Corrected Transcript

20-Feb-2018

KAR Auction Services, Inc. (KAR)

Q4 2017 Earnings Call

CORPORATE PARTICIPANTS

Michael Eliason
Vice President, Investor Relations & Treasurer, KAR Auction Services, Inc.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

OTHER PARTICIPANTS

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Matthew J. Fassler
Analyst, Goldman Sachs & Co. LLC

John Murphy
Analyst, Bank of America Merrill Lynch

Benjamin Bienvenu
Analyst, Stephens, Inc.

Bret Jordan
Analyst, Jefferies LLC

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Robert Labick
President, CJS Securities, Inc.

Chris Bottiglieri
Analyst, Wolfe Research LLC

James J. Albertine
Analyst, Consumer Edge Research LLC

Matthew Paige
Analyst, Gabelli & Company

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the KAR Auction Services Fourth Quarter Fiscal Year 2017 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host for today, Mike Eliason, Vice President, Investor Relations and Treasurer. Please begin.

Michael Eliason

Vice President, Investor Relations & Treasurer, KAR Auction Services, Inc.

Thanks, Latoya. Good morning, and thank you for joining us today for the KAR Auction Services fourth quarter 2017 earnings conference call. Today, we'll discuss the financial performance of KAR Auction Services for the quarter ended December 31, 2017. After concluding our commentary, we will take questions from participants.

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

Lastly, let me mention that throughout this conference call, we will be referencing both GAAP and non-GAAP financial measures. Reconciliations of the non-GAAP financial measures to the applicable GAAP financial measure can be found in the press release that we issued this morning, which is also available in the Investor Relations section of our website.

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

James P. Hallett

Chairman & Chief Executive Officer, KAR Auction Services, Inc.

Great. Thank you, Michael, and good afternoon, ladies and gentlemen and welcome to our call. At the outset here, I just want to review my agenda for today, the things I plan to cover. I want to review our 2017 performance, provide you with our guidance for 2018, provide you with an overview of our trends that we see taking place in our businesses. I want to review a number of key strategic initiatives that are ongoing at ADESA – or excuse me, at KAR, and then finish up with comments on capital allocation.

First, let me comment on our 2017 performance. I believe that KAR had a very good year. The highlights of our consolidated performance were a 10% increase in revenue, a 21% in operating adjusted net income per share, and we generated $838 million of adjusted EBITDA which represents a 12% increase over 2016.

We did record a significant tax benefit due to the tax reform. Our operating adjusted net income per share excludes the impact of the tax reform, and there is no impact on our cash taxes in 2017. However, we will save over $100 million in future years as reflected in the revaluation of our deferred tax liabilities.

As you saw in our press release this morning, all of our businesses performed well. ADESA saw volumes growth 10% in 2017 with same-store volumes up 5% for the year. Online sales drove the increased volume. Same-store physical volume was down 2% for the year, but this was offset by increases in physical revenue per unit.

AFC had a very strong finish to the year, revenue growth in the fourth quarter contributed to a 5% increase in the revenue in 2017, and net credit losses were 1.4% of average receivable balances in the fourth quarter and 1.9% for the year. This is the improvement in loan losses that we expected in the second half of the year.

Insurance Auto Auctions continued its strong performance in the fourth quarter. For the year, volume was up 8%, revenue was up 11%, and adjusted EBITDA was up 18%. The salvage market is going strong, and it looks like this will continue for the foreseeable future.

Turning to our guidance for 2018, we are expecting adjusted EBITDA of $895 million to $925 million in 2018. This represents a growth of 7% to 10% over 2017. This will result in operating adjusted net income per share of $2.89 to $3.04 or 16% to 22% growth over 2017. We're often asked what factors could cause us to be at the high or low end of our guidance. The most important item is what will volumes be at ADESA and at Insurance Auto Auctions in 2018.

Another factor is the speed of our rollout of TradeRev and the level of incentives that we use to introduce the platform to individual U.S. markets that will influence where we fall within our ranges. Also our acquisition of STRATIM as a mobility platform is expected to generate a net loss in 2018, and our range of guidance contemplates various possible outcomes based on the pace we enhanced the technology and add services to the platform.

Some key trends that are taking place in our business, starting with the used car supply. Lease returns in 2018 are expected to be 300,000 to 400,000 vehicles greater than they were in 2017. We also expect repo activity to increase over 2017 levels. Offsetting these increases in commercial volumes will be a reduction in the dealer consignment vehicles at physical auction. We saw a 7% decline in dealer consignment volumes on a same-store basis in 2017.

On the salvage front, we expect the supply of vehicles to remain strong. We expect volumes to increase 5% to 7% annually over the next several years. Of course, the number of catastrophic events in 2018 will impact the level of volume growth.

At AFC, we continued to pursue growth in our portfolio without taking on increased underwriting risk. Our AFC team is doing a great job of identifying new customers and expanding our floor plans with existing customers. However, the decline in dealer consignment volumes at physical auctions may impact the number of vehicles floored. Our credit outlook remains positive for 2018, and we expect loan losses to be below 2% throughout the year consistent with what we experienced in the second half of 2017.

Now, I'd like to spend a few moments discussing three strategic initiatives that we have going on within KAR. Let me start by stating that our industries continue to evolve, and I believe that we are making the investments and dedicating the resources to ensure that we are a leader in this evolution.

First off, all of our businesses are at various stages of a digital transformation. We intend to be a leader in our markets in facilitating this transition to a more digital marketplace. We will spend half of our capital expenditures in 2018 on technology projects expanding our internal suite of tools.

We have acquired an extensive portfolio of digital assets over the past several years including OPENLANE, Autoniq, DRIVIN, TradeRev, and STRATIM to name a few, and we're working with our customers to better understand the future and position our businesses for the changes that are inevitable.

