KAR AUCTION SERVICES, INC.

Moderator: Jonathan Peisner
February 18, 2015
10:00 am CT

Operator: Please stand by. Good day, ladies and gentlemen, and welcome to the KAR Auction Services, Inc. Q4 2014 Earnings Conference Call. Please note today's conference is being recorded. At this time I'd like to turn the conference over to Mr. Jonathan Peisner, Treasurer and Vice President of Investor Relations. Please go ahead, sir.

Jonathan Peisner: Thanks, (Holly). Good morning, and thank you for joining us today for the KAR Auction Services fourth quarter and year-end 2014 earnings conference call. Today we will discuss the performance of KAR Auction Services for the quarter and year ended December 31, 2014. 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 risk 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 issues yesterday, which is also available in the Investor Relations section of our Web site.

Now I'd like to turn this call over to KAR Auction Services CEO, Jim Hallett. Jim?

Jim Hallett: Great. Thank you, Jon, and good morning ladies and gentlemen. Welcome to our call. I'm very pleased to report our fourth quarter results and our full-year results for 2014. But even more important, I'm looking forward to sharing our outlook for 2015 as we move forward.

Today on the call I want to give you an overview of our performance. I want to update you on a number of initiatives, provide guidance and our outlook for 2015, and then talk a little bit about capital allocation.

So starting with the KAR performance, KAR had a very good year with a very strong finish in the fourth quarter. Our adjusted EBITDA came in at $599 million, which is right at the top of our range in terms of our guidance. And we experienced this through a 9% growth in revenue.

We were able to expand our gross profit percentage, and we did a good job of controlling our SG&A. And we saw our adjusted EBITDA margin climb to 25.3%, and our cash flow came in at $321 million.

So as I turn to the business segments, starting with ADESA. ADESA's revenues were up 9% for the year and 13% for the fourth quarter. Adjusted EBITDA came in at $285 million, which was an 11% increase year over year.

And if I can focus on the fourth quarter for just a moment, in the fourth quarter we've seen a 7% increase in volumes at the physical auction. As well, we saw revenue per unit at the physical auction grow to $700.00 per vehicle sold. And this is exactly what we've been waiting on.

We started talking about this last year in the second quarter when I got out of the predicting business. And then we saw it rise to above 4% in the third quarter. And now we see 7% here in the fourth quarter. So I would now say it's starting to look like a trend.

With that said, we also saw success in our online business. Our online business, our buying grew 17% in the fourth quarter, and our revenue per unit rose to $106.00 per unit, and that's up from the last two quarters that we reported. So there's no question that the increased supply has been a positive outcome for both our physical auctions and for our online auctions as well.

Turning to Insurance Auto Auctions, you know, we spent a lot of time talking about the whole car business. I think it would be a huge mistake to look past the tremendous job that the folks at Insurance Auto Auctions have been doing here in 2014 and even beyond.

Insurance Auto Auctions grew their revenue 8%. Their volume was up 7%. They improved their gross margin and their adjusted EBITDA margin. And more importantly, they're extremely well-positioned for 2015. As of December 31, we finished the year with 20% more volume than we had one year previously.

So as we look at IAA, there's no question that they've been a model of consistency over the last several years in terms of their performance and their contribution to KAR's overall consolidated results.

And then, looking at AFC, AFC had a very challenging first half. But the good news is we finished very strong -- kind of like the story of the tortoise and the hare. Their loan portfolio has now grown to $1.4 billion, which is up almost 25% from 2013. And as we indicated, we had a very strong fourth quarter where we saw a 10% increase in loan transactions.

With that, I'd like to give you a quick update on TradeRev. Many of you know that we made an investment in TradeRev last year. The progress in Canada continues to be very good. We've entered a number of new markets. We've seen an increase in growth in our listings, as well as vehicles sold.

We lag a little bit behind in the US markets. We've been focused on hiring staff and getting staff trained. We have rolled out to four major metropolitan markets, and we recognize the need to continue to move quickly as we roll into other markets throughout the United States.

In terms of the acquisition pipeline, there's really two areas that I would suggest you focus on, and one is we are very focused on acquisitions that will involve technology that can be used by our sellers and by our buyers.

And then secondly I would say we're still interested in expanding our footprint through brick and mortar. There's no question that dealers and sellers become more and more focused on the use of technology. And we not only want to be able to enhance our technology and grow our technology and acquire new technologies to support our dealers and our sellers, but we also feel there's an opportunity to expand our footprint in brick and mortar as well.

When you think about brick and mortar, you should not just think about the physical cars and ancillary services that we get, but you should think about creating the buyer base and expanding the buyer base in new markets which not only contributes to physical, but certainly supports our online selling as well.

So with that I have nothing to announce today, but I would say that over the coming months you should look for some announcements in the areas of technology acquisitions and brick and mortar acquisitions.

You may have also read the announcement that we put out not long ago about ADESA's decision to form a digital services group. And this is really bringing all of our technology offerings together, when you think about it.

ADESA dot com, powered by OPENLANE; our private label Web sites, Carsarrive, RDM -- all those technology offerings were reporting maybe to different people within the company, and we felt it was important to align all of these technology offerings under one person, and we're pleased that we're able to announce that Peter Kelly would become the President of ADESA Digital Services.

