

09-May-2018

KAR Auction Services, Inc. (KAR)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the KAR Auction Services First Quarter 2018 Earnings 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] And as a reminder, this conference is being recorded.

I would now like to turn the call over to Mr. Mike Eliason, Treasurer and Vice President of Investor Relations. Please go ahead.

Michael Eliason

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

Thanks, Amanda. Good morning, and thank you for joining us today for the KAR Auction Services first quarter 2018 earnings conference call. Today, we'll discuss the financial performance of KAR Auction Services for the first quarter ended March 31, 2018. 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 was issued yesterday, which is also available in the Investor Relations section of our website.

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

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. Before I get into my comments, let me provide you with an overview of what I plan to cover today. I want to cover our first quarter performance, review the progress of a few of our strategic initiatives. I'll also provide you with an update on our guidance and review our expected uses of capital and I will finish my comments with an update on the status of activities related to the separation of Insurance Auto Auctions.

Turning to our first quarter 2018 highlights; I'm very pleased with our consolidated results for the first quarter. Adjusted EBITDA of \$229 million was right in line with our expectations. Operating adjusted net income per share of \$0.82 was slightly ahead of our expectations for the first quarter. We are focused on improving our incremental margins – our incremental adjusted EBITDA margins. We saw strong incremental margins in Insurance Auto Auctions and the AFC segments. The ADESA businesses generated incremental margins in the mid-20% and this is well below our targets. Let me assure you that we are focused on hitting our targets for incremental adjusted EBITDA margins.

To achieve our targets, we will need to demonstrate discipline around our expense controls, especially SG&A expenses. To help you understand the items impacting SG&A, I've asked Eric to give you some clarity in his comments on what is driving these increases.

I would like to go into a little more detail on the ADESA performance. I think it is important to point out that the volume sold in our ADESA segments are right in line with our expectations. Total volume is up 7%. This is clearly ahead of the industry volume growth. Our market leadership in the private label online offerings for various manufacturers is the driver of our performance. An offset to our strong performance in the online channel is the declines we're experiencing in physical auction volumes, especially in dealer consignment volumes.

First, let me say that this is a trend that is expected to continue. We are clearly in the early stages of a digital transformation in the wholesale used car auction business. This is not the first time that we've seen transformation coming. I remember our decision in 2011 to purchase OPENLANE, the acquisition of OPENLANE made us the leader in the private label online auction sites in the U.S. and Canada. Yet, we experienced significant decline in our online volumes immediately following the acquisition.

However, we've seen our volumes sold to private label sites grow from under 300,000 vehicles sold in 2012 to nearly 1 million vehicles sold in 2017, and we have navigated this shift to online venues for the commercial vehicles, while managing our cost structure and meeting our financial targets. It is our past experiences with transformations in our business that give me confidence in our ability to navigate the change today and into the future.

I've said many times that we will not dictate to our customers how, where or through what channels they should sell their vehicles. And this will not change. In fact, we are focused on expanding the breadth of our offerings to ensure KAR can meet their needs, no matter what channel or location they select. As more cars sell in the lower cost, more efficient online channels, we must remain focused on costs, especially SG&A in order to generate adequate margins.

Now, let me highlight the performance at AFC and Insurance Auto Auctions. AFC has continued to experience relatively loan loss levels. This contributed to 20% growth in AFC net revenues and 27% growth in adjusted EBITDA for the quarter. Insurance Auto Auctions continued this strong performance in the first quarter. Revenue was up 13%, driving 21% growth in adjusted EBITDA for the salvage business. And this shows the operating leverage in the business as volumes were up 9% in the first quarter.

Let me turn and give you an update on a few of our strategic initiatives that we have going on, starting with TradeRev. As I told you in our last call, we're going to put some expense muscle behind the launch of TradeRev. We chose the annual NADA convention that was held in Las Vegas in late March to launch a dealer recruitment effort for TradeRev. We created a buzz at the convention and saw tremendous dealer traffic. I will admit the excitement in our booth was energizing, but what really impressed me was the number of dealers signing up to have TradeRev visit their dealership after the convention. Thousands of dealers visited the TradeRev booth and many have already utilized the TradeRev platform. I feel that we are on target with TradeRev expectations.

Like anyone launching a new business venture or offering, I tend to be impatient and I want immediate gratification. However, I've taken the time to speak to a number of leaders that have launched new technology-based businesses and I'm sharing their advice with all of you. Go hard after the market, but also be patient to allow the business to be successful for the long term.

We have a good plan in place for making TradeRev the market leader. I see many parallels in our efforts at TradeRev when I compare our progress with what we experienced with OPENLANE back in 2012.

Another strategic priority for us is enhancing our data and analytics capability. The integration of DRIVIN with our existing data science team has really stepped our success in using data and analytics as a differentiator with our customers. We've been working with three different clients on pilots that have used our data and analytics to assist in maximizing performance in the wholesale marketplace. With the steady increase in off-lease vehicles returning to the used car marketplace causing constant change in the value of the individual vehicles, our consigners need real-time information in order to maximize the returns on the wholesale transactions. In each of our pilots, we've integrated our data and analytics tools into the remarketing decision making and have demonstrated an improvement in the net realization of value.

We have also developed tools to help the buyers identify inventory they should be acquiring based on the sales activity at their individual dealerships. Our tools allow them to identify a small number of specific vehicles available on any given day that match up with the retail customer demand. This capability allows our consigners to get their inventory in front of a targeted group of dealers that are likely to buy their vehicles and the buyers don't have to wait through thousands and thousands of daily listings to identify the best inventory for their lots. It is easy to see how this will position KAR as a leader in the industry, especially as we see more and more transactions completed online.

Let me finish the strategic update with a comment about our progress in the international markets. Over the past few quarters, our international team has been working on developing an integrated platform for selling cars in the international markets using the best of our online tools and capabilities. We have called this integrated platform ADESA Global. We expect to introduce the integrated ADESA Global platform this year and we are targeting increased growth in our markets outside of North America after the launch of ADESA Global. We have a list of potential acquisitions that would work well with the ADESA Global platform and we will continue to develop this pipeline.