Today, I would like to focus on three of those strategic priorities. First, let me talk about data and analytics capabilities. Over the past several years, we have developed a team of data scientists focused on understanding and utilizing the data collected in millions of transactions that we process annually.

In 2017, we acquired DRIVIN, a data and analytics company and have now integrated these two teams. In a few short months, we have demonstrated to our customers the value of utilizing transaction and market data to improve their performance in the wholesale marketing of used vehicles. I'm excited about the results and utilizing data and analytics to improve the net returns for our commercial customers. This stuff really works, and it's a clear differentiator for us with our commercial customers, we are very early in the evolution of data-driven decision-making, but I see a lot of opportunity for KAR in this space.

Another part of our strategy that I plan to focus on in 2018 is developing our international business outside of North America. As you know, we have a small presence in the UK, to-date, we have used this as an opportunity to learn new markets, pilot new offerings, and develop a knowledge base in the new geographic market. We are focused on growing our businesses outside of North America. We are prepared to release a technology platform designed to serve the global markets. And we are continuously assessing opportunities to enter new markets.

The last strategic priority I want to discuss today is our efforts around advanced mobility. As you saw earlier this month, we completed the acquisition of STRATIM. STRATIM is a platform that uses data analytics to help fleet owners manage, maintain, and service their fleets. We believe that STRATIM platform is a natural extension of the services we offer today to our current customers. This will provide us with the opportunity to take many of our capabilities at the physical auction locations to the developing mobility market. We recognize that servicing mobility companies is in the early stages of development here in North America. However, we feel it's critical that we become a service provider to the mobility market now.

So finally, let me conclude my remarks with an update on our capital allocation priorities. First, the reduction in corporate income taxes will generate over $40 million in additional free cash flow in 2018. We are expecting free cash flow of $455 million to $485 million in 2018. Our priorities for allocating capital generated in our businesses has not changed.

We will continue to return capital to our shareholders in the form of a quarterly dividend. Interest rates remain low, so we believe paying down debt is not the best use of our capital at this time and our total leverage was approximately three times adjusted EBITDA at year-end. We continue to prioritize using our capital for strategic growth.

We have no M&A transactions to discuss today. Our pipeline of potential acquisitions is consistent with our strategic priorities and we will continue to be patient and disciplined as we review opportunities to deploy capital for strategic growth. We will also continue to use our capital to repurchase KAR stock. We purchased $50 million of KAR stock in the open market in the fourth quarter. We typically do not buy back stock in the first quarter as this is a period that utilizes working capital to support our operations. I do not expect us to buy back stock in the first quarter of 2018, and we will revisit our situation in the second quarter.

Our balanced approach to deploying capital has served the businesses and our shareholders well, and I expect to utilize our free cash flows in a similar fashion going forward.

So, thank you for joining our call today. I will now turn it over to Eric for more commentary around our financials.

Eric M. Loughmiller

Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

Thank you, Jim. First, let me walk through a few details about our guidance. As Jim mentioned, our adjusted EBITDA for 2018 is expected to be $895 million to $925 million. We are expecting capital expenditures of approximately $185 million, including the potential purchase of property in Florida for use during catastrophic events. We discussed this purchase in 2017, and expect the transaction to close in 2018. The purchase and development of this 200-acre property is expected to be approximately $20 million.

We anticipate cash interest payments on corporate debt of $130 million and cash taxes of $125 million. We expect free cash flow of $455 million to $485 million for the year. In determining our guidance for net income and operating adjusted net income per share, we have evaluated the impact of the Tax Reform and Jobs Act of 2017. The reduction in the U.S. corporate income tax rate from 35% to 21% will provide a significant benefit to KAR's earnings and reduce our cash taxes beginning in 2018.

Our effective tax rate in 2018 is expected to be 26%. In future years, we estimate our effective tax rate will be 26% to 28%. One provision of the new tax code is the limitation on executive compensation deductions. This limitation will not significantly impact us in 2018, as our existing compensation programs are grandfathered and meet the requirements for tax deductions.

We anticipate that future grants of long-term incentive awards may result in non-deductible compensation expense, and this may increase our effective income tax rate in future years.

For 2018, we expect net income per share of $2.40 to $2.55 and operating adjusted net income per share of $2.89 to $3.04.

Our 2017 results were favorably impacted by two items that I would like to review. First, we had a pre-tax gain of $21.6 million resulting from the revaluation of the 50% interest in Nth Gen Software that was acquired in August 2014. This accounting treatment arises upon purchase of the remaining 50% interest in October of 2017. This gain is included in net income, but is excluded in computing operating adjusted net income.

Another item recorded in our 2017 income statement is the revaluation of net deferred tax liabilities as of December 31, 2017. This reflects the reduction in the U.S. corporate income tax rate from 35% to 21% beginning in 2018. The value of our net deferred tax liabilities was reduced by $103 million and as reflected as a reduction in income tax expense for the year. Offsetting this item is an expense of $11.1 million related to the recording of U.S. income taxes due on unremitted foreign earnings primarily in Canada. This will be due in eight equal annual installments beginning in 2018.

As we typically experience in the fourth quarter, our operating and adjusted EBITDA margins were lower than the previous three quarters in 2017. The lower margins reflects seasonal impact of lower volumes sold at ADESA combined with higher ancillary and other related services revenue. Revenue per units sold at physical auction was $822 in the fourth quarter.

Consolidated incremental margins were impacted by businesses acquired in 2017. Excluding the results of acquired businesses, incremental adjusted EBITDA margins exceeded 30% for KAR in the fourth quarter and for the full year.

I would like to comment on inventories at Insurance Auto Auctions at December 31. Inventory levels were 3% above the prior year-end. While this is the lowest year-over-year increase since 4% in the first quarter of 2016, it is compared to the highest level of inventory in IAA history. A number of IAA initiatives have been focused on reducing cycle times in an effort to help our insurance clients, recover total loss claims cost as quickly as possible.