And again, many of you may know that Peter was one of the co-founders of OPENLANE. Not only is Peter a bright guy that gets technology, he's also a passionate entrepreneur that has a very good relationship with our customers; not only externally with our commercial customers, but internally with our employees.

So we think having Peter head up Digital Services really brings a focus on all these technology offerings, and not just managing these technology offerings day to day, but how do we enhance them? How do we improve them? How do we expand them? And what new offerings do we need to bring into the group to serve our customers as we go forward?

So as we would say, we think we got the right guy in the right chair, and we're excited that Peter has taken the leadership position for our Digital Services group.

In terms of our guidance for 2015, we've announced that we expect guidance in the $630 to $660 million of adjusted EBITDA will result in adjusted - or in free cash flow, I should say, of approximately $325 to $350 million.

And with that, I would say there's a lot of very positive trends that are taking place in our industry, starting with retail new and used car sales continue to be strong. Most are predicting that we're going to see a start of somewhere in the neighborhood of $17 million vehicles. And if you think about that, the very peak for new car sales was back in the year 2000, where volumes came in at 17.3. So we're almost reaching record highs here in 2015.

Leasing continues to be very strong. Leasing came in right in the neighborhood of 29, 30% as a percent of new car sales for 2014. And we expect that leasing could even grow as we go into 2015 and beyond. There's no question that the low interest rate environment is having an impact, a positive impact, on vehicle sales, certainly on leasing originations, and also a very positive impact on our securitization costs.

When you think about the average age of a vehicle on the road today, it's approaching 12 years. And these vehicles not only need to be traded, these vehicles need to be replaced. And as you think about this, this is going to be very good for the retail business, and it's also going to be very good for the recycled parts business, which is certainly going to have an impact on our salvage business.

And again, lower fuel prices having a very, very positive impact on what's taking place in our industry. Not only is it having a positive impact just on general transportation costs, but I would also mention to you it's having positive impacts on the pricing of vehicles, especially in the luxury lineup, the SUVs and the pickups.

And then as we reminded you often in the past, there is a direct correlation between miles driven and the amount of accidents that take place. And this is obviously going to have a positive impact at Insurance Auto Auctions.

Used car prices are a little bit off the peak that we'd seen in 2011 and 2012; however I would say that they remain quite strong. And again I mentioned the high inventory levels at Insurance Auto Auctions -- 20% above where we've seen year over year at December 31. And then the collision repair industry remains very strong and growing.

So I would say all looks very good for 2015. If there was one headwind that I would caution you on, it would be foreign currency and the strength of the US dollar. And I know Eric's going to comment on this in his comments as well. But the impact of currency could - I should say could impact KAR's adjusted EBITDA by more than $10 million in 2015.

So as we think about the return on capital, we've announced our dividend of 27 cents per share for the first quarter. We've announced our share repurchase program, and we are utilizing available cash. In fact, we are purchasing shares in the open market daily. In January we utilized $3.3 million to purchase 94,900 shares.

And I would say that our goal for using our cash is certainly to return value to our shareholders, and to support our strategic growth initiatives as we go forward.

So let me conclude by saying if I haven't expressed it up to this point in time, I feel very, very, very good about 2015. The cyclical recovery continues in the whole car business. We're seeing more vehicles get to the physical auction. Revenue per unit continues to increase as we see growth in the use of our ancillary services. There's no question we continue to have a market-leading position in our online selling.

Insurance Auto Auctions continues to grow. The demand for recycled parts continues to be strong. And the AFC loan portfolio is growing as well, with very low loan losses and again, these continued low interest rates. And finally as I mentioned, I think we've done a great job of controlling SG&A.

So with that, I'll turn it over to Eric, and then we'll come back for some Q&A. Eric?

Eric Loughmiller: Thank you, Jim. I believe Jim's commentary and our earnings release and supplement issued last night provide adequate description of our performance in the fourth quarter and for 2014. I'd like to clarify a couple of items and then provide a little more detail on our guidance for 2015.

First you will notice that we have provided additional disclosure this year on our fourth quarter performance. In past years we provided management's discussion and analysis of the full year, and left it to our investors to back into the fourth quarter results.

I hope you find our additional disclosure helpful in seeing our fourth quarter performance separate from the full year, and we will include this disclosure in our annual report on Form 10-K, which we expect to file later today. Now let me speak to our SG&A for 2014. There's one particular item that I want to highlight. This is stock-based compensation expense that was $28 million in 2014.

This includes about $7 million in expense related to recent grants to directors and officers of the company. The remaining $21 million relates to accounting for grants of options that were issued prior to our 2009 IPO.

This is the last of the expense related to these old grants. As a result I expect a decline in stock-based compensation in 2015 as compared to 2014. Our long term incentive grants generally vest over a period of three or four years. We had a relatively small number of grants in 2014 and have introduced a broad-based program in 2015.

Only about 1/3 of the expense of this broad-based program will be recognized in 2015. We anticipate our long term incentive program will have annual grants so we will see the expense for long term incentives increase in 2016 and 2017 as the 2015 grants vest and roughly 1/3 of each year's grants is also recognized.