Now, let me give you a brief update on our guidance for 2018. We've made no changes to our guidance since our last earnings call. Eric can cover this in more detail in a few moments, but in summary we expect adjusted EBITDA of \$895 million to \$925 million. This will lead to \$455 million to \$485 million of free cash flow for the year. We did not repurchase any KAR shares in the first quarter of 2018. I expect that we will purchase KAR shares in the open market in the second quarter. The number of shares and the timing are subject to market conditions and we will report on our progress on acquiring shares following the end of the quarter.

Let me conclude my comments with a very brief update on the proposed separation of Insurance Auto Auctions. The first step in this process is the auditing of three years of financial statements for the SpinCo businesses. The audits are nearing completion and this is a key input into the Form 10 we will prepare for SpinCo.

We expect to have the first filing of a Form 10 for SpinCo later in the second quarter. We are also documenting the various tax-free reorganizations of entities that need to occur prior to separating Insurance Auto Auctions and Eric will give you more details on this in a few moments.

That concludes my comments for today. I will let Eric provide you with some additional details on our performance and guidance before we take your questions. Eric?

Eric M. Loughmiller

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

Thank you, Jim. Let me start by talking about our guidance. While we have not changed our guidance for 2018, there are still a couple of items to clarify. First, our effective tax rate in the first quarter was below our expectations for the year. This is not a surprise. We had a few discrete items that reduced our effective tax rate in the first quarter. These discrete items were contemplated in our guidance for an effective tax rate of 26% for 2018 that led to an effective tax rate of 22.7% in the first quarter. These items have no impact on our expectations for cash taxes. The reduced effective income tax rate did contribute \$0.03 per share to our earnings in the first quarter.

Our first quarter net income per share and operating adjusted net income per share of \$0.66 and \$0.82 respectively, were a little better than expected for the first quarter. However, this did not change our range of potential outcomes for the full year, so there is no change to our annual guidance. Our capital expenditures in the first quarter of \$38.7 million were only slightly greater than the prior year. We still expect capital expenditures of approximately \$185 million including the purchase of property in Florida that will be dedicated to serving our insurance customers during catastrophic events. The Florida land purchase will close after all conditions have been met by the seller. We have secured the ability to utilize this property as needed prior to the closing of the purchase of this land.

Our consolidated performance was in line with our expectations. Revenue was up 10% over the prior year. Gross margins of 43.7% were better than the prior year level of 42.2%. Operating profit improved 10% and net income improved 30%. The improvement in net income reflects the reduction in our effective tax rate to 22.7% from 33% in the prior year. Jim commented on the mix shift we are seeing in the ADESA business, as our growth is being driven by our online offerings that have a lower revenue per vehicle sold. This caused operating and adjusted EBITDA margins in the ADESA business to decline as compared to the prior year. This decline also reflects recent acquisitions that are operating at a loss in the first quarter as expected. We have provided additional information in our first quarter 2018 earnings slides that were released yesterday and filed on Form 8-K.

Excluding acquisitions in the last 12 months, our operating profit was 18.8% of revenue in the first quarter of 2018, compared to 18.6% of revenue in the first quarter of 2017. The acquisitions that are negatively contributing to operating profit are businesses directly involved in our strategic initiatives. As we mentioned in our comments during our last earnings call, these recent acquisitions are not expected to be profitable in 2018. We are confident these reductions in current profits will contribute to our future success. We are seeing a number of positive trends in the ADESA business.

Our 7% volume growth rate exceeds projected industry growth rates; we've improved our revenue per unit sold in both physical and online channels. However, the mix shift to more online sales caused an overall reduction in revenue per vehicle sold of 1% at ADESA.

I know there are a lot of questions around the increase in SG&A in the first quarter. Let me start by identifying some of the major contributors to this increase. First, we are intentionally investing in the development of several new offerings including TradeRev, STRATIM, and data and analytics services through DRIVIN. These investments are reflected in our financial statements as expense and are almost exclusively SG&A in our income statement. These three businesses accounted for \$16.3 million of the increase in SG&A in the first quarter. In addition, we had an 18% increase in SG&A at Insurance Auto Auctions. A significant portion of this increase at IAA was the timing of expenses in 2018 compared to 2017. We also had increased incentive compensation accruals due to the exceptional performance at IAA in the first quarter. And finally, holding company SG&A had approximately \$1 million in increases that relate to reduced capitalization of IT labor in Q1, compared to what we expected and what I expect to be the capitalization rate for the remainder of 2018.

The capitalization of IT cost is a timing item and not a change in practice or a reflection of the number of projects planned for 2018. There are some increased expenses in the first quarter that won't repeat during this calendar year. We had about \$4 million in SG&A expenses in the first quarter at ADESA that are not expected to recur in the remaining three quarters of 2018. These expenses related to marketing and IT activities that were planned for the first quarter. We also had over \$1 million in marketing expenses at IAA that were incurred in Q1, that had been planned for Q4 of 2017, but due to the hurricanes were delayed until the first quarter of 2018.

At Insurance Auto Auctions, we reported a 4% increase in North American total loss inventory. The team at IAA has been focused on reducing cycle times and working off the significant backlog of inventory that had built up over the past 18 months. The 4% increase in inventory levels as of March 31 does not reduce our expectations for continued strong volume growth in the salvage business. I remind you that we had 9% volume growth in the first quarter, even though year-end inventories were only up 3%. We continue to believe that Insurance Auto Auctions will experience 5% to 7% volume growth for the foreseeable future.

Let me close with a few more details on our activities related to the separation of IAA. I have been asked by many investors, what are the activities that determine when the separation will occur. As Jim mentioned, we must have three years of audited financial statements for the portion of our business that will be carved out. The audits are nearing completion and we expect to have this process done over the next few weeks. In addition, we are taking steps to ensure the separation transaction and any internal reorganization is needed for the separation are tax free. We have developed a plan that requires various reorganizations in the United States, Canada and United Kingdom.

We are seeking rulings from tax authorities and legal opinions from our advisors to ensure that we can complete the separation without creating a taxable event for our shareholders. This process takes at least six months to complete the review of the transaction and receive the requested private letter rulings.