Now, let me update you on hurricanes Harvey and Irma. We have all – we have sold all but about 5,000 hurricane vehicles as of December 31. Through December 31, our net loss on hurricane activity was about $300,000, and we expect to recover this as we sell the remaining vehicles. Most of the remaining vehicles are awaiting titles and we expect will be sold early in 2018.

That concludes my comments on our financial statements and performance for 2017. We expect to file our annual report on Form 10-K in the next day or two. We have provided an earnings supplement with a discussion of our 2017 and fourth quarter results and earnings slides to assist you in understanding our financial performance.

Thanks for your time today, and we will now take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question will come from Ryan Brinkman of JPMorgan. Your line is open.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Hi, thanks for taking my question. Could you please talk a little bit more about strategic rationale for the STRATIM acquisition? In particular, I'm interested whether you're attracted to the business kind of in and of itself or whether you think there might be some kind of knock-on benefits to your core business when it comes time for fleets to dispose the vehicles? And then maybe second to that, do you imagine providing fleet management services over time that are always kind of like digital in nature or perhaps storage of vehicles, et cetera, over time given some of your footprint?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Right. So, Ryan, let me take that, it's Jim. First, I think the thing that we're focused on here is, we're focused on mobility, and oftentimes I think when people think about mobility, they go right to autonomous vehicles. What I'm really focused on here at this stage of mobility is ride sharing and car sharing.

And in many respects, North America is very much behind many of the international markets. And I believe that what you're going to see is you're going to see a very different way cars are sold in the future, and how people use cars. I think as people move back to the urban centers as the millennials come into play here, people are going to want the car when they need a car and not have total ownership. So, it's going to be renting a car by the minute, by the hour, by the day, by the week, by the month, by the year, whatever it is that they need.

And as such, I would tell you that I envision the customers that we have today owning very, very large fleets of vehicles. They are not going to leave all of this business to the Uber's and the Lyft's of the world. They're going to have their own fleets that they're going to put in place. And as these fleets go into place, they're going to need to manage, maintain, service and resell these vehicles, which is what we do very, very well.

If you take a look at the STRATIM platform, the STRATIM platform was an early start-up, and it's a platform that connects services with these fleet owners, and it's a platform that takes a fee as well. It could also take what I would refer to as a registration fee. So, with STRATIM, we're seeing this as a natural extension of what we do for our customers today. In some cases these won't all be services that you'll have to come to an auction site for. In many cases, we'll be taking these services to the KAR, whether it's going there to cut keys or to pop dents or to replace a windshield or replace tires, we can do that with a mobile outlet.

So, as we looked at STRATIM and we look at where this mobility space is going, it made sense for us to make sure that we don't put our head in the sand here and wake up and see somebody else take a leadership position in this space. And we saw the opportunity to invest and obviously we invested in the company and we believe that it truly prepares us for what's ahead. And is that going to happen in 2018? Perhaps not, but I can tell you, I'm very confident that it's not far away.

So, I think the second part of your question was more digital platforms, if I understood it right, Ryan. And I would say to you, the world is going digital. I mean, you take a look at – and you know this as well as I do, take a look at any business and watch how business transforms. I think there's a transformation that's taking place within business as we see with some of the other products that I talked about today, as we look at data and analytics and how that's transforming business and the impact it's having. As we look at TradeRev and how that is really revolutionizing the dealer-to-dealer space. So, I do see more technology, more digital going forward. So, I hope I've answered your question, Ryan.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Yeah, no, that was super helpful, thanks. And then just lastly for me, thanks for the context, the 3% higher inventory on top of 25% last year, the volume growth at IAA in the fourth quarter on top of what like 18 or something percent a year ago. Just curious though if you could sort of share how you think hurricane-related volumes tracked relative to your expectations. I think there was earlier belief that maybe one of your competitors had overestimated maybe how much volume was going to come. Can you say looking back how it's tracked relative to expectation? And then also just sort of confirm that, I think there should be very few vehicles left at this stage?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Yeah, Ryan, I would say that we've probably got a fewer cars than we anticipated – not by a great margin, but definitely fewer cars than what we anticipated. I think Eric mentioned there was approximately 70,000 cars, we have 5,000 remaining. So, it was a little bit less, but I think the more important thing that I want to point out to you is the lessons that we learned from Hurricane Sandy.

After Hurricane Sandy and that huge loss that we took during that storm, we really went about putting in place what we called a CAT team. This was going to be a team that would be totally dedicated to focusing on all the best practices that we could possibly come up with when these catastrophic events take place. And it would be a team that the minute that we got word of a storm coming that we could deploy the team, we could start to look at the resources that we needed, whether it be land or people or equipment, the services that we're going to provide.

And I absolutely believe, and I'm really proud of our team at Insurance Auto Auctions is the foresights that they had in putting this team together, and I think that gets us to a breakeven position that we're quite pleased with when you consider the amount of investment or the amount of cost that took place within these storms.

So, with that, really, if you look back in history, we've only lost money on one cat, and that was Sandy. We're breaking even or we may even get a little smidge here on this one. But going forward, we normally anticipate that we can profit from these events.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Interesting. Thanks a lot.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

You're welcome.

Operator: Thank you. And the next question will come from Matt Fassler of Goldman Sachs. Your line is open.

Matthew J. Fassler
Analyst, Goldman Sachs & Co. LLC

Q

Hey, thanks so much.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Hi, Matt.

Matthew J. Fassler
Analyst, Goldman Sachs & Co. LLC

Q

Hey, thanks and good afternoon. My first question is on the ADESA business. If you could talk about the drivers of ASP and gross margins. Some of the volume channels are a bit sluggish, which I guess is reflective of channels shift more than anything else. The underlying profitability and the gross profit drivers though remain quite resilient. Can you talk about the different moving pieces that are making that work for you, please?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Well, as we look at ADESA, I mentioned in my commentary that it's going to be driven heavily by the off-lease vehicles. We've got 300,000 to 400,000 additional off-lease vehicles coming. And if you think about that just for a moment, many of these off-lease vehicles are going to sell in our private label upstream programs. They're also a higher dollar car. Last year, we averaged a little over $17,000 a car. This year, we may be pushing close to $18,000 a car. So, that doesn't hurt.

