will give you more detail on that. And our goal of achieving net leverage of three times adjusted EBITDA has not changed; and I will assure you that the leadership team at KAR is very focused and remains focused on achieving all of our objectives in 2012 and going forward.

So, with that, I will turn it over to Eric for a few additional comments on our guidance, as well as our 2011 financial performance. Eric?

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

Thanks, Jim.

Let me start by talking about 2011; and I've noticed a couple of early reports by analysts have been issued, so I'm going to clarify a couple of things for you that may not have been as clear in our press release.

Our consolidated revenue for KAR increased 3.5% in 2011. As Jim mentioned, this reflected strong performances at Insurance Auto Auctions and AFC. At AFC, some have looked at that revenue; I will tell you there's been a minor change in our accounting for pass-through expenses at AFC. All the years presented in our 10-K will be restated to gross up revenue and gross up expenses for pass-through items that previously were netted to zero. This has no impact on the bottom line, whether it be adjusted EBITDA, operating income, or net income. The net income -- the net impact on revenue is an increase in AFC revenue of approximately $8 million in 2011, $8 million in 2010, and $6 million in 2009. We have in the 10-K, or will tonight, provide the details of this change, including the quarterly impact so that you can understand how it affected past quarters.

We also have the limited supply of used vehicles at wholesale auctions that lead us to a 7% decline in volume and a 5% decline in revenue. As Jim pointed out, we are now including OPENLANE in the ADESA segment results, so I'd thought I'd give you a little more color as to what OPENLANE did in the fourth quarter. OPENLANE sold about 50,000 vehicles in Q4, and that gave them about just over 300,000 units sold for the full year. OPENLANE contributed $16 million of revenue, and its adjusted EBITDA was essentially break-even, with a loss for the quarter of just under $100,000. OPENLANE's performance was consistent with our expectations for the fourth quarter and consistent with their historical seasonality for the business.

Now let me turn to gross profit. I think that is a strength of our performance. We came in at 45.1% gross profit for the full year. I think that is an exceptional result, given all the challenges Jim has discussed with you. We did see an increase in SG&A, and that is solely attributable to the OPENLANE addition to our family. I would like you to keep in mind that OPENLANE does not handle the vehicles sold, and a majority of their costs end up in SG&A. And in fact, $10.8 million of OPENLANE SG&A is added to the fourth quarter.

We also had some transaction- and integration-related expenses at ADESA that are now required to be expensed as incurred, as opposed to previous transactions, where you might have capitalized a portion of those expenses into the purchase price. Those amounted to about $4.8 million in the fourth quarter for transaction-related expenses.

Our interest expense for the year came in at $143 million, compared to $141 million in 2010. I just want to highlight that, that includes $14.5 million from the termination of a swap arrangement associated with our May refinancing of our Term Loan B. So, as I look at it and take out the one-time items, our cash interest expense on the outstanding debt on a going-forward basis would compare to $111.6 million. This excludes the interest on that swap, and also the AFC interest expense, which we do not add back to EBITDA.

Earnings per share of $0.52 and adjusted earnings per share of $1.16 for 2011, represents 2% and 10% growth respectively. EPS and adjusted EPS were reduced by $0.02 due to amortization of intangible assets recorded at OPENLANE as of October 3, the closing of the purchase. We do not adjust earnings per share for purchase accounting impacts for businesses acquired subsequent to the forming of KAR in the original LBL, so this will be reflected in our financials and as both GAAP and adjusted earnings per share.

Now I'd like to focus on our cash flows for 2011, because I really think this is a highlight for our Businesses. We generated $305 million of cash from operations in 2011. From this, we spent about $85.8 million on CapEx; we utilized about $100 million of our available cash; and borrowed an additional $110 million on our revolver to acquire OPENLANE on October 3. Since that acquisition was consummated, we've been able to reduce the revolver down to $68.9 million outstanding at December 31, 2011.

Many of you that follow KAR utilize a free cash flow computation that begins with adjusted EBITDA, so I'd like to walk through that performance for 2011. Jim mentioned our adjusted EBITDA of $47.2 million. You reduce that by our capital expenditures of $85.8 million, recurring cash interest expense of $111.6 million, and cash taxes of $36.5 million. That nets to a resulting free cash flow of $253.3 million for 2011. I think an attribute of our business is the strong cash generation we have in all kinds of market conditions, so this is something we expect to continue going forward.