We are also preparing a Form 10 for SpinCo that will provide our shareholders and potential investors with the information on the separated entity. As Jim mentioned, we expect to file the initial Form 10 during this quarter. We are also working with the rating agencies to understand the impact of the separation on their ratings of KAR and its debt and the expected ratings of SpinCo. The analysis by the rating agencies may impact the capital structure of KAR or SpinCo. We have not formed any conclusions on the capital structure at this time. However, we do not expect KAR or SpinCo to have debt levels materially greater than the current level of corporate debt at KAR. Both KAR and SpinCo will have strong cash flow generating businesses.

We are on target to provide additional information on the separation later in the second quarter and we expect to complete the separation of SpinCo no later than the first quarter of 2019. We will keep you updated if anything arises that impacts our timing.

That concludes my remarks. I'll turn it back to Amanda, and we will now take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of John Murphy of Bank of America. Your line is open.

John Murphy

Analyst, Bank of America Merrill Lynch

Hey. Good morning, guys.

Q

James P. Hallett

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

Good morning, John.

A

Eric M. Loughmiller

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

Hi, John.

A

John Murphy

Analyst, Bank of America Merrill Lynch

A first question just sort of on sort of the industry and how it flowed into your business. And I mean I'm just curious what you're seeing on the supply of vehicles, particularly from the institutional side, because you saw a 13% increase in institutional volume and I'm just trying to understand, it sounds like more of that's going online, but are you capturing share or the industry is just seeing the surge of these leased vehicles coming back and striving volume, I'm just trying to understand the industry flow as well as what you're capturing of it in the quarter?

Q

James P. Hallett

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

Yeah. So, John, this is Jim. There is an increase in volumes coming in both the off-lease and the repo sectors. And of course with our leadership position in the private label business, we're capturing more of that business, we're capturing more share and more of those vehicles are being sold in an online venue.

A

John Murphy

Analyst, Bank of America Merrill Lynch

Okay. And then maybe a second question, we think about the TradeRev opportunity, I mean how much is that helping you in that process? But also on TradeRev, if you can give us sort of rough dollar per transaction, the ancillary fees that are attached to it, the margin potential and then also, I mean it sounds like a lot of dealers are getting you involved. So, does this business just get better and better and better as you get more dealers on is that sort of a big part of the success over time.

Q

James P. Hallett

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

Yeah. John, I'm going to take the first part of your question and then I'm going to ask Eric to chime in here. First of all, don't expect TradeRev to be profitable in 2018, but I can assure you that we do have a plan for profitability over the course of the next two or three years. And really, I also want to share with you that I have had the

A

opportunity to get very involved with the TradeRev folks and I've been on the road personally visiting with a lot of dealers and meeting with a lot of dealers myself, including I spent a lot of time in the booth at NADA. And I can tell you, I get accused I'm not being patient and wanting that immediate gratification I talked about. It's going to take a little bit of time and it's really as I meet with these dealers, it's not a hard sell, it's basically bringing these dealers on one at a time. And this is a product that they want, any time that you can show a dealer how to make more money and be more efficient, they're interested in listening to you.

The challenge for us is really going to be getting the people hired in the markets, getting them trained in the markets and getting the product rolled out to more new markets as we go forward. So with that, I'm very pleased with the reaction from dealers, firsthand, and very pleased with the feedback we're getting. I was in Canada last week. I met with a lot of dealers in Canada. I met with the dealers recently here in the United States, it's a great product. I absolutely believe that provides us the leadership position that we want in this space. And with that, maybe I'll let Eric speak to some of the metrics here. Eric?

Eric M. Loughmiller

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

A

Sure. John as you look at TradeRev, we're reporting online-only revenue predominantly from the commercial vehicle sales in the private label sites. You can see that's a majority and we're \$117 in the quarter. If you go to physical auction to give you another data point, you're generally getting about \$400 plus or minus a little bit on auction fees in total. The TradeRev transaction, we haven't given a specific number at this point in time, but it's in between those two and I'd even argue a little closer to the top of that range between \$100 and \$400.

And the margins, the gross margin on that are just like OPENLANE, just like our private label business, very high because we're not touching the car, so very high margin. What's causing the issue, not the issue, what's causing the expense is dealer acquisition costs rolling it out. It's very expensive process to attract these dealers, as Jim mentioned. But ultimately, as you have the volumes grow and that roll out, call it, that acquisition expense becomes a lower portion of revenue allocated, I think it will be a very profitable business and have characteristics similar to our online platforms prior to including TradeRev, which are around the private label sites.

Around ancillary services, there are no ancillary services attached to what I just described to you, but on the TradeRev application, we provide an opportunity for that dealer to click on a button and arrange transportation through CarsArrive to floor plan through AFC, and we're seeing great success. We do not report that revenue though as part of TradeRev. That's being reported trade – CarsArrive as reported within the ADESA segment and AFC reports the revenue from the AFC lending, so that might give you a picture of that. And those transactions are at the same rates we see in the rest of our business. There's no discount or reduction as a result of the TradeRev platform relative to the value to CarsArrive or AFC.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

Okay, that's incredibly helpful. And then just lastly on ADESA Global, the way that you started to talk about it in somewhat sounds like segmented, you're putting together the portfolio of your electronic offerings and everything you guys bring to the table to kind of package it together and you're also talking about making acquisitions. I mean, what kind of acquisitions do you need to add to sort of that portfolio to really grow globally, and is it physical space and physical auctions or is it more technology. How are you thinking about this ADESA Global and really kind of attacking everything outside North America at this point?

James P. Hallett

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

A

Yeah. Thank you, John. First and foremost, I think when you're kind of starting from ground zero here, you have a real opportunity to build your systems and bring your systems together in a manner that you want. When you're out acquiring auctions and other businesses, you are also acquiring systems and you eventually have to convert those systems and integrate those systems. We want to make sure we go to that market with tried and proven and tested offering of what I call seamless integration where all of our systems are speaking to each other and making it as I would say easy for our customers to do business with us, and that's what we're really talking about with ADESA Global, a platform that really allows them to do all of their business on one side with the click of one button and one entry onto the site.