For purposes of determining invested net income and adjusted earnings per share we will not make any adjustment for stock-based compensation expense after 2014 as it relates to grants under our new programs. In terms of our SG&A trends we have been successful in keeping our SG&A relatively flat other than costs added from businesses acquired like preferred warranty and high tech locksmith.

We have now anniversaried those acquisitions so they will not impact future comparisons. However any future acquisitions will obviously increase our SG&A and we will disclose this impact as appropriate.

Next I would like to speak to our effective tax rate for 2014 of about 36%. This rate was below my expectations for the year as we benefited from a couple of discrete items.

First we had tax rate reductions in certain states that were implemented in the fourth quarter. This required us to recognize the lower tax rate prospectively. And this provided a benefit in the fourth quarter as we revalued all deferred income tax balances in accordance with Generally Accepted Accounting Principles.

We also were able to reverse selected reserves established for uncertain tax positions. As the statute of limitations expires on the positions we benefit from the reversal of these reserves. These two items accounted for a reduction in our 2014 effective tax rate of about 2%.

Our capital expenditures for 2014 were $101 million below our expectations for the year. This level of capital expenditures is the result of the timing of completing projects especially at a Odessa and AFC and not the elimination of projects. The reductions in 2014 will result in expenditures in 2015 as projects are completed. We have included this carryover in our estimate of 2015 capital expenditures.

Let me quickly summarize the calculation of free cash flow for 2014. We begin with adjusted EBITDA of $599 million less capital expenditures of $101 million, cash interest on corporate debt of $61 million and cash taxes of $116 million resulting in free cash flow of $321 million.

We also experienced unusual amount of negative working capital at December 31, 2014. The use of cash for working capital was created by the significant growth in our securitized loan portfolio. As you know we securitized about 78% of the gross loan portfolio and the remaining 22% is funded from the company's working capital.

This strong performance of AFC and resulting growth in the loan portfolio in Q4 is the reason for the negative working capital impact on our cash. This growth in the portfolio is attributable to the strong industry auction performance in Q4.

As we begin to see the loan portfolio decline in late February and into the spring our - this is our normal seasonal pattern we should see this use of working capital become a source of working capital. In terms of our guidance we expect adjusted EBITDA as I mentioned of $630 million to $660 million in 2015.

Our capital expenditures are expected to be $115 million. Cash interest on corporate debt is expected to be approximately $60 million and cash income taxes are expected to be approximately $130 million to $135 million.

This will result in the free cash flow for 2015 that Jim mentioned of approximately $325 million to $350 million or $2.27 to $2.45 per share. We expect earnings per share of approximately $1.40 to $1.55 for 2015. Adjusted earnings per share is expected to be approximately $1.60 to $1.75. I recognize that the low end of our guidance is below our 2014 adjusted earnings per share and I would like to explain this.

First we expect an effective tax rate of approximately 38% in 2015. This is about 2% higher than the actual rate in 2014. This is a 5 cent impact in 2015. In addition we have stock-based compensation expense related to our long term incentive program that reduces 2015 adjusted EPS by about 6 cents per share.

This is actually less expense than incurred in 2014 but the 2014 add back for adjusted EPS related to this item was 9 cents per share and will be zero in 2015. And finally we have the headwinds for foreign currency which could be as much is 5 cents per share drag on adjusted earnings per share.

My last topic is to let you know about a change we are going to make in reporting our adjusted earnings per share beginning in 2016. And as a result I will be providing this calculation beginning with our first quarter of 2015.

We have had a lot of investor feedback that a more meaningful measure of our performance would be a cash earnings per share number. After looking at a number of companies that utilize this concept we have decided to migrate to this measure over the next year.

We will be utilizing the term operating adjusted earnings per share to distinguish this new measure. In determining operating adjusted earnings per share we will be excluding the after tax amortization expense per car.

We will not be excluding depreciation or amortization of capitalized software cost as these expenses relate to our ongoing capital expenditures. The primary reason for migrating to this new definition is that the private equity ownership and related expenses are now behind us.

We do not have expense related to one time stock grants from the LBO anymore. And the impact of stepped-up depreciation and amortization from the 2007 LBO is well understood. I believe this will be a cleaner presentation and allow comparison to many other companies that provide a similar adjusted earnings per share calculation. I will provide more detail in our Q1 earnings call. And I will not be discontinuing our current adjusted earnings per share disclosure and guidance until 2016.

In terms of the impact of adding back amortization in 2015 this would increase our estimate of adjusted earnings per share by about 20 cents per share on an after-tax basis. Well that is enough for now. I'm sure I've bored you with all these details. And I will turn the call back to Holly our operator for questions.

Operator: Thank you.

Jim Hallett: Thank you.

Operator: Thank you. Ladies and gentlemen if you would like to ask a question please signal it by pressing Star 1 on your telephone keypad. If you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again ladies and gentlemen that is Star 1 to ask a question. Our first question today will come from Ryan Brinkman with JP Morgan.

Ryan Brinkman: Hi, congrats on the quarter. Thanks for taking my question.

Jim Hallett: Thank you Ryan good morning.

Eric Loughmiller: Good morning.