In terms of guidance for 2012 -- while Jim mentioned the adjusted EBITDA of $515 million, let me tell you this will translate into earnings per share of $0.85 to $0.90, and adjusted earnings per share of $1.15 to $1.20. The amortization of the intangible assets that were established in the purchase accounting for OPENLANE will result in an $0.08 after-tax reduction in adjusted earnings per share, compared to only a $0.02 impact in 2011. That $0.08 has been reflected in the numbers I just gave you.

Our range in earnings per share and adjusted earnings per share in 2012 reflects both the adjusted EBITDA as well as some uncertainty in our effective tax rate. Our effective tax rate for 2011 came in just below 20%. However, we know this rate will be over 30% in 2012. There are some factors that I don't know yet today to tell you exactly what that rate will be. Those would include the amount of profit interest expense we record. As our stock price increases or decreases, an increase results in additional profit interest expense, which is non-deductible for tax purposes; a decrease results in reversal of previously recognized profit interest expense. So those variables can have a big impact on our effective tax rate, because we get no tax benefit for the deductions or the expense we've recorded in our financial statements.

In addition we have some significant state, Canadian, and US net operating losses, and the utilization of those will have some impact on the overall effective tax rate for the year. So, I'll keep you posted throughout the year as we get more information and get clarity on how these factors are going to turn out for us, but you can expect a much higher tax rate in 2012 than we've had the last few years.

Capital expenditures will be about $90 million. This includes capital projects related to the integration of ADESA and OPENLANE. So that's where we expect to come in for the year. Cash interest expense on our corporate debt -- and this does not include the interest on the securitized receivables -- we expect that to be about $95 million, reflecting the lower cost of our new Term Loan B. And our cash taxes are projected to be at about $70 million, which is an increase from what we had in 2011.

The net result, when I add up all these numbers for free cash flow, is we're expecting to generate free cash flow of about $260 million in 2012. And again, I think that demonstrates the type of business we have given all the factors Jim discussed with you that will influence the 2012 performance.

So I think that's enough comments for now. I'll turn it back over to Nancy, our operator, and she'll begin the Q&A session. So, thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take the first question from Ryan Brinkman from Goldman Sachs.

Ryan Brinkman - *Goldman Sachs - Analyst*

Congratulations on the quarter. My first question relates to OPENLANE. When you first announced the acquisition, I believe you guided to $13 million of stand-alone adjusted EBITDA on revenues of roughly $100 million, suggesting 13% EBITDA margins on a stand-alone basis, which would compare to the core ADESA business of more like 24%, and there were some questions as to the modeling implications of that disparity. Last night we saw our the first glimpse of ADESA results with OPENLANE, and it seemed like gross margin held in really strong there, maybe even improved year-over-year. Can we infer from this that OPENLANE gross margins might be similar to ADESA gross margins or maybe even higher, given the lack of ancillary services, and that the lower stand-alone EBITDA margin at OPENLANE historically might relate to its having been sub-scale? And if so, as you grow OPENLANE, could the EBITDA margin difference between an OPENLANE and a core ADESA auction narrow over time?

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

Well, Ryan, let me take that, first. You're right pointing out the gross profit margin on the OPENLANE transactions is higher. And as I mentioned in my comments, it is because a substantial amount of their cost structure is in SG&A, they don't handle the cars. So, it's higher than what we have at ADESA where you are constantly moving vehicles at the physical auctions sites. Relative to the EBITDA contribution, you are absolutely correct. As you look at the OPENLANE business in its first 10 or 12 years, it was focused on growing market share, increasing the top line, and again, I would describe it as not a real focus on the bottom line. And as we've put these two businesses together, we have an infrastructure in place at KAR Auction Services that is available to them. And so we are able to reduce their overhead cost to some regard, and we've accomplished that as Jim mentioned. We have the ability to look at the sales teams that Jim talked about. So, again, I think we can see that business as we integrate it beyond 2012. I think you will see a profile where you won't notice a difference, as Jim mentioned, how the cars sold. It will contribute to our EBITDA and our gross profit fairly consistently and have strong margins going forward because we are running it as one business. Jim, anything to add on that?