And with that we've said and we continue say, we are going to lead with technologies. We are going to lead with a lot of our technology projects, or a lot of our technology offerings that we have here in North America. We're going to transport those technologies but then we're going to look for additional technology platforms that can bolt-on to what we want to offer. That's not to say that we wouldn't own some land, it's not to say that we wouldn't have some brick-and-mortar, but we would see the brick-and-mortar and land as a supplement to what we're doing with our online offerings.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

So, just to be fair to say the acquisitions are more tech focused, and the brick-and-mortar would be an easy thing to pull off if you decide down the line that you actually need it internationally, is that a fair statement?

James P. Hallett

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

A

That's a very fair statement.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

Okay. Thank you very much.

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. Our next question is from the line of Matt Fassler of Goldman Sachs. Your line is open.

James P. Hallett

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

A

Hi, Matt.

Matthew J. Fassler

Analyst, Goldman Sachs & Co. LLC

Q

Thanks so much. How are you guys? So, my first question relates to the SG&A investment. And just to think about the cadence of that investment, do you expect it to continue at a similar rate through the year that we saw here in Q1? And if there's any kind of rhythm to that we'd love to hear about it?

James P. Hallett

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

A

Yeah. So, Matt. No, we don't expect it to continue. And I can tell you that we are constantly reviewing our cost structure. And I think it's important to point out to you that over half of our cost structure is labor. And now what we need to do is we need to be able to match that labor to the channels where the transactions are taking place. And then I also think it's important, I think Eric brought this out in some of his commentary, it's also important to understand that I need to serve the customer today, but I'm not going to stick my head in the sand, I also have to think about the customer tomorrow.

And that's a balance, that's a fine line that you walk, because you want to continue to make sure you're taking care of what we're doing today, but also we want to make sure you're going to where the business is going as well in the future with these products. Eric, you want to add to that?

Eric M. Loughmiller

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

A

Sure. And Matt, specifically what I identified at ADESA as items that would not recur in the remaining three quarters that \$4 million of SG&A at ADESA that won't recur, most of that was related to actually the TradeRev rollout.

Matthew J. Fassler

Analyst, Goldman Sachs & Co. LLC

Q

Got you.

Eric M. Loughmiller

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

A

So that specifically is something I said ADESA, but it was the TradeRev component that made up the majority of that \$4 million.

Matthew J. Fassler

Analyst, Goldman Sachs & Co. LLC

Q

Perfect. And then if you think conceptually, and you are quite clear, Jim, that you expect the trend at pure physical to remain one of volume declines. Obviously, your cost structure at the physical auctions and at the company in general has been run real tightly over the past number of years. How do you think about the variable cost component at physical? And is there a way to manage that definitely while still running the kind of high-quality events that you are running and obviously they're still generating the majority of – or a good deal of your activity.

James P. Hallett

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

A

No, I think that's the point, Matt, is we really need to focus on how do we manage that cost structure. And we saw physical volumes declined 2% in 2017. We expect 2018 to be similar to what we saw in 2017. And as we see the

shift online and more cars being sold in a digital platform, whether it be with OPENLANE or whether it be with TradeRev, then we need to make sure that we're matching those costs up with the channel that we're sealing in. And maybe Eric, you want to add a little bit to that?

Eric M. Loughmiller

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

A

Yeah. And Matt, specifically in terms of impact on margins as an example, in the first quarter, our gross margins were up to 42.1% at ADESA, up 50 bps and we're very pleased with that. So, it's actually not in the field. What we're really focused on is the corporate overhead and making sure that matches up. So...

Matthew J. Fassler

Analyst, Goldman Sachs & Co. LLC

Q

And then, one – oh, sorry.

James P. Hallett

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

A

Go ahead.

Matthew J. Fassler

Analyst, Goldman Sachs & Co. LLC

Q

One follow-up question on TradeRev. So, obviously you have this emerging peer-to-peer, dealer-to-dealer ecosystem and I know you're a very prominent player in that space, but presumably not the only player. As you ramp TradeRev, how do you try to sew up that ecosystem. Are you able to obtain commitments to be exclusive; is it to the dealer customers' benefit to be exclusive with you as their peer-to-peer facilitator?

James P. Hallett

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

A

So, a good question, Matt. First of all, I think a dealer is going to choose his platform and where that dealer wants to do business. And obviously I think if – I don't think – I don't imagine and speaking with many dealers myself, it's not a dealer is going to use multiple platforms here, they're going to pick a platform that has the offerings that is going to service them best. One of the differentiators with us and we often refer to it as our unfair advantage is the other services that we can put around TradeRev. There is only two companies that I know of in North America that have that unfair advantage. And Eric talked about the fact that not only can we sell the car on TradeRev over a mobile phone, but you hit the button and you finance your car, you see the balance on your floor plan. Number two, you hit the button and you see what it costs to shift that car on CarsArrive zip-to-zip, right? And then TradeRev is going to be integrating data and analytics and giving price guides and things of that nature. So, it really gives us what we call that unfair advantage. And we believe that's the differentiator and that's going to make the difference. But at the end of the day, it comes down to providing speed, cost, reducing cost and providing the efficiency to our customers making it easier for them to do business.

Matthew J. Fassler

Analyst, Goldman Sachs & Co. LLC

Q

Super helpful. Thank you, guys.

James P. Hallett

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

A

You're very welcome.

Operator: Thank you. Our next question comes from the line of Ben Bienvenu of Stephens. Your line is open.

James P. Hallett

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

A

Hi, Ben.

Daniel Imbro

Analyst, Stephens, Inc.

Q

Yeah. Thanks, guys. This is actually Daniel Imbro on for Ben this morning, but thanks for taking our question.

James P. Hallett

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

A

Welcome.

Daniel Imbro

Analyst, Stephens, Inc.

Q

Wanted to actually start on the IAA business, Eric I think you touched on the volume outlook there, but revenue per unit has been pretty strong in recent quarters. Can you talk about the drivers of that, and then what's your outlook for that line item as we look – as we move through the year?