Ryan Brinkman: Could you just elaborate on the drivers of the improvement in Odessa physical auction volume? Was a primarily a continuation of the factors that benefited you in 3Q like repo cars or was it a result of the improvement in off lease volume as you've been calling for? And how does the composition of the type of volume at physical auctions in 4Q cause you to maybe think differently about how it might trend in the future?

Jim Hallett: Ryan, thank you for your question. I would say all of the above. And to break that down for you we had a good performance in dealer consignment. We saw our dealer consignment rise by 3%. And that continues to be impressive with the number of leased cars in commercial cars that we see coming.

And then when you think about the commercial sector all those segments actually did well. Not only we recognize the off lease cars but certainly the factory volumes grew and the repossessions in railcars grew as well. So it was kind of a combination of all of those things.

And then you asked about going forward? We - we're hopeful that we can maintain those levels on dealer consignment. But this is really an initiative that started several years ago as you know. And we thought the dealer consignment could possibly fall with the increased commercial volumes.

So hopefully we can continue the dealer consignment trends. But there's no question that we're expecting an additional 700,000 off lease cars to come to the market in 2015.

So I think the outlook is that those off lease cars will continue to drive commercial volumes which ultimately we feel will continue to improve the number of cars that get to a physical auction where we can provide those ancillary services and continue to offer or continue to grow those revenues.

Ryan Brinkman: Okay great. And then just switching from Odessa volume to Odessa ARPU it continues to grow. You mentioned ancillary services as a driver in your prepared remarks but what about the other puts and takes? So for example it looks like your online only ARPU also improved. So what happened there?

And then how to think about the impact of the Canadian dollar? Maybe just remind investors of your exposure to Canada. I think it's a bit higher than most appreciate. And then does that then mean that adjust for FX that really Odessa ARPU would have been even higher?

Jim Hallett: Yes. I think the ARPU on the online sales was a result of the mix of vehicles and the customer mix just the way that they came in. In terms of the ancillary services I think obviously we continue to be able to offer those ancillary services on the cars we get to physical auction.

Although sometimes the margin is a little bit less on those cars. But overall we came in at $700. And we would expect that that trend would continue. And I'll defer to Eric perhaps to talk a little bit more about the Canadian currency here.

Eric Loughmiller: Sure Jim. And I'll go back on ancillary services, real strength in transportation. And, you know, that's across the board for us, cars getting to auction, moving cars between dealers as they're doing business with us online or at the physical auction.

And then we've also seen success in other services like our repossession business and again it goes across the board.

In terms of the Canadian dollar, Canadian revenues make up about 15% of our total revenue in the business. And a little bit more than that in terms of adjusted EBITDA. So it's a pretty significant factor. And that is a bit of a headwind and will continue in our opinion to be a headwind and has been factored into our guidance for 2015.

Ryan Brinkman: Okay great. I'll just finish with a housekeeping item. You know, does the EPS outlook include the impact of any repurchases you might do? And then did you do any repurchases in 4Q? I know sometimes it takes a bit of time to get the mechanics about the plan in place? Thanks.

Eric Loughmiller: Ryan good point. Yes it did - we put the buyback plan in place. It took some time to get the mechanics in and again to put a plan in place and a cooling off period.

But now we're active in the marketplace. And our guidance contemplates while we aren't giving disclosure specifically about the numbers yes our guidance contemplates that we will continue with the stock repurchase program throughout 2015.

Ryan Brinkman: Great. Appreciate it. Thank you.

Jim Hallett: You're welcome.

Operator: Thank you. And our next question will come from Brett Jordan with BB&T Capital Markets.

Brett Jordan: Hi. Good morning guys.

Jim Hallett: Hi Brett.

Eric Loughmiller: Good morning.

Brett Jordan: A couple quick questions and one on trade rev. I assume that there was more expensive test to trade rev than there was the income in the quarter. Could you give a sort of a feeling on how many pennies you spent on that initiative and sort of what your thoughts are and it turning towards profitability in 2015 or ‘16?

Eric Loughmiller: Well let me speak to it was not even pennies. The good news is Jim mentioned Canada was doing well. And that’s paying for again our sure of that loss was very insignificant both for the quarter and for the year. It would’ve - it rounds to zero, not to a penny, so it’s that small. And the success we’re contemplating is really just getting the velocity up in the United States, right Jim?

Jim Hallett: Exactly. In fact, we really hadn't factored anything material into our 2015 numbers from the outset. Again, it's getting it rolled out to new markets here with a sense of urgency.

Eric Loughmiller: Just a reminder, we use equity accounting because we only own 50%, so it does not have any impact on adjusted EBITDA. It does run through her share but not adjusted EBITDA.

Brett Jordan: Okay. And then a question on IAA with your inventory being pretty robust at the end of the quarter. How are we looking on cycle times on the salvage side of the business? I think it had slowed a bit in the beginning of last year and maybe we're about to anniversary that. Is inventory high because there is just a lot of product coming to you or is inventory up 15% because we're still seeing sort of a delay on cycle times on a comparable basis?

Jim Hallett: Yes. Brett, thank you. Two things: Number 1 is there is no question -- we feel we continue to gain share and continue to grow our volumes there. But the other thing that we mentioned in previous calls -- which plays into this -- is we do have one major customer who has changed their internal processes in terms of how they want to process their vehicles. And they've been holding inventory back. As a result of those vehicles, those vehicles are going through a slower cycle than our other customers. So it's a little bit of a buildup from both.