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

No, I would maybe just add that there are different offsets, obviously, when you're selling the car virtual, right? You're also gaining the transportation and some of those services. When you're selling the car in the physical auctions, then you're getting ancillary services. So, at the end of the day, I think both of those businesses will have similar revenue growth.

Ryan Brinkman - *Goldman Sachs - Analyst*

Okay, that is really helpful. I would just say that the other thing I was really interested in the results was the strength on salvage volumes? It's really been exceptionally strong the last couple of quarters, but especially in 4Q. And I know that there is not really good publicly available information out there on salvage volume trends like there is for whole car. But from an outsider's perspective, given the trend in miles driven, it would seem that the market should be tracking roughly flat at best and given that backdrop, can you help us better understand what might be, I think I backed into a plus 15% or 16% year-over-year gain in volumes, which is really strong. Does that relate to a specific material win, a contract win or smaller wins in aggregate, or to stronger charity volumes, which can be seasonal in 4Q? Can you help us understand the drivers and the sustainability of those type of results?

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

Well, I think it is a number of those things, Ryan. I think number one is, we've been successful in growing our non-insurance business that we've talked to you about the past. Also, we've been able to grow the charity side, and then we've had strong volumes come from some of the hurricanes and some of the natural disasters that have taken place over the past couple of years.

Ryan Brinkman - *Goldman Sachs - Analyst*

Okay, but fair to say you've gained share relative to the industry the fourth quarter, right?

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

Right. I think the -- and then you talked and just reinforce, and I said in my comments, there is continuous wins and losses throughout the course of the year and of course our goal is to be on the top side of those wins.

Ryan Brinkman - *Goldman Sachs - Analyst*

All right, and then just last question. Do you think that there is still a trend towards national accounts in the salvage business and that being one of the maybe two at most there that you should gain volumes over time as a result of that trend?

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

You know, Ryan, let me say that we've spent a lot of time talking about this sort of thing over the last couple of years. And we've said that we don't get into talking about specific customers and quite frankly we can't, because we are under confidentiality anyway. But there was a lot of talk a couple of years ago about a major customer, and I think the results speak for themselves. We come back with a 9% increase in our volume. So, in terms of, there's always going to be wins and losses. Insurance customers are always going to look at how they divvy up their business, and again, I think the result speak for themselves.

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Ryan Brinkman - *Goldman Sachs - Analyst*

Yes, they do.

Operator

The next question comes from John Lovallo from Merrill Lynch.

John Lovallo - *BofA Merrill Lynch - Analyst*

First question is, I was hoping you could talk a little bit about the opportunity from the recent announcement where you're going to export salvage vehicles to China. Just hoping you could dimension that opportunity a bit.

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

Yes, John, listen, that's an excellent opportunity for us, having that relationship with a Chinese exporter of scrap metal, but let's not exaggerate it. Again, that is not a major part of the market. I think it is exciting we have that relationship, but I wouldn't read too much into it. I mean it is a -- we sell salvage vehicles all over the world. They get exported to all kinds of places, and I think the fact that we can support multiple languages and support these types of businesses is great. I don't want to exaggerate what the level of volumes though that it creates in terms of the salvage market.

John Lovallo - *BofA Merrill Lynch - Analyst*

Okay.

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

But they do export a fair amount of scrap metal from the United States to China, and that seems to be a trend that occurs when the scrap prices are a little lower.

John Lovallo - *BofA Merrill Lynch - Analyst*

Great, thanks, if I could just sneak one more in here. There is some industry data that suggests that dealer consignment volume increased in 2011, and I think there were some numbers around 55% of whole car auction volume. That seems like a pretty big shift from 2010. Can you help us with what could have been driving that?

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

Well, I think, John, obviously it has been driven by the shortage of commercial vehicles. If I was to put it into one sentence, there is no question, you are right, the market we -- we feel the market's somewhere right around 53%. And I think I've reported to you that we grew our business to 42%, and we feel we can continue to grow that. And I think it is all a question of demand, and that is pretty much it.

Operator

We'll go next to Chris Ceraso from Credit Suisse

Chris Ceraso - *Credit Suisse - Analyst*

A couple of things. I'm sorry if you mentioned this, but it seems like if our numbers are right, that you saw a bit of a reversal in trends at ADESA where units were up that had been down. But revenue per unit was down and that had been up? Do we have that right, and what caused that, and is that something you expect continue in that direction?