James P. Hallett

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

A

Yeah. So this is Jim, and I'll let Eric weigh in as well. You know, first of all, the drivers of our business and the drivers of proceeds is, you can start with just steel prices and commodity prices as that continues to increase, especially with some of the conversations that's going on around the political environment. Steel prices increase that's certainly going to drive the proceeds on vehicles. And then you know you think about the other drivers and I think the short list you know the cost of replacement parts and availability of replacement parts, you take a look at the number of write-offs of vehicles being accident. First quarter was 18.7% of all accidents resulted in a total loss. Three years ago that was more like 13% to 14%. So that continues to grow. You think about the international buyer base. We think about currency and how other global currencies match up against the U.S. currency. You kind of get the picture here that the tailwinds are really blowing in our favor here and that's driving the proceeds that IAA is able to achieve for their insurance customers.

Eric M. Loughmiller

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

A

Yeah, and Daniel, the only thing I'd add to that is we're seeing those trends continue. We're seeing actually strong bidding activity in terms of the values of the cars and we've seen some used car data. There's a good chance that used car values are helping that along as well. Again mixed effects used car values, but it's a really strong pricing environment in the salvage space right now, as well as volume. Good combination for us.

Daniel Imbro

Analyst, Stephens, Inc.

Q

Okay, great. Thank you for that color. And then shifting to the ADESA business, given the mix shift towards online, I think you guys have been pretty clear that it will be a headwind to total revenue per unit. But as far as

magnitude, is the negative 1% result we saw in 1Q, is that kind of the magnitude that you guys think we should expect or could that headwind increase or that magnitude increase as more volume shifts online? Thanks.

Eric M. Loughmiller

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

A

So, Daniel, thank you for the question. Yes, it's just impossible to predict in a 90-day cycle what you would see. But over time, I really think this – we're offsetting the magnitude of decline because of all the ancillary services. We're now able to attach to the online transaction. So, while the actual fees associated with the auction activity declined, it does not reduce the amount we can collect for these other ancillary services around transportation, inspections, all the things we do for that vehicle that might be selling online are contributing and I think that will mitigate some of those declines.

James P. Hallett

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

A

Yeah. And I would just weigh in on what Eric is saying there, Daniel, is really two words are commonly used around these offices recently are innovate and automate. And we continue to innovate, find new ways to create new services. If I can just give you a little history lesson here real quickly, you go back to 2011 we acquired OPENLANE, we got CarsArrive pretty much as a throw in, CarsArrive wasn't doing very much and today CarsArrive is a significant contributor.

You think about what we've done with keys, I think we'd become a very large key cutter, this was a real opportunity where we could find new products and new services. You know, the list goes on with data and analytics and AFC and how we expand that business, and then Eric talked about the inspection business. It's being able to expand these services to our existing customers, but then to find new services and new offerings as we've demonstrated over our history here.

Daniel Imbro

Analyst, Stephens, Inc.

Q

Great. Thanks, guys. Best of the luck.

James P. Hallett

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

A

You're welcome.

Operator: Thank you. Our next question comes from the line of Bret Jordan of Jefferies. Your line is open.

James P. Hallett

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

A

Good morning, Bret.

Bret Jordan

Analyst, Jefferies LLC

Q

Good morning, guys.

Eric M. Loughmiller

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

A

Hi, Bret.

Bret Jordan

Analyst, Jefferies LLC

Q

You've always talked about sort of a shift to 60%-40% commercial dealer. Do you think that's still the number or is the dealer volume, it's actually going to go lower as obviously this is transition to TradeRev and the dealer consignment continues to shift down?

James P. Hallett

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

A

Yeah, if anything we continue to talk about that, dealer consignments are right where we expected it to be, actually, we've said and thank you Bret for reminding us all that we felt that this business would settle in 60% commercial and 40% dealer and that's pretty much where we see it settling in. There's no question that product like TradeRev could cannibalize some of the existing auctions, but there's also market expansion here as well. We have the opportunity to expand our addressable market and that's not only expanding the addressable market that TradeRev can go after, but there may be some cars that are better sold in the physical auction and you may be able to expand that market somewhat as well. So with that said, I think we're in a good spot here.

Bret Jordan

Analyst, Jefferies LLC

Q

Okay. And then within IAA in the quarter, was there any residual taxes inventory in that 9% of volume growth?

Eric M. Loughmiller

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

A

From the hurricanes?

Bret Jordan

Analyst, Jefferies LLC

Q

Yeah.

Eric M. Loughmiller

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

A

No, we were substantially – I'm sure, there is a handful of cars, Bret, that related to it because there are some with title issues that will just kind of sprinkle out through whenever the titles clear. But we were pretty much through at year end, we're selling the cars that did not have title issues and that was a very small number.

Bret Jordan

Analyst, Jefferies LLC

Q

Okay. And then one final question, I guess, on the competitive landscape for the online initiatives, what are you hearing, I guess, you were at NADA, talking about TradeRev, you hear anything – I guess AUTO1 in Germany seems to have a presence over there and talking about coming to North America. Is there anything that you're seeing I guess sort of changing on the landscape as you roll TradeRev out that might be a competitor?

James P. Hallett

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

A

I haven't necessarily heard anything about the company that you mentioned. But listen, there's going to be different individuals chasing the space, it's a large space. People see a lot of money here, a lot of opportunity, but I think it's who gets that early adoption, who has the best products and who can wrap the best services around it, that unfair advantage that I talked about puts themselves in a position to win. And we recognize there's others that are chasing the space, but we like where we stand as we sit today.

Eric M. Loughmiller

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

A

And Bret, let me add one comment. We're putting the – as Jim used the term expense muscle behind this, there aren't a lot of players willing to commit the amount of resources we're committing to attract that dealer on to our platform like we did in the first quarter to spend the money at NADA. The dealer acquisition cost is what differentiates us and we're willing to get those dealers now.

James P. Hallett

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

A

Yeah. I was going to give a little anecdote there, and I think I said in my commentary, we had a very, very busy booth at NADA. As a matter of fact, not to give it in the weeds with you here but that was recognized as the – probably the busiest booth at the show in terms of just the number of dealers visiting and inquiring at the booth. It was – I can tell you, I was worried at the end of day, it was a lot of dealer activity.

Bret Jordan

Analyst, Jefferies LLC

Q

Okay. Great. Thank you.

James P. Hallett

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

A

You're welcome.

Operator: Thank you. Our next question comes from the line of Gary Prestopino of Barrington. 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

Good morning. Hey, Eric, I was scribbling down real quickly. Did you give like a general range of where the fees on TradeRev?