And we've – obviously, we're going to get a very high share of these off-lease cars. Not only we are going to get a high share in the closed private label, but then we've put more of a focus on our open sale. And this year, we actually get a third lick of the lollipop, because now, we can also sell some of those vehicles on TradeRev. And I want to take you, Matt, back to data and analytics here just for a moment. In the past when they've come out of a closed sale, the reason they haven't sold in a closed sale is because of price or because of condition.

So now, when it got to an open sale, they weren't changing prices. Now, what we're able to do is we're able to show our customers through data that they should take a price cut, if you will, when it comes to open. And then if it doesn't sell there, perhaps another price adjustment when it comes to TradeRev before it goes to a physical sale.

So that's a huge driver. We know – we expect that repos will increase just on the amount of credit that's being written, and we expect there could be a slight decline in dealer consignment. If you think about it, last year, we were a 55% commercial and we were a 45% dealer. We've told you in the past and over the past year I think I've mentioned this several times, we expect that our business will settle in at 60% commercial and 40% dealer. Now, the other part that I like on the dealers that or on the vehicles that are getting to physical auctions, we're doing an exceptional job with ancillary services, and that's really driving revenue as well.

So, I think as we look at it overall, I think we're very well positioned with the assets we have and knowing the volumes that are coming that we're in a good position to achieve what we've outlined here for you today.

Matthew J. Fassler
Analyst, Goldman Sachs & Co. LLC

Q

Jim, is TradeRev showing up in the financials in any meaningful way?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Eric, I'll let you comment on that.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Sure, Matt. Not in a meaningful way. In the fourth quarter, it had an impact on our performance. In fact, we incurred a loss from the activity, it represented about 8% of our online only volumes in the quarter. Then, of course, that's the first quarter it's shown up in our volume numbers, Matt. So, it was zero in the previous three quarters in our financials. And then again, the incentives and getting the rollouts going resulted in a net loss in the quarter, and that's not an add back, that's encompassed in our $838 million of adjusted EBITDA. That loss was incurred and part of that.

Matthew J. Fassler
Analyst, Goldman Sachs & Co. LLC

Q

That's very helpful. Thank you so much, guys. I appreciate it.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Thank you, Matt.

Operator: Thank you. The next question is from John Murphy of Bank of America. Your line is open.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Good afternoon, guys.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Hi, John.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Good afternoon, Jim. I just wanted to stay on TradeRev for a second here. It was very helpful, you just said 8% of online only volume, and it booked a net loss in the quarter. I mean, if you weren't running sort of the ramp up cost and the incremental costs here, and you thought about it sort of on an operating basis, I mean, what kind of margins do you think TradeRev can do sort of normally over time, is it significantly higher?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Again, margins, this is very much like any online only business. The margins are very high in this business once you get beyond the rollout costs of introducing to new markets, John. I think that's what you're asking. And more importantly, the average revenue per cars sold on TradeRev is significantly higher than in our private label closed sales, so that's really attractive to us. And at margins that I would consider very comparable in terms of incremental, in particular, very comparable to what we have from what we historically called the OPENLANE activity.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Okay. That's helpful. And then if we think about TradeRev, I mean, as it becomes sort of a less asset intensive sale in business, Jim, as you're looking at sort of your second point of strategy or focus point this year, I mean, a lot of it is international growth, I mean what kind of opportunity does TradeRev open up to you in international markets where you might not have to go in and build a physical footprint and networking? You might be able to go in with this virtual online TradeRev product. I mean did that just open doors to you in other markets that you wouldn't have before and the international growth is that much greater?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

In short, John, we are open to the world. TradeRev is truly a asset that transports very, very well to the international markets. In fact, I can tell you that we have deployed, we have a pilot going on right now, we have customers on TradeRev in the UK right now. But this is a technology that can go anywhere in the world. And, good observation.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Okay. Then just another question on the tax reform, I mean – thank you very much for the color on where you think it's going to land for you directly. But if you think about your customers being the new vehicle dealers or used vehicle dealers, [indiscernible] (30:47) dealers, what kind of impact do you think that has on them and their ability to buy vehicles and what that will do in the market?

And then also, Jim, because you've been in this business and know it so well, what do you think it will mean for the consumers one leg down? I mean, will there be a lot more demand coming from those consumers that benefit from the tax reform, and then the – your direct customers that are sort of the middleman here?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Yeah, you know what – let me – I'll let Eric take the first part of that question, and maybe I can add on, Eric.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Yeah, I mean there was a provision added in the eleventh hour, where we were very concerned about deductibility of interest for our dealers on their floor plan loans, and that ended up being protected in legislation. So the dealers are able to use floor plan borrowings to keep the inventory, which is very good for us, very good for our industry, both on new car and used car. And we see it as basically letting our market continue to operate similar to how it has operated.

And then I'll let Jim talk more. I mean, again, I think right now the economy is such that there's no big change. Jim, the consumer side of that.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Yeah. Certainly, I would say there's nothing negative about this. If anything, there may be a little bit of upside. Anytime there's a tax benefit for the consumer which is what you're asking. I think there is – I think there may be some lift, which will serve our business well going forward.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Okay. And then just lastly, you put on your future hat on that third initiative for the year, where you got STRATIM in there. Is there a place where AFC could grow to help these fleet customers that might be owning these – might be owning the fleets as opposed to selling the cars like your existing customer base?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

I'd tell you, the real opportunity for AFC has been with TradeRev. In fact, many of the AFC dealers are biggest buyers on TradeRev. When you take a look at these mobility providers, which are the OEMs really being managed by the captives, they're pretty capable of getting financing on their own, whereas we're more focused on the independent dealer with our financing. So, I don't see it so much with STRATIM, but I see it much more so with TradeRev and our independent dealer base.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

But John – John, the one thing we will see is AFC will be there when that car reaches end of life within the fleet...