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

No, Chris, our volumes were down year-over-year, not as substantial as previous quarters, but they were down, and our revenue per unit for the fourth quarter remained fairly steady for us. So maybe off-line at some point we can go through it in detail, but I think the numbers when you get the 10-K will help you out a little bit. So I'm looking at something here, the revenue per unit, again, we're nearing -- we don't give a specific number, but we're nearing $600 on the ADESA business. So that's pretty strong and been fairly steady through the market. Now, if you look at consignment volumes increase, that fluctuates a little bit because you have fewer ancillary services.

Chris Ceraso - *Credit Suisse - Analyst*

Okay, we'll go back through that, then. You sounded pretty bullish about OPENLANE and how the integration is going. Is there an opportunity to leverage that into the IAA business?

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

I would say it is not something that we -- we've certainly talked about it, and we talked about are there possibilities for our other business units. And I think we've said in the past that we think there may be possibilities to use the platform for other than the obvious. But certainly, at this point in time we remain focused on just bringing ADESA and OPENLANE together, and once we can put a successful stamp on that, then I think we will look at other opportunities.

Chris Ceraso - *Credit Suisse - Analyst*

Okay, you had made a comment, Jim, about a channel shift. Can you expand on that a little bit on what kind of magnitude you're talking about and whether or not you think that puts any pressure on your EBIT margins?

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

I have said that there may be a channel shift. We are not exactly sure how that will play out. We've seen more and more cars shift to the virtual market place over the last few years. But I don't have any indication of where the sweet spot will be or where that will finish at. I don't think there's been any great shift that is going to take place. But if I was looking at it, I would say it may follow some of the trends that we have seen in the salvage business over the past five years in terms of how that market has grown from the physical to the online business. But I think the most important thing, and I'll repeat, is that we are well positioned with the OPENLANE platform and well positioned with the ADESA physical footprint to sell the car. At the end of the day, you just want to make sure that you are able to play at a superior level in both places, and OPENLANE gets us there on the virtual side and obviously ADESA gets us there on the physical side. So I don't know -- I hopefully try and answer your question. I think there will be some gain, and in terms of pressure on margins, I think we've said there isn't really going to be that much difference when you add up the revenue. And then you take the additional opportunities you get with the virtual cars in terms of the postings fees and in terms of the delivery through CarsArrive and the transportation solution versus the physical with the ancillary services, it kind of balances itself out. So I don't think it does really create any additional pressure on margin or EBITDA levels.

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

And, Chris, I'd like to add one comment. Not just OPENLANE, but we should also remember that LiveBlock is really gaining traction, which is basically a virtual buyer at the physical auctions. He is able to buy without attending, and at IA we have that with our live and online offering, which we are -- again we're simulcasting both the physical auction to the virtual buyers, and that's where a lot of the online buying is also migrating. There just seems to be less reasons for the buyers to show up at every auction every week, yet they want to participate in the auction and buy the cars.

Chris Ceraso - *Credit Suisse - Analyst*

Interesting. Okay. And then just one housekeeping one. You mentioned what you thought the cash interest expense would be. Is there much of a difference in what your book interest expense will be?

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

Yes, we do have some amortization that typically runs in between $5 million and $10 million per year of debt issuance costs.

Chris Ceraso - *Credit Suisse - Analyst*

$5 million to $10 million on top of your cash?

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

Yes, it's pretty consistent. When you get the 10-K you'll be able to figure it out, Chris. I don't have it right in front of me.

Chris Ceraso - *Credit Suisse - Analyst*

Got it.

Operator

The next question comes from Manav Patnaik from Barclays Capital.

Manav Patnaik - *Barclays Capital - Analyst*

Just wanted to clarify a couple of things with the OPENLANE numbers you gave. So you said it was 50,000 volume and $16 million in revenues for the quarter, and if I back that out, I get the revenue per vehicle sold as $570, which is short of what you said about $600 just now. I just wanted to know what other moving factors there are between that $600 number you were talking about?

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

It's nearing $600, Manav, and the dealer consignment brings it down. It is in the upper $500.

Manav Patnaik - *Barclays Capital - Analyst*

Okay, fair enough. And then just to clarify as well, you had mentioned that you had expected OPENLANE to contribute $20 million to $25 million in EBITDA in '12, so does that mean that the $515 million guidance you gave without OPENLANE would imply something in the $490 million, or are you not factoring that [pure] $25 million in there?