Eric M. Loughmiller

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

A

It's in between the roughly \$117 we had in online and roughly \$400 at physical auction that you get an auction fees. And I said it's in the middle of that maybe even above the midpoint.

Gary Frank Prestopino

Analyst, Barrington Research Associates, Inc.

Okay. So....

Q

Eric M. Loughmiller

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

And it moves around, again this is a developing marketplace, Gary. We're not giving guidance on that number yet. Ultimately, when it settles in, we'll give you, but we know it will remain much better than the commercial online-only private label revenue, it's better than that and will remain.

A

Gary Frank Prestopino

Analyst, Barrington Research Associates, Inc.

And then since you don't have to use a physical auction site with this and you're not doing any touch points reconditioning, this should have an inherently very high gross margin and then all you really need is SG&A to support it once it's rolled down, is that kind of a correct assumption?

Q

Eric M. Loughmiller

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

That's an accurate statement of how we see the model. Yes.

A

Gary Frank Prestopino

Analyst, Barrington Research Associates, Inc.

Okay. So as you were at NADA and you had all these dealers come to your booth, what level of excitement? What were they citing as some of what they think the benefits of this new product is versus how they were doing things in the past? I mean if they're selling cars to wholesalers, having to pick up the phone and talk to other dealers to trade cars, what were they citing as some of the benefits of it.

Q

James P. Hallett

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

I think I mentioned earlier, really it comes down to three words; right speed, cost, efficiency and I could add profitability in there. This is really changing dealer behavior. And Gary, I lived the former life as a dealer and a lot of the stuff, I'm not the expert, but it really resonates with me when I look at how business is getting done.

A

Today many dealers are still very dependent on wholesalers. Many dealers have multiple dealerships. They have 10, 20 dealerships with 10 or 20 used car managers doing business 10 or 20 different ways. And this really creates transparency, it really standardizes. It allows them to sell more new cars, because they're able to take more trade-ins. It allows them to make more growth, because they're able to get more immediate real time price discovery, which you're not talking to your four or five favorite wholesalers, you basically have a network that goes coast-to-coast, which stretches right across the entire country. I could tell you that it stretches across North America and I could go further and tell you it could really stretch across the world as you think about our buyer base and where our buyer base comes from.

So, they really see the value in this. This is really – it's really a tool. As I say, it doesn't take any selling, it just takes time to sit down and walk them through the technology. The other thing that's very cool is the inspections that we're able to provide. How they're not only able to sell the cars and get immediate bid and real time information on price discovery, but how they're able to inspect the car with their phone, how they're able to

populate the data just by scanning the VIN plate and just how easy it is and when they can see that this whole process can be done, while your customer's sitting right there in the showroom or out on a test drive, it takes minutes to completely load and launch a vehicle.

Gary Frank Prestopino

Analyst, Barrington Research Associates, Inc.

Q

So what you're saying in inspect the car, they put the VIN in and it comes back from the DMV to see if there was any kind of accident things like that or?

James P. Hallett

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

A

No. What happens is we have technology that as you scan the VIN with your iPhone, it explodes the VIN as we say and it populates all the build data on that vehicle. So it'll tell you all the equipment on the vehicle, it will describe the vehicle year-make model, color right down to the equipment. So all of that information is getting populated in seconds with the scan of a VIN and then you're taking pictures right on your phone, taking videos right on your phone. Now, we're down to the point where we're even holding the phone up to the engine and they can hear the engine run. So it's just advancing the business so much from their archaic ways that dealers have been doing it for so many years.

Gary Frank Prestopino

Analyst, Barrington Research Associates, Inc.

Q

And then when is your earliest target that you think you'd have this rolled out across North America?

James P. Hallett

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

A

Well, I'll tell you what, we're definitely rolled out across Canada and we're well on our way to rolling it out throughout the United States. I don't have an exact number, but I know we're somewhere in the neighborhood of 25 to 30 markets today. I think, that's a bit of a guess or don't hold me that number, but I think it's somewhere in the neighborhood 25 to 30 markets in the United States. So as I said earlier, now it's just a question of, it really – the bottleneck here is getting people hired and getting people trained, and there's – but competent people that understand the technology that can articulate the technology and also understand the value proposition for that dealer and what that dealer is trying to accomplish.

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. Our next question comes from the line of Bob Labick of CJS Securities. Your line is open.

Bob J. Labick

President, CJS Securities, Inc.

Q

Good morning. Thanks.

James P. Hallett

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

Hi, Bob.

A

Bob J. Labick

President, CJS Securities, Inc.

Hi. Just following up on the last question in terms of TradeRev, you said we're not going to hold you to it, but 25 to 30 or so markets in the U.S. and then obviously rolled out in Canada. How many of the markets are profitable or are any yet and typically how long does it take to get to the critical mass in each market?

Q

James P. Hallett

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

So from a profitability standpoint, we look at it on a consolidated basis and we shared with you that we don't expect profitability in 2018, but we do have plans for it to be profitable over the next two to three years. So I don't think we have metrics that speak specifically to what it takes to make one market profitable. Eric?

A

Eric M. Loughmiller

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

No, the only thing we'd say, the Canadian markets are more mature, so they're further along on the profitability than the U.S. markets. After you've established it in a city like Toronto, of course, you do quite well, but you also don't have the same level of dealer acquisition cost, because the dealers are on the platform.

A

Bob J. Labick

President, CJS Securities, Inc.

Got it. Okay. And then just shifting over to IAA, you mentioned faster cycle times. Can you describe, I guess, how you got those faster times and if there – if you can maintain them or perhaps even improve them going forward?

Q

Eric M. Loughmiller

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

Yeah. We've developed some services around total – what's called total loss solution. And in there are individual kind of components of service. So it's not like you're buying a package, but you're really focused on how fast can you get the title release so the car can be sold, and it's all around titling and where we're focused right now is, we've developed an offering using a product that was acquired in December, where it's a loan pay off after an accident. One of the big hold ups of getting that title released is if there is a loan and how does it get released, and how do we transfer the money. So, we have loan pay up in there and then again just the processing of the title. We have several groups within IAA that spend their time focusing on processing difficult titles. So, I would tell you I would just take the topic of title processing and that's the main thing.