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Right.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

...and moves to that that private ownership network, we expect to be a big player helping the dealers get access to that inventory. In theory, it will be a lower value inventory that's really attractive to the independent used car dealer.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

And when you use TradeRev, is there an AFC button right there just to finance the vehicle sort of almost automatically?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Yeah, as a matter of fact there's two buttons there. There's one to finance on AFC and there's another one to transport it with CarsArrive.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

That's awesome. Thanks so much, guys.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

You're welcome.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Thanks, John.

Operator: Thank you. The next question is from Ben Bienvenu of Stephens, Inc. Your line is open.

Benjamin Bienvenu
Analyst, Stephens, Inc.

Q

Yeah, thanks. Good afternoon. Thanks for taking my questions.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Hi.

Benjamin Bienvenu
Analyst, Stephens, Inc.

Q

I want to ask about what's reflected in the guidance for next year as it relates to TradeRev. Is it a similar magnitude of contribution that we saw in the fourth quarter i.e., a smaller contribution, but one that grows very long-term? If you could give us a sense of sort of the glide path from here of that business in your mind?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Yeah. So, if you think about TradeRev, we need to think of it in the context of it's a start-up here in the U.S. right? It's a little bit more mature in Canada, because it's been there longer, but we're still continuing to roll it out to new markets here in the U.S. In fact, I'm very pleased to tell you we just rolled out in Southern California last week. We've been primarily on the East Coast. So, now, we have it on both coasts, now we just have to close it in, come to the middle of the country.

But with that, we don't expect that TradeRev will contribute this year. And I think it is a little bit more of a longer term play. But the thing I would ask you to focus on here is, how I refer to the total addressable market. If you think of the number of vehicles that – I'm talking dealer cars now. If you think of the number of dealer cars that are coming to auction today and then the cars that don't come, there's an additional 10 million vehicles that dealers are not bringing to auctions today. They're either trading among themselves or wholesaling in some fashion, and that's where TradeRev is going to get in the middle of that transaction – is going to get in the middle of that transaction much like we do in a physical auction or much like we do on an online auction, and that's what we're really chasing. It's not – we're not looking to cannibalize our existing auctions, although we may cannibalize some of it, but we're really looking to grow that total addressable market and get a slice of that 10 million cars.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

And Ben, let me clarify just specifically to your question, the impact on the fourth quarter is pretty consistent with what we would expect on a quarterly basis looking into 2018 in terms of expected performance, each quarter though.

Benjamin Bienvenu
Analyst, Stephens, Inc.
Q

Okay, great. Thanks for that.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

You're welcome.

Benjamin Bienvenu
Analyst, Stephens, Inc.
Q

Shifting gears to IAA, volume excluding the 65,000 hurricane units declined somewhat meaningfully year-over-year. Now, I realize that a proportion of the declines a function of the huge compare against the Matthew volumes in 4Q of 2017, but what other factors were at play? To what extent do you see hurricane vehicles displacing traditionals or non-cat units, particularly in light of the positive commentary you provided around the broader salvage industry sustaining?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

Ben, just one technical thing I should point out, and this is only at the salvage business, we operate on the 52, 53-week fiscal year. 2017 was 52 weeks long, 2016 was 53 weeks long. So there's one less week of actual activity in the salvage business.

Second, I'll let Jim answer a little bit more, but I'll also remind you not only did we have a difficult comp, but a lot of people probably have forgotten that in the fourth quarter of last year there was a real backlog from the Louisiana floods and Hurricane Matthew. That was probably more cars stuck in the system than what we experienced with Hurricane Harvey and Irma.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Yeah. No, Eric, has said it, the only thing I was going to add is what Eric said is the fact we did have a very, very difficult comparison-wise in 2017 over 2016. And the other thing that we mentioned, and I'll remind you of, is IAA has had a real focus on reducing cycle times. And I think that's taken the inventory down as well as we've turned that over a little bit faster.

Benjamin Bienvenu
Analyst, Stephens, Inc.
Q

Okay great. And then just one last question on IAA. The ARPU of the hurricane units looked to be meaningfully higher than the non-hurricane units in the quarter. Is all of that difference just that the vehicles sustain less damage than a traditional salvage unit? Or are there additional services that you're providing for the insurance companies for this hurricane units that might be skewing the ARPU higher?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Yes. I think where you get that is not necessarily with the insurance vehicles. It would be with some of these vehicles that were flooded by non-insurance companies. If you think about all the cars that were flooded at dealerships and all of the cars that were flooded in other businesses where they had volumes of vehicles, obviously, we get a much different fee for selling those vehicles in the cat than what we get from the insurance companies. So, that certainly impacted the revenues on those cars.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

And Ben, I'd also add there is typically a higher value car totaled in a hurricane than you have in collisions. And so, we end up the average selling price in any catastrophic event tends to be higher than the average of the collision-related total losses in the industry.

Benjamin Bienvenu
Analyst, Stephens, Inc.
Q

Great. Thanks so much and best of luck.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

You're welcome.

Operator: Thank you. The next question is from Bret Jordan of Jeffries. Your line is open.

Bret Jordan
Analyst, Jefferies LLC
Q

Hey, good morning, guys.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Hey, Bret.

Bret Jordan
Analyst, Jefferies LLC

Q

Good afternoon.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Good morning.

Bret Jordan
Analyst, Jefferies LLC

Q

On the physical being down 2%, and I guess the expectations have continued to decline in dealer consignment cars, would we expect physical to be down in 2018 versus 2017?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

I think it could be a similar story to what we've seen last year, it was down 2% in 2017 as you mentioned, Bret. And if you think about it, our expectation is always, again, I'm repeating forgive me, but we settle in here at 60%-40%. We're at 45% dealer now. Could that drop another couple of points or three points or whatever? Yes, I would expect, especially as you consider the impact that these commercial vehicles are going to have on dealer cars.