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

No, and again, I don't want to get into breaking the pieces apart because when you have OPENLANE as we have integrated the sales teams, some of that $20 million to $25 million might have historically been at ADESA. But you are doing the math right, Manav. It's $515 million with all of our businesses.

Manav Patnaik - *Barclays Capital - Analyst*

Okay, fair enough. And I add the loss that you mentioned about and the fact that you said it was factored into guidance, would we see -- how should we model in the sequential impact of that loss? Is it going to be more gradual or only towards the end of the year? Can you give us a little more color on how that will play in?

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

All I'll say is that it is a recent announcement that will come in over the course of the year. And again, it's not going to have a material impact. Jim only pointed it out because, again, we have had such strong volume growth the last two years. We're not expecting to be quite as strong in 2012.

Manav Patnaik - *Barclays Capital - Analyst*

Okay, and then the last question is housekeeping stuff. Can you -- what is the expected stock comp number? And also what should we be modeling in for the stepped up D&A, if there is a number you can give us?

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

That's the level of guidance, Manav that we -- we don't get into the details. You can see the stepped up D&A is easy because it is a straight line, so it will be consistent with what's this year, although I will tell you, 2012 we will fully amortize some of the original assets that had five-year lives. So it will decline after 2012 by a little bit. And in terms of stock comp, again, I don't want to be projecting the stock price, which is what influences that, so we'll just have to wait and measure it. It's been a number that's been highly variable year-over-year depending on how the stock moves.

Manav Patnaik - *Barclays Capital - Analyst*

Okay, fair enough.

Operator

And we'll move next to Gary Prestopino from Barrington Research

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

Jim, did you say on the industry outlook that you are looking for a flat year this year in 2012?

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

Yes.

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

Okay. So looking at something like 7.7 million cars in this year?

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

Yes.

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

Okay and the industry is not going to pound OPENLANE's cars since you bought them? Since you purchased OPENLANE, there's still going to be physical auctions?

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

No, the industry will include the OPENLANE numbers in the ADESA reporting.

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

So then the real number would be something where you'd still looking for a -- on an apples to apples basis, on an industry basis, you're still looking for someone of a down year in --

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

No, I don't think it would be down, Gary. I'm saying if you take the 7.7 million and you take the 300,000 from OPENLANE, you get to 8 million cars this year, which would put us flat if we had added them together for the past year.

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

Okay, so still flat. Okay.

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

Yes.

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

And then in terms of -- have you got the sales forces integrated now with OPENLANE? Is that what you said, or you just finished that up or what?

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

We have just finished it up, and we now have one sales force under one Vice President of Sales and Marketing that is now brought the sales teams together. They have cross-trained. Some of those sales people have remained from the OPENLANE team. Some have remained from the ADESA team. We've, as we would say, we've taken the best of the best, and we've completed the training. They are integrated. They are now out there speaking with one voice much similar to what we did on the dealer consignment side as well.

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

So the advantage now is obviously you can do physical as well as virtual, but I mean how has the reception been with your sales force initially knocking on the doors of the suppliers?

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

Well, I think more so it was -- our customers really wanted to be speaking to one person. Rather than having an OPENLANE rep call on them and having an ADESA rep call on them, and you could even go further - in some cases we've had an Insurance Auto Auction rep calling on them. That was what they did not want. They really wanted one person that could interface with them, that could handle the account, whether it be virtual or whether it be physical, or in some cases even send cars to some of the salvage auction. And that was the goal. That's what we heard from our customers as we did a lot of these interviews, and that's the direction we took, which was not originally, Gary, which was originally what we had anticipated. Quite frankly we anticipated that we would keep two sales teams originally, we'd keep the ADESA sales team and the OPENLANE sales team, and then as we got into it with our customers and we listened to what they had to say, it made perfect sense that we just merged these under one sales team.

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

And can you help us in terms of the virtual side of the business? How many vehicles are going through that every year? On an industry basis?

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

Oh, I'm sorry, yes, on an industry basis? I think it's roughly, Gary, I would say you're looking at about 1 million vehicles.

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

And that would've been a 2009 number that was in some publications. I suspect it would have declined with the commercial vehicle declines we've had in 2011, right, Jim?