Brett Jordan: Okay. Great. Thank you.

Jim Hallett: You're welcome.

Operator: Thank you. Next we'll hear from Matthew Fassler with Goldman Sachs.

Matthew Fassler: Thanks a lot. Good morning to you.

Group: Morning.

Matthew Fassler: My first question, just to be clear, of the 15% of the business that comes from Canada, which division does that show up in? Is that primarily ADESA or is this spread evenly?

Eric Loughmiller: It's spread fairly evenly, Matt. It's in actually all three major segments. The one segment that isn't impact as much would be the holding company. We actually have most of that in the U.S. In terms of the operating segments, it's spread across all three.

Matthew Fassler: And then a couple of questions on ADESA metrics. I want to follow up on a question that Ryan asked. You talked about your growth in revenue per car sold at auction. I guess that was up 4%. Is that number inclusive of dilution from currency translation or does that exclude the currency translation?

Eric Loughmiller: It's inclusive.

Matthew Fassler: So in other words, it would have been up more than 4% had you not had the burden of currency translation?

Eric Loughmiller: That is a fair assessment, yes.

Matthew Fassler: Got it. Also, on the ADESA piece, your revenue per car sold -- the physical --is that very nicely up 6%? Last quarter had been up 9, not to quibble over 2 or 3 percentage points. Was there any meaningful difference in trend other than currency that would have led to that deceleration? As a follow up to that, what do you of sustainable? In other words, can this metric continue to grow in 2015?

Eric Loughmiller: Matt, I would tell you, as you know, last quarter was 697. This quarter is 700. That is not a rounded number. That is the actual number. We disclosed those numbers. It's really the comps that are the issue. I think it's really just the maturation of the use of ancillary services. Jim, you and I would have both agreed that there is room for more.

Jim Hallett: Yes. And the other thing is not only the ancillary services that you see at physical auctions, but there is other revenue from other services that can grow as well. As we think about things like high-tech locksmiths and our dent business and other businesses as well, so I would feel comfortable in saying we do feel that it is a sustainable number, and there is room for growth there.

Matthew Fassler: Great. And then my final follow up. Eric, this relates to your shift to operating adjusted EPS. Can you just clarify for us one more time which type of depreciation you're going to exclude and which you are going to include in operating results.

Eric Loughmiller: Sure. All depreciation and amortization will be included except for amortization that is related to intangibles typically through acquisitions, you know, the intangibles that are created that aren't tied to an annual spend in CAPEX.

Matthew Fassler: And that DNA tends to show up if you look at your three divisions and then your corporate line. Which of those four divisional disclosures would that DNA typically follow?

Eric Loughmiller: It's actually an all for - there would be very little in holding company because the acquisitions aren't there. In our current disclosure -- just a head's up -- amortization includes amortization of capitalized software costs. We will be breaking that out separately so that you can get to the amortization number that is added back in the reconciliation of net income to operating adjusted earnings per share.

Matthew Fassler: And you said that will be about 20 cents a share, which it sounds like if we're just thinking about the (Optex), would more than offset the hit that you're going to take by not adding back an adjustment for (L tip) next year.

Eric Loughmiller: Well, the impact of long term incentive this year was I think I said 6%. Let me check my notes so I don't give you. Six cents...

Matthew Fassler: I think you said 6 cents and then, yes. Okay.

Eric Loughmiller: The 20 cents is a net of tax number. They are independent. I'm not going to say they net, but yes, the long-term incentive in total for 2014 was 9 cents and that was a full amount. So I think the two numbers -- the long-term incentive -- would be less than that 20 cents that I'm adding back for the amortization.

Matthew Fassler: Got it. Thank you so much.

Eric Loughmiller: You're welcome.

Operator: Thank you. Our next question will come from Craig Kennison with Robert W. Baird.

Craig Kennison: Good morning. Thanks for taking my question. Eric, I want to thank you for the additional disclosure as well as quarter -- very helpful.

Jim, you've mentioned the acquisitions and you've hinted at bricks and mortar. I'm curious about your geographic aspirations and then whether you're more just in salvage of whole care type acquisitions?

Jim Hallett: Yes. Thank you. A couple of things. I would say we're interested in acquisitions in both of those businesses. Both ADESA and insurance auto auctions. We've told you in the past that there are some holes in the footprint that we feel that we would like to fill. We continue to look at filling those opportunities. But we would not let those opportunities stand in the way if something came before.

I would say that we identified three markets in the past that we said there was a hole and I can speak to those. They were in the Detroit market, the Chicago market and the South Florida market. But certainly we wouldn't limit it to that. If there was an acquisition to surface and it made sense from the metrics that we look at, we would certainly be prepared to act on that as well.

Craig Kennison: And as a second question, Jim, in the past you've outlined the Kontos outlook on whole car volumes for the upcoming years. What is the Tom Kontos' opinion of volume this year and also in 2016 and '17, if you have those figures?