Normally, an off-lease car or a repossessed vehicle or a commercial vehicle will oftentimes displaces the dealer consignment car. Why? Because today that car has had all the additional services. The car has been enhanced for resale. So, any paintwork or bodywork or dents or anything that needed to be done to a car cosmetically has been taken care of in an effort for these commercial sellers to get the most attraction and to get the best economic outcome on the car. So, I would say that there's a likelihood that you could see dealer consignment continue to fall a little bit this year.

Bret Jordan
Analyst, Jefferies LLC

Q

And I guess from a fixed overhead standpoint, can you flex the cost enough with the physical auctions and offset the decline in units, so it doesn't become less productive? Or again, is it...

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

[ph] You know, Bret... (40:40)

Bret Jordan
Analyst, Jefferies LLC

Q

...down against the down year?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

No, Bret, it's actually something that I think we've done a really good job of controlling including – many of our locations have leased properties that's even adjacent to our own property if we own it, and we're going to let those leases go. We are running – despite this slight decline in volume, we are running at very high levels of capacity at almost all of our auctions, keeping it well under control. And we have really strong processes around labor to make sure that we're using the right amount of labor for the number of cars running through the processes.

Bret Jordan
Analyst, Jefferies LLC
Q

Okay, great. And then one last question, I mean, you talked about the digital transformation of KAR Auction Services, is there any thought about taking the live auction portion of IAA out and going all digital?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Well, I think we've demonstrated over the course of time that we like the hybrid methodology where all cars are being shown digital or showing digital as well as physical. At this point in time, it's something – that's something that I would never say never, but it's not something that we're contemplating at this point in time.

Bret Jordan
Analyst, Jefferies LLC
Q

Okay, great. Thank you, guys.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

You're welcome.

Operator: Thank you. The next question is from Gary Prestopino of Barrington Research. Your line is open.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Hi, Gary.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.
Q

Hi. Good afternoon. How are you doing?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Doing well. How are you doing?

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.
Q

Oh, just fine. Hey, Jim, you gave us some data on the lease returns for the year or what the market is saying for 2018. You also said repos were going to be a source of growth. Can you give or share any data with what you think the – or what the various pundits think the total amount of repos coming back to market would be year-over-year?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Yeah, Gary, I don't have a number. We know that last year it was a little over 1.7 million vehicles and we know at the very peak. If we go back in history, the very peak, repos were up to 2.1 million pre-recession. So, I don't have an exact number other than I can tell you that obviously the credit markets continue to be strong and they continue to write more paper. And as a result, it comes back to more volume written, results in additional repossessions.

Eric, do you want to add to that?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

Yeah, our industry data that we receive from NAAA just really looks at the number of loans outstanding, Gary, and if we have the same default rate that we've been experiencing historically, that would result in about another 100,000 repos coming through the wholesale marketplace per year, and they're projecting that for the next several years, it's an increase of about 100,000 units per year as an industry. And we'll get our share of those.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.
Q

Okay. And then just in terms of TradeRev, I mean you're still rolling it out. When do you think you'll have it rolled out across the entire North American platform?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Well, I would like to think that over the course of the next year, we can be – we can certainly be starting to be in most major markets across the country. And I apologize, I'm probably not up-to-date on my count, but I know that we're in over 20 markets now. We've just gone to Southern California. I know we're going to be starting to move more back towards the East now.

And I think if we can get into those additional markets over the course of the next year, maybe a little bit longer than that, but I guess the message is, deploy as quickly as we can, but not at a pace that we trip over ourselves in the marketplace, and don't do a good job of putting the people – the trained people in the marketplace that are truly able to articulate what TradeRev is capable of doing and to represent the product. There's sometimes – there's always that fear of trying to go too fast. So there's a balance there, Gary.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.
Q

Your goal would be to get the majority of the franchise dealers in this country signed up and as well in Canada. And then, this also is applicable to the independent dealers as well, right?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Well, I would say that the sellers from a selling standpoint, we're focused on the franchise. We're focused on the franchise dealers. There are some exceptions to that. I think that there are some exceptions where we may allow an independent to sell, but it's typically – not typically – it's from a selling standpoint, it's for the franchisers and the buyers are oftentimes could be – the franchisers could be buyers, but the independents are strong buyers as well as the wholesalers which the independents are buyers as well.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. And is there any – in terms of like, the kind of cars that are being offered by the franchise dealers, is there anything you can bucket? Is it more of an older vehicle and like a non – a brand that are franchised, say, it's a Buick to a GMC dealer? I guess what I'm trying to get out is what kind of car is going through that system right now?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Yes. So, Gary it's really all of the above. We have a way of a mix. We've sold some very, very high-end dollar cars, some luxury cars, we've sold some bottom-end cars. I would say what dealers are selling is kind of what you are mentioning. This is an opportunity for them to sell a product that doesn't fit their brand, doesn't fit the profile of their car that they typically sell.

And then it's also an opportunity just for cars that they just wouldn't keep because of miles and condition and things of that nature. And in some cases, we even get the opportunity to sell their aged inventory that's been around for 45 or 60 days that they want to dispose of. So, it's kind of a mixed bag and that's really what we're after. We just want to create the biggest seller base we can, bring the biggest buyer base we can, and sell all those cars.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. Thank you so much.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

You're welcome.

Operator: Thank you. The next question is from Bob Labick at CJS Securities. Your line is open.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Hi, Bob.

Robert Labick
President, CJS Securities, Inc.

Q

Hi, thank you. Thanks for all the detail on the call so far. I just wanted to...

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

You're welcome.