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

Yes, I think in its best year, it was around 1 million, and it's somewhat -- we all know what's happened over the last couple of years here, so I would say the number is down. The only number we know for sure is the OPENLANE number.

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

And that would be virtual-only auctions, not us and our competitors that actually sell some online vehicles that got reported in AAA.

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

Okay, and those are -- and that virtual auction business is all very high-end institutional vehicles, or does it span the dealer side as well?

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

No, I think it continues to expand. And certainly it is not all high-end vehicles. It's dominated by lease returns right now, but we are also seeing repossessions, we're also seeing dealer cars sold on there, rental cars being sold on there, so we see that channel continued to expand into other segments. So I would say that it's right across all segment.s

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

Okay and then one last question. In terms of Insurance Auto Auctions, great volumes there. What -- besides on the non-insurance side, could you site three or four markets getting the growth in these cars?

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

Well, number one, I think I spoke about the charity growth, the non-insurance vehicles. And then we have a number of our commercial sellers that are chosen to sell some of their very low-end vehicles, especially the repossession vehicles, as I call some of the push, pull, and drags. We see our commercial customers selling some of those vehicles in the salvage venue rather than the whole-ar venue, so there's been a little bit of a shift there.

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

And Jim, you might mention the insurance companies that have -- I'll just go through it. There are some insurance companies where with the economy and the age of the cars, Gary, that are no longer carrying collision coverage. I think we are seeing some success when someone has an accident. They've got this wrecked vehicle. The insurance company is not going to process a total loss, and we have a couple situations where we're able to market directly to that customer. And so it's not an insurance vehicle because they didn't handle the car, but it is a very similar vehicle because it was in an accident.

Operator

And we'll move next to Craig Kennison from Robert W. Baird.

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

Just to follow on the OPENLANE series of questions, what should we monitor as important milestones as you integrate that business? And is there a material cost save associated with the migration from DealerBlock to OPENLANE?

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

Craig, let me answer the last part of that question first. You say cost savings, I hope ultimately there is, but really it's the better allocation of capital, because OPENLANE was well ahead of where ADESA was with its platforms. And so once we get through this integration, we think we can ultimately reduce the capital allocation to that platform. Beyond that, the cost saving -- the cost isn't really much different for any company that operates a virtual platform. You have to support the technology, but you have a lot less labor, so, again, it depends on what we want to compare it to. There is a lot lower cost compared to a physical sale of a vehicle, but I don't know that there would be that much of a difference from our previous platforms to the OPENLANE platform to support it. Jim, any thoughts on that?

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

No, I would just follow-up by saying, yes but what success looks like. And I think success is a full migration of all of the ADESA e-business that we currently have going seamlessly onto the OPENLANE platform and our customers all feeling good about the transition and the integration. And I can tell you that we've spoken with the customers that we are going to transition to the OPENLANE platform, and not only are they supportive, but they are excited because it does add additional features and enhancements that maybe they weren't getting on the DealerBlock platform. So, if I look at success and I look at -- I said originally I thought this was going to be a 15-month integration, 18-month integration, as I look at success, from a year from now, I want to know that the customers were very pleased with the transition, very pleased with the levels of service, and feeling good about their decision on switching over.

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

Okay. And then shifting gears to AFC, I believe one of your larger auction competitors acquired an AFC competitor in January. How should we weigh the risk of that particular dynamic?

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

I would say that DSC has been a competitor with AFC as well as MAFS have been a competitor with AFC. We've competed with them in the past, and we will continue to compete with them in the future. I don't know exactly what their goals are. They would have to speak to that, but anecdotally I hear that they are going to continue to run them as two independent businesses. So I think that we see us continuing to compete pretty much the same way we have for the past several years.

Operator

The next question comes from Joseph Edelstein from Stephens Inc.

Joseph Edelstein - *Stephens Inc. - Analyst*

Just want to come back to the comment around the hurricane. I'm just wondering if you experienced any quantifiable lift this quarter between volume shifting from the third quarter into the fourth? And then also a similar question around the holiday calendar that you spoke about last quarter and how that freed up extra days for you, or how those shifted into better days for a typical auction?