A

And then, when you get it on the land, how fast can we turn it once we receive it and get it into a sale, and we work very hard to do that by using a combination of online tools as well as the physical auction itself at IAA to see how fast we can sell that vehicle. When you look at the hurricanes, there were a number of cars in Texas that never were sold at a physical auction, because we were able to post them and sell them online and the insurance companies loved that we were able to do that so quickly.

James P. Hallett

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

A

And right from the recovery zone.

Eric M. Loughmiller

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

A

Right from the recovery zone.

Bob J. Labick

President, CJS Securities, Inc.

Q

Okay, great. And your margins obviously are very strong based on the volumes and the price, and the speed that you're talking about. Is there an opportunity? How is your capacity looking and is there an opportunity for further margin increases from here?

Eric M. Loughmiller

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

A

Well, Bob, good question. Yes, there probably is, particularly as we focus on how we can maximize utilization of our land, how can we – how can we get more efficient at using the land. And that's a relatively fixed cost, but a direct cost, the land we have on the locations. So, I think our greatest opportunity, we're acquiring land. It's a very competitive world out there, and we have to have places to park these cars with these strong volumes. And we've talked about the amount of land, and adding the land – 200 acres in Florida that we've talked about previously and I mentioned in my commentary today.

And then how many cars can we sell through that land is where the increased profitability will come. This business is just such a strong, predictable performing business. It's great and to have these little things that can improve performance, we are always looking for them.

Bob J. Labick

President, CJS Securities, Inc.

Q

Sounds super. Thank you.

James P. Hallett

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

A

You're welcome.

Operator: Thank you. Our next question comes from the line of 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

Hey, thanks for taking the question. Just first quick clerical one from an earlier question. The \$16.3 million in kind of growth investments we call them and \$4 million of transitory piece of that. Can we just take the differential and roll that out, or do you expect that to kind of step up throughout the year?

Eric M. Loughmiller

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

A

Well, again, Chris, I'm not going to give quarterly guidance going forward, but what I've identified is roughly \$4 million that won't repeat in future quarters from Q1. And the \$16.3 million is specifically those businesses that I mentioned, TradeRev, STRATIM and DRIVIN related. So again, I don't want to give any prediction, but I think we have a full cost structure in place in Q1, and in fact it included some things that won't repeat, that's part of that \$4 million I mentioned were those three businesses and especially TradeRev.

Chris Bottiglieri

Analyst, Wolfe Research LLC

Q

Got you, okay. And then I think – and maybe you gave this and I apologies if I missed it somehow but, last quarter you gave the contribution of TradeRev to all my new units or total units. Did you give that again this quarter and if not, is that something you would want to share?

Eric M. Loughmiller

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

A

Yeah, so if you look at the – our earnings supplement, you'll be able to see our acquisitions contributed 22,000 online vehicles.

Chris Bottiglieri

Analyst, Wolfe Research LLC

Q

Got you. Okay. And then finally just one real question. So when you think about, one of your peers saw in a trade mag is rolling out their technology for online process to China. You've had [ph] personally (52:57) had kind of a leadership position here in North America and online. Wanted to get sense what you're doing today with the global technology, are those investments that you're making today, would that enable you to compete in China immediately or would you or other international markets or would you need to make acquisitions to do some of these markets first?

James P. Hallett

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

A

Yeah. So Chris, I would say to you that the – we have an international strategy and international strategy is we've looked at the entire map of the world and we thought about the markets that we want to be in. We thought about the products and services [ph] that takes us (53:38) to service those markets and we thought about how we enter those markets. So I would tell you as we think about online, as we think about digital and technology and brick-and-mortar and land and all of the things that go with our international strategy, we're not looking at it country-by-country. We're looking at the – it's like we're looking at the world.

Chris Bottiglieri

Analyst, Wolfe Research LLC

Q

Got you. Okay. Thank you for the help.

James P. Hallett

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

A

You're welcome.

Operator: Thank you. Our next question is from line of Craig Kennison of Baird. Your line is open.

James P. Hallett

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

Hi, Craig.

A

Craig R. Kennison

Analyst, Robert W. Baird & Co., Inc.

Hi. Good morning. Thanks for taking my questions. Eric, I know we've hit on this \$4 million related to TradeRev and I'm just wondering if you expect some of that not to recur because it's related to customer acquisition cost. My question would be why isn't it going to recur when you're at such a critical moment as it relates to getting more people on the platform?

Q

Eric M. Loughmiller

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

Well, again it's a portion of that \$4 million, it's a majority of the \$4 million, Craig. And the reason it won't occur it was event driven specifically in Q1 and those events don't recur and we had a heavy spend. I think Jim gave you the flavor of what we did at NADA. It might – it's around that top – around that event.

A

James P. Hallett

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

Yeah, I think I referred to NADA as our Super Bowl. It was a planned event and well-orchestrated and well-executed.

A

Eric M. Loughmiller

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

So Craig, you're on a good point. We will increase our level of activity around customer acquisition, but not have the concentration or spend at a single event like we did in Q1.

A

Craig R. Kennison

Analyst, Robert W. Baird & Co., Inc.

That helps. And then an unrelated question just on rates, we've seen obviously rising interest rates and I know AFC is primarily a fee business, but how do rising rates impact AFC and how do they impact your customer willingness to kind of floor inventory given the higher cost of doing so?

Q

James P. Hallett

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

Yeah. I think you mentioned at AFC, at AFC interest rates is not really a factor, it's really a pass-through, right? And the dealers still require the flooring. And really from a customer standpoint, obviously it impacts the consumer, but I would remind you that we're very much a transaction company focused on the transaction and doesn't have a material impact on what we do within KAR. And I think Eric would tell you 80% of our debt is fixed and it doesn't really have an impact there as well.

A

Eric M. Loughmiller

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

A

And, Craig, I would point out, the average loan transaction generates revenue of \$166 that's disclosed in our information, even rising interest rates doesn't move the needle on that, because it's such a short-term financing that we don't see any interest rate sensitivity in terms of the behavior of the dealers using our floor plan.