Robert Labick
President, CJS Securities, Inc.
Q

...shift over to IAA again. The margins ex the CAT and HBC were very strong in the back-half and in Q4 in particular. Could you talk a little bit about what has been the driver of the strong margins, and if you see that continuing into 2018?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

Yeah, Bob, this is Eric. I'll start by just talking about our focus on cycle times. As we're trying to move those cars quicker through the process, have them sit on the ground less, that will be very good for our margins, very good for our operations. But also we can go back to all of 2017, it's been a steady throughput of salvage vehicles, and you know when we can be efficient it's because we're constantly processing the vehicles, not having any big disruptions in the marketplace. And it's been a pretty good year for that notwithstanding hurricanes and the like. Across our network, we've seen the volumes steadily move through the process.

One thing that helps us is when states are more efficient at processing titles for the insurance companies. And there is a state right now in a kind of the Northern Midwest that is having difficulty. They've admitted difficulty in processing titles and it causes buildup of inventory in that one location. And you can see that impact when we're more efficient at processing titles and we can move the cars on a steady pace, our margins go up. And we've also – the other thing, Bob, I'd point out is we've seen strong average selling prices. Some improvement in what we call proceeds or the average price paid for cars has really upped us a little bit as well.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Yeah, and Bob, if I could add to that, I don't know if Eric said or not, but I would add to that is, we told you last year that we're going to get very focused on SG&A and very focused on our costs. And we continue to do that throughout the course of the year and continue to do it going forward. We talked a lot about the acquisitions last year and the integrations that were taking place. For the most part, those integrations have been completed. And so, we think we can continue to grow margins.

And then finally, I would add, if you think about all these acquisitions that we're talking about and some of the new services and products that we're providing, those all create additional revenue opportunities for KAR as well. So with that, I think we're in a good spot.

Robert Labick
President, CJS Securities, Inc.
Q

Okay, super. And then just on the proceeds with ASPs at IAA, is there a – is it the mix factor or what would be the kind of underlying driver behind the rising ASPs, and is that likely to continue?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

You know what, it's the strength of the market. There's such a high utilization of aftermarket parts, and I would argue to some extent in the collision repair industry, a relative shortage, not a shortage, but a mismatch as to when it's there. So, it's been a very strong market for the buyers to come in and they have a strong support function with distribution into the aftermarket for collision repair. So, that's really what's driven it.

And we are coming off of a period where there were some declines due to commodity prices and the like. So it's a natural – probably a natural that it's coming up a little bit right now, Bob.

Robert Labick
President, CJS Securities, Inc.

Q

Okay, super. Thank you.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

You're welcome.

Operator: Thank you. The next question is from Chris Bottiglieri of Wolfe Research. Your line is open.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Hi, Chris.

Chris Bottiglieri
Analyst, Wolfe Research LLC

Q

Hi. Thanks for taking my question.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

You're welcome.

Chris Bottiglieri
Analyst, Wolfe Research LLC

Q

Just a quick one on – a couple of questions. A quick one on ADESA. So any lateral section of the hurricane, are you seeing maybe some vehicles that might have been wholesaled being diverted directly by the OEMs or the dealers? And then, two, have you seen like any kind of uptick in ancillary services related to the hurricane?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

I would say, the biggest benefit was, there were a number of vehicles being shipped into the Houston market to replace those vehicles that were flooded. And this is where our online platform really played a big role is dealers in Houston, we're reaching for cars and it wasn't uncommon to see dealers transporting cars 5 to 800 miles. So, it's a good opportunity for CarsArrive to ship those cars. It's a good opportunity for TradeRev to sell vehicles on their platform. And it was a good opportunity for us to get fresh inventory into the market and really supply these dealers that were basically out of business until they got more vehicles into the marketplace. But, not so much in terms of our ancillary services related directly to the floods.

Chris Bottiglieri
Analyst, Wolfe Research LLC

Q

Got you. Okay. And then question on TradeRev, I know it's still extremely early. I think previously you had said that the TradeRev fees could be as much as three times kind of like the core online fees. At 8% [indiscernible] (52:02) should have been a really massive tailwind to ARPU. So, I guess it's a take away that some of these initial incentives that you're putting in or you're just accepting a lower ARPU to get people transacting on the platform, and then over time, you should start to see the ARPU go up or how should we think about that?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

Well, these incentives are not running through as a reduction in revenue, Chris. So, it is impacting bottom line performance. On the top line, when you look at it, it was only – those vehicles were only 8%. The acquisitions were 8% of our total online only volumes, and we saw a pretty good increase in the online only volumes excluding the ADESA Assurance Program. And when you look at the online ARPU, being up $7 year-over-year, that's attributable to the cars that were being sold on TradeRev platform.

Chris Bottiglieri
Analyst, Wolfe Research LLC
Q

Got you. So, I mean, so interpolate that is – does that mean that TradeRev is actually up three times as much as the regular core fee or is it something different?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

Let's not be that specific, but it's up substantially and in the fourth quarter, it was close to that number but not quite that number. How's that...

Chris Bottiglieri
Analyst, Wolfe Research LLC
Q

Got you.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.
A

... [indiscernible] (53:12) for you without being specific.

Chris Bottiglieri
Analyst, Wolfe Research LLC
Q

All right, that's fair. Okay, [ph] I'll leave it (53:16) that's all I have for now. Thank you.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Great. Thank you.

Operator: Thank you. The next question is from James Albertine of Consumer Edge. Your line is open.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.
A

Good afternoon.

James J. Albertine
Analyst, Consumer Edge Research LLC

Q

Thank you. Yeah, good afternoon, thank you for taking the question and congratulations on the fourth quarter.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Thank you.