Jim Hallett: Yes. And that will be actually summarized in our 10K, Craig. But we think we were right on this 2014 year. We have 2015 moving to about 9.5 million units; 2016 at about 9.8 million units; and then about 10 million units in 2017. That is the disclosure we'll have in our 10K and you'll see that in our investor presentations that we'll put out within the next couple of weeks.

Craig Kennison: Very helpful. Thank you.

Jim Hallett: Good. Thank you.

Operator: Thank you, Craig. Our next question will come from John Healy with North Coast Research.

John Healy: I've got kind of a bigger picture question. A year ago at this time frame we were debating if RPU would ever turn positive. And now it's headed in the right direction at a nice pace. I feel like we should be thinking about where the potential is for that? You and Eric both seem to feel like that. We're not there yet from a mix standpoint and an attachment standpoint.

But is there a way you can think about, you know, maybe a milestone or a goal or maybe just aspirationally where you think RPU might be able to get to from a dollar standpoint hypothetically for the company over maybe the next two years, three years?

Jim Hallett: Well, I always get accused of too optimistic, so I'm going to allow Eric to answer that.

Eric Loughmiller: And John, that's a good question. We don't want our guidance to get that level of detail because there are so many variables. But I think as you look at the business just in general, we've talked in the past when you take an off lease car, you could have as much as 900 to $1000 in ancillary services. So the question is, "What's the mix? How many cars are using a heavy dose of ancillary services? And how many cars are just using transportation, which would be a much lower number?"

So we think the upside is really as the mix changes and the heavier uses of ancillary services grow, that number will continue to grow. But I don't want to put a number out there because it would be nothing more than a guess.

Jim Hallett: Again, it's going to be highly driven by the number of vehicles that get to the physical auction site.

Eric Loughmiller: But the way we look at it, John, again, I'll just reiterated. If it's more off lease cars, we do assume higher than $700 in ancillary services. That is what makes the number go. Not inflation of the value of ancillary services.

John Healy: That makes sense. I wanted to ask about the insurance auto auction business. You've done really well there for a while. How do you feel that you're positioned from a share standpoint? Are you picking up share versus the market? Technically, what's on the RFP docket for 2015 or '16? Maybe not naming names but are they very active years where there are opportunities out there or are they fairly normal years?

Eric Loughmiller: Again, we feel that we've grown our share and we feel that we've grown our share with the major providers in the fastest growing companies. In terms of RFPs coming, I would term it as just part of the ongoing business. We're always dealing with RFPs. As you say -- or you eluded to -- we don't get specific with customers. It's just part of what we deal with on a daily basis.

Jim Hallett: And I'd like to reminder you in 2014 we acknowledged it was going to be a very light year because there had been a very active period in 2012 and '13. Now we're probably back to a more normal cycle. We're just going to - it's really part of that business. It happens all the time, back to a more normal cycle of RFPs.

John Healy: Thank you, guys.

Eric Loughmiller: You're welcome.

Operator: Thank you. Next we'll hear from John Lovallo with Bank of America Merrill Lynch.

John Lovallo: Hey, guys. Thanks for taking the call.

Eric Loughmiller: You're welcome. Hi John.

John Lovallo: First question is: There appear to be again solid pull through to the physical auctions which was pretty encouraging. But I thought what was interesting, too, is it seemed to be at the top of the funnel -- more closed sales versus perhaps open sales which kind of lowered the revenue per vehicle on the online channel. So it seems like at the top of the funnel and the bottom of the funnel there is increased activity.

Am I thinking about that correctly? How should we think about that dynamic?

Eric Loughmiller: Yes. I think it's just the result of more cars going into the funnel, right? There are more vehicles coming off and there is more activity. As you said -- I think you said it well -- I think there is more activity at the top and certainly more activity resulting at the bottom as they make their way through.

You did see -- if you look back, as you look back from a year ago -- the number of vehicles sold as a percentage at the top of funnel was the higher percentage than what it actually was in the fourth quarter which obviously demonstrated more cars getting to the physical.

Jim Hallett: Yes. John, you captured a ride that a year ago in the fourth quarter we were $115 per car sold online only and now 106. That is the top of the funnel. But compared to the last two quarters, we had fewer grounding dealer sales where we get even less revenue than we do in the closed transaction at the top of the funnel.

John Lovallo: That's very helpful. This next question may seem a little bit odd, but given the severity of the weather that we've experienced in the first quarter, is it possible that the weather is actually too severe where people weren't driving at all, which may have actually reduced accidents? Or do you expect that the really bad weather that we've had is going to result in pretty good inventory even going into the next quarter?

Eric Loughmiller: Well I think if you're in Boston, that would be a problem. Other than that, we would tell you -- and we've said it in the past -- we're dealing with weather all the time. At the end of the day, we consider it to be a push. In fact, I would tell you we had relatively good weather in the fourth quarter.

And that’s being offset a little bit here in the first quarter with some of the weather that we’ve experienced recently. And again I think at the end of the day it’s just something that we deal with. We know it’s going to take place at one point or another. And that it just evens itself out over the course of a year.

John Lovallo: Okay. That’s helpful. Finally in the AFC Division, very strong volume, but revenue per loan I believe was flat year-over-year.

And I guess the question is are we reaching kind of isotropic limits on, you know, what that revenue per loan could be or is there still room for upset there?