Craig R. Kennison

Analyst, Robert W. Baird & Co., Inc.

That helps. Thank you.

Q

James P. Hallett

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

You're welcome.

A

Operator: Thank you. Our next question comes from the line of John Healy of the Northcoast Research. Your line is open.

James P. Hallett

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

Hey, John.

A

John Healy

Analyst, Northcoast Research Partners LLC

Thank you. Hey guys. I wanted to ask a little bit about the ADESA business and I thought the comments regarding the transformation of the future are very strong. And if you think about the brick-and-mortar auction business, curious to know what percentage of your online cars are being – that you sell are being supported by the ADESA business either in terms of marketing or storage and as you think about the transformation to online not only for commercial, but for dealer customers, do you see the need to have as large of a real estate and physical footprint as you did over the next say 5 years to 10 years? And could that potentially be a source of capital and other opportunities for you guys as maybe you kind of shift the business to a little bit more of an asset-light model because theoretically I feel like that's what you're describing with the ADESA Global business and curious to know if you think that the U.S. business needs a little bit of a diet as well?

Q

James P. Hallett

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

So, John, lots of questions there and we'll try to answer them. First of all, let me start with saying that I don't believe that physical auctions are going away anytime soon. I believe that there's still going to be physical auctions and there's going to be cars going through the lanes and we have a lot of runway left before they disappear.

A

Second of that, I think that physical auctions provide a lot of services other than running the car through the lanes and those services that we talked about, all those ancillary services and we can talk about the recon and the paint and body and the mechanical work, and the dents and on down through the list of all those ancillary services that we provide. We're still going to need to provide those.

The other thing is, as you think about the support and I think you mentioned this is, of all those vehicles being sold on our platforms, right, and on somewhere a different digital channels, many of these vehicles are sitting at the physical auctions and being sold from physical auction. So, we may make money a little bit differently going

forward and we may cannibalize a little bit of business here and there and we may expand the market a little bit. But net-net at the end of the day, I think that we are still able to generate strong revenues at a physical auction site, especially when you think about some of the innovation and automation that we have planned for a various services and products, the new services and products that will come along. Eric, is there anything you want to add to that.

Eric M. Loughmiller

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

A

Yeah, and getting into the mix we sell – about 35% of the vehicles we sold in Q1 were in online-only venues. And then – and we had 52% in total sold. So you got about almost 17% that appears would have been sold where it was from a physical auction location sold to an online buyer, if that helps you John.

John Healy

Analyst, Northcoast Research Partners LLC

Q

Sure. And I guess we...

Eric M. Loughmiller

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

A

And we see that number growing over time.

John Healy

Analyst, Northcoast Research Partners LLC

Q

Okay. And just one clarification question on that, online sales, are a lot of those cars being stored at the ADESA or ADESA location or marshaling yard, whether it's a private label sale or another format of it is online only, would they still be being stored at ADESA location itself?

Eric M. Loughmiller

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

A

John, as we define online only, it means we haven't touched the car.

John Healy

Analyst, Northcoast Research Partners LLC

Q

Okay.

Eric M. Loughmiller

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

A

I do think you could evolve into some of these where our sites are used as part of the transaction. But at this point, generally speaking, it's sold before we touch the car. Meaning it's not at our site.

John Healy

Analyst, Northcoast Research Partners LLC

Q

Okay, great. And then just one final question, the AFC business, the credit losses were actually very good this quarter. I know it is somewhat of an easy comp due to some issues last year, but maybe a little bit of color on the low number there, and if you think that's sustainable as we move throughout 2018?

James P. Hallett

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

A

Yeah, John. I think we've told you that we expect our loan losses to be between 1.5% and 2% and we're right there where we were expected to be if you take a look at our history over the course of many, many years, those loan losses have stayed in that 1.5% to 2% range. I think we continue to manage that portfolio with discipline. We don't look at AFC as the growth driver for the business and we're not out there chasing dealers and chasing money, and so we think that the AFC business is sustainable as we see it going forward here.

John Healy

Analyst, Northcoast Research Partners LLC

Q

Okay. Thank you, guys.

Eric M. Loughmiller

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

A

Thanks, John. Amanda, I think, we're out of time, but we'll take one last question, just to be polite and then move on.

Operator: Okay. No problem. And our next question is from the line of Matthew Paige of Gabelli. Your line is open.

Matthew Paige

Analyst, Gabelli & Company

Q

Great. Thanks for squeezing me in. I'll be quick. I just wanted to talk about your decision to reiterate your guidance, and if you could just provide any puts and takes that would take you to either end of the range that you provided?

Eric M. Loughmiller

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

A

Sure. Sure. Matt, as I said in my commentary, we're seeing the possible outcomes within the range, not a material change. We don't – as a practice and a policy, we do not provide quarterly guidance. So it takes some material change before we do it and we look at it on an annual basis, not quarter-to-quarter. So really we're slightly ahead and we mentioned that tax contribute a little bit, as I mentioned you can deduce at 22.7%, the tax rate will be a little higher in the next three quarters. So there's a little bit perhaps of a take there and there's other things. So it's one quarter, I personally don't think it's the time to start projecting that forward as a material change to the year.

Matthew Paige

Analyst, Gabelli & Company

Q

All right. Got it. I appreciate you taking my question. Thanks.

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

Thanks, Matt.

Operator: Thank you. And at this time, I would like to turn the conference back over to Mr. Jim Hallett, CEO for the closing remarks.

James P. Hallett

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

Okay. Thank you, Amanda. And ladies and gentlemen, thanks for being on our call today, and thank you for your questions and your continued interest in our company. I would close, just reminding you with what I said earlier is, we just don't need to think about where this business is today, we think – we need to think about where this business is going tomorrow and well into the future. And if you take a look at the investments that we've made, we've made those investments with a strong conviction and a strong vision of where we think that the business is going. And we have a strategy that is very defined and well documented, and we continue to follow that strategy. And I think that we have got these businesses well positioned not only for today, but for the future as we move forward. So, we look forward talking to you next quarter and updating you on how things are going. And so, I'll end my conversation there, and have a good day. And I'm sure we'll chat as we go along here. Thank you.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. You may now disconnect. Everyone, have a great day.

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