James J. Albertine
Analyst, Consumer Edge Research LLC

Q

I wanted to ask a couple of follow-ups, if I could. Look, we're two-thirds of the way almost to the first quarter. Without giving specific guidance, can you help us understand anything we should be considering in terms of year-over-year compares, whether year-over-year or any kind of trends that you've noticed that might be helpful for modeling perspective?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Well, the only thing I would mention is what I've already spoken to in terms of the volumes at ADESA. We know there's – we kind of know there's 300,000 to 400,000 additional lease cars coming. We know we're going to get a very high percentage of those cars, because of our private label platforms. We know we're going to get three licks of the lollipop before they go to a physical auction. Other than that, I think I'll stop there. Eric?

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Yeah, I mean, again I'm not going to look forward, but I will look back for you on this Jamie. The – we had a very good first quarter last year, our ADESA volumes were up mid-teens, of which – because of acquisitions, those acquisitions are integrated, so we'll get the power of that, but it will be probably again not the same level of growth, but a strong number. IAA without any acquisitions last year was up double digits in the first quarter. So those are tough compares, but we feel really good about how the business is performing. And again, I don't see that as a negative, but last year's first quarter was particularly strong on the volume front.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Yeah, and I'd just take you back to what we said about the IAA here for a minute to, we tell you that we see 5% to 7% being sustainable for the foreseeable future. And I don't think I mentioned this in my commentary, but as a percentage of vehicles being written off, that number just continues to climb. Last year, that number was over 18% and it was only a few years ago that we're talking about total write-offs being in that 13% range. So, more and more vehicles are being written off, some of it has to do with the complexity of these vehicles. Some of it has to do with the age of these vehicles. And I think that you'll continue to see – you continue to see this number rise as we go forward.

So, when you think about IAA, and you think about the sustainability of that 5% to 7%, that's what gives us confidence really. And then if you think of the other drivers of that business, you think about scrap prices, you think about miles driven, you think about international currency, you think about the cost of used parts and that supply, all those factors and all those drivers, as I say, a little bit plus – a little bit adds up to a lot, are really providing a pretty good tailwind for the salvage business today.

James J. Albertine
Analyst, Consumer Edge Research LLC

Q

Understood, and I appreciate all the additional color there. If I may, just a follow-up and a final one here, more strategic question. Just to go back to your comments in the beginning of the call, very exciting comments about the international opportunities you were alluding to, that you're sort of nosing around using TradeRev, potentially to open up doors there.

And then, by the same token as you're talking about cycling through 2017 and off of higher acquisition spend, having those acquisitions integrated at this point, just trying to marry the two. And if you could help us understand what international growth could look like from an incremental SG&A or cost perspective relative to some of the growth you've undertaken in North America I think that might be helpful?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Yeah, I'll just talk about the international markets a little bit and then maybe Eric can talk about the financial impact that we might think about. The opportunity we – as with TradeRev, that we mentioned, there's a real demand for many of our technologies.

We are focused on being asset light with many, many technologies aside from TradeRev. I talked about a platform that we're rolling out that will service the global markets, and how these technologies will speak to each other.

There are a number of targets and a number of different geographies that we have very, very good relationships with. And at the current point in time, we're prioritizing, and we're taking a look at where we get the best bang for our buck or where from a strategic standpoint we should invest. And the one thing I'll remind you before I turn it over to Eric is, we're proud that we have patience and we're proud that we have discipline. And we're not going to chase anything with money, unless it makes sense, unless it fits our profile. So with that, Eric I'll turn it to you.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Yeah. And, the last thing I'd say on the SG&A front, we've been building the infrastructure as we prepare to grow in the UK market in particular. And even to be able to step into other markets in that region, Europe in particular over time. So, I don't see a big step-up in order to do this. It's really, now...

James J. Albertine
Analyst, Consumer Edge Research LLC

Q

Okay.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

...creating the business opportunity and creating – there will be direct costs that come with it. But the SG&A will not have a big step function in my view in the near term.

James J. Albertine
Analyst, Consumer Edge Research LLC

Q

That's very helpful. Thank you again and best of luck.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Thank you.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Latoya, we probably have time for one more question.

Operator: Yes sir. The last question will come from Matthew Paige of Gabelli. Your line is open.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Hey, Matthew.

Matthew Paige
Analyst, Gabelli & Company

Q

Good morning or good afternoon. I appreciate you fitting me in. Just one quick follow-up here on tax reform. Has it impacted your view of the credit worthiness of the independent dealers from an ASP perspective?

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

No. Matthew, I would say not. We look at these independent dealers through a very focused lens where it's all about the dealer and his stability and his credit worthiness on a standalone basis not impacted by tax reform.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

And Matt, I'll add, when we look at the credit files for these customers, many of them are passed through entities. Again, one of the provisions giving that reduction in tax rate on a certain amount of income passing through is probably avoiding something that could have been negative in terms of their profitability. Now, it looks neutral giving them that 20% deduction against their pass through income on their personal returns.

Matthew Paige
Analyst, Gabelli & Company

Q

Got it. All right. Appreciate that color and congrats on a nice quarter.

James P. Hallett
Chairman & Chief Executive Officer, KAR Auction Services, Inc.

A

Thank you, sir.

Eric M. Loughmiller
Executive Vice President and Chief Financial Officer, KAR Auction Services, Inc.

A

Thanks, Matt.

Operator: Thank you, I'll now turn the call back over to Jim Hallett for closing remarks.

James P. Hallett

Chairman & Chief Executive Officer, KAR Auction Services, Inc.

Thank you, Latoya. And thank you, ladies and gentlemen, I truly appreciate you being on the call today, and more so appreciate you being interested in investing in our business. I can tell you from my chair, I'm extremely pleased with how our business is performing and I'm pleased with the vision that we have going forward. I think you heard today that we've made some very significant investments that truly support a very defined strategy that we have.

I look to continue to improve the services that we offer to our dealers through adding more value to our customers, through some of the things that you heard again today. And a real opportunity for KAR, but also a real focus on creating as much value as we can for our shareholders.

So, with that, thank you for your participation and I look forward to talking to you in the near future. Have a great day.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect. Good day, everyone.