Eric Loughmiller: Jim mentioned competition at the beginning. I mean it’s a competitive environment.

And I think it's been fairly stable. You know, the main factors that are going to influence it are going to be loan losses and foreign currency. That's really what's going to impact it.

I'm not going to say we don't have opportunities to take price once in a while. But I probably would tell you there wouldn't be much of that as long as, you know, we're going competitively against another large company. It's probably in the right pricing range right now.

And as such, you look at our margins John I mean we have to be a little careful, not to charge too much.

John Lovallo: Okay. Thanks a lot guys. Appreciate it.

Eric Loughmiller: You're welcome.

Operator: Thank you. Our next question will come from Shreyas Patil with Credit Suisse.

Shreyas Patil: Oh hi. Thanks for taking my question.

Eric Loughmiller: You're welcome.

Shreyas Patil: Sorry. You talked about - I just wanted to follow-up on the previous question where it looks like online only volumes decreased sequentially for the second quarter in a row. You know I'm not sure if that's a seasonal trend.

But should we continue to think about online only as outpacing physical as we look ahead to '15 and maybe even '16?

Eric Loughmiller: Shreyas I think you're referring to the growth rate in online only volumes has decreased two quarters in a row. Not the - the absolute number is up actually 17% in Q4 and I think it was only 11% or 12% in Q3.

But I don't have that right in front of me. But so the pace is - and, you know, that we think that's good. That means we're back to normal. And while there'll be growth in online only as more cars come to market, again we have believed that they will get to physical auction because there's not more demand in the online only venue than what can be met as that market reaches back to its stable levels because it's a limited number of days that it's in that venue.

Jim you may want to add some color to that or is that enough?

James Hallett: No. I think that pretty much gets it. You know the - I guess the one thing I could add is that is these vehicles get priced at the top of the funnel. They normally get priced at a premium. And sometimes when you have that much volume coming the franchise dealer is now taking a look, do I buy this thing at the top of the funnel or do I let it work its way to the physical auction where I might be able to buy the car for considerably less.

Eric Loughmiller: And Jim you'd find that true because there's so many cars. They know there will be cars that make it through the funnel.

James Hallett: Right.

Eric Loughmiller: When there's a limited number of cars, they buy it because they're not going to be there at the end. Is that correct?

James Hallett: Right, exactly. When you have that oversupply, you know, and I go back to my dealer days, you can be more selective.

And then the other thing that plays into it a little bit, I said maybe I'll add one more thing, the other thing that plays into it a little bit is when the dealer is buying the car at the physical auction he's buying the car now fully reconditioned and not having to spend a number of days to turn that car to get it to the front line and he basically can buy the car and put the car on his lot for sale that same day.

So there are advantages when you have the oversupply to waiting to buy the car at the physical auction that don't necessarily happen when you have a tight supply like we seen in '11 and '12.

Shreyas Patil: Okay got it. And then looking at IAA, I mean obviously the volumes have been really good for the last few quarters. But looked like the RPU growth slowed a little bit in the fourth quarter.

And I guess I'm trying to think about how that - those two dynamics could play out going forward. I mean is it - you know, should volume growth still be relatively strong in '15 and maybe RPU growth kind of slows or how do you guys think about that?

James Hallett: Well, you know, in terms of revenue per unit, the place we're seeing the most pressure is the low-end of the market, the very low value car that probably has limited recycled parts available from it. And it's more of a scrap vehicle. And that's where we probably see the pressure on revenue per unit in the salvage business.

The rest of the market it's been moderating softening somewhat but staying quite strong relative to historical patterns other than again the peak of '11 and '12 that everybody experienced.

So the way we look at it is we're going to perhaps, the moves will be moderate and they'll be focused on the low-end car is where we think there'll be the most pressure and that'll really just tie to commodities prices.

And in our guidance we've contemplated various scenarios under that. We feel any reasonable outcome is covered by the range of our guidance.

Shreyas Patil: Okay. And then just lastly, I was - on incremental EBITDA margins, I mean looks like you guys did really well in '14 at about 32% for the total company. That's well above sort of the run rate for the last few years. I think they were sort of in the mid-teens.

Is 30% sort of a reasonable run rate for you guys given how well you're doing on SG&A and some of the other factors?

James Hallett: Well I don't want to get into a reasonable run rate because that might border on guidance.

But I will tell you we've said in the past, as the incremental margin comes from ADESA, IAA, utilization of their facility especially now ADESA and AFC growing, it has strong reattributes than we saw over the past few years when they were still coming to the bottom of the cycle and growing a little less slowly.

So I really think you're seeing the leverage of the business model that we have as again, IAA has been at top of its game in performance and now ADESA and AFC are seeing the volumes come back. And that's where you're going to see the real improvement in incremental margins.

And, you know, I think it's a fair reflection however you're calculating it. People do it different ways. You're seeing the power of ADESA's strength of performance coming through because that's our biggest operating unit that's been under the most pressure for several years.

Shreyas Patil: Okay, great. Thanks a lot.

James Hallett: You're welcome.

Operator: Thank you. Our next question will come from John Lawrence with Stephens.

John Lawrence: Good morning guys.

James Hallett: Morning John.

Eric Loughmiller: Morning John.