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

Well, first, the hurricanes that were grounded up at the Northeast created a lot of volume and that is being sold off actually into the first quarter of this year. So while Jim commented on the mild weather, I will tell you that mild weather will have an impact as we get into the second quarter more so than the first quarter. The cars get wrapped and then you've got 75 to 90 days before they sell. So, again, the hurricane, we saw a nice volume of cars on the ground at the end of the year and we're selling those off in the first quarter. So, Joseph, that is the impact of that. The calendar is very interesting, and I will tell you, having the weekend holidays this year, and the way the year fell, we in essence got another week of sales at IAA on our calendar. So that was good for their results and will make it a tough comp in the fourth quarter of 2012, because I believe the holidays are falling on a Tuesday, which basically means people start getting ready for them maybe even earlier than that. And it's hard to have a sale. You might lose the better part of half a week there where this year I would tell you we lost half a day as people took off at noon on Friday getting ready. So that's about all I can say. We'll see how it goes. Again, it was a very strong calendar for us, especially in the salvage business. And we had a lot of inventory on the ground, so the insurance companies were trying to continue to sell those cars, because they had probably a little bit more inventory than we historically would have as we got to year end. Does that answer your question, Joseph?

Joseph Edelstein - *Stephens Inc. - Analyst*

Yes, it does. The majority of my other questions were answered, so thank you for taking the time.

Operator

And we'll take the next question from Bill Armstrong from CL King & Associates.

Bill Armstrong - *CL King & Associates - Analyst*

In IAAI you had a pretty strong revenue increase, and you mentioned an increase in purchase vehicles sold. I don't think I've seen that mentioned before. I was wondering if you could give us a sense for how many revenue dollars of the increase came from purchased vehicles? Maybe just kind of talk about that business a little bit. Under what circumstances would you be buying and selling vehicles for your own account versus as an agent?

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

Yes, Bill, good question. We're up to about 5% of the vehicles that we're selling were purchased. And we aren't purchasing them at auction. We are purchasing them -- if you look at the insured motorist that doesn't carry collision coverage, we buy that car from them. We don't have them repping the car, so we're typically buying lower end low-cost vehicles and then remarketing on behalf of the person we brought it from. And our fees are caught in the -- the difference between the auction sale price and what we paid to the consumer, and we're right about 5%. We don't give -- it's not big enough to really call out. I will tell you the margins at IAA were down slightly. It's because we've grown. We're required to record the revenue at the gross sale price at auction. And cost of sales includes the purchase price of the car which makes it a very low margin business, and we do get impacted with the volume -- up to 5% now it's probably taken a point off the margin because of the reporting of the revenue at gross sale price. But again, it is still not that material. It just influences it a little bit. And at 5%, we disclosed that in the third quarter 10-Q, and the fourth quarter 10-K will include that same disclosure. Prior to that it was below 5% and was not disclosed in terms -- it was typically below 3%.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. Moving on to ADESA, you've really made a push in the last couple of years successfully in the dealer consignment area. As we move through the back half of this year and even more so next year we're going to see more trade-ins. We're going to see more off lease vehicles. At the same time, we're seeing a lot of dealers, especially the publicly traded ones, making a big push to keep a lot of those off lease and trade-in vehicles and re-retail them rather than selling them through auctions. What sort of impact are you seeing there? Are you seeing this just from the big dealership chains or is this industry-wide? And would we be looking at any particular types of cars? Would it be just newer cars or are we seeing this trend across the board?

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

I think primarily you're seeing some of the larger groups buying cars and holding cars. I don't think it's a trend across the independent network, and as you know, there's -- I think there's a handful of groups that are buying cars. So I don't think, again, I don't think it's something that's going to have a major effect. I think more to your point is that as we continue to sell more new cars, and we continue to see more commercial cars come back into the marketplace, I think that is only a good generator of more transactions for the auction. So I don't think it has a major impact.

Bill Armstrong - *CL King & Associates - Analyst*

Got it, okay.

Operator

And it appears there are no further questions at this time. Mr. Hallett I'd like to turn the conference back over to you for any additional or closing remarks.

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

Okay, thank you, Nancy, and I would just say thank you for being on the call today. Again, we appreciate your support. We are excited about our business. We feel that we've been through the difficult times and as I say, through the trough, and it feels good to be knowing that we are heading north. So, with that said, appreciate your time and your interest and look forward to catching up with you soon. Thank you.

Operator

And that does conclude today's presentation. Thank you for your participation.