John Lawrence: Just quickly, can you take that as far as most everything's been addressed on ADESA, but geography across the country, can you give a sense of what places were strong and weak? Was it pretty even? And how did the flow of the quarter even from the de-sell in the third quarter, how did the flow of the quarter go?

James Hallett: I'd say it's pretty much consistent across the country, across all markets. And I would say the flow was consistent as well. I mean, you know, without diving into the details of each specific market, its contributions from across the country.

John Lawrence: And then secondly on trade rev. what - any kind of idea what kind of CAPEX was spent this year and you got four U.S. markets, where would you expect to be say by the end of '15?

Eric Loughmiller: In terms of the CAPEX, you know, trade rev. is at 50% venture so it's not consolidated. So there's no CAPEX related to it. And again as a technology company it's really just paying technology people whether that's capitalized or expense, trade rev. actually probably expenses that right now so as opposed to capitalizing it.

But it's not requiring cash. It's sub-sufficient. Back to the expectations ((inaudible)).

(Crosstalk)

James Hallett: Yes. In terms of markets, you know, the simple answer is as many as we can. And obviously we're in four now. We're continuing to push with a sense of urgency. And, you know, there isn't a specific target.

My goal would be to be in every market in the country. But that probably is not going to happen.

John Lawrence: Right. All right, good luck. Thanks guys.

James Hallett: Thank you.

Eric Loughmiller: Thanks John.

Operator: Thank you. Our next question will come from Bob Labick with CJS Securities.

Robert Magic: Good morning. This is Robert Magic filling in for Bob.

Eric Loughmiller: Good morning Robert.

James Hallett: Good morning Robert.

Robert Magic: Despite higher volumes of course margins were down year-over-year, what were the key factors and where do you expect gross margins to settle out?

Eric Loughmiller: Well the key factor is really it's impacted a little bit by the average selling price especially at the low-end. And a little bit of impact was with the strong inventory we built up at the end of the year and throughout the year. It's increased our field costs for, you know, the lots and the costs that we incur on the ground which hopefully will lead to higher margins later on as we sell more cars.

But I think the outlook is fairly stable. I mean we're down what was it, about 50 basis points year-over-year is what I show I think Robert.

And again I don't think anybody looking at that business could be more precise than that. It's - that's more just a function of how the costs come in.

Robert Magic: Great, thank you.

James Hallett: You're welcome.

Operator: Thank you. And our next question will come from Bill Armstrong with C.L. King & Associates.

Bill Armstrong: Good morning guys. And I'll also add my appreciation for the additional fourth quarter disclosure. You just answered my question on gross margins at IAA for the quarter. What sort of margin trends are you kind of baking into your forecast for 2015 for IAA?

James Hallett: Well again we don't want to get into anything specific. I think it's a stable industry. It's a stable business at IAA. The growth is - has been sustained over a long period of time. And we're settling in at a gross profit profile that's in the high 30s nearing 40. I mean I don't want to be more specific than that. But I think that's what we're seeing.

Bill Armstrong: Okay, great and...

James Hallett: We're not seeing a lot of - my point is we're not seeing a lot of pressure other than again what's the mix of the vehicles. Are they more high-end, more low-end, that's really what - and then what is our, again field costs relative to occupancy as we store more inventory or we sell more, you know, sell more than we store. It'll vary because of those factors.

Bill Armstrong: So that sounds like that's something that could kind of bounce around from quarter-to-quarter but we're not necessarily seeing a big trend up or down.

James Hallett: That is...

Eric Loughmiller: Correct.

James Hallett: That's a good way to put it. And like I said there's a less than 1% change in the margin percentages. I've looked at Q4 year-over-year and the year-over-year. It's fairly modest. I know it changed but it's fairly modest in the big scheme.

Bill Armstrong: Understood. Okay. And then I just wanted to go back and clarify on the LTIP. I want to make sure I have this right.

So I think you said that LTIP costs 9 cents a share in 2014. Was that...?

Eric Loughmiller: In 2014 the add-back to calculate adjusted EPS is 9 cents per share. By the way that's not all of the long term incentive. That's only the portion that related to the historical grants. There's a little bit more than that. You can do the calculation. That's - I told you it was $28 million, 21 of which related to those old grants so that was the gross SG&A was $21 million.

And that number now will not be added back. And it's an impact of 6 cents. And I gave that...

(Crosstalk)

Bill Armstrong: Okay an impact of 6 cents for 2015.

Eric Loughmiller: That is correct.

Bill Armstrong: Got it, okay. Thank you very much.

Eric Loughmiller: You're welcome.

Operator: Thank you Bill. And just a final reminder ladies and gentlemen it's star 1 to ask a question at this time. And we'll pause for just a moment.

And at this time we have no further questions in the queue. Mr. Hallett, I'll turn it back over to you for any additional or closing remarks.

James Hallett: Okay, thank you. And just quickly, I'll say thank you very much for joining our call today and the interest you have in our company. Obviously we enjoy reporting these calls a little bit more in recent quarters and hopefully going forward. We're optimistic and looking forward to a good 2015. So thank you and appreciate your support.

Operator: Thank you. And ladies and gentlemen that does conclude our conference for today. We thank you for your participation.

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